

The
OECD
ECONOMIC
SURVEYS
PORTUGAL

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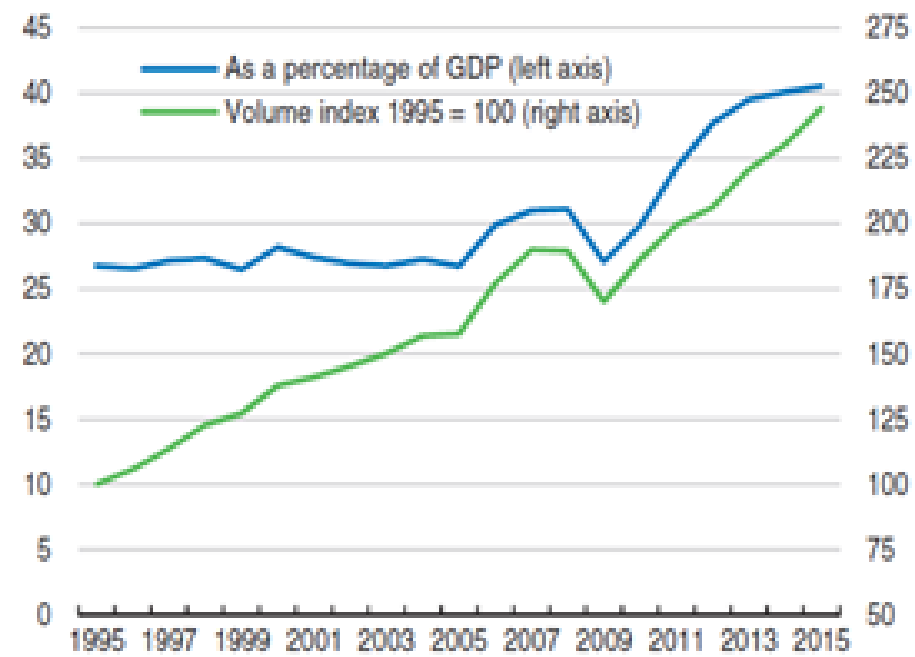
INTRODUCTION

- The economy is progressively recovering and rebalancing
- The outlook is becoming more challenging and vulnerabilities are rising
- Managing limited fiscal space
- Safeguarding financial stability
- Strengthening investment financing
- Improving the business climate to boost investment
- Raising skills
- Making growth more sustainable

*ECONOMY IS
PROGRESSIVELY
RECOVERING
AND
REBALANCING*



A. Evolution of exports of goods and services



Source: OECD (2016), OECD Economic Outlook: Statistics and Projections (dat

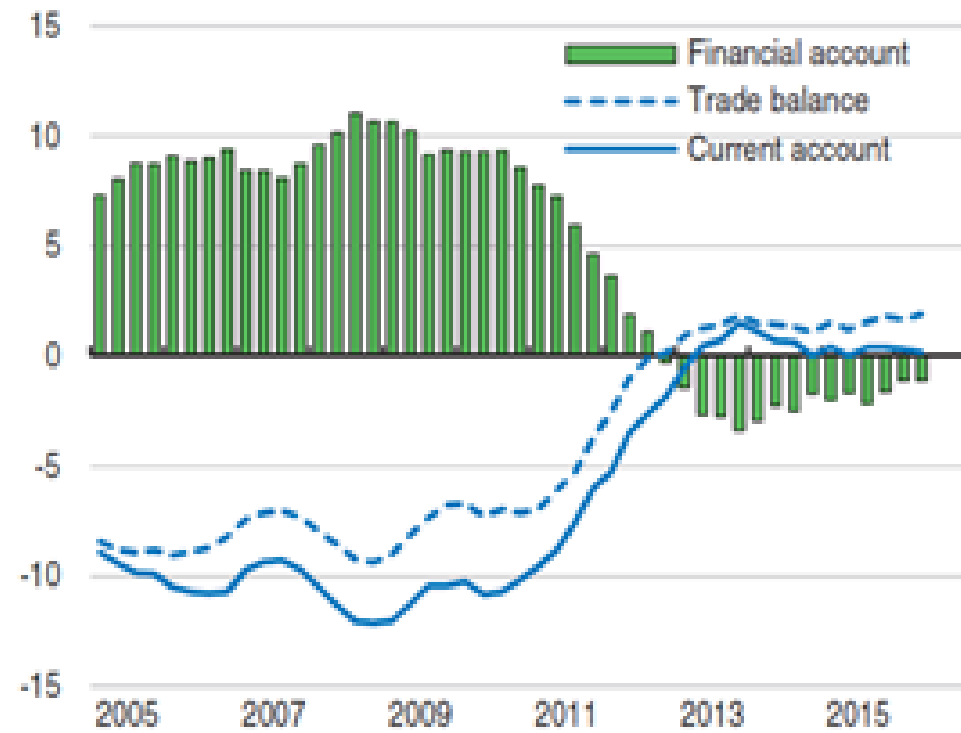
Portugal was an export intensive country.

Exports decreased due to the 2008 crisis.

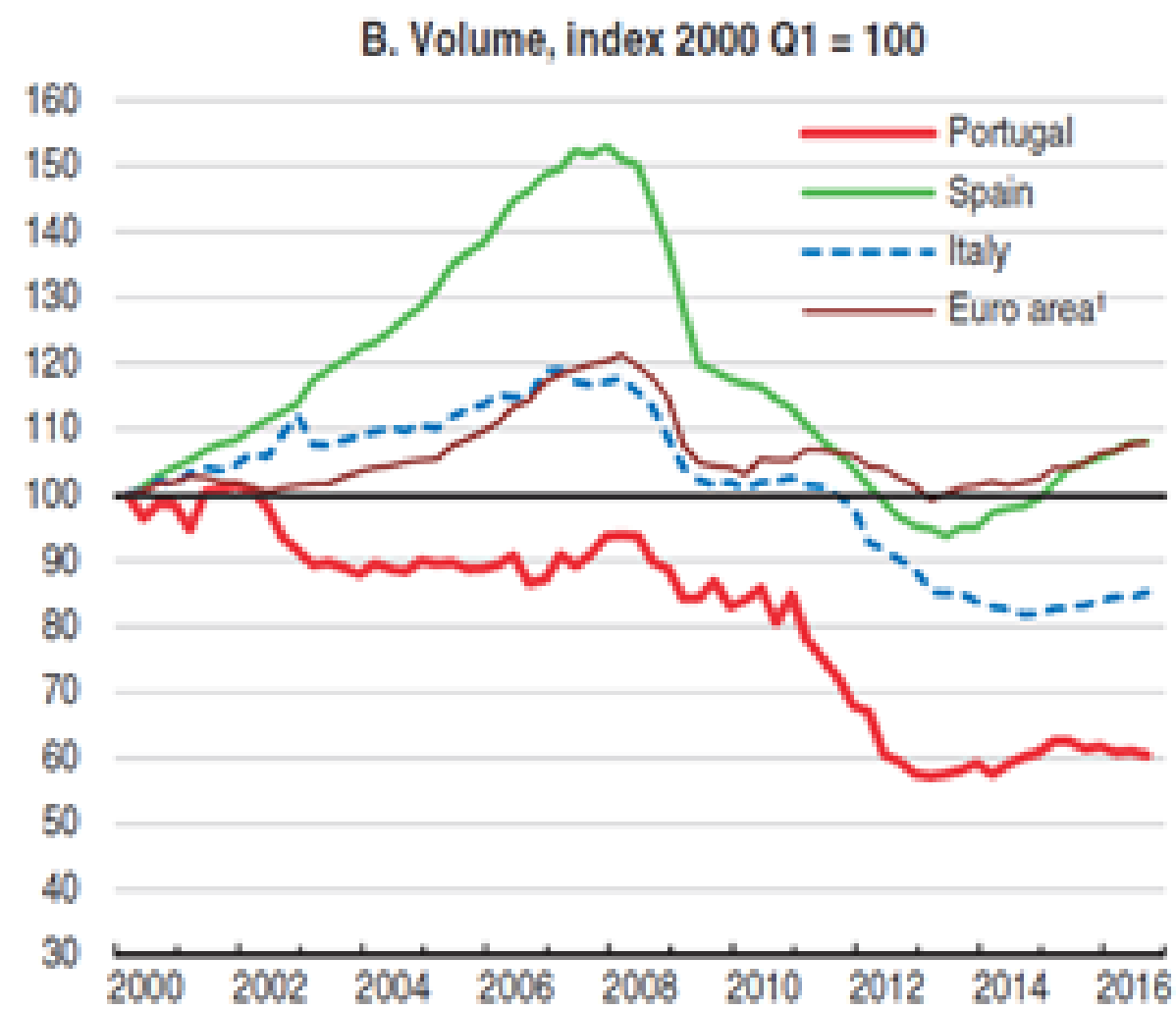
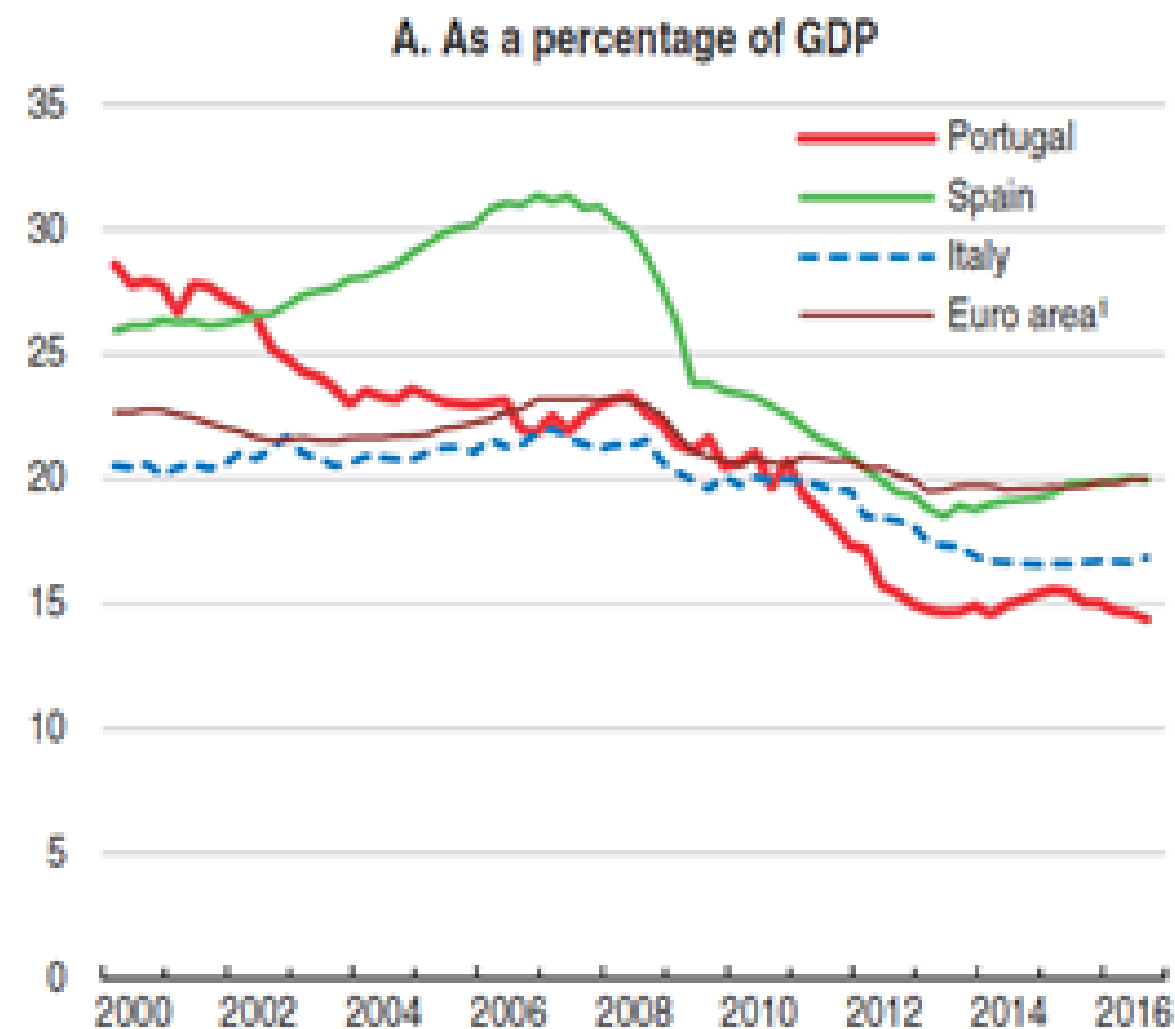
Increased afterwards mainly due to:

- structural reforms
- external assistance program in 2011

A. Balance of payments¹



Stronger exports have allowed a reversal in external imbalances



1. Euro area countries that are also OECD members (including Latvia).

Source: OECD (2016), OECD Economic Outlook: Statistics and Projections (database).

