



Portuguese Republic

Budgetary Policy

Steering Report

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MINISTRY OF FINANCE AND PUBLIC ADMINISTRATION

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Executive Summary

This Budgetary Policy Steering Report implements the provisions of article 60 of the Budgetary Framework Law (Law no. 91/2001, of 20 August, amended by Law no. 48/2004, of 24 August).

The main strategic goals conducting budgetary policy remain unchanged: creating a macroeconomic environment that is favourable to economic growth and the long-term sustainability of public finances continue to steer budgetary policy decisions. In the current scenario of financial and economic crisis, the achievement of these goals encompasses the adoption of an anti-cyclical budgetary stimulus, embodied in the Investment and Employment Initiative (IIE)¹, established by Law no. 10/2009 of 10 March. This initiative complemented the effort already embodied in the State Budget for 2009, namely supporting the measures taken throughout 2008 to assist households and companies.

The financial crisis has spread to all parts of the real economy. A large number of advanced economies have gone into recession and emerging and developing economies have undergone slowdown, reversing the strong growth trend witnessed in recent years. The forecasts now published for the Portuguese economy show a real decline in GDP of 3.4% in 2009, against the preceding forecast of -0.8%. This new forecast is the result of the sharp contraction of overall demand, which is qualitatively aligned with that expected for most developed economies.

The response to this crisis has been jointly articulated by the different countries, as much on a national scale as on a European and worldwide scale. The aim of the joint response is to benefit from the spillover effects associated to the measures to stimulate demand and to combat unemployment, through the implementation of economic recovery plans.

The scale of the budgetary effort of all the European national plans combined is more than 400 billion euros, around 3.3% of the European Union's GDP. This amount includes the anti-cyclical budgetary stimulus of the Portuguese State. This stimulus is temporary in nature. The impact of the IIE Programme on the budget is 0.8% of GDP in 2009, which is in addition to the estimated budgetary impact of the anti-cyclical measures implemented during 2008 - equivalent to 0.4% of GDP. This budgetary effort is only possible on account of the successful budgetary consolidation process initiated in 2005.

The forecast to the general government budget deficit for 2009 is now revised to 5.9% of GDP, 2 p.p. above the forecast presented in January 2009 in the update of the Stability and Growth Programme and the publication of the Investment and Employment Initiative. The worsening of the economic crisis explains, through the action of automatic stabilisers, the drop in revenue and the increase in public expenditure, which have caused this revision. According to current forecasts, public debt will increase by around 8 p.p., to 74.6% of GDP. The worsening of the budgetary balance and the significant increase of the public debt to GDP ratio is being experienced in most countries, reflecting the current crisis' impact on public finances and the discretionary stabilisation measures.

Notable in the budgetary implementation by the State in the first quarter of 2009 was the sharp decline of tax revenue, a clear indication of the economic and financial crisis and the proactive effort by the Tax Administration to make early reimbursement to companies and private individuals (especially VAT and

¹ Portuguese acronym that stands for "Iniciativa para o Investimento e o Emprego".

income tax reimbursements). This effort is in line with the Government's goal to strengthen liquidity in the economy (in April 2009, the rate of change on the corresponding previous period accelerated to 23% for VAT reimbursements, compared to 9.2% in March 2009; 3900 more VAT reimbursements were made in this period that in the corresponding period of 2008, equivalent to a rate of change of around 26%). Separately, certain expenditure increased in a manner totally consistent with the budgeted amounts, indicating their controlled implementation.

The five measures established in the IIE are structural in nature: the modernisation of schools; promoting renewable energy, energy efficiency and energy transmission infrastructures; the modernisation of technological infrastructure – new generation networks; special support to economic activity, exports and SME; and protecting employment and strengthening social protection. These measures are coherent with the 2008-2010 National Plan of Reforms, which aims to strengthen the modernisation and competitiveness of the country, the qualifications of the Portuguese people, energy efficiency and independence, environmental sustainability and social cohesion. The measures also contribute to the establishment of conditions fostering productivity and competitiveness, and create employment in the future, thus raising social well-being.

This period of economic and financial crisis also creates great challenges for public finances, given that it is necessary to conciliate the maximisation of the stabilising impact of public funds, through their application on the source of the main economic challenges, without losing sight of the need to ensure the quality and long-term sustainability of public finances, which was particularly affected by the substantial decline that it has undergone from its initial position. Only along these lines will it be possible to execute a credible exit strategy from the crisis, while strengthening the potential for economic growth.

1. Budgetary Policy

It is the responsibility of the State, in the current international environment of profound economic and financial crisis, to implement initiatives likely to add to and strengthen the impact on growth and employment of the automatic stabilisers, especially in a relatively open economy such as the Portuguese economy.

This action has come to embody, since the middle of 2008, the adoption of budgetary stimulus measures, mostly temporary in nature, and directed towards the households and companies potentially most affected by the crisis, either through their exposure to unemployment, in the case of households, or their greater sensitivity to international trade. International trade has undergone a steep decline in recent months, in harmony with the development of the economies of our main trading partners, which has particularly affected small and medium-size companies (SME).

The chosen strategy also includes measures likely to be capable of generating the expected impact in terms of magnitude and scope, as swiftly as possible, the aim being to contribute to the rapid re-establishment of economic agents' confidence.

It is to be noted that the pursuit of any programme of measures is only possible because the budgetary consolidation process ongoing since 2005 has permitted the creation of a budgetary safety margin that is currently being used in the anti-cyclical effort to support investment, employment and the most vulnerable families, while strengthening the stability of the financial system.

Governments throughout the world have sought to combat the recession by implementing economic recovery plans. The scale of the budgetary effort of all the European national plans combined is equivalent to a significant 3.3% of the European Union's GDP - more than 400 billion euros. This effort aims to generate new investment, foster demand and prevent increasing unemployment.

The budgetary stimulus programme in Portugal - "Investment and Employment Initiative" (IIE), established by Law no. 10/2009 of 10 March, adds to the effort already commenced in 2008. This programme is temporary in nature, only remaining in effect during 2009. The estimated budgetary impact of the IIE in 2009 is 0.8% of GDP, while the estimate of the budgetary impact of the anti-cyclical measures implemented during 2008 is 0.4% of GDP.

The fight against the crisis must also be performed looking towards the future. Thus, the five measures envisaged in the IIE are of a structural nature: the modernisation of schools, promoting the use of renewable energy, energy efficiency and energy transmission networks; the modernisation of technological infrastructure – new generation networks; Special support to economic activity, exports and SME; and protecting employment and strengthening social protection. These measures were chosen for their capacity to make a structural contribution to the 2008-10 National Plan of Reforms, aiming to strengthen the modernisation and competitiveness of the country, the qualifications of the Portuguese people, energy efficiency and independence, environmental sustainability and social cohesion. Investing now in structural reforms will permit the competitiveness and the creation of employment in the future.

The fight against the crisis also comprises, besides the IIE, the Initiative to Strengthen Financial Stability, which aims to ensure the normal financing of the economy and guarantee the protection of deposits. This

Initiative includes measures such as strengthening financial institution's information disclosure and transparency obligations, strengthening the guarantee of bank deposits (from EUR 25,000 to EUR 100,000 per depositor and per bank) and making available an amount up to EUR 20 billion for the granting of State guarantees and to strengthen credit institutions' financial soundness (not exceeding EUR 4 billion in this latter case). To date, the State has issued personal guarantees under this measure to five credit institutions, in a total amount of EUR 4.35 billion.

Budgetary policy, besides its focus on combating the crisis, remains alert to the need to redirect public expenditure to areas and projects likely to foster greater economic growth potential, namely the areas of knowledge and the qualification of human resources. The share of total primary expenditure held by gross fixed capital formation in 2009 increases to 6.4% from 5.0% in 2008.

In this context, the implementation of the Technological Plan will continue, on one hand, focusing on the consolidation of links between research, higher education and industry, and fostering greater participation from the private sector. The focus of the Science and Technology field continues to be on scientific and technological development, which is reflected in the increase of budget allocations to R&D (a 8.5% increase in 2009 from 2008, equivalent to around EUR 145 million), the increase in the number of researchers, the fostering of R&D activities and the increase in internationally recognised scientific output.

On the other hand, the Government will continue to fuel a more friendly business environment, based on competitive markets, fostering initiatives aimed at galvanising corporate investment, promoting entrepreneurship and management competences, facilitating the access of SME to financing, as well as making the process of internationalisation simpler. The development of the Simplex Programme and the measures to improve the legislative process will continue to translate into the cutting of red-tape for companies and, therefore, the creation of a better business environment.

1.1. Implementation of the Investment and Employment Initiative 2009

The Portuguese Government is committed to the swift and effective implementation of the measures to combat the crisis, namely the Investment and Employment Initiative, while safeguarding competition and complying with transparency obligations. Such determination by the Government is to ensure that benefits of those measures swiftly reach those to whom they are addressed, particularly those most affected by the crisis, guaranteeing to taxpayers that their money is being well spent and allowing our economy to emerge stronger from this phase of the economic cycle.

Measure 1 – Modernisation of Schools

The School Infrastructure Modernisation Programme, which envisages the renovation of schools, has already completed renovation work on four schools, while another 30 schools have works in progress, 75 schools are in the contract tendering phase and a further 100 schools in the study and project design phase. The total investment to be made in 2009 is around EUR 700 million.

The number of jobs directly and indirectly generated by the Programme has already surpassed the 5,000 mark, while around 900 companies, mainly small and medium-size companies, are actively involved with the Programme.

Measure 2 – Fostering Renewable Energies, Energy Efficiency and Energy Transmission Infrastructure

Installation of Solar Panels and Micro-Generation Units (Mini-Wind Turbines)

More than 3750 solar panel units, to date, have been installed in homes throughout the country. The installation of this equipment is based on a turnkey solution, comprising the purchase, installation, maintenance and guarantee of the equipment. The purchase price incorporates a discount of EUR 1,641.7 on the current public retail price, further enhanced by the income tax benefit of a 30% allowance on the net cost, up to a ceiling of EUR 796. This initiative forms part of the Government's focus on promoting renewable energy. The aim is to support the installation of 250,000 to 300,000 m² of solar panels in the residential sector, to generate energy for household use. The overall investment (public and private) is estimated to be around EUR 225 million during 2009, covering the installation of thermal solar equipment in more than 65,000 houses and involving a total of 2,500 jobs.

Investment in Energy Transmission Infrastructure

The investment in the very high voltage energy transmission grid will be assured by the concessionaire, which announced in February that it would increase the amount invested in 2009 from EUR 200 million to EUR 500 million. This investment aims to raise energy transmission capacity, thus making market liberalisation feasible. In 2008, the average import capacity for commercial uses was 1277 MW. The construction of two additional interconnections with Spain is planned, which should be concluded during the 2011-2014 time horizon, raising minimum interconnection capacity to around 3000 MW.

Improved Energy Efficiency of Public Buildings

42 buildings or complexes, some, such as Porto University or Santa Margarida Military Camp, comprised of more than 100 buildings, are already covered by the Programme. Energy audits are currently underway at eleven health centres and two Ministry of Finance and Public Administration (MFAP) buildings. The tendering procedure relative to the award of energy audit contracts for nineteen health centres, two hospitals, four military facilities, two universities and one polytechnic have just started. University of Coimbra Hospitals have signed an agreement with MFAP, the Ministry of the Economy and Innovation and the Ministry of Health with the purpose of commencing the award of contract work. The investment to be undertaken will reduce the energy bill of these entities, thus contributing to their financial sustainability and to the environmental sustainability of the country through the reduction of carbon emissions.

Investment in energy metering networks

The changes fostered by the InovGrid project are going to force extensive intervention in the electricity distribution grid, through the introduction of advanced remote energy management capabilities, of the capacity to integrate micro-generation, and, primarily, of intelligent mechanisms that will establish a new form of grid control and management, in harmony with the Smart Grids concept. A pilot project covering 600 homes will start in the second quarter of this year, to demonstrate and test out the technology involved. Implementation of the system, which permits more efficient energy management by the consumers, will subsequently be extended to the grid in general.

Measure 3 – Modernisation of technological infrastructure – new generation networks

The support provided to investment in new generation networks is mainly concentrated in this phase on the definition of the framework and removal of legal barriers and the promotion of the financing for the investments that the private operators are responsible for.

Thus, the Government approved, in the Council of Ministers of 26 March 2009, the Decree Law that establishes the scheme for the construction, access and installation of electronic communications infrastructures and networks. This legislative instrument benefited from the contributions obtained during the (non-mandatory) public consultation phase, with the intention being to:

Remove barriers to the installation of infrastructures capable of housing new generation networks – rights of passage and access rights;

Remove barriers to information. Drawing up a register of infrastructures for housing new generation networks (a utility that extends beyond the communications sector, since it is also a network planning instrument of other sectors, particularly relevant for territorial planning);

Compulsory advertise the undertaking of infrastructure construction or extension work;

ITUR Regulations – Telecommunications Infrastructures in Urban Developments, Divisions of Land into Plots and Co-ownerships of Property. This is an innovative scheme;

ITED – Telecommunications Infrastructures in Buildings. Regulations concerning the removal of vertical barriers in buildings that have already been built as well as future buildings.

Moreover, an agreement between the State, EIB and financial institutions is in preparation for an EUR 800 million line of credit partially financed by the EIB to provide funding support to investment in the field of new generation networks.

Measure 4 – Special support to economic activity, exports and SME

SME Credit Line

The new SME credit line (PME Investe IV) has an overall value of EUR 400 million, earmarked for micro and small companies as well as exporting companies, seeks to contribute towards improving Portuguese businesses' access to bank credit. The value of the operations approved under the PME Investe I, PME Investe II and PME Investe III credit lines is close to EUR 2.9 billion (i.e. close to 86% of the total value of the three credit lines), encompassing more than 27,500 companies.

Autonomous Fund to Support Company Merger and Consolidation

The share capital of the Autonomous Fund to Support Company Merger and Consolidation operations (FACCE), created by Decree Law no.105/2009 of 12 May, is EUR 175 million. The fund aims to create or strengthen the financing instruments and conditions to undertake merger, consolidation and restructuring operations, especially among SME, and industrial restructuring projects, unincorporated joint ventures or other forms of stable industrial and commercial partnership.

The first phase for the presentation of projects terminates on 15 June. The FACCE is limited to directly funding 40% of the borrowing requirements of the operation or project, and up to a maximum of EUR 10 million.

Support to export credit insurance mechanisms

The support to export credit insurance mechanisms is already in force. It is divided into three arms: the OECD I Arm (supporting exports to OECD countries, without the direct guarantee of the State), the OECD II Arm (supporting exports to OECD countries, with the direct guarantee of the State) and the Extra-OECD Arm (export credit insurance to countries outside the OECD, Turkey and Mexico, with the direct guarantee of the State).

Around 400 operations have already been proposed under the OECD I Arm, surpassing EUR 175 million in value. The State, under the OECD II Arm, has already signed agreements with three of the main insurers (Cosec, Cesce and Coface), and portfolio guarantees issued by the State have already amounted to around EUR 540 million. The amount guaranteed by the State under the Extra-OECD Arm amounts to around EUR 20 million (for 134 approved operations).

Support to promotion abroad

Agreements for promotion abroad have already been signed with 8 airlines serving 10 markets (United Kingdom, Germany, Spain, Italy, France, the Netherlands, Denmark, Finland, Russia and Poland) and with 56 tourist operators working in 13 markets (United Kingdom, Germany, Spain, Italy, France, the

Netherlands, Denmark, Finland, Norway, Sweden, Ireland, Czech Republic and Poland). Aggressive promotion campaigns in these markets began at the end of February and are still ongoing.

Support to private investment projects in agriculture and agro-industry

The act of accreditation under the Rural Development Programme (PRODER) has already been issued for the Fisheries and Agriculture Financing Institute to conclude the subsidy award contracts under Action 1.1.1 "Modernisation and Capacity Building of Companies". These contracts are currently in the signing phase. The aim of this measure is to support investments on farms for the production of agricultural products and investments for the transformation and/or commercialization of agricultural products. This measure aims to foster the modernisation of agro-food companies by raising the efficiency of production, strengthening business performance and market orientation, developing the competitiveness of strategic segments of the agro-food sector, and by ensuring any investment is compatible with environmental and occupational health and safety standards. Applications in the amount of EUR 300 million, capable of creating around 1600 jobs, have already been approved under this measure.

Creation of a credit facility supporting agriculture and agro-industry exports and competitiveness

The credit facility to support agriculture and agro-industry exports and competitiveness aims to support companies of the agricultural, livestock, agro-industry and forestry sectors by providing the funds to finance investment in fixed assets and to strengthen the working capital required to business development and refinancing.

The support is provided through the subsidisation of interest for loans with a maximum four-year maturity and a grace period of no more than two years. The subsidy on interest ranges from 80 to 100 percent, with the maximum subsidy provided for merger operations.

The expenditure related to this instrument is covered by funds from the Central Administration Development Expenditure and Investment Programme of the Ministry of Agriculture, Rural Development and Fisheries. The credit line is split with EUR 100 million for agro-industry and forestry and EUR 75 million for agriculture.

Four applications have been submitted so far, in the amount of EUR 3 million, since the publication of Decree Law no. 74/2009 on 31 March.

Tax Measures and Cash Resources and Economic Activity Support Measures

Most of the tax measures to support economic activity, such as the new tax scheme supporting investment, the reduction to the VAT reimbursement threshold and the decrease to the advance tax special payment, came into force on 11 March last, after publication of Law no. 10/2009 of 10 March².

² The implementation of VAT reverse charging in the provision of goods and services to the Public Administration is the exception. The application for derogation was submitted to the European Commission last January.

The average time for VAT reimbursement in 2008 was 30 days for 30-day reimbursement requests and 106 days for reimbursements by the end of the 3rd month following the request (i.e. between 105 and 110 days, in practice)³. The Government intends to reduce that average reimbursement time in 2009 to 20 days for 30-day reimbursements and 66 days for 3-month reimbursements. In April 2009, the accrued year-on-year rate of change for the value of VAT reimbursements accelerated to 23% (9.2% in March 2009). 3900 more VAT reimbursements were made in this period than the same period of 2008, which is year-on-year growth of around 26%.

