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COMMISSION OPINION

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING PORTUGAL

3. On the basis of the Draft Budgetary Plan for 2015 submitted on 15 October 2014 by Portugal, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Portugal is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure (EDP) for Portugal on 2 December 2009 and recommended Portugal to correct the excessive deficit by 2013. Subsequently, the Council adopted revised Recommendations on 9 October 2012 and on 21 June 2013, as the Council concluded that Portugal had taken effective action but adverse economic events with major implications on public finances had occurred. The Council recommended Portugal to correct the excessive deficit by 2015 and to reduce its deficit to 5.5% of GDP in 2013, 4% of GDP in 2014 and 2.5% of GDP in 2015, which was deemed consistent with 0.6%, 1.4% and 0.5% of GDP improvements in the structural balance, respectively.

5. The macroeconomic scenario underlying the Draft Budgetary Plan projects the continuation of the economic recovery at a moderate pace. Having contracted by 1.4% in 2013, real GDP is forecast to grow by 1.0% in 2014 and then accelerate to 1.5% in 2015. Output growth is forecast to be driven mainly by domestic demand. The labour market is further improving and employment is forecast to expand by 1.4% in 2014 and by 1% in 2015, somewhat more strongly than anticipated in the Fiscal Strategy Document (FSD). The Plan's macroeconomic scenario for 2015 is more optimistic than the Commission 2014 autumn forecast. In particular, real GDP growth in 2015 is expected to be somewhat stronger than forecast by the Commission, mainly on the back of a more positive contribution of net exports and higher private consumption growth.

6. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan of Portugal have been endorsed by the Public Finance Council (CFP). In its endorsement, despite finding no noteworthy biases, the CFP flagged downside risks to the macroeconomic outlook which are related to rather optimistic export projections in 2015. The CFP was established through the

2011 reform of the Budgetary Framework Law, which laid down provisions aiming to ensure the CFP's independence.

7. According to the Draft Budgetary Plan, the general government deficit is set to reach 4.8% of GDP in 2014, above the 4% of GDP target set in the April FSD. The difference reflects the cost of approximately 0.7% of GDP related to the debt management of transport state-owned enterprises (SOEs) (indicated as a fiscal risk in the FSD) and 0.1% of GDP for the write-off of non-performing loans by BPN Crédito, unexpected at the time of the FSD. Furthermore, the Plan foresees a different composition of the adjustment than the FSD for 2014, which is less based on expenditure compression and more reliant on revenue collection. For 2015, the Draft Budgetary Plan intends to correct the excessive deficit. It targets a headline deficit of 2.7% of GDP, i.e. exceeding the 2.5% of GDP deficit targeted in the FSD and recommended by the Council under the EDP.

8. The Commission 2014 autumn forecast projects the general government deficit for 2014 to be slightly higher, at 4.9% of GDP, reflecting a somewhat lower yield of a number of measures and risks related to budgetary execution. Risks to the Commission forecast are tilted to the downside, as the one-off operation related to the resolution of Banco Espírito Santo, which is still subject to analysis by the statistical authorities, could have a further deficit-increasing impact of about 2.8% of GDP.

9. Regarding 2015, the Commission projects a general government deficit of 3.3% of GDP, significantly higher than the target in the Draft Budgetary Plan. The discrepancy is to a large extent due to a more cautious assessment of the impact on the budget of macro-economic developments, the fight against fraud and of the yields from certain measures of the consolidation package. Taking into account the most recent information, fiscal risks related to the economic outlook have become more balanced. However, there remain downside risks related to the projected increase in the efficiency of revenue collection and to budgetary implementation in all levels of the general government.

10. The Draft Budgetary Plan projects the general government gross debt-to-GDP ratio to be on a downward path from the second half of 2014 and to reach 127.2% and 123.7% by end-2014 and 2015, respectively. Comparison with the FSD numbers is distorted by the introduction of ESA 2010, which had various effects on Portugal's general government accounts and shifted down the level of the debt ratio compared to its value under ESA 95. Furthermore, there have been a number of stock-flow adjustments impacting debt developments. The Commission forecasts the debt ratio at about 128% and 125% of GDP in 2014 and 2015, respectively. The main difference with the Plan stems from the projected higher fiscal deficit and lower nominal GDP growth.

11. The Draft Budgetary Plan projects the 2015 deficit to reach 2.7% of GDP on the back of discretionary measures with an expected yield of 0.7% of GDP. The measures outlined in the Plan include one-off measures (0.1% of GDP) and permanent measures roughly equally split between revenue increases and expenditure savings. Some of the measures continue reforms initiated under the economic adjustment programme and are considered consistent with the objective of further improving the efficiency of the public sector. For some other measures, however, there are significant implementation risks, as they have repeatedly failed to materialise in the past (e.g. sales of concessions, requalification programme).