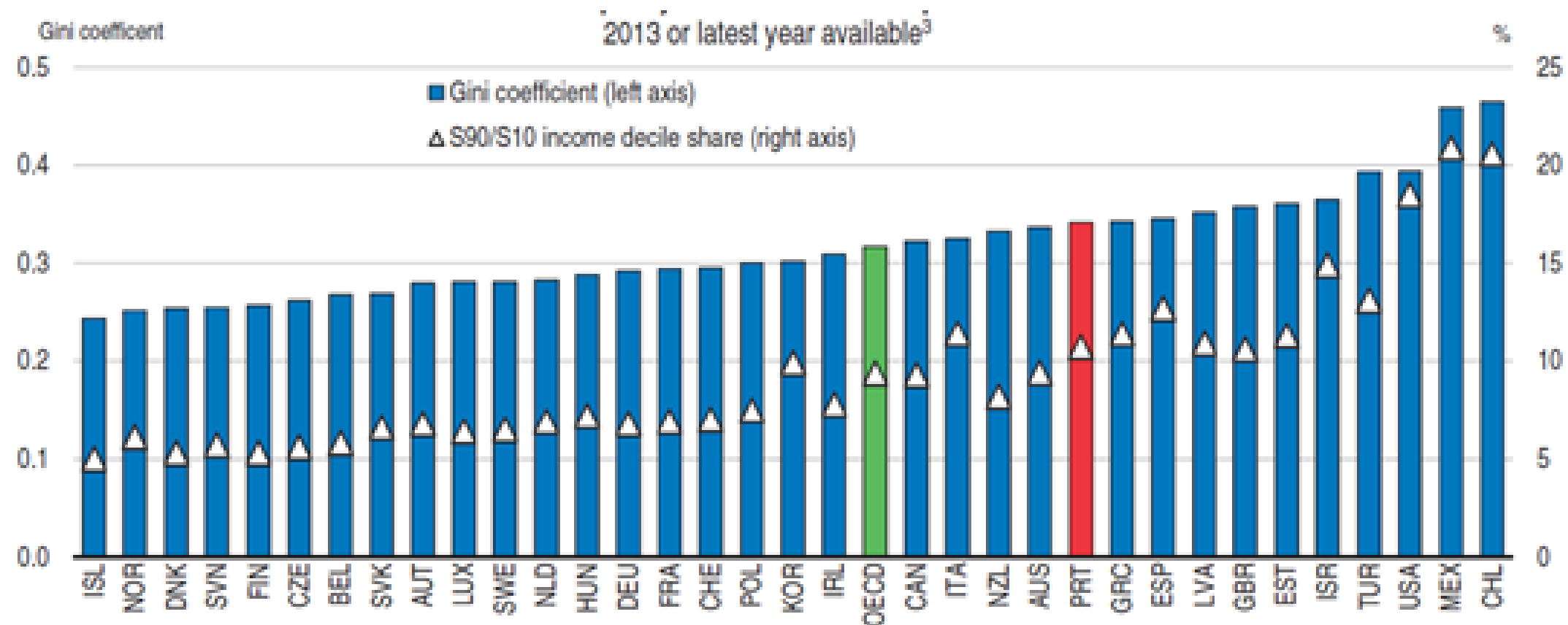
StatLink  <http://dx.doi.org/10.1787/888933447624>

To rebalance the economy, it will be needed more investment, which will be increased by:

- Removing distressed legacy loans from bank balance sheets
- addressing bottlenecks in insolvency procedures
- opening up new sources of financing

Incentives for new capital investments could be strengthened by:

- improvements in judicial efficiency
- administrative reform
- product market regulation reforms or lower labour costs



Portugal also has one of the most unequal income distributions in Europe, and both inequality and poverty have been rising since the crisis.

Reducing inequalities in opportunities will be key to making growth more inclusive in the longer term. This will require rethinking some of the current governance mechanisms that afford advantages and rents to specific groups.

*OUTLOOK IS
BECOMING MORE
CHALLENGING AND
VULNERABILITIES
ARE RISING*



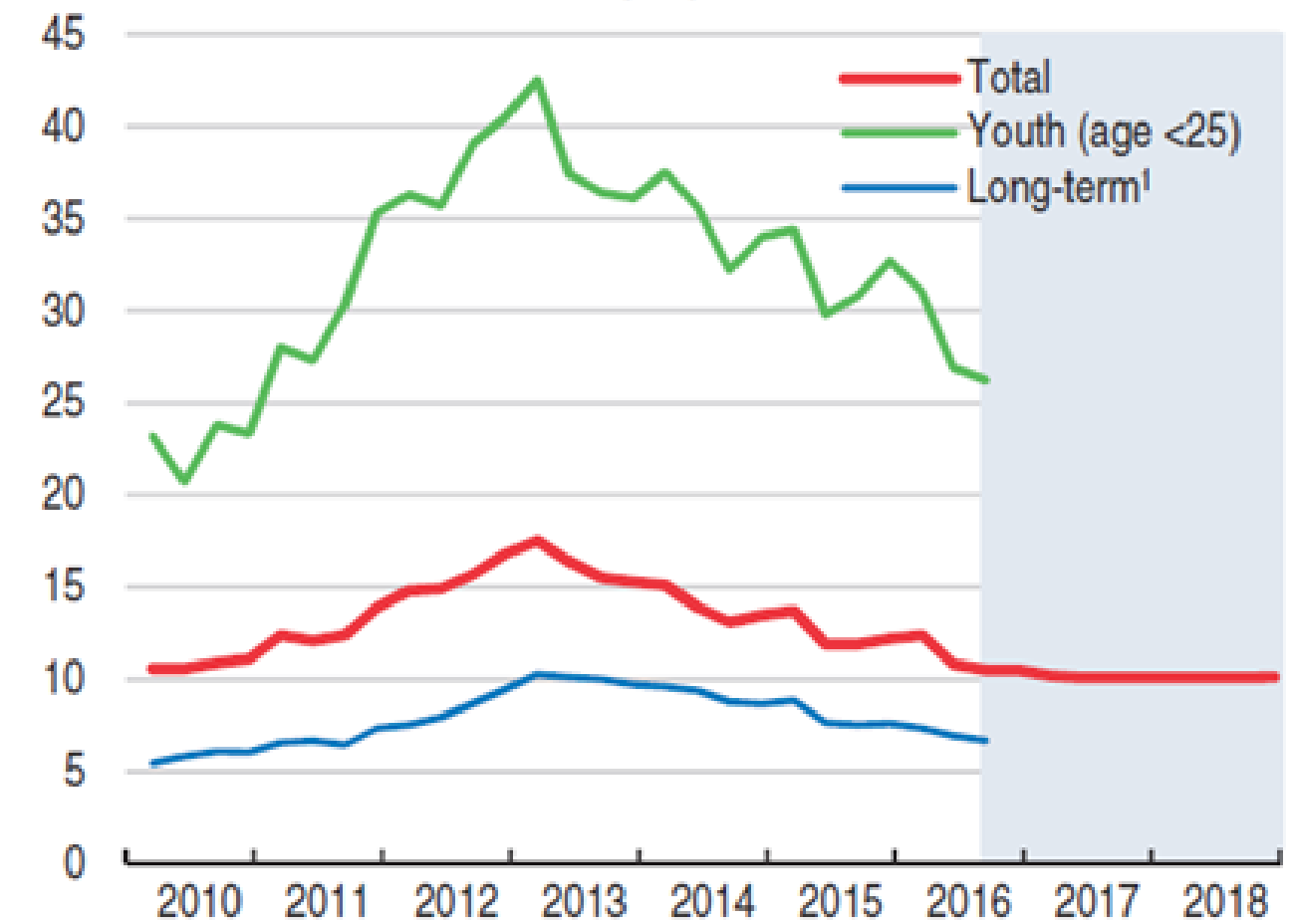
Annual percentage change, volume (2011 prices)

	2013 Current prices (billion EUR)	2014	2015	2016	Projections	
					2017	2018
Gross domestic product (GDP)	170.3	0.9	1.6	1.2	1.2	1.3
Private consumption	111.1	2.3	2.6	2.0	1.2	1.2
Government consumption	32.5	-0.5	0.8	1.1	0.2	0.3
Gross fixed capital formation	25.1	2.3	4.5	-2.0	0.7	1.6
Housing	4.2	-1.1	4.3	-3.1	0.5	1.3
Final domestic demand	168.8	1.8	2.5	1.2	1.0	1.1
Stockbuilding ¹	-0.2	0.4	0.0	0.1	0.1	0.0
Total domestic demand	168.6	2.2	2.5	1.4	1.1	1.1
Exports of goods and services	67.3	4.3	6.1	3.3	3.7	4.0
Imports of goods and services	65.6	7.8	8.2	3.6	3.6	3.6
Net exports ¹	1.7	-1.3	-0.8	-0.1	0.1	0.2

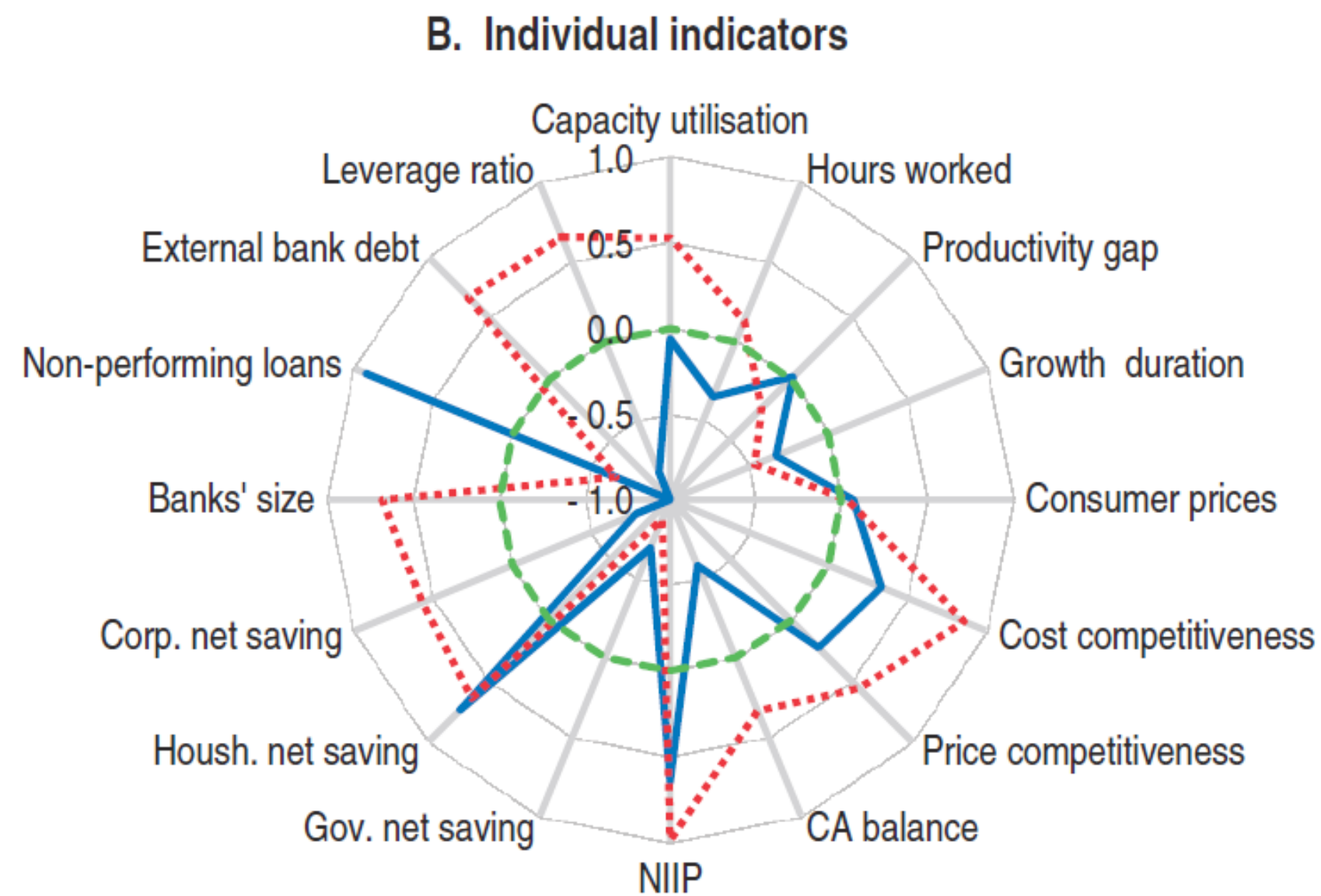
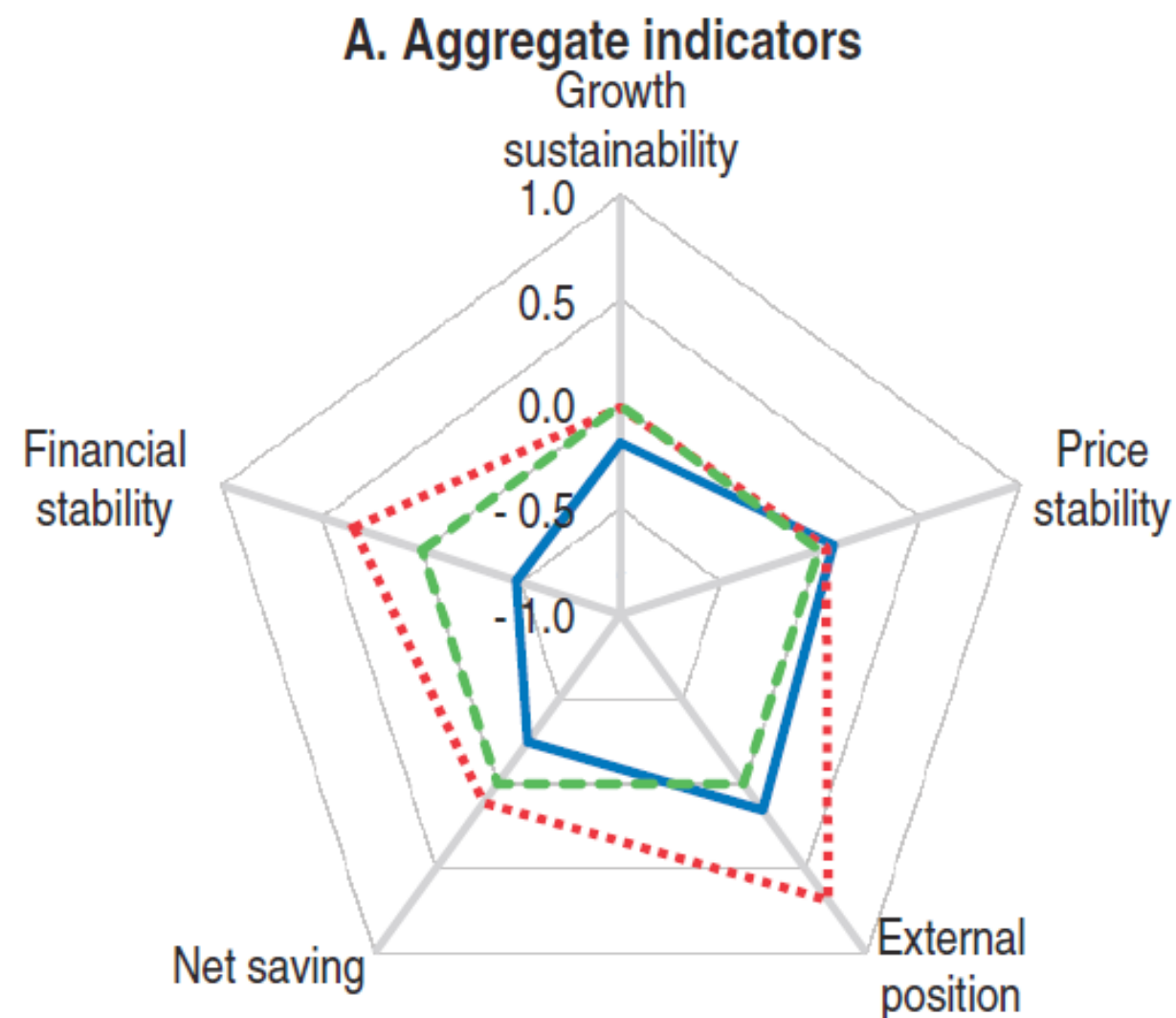
Moderate annual growth of 1.2% is projected for 2017.