Meanwhile, new measures were approved to simplify VAT reimbursement applications, in particular the guarantees provided to the Tax Administration in such situations. Firstly, the mandatory provision of automatic guarantees currently required for the first reimbursement and for situations of termination of business activity and switching between special VAT schemes, has been abolished. Furthermore, in relation to first reimbursements, those taxable persons that choose to provide a guarantee can be reimbursed more swiftly - within 30 days, provided the legal requirements are met. In other situations where the guarantee must be provided on request of the Tax Administration, the time limit for that guarantee decreases from 12 to 6 months.

In the field of improving the liquidity situation of economic agents, the indicator of average payment duration for the public sector fell since the beginning of the implementation of the "Pay on Time" Programme, in line with the decline in the value of the debt to suppliers. Thus, based on the information available to date, the payment duration of public entities in 2008 was 84 days, down from the 87 days registered at the end of the 4th quarter of 2007. This decline is largely due to the implementation of the mechanisms included in the Pay on Time Programme (PTH) and the Programme for the Extraordinary Settlement of the State's Debts (PREDE), to settle debts to suppliers. These mechanisms involved payments in the amount of EUR 1425 million, primarily at the end of 2008, and should achieve a cumulative value of around EUR 1850 million in 2009. The average payment duration is expected to decrease even more in 2009, as all other payments impact on this indicator.

Table 1.1. Payments within PREDE

	2008	2009	Total
Municipal Councils	75	425	500
Autonomous Regions	250	0	250
Health Sector	940	0	940
Central Government	125	35	160
Total	1 390	460	1 850

Source: Ministry of Finance and Public Administration.

A total of 102 municipal councils (out of the 308 in Portugal) and the Madeira Autonomous Region were covered by the loan mechanisms of the PTH and PREDE, to an overall amount of EUR 750 million (around EUR 500 million for the municipal councils). In relation to PREDE, almost all the 69 loans to municipal councils have been made formalised, and the payment of the funds (estimated at EUR 425 million) is to occur after the authorisation of the Court of Auditors.

The National Health Service Payment System Support Fund underwent restructuring in 2008, through Decree Law no. 228/2008 of 25 November and Ordinance no. 1369-A/2008 of 28 November, to broaden its scope to include support to the system of payment of acquisitions of all goods and services from the

³ For comparative purposes, that average payment duration was 66 and 196 days, respectively, in the 2003 recession.

suppliers of the NHS services and institutions. In 2008, the Fund granted loans totalling EUR 766.9 million to corporate public hospitals in the NHS. In December 2008, corporate public hospitals paid off debts totalling EUR 940 million.

The One-Stop Shop of MFAP, which was created by PREDE, registered 2379 applications from private creditors, corresponding to around 45,000 documents, in the amount of about EUR 80 million. Debts in the amount of approximately EUR 35 million were discharged and applications concerning debts totalling around EUR 45 million were not acknowledged. It is estimated that the services of the Central Administration may have paid off, on their own initiative, around EUR 125 million in outstanding debts to suppliers, during the closing months of 2008. The Ministry of Finance and Public Administration, following its good experience with the one-stop shop, will take over responsibility on a permanent basis for one of the basic mechanisms used by the one-stop shop to manage the process of settling debts, this being the management of debt circulation processes between creditors and debtors of the Central Administration of the State.

Moreover, the process of ascertaining the debts existing between central and local governments is in progress, the aim being to settle such debts.

Measure 5 – Protecting Employment and Strengthening Social Protection

Strengthening social protection systems and developing the solidarity arm are fundamental to re-establishing and bolstering confidence and aiding economic recovery. The rise in unemployment is a source of great concern, therefore it is essential to prevent and limit job loss and the consequent negative social repercussions of such, by actively acting on labour market drivers, seeking to keep the jobs of older workers and foster the inclusion of young people and the unemployed in the labour market. Hence, with the goal of acting on job creation and destruction drivers, the Government presented the “2009 Employment Initiative”, which consists of a series of employment support measures, stimuli for the inclusion of young people and the unemployed and the strengthening of social protection.

The 3 p.p. cut in the employer’s contribution to Social Security for workers aged over 45 years in micro and small enterprises, i.e. the organisations most exposed to the economic crisis, which is applied to protect the employment of that age group, already covers around 62,000 companies and 160,000 workers. A further 5,000 workers are covered through the Qualification-Employment Programme.

The support of professional training placements currently encompasses more than 10,000 young people. The aid provided for the contracting of young people covers a similar number.

As regards the aid provided for the return to work, around 2,000 long-term unemployed persons have been or are being contracted. Moreover, around 25,000 unemployed people are undergoing a process of activation, benefiting from transitional employment under Employment-Insertion contracts. This measure aims to foster the integration of the unemployed, considering the strengthening of the response capacity of social institutions in the development of socially useful activities.

The strong impact that the current economic climate will have on the labour market will be mitigated by these measures of the 2009 Employment Initiative, which will permit the slowdown in the growth of the number of unemployed. This is reflected in the unemployment rate forecasts for Portugal for 2009.

Further to this package of active policy measures, the Investment and Employment Initiative includes the extension of the unemployment social benefit of all those beneficiaries concluding in 2009 the initial time limit for entitlement. This measure has already benefited more than 10,000 people.

1.2. Challenges for Public Finances

This period of economic and financial crisis creates additional challenges for public finances. On one hand, governmental anti-cyclical policies must be directed at the source of the main economic challenges, seeking to prevent their spread and, thus, maximise the stabilising impact of public resources. While, on the other hand, the concern with the long-term sustainability and the quality of public finances has its importance strengthened, particularly as a pillar for a credible exit strategy and for strengthening economic growth potential.

The temporary nature of the budgetary stimulus will permit the recovery, in harmony with the economic upturn, of the path towards the Medium-Term Objective for the structural budgetary balance. The results of the structural budgetary consolidation measures implemented throughout the Government's time in office will contribute to meet this goal:

The structural resizing of the Public Administration – 36.1% reduction of central government departments and a reduction of around 25% in managerial positions;

The new public employment scheme, which permits the ordinary compliance with legally established administrative procedures to be combined with the creation of incentives for managers and workers, through performance assessment, so that they may achieve excellence in the provision of public services to citizens through their own initiative and merit.

The control of admissions and recruitment, through the application of the two out for everyone in recruitment rule, which led to a decrease in personnel expenditure through the reduction in the number of civil servants (the number of civil servants fell by 7% from December 2005 to September 2008, equivalent to a fall of about 51,500 civil servants);

The special mobility scheme, which has been used as a mechanism to foster human resources mobility in the Public Administration and to rationalise its management. 3187 civil servants had been placed in a situation of special mobility by the end of April 2008;

The shared management of resources, particularly in the fields of accounting and financial management, human resources management, management of the State's fleet of vehicles and procurement processes;

The management of State-owned real estate, in particular the measures envisaged in the State-Owned Real Estate Management Programme, approved by Council of Ministers Resolution no. 162/2008 of 24 October;

The strengthening of the sustainability of the social security system, which permitted a reduction from a high risk to a medium risk situation concerning the sustainability of public finances, and of the health system;

The fight against tax evasion and fraud and actions to foster taxpayers' voluntary compliance with obligations, which allowed for the broadening of the tax base and to offset competition distortions, and impairment to fiscal fairness and equality.

Other medium-term challenges for the quality of public finances consist of the implementation of measures such as the management planning, control and evaluation in public services, the new governance system of the State-owned company sector, programme budgeting and multi-year budgeting cycles.

2. The Portuguese Budgetary Situation in a European Union Context

The budgetary situation in the European Union (EU) in 2008, reflecting the impact of the financial crisis and, in particular, the slowdown of activity in most economies, worsened, registering a budget deficit of 2.3% of GDP, compared to 0.8% of GDP in 2007 (Table 2.1.). The budget deficit in the countries of the euro area was 1.9% of GDP (0.6% in 2007).

Table 2.1. Public finances in the European Union

	EU27							EA15						
	2005	2006	2007	2008	Diferences			2005	2006	2007	2008	Diferences		
					2006-05	2007-06	2008-07					2006-05	2007-06	2008-07
General Government	% of GDP				p.p. of GDP			% of GDP				p.p. of GDP		
Revenue	44,4	44,9	44,9	44,5	0,5	0,0	-0,4	44,8	45,4	45,5	44,8	0,6	0,1	-0,7
Expenditure	46,9	46,3	45,7	46,8	-0,6	-0,6	1,1	47,4	46,7	46,1	46,7	-0,7	-0,6	0,6
Budget Balance	-2,4	-1,4	-0,8	-2,3	1,0	0,6	-1,5	-2,5	-1,2	-0,6	-1,9	1,3	0,6	-1,3
Public Debt	62,7	61,3	58,7	61,5	-1,4	-2,6	2,8	70,2	68,4	66,2	69,6	-1,8	-2,2	3,4
Number of Member States														
with budget deficit	18	18	17	21	0	-1	4	10	10	9	12	0	-1	3
with a deficit above 3% of GDP	8	5	2	11	-3	-3	9	4	2	1	5	-2	-1	4

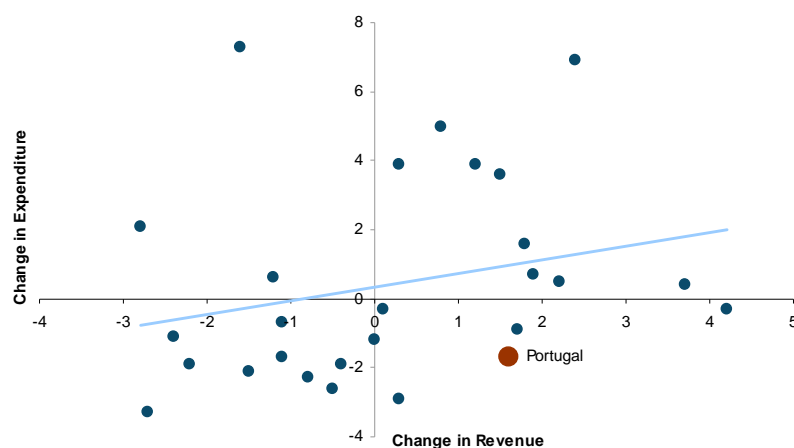
Source: Eurostat.

These results comprise the worsening of the budgetary balances in 21 EU countries, eleven of which belong to the euro area, and where only the deficits of Belgium, Germany, the Netherlands and Portugal remain practically unchanged. It is to be noted that only six EU Member States recorded a budget surplus, compared to ten that achieved that feat in 2007. In the euro area, five Member States recorded a budget deficit of more than 3% of GDP, a significant increase from 2007, when only Greece reported a deficit exceeding 3%. In 2008, the general government debt ratio in the EU was 61.5% (58.7% in 2007) and 69.6% in the euro area (66.2% in 2007).

An analysis of the performance of revenue and public expenditure of Member States since 2005 shows that only five countries — Germany, Luxembourg, Hungary, Poland and Portugal — simultaneously increased revenue and reduced expenditure as a percentage of GDP, which demonstrates the budgetary consolidation effort carried out in those countries (Figure 2.1.).

Figure 2.1. Revenue and expenditure developments between 2005 and 2008

(Differences in p.p. of GDP)



Source: Eurostat.

However, the development of revenue and expenditure reversed for most Member States in 2008. In Portugal, public expenditure as a share of GDP slightly increased (0.1 p.p.), to 45.9% of GDP (Table 2.2). Even so, public expenditure as a share of GDP is below the average for the European Union and for the euro area. The revenue, in Portugal, rose by 0.1 p.p., to 43.2% of GDP, remaining below the European average.

Table 2.2. Budgetary indicators in the European Union

(% of GDP)

	EU27				EA15				Portugal			
	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008
Total revenue	44.4	44.9	44.9	44.5	44.8	45.4	45.5	44.8	41.6	42.3	43.1	43.2
Total expenditure	46.9	46.3	45.7	46.8	47.4	46.7	46.1	46.7	47.7	46.3	45.7	45.9
Budget balance	-2.4	-1.4	-0.8	-2.3	-2.5	-1.2	-0.6	-1.9	-6.1	-3.9	-2.6	-2.6

Sources: Eurostat and INE.

In all other Member States, except for Bulgaria, Czech Republic, Germany and Austria, public expenditure as a share of GDP grew from 2007 to 2008, while only nine countries registered an increase in revenue.

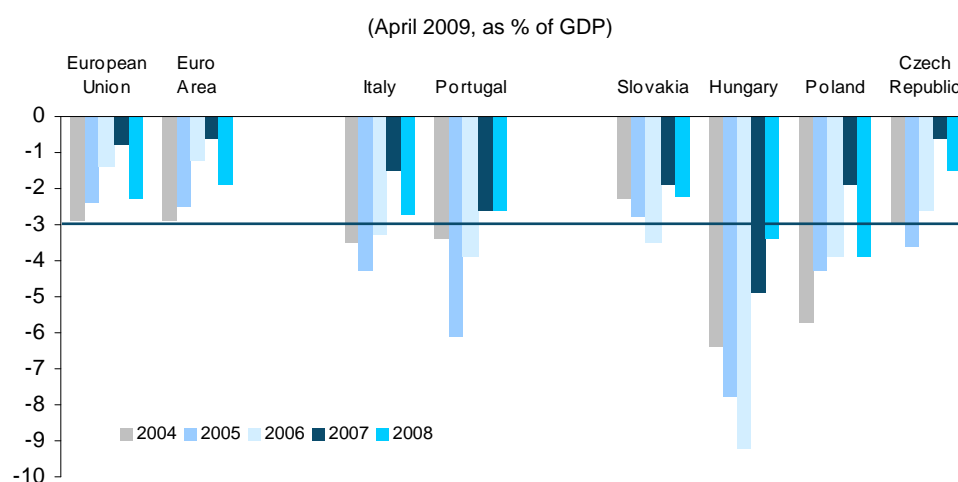
In 2008, following the publication of the figures for 2007 by Eurostat, the Council abrogated the decision concerning the existence of a situation of excessive deficit for five countries: Portugal, Italy, Czech Republic and Slovakia, on 3 June, and Poland on 8 July. It is to be noted that, in the case of Portugal and the Czech Republic, the adjustment of the budgetary deficit to a value below 3% of GDP occurred one year earlier than initially forecasted (Table 2.3).

Table 2.3. Member States in a situation of excessive deficit (April 2009)

	Date of declaration of excessive deficit by the ECOFIN council	Year in which excessive deficit occurred	Year set by the Council for the correction of the situation	Correction year
Member States belonging to the euro area				
Italy	28 July 2005	2005	2007	2007
Portugal	20 September 2005	2005	2008	2007
Member States not belonging to the euro area				
Slovakia	5 July 2004	2004	2007	2007
Hungary	5 July 2004	2004	2009	n.d.
Poland	5 July 2004	2004	2007	2007
Czech Republic	5 July 2004	2004	2008	2007

Source: European Commission.

Portugal and Italy had similar budgetary balance development trajectories until 2008 (Figure 2.2). Nevertheless, the adjustment strategies employed were different. In Italy, the reduction of the budget deficit was primarily due to the contribution from revenue, which grew 2.2 p.p. while expenditure rose 0.5 p.p. In Portugal, total expenditure declined 1.8 p.p., which was slightly greater than the change to total revenue that increased 1.7 p.p. The budgetary balance in Portugal in 2008, despite the unfavourable economic climate, remained at 2.6% of GDP, identical to that of 2007, while in Italy the deficit grew 1.2 p.p., to 2.7% of GDP.

Figure 2.2. Development of budgetary balances of EU Member States in a situation of excessive deficit

Source: Eurostat.

Only Hungary, among the countries outside to the euro area, remained in a situation of excessive deficit as declared by the Ecofin Council, despite the significant budgetary consolidation effort carried on in 2008. The other Member States that had ceased to be in such a situation, recorded a worsening of the budgetary balance, with Poland even breaching the 3% of GDP reference value.

Table 2.4. Breakdown of change in budgetary balance

Member States of the euro area in a Situation of Excessive Deficit (April 2009)

	Change in 2008 compared with 2005			2008
	Budget Balance	Revenue	Expenditure	Budget Balance
	p.p. of GDP			% of GDP
Italy	1,6	2,2	0,5	-2,7
Portugal	3,5	1,6	-1,7	-2,6

Source: Eurostat.

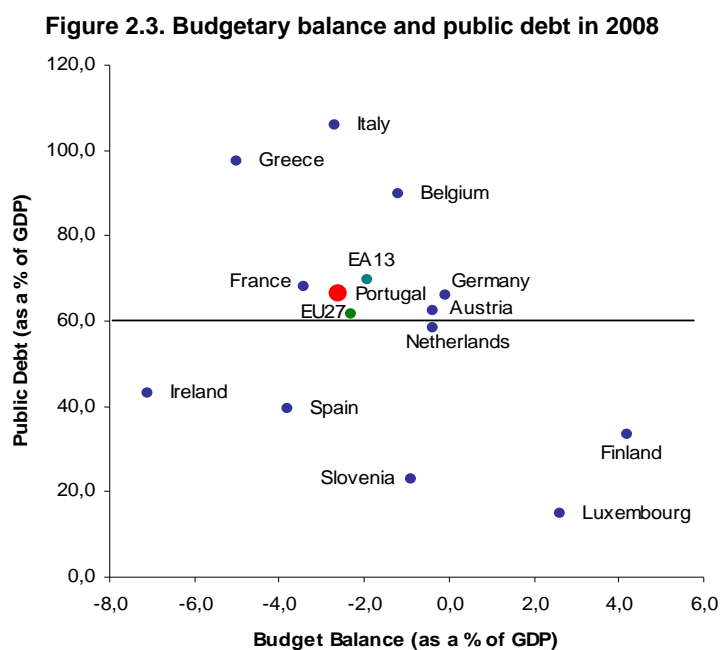
According to the provisions of the Stability and Growth Pact, the medium-term budgetary policy guidelines are set out in the annual updates to the Stability and Growth Programmes of the euro area Member States, which are submitted to the appraisal of the European Commission. In this regard, the European Commission issued an assessment on 11 March 2009 on the January 2009 update of Portugal's Stability and Growth Programme, in which it deems the stimulus fiscal package envisaged in the Programme to be, in line with the European Economic Recovery Plan (EERP), to be significant, of a temporary nature and appropriate to the climate of economic recession. It also considered the plan to be able of stimulating economic activity, particularly through the measures to foster investment. Thus, the Portuguese strategy is considered to be timely, capable of having an impact in the very short term, to be targeted on well-defined areas, and to be temporary, in the sense that the measures are limited to 2009, being reversible in subsequent years. The budgetary policy envisaged for 2009, based on these discretionary measures, will be expansionist, on a temporary basis.

