Notes on the Stability Program for 2016-2020

- **On April 21st, the Government submitted to Parliament the Stability Program for 2016-20, describing the medium-term macroeconomic scenario and budgetary plan for Portugal, and the National Reform Plan, reinforcing its commitment with fiscal consolidation and growth-enhancing structural reforms**
- **The macro scenario points to a gradual recovery of the economic activity, with GDP growing 1.8% in 2016-17 and then slightly accelerating up to 2.1% in 2020, on the back of a gradual recovery of investment and labor market conditions**
- **The budget deficit is expected to decline to 2.2% of GDP this year and to continue declining in future years, reaching a surplus of 0.4% of GDP in 2020**
- **Fiscal consolidation will be achieved through expenditure reduction, part of which will be offset by a simultaneous reduction in revenue**
- **The European Commission has recently revised the medium-term objective (MTO) for the structural balance in EU countries (three-year revisions), raising Portugal's to +0.25% (vs a previous target of -0.5%), which implies further structural adjustment to be continued beyond 2020**
- **Public debt is expected to decline gradually over the period, at a pace of about 3.5pp of GDP per year, on the back of large primary surpluses (between 2 and 4% of GDP) and solid nominal GDP growth**
- **The National Reform Plan presents six pillar objectives (namely encompassing the improvement of the labor force qualifications and the capitalization of the corporate sector), which aim to address the five country-specific recommendations recently presented by the European Commission**

Gradual macroeconomic recovery

On April 21st, the Government presented its proposal for the Stability Program for the next 4 years, where it outlined the country's medium-term fiscal strategy, along with the National Reform Program to promote economic growth, employment and social equality.

The documents are based on the following macroeconomic scenario:

GDP is projected to grow 1.8% in 2016 and 2017 and accelerate to around 2.0% in the following years

Inflation is expected to progressively increase to from 1.2% in 2016 to 1.8% in 2019-20

Macroeconomic scenario (Stability Program for 2016-2020)							
	2014	2015 E	2016 P	2017 P	2018 P	2019 P	2020 P
Real GDP (yoy %)	**0.9**	**1.5**	**1.8**	**1.8**	**1.9**	**2.0**	**2.1**
Private consumption	2.2	2.6	2.4	1.8	1.8	1.8	1.8
Public consumption	-0.5	0.6	0.2	-0.7	-1.1	-1.2	-0.3
GFCF	2.8	3.9	4.9	4.8	4.1	4.7	4.1
Exports	3.9	5.2	4.3	4.9	4.9	4.9	4.9
Imports	7.2	7.4	5.5	4.9	4.2	4.3	4.4
Contributions to GDP growth (pp)							
Domestic demand	2.2	2.5	2.4	1.9	1.7	1.8	1.9
Net external demand	-1.3	-1.0	-0.6	-0.1	0.2	0.1	0.1
External sector (% GDP)							
Goods	-4.6	-4.2	-4.2	-4.0	-3.8	-3.8	-3.8
Current account	0.0	-0.1	0.4	0.6	0.8	0.7	1.0
Current and Capital account	1.4	1.1	1.6	1.8	2.0	1.9	2.4
Unemployment (% labor force)	**13.9**	**12.4**	**11.4**	**10.9**	**10.4**	**9.8**	**9.0**
CPI (%)	**-0.3**	**0.5**	**1.2**	**1.6**	**1.7**	**1.8**	**1.8**

Source: Ministry of Finance

GDP is projected to grow 1.8% in 2016-17, supported by a sustained recovery of domestic demand, in particular private consumption and investment.

Net external demand continues posting a negative contribution, as import growth still outpaces export growth. Nevertheless, exports growth is expected to maintain a healthy growth pace of around 4%, which together with improved terms of trade, continue to sustain a surplus of the current and capital account.

Sustained exports growth and improved terms of trade sustain surplus in external accounts

Projections for 2017-2020 point to a gradual acceleration of GDP growth up to 2.1% in 2020, especially supported by a recovery of net external demand, which is expected to present a positive contribution from 2018 onwards. Throughout this 5-year period, the GDP performance is also supported by a sustained improvement of investment, with GFCF expected to grow above 4%/year.

