Constitutional Court Ruling

On August 14th, the Constitutional Court (CC) ruled on two pieces of legislation supporting the 2015 Budget:

- **Remuneration Policy:** the **reinstatement and gradual reversal of the 2011-2013 wage reduction** (3.5% to 10% progressive cut for public employees with monthly pay over 1500€) was **partially approved**. The wage reduction will be **applied in full still in 2014** (once the Law enters into force) **and by 80% during 2015**, as proposed by the Government. However, the CC deemed the extension of **wage reductions beyond 2015 unconstitutional.**
- **Permanent Solution for Pensions**: part of the solution proposed by the Government (the **Sustainability Contribution for Pensions**) was deemed **unconstitutional**.

Economic Activity

Official data for the second quarter of 2014 confirm the ongoing recovery of economic activity.

i. GDP performance

GDP grew 0.6% q-o-q in the second quarter, thus reversing the adverse performance in 2014Q1 (-0.6%) that was negatively affected by one-off factors. Portuguese GDP growth **outperformed euro area average (0.0%) and EU average (+0.2%).**

In y-o-y terms, GDP grew 0.8% in 2014Q2, confirming the third consecutive quarter of positive y-o-y GDP performance, for the first time since 2010.

INE's and Eurostat's flash estimates are available here and here.

ii. Labor market developments

The **2014Q2 unemployment rate was 13.9%, down from 15.1% in the previous quarter and from 16.4% in 2013Q2**. In addition, unemployed population decreased by 15.9% y-o-y, while employed population grew 2.0% y-o-y.

INE's press release is available here.

Fiscal Adjustment

Up to July, the **General Government budget deficit** on a cash basis was €5.823M**,** about **€389M higher than the deficit in the first seven months of 2013**.

In January-July: **cumulative Central Administration expenditure increased by 5.8%** y-o-y; cumulative **State Tax Revenue (in net terms) grew 3.8%** y-o-y; the **Social Security balance improved to approximately €266M**, from about €172M in the same period in 2013.

Further information is available here.

Second Supplementary Budget 2014

The **2nd Supplementary Budget** was submitted to Parliament, **ensuring compliance with the 4% of GDP deficit target for 2014 and with the annual 0.5 p.p. structural effort required** under the EU Fiscal Compact. The Draft Law and a detailed Report are available here (only in Portuguese).

The 2014 fiscal **accounts were revised** according to the effects of recent **CC rulings**, the ongoing **budget execution** and the **latest data on economic activity**. The **pressures** that were identified are fully **compensated by** an upward revision of **tax revenue,** a better **Social Security balance** and overall **expenditure control**. Thus, **no additional fiscal consolidation measures** were considered necessary.

i. Updated macroeconomic scenario

Until now, **the macroeconomic scenario underlying the budget was still the original presented in October** 2013, notwithstanding revised estimates published since then. The 2nd Supplementary Budget considers an updated scenario for 2014:

- **GDP** is expected to grow by **1%**;
- Growth is expected to **rely more on domestic demand** (1.1 p.p. contribution), especially given the **recovery of private consumption**;
- **Unemployment is projected to reach 14.2%**, down from a 16.2% annual average in 2013;
- **Employment** is forecast to **grow by 1.7%**;
- The external adjustment is ongoing, with an **expected net lending position of 1.3% GDP.**

ii. Key revisions in fiscal accounts

On the expenditure side, the main revisions occurred in compensation of employees, which increased mainly due to the impact of the CC ruling of May 30th (on the 2.5% to 12% progressive cut for public employees with monthly pay over 675€) and to pressures arising from the delay in execution of the Mutual Agreements and Requalification programs (as identified in the Fiscal Strategy Document).

On the revenue side, stronger employment growth and a quicker recovery of domestic demand justify an **upward revision of the estimated revenue from taxes and from social contributions**.

iii. Debt Sustainability

Gross Public Debt is expected to reach **130.9% of GDP by end-year** (up from 130.2% foreseen in April). **Net Public Debt**, which reflects the accumulated cash buffer, is forecast to be **lower** (**123.5% of GDP**).

iv. National Accounting Framework

Since the move to the new European System of Accounts occurs in September, the 2nd Supplementary Budget is **still presented according to ESA95.**

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