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Portugal: Execution worsens but remains manageable

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Budget execution until April similar to 2016: expenditure and revenue grow well below expectations.

The budget deficit worsened until April, due to a larger growth of expenditure relative to revenue. Part of this is due to a decrease in tax revenue, which might be reversible as an earlier distribution of tax refunds is hurting direct tax revenue. On the other hand, the positive performance of the labour market is supporting budget execution, both by increasing social contributions and reducing unemployment subsidies (when the opposite was expected of both variables). Projecting the current growth rates of the various expenditure and revenue categories, 2017 would see a budget deficit of around 3% in cash-basis, which would then result in a headline figure around 2%, above the Government forecast of 1.5% of the GDP.

The public accounts in cash-basis until April saw a worsening of the budget deficit, of about EUR 314 million, in comparison with the same period of 2016. The deficit stood at EUR 1.931 billion, which compares with a much lower deficit of EUR 358 million in the first quarter of the year. Still, this evolution is relatively normal due to seasonal effects.

Revenue is growing well below expectations, at 0.2% yoy (prediction of 4.1% yoy in the State Budget). Current revenue is actually down 0.1% yoy, dragged down by a widely negative evolution of tax revenue, down 3.2%: direct taxes are decreasing 6.7% yoy, while indirect taxes are shrinking 0.8%. On the other hand, social security contributions are increasing 1.0%; other current revenue is rising 9.6%. At the same time, capital revenue is up 11.7% yoy.

Expenditure is also increasing at a lower rate than expected, up 1.4% yoy (expected increase of 4.5%). All types of expenditure are on the rise, except for current transfers, where unemployment subsidies are included, which are decreasing 2.9% yoy. Capital expenditure is also increasing, at a rate of 14.3% yoy. **Despite the budget deficit, the large share of interest spending means that the primary balance is positive, at EUR 983 million.**

2017 Budget execution	Values		% Change		SB17	Naïf projection	Implied gap*	
EUR millions	Apr-2016	Apr-2017	Actual	SB17	EUR millions	EUR millions	EUR millions	% of GDP
Current revenue	**22653.8**	**22637.7**	**-0.1%**	**3.1%**	**78572.9**	**75757.8**	**-2815.2**	**-1.5%**
Tax	13244.4	12826.1	-3.2%	2.1%	46654.3	44071.6	-2582.8	-1.4%
Direct taxes	5302.0	4947.7	-6.7%	2.0%	21461.0	19630.2	-1830.8	-1.0%
Indirect taxes	7942.4	7878.4	-0.8%	2.2%	25193.3	24441.3	-752.0	-0.4%
Social security contributions	6110.7	6170.2	1.0%	-0.6%	19369.3	19672.6	303.3	0.2%
Other current revenue	3273.2	3586.1	9.6%	14.4%	12542.1	12006.3	-535.7	-0.3%
Capital revenue	**474.1**	**529.5**	**11.7%**	**44.6%**	**2541.1**	**1961.9**	**-579.2**	**-0.3%**
Effective revenue	**23127.9**	**23167.2**	**0.2%**	**4.1%**	**81114.0**	**77719.7**	**-3394.3**	**-1.8%**
Current expenditure	**23431.4**	**23597.5**	**0.7%**	**3.0%**	**79474.0**	**77792.8**	**-1681.2**	**-0.9%**
Compensation of employees	5974.6	6019.8	0.8%	0.9%	19797.6	19761.8	-35.9	0.0%
Purchase of goods and services	3128.8	3324.1	6.2%	2.4%	12009.8	12456.2	446.4	0.2%
Interests and other charges	2735.1	2913.7	6.5%	0.0%	8285.2	8825.3	540.1	0.3%
Current transfers	11144.2	10817.9	-2.9%	1.7%	36094.9	34450.5	-1644.4	-0.9%
Subsidies	222.6	228.1	2.5%	41.5%	1446.4	1047.4	-399.0	-0.2%
Other current expenditures	223.3	284.9	27.6%	90.0%	1791.7	1203.3	-588.4	-0.3%
Capital expenditure	**1313.2**	**1500.4**	**14.3%**	**27.9%**	**6403.4**	**5831.4**	**-572.0**	**-0.3%**
Investments	1056.8	1187.8	12.4%	26.9%	4987.5	4416.4	-571.1	-0.3%
Capital transfers	234.1	257.2	9.9%	12.7%	1061.8	1034.8	-27.0	0.0%
Other cap. exp.	16.7	32.0	91.6%	70.9%	215.3	241.4	26.1	0.0%
Effective expenditure	**24744.6**	**25098.0**	**1.4%**	**4.5%**	**85877.4**	**83624.2**	**-2253.2**	**-1.2%**
Overall balance	**-1616.6**	**-1930.8**	**19.4%**	**-**	**-4763.4**	**-5904.5**	**-1141.1**	**-0.6%**
Primary expenditure	22009.4	22184.3	0.8%	5.0%	77592.2	74125.4	-3466.8	-1.8%
Primary balance	**1118.5**	**982.9**	**-12.1%**	**-**	**3521.8**	**2920.8**	**-601.1**	**-0.3%**

Source: DGO, BPI calc.

*Difference between expected execution according to current yoy changes and expected execution implied in the State Budget, for the whole year; GDP predictions used for 2017 are according to the State Budget

Projecting current performance of the various expenditure and revenue categories until the end of the year, we can produce a forecast for the end of the year. Revenue would likely fall more than EUR 3 billion short of the target, while expenditure would be over EUR 2 billion less than expected. This would, in turn, mean that the budget deficit would enlarge by about EUR 1 billion. This would be translated into a budget deficit of about 3% of the GDP in cash-basis. One should note, however, that the target of the Budget is 2.5% of the GDP (the difference between this figure and the forecasted 1.5% comes from adjustments from cash-basis to accrual-basis).

The main variables contributing for this deviation are related with taxes, mainly direct taxes. The forecasted gap in direct tax collection amounts for 1.0% of the GDP. Some of this gap is likely to be closed, as tax refunds begun earlier this year, making the comparison with 2016 slightly harder – not all of the gap is due to that: the projected deviation would already amount to 0.5% of the GDP considering only March figures.

On the other hand, the situation in the labour market is supporting budget execution: the decrease in current transfers (mostly due to unemployment subsidies), would allow at the end of the year (assuming the same decrease rate, not a sure scenario but possible) for a positive gap of EUR 1.6 billion, while the increase in social security contributions could provide a EUR 300 million buffer. Both of these together would then account for an extra buffer amounting to 1.1% of the GDP.

Despite this more negative evolution – which, assuming the same cash/accrual adjustments, would still allow for a budget deficit of around 2.1%, one should take into account that the Executive will always be able to accommodate a harder execution by cutting back in investment spending. Although this is likely to be politically more difficult after having used that same tool last year, it is still a possibility that remains available. Until April, despite the solid increase in investment (14.3%, as mentioned above), this is still below the expected rise of 27.9% - this performance, if carried through to the end of the year, would still amount to a buffer of EUR 572 million, about 0.3% of the GDP.

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