The unemployment rate is projected to continue in a downward trajectory, declining from 12.4% in 2015 to 11.4% in 2016 and 9.0% in 2020.

Fiscal consolidation efforts to be sustained going forward

On the fiscal side, the Portuguese Government reaffirmed its commitment to achieve a budget deficit of 2.2% of GDP in 2016 and to proceed with a fiscal structural adjustment throughout the 5-year horizon, in order to get closer to the new MTO for the structural balance (+0.25% of GDP).

OVERALL BALANCE							
	2010	2015	2016 P	2017 P	2018 P	2019 P	2020 P
Overall balance	-11,2	-4,4	-2,2	-1,4	-0,9	-0,1	0,4
Structural overall balance	-8,6	-2,0	-1,7	-1,3	-0,8	-0,4	-0,1

PRIMARY BALANCE							
	2010	2015	2016 P	2017 P	2018 P	2019 P	2020 P
Primary balance	-8,2	0,2	2,2	2,8	3,2	3,8	4,2
Structural primary balance	-5,6	2,6	2,7	2,9	3,3	3,6	3,7

Source: Statistics Portugal and Ministry of Finance

Budget deficit is expected to reach 2.2% of GDP in 2016 and to turn into a surplus of 0.4% of GDP in 2020

Between 2010 and 2015, the GG deficit reduced by 6.8pp, from 11.2% of GDP in 2010 to 4.4% of GDP in 2015. This evolution reflected an increase of the revenue contribution of 3.3pp and a reduction of expenditure of 3.5pp. Excluding interest costs, which increased by 1.6pp mainly due to a higher debt stock, primary expenditure fell by 5.2pp.

From 2016 onwards, the budget balance is expected to improve gradually – reaching a surplus of 0.4% in 2020 –, on the back of an expenditure reduction of about 6.0pp of GDP between 2015 and 2020, which more than compensates a reduction in revenue of around 1.3pp of GDP (see detailed breakdown in Annex 1).

The structural balance has already improved 6.6pp of GDP since 2010, reaching a balance of -2.0% of potential GDP in 2015 (adjustment of 8.2pp in the structural primary balance, for a balance of +2.6%) and is expected to improve further to -0.1% by 2020.

The structural balance is projected to improve by about 0.4pp of GDP / year

The decline in expenditure is mainly explained by a reduction of the following components:

- compensation of employees (-1.3pp of GDP between 2015 and 2020): ratio between new hiring and workers leaving Public Administration below 1 until 2019 (equal to 1 from 2020 onwards) offsets the reversal of the temporary wage cuts planned to be concluded by the end of 2016 and fully implemented in 2017;
- social benefits (-1.5pp of GDP): reduction of expenditure with unemployment benefits and tighter control in the attribution of social benefits more than compensates the attribution of wage supplements to families living below the poverty threshold after 2018;
- intermediate consumption expenditure (-0.5pp of GDP): resulting from the ongoing *spending review*, as well as from decreasing expenditure with PPPs and road concessions;
- interest costs (-0.8pp of GDP): explained by a reduction of both the implicit interest rate and the debt-to-GDP ratio, supported in particular by additional early reimbursements of the IMF loan.

Fiscal consolidation efforts to be sustained in coming years, through continued expenditure control, which shall be supported by a low replacement ratio of civil servants and a *spending review* on intermediate consumption

The decrease in revenues is broadly justified by the reduction of taxes on income and wealth (-1.0pp), mainly resulting from the reduction of the extraordinary surcharge in the PIT in 2016 and its elimination in 2017. This reflects the restructuring of fiscal revenues, with a lower weight on direct taxation and a higher weight on indirect taxation, which promotes the utilization of productive factors and increases households' disposable income.

National Reform Plan aimed at strengthening MLT growth prospects

The National Reform Plan encompasses six main pillars, which were developed to tackle the main structural obstacles to MLT growth in Portugal and address the country-specific recommendations adopted by the EU Council in 2015.

