



SUMMARY

- **Governor Luis Fortuño has proposed a \$7,670 million General Fund budget for fiscal year 2010.**
- **The proposed budget for fiscal year 2010 is based on a multi-year economic and fiscal perspective and addresses the fiscal imbalance affecting the Government of Puerto Rico.**
- **Revised economic forecasts show recovery in real economic growth of 0.1% for fiscal 2010, and moderate growth of 0.9% and 1.0% for fiscal years 2011 and 2012, respectively.**
- **Economic growth is to be mainly driven by economic stimuli and investment programs that can potentially outweigh or compensate for the adopted fiscal measures.**
- **Revenue forecasts are set at annual average growth rate of 1.5% for fiscal years 2009 through 2012.**
- **The proposed 2010 consolidated budget total \$29,264 million.**
- **The Stabilization Fund and ARRA will provide support to fiscal and budgetary balance.**

Introduction

The Governor of Puerto Rico has submitted a proposed consolidated budget for fiscal year 2010 of \$29,264 million. The budget has been constructed on a multi-year economic and financial perspective for Puerto

Rico and proposes a balanced approach between recurrent expenses and revenues within a four-year term. The budget addresses the fiscal imbalance affecting the Government of Puerto Rico by implementing measures such as reductions in expenditures, and temporary and permanent tax revenue increases, among others. This *Progress Report* presents a summary of the proposed budget for fiscal year 2010 and highlights its multi-year perspective.

Updated Economic Forecasts

The Puerto Rico economy has been adversely affected by a marked decline in the U.S. economy and internally by a continued drop in fixed investment, job losses and restrictions on credit availability. Puerto Rico is experiencing a third consecutive year of recession in fiscal year 2009.

Against this backdrop, economic output will remain weak if economic conditions are not addressed and improved. The Puerto Rico Planning Board—the government entity charged with conducting official economic analysis and forecasting—has updated its forecasts to provide a comprehensive and multi-year perspective of the economic landscape and prospects for the next three fiscal years. The forecasts include the estimated effects of the economic stimulus programs: (i) American Recovery and Reinvestment Act stimulus for Puerto Rico (ARRA), (ii) the Local Economic Stimulus Plan and (iii) supplemental investment. The Planning Board forecasts also take into account the payment of benefits associated with the Program of Alternatives for Public Employees and approved increases in Pell grants, Social Security and the Nutritional Assistance Program. The economic forecasts account as well for a combination of fiscal

measures, including government expenditure reductions, and temporary and permanent tax revenue increases for individuals.

The Puerto Rico Planning Board has estimated that the combination of stimuli, benefits to displaced public employees and strategic investments will aggregate \$9,866 million over the next three fiscal years. Simultaneously, the fiscal measures will have an aggregate negative impact estimated to be \$3,345 million. As a result, the local economy is expected to receive an estimated net benefit of \$6,521 million between FY 2010 and FY 2012.

Summary of Factors in the Puerto Rico Economy from Fiscal 2009 to 2012 (\$ in millions)						
Main Economic Variable	Factors	FY09	FY10	FY11	FY12	Total
Government Spending	Expense Measures & Local Stimulus	\$0	(\$1,985)	\$0	\$0	(\$1,985)
Construction Investment	Local, Federal & Supplemental Stimuli Plans, PPPs*	\$0	\$649	\$1,265	\$2,502	\$4,417
Machinery & Equip. Investment	Supplemental Stimulus Plan	\$0	\$0	\$0	\$165	\$165
Personal Consumption	Public Employees Alternatives Pgm. & Revenue Measures	\$0	\$569	(\$448)	(\$467)	(\$345)
Federal Transfers Individuals	Federal & Local Stimuli Plans	\$0	\$918	\$805	\$0	\$1,723
Federal Transfers Govt. Agencies	Federal Stimulus Plan	\$0	\$725	\$884	\$634	\$2,243
Federal Transfers Pub. Corps.	Federal Stimulus Plan	\$0	\$70	\$93	\$0	\$163
Federal Transfers Municipalities	Federal Stimulus Plan	\$0	\$61	\$79	\$0	\$140
Total Estimate		\$0	\$1,008	\$2,679	\$2,835	\$6,521

* PPPs = Public-Private Partnerships.
Source: Puerto Rico Planning Board.

