Conselho das Finanças Públicas
Portuguese Public Finance Council

Macroeconomic projections underlying the 2015 State Budget Proposal

Opinion of the Portuguese Public Finance Council

October 14, 2014

The Portuguese Public Finance Council is an independent body, set up by article 3 of Law no. 22/2011 of 20 May that introduced the 5th amendment to the Budgetary Framework Law (Law no. 91/2011 of 20 August, republished by Law no. 37/2013 of 14 June).

The decision to set up the Council was taken following the publishing of the final report of the Taskforce to the European Council on economic governance in Europe, and became a reality in October 2010 after agreement was reached between the Socialist Party (PS), in Government, and the Social Democratic Party (PSD). The final version of its Statutes was approved by Law no. 54/2011 of 19 October.

The Council began its work in February 2012 and its mission is to conduct an independent assessment of the consistency, compliance with the stated objectives and the sustainability of public finances, while promoting fiscal transparency, so as to contribute to the quality of democracy and of political economic decisions and so strengthen the State's financial credibility.

This report uses the information available up to 13th October 2014.

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I. Introduction

In the terms of Article 12-I (1) of the Budgetary Framework Law (Law No 41/2014, of July 10), of Article 6 (a) of the Statutes of the Portuguese Public Finance Council, approved by Law No 54/2011, of October 19, Article 4 (4) and Article 6 (3f) of Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013, the Portuguese Public Finance Council (CFP) was requested, on September 29, 2014, by the Minister of State and Finance, to issue this Opinion on the macroeconomic forecasts underlying the 2015 State Budget Proposal.

This opinion relates only to the macroeconomic forecasts. The Report on the State Budget that CFP is to prepare, in the terms of Article 7 (1c) of its Statutes, shall provide a general analysis of the 2015 State Budget Proposal and of the fiscal policy stance.

II. Calendar, methodology, and process of analysis of the macroeconomic projections

CFP received a first working version of the macroeconomic projections on October 4, which were then partially revised and updated in a phone conference on October 7. Finally, the version on which the present Opinion is based was received on October 13. This Opinion focuses on the communicated values for external and technical assumptions and for the point forecasts. Tables 1 and 2 present the main indicators.

In order to carry out the analysis of the forecasts CFP resorted to the following sources:

a) Analysis of forecasts by CFP technical staff;
b) Comparison with projections of reference institutions: the European Commission, the Organization for Economic Cooperation and Development, International Monetary Fund (IMF) and the Bank of Portugal;
c) Comparison with recent forecasts by other bodies, official and unofficial;
d) Coincident and leading indicators, and the latest available statistical information produced by the national statistical authorities (INE and Banco de Portugal);
e) Technical clarifications provided by the Ministry of Finance with respect to the forecasting model used and to the forecasts themselves;
f) Consultation with technical staff of the European Commission, the International Monetary Fund and the Bank of Portugal.

The main figures to highlight from the forecasts underlying the 2015 State Budget Proposal refer to GDP growth, projected to be 1.0% and 1.5% in volume in 2014 and 2015, respectively, and 2.5 % and 3.0% in nominal terms in the same periods. The main contribution to real growth comes from domestic demand, amounting to 1.4 p.p. in 2014 and 1.3 p.p. in 2015. Private consumption, with growth accelerating from 1.8% in 2014 to 2.0 % in 2015, is, after exports, the component providing the largest contribution to the positive GDP growth (1.2 p.p. and 1.3 p.p. respectively). The contribution of gross fixed capital formation, while accelerating from 1.5% to 2.0%, remains very modest (0.2 p.p. and 0.3 p.p. respectively). The external sector resumes a slight positive contribution in 2015 (0.2 p.p.) following the negative contribution of 0.3 p.p. in 2014 which interrupted the significant positive contributions of the previous triennium. The positive outlook for this component in 2015 is primarily due to accelerating exports of goods and services (3.7% in 2014 to 4.7% in 2015), in line with the assumption regarding growth of foreign demand for Portuguese exports (from 3.1% in 2014 to 4.3% in 2015, according to the European Commission), and also to decelerating import growth (from 4.7% to 4.4%).