In particular, it is important to notice the focus on improving the skills of the labor force, modernizing and simplifying Public Administration, and strengthening the capital structure of the corporate sector.

National Reform Plan							Stability Program
Pillars	***Improve labor qualification***	***Economic innovation***	***Territorial Enhancement***	***Modernization of Public Administration***	***Strengthening social cohesion and equality***	***Corporate sector capitalization***	
Main fields	•Promote equal access to all education levels (including pre-school) •Tackle school dropouts (in particular at the higher education level) •Improve qualification of adult population •Reduce segmentation of labor market	•Promote relation between science, technology and innovation •Promote substitution of imported products by national ones •Strengthen the transference of knowledge from scientific institutions to economic activity •Give more support to national start-ups and attract international ones	•Promote sustainable and intelligent cities •Improve efficiency in the use of resources, enhancing the circular economy in all sectors •Promote territorial cohesion, taking advantage of natural resources of each region	•Simplify fiscal and licensing procedures •Prioritize intervention at the local level through municipalities •Improve efficiency of judicial system •Promote innovation in the public sector	•Increase social benefits to families below the poverty threshold •Guarantee the access of all citizens to public services of primary need	•Diversify companies' financing sources (also through the use of fiscal instruments) •Improve balance sheet of financial institutions	•Enhance application of Commitments Control Law •Guarantee sustainability and promote reform of the National Health Service •Improve medium- to long-term sustainability of the social security system
Country-Specific Recommendations 2015	*CSR2 - Promote alignment of wages and productivity*	*CSR2 - Promote alignment of wages and productivity*	*CSR2 - Promote alignment of wages and productivity* *CSR5- Increase transparency in concessions and PPPs*	*CSR2 - Promote alignment of wages and productivity* *CSR5- Increase transparency in concessions and PPPs*	*CSR3 - Strengthening social cohesion and equality*	*CSR4 - Reduce corporate debt overhang*	*CSR1 - Sustainability of public finances* *CSR4 - Reduce corporate debt overhang*

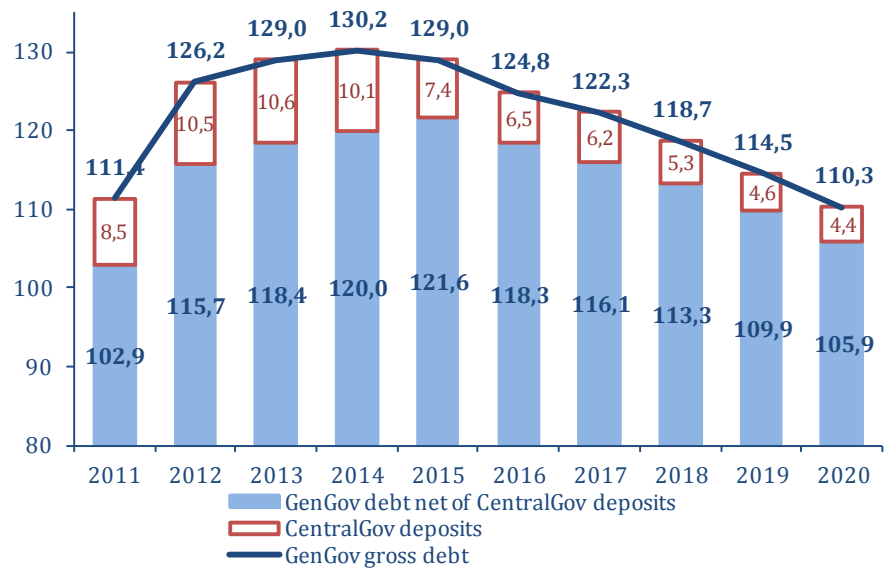
Source: Ministry of Finance

Public debt projected to accelerate the declining trend

The Maastricht gross debt is expected to decline to 124.8% of GDP this year, a downward revision of almost 3pp of GDP when compared with the figure presented in the 2016 Budget Report. This decline results mainly from the expected use of proceeds from the sale of financial assets in further early pre-payments of the IMF loan.