Furthermore, two temporary consolidation measures introduced under the economic adjustment programme related to public sector wages and pension payments have been partly or entirely reversed without being replaced by structural measures. On tax policy, the Draft Budgetary Plan envisages the continuation of the corporate income tax reform, additional collection of property taxation and announces reforms of the personal income tax and environmental taxes, which overall seem to contribute to a more growth-friendly tax system, as recommended in the country-specific recommendations (CSRs). The Plan also maintains the temporary 3.5% personal income tax (PIT) surcharge, but introduces a tax credit that could be potentially used against the surcharge, should the effective revenue from PIT and VAT outperform the initial estimates.

12. The headline deficit targeted in the Draft Budgetary Plan is, at 4.8% and 2.7% of GDP in 2014 and 2015, respectively, above the EDP headline deficit targets of 4% and 2.5% of GDP for the same years. At the same time, the Draft Budgetary Plan plans to correct the excessive deficit by 2015, in line with the Council recommendation.

In light of the 4.9% of GDP deficit projected for 2014 in the Commission autumn forecast, Portugal is seen to miss the headline target recommended by the Council. The 2014 deficit is projected to exceed the target due to deficit-increasing one-off operations amounting to 1.1% of GDP which do not deteriorate the baseline carried forward to 2015. The structural improvement in 2014 is estimated at 0.6% of GDP, below the recommended improvement of 1.4% of GDP, and the cumulative change in the structural balance over 2013-2014 of 1% of GDP falls short of the required cumulative change of 2% of GDP. The adjusted structural effort is estimated to be 0.4% of GDP in 2014 (and -0.5% of GDP over 2013-2014), well below the required effort. The amount of permanent consolidation measures taken under the programme and thereafter is estimated at 1.5% of GDP in 2014, showing a shortfall with respect to the 2% of permanent measures recommended under the EDP.

For 2015, the Commission forecast projects the headline deficit at 3.3% of GDP, substantially above the recommended target and also somewhat above the Treaty reference value, and therefore points to considerable risks to a timely correction of the excessive deficit by 2015 as recommended by the Council. Moreover, the Commission forecast points to a deterioration of the structural balance by 0.3% of GDP, an outcome significantly worse than the recommended improvement of 0.5% of GDP. In addition, the cumulative change in the structural balance over 2013-2015 of 0.6% of GDP falls markedly short of the recommended 2.5% of GDP. The adjusted structural effort of 2015 is -0.1% of GDP (and -0.6% of GDP over 2013-2015). Methodological and statistical changes introduced in 2014 had a negative effect on the cumulated structural effort for Portugal over the EDP horizon 2013-2015, amounting to about 0.8% of GDP, with the largest impact concentrated in 2013. Based on an overall assessment of the Draft Budgetary Plan, compliance by Portugal with the EDP recommendation is at risk.

13. The Draft Budgetary Plan takes stock of measures intended to address the CSRs directed to Portugal. On fiscal-structural issues, the Plan points to progress on the comprehensive reform of the Budgetary Framework Law and the implementation of the single wage scale and single supplements scale, while it reports that the comprehensive pension reform has come to a halt. The Draft Budgetary Plan announces reforms of the personal income tax (PIT) that could reduce the tax wedge on labour. The effects on employment of these reforms are however uncertain at this

stage, as the potential tax reduction is undefined (conditional on tax revenue outturn) and the full details of all the reforms are unknown at this stage. It will have to be ensured that the announced PIT and green tax reforms have a budget-neutral impact.

14. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Portugal, which is currently under the corrective arm, is at risk of non-compliance with the provisions of the Stability and Growth Pact. In particular, there is a risk that the Draft Budgetary Plan for 2015 will not fulfil the Council recommendation of correcting the excessive deficit by 2015. This risk mainly arises from favourable assumptions of the impact on the budget of macroeconomic developments and from the lack of structural measures underpinning the Plan. The fiscal effort falls clearly short of the recommendation, even taking into account the impact of methodological and statistical revisions, and thus indicates the need for additional structural consolidation measures for 2015 to underpin a credible and sustainable correction of the excessive deficit. The Commission therefore invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2015 budget will be compliant with the Stability and Growth Pact.

The Commission is also of the opinion that Portugal has made limited progress with regard to the structural part of the recommendations issued by the Council in the context of the 2014 European Semester and thus invites the authorities to accelerate implementation.

Done at Brussels, 28.11.2014

For the Commission
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Member of the Commission