Table 1 – Technical and external hypotheses underlying the forecasts

	Source	2012	2013	2014	2015
Growth of relevant foreign demand	EC	-0.2	0.7	3.1	4.3
Oil price (USD/bbl)	EC+ NYMEX	111.6	108.6	104.2	96.7
Short run interest rate (year average, %)	EC	0.6	0.2	0.2	0.1
EUR/USD exchange rate (year average)	EC + FT + MF	1.3	1.3	1.3	1.3

Notes: EC - European Commission; MF - Ministry of Finance; NYMEX - New York Mercantile Exchange; FT - Financial Times

Source: Ministry of Finance

Table 2 – Macroeconomic projections for the Portuguese economy

	ESA 1995						ESA 2010			
Source:	INE	MF (FSD)		EC	OECD	IMF	INE	BdP	MF (SB2015)	
Year:	2013	2014	2015	2015	2015	2015	2013	2014	2014	2015
Publication Date:	jun/14	apr/14		apr/14	may/14	oct/14	sep/14	oct/14	oct/14	
GDP and Expenditure Components (real growth rate, %)										
GDP	-1.4	1.2	1.5	1.5	1.4	1.5	-1.4	0.9	1.0	1.5
Private Consumption	-1.7	0.7	0.8	0.7	0.7	n.d.	-1.4	1.9	1.8	2.0
Public Consumption	-1.8	-1.6	-1.5	-1.5	-2.1	n.d.	-2.0	-0.7	-0.6	-0.5
Investment (GFCF)	-6.6	3.3	3.8	3.8	2.8	n.d.	-6.3	1.6	1.5	2.0
Exports of Goods and Services	6.1	5.7	5.7	5.5	5.1	5.6	6.4	3.7	3.7	4.7
Imports of Goods and Services	3.1	4.1	4.2	4.0	3.1	4.2	3.6	6.4	4.7	4.4
Contributions for GDP growth (percentage points)										
Domestic Demand	-2.5	0.5	0.8	0.8	n.d.	0.9	-2.4	1.9	1.4	1.3
Net External Demand	1.1	0.7	0.7	0.7	0.9	0.6	1.0	-1.0	-0.3	0.2
Evolution of Prices										
GDP Deflator	1.7	0.7	0.9	1.0	0.1	0.9	2.3	n.d.	1.4	1.5
CPI/HICP	0.3	0.4	1.1	1.2	0.4	1.1	0.3	n.d.	0.0	0.7
Evolution of the Labour Market										
Employment	-2.6	1.0	0.8	0.7	n.d.	0.8	-2.6	n.d.	1.4	1.0
Unemployment rate (%)	16.3	15.4	14.8	15.0	14.8	13.5	16.2	n.d.	14.2	13.4
Apparent productivity of labour	1.7	0.4	0.7	0.7	0.5		1.6	n.d.	-0.4	0.5
Current and Capital Account Balances (as % of GDP)										
Net lending/borrowing	2.0	2.9	3.4	2.9	n.d.	n.d.	1.3	n.d.	1.5	1.5
- Current Account Balance	0.4	1.6	2.2	1.0	1.1	0.8	-0.3	n.d.	0.3	0.3
of which Balance of Goods	-3.5	-2.7	-2.3	-2.6	n.d.	n.d.	-4.0	n.d.	-3.8	-4.0
- Capital Account Balance	1.6	1.3	1.3	1.9	n.d.	n.d.	1.5	n.d.	1.2	1.2

Notes: MF - Ministry of Finance; INE - Instituto Nacional de Estatística (National Institute of Statistics); IMF - International Monetary Fund; OECD - Organization for Economic Cooperation and Development; EC - European Commission; BdP - Banco de Portugal (Bank of Portugal). The publication dates of INE correspond to the dates of publication of the latest relevant National Accounts.

Sources: INE; MF - Fiscal Strategy Document, April 2014; MF - Macroeconomic Forecasts of SB2015, October 2014; IMF - World Economic Outlook, October 2014; OECD - Economic Outlook, May 2014; EC - Occasional Papers 191, The Economic Adjustment Programme for Portugal - Eleventh Review, April 2014; BdP - Economic Bulletin, October 2014.