Going forward the debt is expected to decline at an average pace of 3.5pp of GDP per year, reaching about 110% of GDP by 2020. Public debt net of Central Government deposits is expected to decline at a similar pace, reaching 106% of GDP in 2020 (from 121.6% in 2015).

General Government debt (under ESA 2010 rules)
(% GDP)



Source: Banco de Portugal and Ministry of Finance

Public debt is projected to sustain a clear declining trend from 2015 onwards, on the back of a solid primary surplus in excess of 2% of GDP and nominal growth of more than 3.5%

The decomposition of debt dynamics shows that in 2016, for the first time since 2007, the snowball effect will be negative, as the impact of nominal GDP growth is expected to exceed interest costs by 0.4pp of GDP. Together with a primary surplus in excess of 2% of GDP public debt would be able to decline more than 2.5pp of GDP.

Public debt dynamics (pp GDP)							
	2014	2015	2016 P	2017 P	2018 P	2019 P	2020 P
Maastricht debt (% GDP)	**130,2**	**129,0**	**124,8**	**122,3**	**118,7**	**114,5**	**110,3008**
Change (pp GDP)	1,2	-1,2	-4,2	-2,5	-3,6	-4,2	-4,2
Primary balance effect	2,3	-0,4	-2,2	-2,8	-3,2	-3,8	-4,2
Snowball effect	2,5	0,4	-0,4	0,1	0,0	-0,1	-0,2
Interest	4,9	4,7	4,4	4,2	4,1	4,0	3,8
Nominal GDP	-2,4	-4,3	-4,8	-4,1	-4,1	-4,0	-4,0
Other stock-flow adjustments	-3,6	-1,2	-1,6	0,2	-0,4	-0,3	0,1

Source: Statistics Portugal, Banco de Portugal and Ministry of Finance

Borrowing needs for 2016 almost covered

The State's gross borrowing requirements stand close to €23 bn, given MLT debt redemptions of €7.9 bn and assuming €8.6 bn redemptions of IMF loans, of which about €2.0 bn already executed in February.

Any additional pre-payments of the IMF loan are contingent on the proceeds to be obtained from the sale of financial assets, as well as on market conditions

Early reimbursements of the IMF loan have been raised by €4 bn, but this does not change the gross borrowing needs for the year, as the increase results directly from the expected proceeds from the sale of financial assets now planned to occur towards the end of the year.

The financing needs will be covered by:

- MLT debt market issuance (circa €19.5 bn, of which €9.7 have already been raised); and
- retail issuance (€2.5 bn, of which €1.0 bn already raised).

New 5-year FRN targeting retail investors to be issued in early May

The issuance of retail debt has been increased by €0.5 bn to take into account the launch of a new floating-rate note specifically tailored to the domestic retail market. Moreover, given the recent performance of traditional retail instruments (more than €1 bn raised in Q1), there is a substantial probability of exceeding the current target for the year.

State Treasury borrowing needs and sources (€ billion)

	2014 E	2015 E	2016 P	2017 P	2018 P	2019 P	2020 P
State borrowing requirements	**30,9**	**29,0**	**22,9**	**16,0**	**16,6**	**15,7**	**15,0**
Net financing needs	**14,3**	**11,8**	**6,4**	**6,1**	**4,5**	**4,7**	**2,8**
Overall deficit *	7,1	5,6	6,3	3,6	2,6	1,4	0,6
Other net acquisitions of financial assets **	7,6	6,2	0,1	2,5	1,9	3,4	2,2
Privatizations (-)	-0,4						
MLT Redemptions	**16,6**	**17,2**	**16,5**	**9,9**	**12,1**	**10,9**	**12,2**
Tbonds (PGB + MTN)	16,6	8,8	7,9	8,4	8,6	10,4	10,7
IMF (executed)		8,4	2,0				
IMF (to be executed)			6,6	1,5	3,5	0,5	1,5
p.m. IMF (original maturity of outstanding loan)			*0,0*	*0,0*	*1,8*	*4,8*	*4,8*
State financing sources	**30,9**	**29,0**	**22,9**	**16,0**	**16,6**	**15,7**	**15,0**
Use of deposits	**2,8**	**5,8**	**0,0**	**0,1**	**1,0**	**1,0**	**0,0**
Financing in the year	**28,1**	**23,2**	**22,9**	**16,0**	**15,6**	**14,7**	**15,0**
Executed	**28,1**	**23,2**	**10,8**				
EU-IMF	5,2						
Tbonds (PGB + MTN)	19,9	20,2	9,7				
Tbills (net)	-2,8	-0,7					
Retail debt (net)	5,0	3,5	1,0				
Other flows (net)	0,7	0,2	0,2				
To be executed			**12,1**	**16,0**	**15,6**	**14,7**	**15,0**
Tbonds (PGB + MTN)			9,8				
Tbills (net)							
Retail debt (net)			1,5				
Other flows (net)			0,7				
State Treasury cash position at year-end ***	**12,4**	**6,6**	**6,6**	**6,5**	**5,5**	**4,5**	**4,5**