- Private consumption, has played a stronger role
- Investment, is expected to remain weak
- Exports, will grow less than in previous years

B. Unemployment rates



Rising unemployment has been the main cause behind the increases in income inequality in the aftermath of the financial crisis.



Problem: The fragility of the banking system in the context of low growth could lead to a deterioration of public finances.

Solution: policy stance towards reducing corporate debt and repairing banks balance sheets.

Problem: economy growth potential has decreased due to low investment growth and a shirking labour force.

Solution:

- stronger investment to rebuild the economy capital stock and support structural rebalancing of the economy towards tradable sectors.
- Raising the skills of labours.
- Both investment and the increase of the skills will increase productivity.

MANAGING LIMITED FISCAL SPACE



11,2% of GDP (2010) →

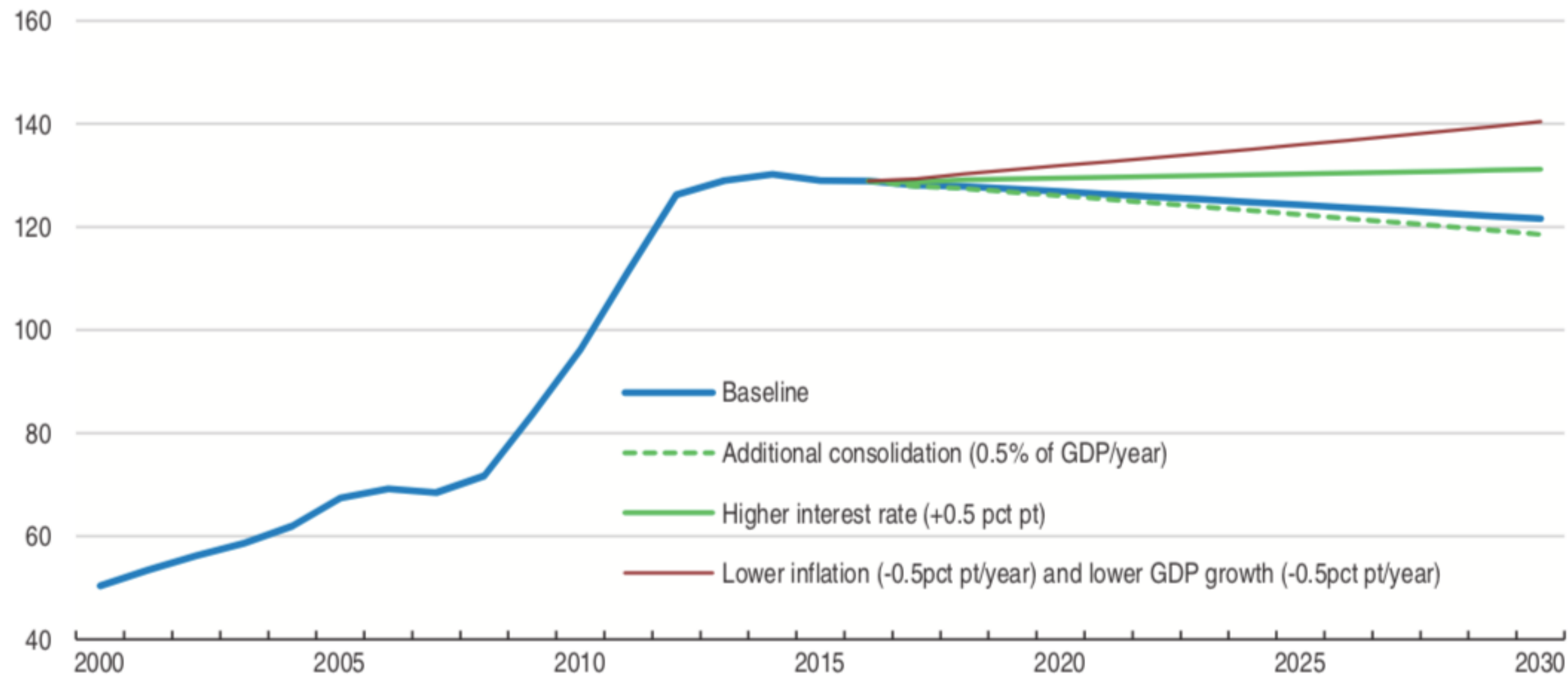
3,0% of GDP (2015)

PORTUGAL'S DEFICIT

From 2016 to 2017 fiscal stance is neutral because of fragile economic recovery – fiscal sustainability remains weak

Public Debt is declining very slowly, according to projections (2015: 129,0% of GDP; 2030: 120,00% of GDP)

Figure 9. **Illustrative public debt paths**
General government debt, Maastricht definition, per cent of GDP¹



STRENGTHENING THE EFFICIENCY OF THE PUBLIC SECTOR:

REVENUE SIDE:

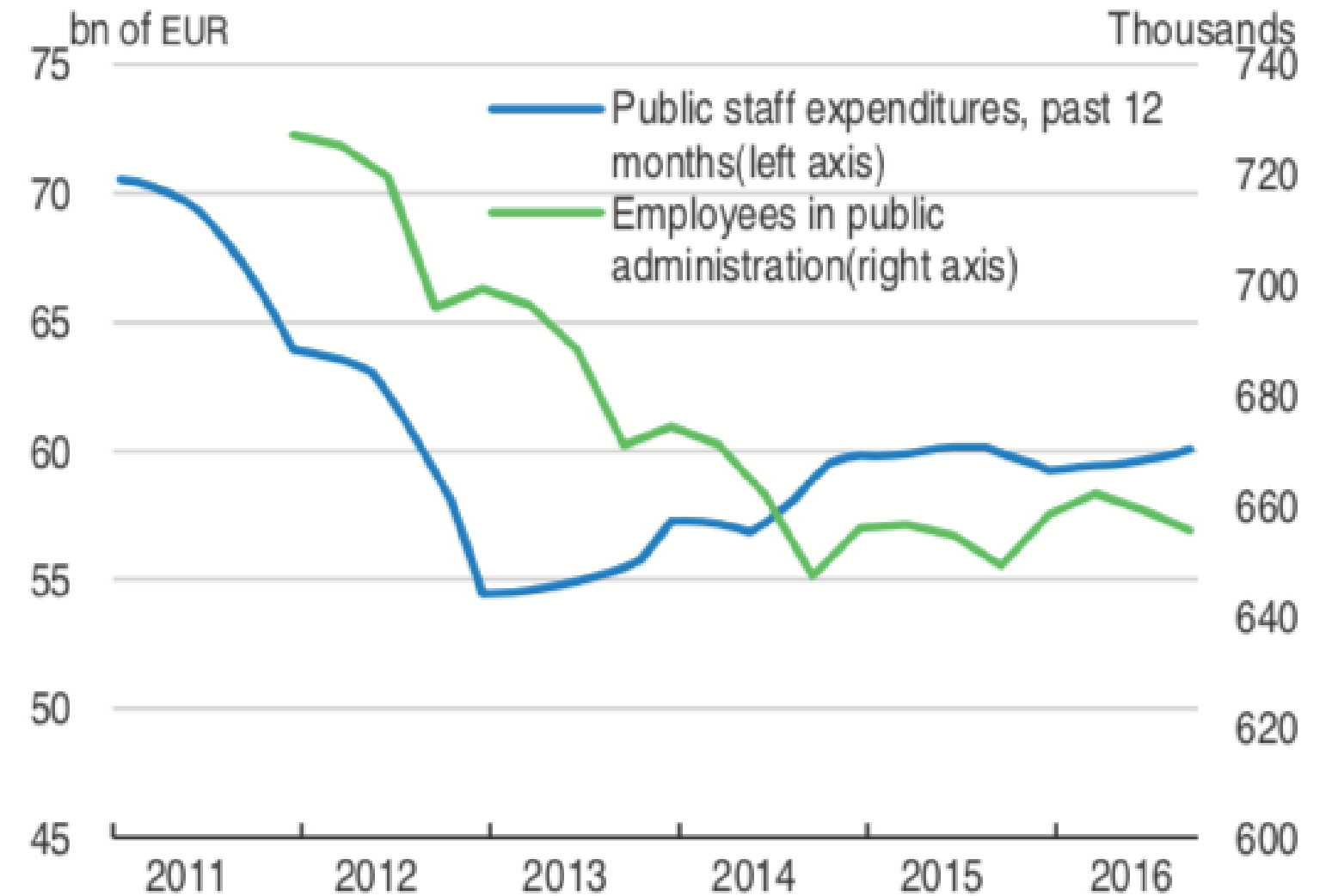
Enhance efficiency of the tax system (consumption taxes, eg: VAT)

EXPENDITURES SIDE:

Public staff expenditures (wage cuts and decrease public employment);

Expenditures reviews on health, education, public procurement and procurement in SOEs;

B. Public employment and staff expenditures



Contingent Liabilities are also a concern for the sustainability of public finances:

Debt of SOEs has risen recently

Public-Private Partnerships (eg: motorways)

Aging Costs will rise but remain manageable

Public pension expenditures will increase (2017: 13.7% of GDP; 2033: 15% of GDP; 2060: 13.1% of GDP)

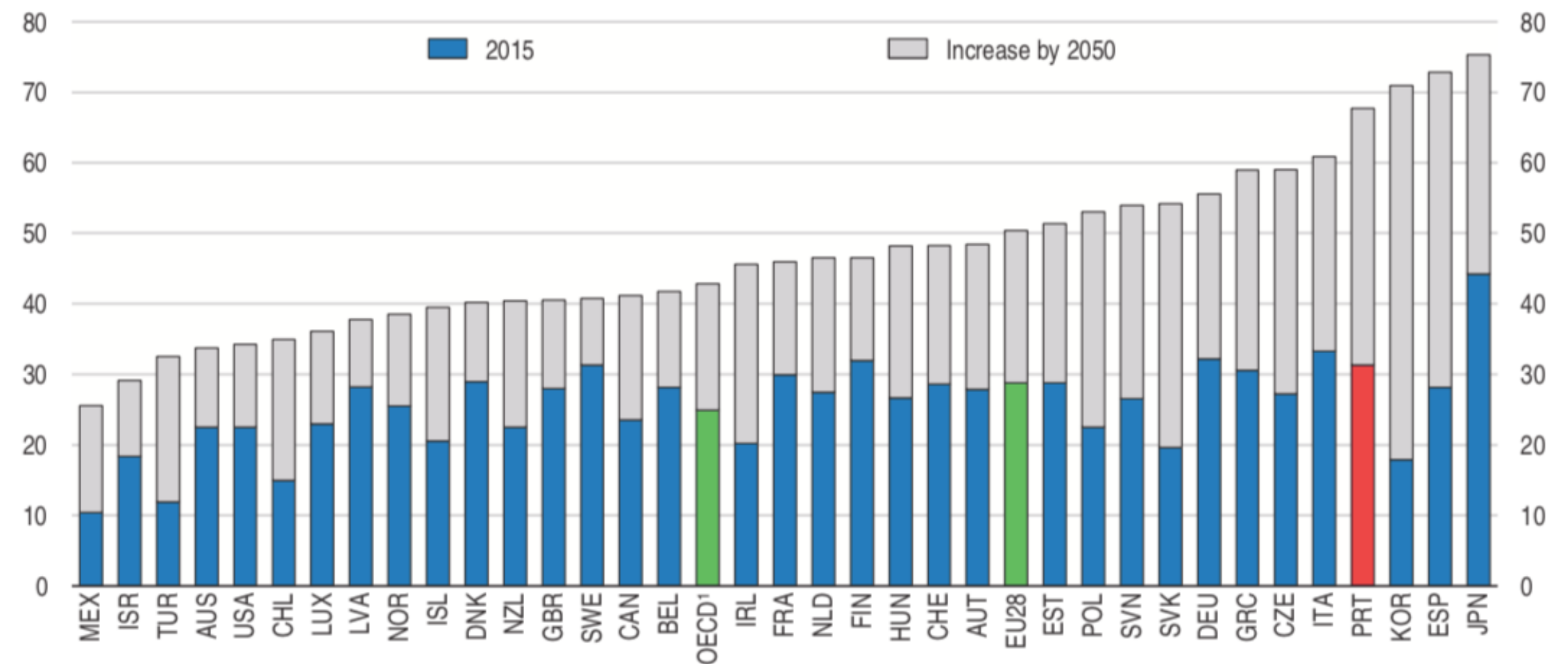
Burden of adjustment has shifted onto future generations

D. Debt of public enterprises



Figure 11. **The dependency ratio will rise**

Population aged 65 years-old and over as a percentage of population aged 15-64



*SAFEGUARDING
FINANCIAL
STABILITY*



SAFEGUARDING FINANCIAL STABILITY

- Bank capitalization has improved and funding from deposits has increased
- Low profitability is major challenge for portuguese banks
- Markets view portuguese banks as more risky then other european banks

SAFEGUARDING FINANCIAL STABILITY

Solving Non-Performing Loans is a key issue for Portugal:

Several instances of state support for banks...

