# A favourable context facilitates the surplus of the Portuguese public accounts

- **The Portuguese public accounts performed better than expected in 2019 and are looking healthy for 2020, a year in which the government hopes to achieve a slight surplus.**
- **Although our forecasts are somewhat less optimistic than the government's, the government balance is expected to continue to improve thanks to revenues growing more than expenditure, with tax and contributory revenues offsetting the increase in staff costs and social benefits.**
- **All in all, public debt is still high and is expected to remain above 115% of GDP in 2020.**

Now that we have fully entered into 2020, it is a good opportunity to take stock of how the public accounts are performing. The budgetary execution for 2019 as a whole is not yet known, but the available data suggest that the government balance will have improved from –0.4% in 2018 to –0.1% of GDP in 2019,[1] as shown in the first chart. This is a more positive figure than previously anticipated (a year ago, we expected an overall balance of –0.6% in 2019). This improvement reflects two trends: on the one hand, the increase in tax and contributory revenues and, on the other hand, the fall in interest charges and a lower than expected execution of public investment.

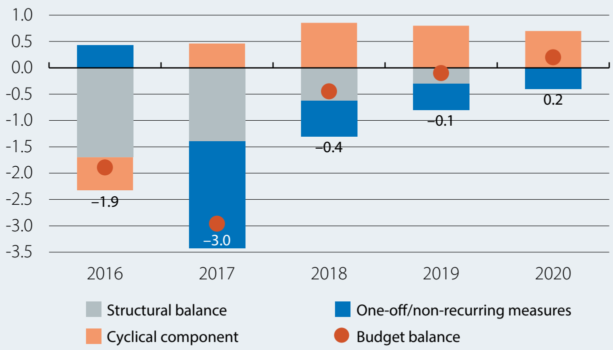
What can we expect for 2020? The draft of the 2020 State Budget, which is due to be put to a final vote on 7 February, helps us to shed some light on the outlook for the new year. The budget forecasts a surplus of +0.2% for 2020 as a whole, with revenues growing more than expenditure (see table), based on a reasonable macroeconomic scenario. However, some of the forecasts are rather more optimistic than those we have developed at CaixaBank Research. For instance, GDP growth is projected to remain stable at the levels of 2019 (1.9%, compared to our forecast of 1.7%), with an acceleration in the rate of export growth that seems somewhat unlikely. In this regard, as we shall see below, the budget includes more favourable growth rate projections for revenues and expenditure than those suggested by the macroeconomic scenario projected by CaixaBank Research, which means that our forecast for the overall fiscal balance in 2020 is somewhat less optimistic.

Before diving into the details of revenues and expenditure, it should be noted that the government estimates that the structural balance[2] will improve by +0.3 pps in 2020, to 0%, thus reaching the medium-term target set by the European Commission. In addition, excluding interest, which is projected to reduce in a context of accommodative financial conditions, the budget suggests that the primary structural surplus will reach 2.9%.

1. Government forecasts.
2. i.e. the balance after adjusting for the effect of the business cycle and excluding one-off and temporary measures.

***Portuguese government forecasts: breakdown of the budget balance***

*(% of GDP)*




***Note:*** *The figures for 2016 to 2018 correspond to data from the European Commission, while those for 2019 and 2020 refer to the government's estimates.*
***Source:*** *CaixaBank Research, based on data from the European Commission and the Portuguese government.*

***Portugal: forecast for revenues and expenditure according to the 2020 Draft Budgetary Plan***

| | % of GDP | | Change (%) | |
|---|---|---|---|---|
| | 2019 | 2020 | 2019 | 2020 |
| **Total revenues** | **43.3** | **43.7** | **4.0** | **4.5** |
| Tax revenues | 25.1 | 25.1 | 2.5 | 3.4 |
| Taxes on income and wealth | 9.9 | 9.9 | 1.3 | 3.3 |
| Taxes on production and imports | 15.2 | 15.2 | 3.3 | 3.4 |
| Social contributions | 12.0 | 12.1 | 6.0 | 4.4 |
| **Total expenditure** | **43.3** | **43.5** | **3.1** | **3.7** |
| Staff costs | 10.8 | 10.8 | 4.0 | 3.6 |
| Social benefits | 18.4 | 18.3 | 4.4 | 3.1 |
| Interest charges | 3.1 | 2.9 | –5.4 | –2.5 |
| Investment | 2.0 | 2.3 | 9.0 | 18.1 |
| **Total balance** | **–0.1** | **0.2** | – | – |
| **Primary balance** | **3.0** | **3.2** | – | – |

***Source:*** *CaixaBank Research, based on the draft of Portugal's 2020 State Budget.*

Entering into the detail of the 2020 draft budget, it includes an increase in revenues which predominantly comes from tax and contributory revenues (with a projected growth of +3.7% and accounting for over 70%

of the total increase in revenues). The increase in employment (which the government estimates at 0.6%) and in economic activity will favour the growth of revenues from direct taxes and Social Security contributions, while the buoyancy of private consumption (with an increase of 2.0% estimated by the government) will support the growth of VAT revenues, the main source of indirect taxes. However, the sensitivity analysis between the economic growth and fiscal revenues suggests that the government's projections for tax and contributory revenues in 2020 are slightly optimistic.[3] Our forecasts, which are based on the latest elasticity data and a slightly lower estimate for economic growth, point towards a somewhat lower increase in total revenues than that projected by the government (3.2%, *versus* the 4.5% projected by the government).

