Budget execution under control

Overall balance improved in 2017, in line with the rise of revenues (+3,8%) higher than expenditure (+1,6%). Considering the data in cash basis, it is highly probable that the deficit should have ended the year below the Government's target (-1,4% of GDP, accrual basis). The official balance, on accrual basis, will be published by end of March, together with the decision whether to include the CGD recapitalization as an expenditure on the budget balance for 2017. This impact can reach 2,1 percentage points of GDP; however, this should be considered a one-off effect.

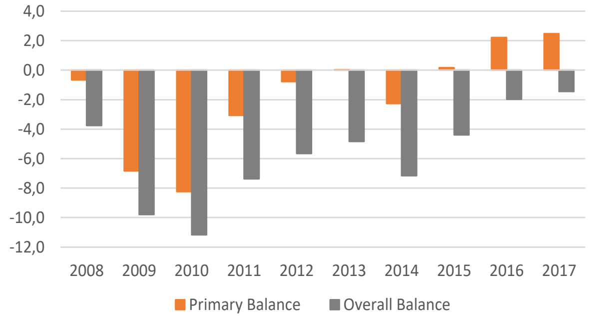
Public accounts recorded an improvement in January 2018, benefiting from the tax revenues and social contributions, responsible for more than 80% of the increase in current revenues. Positive macroeconomic scenario should have contributed for this performance. On the expenditure side, interests and other charges contributed considerably to the growth of expenditure in January, but are solely associated with interests paid by the Reclassified Public Entities. Final note for overdue payments (unpaid debts for more than 90 days), which increased again in January, with special emphasis on Hospitals' unpaid debt.

1. Fiscal balance improved in 2017 (cash basis)

- **The overall fiscal balance improved in 2017, in comparison to the previous year.** Fiscal balance improved by EUR 1,61 billion, to EUR -2,57 billion; according to our calculations, this balance is equivalent to -1,3% of GDP in cash basis. However, the official balance (on accrual basis) will only be published in March, when the decision about the inclusion of CGD recapitalization process on 2017's budget balance will be taken (Government expects a fiscal balance of -1,4% of GDP in 2017, according to the State Budget for 2018). It was also registered a primary surplus in 2017 (the third consecutive year), equivalent to 3,0% of GDP, according to our calculations.

Overall Balance and Primary Balance

(% of GDP)



Source: BPI Research, based on Datastream data.

- **The improvement recorded in public accounts in 2017 was due to the rise in revenues, which was superior than the expenditure increase.** Tax revenues were responsible for more than half of total revenues and surpassed the Government's forecast, reflecting the positive economic environment. We highlight the performance recorded in corporate tax revenues (+9,9% yoy), as well as VAT and other taxes related to vehicles (in line with the increase in vehicle sales in 2017[1]). Additionally, it was also relevant the social contributions performance (+1,4% in 2017 vs 0,7% projected by the Government), favoured by the sustained and strong job creation.

- **Expenditure grew less than projected.** Total expenditure increased 1,6% in 2017, less than estimated by the Government (+2,5%). On the other hand, compensation of employees rose more than estimated, reflecting the total reversal of remuneration cuts in 2017. Current transfers were affected by diverse factors during the year: on the one hand, ordinary and extraordinary updates of pensions under the Social Security regime, and the in-

1) Vehicle sales rose 7,7% in 2017, according to the ACAP's statistics.

2) Social Security expenditure on unemployment benefits dropped 13,1% in comparison to 2016, in line with the positive performance in the labour market; in fact, the unemployment rate decreased to 8,9% in 2017, from 11,1% in 2016, and the number of beneficiaries of unemployment benefits decreased to 185.000 at the end of 2017, from 224.000 in 2016, according to the Social Security's statistics.

crease of transfers to Local Government added some upside pressure; on the other hand, the reduction of unemployment benefits[2] and the reduced Portugal's contribution to the European Union's budget contributed to some downside pressure. Capital expenditure rose until December (+4,5% yoy), below the Executive estimates (+11,4% yoy).