... but at the end of 2015, 11.9% of overall loans were non-performing (IMF data)

Stronger Regulatory incentives are suggested (Rewards & Penalties for banks; Differentiation between old and new NPLs)

- Between 2008 and 2014 there were 11.8 Billion euros injected in the portuguese banking system
- Cases of portuguese banks BPN, BPP, BES and BANIF and how the state interviened between 2008 and 2014 (BOX 2)

STRENGTHENING INVESTMENT FINANCING





Credit to the corporate sector is still contracting, mainly due to the construction sector



Loans to exporting firms are growing

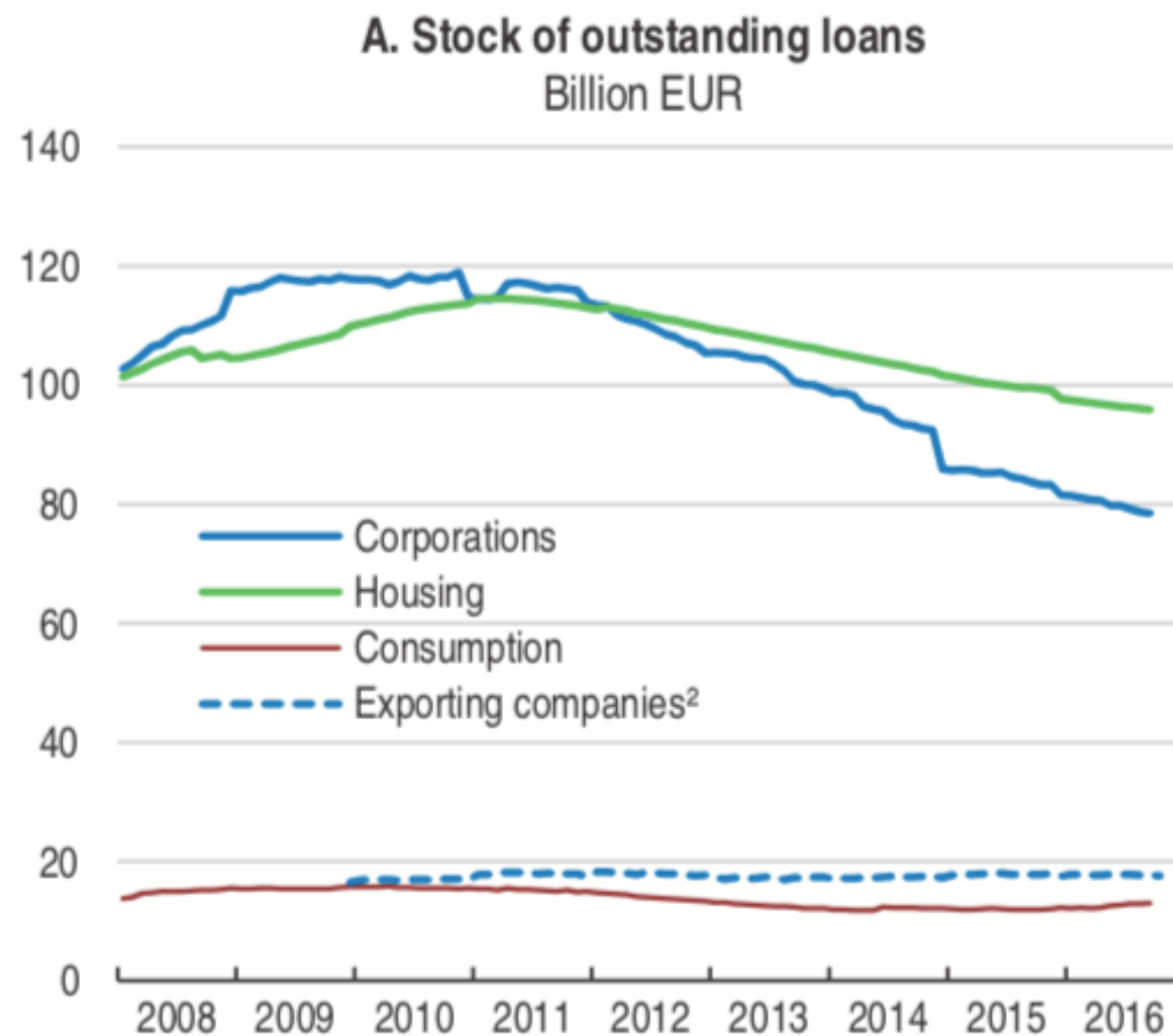


Borrowing costs are still higher than in Spain or Italy



This spread has returned to pre-crisis levels

Figure 14. **Financial indicators**¹



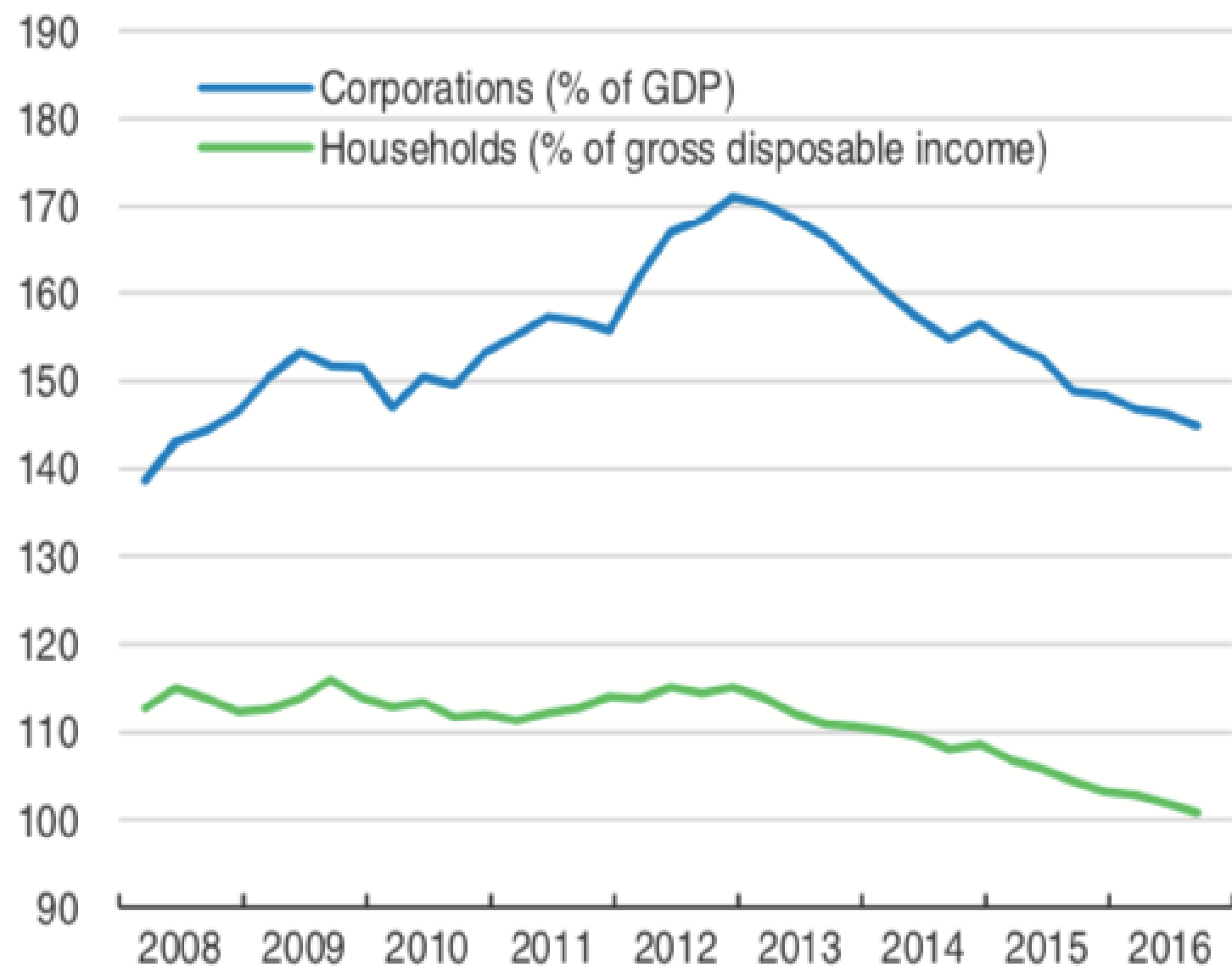
The debt of non-financial companies amounts to 145% of GDP

Placing Portuguese enterprises among the most heavily indebted ones in Europe

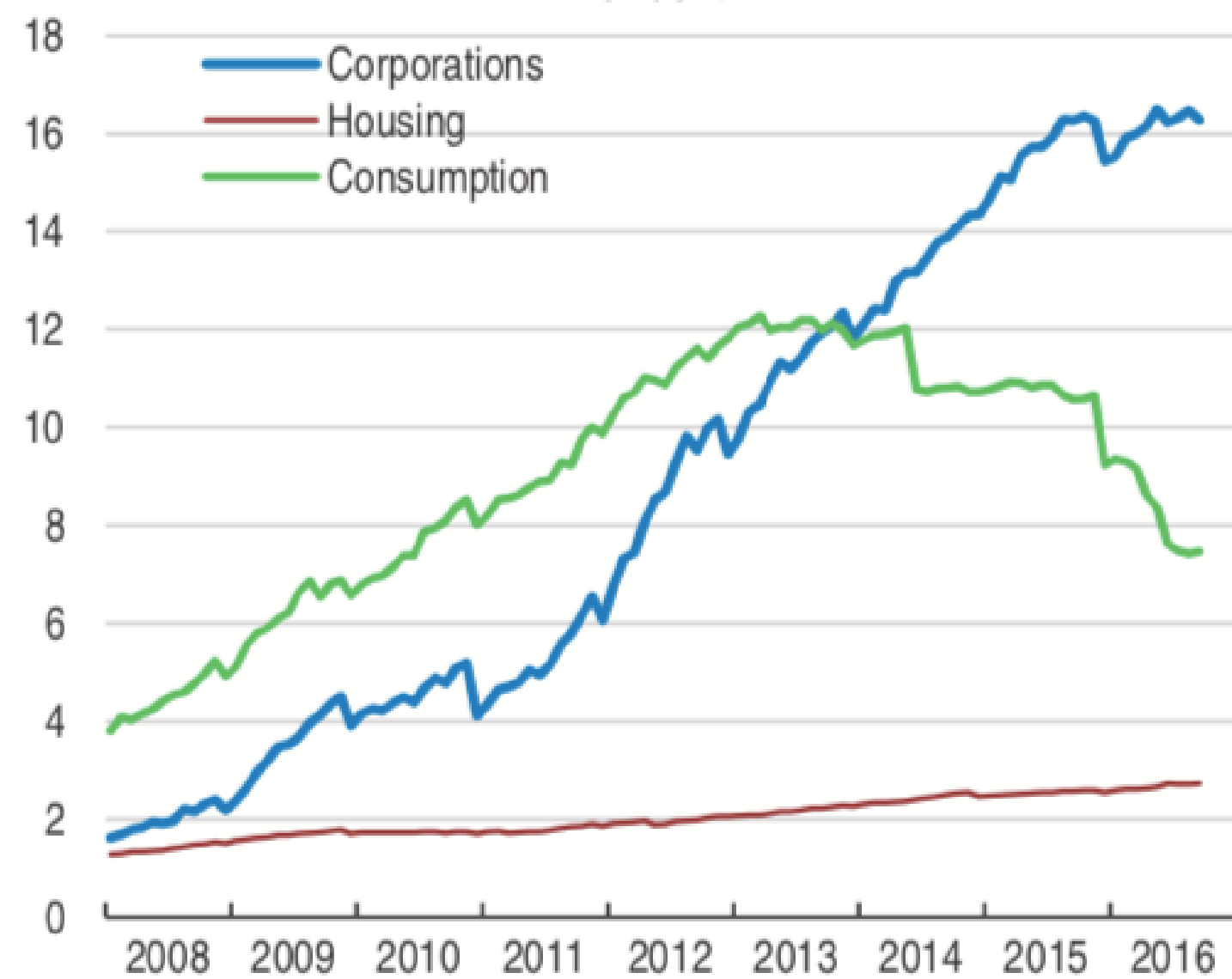
Indebtedness has come down by 14.4% since 2013 as a result of the exit of highly indebted firms rather than deleveraging of existing firms.

Around 16% of corporate loans are overdue

C. Private sector debt⁴



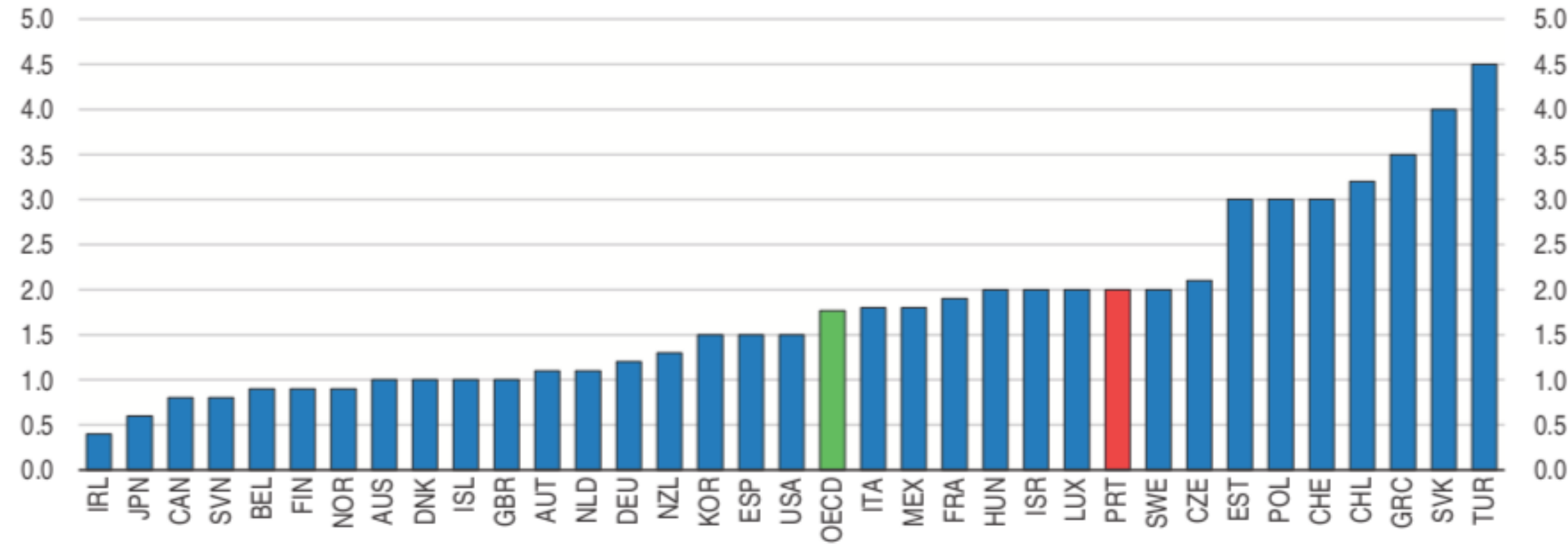
D. Share of non-performing loans
Per cent