III. Analysis of Forecasts

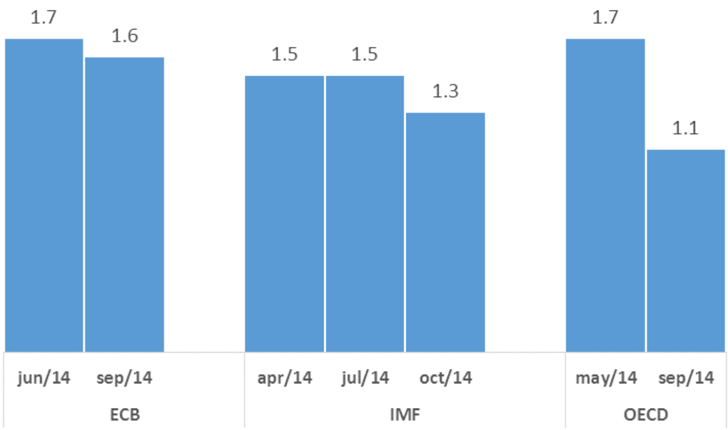
CFP highlights the uniqueness of the process of analysis in the current year, due to the change of base of the National Accounts (from ESA 95 rules, based on 2006, to ESA 2010 rules, based on 2011), which resulted in the new statistical series only becoming available along the month of September, compliant with the limit set by Eurostat, but difficult to reconcile with the timing for presenting the State Budget. This change in statistical base, involving significant changes in the perimeter covered by the budget as well as in the level and composition of the variables included in the macroeconomic scenario, decisively conditioned the ability of the Ministry of Finance to make elements available for the preparation of this opinion, as well as the respective analysis. Mention should be made, however, of the availability of the Ministry of Finance services to collaborate with the work of CFP.

The change in statistical base has also made it impossible, given the short time available, for the macroeconomic scenario underlying the Fiscal Strategy Document 2014-2018 to be converted to a statistical base compatible with the forecasts now presented. This fact introduces a significant degree of difficulty in analysing the compliance of current forecasts with the medium-term budgetary plan, a point which CFP regards as of utmost importance in assessing the macroeconomic scenario underlying the budget. The comparison with international forecasts is also hampered by this effect, particularly in the case of the IMF, whose Fall projections are still based on ESA95. Despite these constraints – particularly relevant in what concerns the level and composition of the different variables, and hence for the forecasting models which rely on them – Table 2 provides a comparison of the growth forecasts included in the 2015 State Budget Proposal with those of the FSD and with the latest available official forecasts.

The most relevant fact that emerges from comparing the forecasts underlying the 2015 State Budget Proposal and the FSD 2014-18 is the increased role of private consumption as a driver of GDP growth, returning to a growth rate exceeding that of GDP, and contributing to reduce the households' savings rate. We also note a smaller contraction in public consumption, a reduction in the relative weight of gross fixed capital formation, and a reduction in the external current surplus, a set of changes that do not contribute to the sustainability of economic growth and national public finances.

With regard to the comparison with other available official forecasts, the scenario on which the 2015 State Budget Proposal is based is broadly in line with the most recent projections. It must be noted, however, that several recent indicators suggest that these may be revised in a less favourable direction in what concerns the international environment, particularly in the case of the euro area. The following graph illustrates the trend, started in September 2014, of downward revisions to forecasts of 2015 euro area GDP growth, which, if realised, would result in a reduction of the relevant foreign demand for the Portuguese economy.

Figure 1 – Euro area growth forecasts



Sources: ECB – Macroeconomic projections for the euro area, prepared by ECB experts, Monthly bulletin, September 2014; IMF - World Economic Outlook, April 2014; World Economic Outlook Update, July 24, 2014; World Economic Outlook, October 2014; OECD - OECD Economic Outlook, May 2014; Interim Economic Assessment, September 16, 2014.

The projected evolution of nominal GDP, rather than real GDP, is used to calculate fiscal indicators expressed as ratios of GDP, as well as to compute the revenue forecast to be included in the budget proposal. Nominal GDP growth results both from changes in volume and changes in implicit prices. In the forecast in question for 2015, price changes amount to half of the 3% growth of GDP at current prices. A possibly milder than expected increase in implicit prices, particularly with respect to private consumption, will make fiscal targets expressed as a percentage of GDP harder to achieve.

IV. Conclusions

As a result of the analysis of the macroeconomic forecasts underlying the Proposed State Budget for 2015, with the aforementioned limitations, the Portuguese Public Finance Council concludes that:

1. **The macroeconomic forecasts underlying the Proposed State Budget for 2015 are in line with known predictions and show no noteworthy biases.**
2. **In case the most negative expectations with respect to the international environment materialize, in particular as regards the euro area, the forecasted contribution of exports may prove optimistic, which will tend to reflect directly and indirectly on the projected outcomes.**

V. Final Note

CFP considers that in subsequent years this assessment cannot be carried out within such a narrow time frame, with limited information as a consequence, as it was in the current exercise, largely due to the change in statistical base, which constituted an extraordinary factor that would in any case need to be taken into account.

In future exercises, in the terms of the Code of Conduct for the implementation of Regulations no. 472/2013 and 473/2013 (*Two Pack*) of the European Parliament and of the Council, CFP will propose a Memorandum of Understanding with the Government, setting out the procedures and timetables for the preparation of opinions on the macroeconomic forecasts underlying updates to the Stability Program and State Budgets.