Considering the factors above and their planned effect over the next three fiscal years, the Puerto Rico economy is expected to post favorable signs of recovery in fiscal year 2010.

Revised Forecasts including Economic Stimuli and Fiscal Measures					
Forecasts (\$ in millions)	FY08 A	FY09 E	FY10 E	FY11 E	FY12 E
GNP Nominal*	\$60,787	\$61,701	\$63,792	\$67,157	\$71,106
% Annual Growth	3.8%	1.5%	3.4%	5.3%	5.9%
GNP Real*	\$6,742	\$6,513	\$6,517	\$6,578	\$6,646
% Annual Growth	-2.5%	-3.4%	0.1%	0.9%	1.0%

* GNP = Gross National Product. A = Actual. E = Estimate.
Source: Puerto Rico Planning Board.

Current forecasts point to a modest recovery of 0.1% in fiscal year 2010, followed by moderate growth rates of 0.9% and 1.0% in fiscal years 2011 and 2012, respectively.

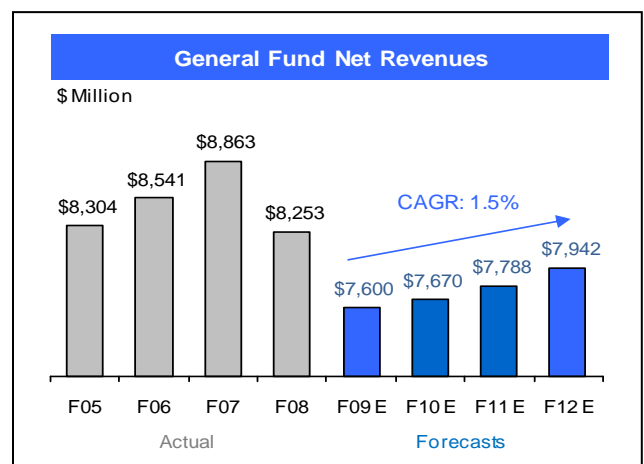
This revision of the economic outlook involved a high level of complexity due to the numerous factors that will be simultaneously affecting economic activity in the next three fiscal years. The Puerto Rico Planning Board will be revising the economic forecasts on a regular basis.

The current revised forecasts for Puerto Rico consider the implementation of a significant investment program that will complement the short-term economic stimuli. The Administration has assumed this business development, retention and financing responsibility and is currently working on a series of initiatives aimed at bringing about such investment in fiscal year 2011.

Summary of Proposed Budget 2010

The Governor has proposed a General Fund budget of \$7,670 million for FY 2010. The proposed budget underscores the objective of bringing expenses in line with revenues.

The proposed budget is \$1,814 million lower than the proposed 2009 General Fund budget. In fact, the proposed 2010 General Fund budget is just 0.9% higher than the revised General Fund revenue forecast of \$7,600 million for fiscal year 2009.



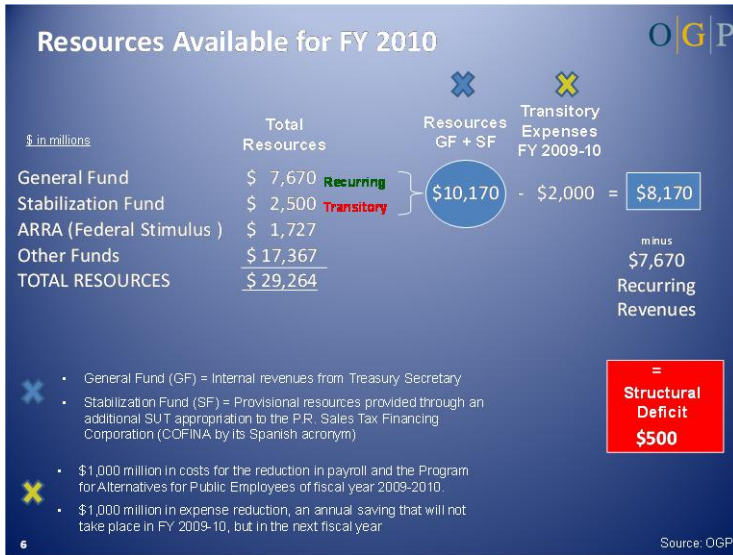
The proposed budget is based on a conservative multi-year revenue forecast. The Puerto Rico Department of the Treasury has formulated revenue forecasts that show an annual average growth rate of 1.5% between fiscal 2009 and 2012—a lower rate than the forecasted nominal GNP growth rate of 4.8% for the same fiscal years. The 2010 revenue forecast takes into account temporary and permanent revenue measures as approved by Act No. 7 of March 9, 2009.