INSOLVENCY

Figure 15. **Insolvency framework**

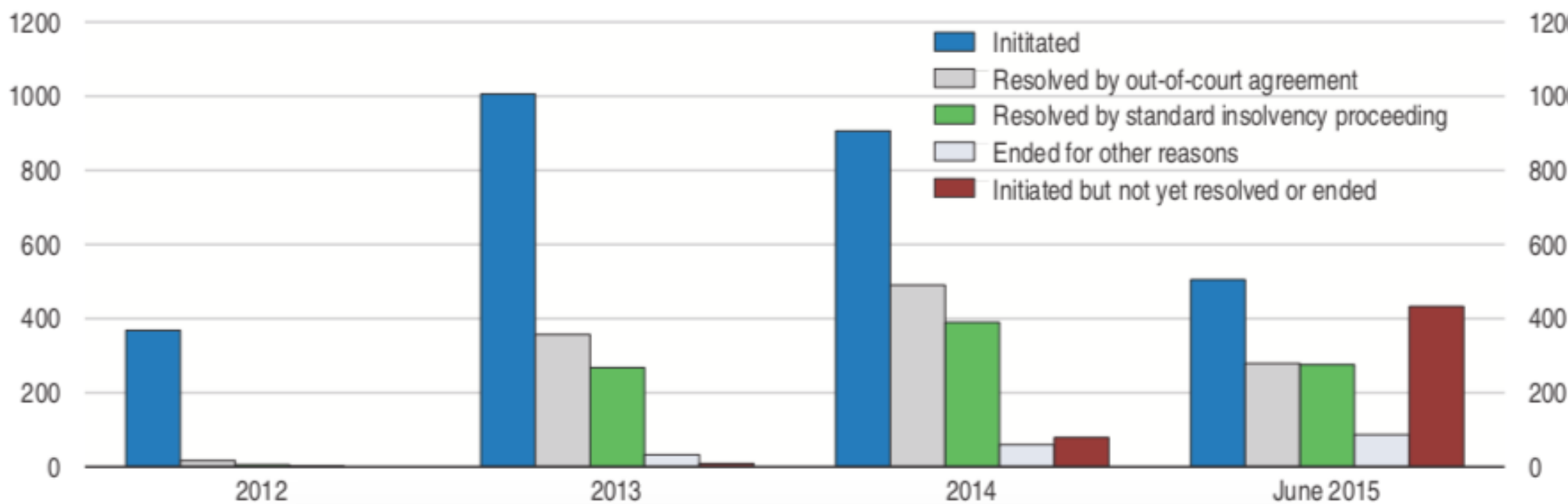
A. Years required to resolve an insolvency case¹
2015



Insolvency procedures have improved since 2012, however they still take an average of 2 years to process.

Ireland, Japan, Belgium or the United Kingdom, good practise insolvency cases are processed in less than a year.

B. Number of out-of-court settlements



Speedy insolvency procedures translate into better recovery values of distressed loans higher prices for NPL-backed securities, so accelerating insolvency procedures would have significant benefits for Portugal.

*IMPROVING THE
BUSINESS
CLIMATE TO
BOOST
INVESTMENT*



JUDICIAL SYSTEM

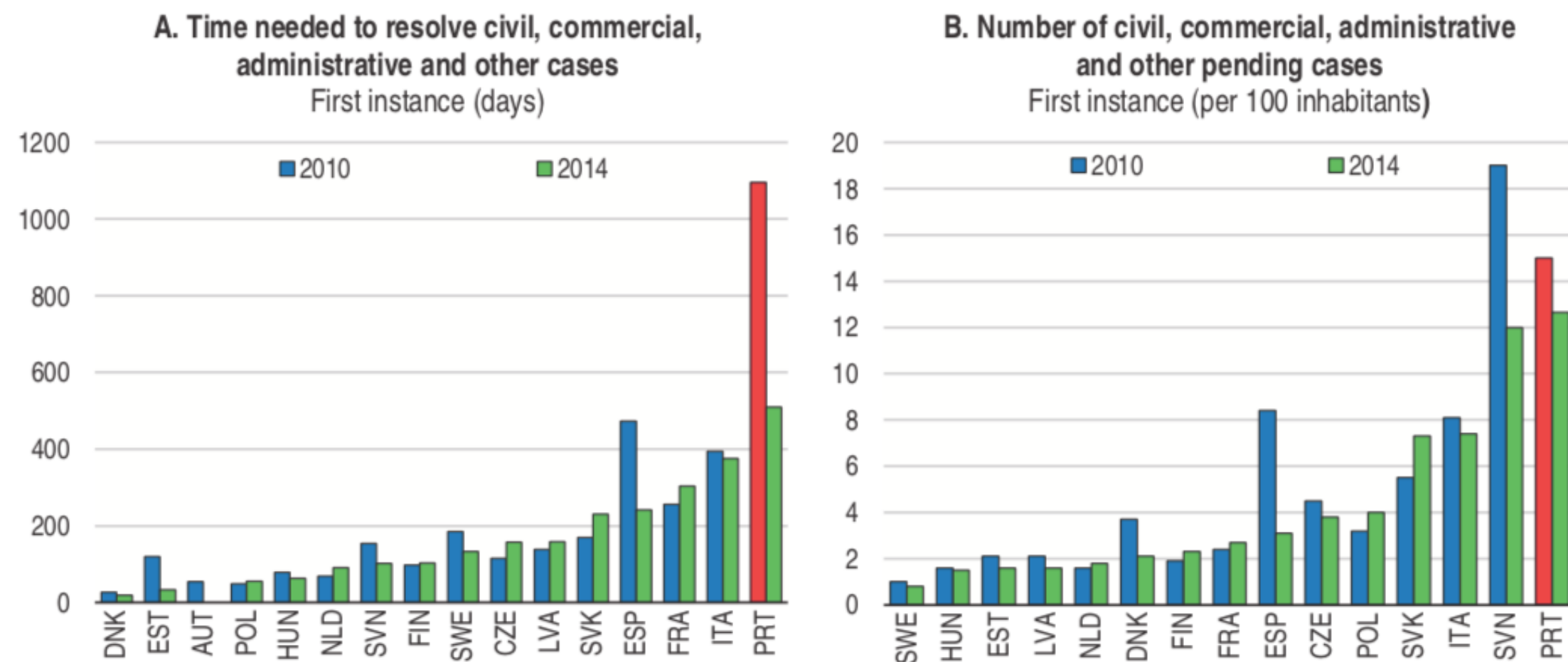
Despite remarkable progress made, civil cases still take more than 500 days to be resolved, which is long by international comparison.

A new civil procedure code has been able to give independence to judges, reducing the number of appeals and allowing for mediation and out-of-court settlements at different stages of a civil process.

International evidence suggests that the use of specialised courts can reduce trial lengths but Portugal has specialised courts without specialised judges.

Recent efforts are being done for training judges.

Figure 16. **Performance of the judicial system**¹



REGULATION AND RED TAPE

Portugal has made strong progress in reducing administrative burdens for businesses.

Simplex+2016 includes an expansion of one-stop-shops, electronic applications and a wider application of silence-is-consent rules

At the local level, single windows and speedy service is offered in almost all areas

Less “red tape” reduces costs and raises the returns on investment

Despite these promising initiatives and plans, the implementation of administrative reforms seems to lag and behind ambitions and need to gain track

PRODUCT MARKET REGULATION IN SERVICES AND UTILITY SECTORS

Services and utility sectors provide essential inputs for Portuguese companies, accounting for 16% of their direct costs. Since services inputs often have to be sourced domestically, their prices influence the competitiveness of Portuguese companies

In the past, services sectors have traditionally been characterised by low levels of competition and significant rents resulting from regulatory policies that stood in the way of competition.

An ambitious reform agenda has led to improvements, but there is scope for further strengthening competition in many areas

ENERGY SECTOR

A series of reforms has improved regulation and eliminated the scope for remuneration above market prices, but only for new entrants. However, these new rules are not necessarily those that govern the bulk of current sales volumes.

Despite new entry, the incumbent electricity producer continues to serve 85% of electricity customers and the incumbent gas company serves 50% of gas clients.

Electricity prices for medium-sized companies are among the highest in Europe.

Rising prices are also the legacy of poor policy settings in the past, such as a massive tariff debt of over EUR 4 billion that is now being winded down through pricing above average costs.

That only started to decline in 2016.

LABOUR COSTS



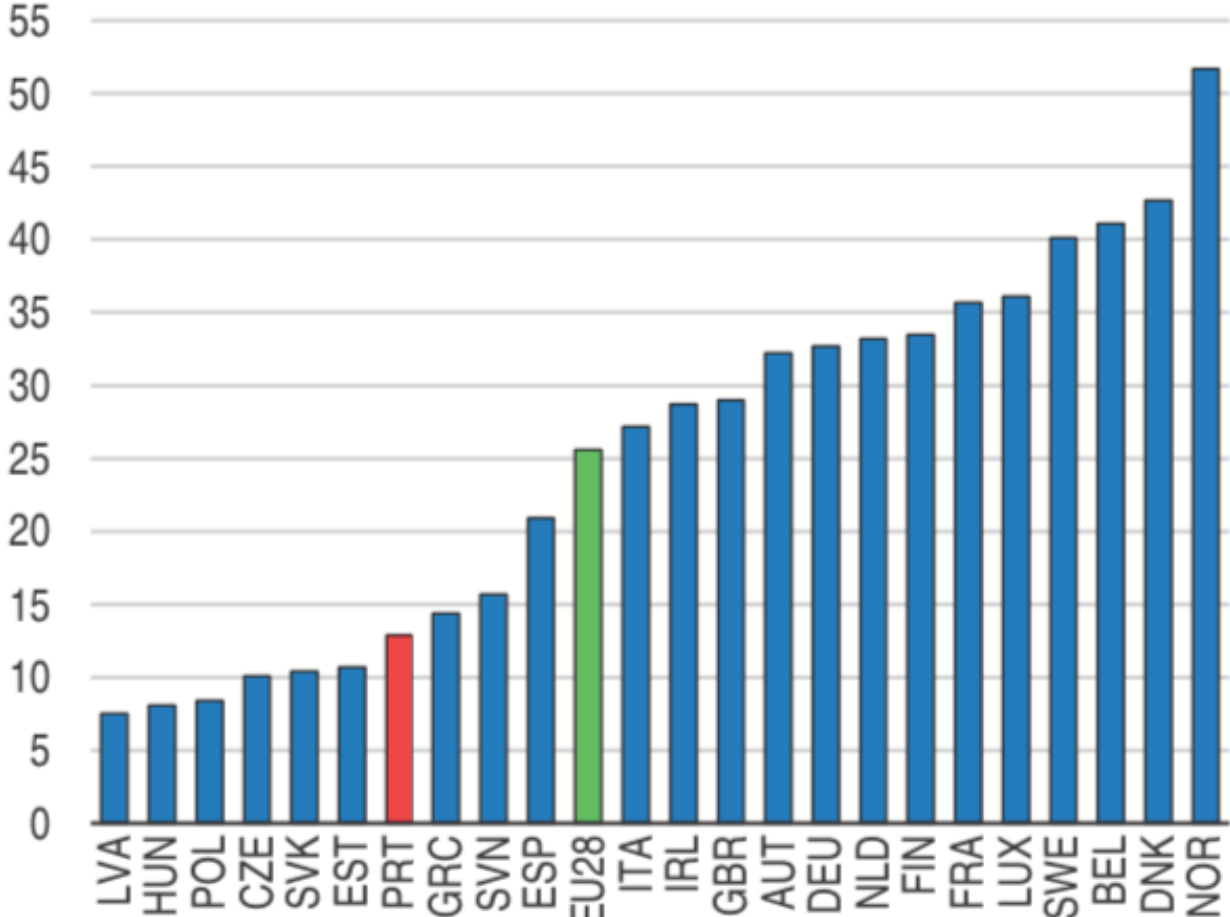
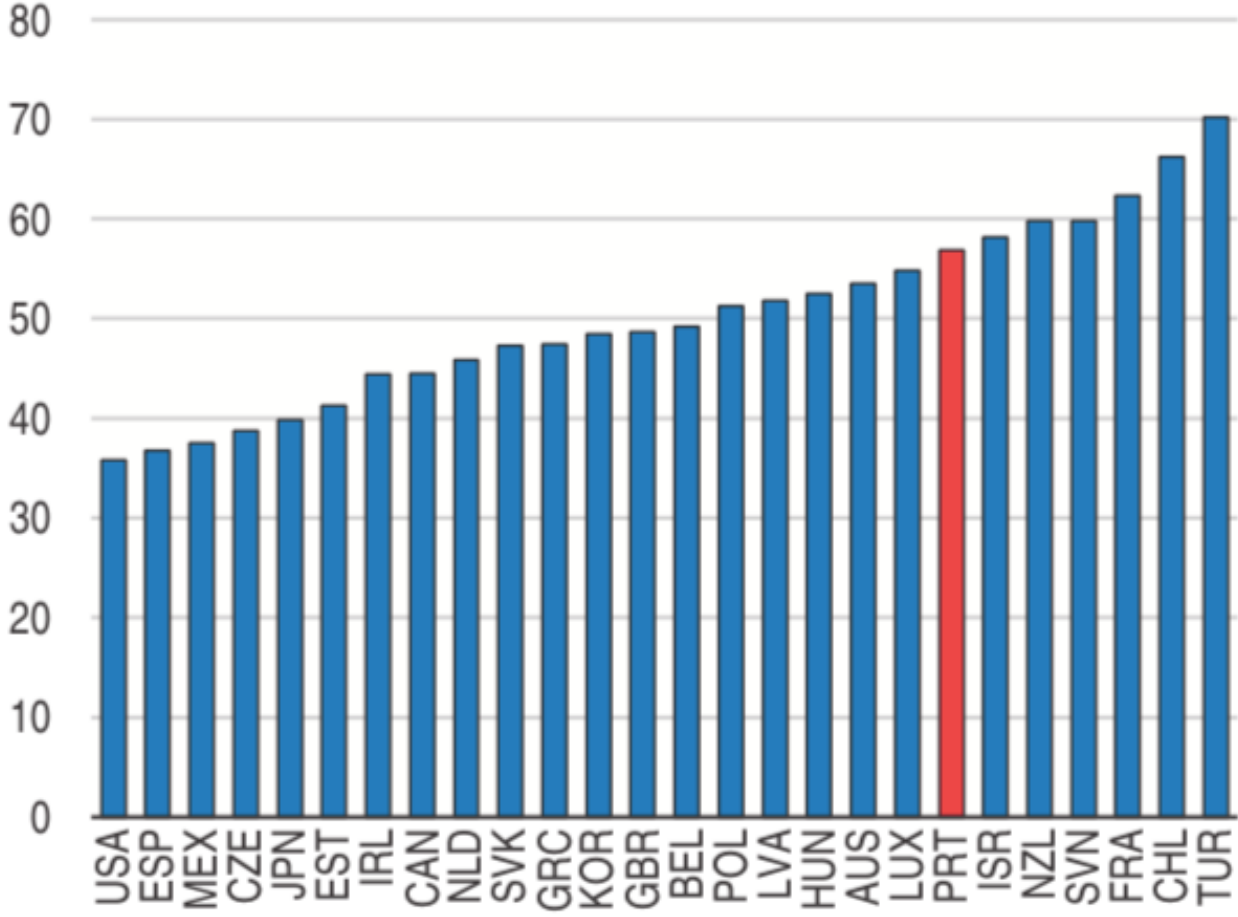
19% of the costs of Portuguese companies

Strong wage increases without similar improvements in productivity risk undoing previous improvements in competitiveness and conflict with the objective of strengthening exports, even though they may reduce wage inequality.