The Council concluded, considering the Commission's assessment, that the Programme correctly presents the return to the budgetary consolidation process when the economy recovers, taking into account that

there are risks of the macroeconomic scenario being less favourable than envisaged, with the consequent impact on public accounts. Portugal is invited to implement the 2009 budgetary policy as envisaged, in accordance with the EERP and within the framework of the Stability and Growth Pact, avoiding the further deterioration of public finances in 2009, and proceeding with the adjustment planned for 2010 and subsequent years. The budgetary consolidation pace should be strengthened if the cyclical conditions are better than expected.

The Commission had declared by April 2009, based on the results recorded in 2008, a further five countries to be in a situation of excessive deficit: United Kingdom (on 11 June 2008) and France, Ireland, Greece and Spain (on 18 February 2009).

The deterioration of the budgetary situation in the EU is reflected in the change to public debt, which increased its share of GDP. The average public debt ratio of the EU-27 Member States worsened from 58.7% at the end of 2007 to 61.5% at the end of 2008, while that ratio grew from 66% to 69.3% of GDP in the euro area. Portugal registered a ratio of 66.4% of GDP in 2008, 2.9 p.p. up on the 2007 ratio (Figure 2.3).



Source: Eurostat.

The development of the public debt ratio reflects the performance of the (primary) budgetary balance and also a set of other factors usually known as stock-flow adjustments, which includes the growth differential of interest rates against GDP, the net acquisition of financial assets and the impact of the valorisation, besides any possible statistical discrepancies. In recent years, up to 2007, the stock-flow adjustment was, on average, relatively minute for the EU as a whole and for the euro area⁴. However, the stock-flow adjustment increased considerably in 2008, to 3.5% of GDP for the EU and to 3.4% for the euro area, reflecting the response of the Member States governments to the financial crisis. Accordingly, in some countries capital injection operations were undertaken and loans of particularly significant amounts were

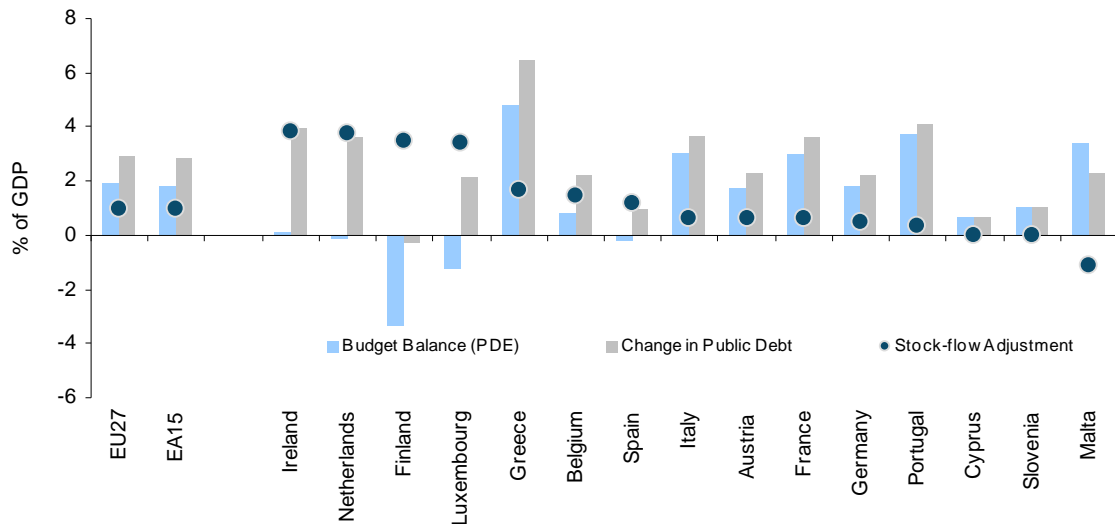
⁴ The values for the euro area average (15) were in fact, as a percentage of GDP, 0.2, 0.6, 0.3 and 0.5 in 2004, 2005, 2006 and 2007, respectively.

granted to banking institutions while in other cases, primarily for precautionary reasons, cash investments in deposits financed by public debt issues or the contracting of loans was strengthened.

Hence, the average stock-flow adjustment between 2004 and 2008 was 1% of GDP for the two aggregates (Figure 2.4). The Member States with the highest values mainly reflect the acquisition of financial assets, as is the case of Finland and Luxembourg, partially financed by the budget surpluses observed. In Portugal, despite the more significant value registered in 2008 (1.4% of GDP), the average stock-flow adjustment remains close to zero, reflecting the consistency of the two budgetary indicators in recent years. The increase to the stock-flow adjustment in 2008 was essentially driven by the decision to issue public debt in order to finance the settlement of trade debts, capital raising operations for state-owned companies and loans granted by general government, as well as valuation differences resulting from below par debt issues.

Figure 2.4. Budgetary deficit, change in public debt and stock-flow adjustment

(Average values 2004-2008, as percentage of GDP)



Note: The deficit-debt adjustment is calculated by the difference between the change in public debt and in budgetary balance (symmetrical value) in a given period.
Source: Eurostat.

3. Recent Macroeconomic Developments and Prospects

3.1. Macroeconomic Development in 2008

Reflecting the very unfavourable development of the world economic environment and, above all, that of Portugal's main trading partners, in 2008 the Portuguese GDP broke off the recovery trend that had been following since 2005 and registered zero growth in real terms (1.4% in 2006, 1.9% in 2007). The sharp decline in external demand – exports fell 0.5% in real terms – and investment – which registered a negative real year-on-year change of 1.1% – were the factors that most contributed to the stagnation of domestic economic activity. Thus, the behaviour of GDP reflected the negative contribution of net external demand (which fell from 0.1 p.p. in 2007 to -1.1 p.p. in 2008), as well as the significant slowdown of domestic demand, and arising from the shrinkage of investment (-1.1% changes in real terms, compared to 3.2% in 2007).

However, the profile of GDP growth in real terms was not constant throughout 2008, given that the significant declines in exports and investment recorded in the final quarter of the year were the main driver of the overall result for the year.

The Portuguese economy's net borrowing vis-à-vis the rest of the world increased 1.8 p.p. of GDP to 10.2% in 2008, as a result of the development of the income account balance and, above all, as a result of the unfavourable behaviour of the goods account balance, essentially driven by developments in the first half of the year, in response to a high price of oil.

General Government net borrowing vis-à-vis the rest of the world in 2008 was equivalent to 2.6% of GDP, the same as 2007. Public expenditure, however, grew 0.5% in real terms, raising its weight in GDP by 0.4 p.p.

The average unemployment rate in 2008 was 7.6%, exhibiting a 0.4 p.p. decline on 2007. The change in employment was 0.5%, accelerating slightly from the previous year (+0.3 p.p. on 2007).

3.1.1. External Environment

The world economy slowed down significantly in 2008, as worldwide GDP grew only 3.1% (5.2% in 2007). The sharp weakening of economic growth in the closing part of the year was particularly relevant, this being the period when a large number of advanced economies went into recession. The emerging and developing economies also slowed down, reversing the strong growth trend recorded in preceding years.

This evolution was driven by the impact of both the international financial crisis, and the construction sector slump which affected the property segment in the USA and other advanced economies (United Kingdom, Spain and Ireland for example). In addition to the negative effects that resulted from these developments, emerging and developing economies also suffered with the fall in the price of raw materials (oil and non-energy goods) at the end of 2008.

Table 3.1. GDP at constant prices, inflation, prices of raw materials and unemployment rate

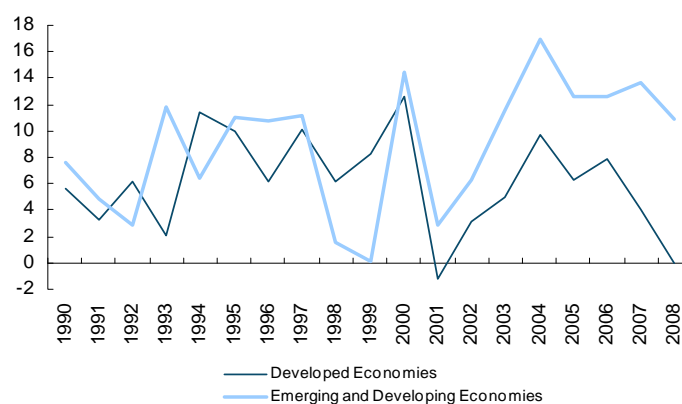
	GDP		Inflation		Unemployment rate	
	(year-on-year change, %)		(annual average, %)		(annual average, %)	
	2007	2008	2007	2008	2007	2008
World Economy	5,1	3,1	:	:	:	:
Developed Economies*	2,7	0,9	2,2	3,4	5,4	5,8
USA	2,0	1,1	2,8	3,8	4,6	5,8
Japan	2,4	-0,7	0,0	1,4	3,9	3,9
European Union	2,9	0,9	2,4	3,7	7,1	7,0
United Kingdom	3,0	0,7	2,3	3,6	5,3	5,6
Euro Area	2,7	0,8	2,1	3,3	7,5	7,5
Germany	2,5	1,3	2,3	2,8	8,4	7,3
France	2,2	0,7	1,6	3,2	8,3	7,8
Italy	1,6	-1,0	2,0	3,5	6,1	6,8
Spain	3,7	1,2	2,8	4,1	8,3	11,3
Portugal	1,9	0,0	2,4	2,7	8,1	7,7
Emerging and Developing Economies*	8,3	6,1	6,4	9,3	:	:
Russia	8,1	5,6	9,0	14,1	5,6	5,9
China	13,0	9,0	4,8	5,9	4,0	4,0
India	9,0	7,2	6,4*	8,3*	:	:
Brazil	5,4	5,1	3,6*	5,7*	:	:
<i>p.m. (year-on-year change, %):</i>						
Average price of Brent oil (USD/bbl)	9,5	35,9				
Average price of raw materials (excluding oil)	12,9	11,8				

Sources: CE, *Economic Forecast*, May 2009; * FMI, *World Economic Outlook*, April 2009.

The spreading of the crisis in international financial markets to the real economy, combined with the increased uncertainty and the deterioration of world demand and growth prospects, amplified the worldwide dimension of the recessive process. The fall in demand and dwindling business confidence has led to economic agents postponing investment decisions. Furthermore, the existence of more restrictive conditions in the granting of loans, due to the asymmetrical distribution of liquidity and the rise in risk premiums incorporated into loan interest rates, has fuelled economic decline in most countries.

International trade deteriorated, in line with the slowdown of the world economy and the slump in confidence, thus interrupting the strong upward trend registered in the last decade. A deceleration was already visible since 2007; both in advanced economies and emerging economies, but the final months of 2008 were marked by an abrupt decline of imports (Figure 3.1), especially in some economies.

Figure 3.1. Imports of goods
(real change rate, %)



Source: FMI, *World Economic Outlook*, April 2009.

The US economy slowed down in 2008, owing to a particularly sharp fall in domestic demand and exports at the end of the year. Private investment worsened, as the residential component fell for the third

consecutive year. Even though in the first half of the year the decline in residential investment was offset by the performance of other GDP components, that was not the case during the second semester of 2008, when the deterioration of domestic financial conditions and the deceleration of the world economy led to the substantial decline of private consumption and exports. The sudden rise in the unemployment rate and the fall in the financial wealth of US households, caused by the decline of the stock market and by the fall in property prices, were the determining factors in the development of private consumption (a fall in the second half of the year of almost 1%, in real terms, on the corresponding period of 2007). According to the flash estimate of the BEA, during the 1st quarter of 2009 the decline in economic activity has intensified, with GDP recording a real year-on-year change of -3.7%, due to the continued unfavourable evolution of most expenditure components.

Portugal's main trading partners (Spain, Germany, France, Italy and the United Kingdom), which account for around 64% of total Portuguese exports, recorded a very sharp deceleration of economic activity in 2008.

Table 3.2. Real GDP
(change rates, %)

	2008	Percentage change on previous period				Percentage change on corresponding period of the previous year			
		2008			2009	2008			2009
		2T	3T	4T	1T	2T	3T	4T	1T
EU-27	0,9	-0,1	-0,3	-1,5	:	1,7	0,7	-1,4	:
EA-15	0,8	-0,3	-0,3	-1,6	:	1,4	0,6	-1,5	:
Germany	1,3	-0,5	-0,5	-2,1	:	2,0	0,8	-1,6	:
United Kingdom	0,7	0,0	-0,7	-1,6	-1,9	1,8	0,4	-2,0	-4,1
France	0,7	-0,3	0,1	-1,1	:	1,1	0,6	-0,9	:
Italy	-1,0	-0,6	-0,7	-1,9	:	-0,4	-1,3	-2,9	:
Spain	1,2	0,1	-0,3	-1,0	:	1,8	0,9	-0,7	:
Netherlands	2,1	-0,1	-0,3	-1,0	:	3,5	2,0	-0,6	:
Belgium	1,2	0,3	0,1	-1,7	:	1,9	1,2	-0,8	:
Sweden	-0,2	-0,5	-1,0	-2,4	:	0,8	-0,5	-4,4	:
USA	1,1	0,7	-0,1	-1,6	-1,6	2,1	0,7	-0,8	-2,6
Japan	-0,6	-1,2	-0,4	-3,2	:	0,5	-0,2	-4,3	:
China	9,0	-	-	-	-	10,1	9,0	6,8	6,1

Sources: Eurostat, Bureau of Economic Analysis; China, Japan and UK Statistical Offices.

The Spanish economy slowed down significantly in 2008 (recording a real growth of 1.2%, which compares to a average growth rate of 3.6% in the last 4 years). This outcome was driven by the heavy deceleration of private consumption and by the decline in investment, particularly in construction investment. The most recent data for the Spanish economy, Portugal's main trading partner, continues to indicate a very unfavourable performance. According to preliminary data released by the Spanish National Statistics Office, in the first quarter of 2009 real GDP has recorded a fall of 2.9% on the corresponding period of 2008, and quantitative indicators of private consumption, investment and international trade all developed adversely, leading to a rise of unemployment rate to around 17.4% in that period (the highest value since the 3rd quarter of 1998).

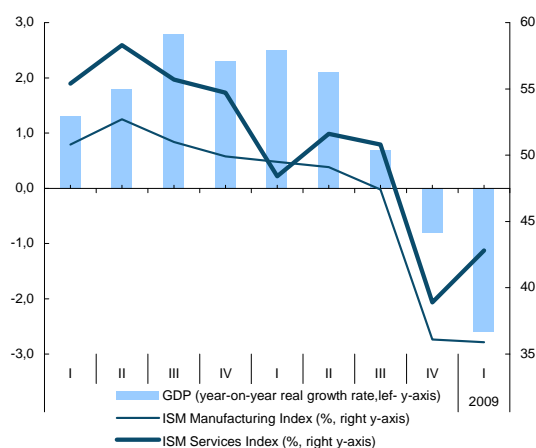
The German and French economies also underwent a deceleration of economic activity (Table 3.2). Nevertheless, while the negative developments of the German economy were caused by the sharp decline in external demand, domestic demand was the driving force in the slowdown of the French economy. One of the significant features of the most recent data is the decline of industrial production at the start of 2009, which recorded, in January and February, year-on-year average declines of 19% and 15%, respectively (-7.8% and -9%, respectively, in the 4th quarter of 2008). That decline contributed to the worsening unemployment rate, which rose to 7.4% and 8.6% in February, respectively. Retail sales also developed

negatively in those two countries, falling 1.1% and 1.7% year on year, in real terms, in the first two months combined (+0.6% and -0.6% in the last quarter of 2008). The external trade of Germany developed unfavourably at the beginning of the year, with January and February combined exports of goods falling by 23.1% in nominal terms when compared to the same period of 2008 (-6.3% in the 4th quarter of 2008), and imports falling by 15.1% (-0.4% in the last quarter of 2008). Recently, the German Ministry of Finance published an estimate indicating a 6% decline of GDP in 2009.

The Italian economy exhibited a year-on-year real decline of 1% in 2008, making it, along with the Ireland and Luxembourg, one of the euro area economies that recorded a negative year-on-year change in economic activity in 2008, with the deterioration of all components of GDP driving this performance. The most recent data relative to the 1st quarter of 2009 continue to indicate a negative performance.

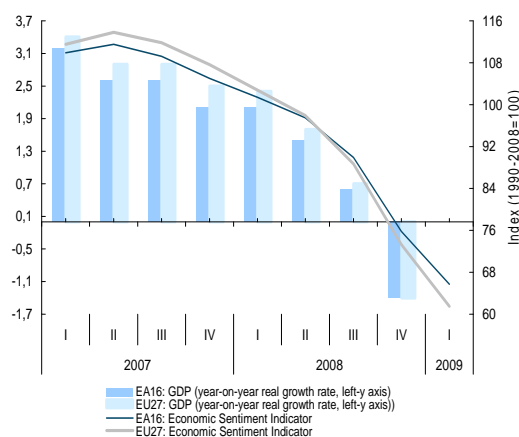
2008 was also a bad year for the UK economy, as the spread of the financial crisis had a significant impact on all components of GDP, especially in investment, which suffered a severe decline. Data for the 1st quarter of 2009 remains unfavourable, with GDP falling 1.9%, in real terms, with respect to the previous quarter (-4.1% when compared to the corresponding quarter of 2008, which compares to figure of -2% in the 4th quarter of 2008), thus extending the negative performance that has been in place since the 3rd quarter of 2008.