* State sub-sector cash deficit in 2014-16. Projection for GG deficit (excl SS) in 2017-20 (Stability Program, Apr 2016).
** Includes refinancing of other public entities (namely SOEs and regions), as well as ESM participation and redemption of CoCos in 2014, loans to the Resolution Fund in 2014-15, and direct capitalization of Banif in 2015.
*** Excluding cash-collateral.

Source: IGCP

Needs of additional issuance of MLT debt in 2016 effectively amount to €7.2 bn

As previously stated, the additional pre-payments on IMF loans still projected for 2016 (€6.6 bn) are dependent on market conditions and the sale of financial assets. Hence, the funding needs to be covered with MLT debt issuance for the remainder of 2016 effectively amount to about €7.2 bn.

IGCP expects to end 2016 with a cash position of €6.6 bn (in line with the one observed at the end of 2015), close to 50% of 2017 borrowing needs, which are projected to stand at €14.5 bn excluding additional IMF loan repurchases.

Annex 1: General Government Accounts 2010-2020 (ESA 2010)

General Government Account (accrual basis)							
(% GDP)	2010	2011	2012	2013	2014	2015 P	2015 vs 2010
Total revenue	**40,6%**	**42,6%**	**42,9%**	**45,1%**	**44,5%**	**44,0%**	**3,3pp**
Current revenue	39,4%	41,5%	41,1%	44,0%	43,7%	43,1%	3,7pp
Current taxes on income and wealth	8,5%	9,5%	9,0%	11,4%	10,9%	10,8%	2,4pp
Taxes on production and imports	13,2%	13,9%	13,9%	13,7%	14,2%	14,5%	1,3pp
Social contributions	11,9%	12,0%	11,4%	12,0%	11,7%	11,5%	-0,3pp
Other revenue	5,8%	6,2%	6,9%	6,8%	6,8%	6,2%	0,3pp
Capital revenue	1,3%	1,1%	1,8%	1,1%	0,8%	0,7%	-0,5pp
Total expenditure	**51,8%**	**50,0%**	**48,5%**	**49,9%**	**51,7%**	**48,4%**	**-3,5pp**
Current expenditure	44,6%	45,6%	45,3%	46,8%	45,7%	44,3%	-0,3pp
Social benefits	18,6%	18,9%	19,6%	20,4%	19,7%	19,2%	0,7pp
Compensation of employees	13,7%	12,8%	11,7%	12,5%	11,8%	11,3%	-2,4pp
Interest (EDP)	2,9%	4,3%	4,9%	4,9%	4,9%	4,6%	1,6pp
Intermediate consumption	5,9%	6,0%	5,8%	5,6%	5,8%	5,9%	0,0pp
Subsidies	0,7%	0,7%	0,6%	0,6%	0,7%	0,7%	-0,1pp
Other current expenditure	2,8%	2,9%	2,7%	2,7%	2,8%	2,5%	-0,3pp
Capital expenditure	7,2%	4,4%	3,3%	3,2%	6,0%	4,1%	-3,1pp
Gross fixed capital formation	5,3%	3,5%	2,3%	2,3%	2,0%	2,2%	-3,1pp
Other capital expenditure	1,9%	0,9%	1,0%	0,9%	3,9%	1,9%	0,0pp
Overall balance	**-11,2%**	**-7,4%**	**-5,7%**	**-4,8%**	**-7,2%**	**-4,4%**	**6,8pp**
Memo items							**0,0pp**
Primary expenditure	**48,9%**	**45,7%**	**43,6%**	**45,1%**	**46,8%**	**43,7%**	-5,2pp
Primary balance	**-8,2%**	**-3,1%**	**-0,8%**	**0,0%**	**-2,3%**	**0,2%**	**8,4pp**