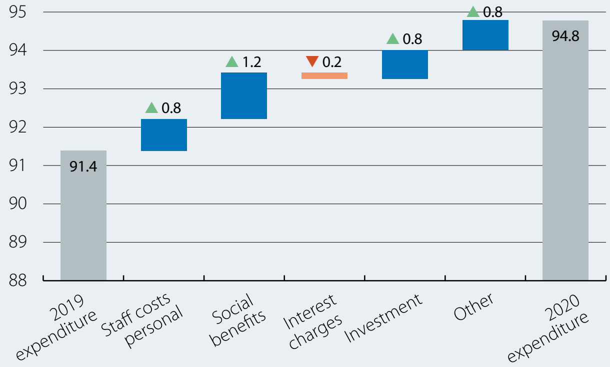
On the expenditure side, the third chart shows that three items will be responsible for more than 80% of the projected increase included in the State Budget Proposal: (i) staff costs, (ii) social benefits, and (iii) investment. First of all, the budget foresees an increase of 827 million euros in staff costs, mainly due to measures related to the unfreezing and revisions of careers, as well as the salary review (715 million euros). In this regard, our estimates suggest that these measures, coupled with the increase of the public sector workforce, should contribute to an increase of staff costs of closer to 4% (as opposed to the 3.6% estimated in the budget proposal).

Regarding to social benefits, the government estimates an increase of 1,203 million euros, with the implementation of some additional measures, whose impact will be around 227 million euros. This increase will be driven by pensions, through both the increase in the number of retirees and the update of their pension, while unemployment benefits will continue to decrease (–2.4%, according to the government's projections) in line with the reduction in the unemployment rate. However, in a scenario of stabilisation in the number of unemployment benefit recipients, the expenditure related to social benefits could increase by 3.8%.

The analysis of these first two items of expenditure suggests that the future trend anticipated by the government could be somewhat optimistic. However, public investment can be used as a source of budgetary leeway. In fact, the expected increase in investment could also be optimistic, given that this item has been constantly revised downwards and has always ended up

***Portugal: general government expenditure (2020 Budget)***

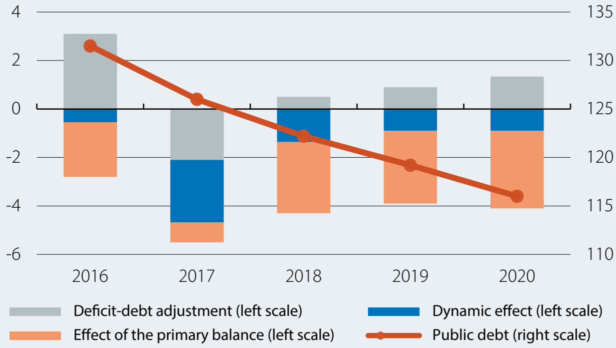
*(EUR billions)*




**Source:** *CaixaBank Research, based on data from the draft of Portugal's 2020 State Budget.*

***Portugal: factors behind the reduction in public debt***

*(% of GDP)* *(% of GDP)*




**Note:** *The estimates for 2019 and 2020 correspond to the Ministry of Finance.*
**Source:** *CaixaBank Research, based on data from the National Statistics Institute of Portugal, the Bank of Portugal and the draft of Portugal's 2020 State Budget.*

being significantly lower than anticipated in the initial budget.[4] If we assume an execution rate similar to that of 2019 and keeping everything else constant, this would increase the overall fiscal balance by +0.3 pps of GDP, which means that the surplus would reach 0.5% of GDP, instead of the current projection (+0.2%).

What are the implications of these forecasts for public debt? The government foresees a reduction in the public debt ratio to 116.2% of GDP in 2020, which represents a 2.7–pp decrease in relation to the forecast for 2019 (see fourth chart). All in all, in nominal terms debt will continue to increase. As such, the central government's net funding needs were revised upward to 9,500 million euros, *versus* the 5,200 million estimated in October.[5]

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3. Despite the fact that the historical elasticities (1996-2019) between tax and contributory revenues and nominal GDP would suggest a growth of 4.6% in the tax and contributory revenues, according to the elasticities of the past six years (which better represent the current relationship between economic growth and fiscal revenues) the increase would be around 3.4%.

4. In 2019, considering the government's estimates, investment will fall short of what was set out in the 2019 State Budget by 685 million euros (0.3% of GDP).
5. Data from the Portuguese Treasury and Debt Management Agency (IGCP).