Figure 3.2. United States GDP and industry and services confidence indexes



Sources: BEA, ISM.

Figure 3.3. EU and euro-area GDP and economic sentiment



Sources: CE.

In this context, this worldwide economic and financial crisis, considered to be the largest crisis of the last eight decades by the main international institutions, has played a decisive role in the slowdown of the Portuguese economy, particularly in terms of the decline of investment and exports.

Accordingly, the fall in imports by our main trading partners in 2008 (negative rates of change in Spain, United Kingdom, Italy and USA) led to a significant deceleration of external demand directed towards the Portuguese economy. This trend should continue throughout 2009, with a significant decline forecast for 2009. The consequences of this intensive, general shrinkage of the main world economies on a small, open economy like the Portuguese one are significant, especially on exports and investment.

Table 3.3. Imports of goods and services in some of the main Portuguese export markets
(real change rate)

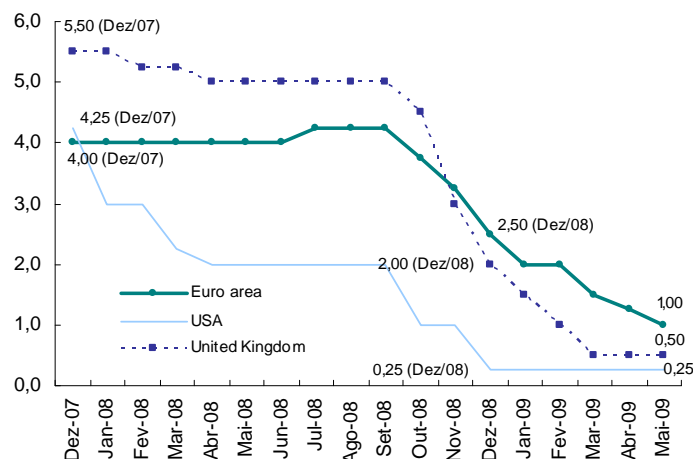
	Weight in 2007 (% of)	2006	2007	2008
Spain	28,3	10,3	6,2	-2,5
Germany	13,0	11,9	5,0	4,0
France	12,6	6,5	5,9	2,0
United Kingdom	6,0	9,6	-1,5	-0,6
USA	4,8	6,0	2,2	-3,5
Italy	4,1	5,9	3,8	-4,5

Sources: Eurostat, Bureau of Economic Analysis; Office for National Statistics.

As a large number of advanced economies slid into technical recession in the fourth quarter of 2008, fuelling a significant increase in unemployment rates, especially in the USA, financial, monetary and budgetary policies were adopted with the aim of restoring confidence, stabilising financial markets and fostering economic recovery.

The monetary policy of most countries (especially the USA, United Kingdom and the euro area) became more accommodating, given the fall in inflation in the second half of 2008 and the significant economic slowdown (see Figure 3.4).

Figure 3.4. Interest rate of main refinancing operations
(%)



Sources: ECB; Federal Reserve; Bank of England.

The uncertainty remains high and the confidence of economic agents remains at historically low levels.

3.1.2. Demand

Economic activity in Portugal in 2008 recorded zero growth in real terms, following a growth of 1.9% in 2007. This performance was primarily due to the behaviour of domestic demand in the final quarter of the year, reflecting the adverse performance of investment, and of exports. Notwithstanding the deceleration and decline profile recorded in exports throughout 2008, net external demand recorded an upwards intra-annual trend, owing to a progressive deceleration of imports associated with the development of world demand.

Table 3.4. Key Indicators for the Portuguese economy

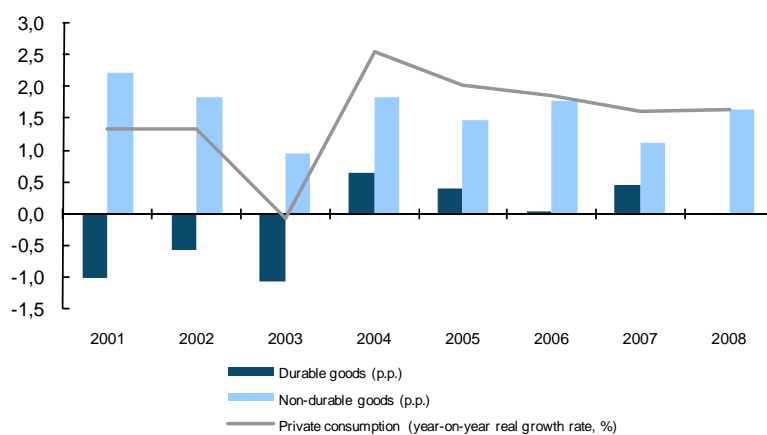
	2006	2007	2008	2008			
				I	II	III	IV
Rate of change, in real terms (%)							
GDP	1,4	1,9	0,0	0,8	0,6	0,4	-1,8
Domestic Demand	0,8	1,6	1,0	2,3	1,6	1,5	-1,2
Private Consumption	1,9	1,6	1,6	2,1	1,0	2,4	1,1
Public Consumption	-1,4	0,0	0,5	0,6	0,4	0,4	0,5
Investment (GFCF)	-0,7	3,2	-1,1	3,3	2,4	-1,0	-8,6
Exports	8,7	7,5	-0,5	4,1	2,2	0,8	-8,9
Imports	5,1	5,6	2,1	7,2	4,2	3,2	-5,9
Contributions to GDP growth (percentage points)							
Domestic Demand	0,9	1,8	1,1	2,5	1,7	1,6	-1,3
Net Exports	0,6	0,1	-1,1	-1,8	-1,1	-1,2	-0,5
Unemployment rate (%)	7,7	8,0	7,6	7,6	7,3	7,7	7,8
Total Employment (rate of change, %)	0,7	0,2	0,5	1,1	1,4	-0,1	-0,2
Inflation	3,1	2,5	2,6	2,9	2,9	3,0	1,5
Current and Capital Accounts (% of GDP)	-9,3	-8,6	-10,6	-9,5	-10,6	-12,2	-10,0

Source: INE – Quarterly National Accounts, March 2009.

3.1.3. Private Consumption

Private consumption maintained the positive development recorded during the previous year, growing 1.6% in real terms. To this performance was essential the acceleration in the consumption of current goods, which grew 1.9% (up 0.6 p.p. from the growth in 2007). This acceleration was stronger in the category of non-food goods and services, although the category of food goods also recorded an increase in its real growth.

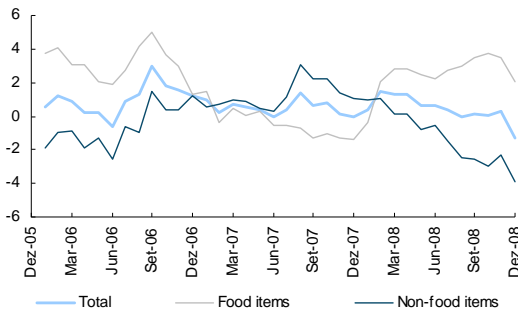
Figure 3.5. Contributions to private consumption growth in real terms
(% and p.p.)



Source: INE.

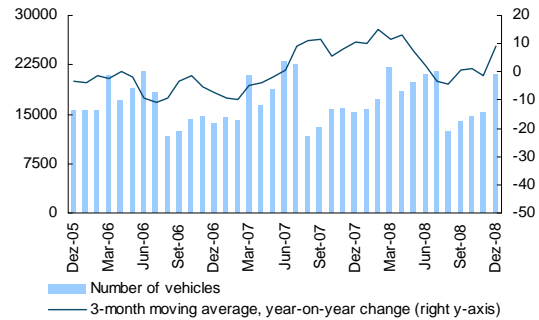
Durable goods, however, developed unfavourably in 2008, recording a small contraction in real terms (-0.2%), after a 3.9% growth in 2007. The unfavourable evolution in this class of goods was, in part, mitigated by the improved sales of passenger motor vehicles, which recorded a slight acceleration in growth in 2008. Based on the available data, sales of light passenger vehicles grew 5.7% in 2008, which compares to a smaller growth of 3.7% in 2007.

Figure 3.6. Retail trade turnover index



Source: INE.

Figure 3.7. Sales of light-weight passenger vehicles



Source: ACAP

3.1.4. Public Consumption

Public consumption grew 0.5% in real terms in 2008, increasing its share of GDP by 0.4 p.p. (Figure 3.8).

Figure 3.8. Public consumption components
(change, in percentage points of GDP)



Source: INE.

The development of the main components is, nonetheless, influenced by the operations to transform hospitals into corporate public entities in 2007 and 2008. Correcting for this impact, in 2007, the compensation of employees component would have fallen 0.5 p.p. of GDP, intermediate consumption would have increased 0.2 p.p. and social benefits in kind would have declined slightly by 0.1 p.p. In 2008, compensation of employees remained stable, intermediate consumption increased its share of GDP by 0.3 p.p. and the increase in benefits in kind would be marginal (0.1 p.p.).

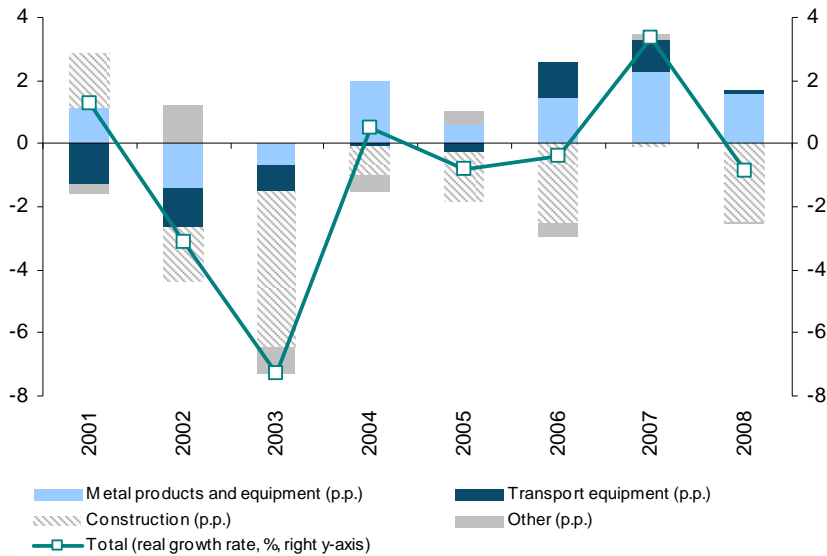
3.1.5. Investment

Investment (GFCF) was the component of domestic demand that performed most unfavourably over 2008, decreasing 1.1% in real terms from the previous year. Nonetheless, it should be emphasized that this

result was mainly driven by the performance of GFCF during the 4th quarter of the year, with a year-on-year decline of 8.6% being recorded in that period.

Breaking down the aggregate behaviour of GFCF by different types of goods, the most relevant contributions came from the decline of construction investment, which recorded a year-on-year decrease of 5.8% in real terms, and from the deceleration in investment in metal products and equipment (excluding transport equipment), which grew only 4.9% in real terms.

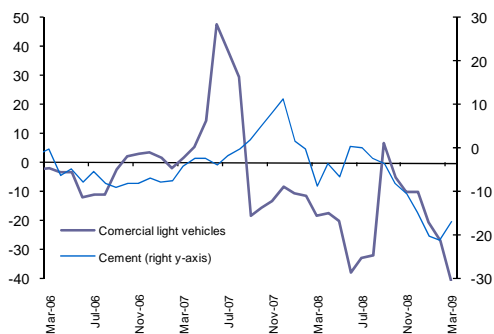
Figure 3.9. Investment components
(contributions to Total GFCF Growth in Real Terms)



Sources: INE.

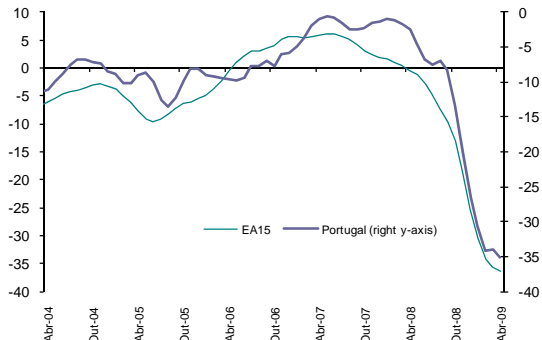
Intra-annually, construction investment followed the general development of economic activity, registering a more negative performance in the second half of the year, with the year-on-year real change rates in the 3rd and 4th quarters of 2008 being -1.3% and -5.8%, respectively. The decline in construction investment was largely due to the negative development of the residential component.

Figure 3.10. Investment indicators
(3-month moving average, year-on-year change rate)



Sources: SECIL, CIMPOR e ACAP.

Figure 3.11. Manufacturing sector confidence indicator
(seasonally adjusted, 3-month moving average)



Source: European Commission.

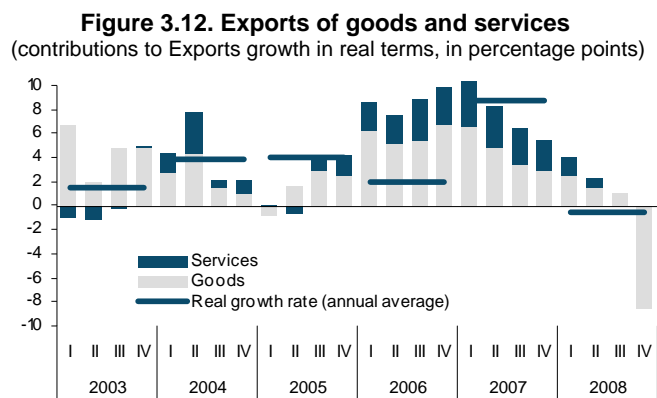
On the other hand, investment in transport equipment recorded a mixed performance throughout the year. In the first half of 2008, it underwent strong growth, driven by the purchase of aircraft and other transport equipment. This trend was reversed in the second half of the year, with investment recording year-on-year

declines in real terms, owing not only to the fact that no aeronautical equipment was acquired, but also because investment in the corresponding period of 2007 was highly positive.

The most dynamic component of GFCF (though undergoing deceleration) was investment in metal products and equipment, which also recorded a mixed performance in 2008, exhibiting a decline in the 4th quarter. That decline is in line with the development of business investment, which also fell in a scenario of shrinking order books and falling business confidence, especially in the second half of the year.

3.1.6. External Trade

Real exports recorded a decrease of 0.5%, accompanying the evolution of the external demand relevant for the Portuguese economy. The sharp slowdown on growth of 2007 (7.5%) developed throughout the year, though it accentuated abruptly in the 4th quarter of 2008, during which a year-on-year fall of 8.9% was recorded.



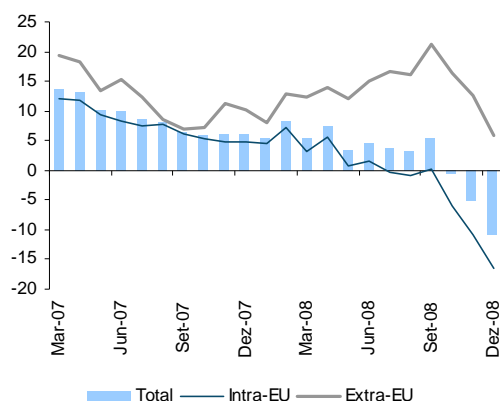
Source: INE.

The development of exports in 2008 resulted from the unfavourable performance of both the goods and services components. Exports of goods recorded a year-on-year fall of 1.1% (which compares to a growth of 5.7% in 2007) and the year-on-year growth in exports of services decelerated from 13.5% in 2007 to 2.3% in 2008. It is worth noting that exports followed two different trends during the year (though still in deceleration), exhibiting a positive year-on-year change in the first three quarters, and then recording a significantly negative result in the fourth quarter, in line with the intensification and proliferation of the international crisis.

The data on nominal year-on-year changes for the goods balance shows that the fall in the export of goods in 2008 was due to the developments in intra-EU exports, which fell 2.8%, while extra-EU exports rose 13.5% in that period (Figure 3.13.).

Figure 3.13. Exports, intra and extra-EU

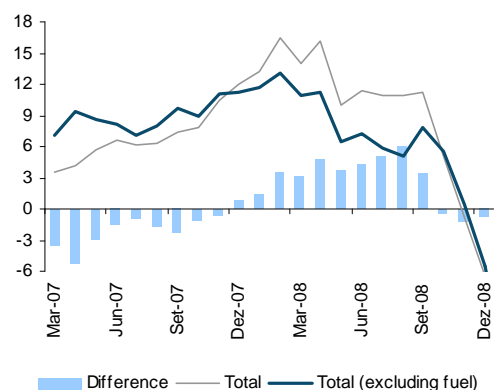
(3-month moving average, year-on year change rate)



Source: INE.

Figure 3.14. Imports, total and excluding fuel

(3-month moving average, year-on year change rate)



Source: INE.

Imports slowed down in 2008, recording a real year-on-year rate of change of 2.1% (5.6% in 2007), affecting both the goods component (decelerating from 5.7% in 2007 to 1.9% in 2008) and services (from decelerating from 4.5% in 2007 to 3.6% in 2008). Breaking down by product, the highest nominal growth rates were recorded in the imports of vehicles and other transport equipment account, and in fuels (29.1% and 11.2%, respectively), owing to the import of aeronautical material and to the increase in the price of fuel in international markets during the first half of 2008 (Figure 3.14.).