Figure 19. **Minimum wages and labour costs in international comparison**
Total business sector

A. Minimum wages relative to median wage
Per cent, 2015

B. Hourly labour costs
In EUR, 2015¹



In fact, Portugal's declining export market share during 1996 to 2011 was largely attributable to price factors. Labour costs are now lower than in most of Western Europe, but higher than in most Eastern European countries, some of which compare favourably to Portugal in terms of proximity to major European markets.

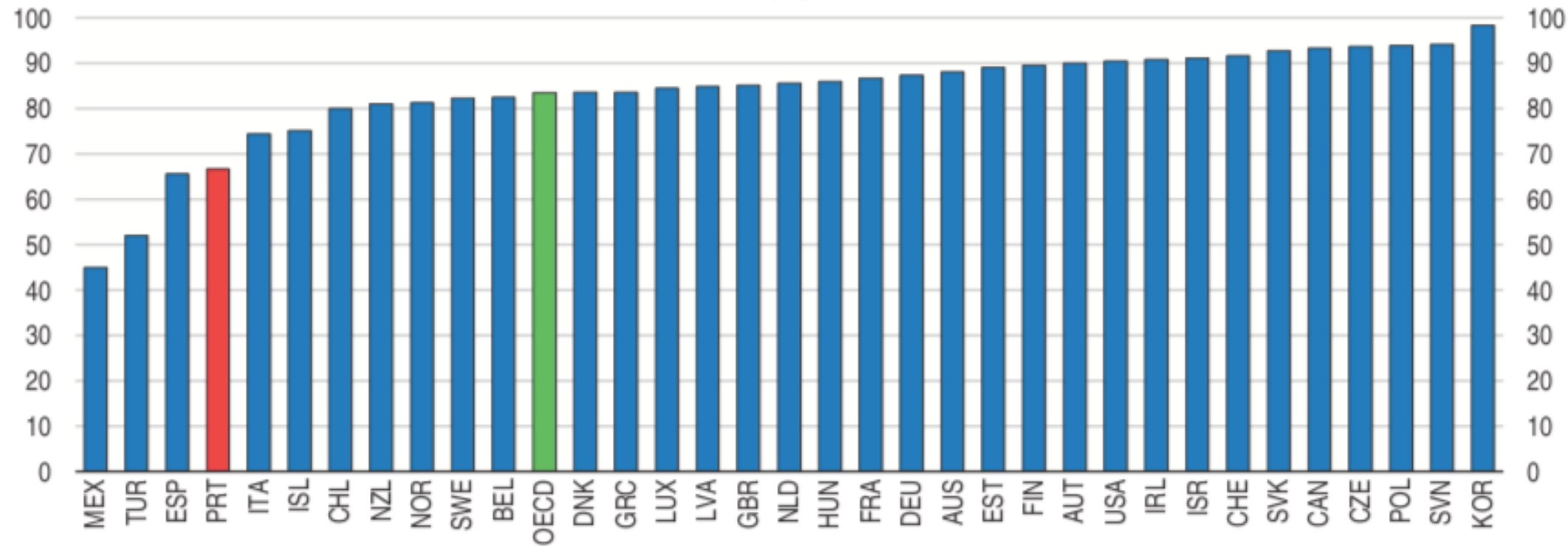
RAISING SKILLS



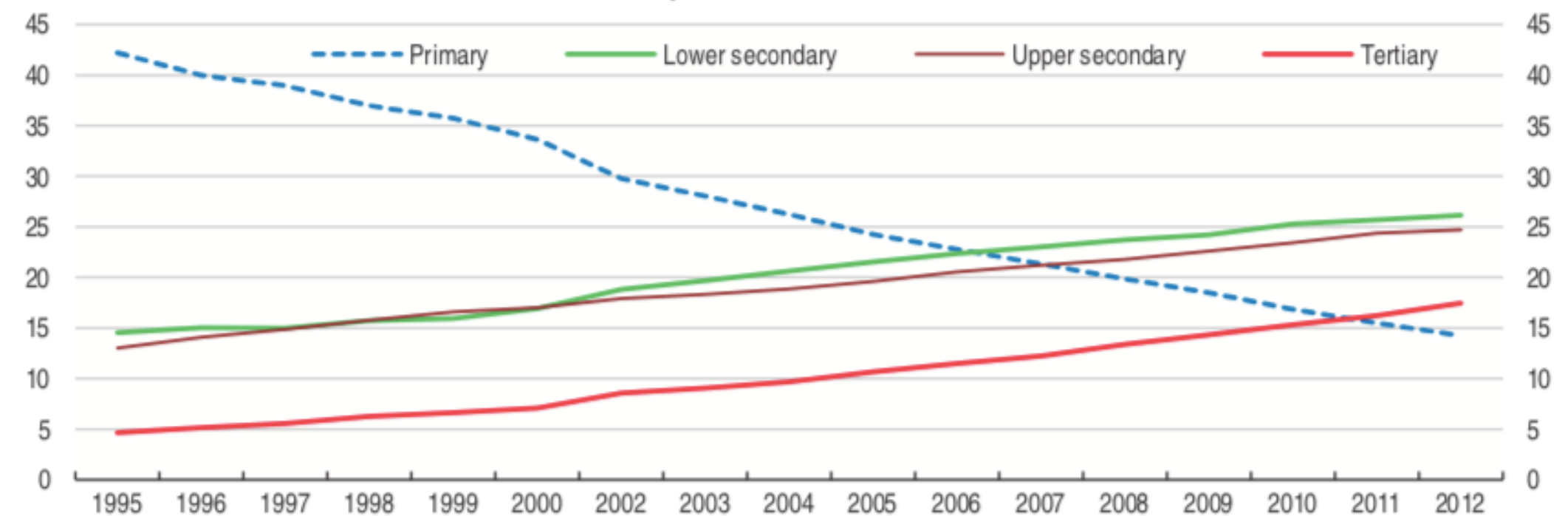
Figure 20. **Raising skill levels remains a priority**

Per cent

A. 25-34 year-olds having completed at least upper secondary education 2015¹



B. Workers by level of educational attainment



UPPER SECONDARY EDUCATION = HIGH SCHOOL LEVEL



43% & 67%

of working population

of young adults (25-34)

4TH LOWEST RATE OF OECD

PRIMARY = TILL 4TH GRADE

LOWER SECONDARY = TILL 9TH GRADE

UPPER SECONDARY = HIGH SCHOOL

TERTIARY = UNIVERSITY

33%

of young adults have a tertiary education (42% on OECD)

Raising Skills:

1. Reducing grade repetition and drop-out rate
2. Raising quality and equity in education
3. Developing vocational education and training (VET)
4. Improve labour market signals and incentives to invest in skills

A teal-colored brushstroke graphic with a textured, hand-painted appearance, slanted upwards from left to right. The text is centered within this graphic.

1. Reducing Grade Repetition and Drop-out Rate

63% (1991)

Early school leaving rate among youths 18-24



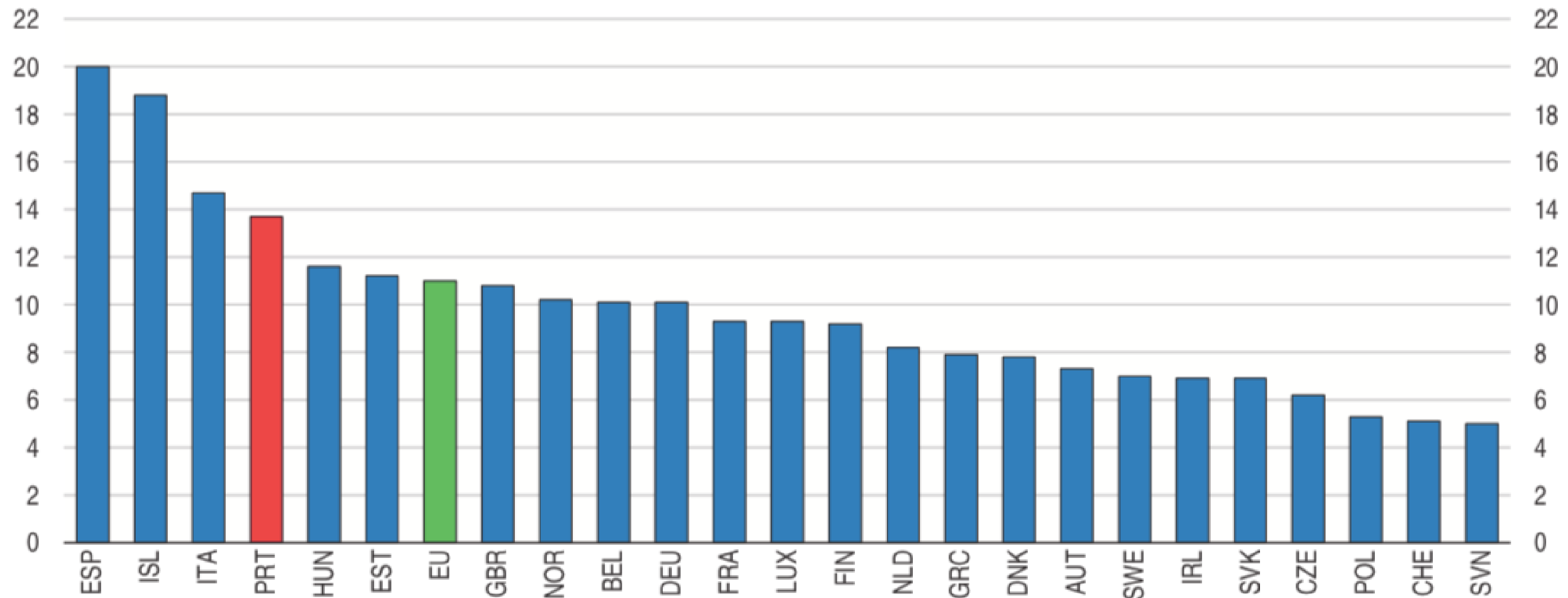
14% (2015)

Early school leaving rate among youths 18-24

BUT IT IS STILL HIGH IN COMPARISON TO OTHER EUROPEAN COUNTRIES.

Figure 22. **Student early school leaving rate is high**

Percentage of the population aged 18 to 24 having attained at most lower secondary education and not being involved in further education or training¹



AVERAGE 15 YEAR OLD:

34% (PT)



12% (OECD)

have already repeated a year by the age of 15

have already repeated a year by the age of 15

GRADE REPETITION IS A STRONG PREDICTOR FOR EARLY SCHOOL DROPOUT.

Leaving school before completing secondary education implies that students do not achieve their potential, exacerbates inequalities and narrows the skill base of the labour force.

AVERAGE 15 YEAR OLD WITH SOCIAL-ECONOMICALLY DISADVANTAGES:


50% (PT)



20% (OECD)

of socio-economically disadvantages 15 year olds reported having repeater a grade at least once

of socio-economically disadvantages 15 year olds reported having repeater a grade at least once

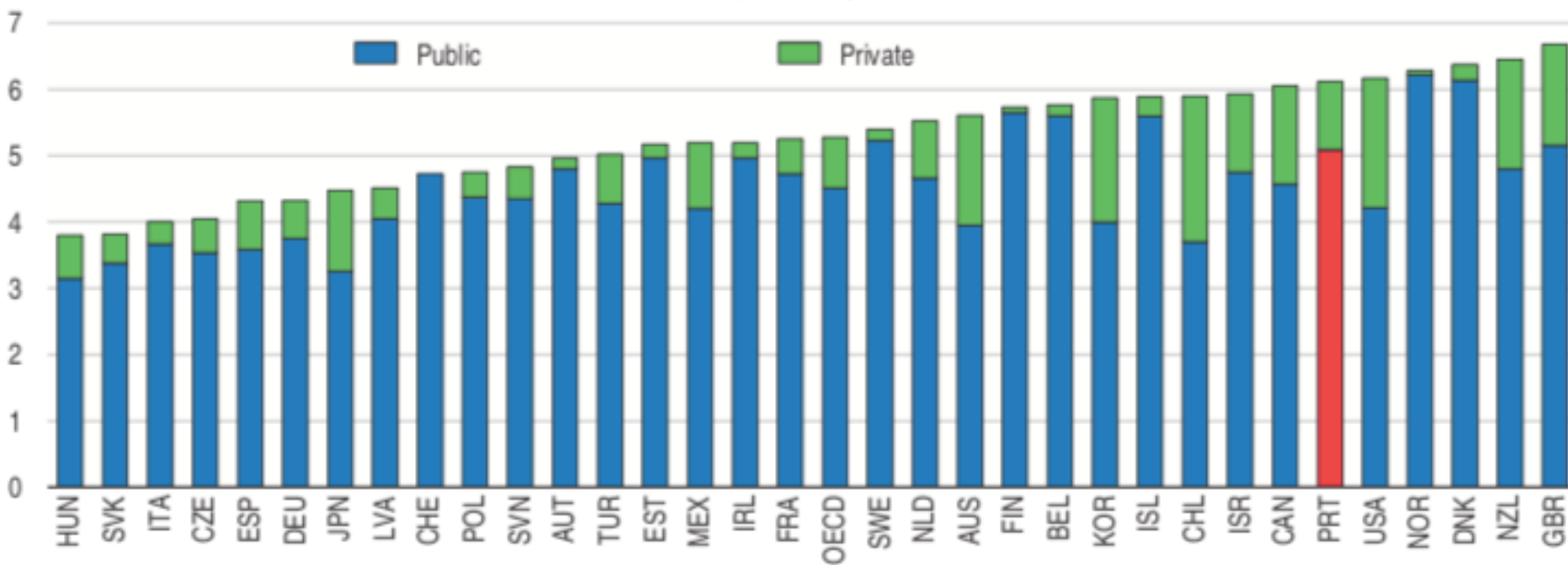
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2. Raising Quality & Equity in Education