2. Budget execution in January 2018 (cash basis)

- **Public accounts recorded an improvement in the first month of the year, benefiting from the contribution of tax revenues and social contributions, prolonging the pattern seen in last year**. According to the DGO information, overall balance of the Public Administrations (PAs) stood at EUR +774,8 million in January, a EUR 153 million increase in comparison to the same period of 2017. The improvement was transversal to all PA's subsectors, except for the Local Government.

- **The maintenance of a positive macroeconomic scenario continued to support the growth of the fiscal revenues and social contributions, responsible for more than 80% of the increase recorded in the current revenues.** Tax revenues rose 8,1% yoy and social contributions rose 7,4% yoy in January, both surpassed the projected for the whole year (+3,4% and 4,3% yoy, respectively). This evolution contrasts with the changes in income tax brackets, with a projected negative impact on the revenues (EUR 230 million), and the removal of income surcharge, with an expected negative effect of EUR 260 million; the favourable evolution of the Portuguese economy, reflected in the economic indicators and labour market, should compensate these unfavourable expected effects. Additionally, the item other current revenues registered a significant growth, +9,3%, reflecting the behaviour of European Union's transfers, especially those related to the investment program "Portugal 2020". A final note to the substantial decrease observed in capital revenues, those were influenced by base effects related to the amounts received for the sales of F-16 aircraft to Romania in January 2017.

- **Interests and other charges contributed considerably to the growth of expenditure in January, exclusively associated to the interests paid by the Reclassified Public Entities.** Compensation of employees decreased by 6,7% yoy in the first month of the year, contrasting with the expectation for the whole year (+0,9%), due to the fact that the unfrozen of careers haven't begun yet for the majority of the civil servants (it is expected a negative impact of EUR 211 million related to this measure for this year) and a different payment mode of the Christmas allowance[3]. This different mode of payment of the 13rd month contributed also for the reduction of expenditure with pensions. Additionally, expenditure with unemployment benefits decreased (-9,1% yoy), in line with the improvement of the labour market[4]. The substantial increase of interests and other charges was solely due to interests supported by the Reclassified Public Entities, especially the payments of Metro de Lisboa, S.A. to Banco Santander Totta S.A., related to the swap agreements. On the other hand, interests of direct public debt dropped 14,7% yoy in January. Government expects EUR 307 million in savings with interests during this year.

- **Overdue payments increased again in January.** Overdue payments (unpaid debts for more than 90 days) reached EUR 1,19 billion in January, which compares to EUR 912 million in the same month of the previous year. The amount of overdue payments in the case of Hospitals rose in comparison to December 2017 (EUR +114 million) and in comparison to January 2017 (EUR +339 million), being responsible for 80% of total arrears.

3) In 2017, Christmas allowance was paid as follows: half in duodecimals with the wages during the year, and the other half in November; in 2018, total amount of Christmas allowance will be paid in November.

4) The number of beneficiaries of unemployment benefits dropped 13% yoy in January 2018, to 192.331 individuals. At the same time, unemployment rate (individuals between 15 and 74 years old) decreased by 2,2 p.p. in comparison to the same month of 2017, to 8,2% (not seasonally adjusted).

Budget Execution: 2017 and January 2018
(Cash-basis)