Table 3.5. Imports of goods and services
 (year-on-year change rate, in real terms)

	2003	2004	2005	2006	2007	2008	1Q 2008	2Q 2008	3Q 2008	4Q 2008
Germany (12,9%)	5,4	7,3	6,5	11,9	5,0	4,0	4,5	3,5	5,0	1,5
Belgium (2,5%)	2,9	6,6	4,1	2,7	4,6	3,7	5,5	6,7	4,8	-1,9
Spain (27,3%)	6,2	9,6	7,7	10,3	6,2	-2,5	3,6	1,8	-2,0	-13,2
France (11,7%)	1,1	7,1	5,9	6,1	5,6	:	4,3	1,9	1,7	0,3
Italy (3,8%)	1,2	4,2	2,1	5,9	3,8	-4,5	-2,4	-2,7	-4,1	-8,8
Netherlands (3,3%)	1,8	5,7	5,4	8,2	5,7	4,1	7,4	5,2	4,1	-0,1
Euro Area (64,3%)	3,1	6,9	5,6	8,2	5,3	1,2	3,7	2,4	1,7	-2,9
United Kingdom (5,5%)	2,2	6,8	7,0	9,6	-1,5	-0,6	3,9	3,3	-1,5	-7,6
European Union (73,6%)	3,4	7,6	6,2	9,2	5,2	1,6	4,8	3,6	1,8	-3,5

Source: Eurostat. Weight of each country in the Portuguese imports given inside brackets.

Table 3.6.. Exports of goods and services
 (year-on-year change rate, in real terms)

	2003	2004	2005	2006	2007	2008	1Q 2008	2Q 2008	3Q 2008	4Q 2008
Germany (12,9%)	2,5	10,3	7,7	12,7	7,5	2,7	6,9	5,1	3,1	-5,6
Belgium (2,5%)	2,9	6,5	3,6	2,6	4,0	2,4	3,6	5,2	3,9	-3,5
Spain (27,3%)	3,7	4,2	2,5	6,7	4,9	0,7	4,8	4,4	1,5	-7,9
France (11,7%)	-1,2	4,0	3,1	5,4	3,1	:	4,6	0,9	1,5	-2,2
Italy (3,8%)	-2,0	4,9	1,1	6,2	4,6	-3,7	-0,5	0,0	-3,6	-10,7
Netherlands (3,3%)	1,5	7,9	6,0	7,3	6,5	2,6	6,3	4,3	3,5	-3,4
Euro area (64,3%)	1,2	7,3	4,9	8,3	5,9	1,3	5,0	3,7	1,8	-5,8
United Kingdom (5,5%)	1,8	4,8	8,1	11,0	-4,1	0,1	3,7	1,6	-0,4	-4,4
European Union (73,6%)	1,9	7,5	5,9	9,2	5,0	1,6	5,4	4,1	1,9	-5,3

Source: Eurostat. Weight of each market in the Portuguese exports given inside brackets.

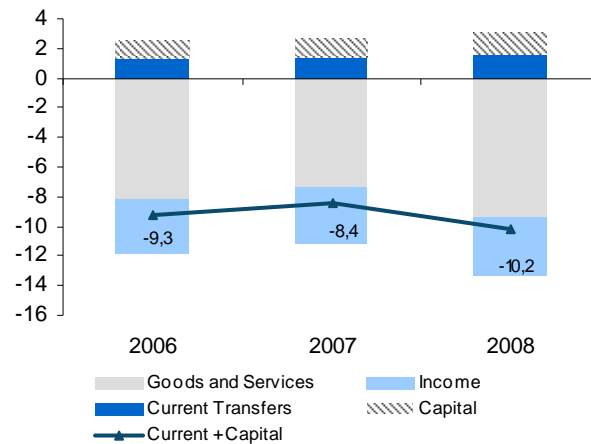
3.1.7. Net borrowing of the Portuguese Economy vis-à-vis the rest of the world

In 2008, the net borrowing of the Portuguese economy vis-à-vis the rest of the world, measured by the combined balance of the Current and Capital Accounts was 10.2% of GDP (+1.8 p.p. than in 2007).

The worsening of the balance on goods and services (-2.1 p.p.) and the slight dip in the income account balance (-0.2 p.p.) contributed to that result, since they were only partially offset by the improvement in the current transfers account balance (+0.1 p.p.) and the capital account balance (+0.3 p.p.).

The growth of the goods account deficit was driven by the decline in exports, particularly in the second half of the year, and the lower rate of deceleration of nominal imports, which was largely due to the sharp growth in raw material and fuel prices in international markets in the first half of 2008.

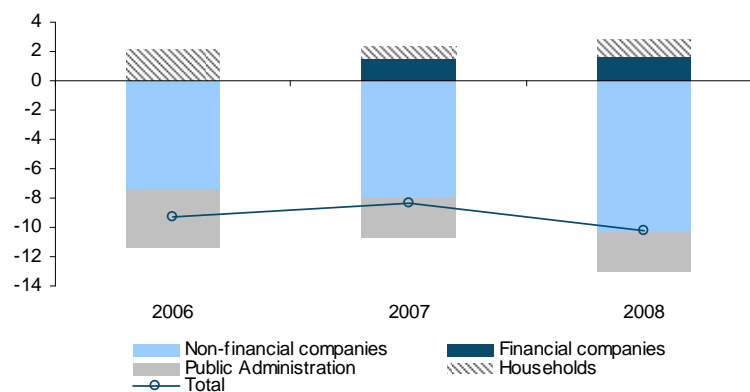
Figure 3.15. Current and capital accounts balances
(as a % of GDP)



Source: INE.

In sectoral terms, the increased net borrowing vis-à-vis the rest of the world, as a percentage of GDP, was due to the growth of the deficit of Non-Financial Companies (-2.3 p.p.), only partially offset by the improvement to the net lending of private entities (+0.5 p.p.), as the balance of Financial Companies and General Government stabilised from 2007.

Figure 3.16. Net borrowing/lending by institutional sector
(as a % of GDP)



Source: INE.

3.1.8. Labour Market

The labour market evolved positively in 2008 as a whole, embodying a higher growth of employment and a drop in the unemployment rate compared to 2007, as a result of the normal lagging behaviour of the labour market in comparison with the economic cycle. This evolution was determined by the positive performance during the first six months of the year, given that the performance of the labour market in the second half of 2008 was heavily influenced by the developments of the international economic crisis.

The annual growth of total employment (0.5%) was fuelled by the gains obtained in the first half of the year, with a heavy contribution from female employment, which maintained a positive performance, notwithstanding the unfavourable intra-annual development. In a context of lower growth of the Portuguese active population in Portugal and of slight improvements in the participation rate (74.2% in the 15-64 years age group, compared to 74.1% in 2008), total employment benefited from a slight increase in the employment rate, which was on average 57.8% during 2008, up 0.2 p.p. from the 2007 figure.

Table 3.7. Active population, employment and unemployment

(Year-on-year change, %) *

	2005	2006	2007	2008	1st Half 2008	2nd Half 2008
Active Population	1.0	0.8	0.6	0.1	0.5	-0.3
Male	0.2	0.7	0.1	0.2	0.5	-0.2
Female	2.0	0.8	1.1	0.0	0.5	-0.4
Total Employment	0.0	0.7	0.2	0.5	1.3	-0.2
Male	-0.7	0.9	0.0	0.3	1.0	-0.4
Female	0.8	0.5	0.4	0.9	1.6	0.1
Unemployment rate (% of active population)	7.6	7.7	8.0	7.6	7.4	7.7
Male	6.7	6.5	6.6	6.5	6.3	6.6
Female	8.7	9.0	9.6	8.8	8.7	9.0

Note: *Unless stated otherwise.

Source: INE.

The improvement to the labour market over 2008 primarily benefited individuals aged over 25, with the age group of individuals aged 45 and above contributing most to the growth of overall employment (0.6 p.p.). Employment among the youngest workers (15-24 years of age) however, recorded a year-on-year fall of 1.9%, which contributed -0.2 p.p. to the change in total employment. Nevertheless, the employment dynamics in this age group was more favourable than in 2007, given that the decline in 2008 was considerably less than that registered in 2007 (-5.1%).

The unemployed population recorded a year-on-year fall of 4.8% in 2008, thus reversing the increase that had been recorded in 2007 (+4.9%). This development caused the unemployment rate to fall to 7.6%. This positive result benefited women above all, allowing the female unemployment rate to decrease from 9.6% to 8.8%. As for age groups, the falling unemployment rate primarily benefited individuals aged from 25 to 44 years, with an unemployment rate of 7.7% (down 0.5 p.p. on 2007) recorded for this age group.

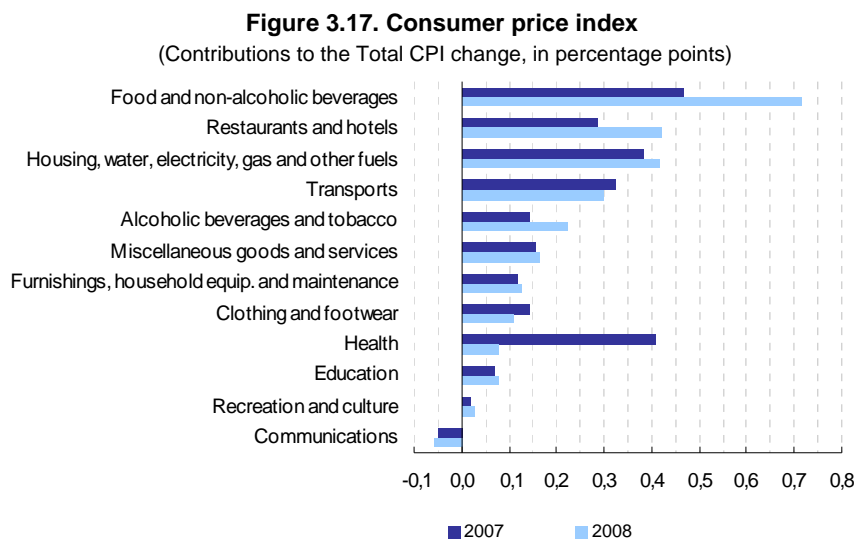
Long term unemployment fell 3.2% in 2008, accentuating the favourable development that had occurred in the previous year (a fall of 0.7%). Nonetheless, given that the total unemployed population fell more

sharply, the share of long-term unemployment grew slightly in 2008, to 49.8% of total unemployment (up 0.8 p.p. from the 2007 figure).

In terms of sectors, the labour market proved to be especially dynamic in the services sector, embodying a 3% increase in employment in this sector, which contributed substantially to the reduction of overall unemployment. The development in the secondary sector was less favourable, given that its contribution to reducing unemployment did not result in an increase to employment. When considered as a whole, these sectoral performance profiles suggest that services have been absorbing a considerable number of workers who were formerly employed in the secondary sector.

3.1.9. Prices

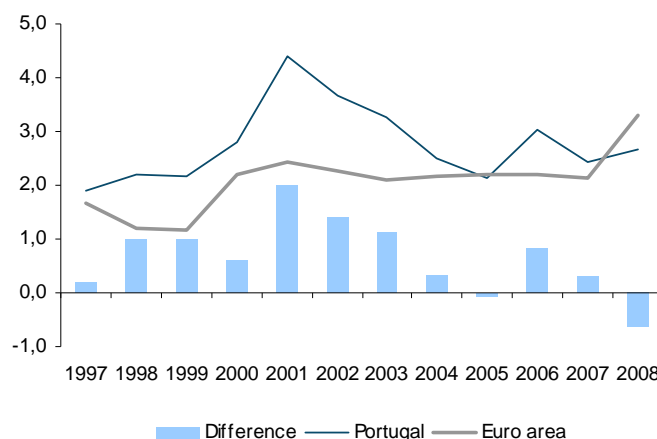
In 2008, the performance of the annual average inflation rate (2.6%), as measured by the Consumer Price Index (CPI), encompassed a high volatility in the price of goods, which is mostly explained by the fluctuations in the price of energy goods. The year-on-year change of the goods CPI was, on average, 2.9% in the first three quarters of 2008, before contracting to 0.7% in the fourth quarter, whereas the rate of year-on-year rate of change in the services CPI remained practically constant throughout the year, at around 3%.



Source: INE.

The three main contributions to the change in the CPI were provided by the categories of food products and non-alcoholic drinks, restaurants and hotels, and housing expenditure, all of which exhibited price increases relative to 2007. Also noteworthy is the lower contribution of health expenditure to the rate of change of the CPI in 2008, down 0.33 p.p. from the 2007 figure.

Figure 3.18. HICP in Portugal and in the euro-area
(year-on-year change, %)



Source: Eurostat.

The differential of the average annual inflation rate vis-à-vis the euro area, as measured by the HCPI differential, reversed its trend in 2008 and recorded a value of -0.6 p.p. (+ 0.3 p.p. in 2007). From September 2007 onwards, the differential in monthly year-on-year CPI changes has been negative, given that the impact of the acceleration of energy prices and non-processed food product prices has been lower in Portugal than in the euro area.

3.2. Macroeconomic Forecasts for 2009

The current scenario for the development of the Portuguese economy in 2009, in the context of an international environment that continues to be characterised by a high degree of uncertainty, adjusts downwardly the forecasts underlying the January 2009 update of the Stability and Growth Programme (SGP). The new forecasts indicate a real GDP decrease of 3.4% in 2009.

That revision is based on more unfavourable assumptions about the global economic environment, owing to the materialisation of the most pessimistic forecasts for the development of the world economy. Such developments will translate into a fall in the contribution from domestic demand to GDP growth and a sharp deceleration of prices. Despite the expected contraction of exports, in line with the significant deterioration of relevant external demand vis-à-vis the Portuguese economy, net external demand will make a positive contribution to GDP, as a result of a downward adjustment in imports due to the negative performance of overall demand.

The current forecasts incorporate the most recent data for the Portuguese economy, namely the quarterly national accounts and the general government account, as well as the most recent forecasts for the international economic environment. Reflecting the recession affecting our main trading partners, namely the US and EU economies, the relevant external demand for the Portuguese economy should fall by 11.6% in 2009 (-2.8% in the SGP). Furthermore, based on the available data for spot and future prices, the underlying assumptions about short and long-term interest rates were revised downwards and the oil price forecast adjusted slightly upwards.

Table 3.8. International economic environment – main assumptions

		2008	Current forecast		SGP 2009		Difference current forecast vis-a-vis SGP (p.p.)*	
			2009	2008	2009	2008	2009	
Relevant external demand for Portuguese products	rate of change (%)	2,5	-11,6	2,5	-2,8	0,0	-8,8	
Oil price (Brent)	USD/bbl	96,4	52,4	96,93	51,0	-0,5	1,4	
Portuguese nominal effective exchange rate	rate of change (%)	1,3	-1,9	1,3	-1,6	0,0	-0,2	
Exchange rate (1 EUR = ... USD)	annual average	1,47	1,32	1,47	1,34	0,00	-0,02	
Short-term interest rate (a)	annual average (%)	4,6	1,6	4,6	2,2	0,0	-0,6	
Long-term interest rate(b)	"	4,6	4,1	4,6	4,2	0,0	-0,1	

Notes: (a) 3-month Euribor, (b) 10-year Treasury Bonds. * Except Oil and Nominal Exchange Rate.

Sources: European Commission and Portuguese Ministry of Finance and Public Administration.

Forecasts point to an unfavourable performance of all components of domestic demand, in particular investment, which is forecast to decline significantly, reflecting both the expected economic trajectory and the slump in business confidence.

Private consumption is expected to decrease sharply in 2009, affecting in particular the component relating to the consumption of durable goods. The expected adverse reaction of the labour market to the economic climate and to the environment of great uncertainty surrounding economic prospects will have a negative impact on consumers' expectations, thereby contributing to enhance the contraction of private consumption and to increase precautionary saving.

The expected reduction of exports from 2008 is now significantly higher than the forecast contained in the SGP (-11.8% instead of -4.4%), in line with the forecast shrinkage of external demand. The behaviour of imports should be tied to the performance of overall demand, and should record a decline of 11.1%. These developments will translate into a positive contribution of external demand to the real growth of GDP.

Net borrowing of the Portuguese economy vis-à-vis the rest of the world should fall in 2009 to 8.2% of GDP (10.2% in 2008), benefiting from the improvement of all the components contained in the current and capital accounts.

Table 3.9. Macroeconomic forecasts

	2008	Current forecast
		2009
Rate of change, in real terms (%)		
GDP	0,0	-3,4
Private Consumption	1,6	-1,4
Public Consumption	0,5	-0,6
Investment (GFCF)	-1,1	-14,1
Exports	-0,4	-11,8
Imports	2,1	-11,1
Contributions to GDP growth (percentage points)		
Domestic Demand	0,9	-4,1
Net Exports	-1,0	0,8
Total Employment (rate of change, %)	0,4	-1,2
Unemployment rate (%)	7,6	8,8
Inflation rate (%) (a)	2,6	0,1
Current and Capital Accounts (% do GDP)	-10,2	-8,2

Notes: (a) as measured by the annual average change in the Consumer Price Index.

Sources: INE and Portuguese Ministry of Finance and Public Administration.

The labour market is expected to develop adversely compared to 2008, taking into account the worsening economic environment. The average unemployment rate should accordingly increase to around 8.8% in 2009, and total employment should fall 1.2%, although the heavy impact that the current climate will have on the labour market is likely to be attenuated by the measures aimed at protecting employment and stimulating integrated recruitment, implemented under the “2009 Employment Initiative”.

The heavy fall of oil prices in international markets, occurred on the last quarter of 2008 and in the first months of this year, – caused by a reduction of world demand – contributed to a sharp deceleration and, more recently, to a decline in overall prices, which is likely to continue until end of the 3rd quarter of 2009. The average inflation rate, as measured by the Consumer Price Index, is estimated to be 0.1% in 2009, 0.3 p.p. below the forecast for the Euro area.