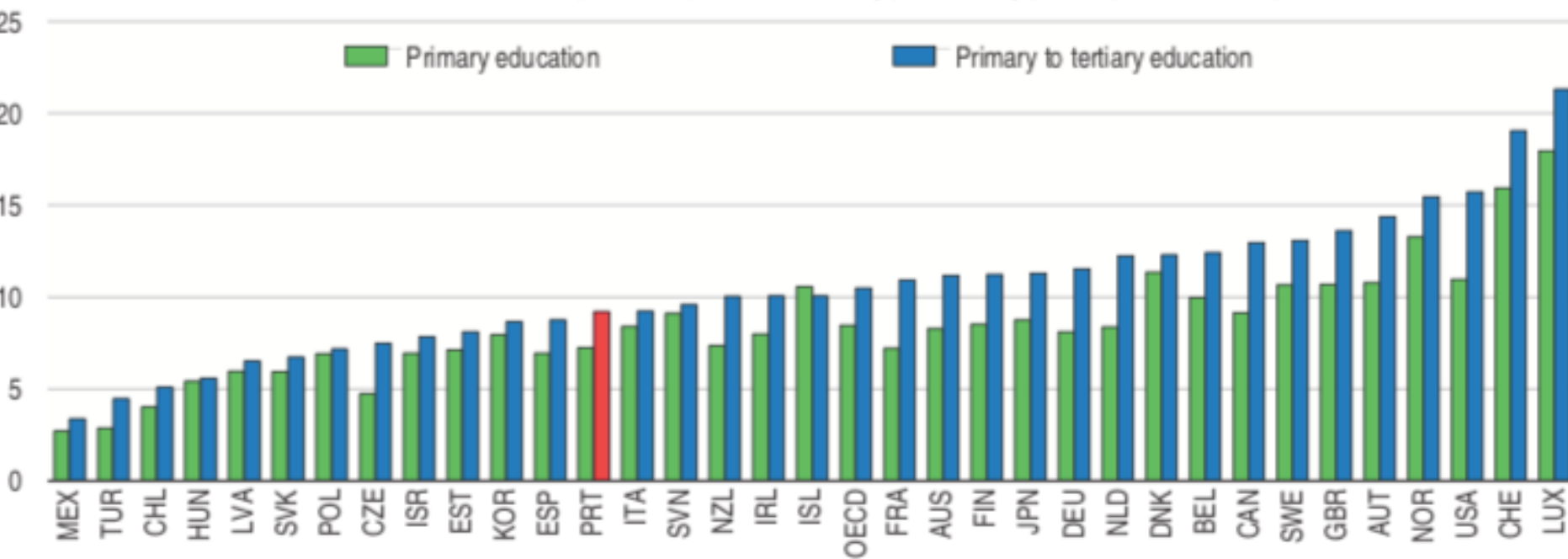
EDUCATION EXPENDITURE IN PORTUGAL > OECD AVERAGE

Figure 23. Allocation of resources in education 2013¹

A. Expenditure on primary to tertiary educational institutions²
As a percentage of GDP



B. Annual expenditure per student³
In thousand USD equivalent (calculated using purchasing power parities [PPP])



However

ANNUAL EXPENDITURE PER STUDENT IS AMONG THE LOWEST



INCREASE SPENDING IN PRIMARY AND PRE-PRIMARY EDUCATION

WHY?

rate of return on investment in human capital is greatest in the early years of schooling

A teal-colored brushstroke graphic with irregular, hand-painted edges, slanted upwards from left to right. The text is centered within this stroke.

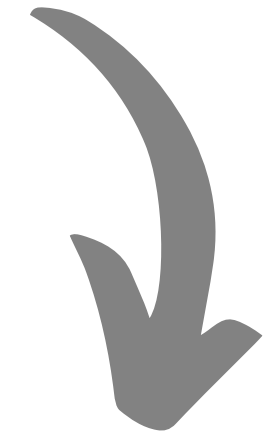
3. Developing Vocational Education & Training (VET)

46% (2014)

of students in upper-secondary education were enrolled in VET courses

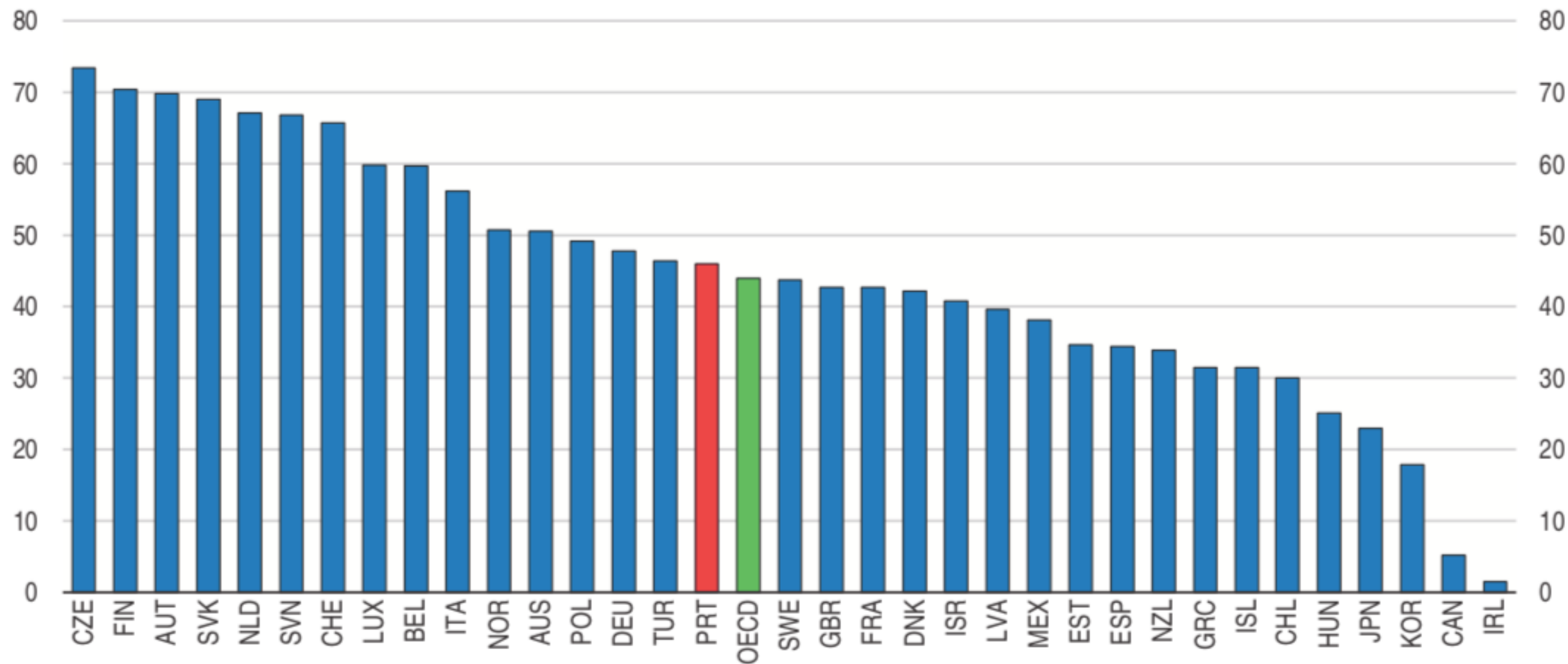


Vocationally-oriented upper secondary training often leads to better employment prospects than academically-oriented training for students who do not pursue further studies



Effort to increase the attractiveness of the VET system and strengthen its links to labour market

Figure 24. **Upper-secondary vocational education and training enrolment rates**
Percentage of students, 2014¹



**4. Improve Labour Market
Signals & Incentives to Invest in
Skills**

Labour Market

prospects are disappointing

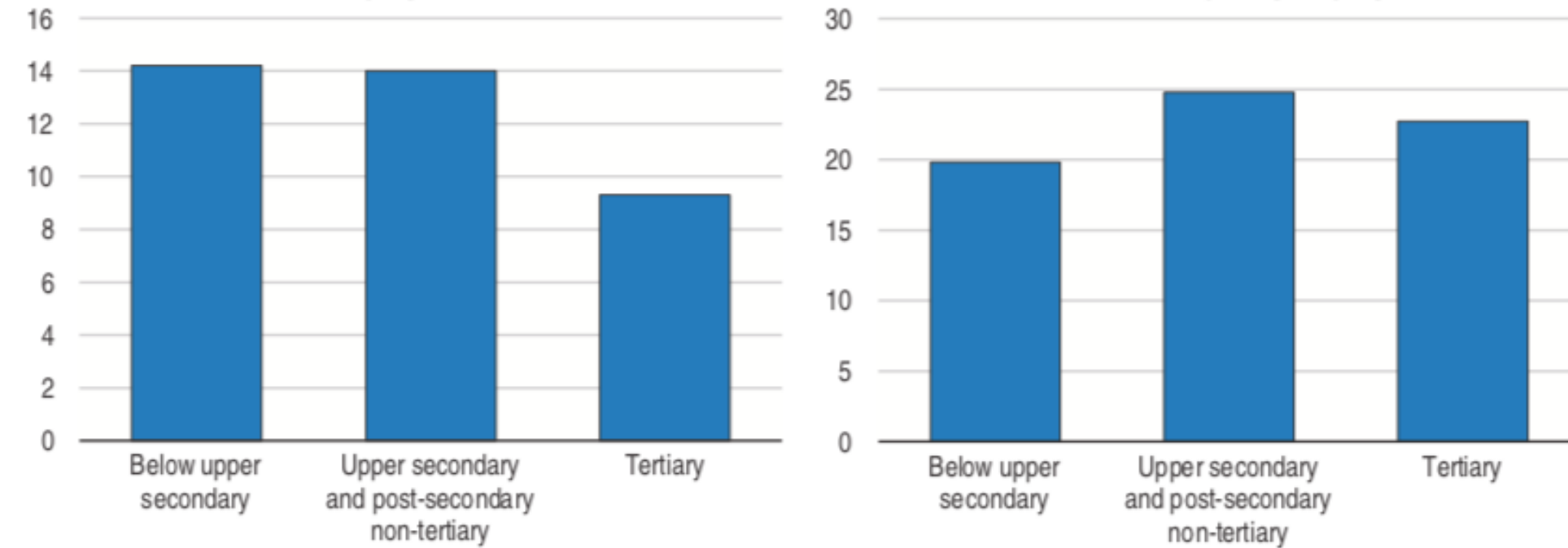
Figure 25. **The labour market remains segmented**

Per cent, 2015

A. By level of educational attainment (age 15-64)

Unemployment rates

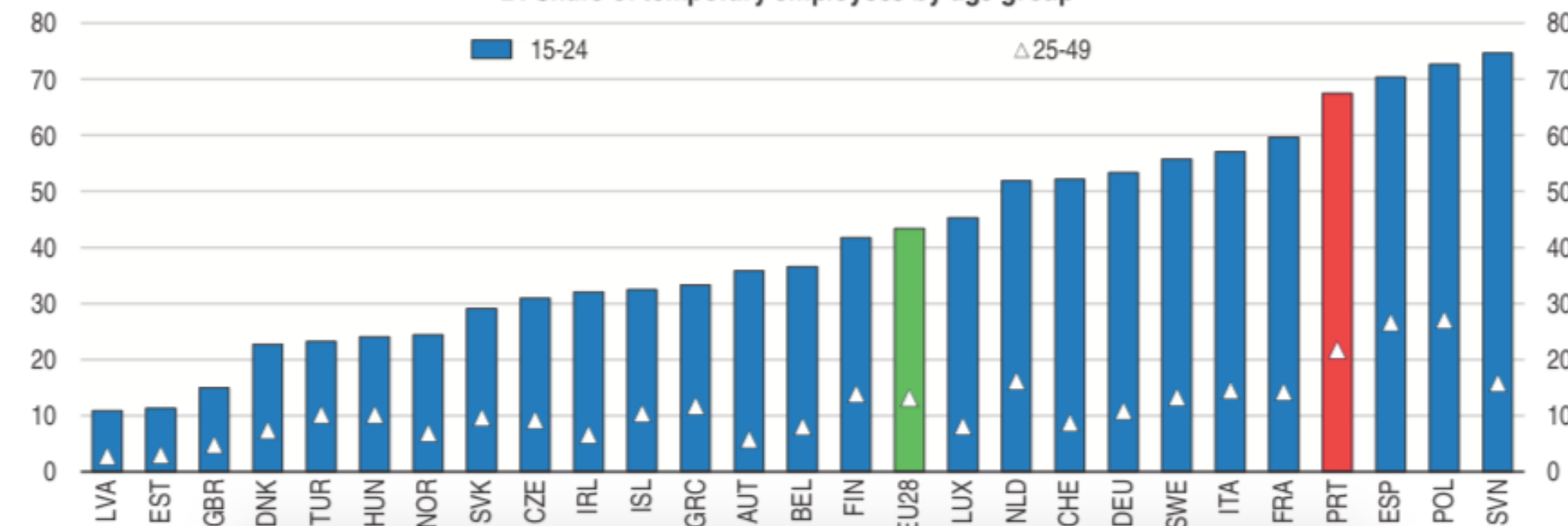
Share of temporary employees



B. Share of temporary employees by age group

■ 15-24

△ 25-49



Prospects for employment and job quality, and their link to training, are therefore crucial for raising skills, as getting a better job is a key motivation for acquiring skills and investing in education.