	Budget Execution		yoy%		Contributions	Budget Execution		yoy%		Contributions
million EUR	2016	2017	? 2017/16	SB 17*		Jan 17	Jan 18	? 2018/17	SB 18	
Current Revenue	**76.216**	**79.000**	**3,7%**	**3,9%**	**3,6%**	**5.708**	**6.138**	**7,5%**	**4,2%**	**7,4%**
Tax	45.715	47.681	4,3%	3,3%	2,5%	3.008	3.251	8,1%	3,4%	4,2%
Direct Taxes	21.047	21.753	3,4%	2,2%	0,9%	1.290	1.432	11,1%	1,8%	2,4%
Indirect Taxes	24.668	25.928	5,1%	4,3%	1,6%	1.718	1.819	5,9%	4,7%	1,7%
Social Security Contributions	19.485	19.760	1,4%	0,7%	0,4%	1.674	1.798	7,4%	4,3%	2,1%
Other Current Revenue	10.944	11.555	5,6%	13,3%	0,8%	981	1.072	9,3%	10,6%	1,6%
Capital Revenue	**1.821**	**2.003**	**10,0%**	**40,5%**	**0,2%**	**140**	**108**	**-22,7%**	**36,0%**	**-0,5%**
Effective Revenue	**78.037**	**81.003**	**3,8%**	**4,8%**	**3,8%**	**5.848**	**6.246**	**6,8%**	**5,2%**	**6,8%**
Current Expenditure	**77.190**	**78.323**	**1,5%**	**1,9%**	**1,4%**	**5.039**	**5.266**	**4,5%**	**5,2%**	**4,4%**
Compensation of Employees	19.623	20.144	2,7%	1,9%	0,6%	1.459	1.362	-6,7%	0,9%	-1,9%
Acquisition of Goods & Services	11.769	11.779	0,1%	3,8%	0,0%	576	564	-2,1%	6,3%	-0,2%
Interests & other charges	8.229	8.299	0,8%	0,3%	0,1%	194	451	132,5%	2,1%	4,9%
Current Transfers	35.522	35.596	0,2%	0,0%	0,1%	2.680	2.720	1,5%	5,3%	0,8%
Subsidies	1.023	947	-7,4%	-2,4%	-0,1%	67	83	23,8%	0,0%	0,3%
Other Current Expenditures	946	1.500	58,6%	50,1%	0,7%	57	38	-34,3%	70,0%	-0,4%
Capital Expenditure	**5.030**	**5.254**	**4,5%**	**11,4%**	**0,3%**	**187**	**205**	**9,6%**	**22,1%**	**0,3%**
Effective Expenditure	**82.219**	**83.577**	**1,7%**	**2,5%**	**1,7%**	**5.226**	**5.471**	**4,7%**	**6,3%**	**4,7%**
Overall Balance	**-4.182**	**-2.574**	**-38,5%**	-	-	**622**	**775**	**24,6%**	-	-
Primary Balance	**4.047**	**5.725**	**41,5%**	-	-	**816**	**1.225**	**50,2%**	-	-

Source: DGO, BPI calc.

** Annual rates, taking into account the new projections of the Government, inscribed in the SB 18.*

Social Security: Expenditure

million EUR	Jan 17	Jan 18	YOY %	% of total expenditure	Contributions
Pensions	1.179	1.166	-1,1	60,0	-0,7
Survival	168	168	-0,0	8,6	0,0
Disability	96	79	-17,5	4,1	-0,9
Old-age	915	906	-1,0	46,6	-0,5
War veteran beneficiaries	0	0	-5,6	0,0	0,0
Family benefit	50	52	4,7	2,7	0,1
Illness benefit	38	44	16,4	2,3	0,3
Unemployment benefits	122	111	-9,1	5,7	-0,6
Elderly pension supplement	17	18	2,7	0,9	0,0
Social assistance	133	133	-0,7	6,8	0,0
Social Integration Income	28	29	2,7	1,5	0,0
Other Expenditure	349	392	12,1	20,1	2,2
Total Expenditure	**1.917**	**1.944**	**1,4**		

Source: DGO; BPI calc..

Overdue payments (unpaid debts for more than 90 days)

stock at the end of period, million EUR	Dec 13	Dec 14	Dec 15	Dec 16	Jan 17	Dec 17	Jan 18*
Public Administration	**1.199**	**1.539**	**920**	**851**	**911**	**1.073**	**1.188**
Central Govern.,excl.health	30	22	13	17	19	16	18
Health subsector	10	7	4	6	0	7	4
Hospital EPE	1	553	451	544	613	837	951
Reclassified Public Companies	671	3	15	13	13	12	12
Local Government	523	437	242	150	151	103	106
Regional Government	714	516	194	120	115	98	96
Other entities	**103**	**1**	**1**	**3**	**1**	**0**	**0**
Non-reclassified public companies	611	1	1	3	1	0	0
Total	**1.913**	**1.539**	**921**	**854**	**912**	**1.073**	**1.188**

Source: DGO.

Note (*): Provisional figure.

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