4. Public Finances

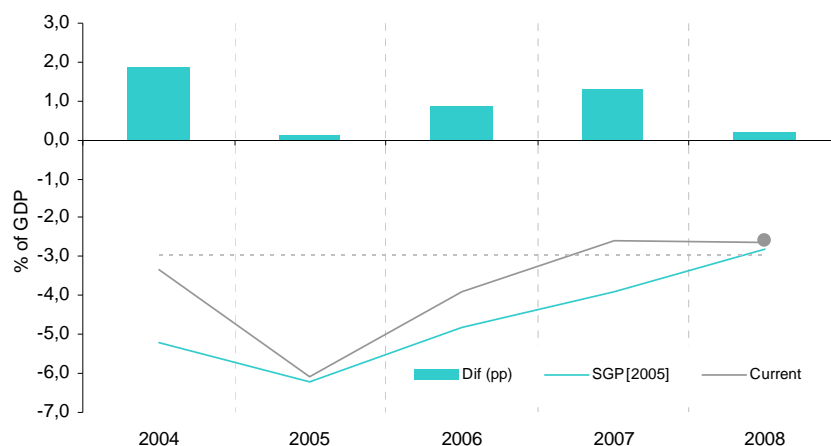
4.1. Recent Public Finance Developments

In 2008, the general government deficit was 2.6% of GDP, value identical to the previous year. Macroeconomic developments influenced budgetary results in 2008 by means of the automatic stabilisers, causing tax revenue to slow down in the last quarter of the year. Moreover, discretionary measures were taken to strengthen social support, which contributed to the rise in current primary expenditure.

As a result, the general government debt to GDP ratio increased to 66.4% in 2008, opposing the decrease achieved in 2007.

The general government deficit decreased from 6.1% to 2.6% of GDP between 2005 and 2008, due to the reduction of expenditure (-1.8 p.p. of GDP) and improved revenue (+1.7 p.p. of GDP). The correction of the general government's excessive deficit situation was swifter than that initially forecast in the 2005 SGP (Figure 4.1).

Figure 4.1. General Government balance
Comparison between SGP 2005 and the current situation
(% of GDP)



Sources: INE and Ministry of Finance and Public Administration.

In structural terms, i.e. correcting for the impact of the economy's cyclical position and one-off measures, the general government deficit in 2008 was 2.9% of GDP, improving 0.2 p.p. and 2.8 p.p. of GDP when compared to 2007 and 2005, respectively. Excluding the interest expenditure component the structural primary balance in 2008 was 0% of GDP, 3.1 p.p. above the negative value registered in 2005.

Budgetary Deficit

The overall general government deficit in 2008 was 2.6% of GDP, identical to the figure recorded in the previous year (Table 4.1.). The primary balance (i.e. excluding interest expenditure) registered a surplus of 0.3% of GDP, a 0.1 p.p. improvement on 2007.

Table 4.1. Budgetary balances

(% of GDP)

	2005	2006	2007	2008
General government balance (EDP) ⁽¹⁾	-6,1	-3,9	-2,6	-2,6
Primary balance	-3,5	-1,2	0,2	0,3
Excluding one-off measures:				
Overall balance	-6,1	-3,9	-2,6	-2,6
Primary balance	-3,5	-1,2	0,2	0,3
Excluding one-off measures and the cyclical budgetary component ⁽²⁾				
Overall balance (EDP)	-5,7	-3,8	-3,1	-2,9
Change as a p.p. of GDP	-2,8	1,9	0,7	0,2
Cumulative change as a p.p. of GDP	-2,8	-0,9	-0,2	0,0
Primary balance	-3,1	-1,1	-0,3	0,0
Change as a p.p. of GDP	-2,8	2,0	0,8	0,3
Cumulative change as a p.p. of GDP	-2,8	-0,8	0,0	0,3

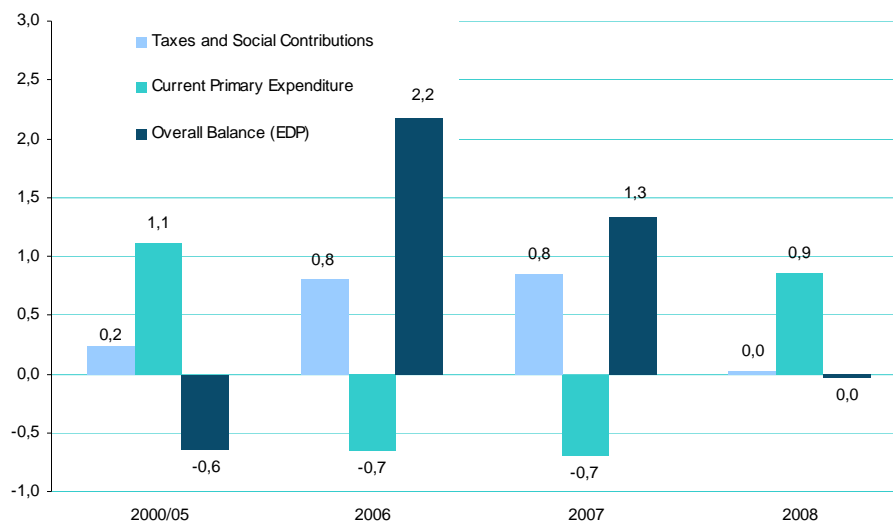
Notes: (1) EDP – Excessive Deficit Procedure; (2) In the period considered, no one-off measures occurred.
Sources: INE and Ministry of Finance and Public Administration.

The structural deficit in 2008 was 2.9% of GDP, representing a 0.2 p.p. improvement on 2007. The structural primary balance in 2008 was zero, 0.3 p.p. of GDP above the 2007 figure.

This budgetary consolidation effort that has been ongoing since 2005, which is primarily based on curbing current primary expenditure (-0.5 p.p. of GDP between 2005 and 2008) and increasing revenue, contrasts with the course followed in the first half of the decade, when this component of expenditure underwent an average annual increase of 1.1 p.p. of GDP (Figure 4.2).

Figure 4.2. Contributions to the change in overall balance (EDP)

(Excluding one-off measures, as p.p. of GDP)



Note: The overall balance increases (decreases) by positive (negative) changes of tax and contributory revenue and other factors and by negative (positive) changes in current primary expenditure.
Source: INE.

Table 4.2. General Government Account

	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008
	EUR million				Percentage of GDP				Change in p.p. of GDP			
Current Revenue	59.838	64.048	68.910	70.323	40,1	41,2	42,2	42,3	0,9	1,1	1,0	0,1
Taxes on production and imports	22.384	23.947	24.535	24.265	15,0	15,4	15,0	14,6	1,0	0,4	-0,4	-0,4
Current taxes on income and wealth	12.574	13.719	15.905	16.524	8,4	8,8	9,7	9,9	0,0	0,4	0,9	0,2
Social contributions	18.697	19.360	20.717	21.546	12,5	12,5	12,7	13,0	0,5	-0,1	0,2	0,3
of which: Actual social contributions	16.954	17.712	19.077	19.853	11,4	11,4	11,7	11,9	0,3	0,0	0,3	0,3
Other current revenue	6.183	7.021	7.753	7.987	4,1	4,5	4,8	4,8	-0,5	0,4	0,2	0,1
Capital Revenue	2.148	1.769	1.462	1.549	1,4	1,1	0,9	0,9	-2,1	-0,3	-0,2	0,0
Total Revenue	61.986	65.817	70.372	71.872	41,6	42,3	43,1	43,2	-1,2	0,8	0,8	0,1
Current Expenditure	64.673	66.611	68.900	71.741	43,4	42,9	42,2	43,2	1,8	-0,5	-0,6	0,9
Intermediate consumption	6.316	6.392	6.755	7.265	4,2	4,1	4,1	4,4	0,3	-0,1	0,0	0,2
Compensation of employees	21.541	21.174	21.059	21.377	14,4	13,6	12,9	12,9	0,5	-0,8	-0,7	0,0
Social transfers	27.516	29.181	31.334	33.040	18,5	18,8	19,2	19,9	1,0	0,3	0,4	0,7
of which: Social transfers in kind	5.265	5.748	6.621	7.071	3,5	3,7	4,1	4,3	0,2	0,2	0,4	0,2
Interest expenditure (EDP)	3.887	4.267	4.592	4.816	2,6	2,7	2,8	2,9	0,0	0,1	0,1	0,1
Subsidies	2.339	2.231	1.901	1.931	1,6	1,4	1,2	1,2	0,1	-0,1	-0,3	0,0
Other current expenditure	3.075	3.366	3.260	3.313	2,1	2,2	2,0	2,0	0,0	0,1	-0,2	0,0
Capital Expenditure	6.396	5.298	5.690	4.471	4,3	3,4	3,5	2,7	-0,2	-0,9	0,1	-0,8
GFCF	4.374	3.696	3.762	3.544	2,9	2,4	2,3	2,1	-0,2	-0,6	-0,1	-0,2
Other capital expenditure	2.022	1.602	1.928	927	1,4	1,0	1,2	0,6	0,0	-0,3	0,2	-0,6
Total Expenditure	71.069	71.909	74.590	76.213	47,7	46,3	45,7	45,9	1,6	-1,4	-0,6	0,1
Net Lending(+)/Borrowing(-) of Gen. Government (EDP)	-9.083	-6.092	-4.218	-4.341	-6,1	-3,9	-2,6	-2,6	-2,8	2,2	1,3	0,0
Public Debt	94.792	100.522	103.702	110.377	63,6	64,7	63,5	66,4	5,3	1,1	-1,1	2,9

memo item:

Nominal GDP	149.123	155.446	163.190	166.197
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Note: EDP - Excessive Deficit Procedure.

Sources: INE and ministry of finance and Public Administration.

Revenue

Current revenue in 2008 was slightly up on the previous year (+0.1 p.p. of GDP), while tax and contributory revenue (taxes and actual social contributions) were identical to the previous year in terms of percentage of GDP. The fall in revenue from taxes on production and imports was offset by the increased revenue from taxes on income and wealth and from actual social contributions (Table 4.2.).

The favourable development of taxes on income and wealth reflected, in particular, the growth in the corporate tax base and the non-repercussion of the economic slowdown effects on advance tax payments during 2008.

The continuous increase in the social contributions revenue has been driven by the measures to fight contributory fraud and evasion combined with the increase in employment in 2008 as a whole.

Lastly, the development of revenue from taxes on production and imports (-0.4 p.p. of GDP compared to 2007) is justified by the lower revenue from VAT and motor vehicle tax. VAT revenue developments are, associated with the one percentage point reduction of the standard rate, which came into force from July 2008, and the reduction to the tax base brought about by the economic slowdown during 2008. The lower revenue generated by motor vehicle tax reflects the decrease to tax rates as planned in the recent reform of motor vehicle tax regime. The impact of the economic activity slowdown on indirect taxes revenue is also particularly relevant, especially in the final quarter of the year.

Table 4.3. General Government tax revenue
(% of GDP)

	2006	2007	2008
Taxes on imports and production	15,4	15,0	14,6
of which Value Added Tax (VAT)	8,7	8,6	8,5
Specific consumption taxes	2,7	2,5	2,4
Stamp duty	0,9	0,9	0,9
Motor vehicle taxes	0,8	0,7	0,6
Real estate taxes	0,6	0,6	0,7
Current taxes on income and wealth	8,8	9,7	9,9
of which Personal income tax	5,4	5,7	5,8
Corporate tax	3,0	3,7	3,8

Source: INE.

In relation to coercive tax collection, the amount collected in 2008 exceeded the target of 1 500 million Euros by 48 million Euros. The downwards trend in initiating debt proceedings, due to the successive growth in voluntary compliance by taxpayers, ensured that the amount obtained through coercive tax collection was lower than the 2007 figure (Table 4.4.).

Table 4.4. Indicators of the fight against tax fraud and evasion

	Unit	2007	2008	Change(%)
Number of tax returns submitted				
Personal income tax	Thousands	4.371	4.489	2,7
Corporate tax	Thousands	373	381	2,1
VAT	Thousands	3.871	3.852	-0,5
Number of missing tax returns				
Personal income tax	Thousands	118	127	7,7
Corporate tax	Thousands	35	31	-12,3
Inspections	Thousands	128	138	7,9
Corrections of submitted tax base	EUR million	4.671	4.048	-13,3
Tax found to be in default	EUR million	975	851	-12,7
Voluntary settlement				
Tax base	EUR million	1.060	1.244	17,4
Tax	EUR million	271	241	-11,1
Coercive collection	EUR million	1.633	1.548	-5,2

Source: Ministry of Finance and Public Administration.

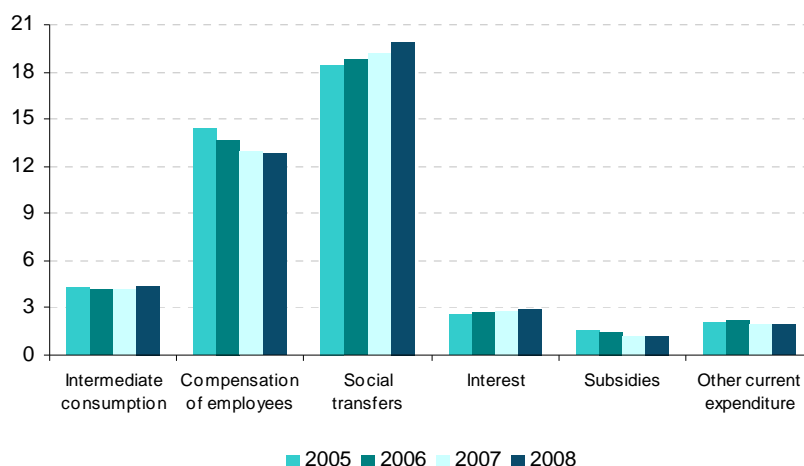
Expenditure

In 2008, total expenditure of general government as a percentage of GDP recorded a slight increase on the previous year (+0.1 p.p. of GDP), as current primary expenditure grew by 0.9 p.p. of GDP, which was almost fully offset by the good performance of capital expenditure (-0.8 p.p. of GDP). Interest expenditure as a percentage of GDP only increased slightly despite the growth of public debt stock, benefiting from the fall in interest rates in the second half of the year.

The increase of current primary expenditure reflects the growth in expenditure on social transfers and, to a lesser extent, on intermediate consumption. Social transfers recorded an increase of 0.7 p.p. of GDP in 2008, driven by the growth of public expenditure on pensions and the impact of the new social support measures recently taken. Notwithstanding the start, of the necessarily gradual, impact period of the reform measures to ensure that pension expenditure growth is curbed, the registered increase is still above the nominal GDP growth rate. Moreover, expenditure on family benefits to children and young people, the social integration income and other social benefits significantly increased, only partially offset by the reduction to expenditure on unemployment benefits, and despite the fact that this accelerated in the last quarter of 2008. Intermediate consumption recorded a slight 0.2 p.p. increase of GDP as a result of, among other factors, the development of payments arising from the existing contracts with the concession holders of the SCUT shadow toll motorways.

Compensation of employees stabilised as a percentage of GDP in 2008 (due to the continuation of the restrictions on civil service admissions, curbs to the wage scale update and the continued reduction of the average wage through the composition change to the retirement/recruitment quotient) (Figure 4.3.).

Figure 4.3. Development of current expenditure components
(% of GDP)



Source: INE.

In relation to capital operations, a greater amount of Community funds became available, growing above nominal GDP, bolstered further by the overlap of funds from the CSF III and from NSRF. It is to be noted that concession operations undertaken during 2008, the most significant being those referring to national hydroelectric capacity, were reported in national accounts under the sale of assets, and they contributed to reducing the GDP relative weight of the other components of general government capital expenditure.

Public Debt

Public debt as a percentage of GDP recorded year-on-year growth of 2.9 p.p. in 2008, to 66.4% of GDP at the end of the year. This increase is largely due to the effect of the differential between the implicit interest rate on debt and the reduced nominal GDP growth rate, while the primary balance contributed to reducing the general government debt to GDP ratio (Table 4.5.). Other effects encompass public debt issues to finance the settlement of trade debts, capital injections operations in State-owned companies and loans granted by general government during 2008, as well as valuation differences due to debt issued at a discount.

Table 4.5. Public debt developments
(% of GDP)

	2004	2005	2006	2007	2008
Debt level (at the end of year)	58,3	63,6	64,7	63,5	66,4
Change in debt (p.p. of GDP)	1,4	5,3	1,1	-1,1	2,9
Interest and GDP effect (snow-ball effect)	0,5	0,7	0,2	-0,3	1,7
Interest effect	2,6	2,6	2,7	2,8	2,9
Nominal GDP growth effect	-2,2	-2,0	-2,6	-3,1	-1,1
Primary balance effect	0,7	3,5	1,2	-0,2	-0,3
Other	0,3	1,1	-0,2	-0,6	1,4

Sources: INE and Ministry of Finance and Public Administration.

4.2. Budgetary Outturn in the First Quarter of 2009

This section analyses the results of budgetary outturn in the first quarter of 2009 for the main entities comprising the Portuguese Public Administration: the State, Autonomous Funds and Services, Regional Government, Local Government and Social Security⁵.

4.2.1. State

The value of the State sub-sector deficit for the first quarter of 2009 calculated on a public account basis was EUR 2,355.8 million, reflecting an increase of EUR 1,475.4 million on the same period of the previous year (Table 4.6). The primary deficit was EUR 1,940.2 million, which, likewise, represents a decline of EUR 1,557.6 million on the same period of 2008.

Table 4.6. State budget outturn - main aggregates

(Millions of Euros and percentage)

	2008	2009	Year-on-year change rate (%)
	1 st quarter	1 st quarter	
Total revenue	8.952,6	7.958,9	-11,1
Tax revenue	8.039,4	7.047,5	-12,3
Total expenditure	9.833,0	10.314,7	4,9
Primary expenditure	9.335,2	9.899,1	6,0
Current primary expenditure	8.774,2	9.318,6	6,2
Capital expenditure	561,0	580,5	3,5
Overall balance	-880,4	-2.355,8	:
Primary balance	-382,6	-1.940,2	:

Source: Ministry of Finance and Public Administration.

The State budget outturn in the first quarter of 2009 was characterized by the fall in total revenue, in particular lower tax revenue, compared to the same period of 2008. This performance mirrors the unfavourable economic climate and the effort to speed up tax reimbursements to companies and households. The expenditure outcome is consistent with the budgeted figures.

State Revenue

State revenue in the first quarter of 2009 registered a reduction of 11.1% in comparison to the same period of the previous year (Table 4.6). Tax revenue showed a year-on-year decreased of 12.3%, driven by the 17.2% and 3.3% decline in revenue from indirect taxes and direct taxes, respectively (Table 4.7).

⁵ The amounts in this section are generally expressed on a cash basis (income and payments) and not on a National Accounts basis.