Source: Statistics Portugal and Ministry of Finance

General Government Account (accrual basis)							
(% GDP)	2015 P	2016 P	2017 P	2018 P	2019 P	2020 P	2020 vs 2015
Total revenue	**44,0%**	**43,7%**	**43,4%**	**43,1%**	**43,0%**	**42,7%**	**-1,3pp**
Current revenue	43,1%	42,8%	42,3%	42,2%	42,0%	41,8%	-1,3pp
Current taxes on income and wealth	10,8%	10,2%	10,0%	10,0%	9,9%	9,8%	-1,0pp
Taxes on production and imports	14,5%	14,9%	14,9%	14,9%	14,8%	14,7%	0,2pp
Social contributions	11,5%	11,5%	11,4%	11,3%	11,3%	11,4%	-0,1pp
Other revenue	6,2%	6,2%	6,1%	6,0%	5,9%	5,9%	-0,3pp
Capital revenue	0,7%	0,9%	1,1%	1,0%	1,0%	0,9%	0,2pp
Total expenditure	**48,4%**	**45,9%**	**44,8%**	**44,0%**	**43,2%**	**42,4%**	**-6,0pp**
Current expenditure	44,3%	43,5%	42,3%	41,4%	40,5%	39,8%	-4,5pp
Social benefits	19,2%	18,6%	18,4%	18,2%	18,0%	17,7%	-1,5pp
Compensation of employees	11,3%	11,1%	10,8%	10,5%	10,2%	10,0%	-1,3pp
Interest (EDP)	4,6%	4,4%	4,2%	4,1%	4,0%	3,8%	-0,8pp
Intermediate consumption	5,9%	6,2%	5,9%	5,7%	5,5%	5,4%	-0,5pp
Subsidies	0,7%	0,8%	0,6%	0,6%	0,6%	0,6%	-0,1pp
Other current expenditure	2,5%	2,5%	2,4%	2,3%	2,3%	2,3%	-0,2pp
Capital expenditure	4,1%	2,3%	2,5%	2,6%	2,7%	2,6%	-1,5pp
Gross fixed capital formation	2,2%	1,9%	2,0%	2,0%	2,1%	2,1%	-0,1pp
Other capital expenditure	1,9%	0,5%	0,6%	0,6%	0,6%	0,6%	-1,3pp
Overall balance	**-4,4%**	**-2,2%**	**-1,4%**	**-0,9%**	**-0,1%**	**0,4%**	**4,8pp**
Memo items							
Primary expenditure	**43,7%**	**41,4%**	**41,4%**	**41,4%**	**41,4%**	**41,4%**	-2,3pp
Primary balance	**0,2%**	**2,3%**	**2,3%**	**2,3%**	**2,3%**	**2,3%**	**2,2pp**

Source: Statistics Portugal and Ministry of Finance

Stability Program and National Reforms Plan (in Portuguese only):

- http://www.portugal.gov.pt/pt/pm/documentos/20160421-pm-pnr-pe.aspx

Further information on the Portuguese economy can be obtained from:

- **Ministry of Finance** www.portugal.gov.pt/en/the-ministries/ministry-of-finance
- **Banco de Portugal** www.bportugal.pt
- **Statistics Portugal** www.ine.pt
- **Public Finance Council** www.cfp.pt
- **UTAO (only in PT)** Website
- **Portugal Economy Probe** www.peprobe.comi

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