In consolidated budget terms, the proposed 2010 budget amounts to \$29,264 million, up 7% from the 2009 proposed consolidated budget. This increase is attributable to two new budgetary components: 1) the Stabilization Fund; and 2) the temporary budgetary funds from ARRA. When adjusting for these two new components and the increased budgeted amount to service government debt, however, the consolidated budget is actually 6% lower compared to the consolidated 2009 budget. The Stabilization Fund is a \$2,500 million fund allocated to provide provisional budgetary support for the transition process to a balanced budget. Funds for the Stabilization Fund will come from bond issuances during fiscal year 2010 involving the Puerto Rico Sales Tax Financing Corporation (*COFINA*, for by its Spanish acronym). ARRA funds allocated to Puerto Rico amount to \$1,727 million and will be directed to the different economic stimulus programs mandated by the Federal legislation.

The following table shows a detailed comparison between 2009 and 2010 proposed consolidated budget. Excluding the Stabilization Fund and the ARRA funds, the proposed 2010 consolidated budget is 5% lower the sub-total of consolidated expenditures from the previous proposed budget, and 6% lower when considering total consolidated expenditures.

Comparison of Proposed Consolidated Budget for Fiscal Years 2009 and 2010			
Proposed Consolidated Budget F2010 (\$ million)	FY09	FY10	% Change
Consolidated Resources			
General Fund	\$9,484	\$7,670	-19%
Federal Funds	\$5,643	\$5,587	-1%
Public Improvements Fund	\$0	\$0	0%
Other Revenues	\$1,047	\$1,273	22%
Internal Resources	\$8,695	\$8,187	-6%
Special State Funds	\$524	\$1,162	122%
Stabilization Fund	\$0	\$2,500	-
Federal Stimulus Plan - ARRA Funds	\$265	\$1,727	552%
Loans and Debt Resources	\$1,777	\$1,158	-35%
Total Consolidated Budget	\$27,435	\$29,264	7%
Consolidated Expenditures			
Payroll and Related Expenses	\$8,702	\$7,569	-13%
Subsidies and Distributions	\$3,085	\$3,296	7%
Office Supplies and Other Materials	\$3,234	\$3,056	-6%
Purchased Services	\$1,600	\$1,558	-3%
Payments for Public Services	\$786	\$899	14%
Other Operating Expenses	\$2,602	\$2,597	0%
Stabilization Fund	\$0	\$1,000	-
Federal Stimulus Plan - ARRA Funds	\$0	\$1,727	-
Sub-Total Consolidated Expenditures	\$20,009	\$21,702	8%
Excl. Stabilization Fund and ARRA Funds	\$20,009	\$18,975	-5%
Distributions to Non-Governmental Entities	\$175	\$141	-19%
Incentives and Subsidies	\$1,925	\$1,986	3%
Permanent Improvements	\$2,488	\$1,900	-24%
Debt Service	\$2,838	\$3,535	25%
Total Consolidated Expenditures	\$27,435	\$29,264	7%
Excl. ARRA, Stabilization Fd & Ch. Debt Service	\$27,435	\$25,840	-6%

The proposed budget evidences the Administration's goal of reaching budgetary balance in the coming years.



General Fund + Stabilization Fund Multi-Year Forecast: FY 2009 – FY 2012

	2009 E	2010 P	2011 E	2012 E
Internal Revenues – General Fund	\$ 7,600	\$ 7,670	\$ 7,788	\$ 7,942
Expenses – General Fund + Stabilization Fund	(10,833)	(10,170)	(8,247)	(8,095)
Internal Revenues versus Expenses	(3,233)	(2,500)	(459)	(153)
Transitory Expenses				
Cost of payroll reduction		1,000		
Cost of expense reduction (Act #7 FY2010)		1,000		
Efficiency and Government Re-Organization			200	153
STRUCTURAL DEFICIT	\$ (3,233)	\$ (500)	\$ (259)	-

Source: OGP, Department of the Treasury and GDB.

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