Table 4.7. Tax revenue outturn

(Millions of Euros and percentage)

	2008	2009	Year-on-year change rate (%)
	1 st quarter	1 st quarter	
Tax Revenue	8.039,4	7.047,5	-12,3
Direct Taxes	2.816,4	2.724,6	-3,3
Personal Income Tax	2.348,1	2.410,5	2,7
Corporate Tax	463,6	313,1	-32,5
Other	4,7	1,0	-78,7
Indirect Taxes	5.223,0	4.322,9	-17,2
Tax on Oil Products	665,5	575,1	-13,6
Value Added Tax (IVA)	3.625,7	2.889,1	-20,3
Motor Vehicle Tax	236,2	177,0	-25,1
Tax on Tobacco Products	145,8	142,7	-2,1
Tax on Alcohol and Alcoholic Products	46,3	41,1	-11,2
Stamp Duty	471,7	458,5	-2,8
Other	31,8	39,4	23,9

Source: Ministry of Finance and Public Administration.

The downwards developments in direct taxes (-3.3%) was essentially due to the fall in revenue from corporate income tax (-32.5%), representing the increase in reimbursements and transfers to Local and Regional Government. Revenue from personal income tax, however, grew by 2.7%, thus preventing a more significant decline in revenue from direct taxes.

Indirect taxes recorded a decrease of 17.2% on the same period of 2008. All indirect tax components contributed to this performance, the most significant being the fall in revenue of VAT (-20.3%), tax on oil and energy products (-13.6%) and stamp duty (-2.8%). The fall in VAT is mainly associated with the sharp downturn in economic activity, with particular focus on the consumption of durable goods and, to a lesser extent, the reduction of the standard tax rate to 20% in July 2008, as well as the increase to reimbursements. It is worth to be noted that in April 2009 the accrued homologous rate of change in the value of VAT reimbursements accelerated to 23% (9.2% until March 2009). In this period, an additional 3,900 VAT reimbursements were made than in the identical period of 2008, equivalent to an increase of around 26%. The decrease in the revenue of tax on oil products is primarily due to the lower quantity of fuel sold. A lower revenue (-11.2%) from the tax on alcohol and alcoholic products was also reported. The other indirect taxes grew 23.9% due to the increased revenue from the Single Road Tax.

State Expenditure

In the first quarter of 2009, State expenditure recorded a 4.9% year-on-year increase, in accordance with the State Budget for the year. This increase is divided between the 5% growth of current expenditure and the 3.5% growth of capital expenditure (Table 4.8). Disregarding the effect of the reduction to interest expenditure, owing to the decrease in interest rates, current primary expenditure increased by 6.2%.

The breakdown of these aggregate shows that current transfers, subsidies and the acquisition of goods and services recorded the largest growth. Conversely, compensation of employees fell 21.1%, reflecting the reclassification of the block of funding from the State Budget assigned to cover the deficit of the *Caixa Geral de Aposentações* pension system, which was instead reported under "current transfers to Central

Administration". Hence, correcting for this effect, compensation of employees would register an increase of 0.2% and current transfers to the Central Administration a rise of 12.1%.

Table 4.8. State expenditure outturn

(Millions of Euros and percentage)

	2008	2009	Year-on-year change rate (%)
	1 st quarter	1 st quarter	
Total Expenditure	9.833,0	10.314,7	4,9
Current Expenditure	9.272,0	9.734,2	5,0
Compensation of employees	3.071,4	2.422,2	-21,1
Wages	1.820,4	1.808,2	-0,7
Variable or contingent bonuses	86,2	110,6	28,2
Social security	1.164,8	503,4	-56,8
Current goods and services	173,5	209,7	20,9
Interest and other expenses	497,8	415,6	-16,5
Current transfers	5.410,9	6.511,9	20,3
General Government	4.496,9	5.614,2	24,8
Central Government	2.481,7	3.514,3	41,6
Regional Government	0,0	0,0	:
Local Government	506,6	473,2	-6,6
Social Security	1.508,6	1.626,8	7,8
Other current transfers	914,1	897,7	-1,8
Subsidies	26,8	73,1	172,2
Other current expenditure	91,5	101,7	11,2
Primary Current Expenditure	8.774,2	9.318,6	6,2
Capital Expenditure	561,0	580,5	3,5
Investment	25,6	27,8	8,9
Capital transfers	530,9	547,3	3,1
General Government	488,3	490,2	0,4
Central Government	162,8	147,5	-9,4
Regional Government	138,4	140,1	1,2
Local Government	185,0	201,3	8,8
Social security	2,1	1,3	-37,4
Other capital transfers	42,6	57,1	33,9
Other capital expenditure	4,6	5,4	17,8

Source: Ministry of Finance and Public Administration.

The increase to current transfers additionally comprises an increase in transfers from the State to Social Security, to comply with the Framework Law on Social Security, as well as the growth of transfers to finance the National Health Service. The reduction of transfers to Local Administration is due to the fact that the "variable share of personal income tax IRS" component envisaged in the Local Government Financing Law began to be reported in 2009 as tax revenue of municipal councils, contrary to 2008 when it was reported as revenue from the State and a transfer from the State Budget.

The increase in expenditure related to the acquisition of goods and services is partly justified by the payment to private creditors of outstanding debts under the Programme for the Extraordinary Settlement of the State' Debts as well as the greater intra-annual concentration of the implementation of the expenditure established in the Armed Forces Planning and Regulation Law.

The increased expenditure on subsidies was essentially the result of a different intra-annual budget implementation pattern of some subsidies than that registered in the same period of the previous year.

Capital expenditure year-on-year growth rate was 3.5% on the homologous period of 2008, in line with that established in the State Budget, and reflecting the increased expenditure in investments forming part of the Plan.

4.2.2. Autonomous Funds and Services

The provisional overall surplus of Autonomous Funds and Services (AFS), excluding the Public Debt Settlement Fund (PDSF) and the public entities of the National Health Service (NHS), was EUR 522.4 million in the first quarter of 2009, equivalent to an increase of EUR 242.9 million on the corresponding period of 2008 (Table 4.9).

The total revenue of AFS grew by 6.1% from the same period of 2008. Current revenue increased 6.2%, primarily driven by the growth of “other current revenue” and indirect taxes. It is to be noted that contrary to that observed in the State sub-sector, the development of AFS current revenue is influenced by the methodological change in the reporting of the block of financing from the State Budget intended to cover the deficit of the *Caixa Geral de Aposentações* (CGA) pensions system. This sum is no longer registered under contributions received by CGA and is instead included under current transfers received. Hence, correcting for that effect, contributions recorded a 4.3% increase and current transfers from General Government rose by 24%.

The total expenditure of the AFS also contributed to the balance improvement, given its 1.2% fall in comparison with the first quarter of 2008. Current expenditure shrunk by 3.4% while capital expenditure, which represents a significantly lower share, increased by 25.2%. The development of current expenditure reflects restrained growth in compensation of employees and a decrease in the acquisition of goods and services and subsidies awarded, whereas transfers to sectors other than the Public Administration remained stable.

Table 4.9. Budgetary outturn of autonomous funds and services
(Millions of Euros and percentage)

	2008	2009	Year-on-year change rate (%)
	1 st quarter	1 st quarter	
Total Revenue	3.366,6	3.573,6	6,1
Current Revenue	3.029,5	3.217,2	6,2
Direct taxes	22,2	24,3	9,5
Indirect taxes	113,5	135,9	19,7
Contributions to Social Security, CGA and ADSE	1.395,5	773,3	-44,6
Other current revenue	1.498,4	2.283,6	52,4
of which: transfers from other Gen. Gov. subsectors	647,7	1.614,5	149,3
Capital Revenue	337,0	356,4	5,8
Capital transfers	335,0	353,7	5,6
of which: transfers from other Gen. Gov. subsectors	180,6	145,1	-19,7
Total Expenditure	3.087,1	3.051,2	-1,2
Current Expenditure	2.848,9	2.753,1	-3,4
Compensation of employees	423,0	437,3	3,4
Goods and services	170,2	156,9	-7,8
Interest and other expenses	4,4	3,3	-24,6
Subsidies	228,4	127,0	-44,4
Current transfers	2.016,6	2.020,2	0,2
of which: transfers to other Public Adm. subsectors	176,2	161,0	-8,6
Other current expenditure	6,3	8,3	31,9
Capital Expenditure	238,2	298,1	25,2
Investment	29,6	17,1	-42,2
Capital transfers	179,5	252,2	40,5
of which: transfers to other Public Adm. subsectors	30,8	34,4	11,5
Other capital expenditure	29,0	28,8	-0,8
Overall Balance	279,4	522,4	:

Note: NHS and the Public Debt Settlement Fund (PDSF) not included. In 2008, Parliament and UP –Escola de Gestão are not included and, in 2009, Parliament is not included.
Source: Ministry of Finance and Public Administration.

4.2.3. National Health Service

The financial outturn of the public entities of the National Health Service generated a provisional balance of EUR 32.7 million in the first quarter of 2009, equivalent to a decline of EUR 92.3 million compared to the identical period of 2008 and for the same universe (Table 4.10).

The explanation for the reduction to the surplus is that total revenue grew by 2.7% and total expenditure by 7.7%. The performance of revenue essentially reflects the 2.5% increase in current transfers from the State Budget, in harmony with envisaged growth, and the development of expenditure is mainly steered by the increase in the Subcontracts component.

The increase to health services' costs provided by the hospitals which were converted into corporate public entities arises from the increase in the relative importance of such entities, whereas the increase in relation to Auxiliary Diagnostic and Therapeutic Means is essentially due to the entry into force of the payment form for haemodialysis comprising the overall price per patient per week, in 2009. The other NHS expenditure also developed upwardly due to the payment of prior-year debts to the sub-systems with which protocols were established. The compensation of employees recorded a moderate increase and the acquisition of goods and services even decreased from the homologous period of 2008.

Table 4.10. Financial outturn of the National Health Service

(Millions of Euros and percentage)

	2008		2009	Year-on-year change rate (%)
	1 st quarter		1 st quarter	
	Real Universe	Comparable Universe (*)		
Total Revenue	2.067,9	2.050,8	2.106,8	2,7
Current transfers from State Budget	1.975,0	1.975,0	2.025,0	2,5
Services provided	41,5	28,2	28,3	0,4
Investment subsidy	19,1	17,2	4,9	-71,5
Other revenue	32,3	30,4	48,6	59,9
Total Expenditure	1.998,3	1.925,8	2.074,1	7,7
Compensation of employees	353,0	269,1	274,8	2,1
Purchases	71,9	37,0	36,7	-0,8
Suppliers and external services	43,9	34,8	33,0	-5,2
Subcontracts	1.500,4	1.558,7	1.645,7	5,6
Products sold in pharmacies	386,1	386,1	393,9	2,0
Auxiliary Diagnostic and Therapeutic Means (1)	177,3	177,3	199,3	12,4
Other health services - EPE hospitals (2)	836,9	920,3	976,9	6,2
Other subcontracts (3)	100,1	75,0	75,6	0,8
Fixed assets	8,3	5,6	5,0	-10,7
Other expenditure (4)	20,8	20,6	78,9	283,0
Balance	69,6	125,0	32,7	:

Notes: (*) Comparable universe in 2008: corresponds to the general government universe in March 2009;

(1) Includes expenditure with Local Healthcare Units;

(2) Doesn't include expenditure with medicines and Local Healthcare Units MCDT;

(3) Includes Partnership with Hospital de Cascais, Hospital da Cruz Vermelha, da Prelada, CMFRSul and does not include hospital pharmacies;

(4) Includes expenditure under agreements with health sub-systems, partnerships, private social welfare entities and other official services as well as international agreements.

Source: Health System Central Administration.

4.2.4. Regional Government

Budgetary implementation in the first quarter of 2009 for Regional Government generated a provisional surplus of 10.8 millions of Euros, which is 18.3 millions of Euros lower than the surplus recorded in the same period of 2008 (Table 4.11).

The total revenue of Regional Government fell by 1.6% compared to the same period of 2008, reflecting the decline in tax revenue (-5.1%), which is sharpest in the case of VAT revenue, owing to the slowdown of economic activity. Other current revenue, on the other hand, increased, driven in particular by current transfers received. Capital revenue fell compared to the same period of the previous year.

The 3.1% growth in total expenditure is essentially due to the increase of current expenditure (12%), whereas capital expenditure fell. The components that most contributed to this growth were current transfers (25.2%), compensation of employees (5%) and the acquisition of goods and services (9.7%).

Table 4.11. Budgetary outturn of Regional Government

(Millions of Euros and percentage)

	2008	2009	Year-on-year change rate (%)
	1 st quarter	1 st quarter	
Total Revenue	404,4	397,7	-1,6
Current Revenue	360,3	374,5	3,9
Direct taxes	74,3	75,8	1,9
Indirect taxes	173,6	159,4	-8,2
Current transfers	93,6	118,6	26,6
Other current revenue	18,8	20,7	10,5
Capital Revenue	44,0	23,2	-47,3
Capital transfers	43,9	23,1	-47,4
Other capital revenue	0,1	0,1	-8,3
Total Expenditure	375,2	386,9	3,1
Current Expenditure	309,8	346,8	12,0
Compensation of employees	163,8	171,9	5,0
Goods and services	37,8	41,5	9,7
Interest and other expenses	10,6	17,6	65,8
Transfers	77,0	96,5	25,2
Other current expenditure	20,5	19,3	-5,8
Capital Expenditure	65,5	40,1	-38,7
Investment	38,2	28,4	-25,8
Transfers	27,2	11,7	-57,1
Other capital expenditure	0,1	0,1	0,0
Overall Balance	29,1	10,8	

Source: Ministry of Finance and Public Administration.

4.2.5. Local Government

Budgetary outturn of Local Government in the first quarter of 2009 generated an overall surplus of 29.2 millions of Euros, which is 42.3 millions of Euros down on the same period of 2008 (Table 4.11).

The increase in total revenue (3.1%) is essentially a result of the rise in capital revenue, with current revenue making a slight contribution to this result. Current revenue recorded an increase, driven by the appreciation in transfers received, particularly through the Local Government Financing Law. Tax revenue, however, developed in the opposite direction with decreases to direct tax - primarily due to lower revenue

from municipal real estate sales tax owing to the shrinkage of the real estate market - and indirect tax. Capital revenue increased 12.3% driven by the growth in capital transfers received through the Financial Equilibrium Fund established under the Local Government Financing Law.

Total expenditure grew 6.6% on the same period of 2008, driven by the performance of current expenditure, which increased 11% in all as its main components recorded identical rises. The growth of compensation of employees was largely due to the effective transfer of powers of the Ministry of Education to Local Government, especially in relation to non-teaching staff. The acquisition of goods and services was also influenced by this powers transferring process in relation to the acquisition of education and teaching material and the supply of meals, for which the Ministry of Education and Ministry of Employment and Social Solidarity, respectively, were previously responsible. Capital expenditure inverted the general trend and decreased 4.4%.

Table 4.12. Budgetary outturn of Local Government

(Millions of Euros and percentage)

	2008		2009	Year-on-year change rate (%)
	1 st quarter	1. ^o Trim.	1 st quarter	
	Real Universe	Comparable Universe		
Total Revenue	1.447,6	1.356,5	1.398,9	3,1
Current Revenue	1.130,4	1.058,9	1.064,8	0,6
Direct taxes	309,9	292,5	286,4	-2,1
Indirect taxes	73,6	66,5	43,7	-34,4
Current transfers	484,6	452,8	494,7	9,3
Sales of current goods and services	156,1	146,1	138,1	-5,5
Other current revenues	106,1	100,9	101,9	1,0
Capital Revenue	317,2	297,6	334,1	12,3
Capital transfers	280,4	262,6	309,1	17,7
Other capital revenue	36,8	35,0	25,0	-28,4
Total Expenditure	1.373,5	1.285,0	1.369,7	6,6
Current Expenditure	984,2	919,0	1.019,6	11,0
Compensation of employees	474,0	441,4	486,1	10,1
Goods and services	318,0	295,8	328,3	11,0
Interest and other expenses	44,0	41,6	47,1	13,3
Transfers	100,1	94,1	108,3	15,0
Other current expenditure	48,3	46,2	49,9	8,0
Capital Expenditure	389,3	366,0	350,0	-4,4
Investment	305,4	285,3	279,8	-1,9
Transfers	76,2	73,2	66,8	-8,7
Other capital expenditure	7,7	7,6	3,4	-54,7
Overall Balance	74,0	71,5	29,2	:

Note: Because of absence of information, the budget implementation of 1 municipality is not included in 2008 and, in 2009, the budget implementation of 24 municipalities is not included, making the comparable universe equivalent to 284 municipalities.

Source: Ministry of Finance and Public Administration.

4.2.6. Social Security

The surplus generated by the budget outcome of Social Security in the first quarter of 2009 was 704.5 millions of Euros, which is 196.7 millions of Euros down on the same period of 2008 (Table 4.13). This development is justified by the difference between the growth of total revenue, which was around 1.8%, and the growth of total expenditure (6.7%).

The 2% increase to current revenue was influenced by the positive development of contributions (0.7%), current transfers from Central Government (8.2%) and, to a lesser extent, other current revenue (11.7%).

The 3.7% rise in expenditure on pensions - old age and survivor's pensions increased 3% and 11.7%, respectively, and disability pensions fell 1.3% - contributed to the growth of current expenditure.

