

Portugal: Public accounts well under control in first half of 2017

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Budget deficit increased EUR 265 million until June, in cash-basis accounts

The budget deficit worsened EUR 265 up until June, according to data in cash-basis published by DGO. Both revenue and expenditure have increased, although at a much slower pace than expected by the Government, as forecasted in the State Budget for 2017. Revenue has been affected by a weak performance of direct taxation, driven by an earlier execution of refunds on income tax and VAT, in comparison with 2016; still, even without this effect, revenue collected is coming short of predictions at this time of the year. After discounting the effect of refunds, income tax revenue is only growing at 0.5% yoy, below the 1.8% prediction in the SB. On the expenditure side, spending on current transfers and on subsidies decreased until June; on the other hand, the remaining categories of expenditure saw increases in comparison with the same period of last year. Taking into account this analysis, we consider likely that the budget deficit at the end of the year should not deviate much from the Executive's objective, despite the existence of various factors that will put more pressure in budget execution on the second half of the year, namely in income tax revenue.

Cash-basis accounts until June showed a higher budget deficit in comparison with 2016, by EUR 264.5 million, amounting to EUR 3075.2 million. This performance is explained by a deterioration in the central State, which showed a larger budget deficit, together with Autonomous Services and Funds and with the Local and Regional Administration, both posting a smaller surplus than in the previous year; on the contrary, Social Security accounts showed an increase in its surplus in the first six months of 2017, of EUR 418.9 million, totaling EUR 1228.8 million. **The primary budget surplus remained positive, at EUR 2.0 billion up to June, despite a decrease of EUR 134 million.**

Budget Execution (January - June 2017) (Cash-basis)

(million EUR)	Budget Execution		YOY %		Contributions
	June 2016	June 2017	Δ June 17/16	SB 17	
Current Revenue	30,027.4	29,913.3	-0.4%	3.1%	-0.4%
Tax	18,065.9	17,459.4	-3.4%	2.1%	-2.0%
Direct Taxes	7,779.8	7,036.4	-9.6%	2.0%	-2.4%
Indirect Taxes	10,286.1	10,423.0	1.3%	2.2%	0.4%
Social Security Contributions	7,655.6	7,692.0	0.5%	-0.6%	0.1%
Other Current Revenue	4,131.2	4,697.6	13.7%	14.4%	1.9%
Capital Revenue	562.1	744.0	32.4%	44.6%	0.6%
Effective Revenue	30,589.5	30,657.4	0.2%	4.1%	0.2%
Current Expenditure	29,332	29,575	0.8%	3.0%	0.8%
Compensation of Employees	7,537	7,566	0.4%	0.9%	0.1%
Acquisition of Goods & Services	4,082	4,335	6.2%	2.4%	0.8%
Interests & other charges	3,263	3,398	4.1%	0.0%	0.4%
Current Transfers	13,847	13,524	-2.3%	1.7%	-1.0%
Subsidies	317	301	-5.2%	41.5%	-0.1%
Other Current Expenditures	281	443	57.5%	90.0%	0.5%
Capital Expenditure	1,596	1,780	11.5%	27.9%	0.6%
Effective Expenditure	30,928	31,355	1.4%	4.5%	1.4%
Overall Balance	-338.5	-697.8	106.1%		
Primary Balance	2,924.5	2,700.2	-7.7%		

Source: DGO, BPI calc.

Total revenue rose 1.0% yoy until June, significantly below predictions (the Executive expected 3.6% yoy in the SB). Current revenue was up 0.8% yoy (forecast of 2.7% yoy), mostly due to tax revenue; in fact, direct tax revenue tumbled 6.1% yoy, dragged by income tax refunds (the latter grew EUR 1113.7 million, an increase that fully covers the reduction in income tax revenue, a performance mostly explained by an earlier execution of these refunds). **Still, one must note that even excluding these refunds, income tax revenue grew 0.5%, short of the increase of 1.8% which was expected, while at the same time refunds executed so far are already similar to the total refunds executed in the whole of 2016, leading us to**

believe that not all of this surge in refunds is due to the different scheduling. Apart from direct taxes, the remaining categories of revenue are not significantly different from what was predicted in the State Budget. At the same time, corporate tax revenue are still showing large increases (22.5% yoy), hinting at an improvement of corporate profitability. In addition, VAT refunds are also increasing significantly (+16.6 yoy until June). The execution rate of total revenue is at 45.7% of the budget target; in the same month of last year, execution ran at 47.0% of what was to be total revenue at year-end. This difference hints at a likely possibility that there will be a significant deviation of revenue from what was initially predicted. Notwithstanding, part of this difference is probably going to disappear in the next few months on account of the different intra-annual behavior of income tax refunds.

At the same time, expenditure has also increased at an inferior rate of what was expected, at 1.6% yoy (the Executive forecasted 4.1% growth for the whole year). With the exceptions of current transfers (-2.1% yoy), where unemployment subsidies are included, and subsidies (-7.9% yoy), all other expenditure is increasing. The decrease in current transfers is mostly due to a reduction in pension expenditure, because of a different scheduling of the "13th month" (a Christmas bonus similar to one month's pension) – this year it's paid 50% over each month, and 50% in November, while in 2016 the amount was divided equally among the 12 months of the year. Moreover, the positive evolution of the labour market had a very meaningful impact, allowing for a decrease in unemployment subsidies expenditure. Wages in the public sector increased 0.3% yoy, driven by different factors with varying impact on this performance. On the one hand, there were contributions for the rise of expenditure: a gradual reversion of the wage cuts in 2016, meaning that these were paid in full from the beginning of 2017; an increase in the meal allowance; other sectorial measures (increase of overtime pay in the health sector, for example). Other factors have pulled expenditure downwards, such as the same issue referred above regarding the "13th month" payment. Purchases of goods and services surged 5.3% yoy until June, well above what was expected by the Government (2.0%), mainly due to purchases related with the National Health Service and other health-related spending (out of EUR 267.5 million of increase in expenditure of this category, EUR 149.1 were in the Health department). At the same time, interest and debt charges increased 2.6% yoy, above the 0.7% predicted in the SB, but this was partly due to a different intra-annual scheduling of these expenses. The execution rate of current expenditure was 47.3% in the first six months of the year. Capital expenditure increased 21.9% yoy until June, closer to the 27.3% surge planned for the year, albeit still below the expected performance.

Concluding, the budget execution remains well under control, despite some significant deviations in expenditure and revenue. Thus, our perspective remains unchanged: the budget deficit in accrual-basis should not rise above the 2% seen in 2016, and the Government is likely to reach its target of 1.5% of GDP. Despite the problems coming from revenue growing below what was predicted, particularly regarding income tax (there should be an even larger negative impact due to the "surcharge" reduction taking effect in the second half of the year), we expect that the Government will still have ways of adjusting expenditure, namely in investment and purchases of goods and services, in order to prevent significant deviations from the target at the end of the year.

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