Table 4.13. Budgetary outturn of Social Security

(Millions of Euros and percentage)

	2008	2009	Year-on-year change rate (%)
	1 st quarter	1 st quarter	
Total Revenue	5.291,6	5.389,3	1,8
Current Revenue	5.279,4	5.386,5	2,0
Contributions and payments	3.211,7	3.233,6	0,7
VAT complement	173,0	172,3	-0,4
Current transfers from Central Government	1.538,7	1.664,5	8,2
Transfers from the European Social Fund	191,2	132,0	-30,9
Other current revenue	164,8	184,1	11,7
Capital Revenue	12,2	2,8	-76,9
Transfers from State Budget	2,1	1,3	-37,4
Other capital revenue	10,1	1,5	-85,1
Total Expenditure	4.390,4	5.389,3	22,8
Current Expenditure	4.379,6	4.679,5	6,8
Pensions	2.748,9	2.849,8	3,7
Survivors	371,8	415,3	11,7
Disability	311,3	307,3	-1,3
Old Age	2.065,8	2.127,2	3,0
Child care benefit	178,7	231,0	29,3
Sickness benefit	108,9	115,6	6,1
Unemployment benefit and employment support	395,3	449,7	13,8
Other benefits and social action	588,9	702,3	19,3
Administrative expenditure	82,3	83,9	2,0
Other current expenditure	168,0	180,0	7,2
Vocational training	108,8	67,2	-38,3
of which: co-financed by European Social Fund	87,9	15,9	-81,9
Capital Expenditure	10,8	5,4	-50,1
PIDDAC	8,0	3,6	-55,8
Other	2,7	1,8	-33,4
Overall Balance	901,2	704,5	:

Source: Social Security Financial Management Institute.

The number of old age pensions increased by 2% in the same period, while the number of survivor's pensions remained relatively stable (+0.8%) and the number of beneficiaries of disability pensions fell 2.6%. Unemployment benefit recorded a 13.8% increase, driven by the 21.9% growth in the number of beneficiaries compared to the same period of 2008. Child care benefit grew by 29.3%, owing to the impact of the new childbirth incentive and households' protection measures. Expenditure on social action and on other benefits recorded a year-on-year growth of 9.9% and 38.8% respectively, with the growth in the latter essentially due to the increased expenditure on the Solidarity Supplement for the Elderly. Other items that contributed to that evolution of current expenditure were the increases in expenditure on Social Integration Income and on unemployment benefits, heightening the impact of those benefits. The budgetary outturn of the Social Integration Income in the first quarter of 2009 reflects the effort throughout 2008 to actually reduce average processing times, leading to an increase in the number of beneficiaries. Sickness benefit underwent year-on-year growth of 6.1% and unemployment benefit year-on-year growth of 13.8%.

4.3. Forecast of 2009 General Government Account

Following the budget outcome reported for 2008 and the revision of the macroeconomic scenario for 2009, the forecast of the General Government Account published in January 2009 in the update of the Stability and Growth Programme and the Investment and Employment Initiative is now revised.

The worsening of the economic crisis, which has had a worldwide impact, provides an explanation in itself, via automatic stabilisers, for the reduction of revenue and the increased in public expenditure, which underlay the revision of the forecast for the general government budget deficit in 2009 - 5.9% of GDP, 2 p.p. higher than the previous forecast (Table 4.14). However, the fall in interest expenditure on public debt and the strict control of public expenditure, in accordance with the budgeted allows the continued implementation of anti-crisis policies, including the acceleration of tax reimbursements to business and households.

In structural terms, the adjustment pathway observed in recent years is interrupted in 2009, as primary balance worsens by 1.7 p.p., owing to the impact of the budgetary policy to combat the effects of the economic crisis.

Table 4.14. Budgetary balances evolution

(% of GDP)

	2006	2007	2008	2009
Nominal Balances				
Overall Balance	-3,9	-2,6	-2,6	-5,9
Primary Balance	-1,2	0,2	0,3	-2,8
Structural Balances (*)				
Overall Balance	-3,8	-3,1	-2,9	-4,8
Change (p.p. of GDP)	1,9	0,7	0,2	-1,9
Cumulative change (p.p. of GDP)	1,9	2,6	2,8	0,9
Primary Balance	-1,1	-0,3	0,0	-1,7
Change (p.p. of GDP)	2,0	0,8	0,3	-1,6
Cumulative change (p.p. of GDP)	2,0	2,8	3,1	1,5

Note: (*) Cyclically-adjusted and excluding one-off measures.

Sources: INE and Ministry of Finance and Public Administration.

Table 4.15. General Government Account Developments (EDP)

	2006	2007	2008	2009	2006	2007	2008	2009	2006	2007	2008	2009
	millions of Euro				% of GDP				Change in p.p. of GDP			
CURRENT REVENUE	64.047,7	68.910,4	70.322,7	67.124,0	41,2	42,2	42,3	41,2	1,1	1,0	0,1	-1,2
Taxes on production and imports	23.947	24.535	24.265	22.893	15,4	15,0	14,6	14,0	0,4	-0,4	-0,4	-0,6
Current taxes on income and wealth	13.719	15.905	16.524	15.670	8,8	9,7	9,9	9,6	0,4	0,9	0,2	-0,3
Social contributions	19.360	20.717	21.546	18.866	12,5	12,7	13,0	11,6	-0,1	0,2	0,3	-1,4
of which: Actual social contributions	17.712	19.077	19.853	17.245	11,4	11,7	11,9	10,6	0,0	0,3	0,3	-1,4
Other current revenue	7.021	7.753	7.987	9.695	4,5	4,8	4,8	5,9	0,4	0,2	0,1	1,1
CAPITAL REVENUE	1.769	1.462	1.549	3.988	1,1	0,9	0,9	2,4	-0,3	-0,2	0,0	1,5
TOTAL REVENUE	65.817	70.372	71.872	71.112	42,3	43,1	43,2	43,6	0,8	0,8	0,1	0,4
CURRENT EXPENDITURE	66.611	68.900	71.741	73.847	42,9	42,2	43,2	45,3	-0,5	-0,6	0,9	2,1
Intermediate consumption	6.392	6.755	7.265	7.707	4,1	4,1	4,4	4,7	-0,1	0,0	0,2	0,4
Compensation of employees	21.174	21.059	21.377	18.718	13,6	12,9	12,9	11,5	-0,8	-0,7	0,0	-1,4
Social transfers	29.181	31.334	33.040	35.247	18,8	19,2	19,9	21,6	0,3	0,4	0,7	1,7
of which: Social transfers in kind	5.748	6.621	7.071	7.735	3,7	4,1	4,3	4,7	0,2	0,4	0,2	0,5
Interest expenditure (EDP)	4.267	4.592	4.816	5.126	2,7	2,8	2,9	3,1	0,1	0,1	0,1	0,2
Subsidies	2.231	1.901	1.931	3.137	1,4	1,2	1,2	1,9	-0,1	-0,3	0,0	0,8
Other current expenditure	3.366	3.260	3.313	3.912	2,2	2,0	2,0	2,4	0,1	-0,2	0,0	0,4
CAPITAL EXPENDITURE	5.298	5.690	4.471	6.924	3,4	3,5	2,7	4,2	-0,9	0,1	-0,8	1,6
GFCF	3.696	3.762	3.544	4.820	2,4	2,3	2,1	3,0	-0,6	-0,1	-0,2	0,8
Other capital expenditure	1.602	1.928	927	2.104	1,0	1,2	0,6	1,3	-0,3	0,2	-0,6	0,7
TOTAL EXPENDITURE	71.909	74.590	76.213	80.771	46,3	45,7	45,9	49,5	-1,4	-0,6	0,1	3,7
Net Lending(+)/Borrowing(-) of Gen.Gov. (EDP)	-6.092	-4.218	-4.341	-9.659	-3,9	-2,6	-2,6	-5,9	2,2	1,3	0,0	-3,3
<i>p.m.</i>												
Primary Current Expenditure	62344	64309	66925	68721	40,1	39,4	40,3	42,1	-0,7	-0,7	0,9	1,9
Primary Expenditure	67642	69999	71397	75645	43,5	42,9	43,0	46,4	-1,5	-0,6	0,1	3,4
Tax revenue and Social Contributions	55378	59518	60643	55809	35,6	36,5	36,5	34,2	0,8	0,8	0,0	-2,3
Public Debt	100.522	103.702	110.377	121.630	64,7	63,5	66,4	74,6	1,1	-1,1	2,9	8,2
memo item:												
Nominal GDP	155446	163190	166197	163073								

Sources: INE and Ministry of Finance and Public Administration.

Revenue

The revision to total revenue in 2009, amounting to 3.450 billion of Euros, essentially arises from the downwards adjustment of around 3.378 billion of Euros to the previous forecast for tax and contributory revenue.

A substantial part of this revision is attributed to the new public accounting forecast for tax revenue of 32.387 billions of Euros, approximately 9% lower than the estimated outcome of tax revenue for 2008.

The expected development of the revenue of direct taxes (-8.2%) and indirect taxes (-9.8%) compared to the values registered in 2008 contributed to this downwards revision. The main contribution to the shrinkage of direct tax is attributed to the expected evolution of corporate income tax, while the major contributors to the contraction of indirect tax revenue are VAT and motor vehicle tax. Table 4.16 illustrates the development of the forecast tax revenue for 2009, by tax.

Table 4.16. State tax revenue outturn

(Public account)

(Millions of euros %)

	2008	2009(F)	Rate of change (%)
Tax Revenue	35.641	32.385	-9,1
Direct Taxes	15.346	14.089	-8,2
Personal Income Tax	9.344	9.202	-1,5
Corporate Tax	5.989	4.881	-18,5
Other	13	6	-53,5
Indirect Taxes	20.295	18.297	-9,8
Tax on Oil Products	2.530	2.433	-3,8
Value Added Tax	13.430	11.628	-13,4
Motor Vehicle Tax	918	734	-20,1
Tax on Tobacco Products	1.296	1.350	4,2
Tax on Alcohol and Alcoholic Products	190	190	-0,2
Stamp Duty	1.769	1.790	1,2
Other	162	173	7,1

(F) Forecast.

Source: Ministry of Finance and Public Administration.

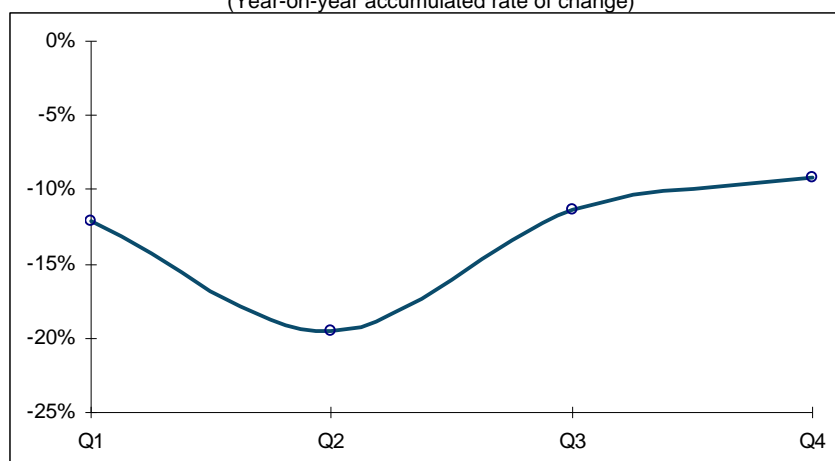
These results reflect, first of all, the impact that the shrinkage of economic activity is having and will have on revenue, via the automatic stabilisers, and secondly, the impact of the early reimbursements to households and business and the impact on the taxation of small and medium-size companies associated with the introduction of a lower corporate income tax rate bracket.

Tax revenue in the first four months of 2009 decreased around 19%, which is less than the change forecast for the year as a whole. There are two basic reasons for this performance: the expected intra-annual profile of economic growth (economic activity is expected to contract less in the second half of the year), and the distribution over time, in 2009, of the impact of the discretionary measures of a fiscal nature, which are primarily associated with the referred to swifter reimbursement of tax.

Figure 4.4 indicates the expected accrued year-on-year rate of change for the final three quarters of 2009.

Figure 4.4. Expected evolution of tax revenue in 2009

(Year-on-year accumulated rate of change)



Source: Ministry of Finance and Public Administration.

As the figure illustrates, the deterioration in the second quarter of 2009 is expected to be greater than in the first quarter. This forecast is based on the expected fall in corporate income tax revenue in May (due to the impact of the reduction to the corporate income tax rate for small and medium-size companies) and the time distribution for the payment of reimbursements, compared to 2008, especially those relating to personal income tax and VAT.

The reimbursements amount of the three main taxes in the first four months of 2009 was more than 56% higher than the amount in the identical period of the previous year, owing to the Tax Administration's continued effort to make swifter payments and, thus, improve the financial situation of the economic agents. It is to be underlined that the higher relative concentration in this period (primarily due to personal income tax reimbursements, which were previously paid in the third quarter) contributed to the negative development of the forecast tax revenue for the first half of 2009.

In parallel, the basis for the slight recovery of tax revenue forecast for the fourth quarter is the fact that this was the worst performing quarter of 2008, which should provide for an improved homologous comparison, assuming that the expected profile of economic acceleration in the second half of 2009 holds true. Also of note in relation to 2008, and despite the fact that tax revenue may have registered zero growth, is the divergent pattern of intra-annual development. Tax revenue in the first three quarters of 2008 registered a change of around 1.5%, while in the fourth quarter it shrunk 4%, which was essentially due to the impact of the economic climate in the second half of 2008, with particular focus on the revenue from indirect taxes.

Further to the effects already mentioned, the reduction to the standard rate of VAT, which came into force in July 2008, also impacted on the decline in the fourth quarter since this is the period when it was first collected. This effect will no longer have a negative impact on homologous comparisons in the fourth quarter of 2009.

Lastly, it is significant that part of the aforementioned positive effects will be mitigated by the expected development of corporate income tax revenue, namely the forecast reduction of the final advance tax payment, which explains the lower rate of acceleration of the rate of change in the final quarter of 2009.

The current economic climate further reflects on the expected development of contributory revenue, which was revised downwards by 369 million of Euros to 17.245 billion of Euros.

The current 2009 General Government Account forecast also includes a correction of less 72 millions of Euros for other current revenue, which combined with a decline of identical amount on the expenditure side - under subsidies - ensures the budgetary balance is unaffected.

Expenditure

The new forecast for total General Government expenditure, reflecting the impact of the revision to interest, which was revised downwards by 500 millions of Euros, in line with the assumptions made for the development of interest rates, establishes an improvement of approximately EUR 444 million.

The difference between the two values is fundamentally due to the impact of the current recessive climate on social benefits, which is already mirrored in the social security budget implementation relative to the first quarter of 2009. It is expected, given the counter-cyclical nature of unemployment benefits, taking into account the new unemployment rate forecast, as well as the measures taken in regard to the award of the social unemployment benefit, that expenditure on this item undergo a EUR 127 million increase on the previous forecast .

The forecast for the components of expenditure will not undergo any materially relevant change in comparison to the General Government Account of January 2009, illustrating the strict control being exercised on the implementation of primary expenditure.

The acceleration of primary expenditure in 2009 from 2008 mirrors that heavy impact of the automatic stabilisers and also the impact of the Investment and Employment Initiative, which was adopted by the Portuguese Government under the Europe-wide co-ordinated anti-cyclical effort, underlying the European economic recovery plan, with particular focus on the development of public investment.

In relation to the Effective Social Contributions and Compensation to Employees items, the reporting of the State's contribution to the *Caixa Geral de Aposentações* (CGA) underwent a change in the State Budget for 2009, though this does not have any implication of the General Government budgetary balance. The social contributions of the State to the CGA prior to 2008 were reported as a State subsidy to that entity, which was, on the expenditure side, fully reported under compensation to employees and, on the revenue side, as effective social contributions. From 2009, following the decision to extend the contribution to the CGA to the services under the direct administration of the State, the value equivalent to 7.5% of the gross wage over which the contribution to CGA is discounted, continued to be reported as effective social contribution. The remaining value, corresponding to the State subsidy intended to guarantee CGA financing, began to be reported as a current transfer. Table 4.17 illustrates the development of the budgetary headings affected by this reporting change, adjusting the amounts of previous years (2007 and 2008) in accordance with the method to be used from 2009 so as to permit comparability with the 2009 forecast of the General Government Account.

Table 4.17. General Government account adjusted from the recording change in the State subsidy to CGA

	(% and p.p. of GDP)			2008-2007	2009-2008
	2007	2008	2009		
	Millions of euro			Rate of change	
Total Revenue	68188,3	69579,0	71112,3	2,0	2,2
Current Revenue	66726,4	68029,8	67124,0	2,0	-1,3
Social contributions	18533,0	19253,0	18865,7	3,9	-2,0
of which: Actual social contributions	16893,1	17560,2	17245,0	3,9	-1,8
Total Expenditure	72406,4	73919,8	80771,0	2,1	9,3
Current Expenditure	66716,2	69448,5	73846,8	4,1	6,3
Compensation of employees	18875,4	19084,3	18717,9	1,1	-1,9
Primary Current Expenditure	62124,6	64632,4	68720,7	4,0	6,3
Primary Expenditure	67814,8	69103,6	75644,9	1,9	9,5
Tax revenue and Social Contributions	57333,6	58349,7	55808,6	1,8	-4,4

Source: Ministry of Finance and Public Administration.

According to the forecasts now made, public debt in 2009 as a share of GDP will undergo an 8.2 p.p. year-on-year increase (Table 4.18). Contrary to recent years, the dynamic effect does not benefit from the nominal growth of GDP, which shrinks in 2009, further fuelled by the envisaged worsening of the primary balance, owing to the implementation of the package of stabilisation measures, which will register a negative value following the positive performances recorded in 2007 and 2008. These factors are further bolstered by the impact of the operations arising from the implementation of the Programme for the Extraordinary Settlement of the State Debts and the acquisition of financial assets. The revision of the forecast of public deficit published in January 2009 is fundamentally explained by the negative contribution associated with the worsening of the dynamic effect, by around 2 p.p. of GDP, arising from the new forecast for nominal growth of the economy and the worsening of the primary balance by 1.4 p.p. of GDP, due to the significant contraction of tax and contributory revenue.

Table 4.18. Public debt dynamics

	(% of GDP)		
	2007	2008	2009
Consolidated Public Debt	63,5	66,4	74,6
Change as p.p. of GDP	-1,1	2,9	8,2
Dynamic effect ("snow-ball")	-0,3	1,7	4,4
Primary balance effect	-0,2	-0,3	2,8
Other	-0,6	1,4	1,0

Sources: INE and Ministry of Finance and Public Administration.