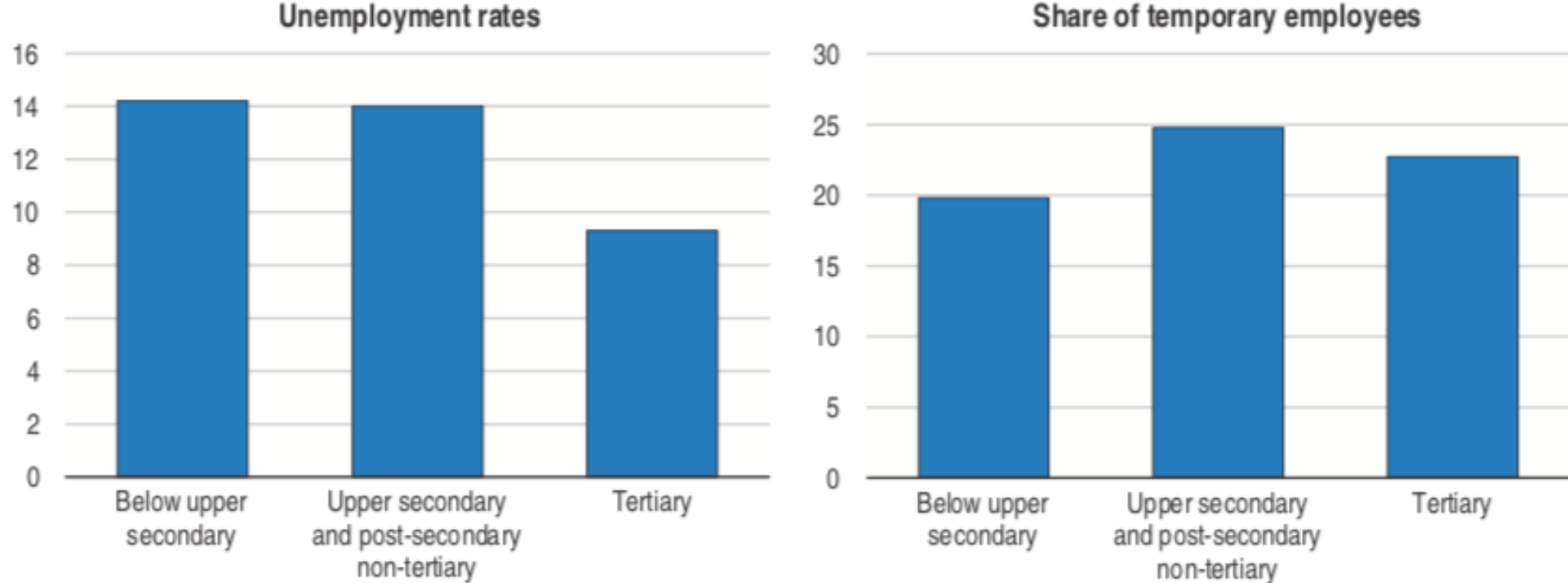
Portugal's unemployment rate is one of the highest of the OECD

Permanent & Temporary Contracts

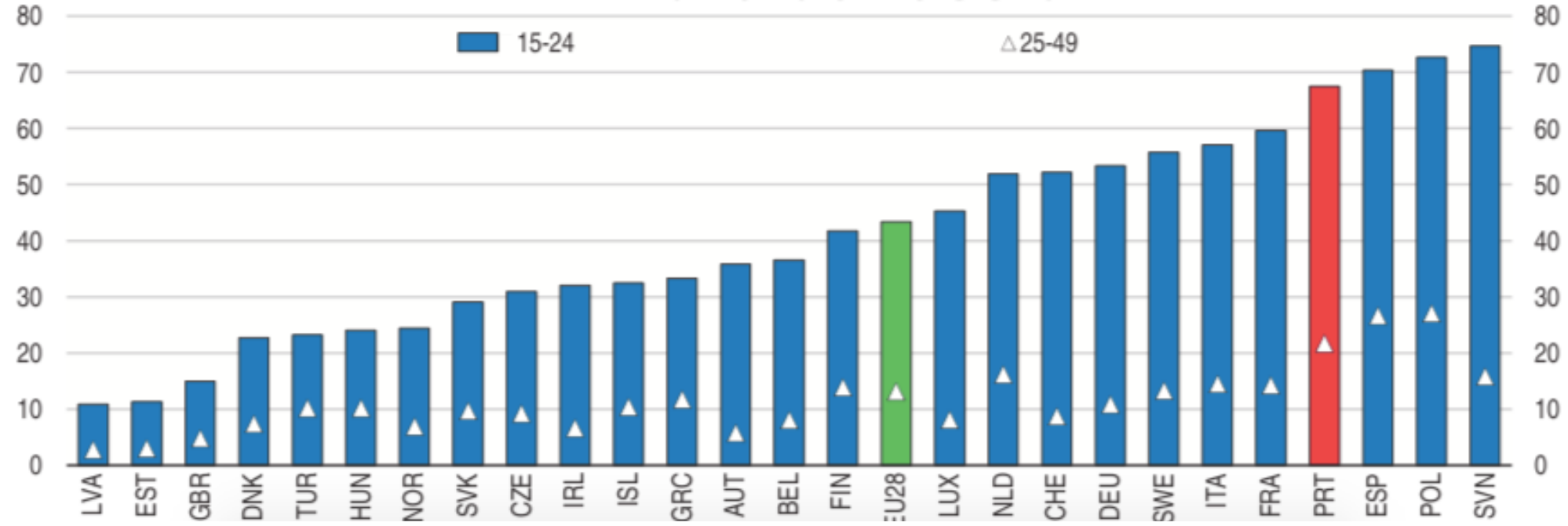


Figure 25. **The labour market remains segmented**
Per cent, 2015

A. By level of educational attainment (age 15-64)



B. Share of temporary employees by age group



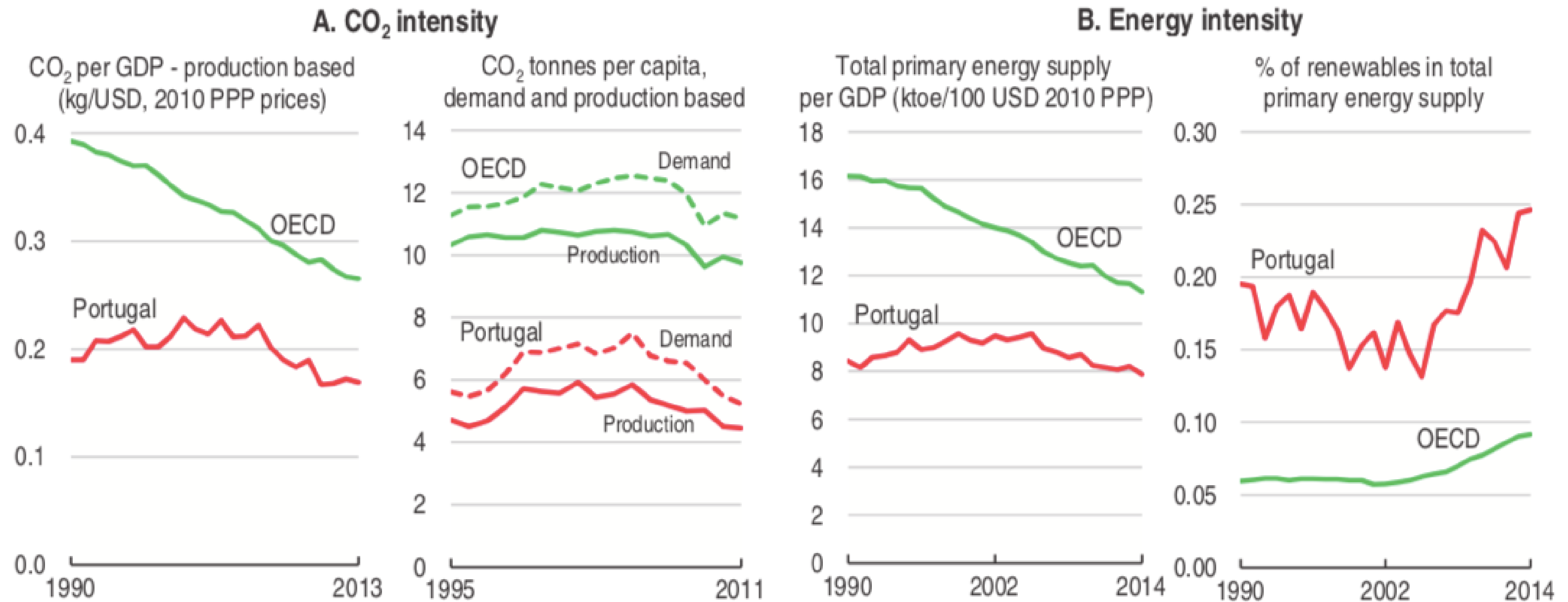
Among EU countries, Portugal has one of the highest shares of young workers in temporary contracts, which are frequent even among tertiary graduates

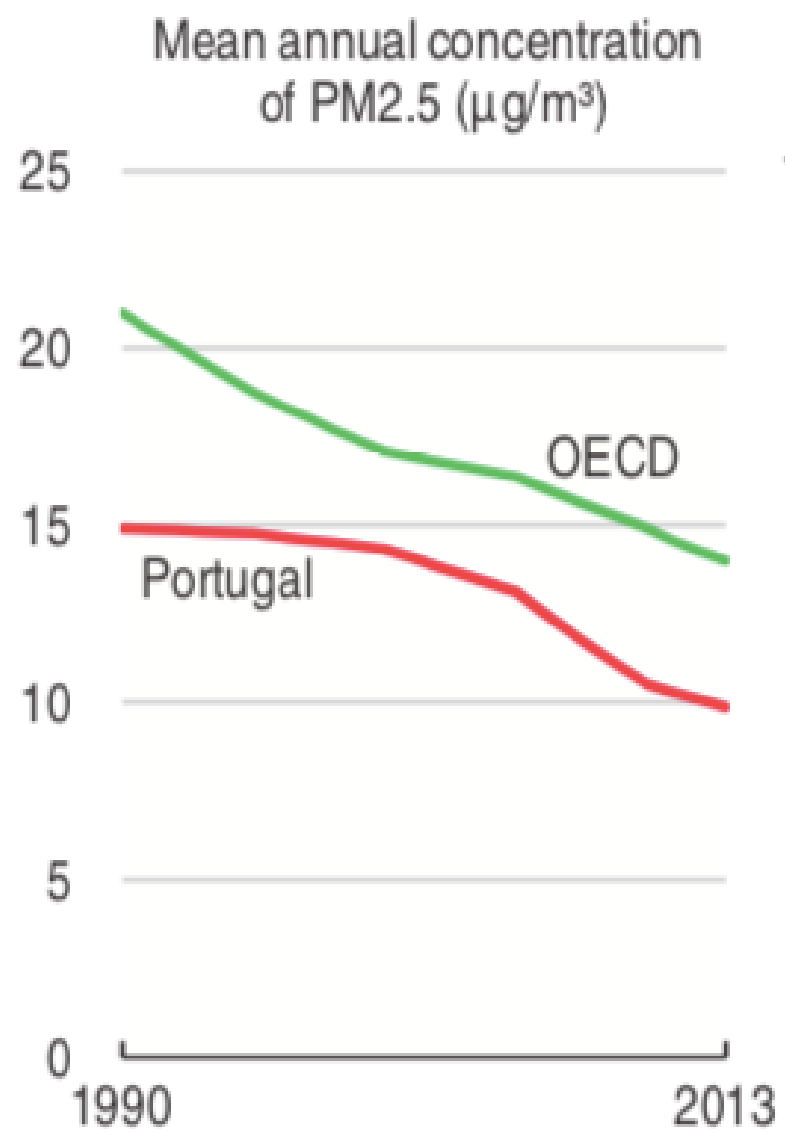
The high incidence of temporary contracts diminishes the incentives to invest in human capital and reduces the incentives for on-the-job-training for both employees and employers.

*MAKING
GROWTH
MORE
SUSTAINABLE*

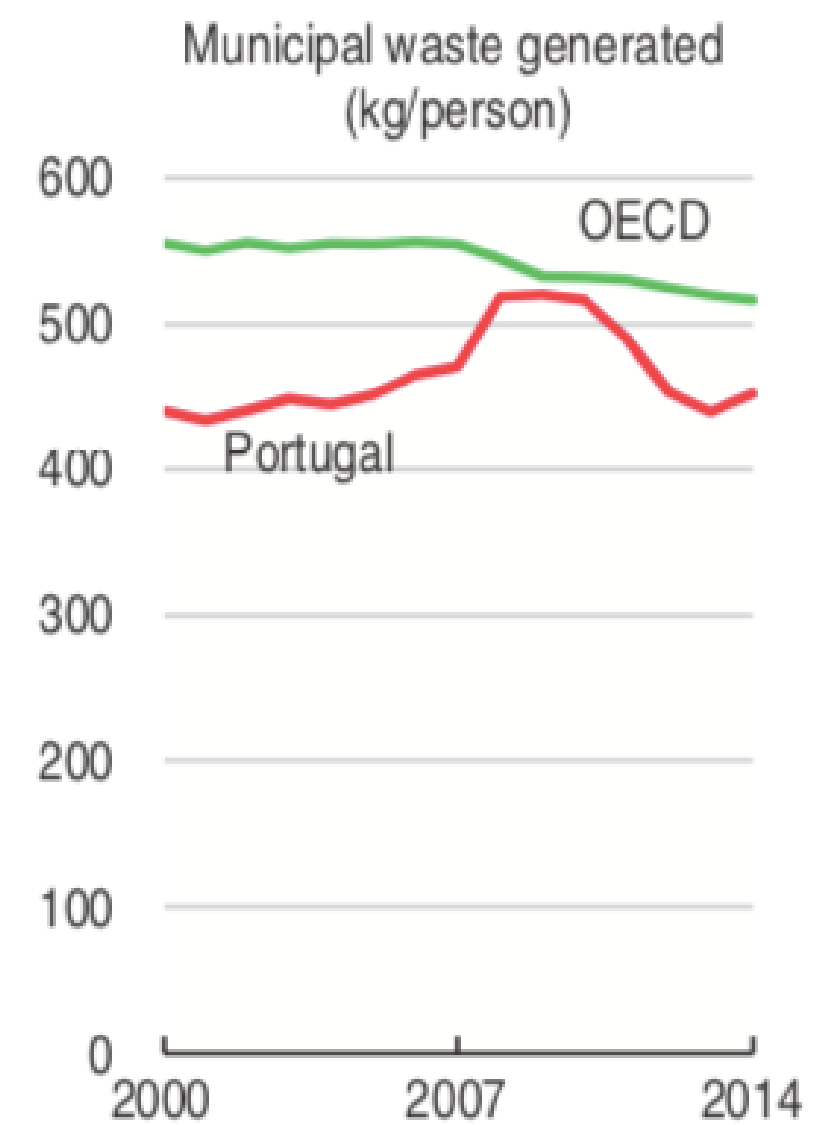
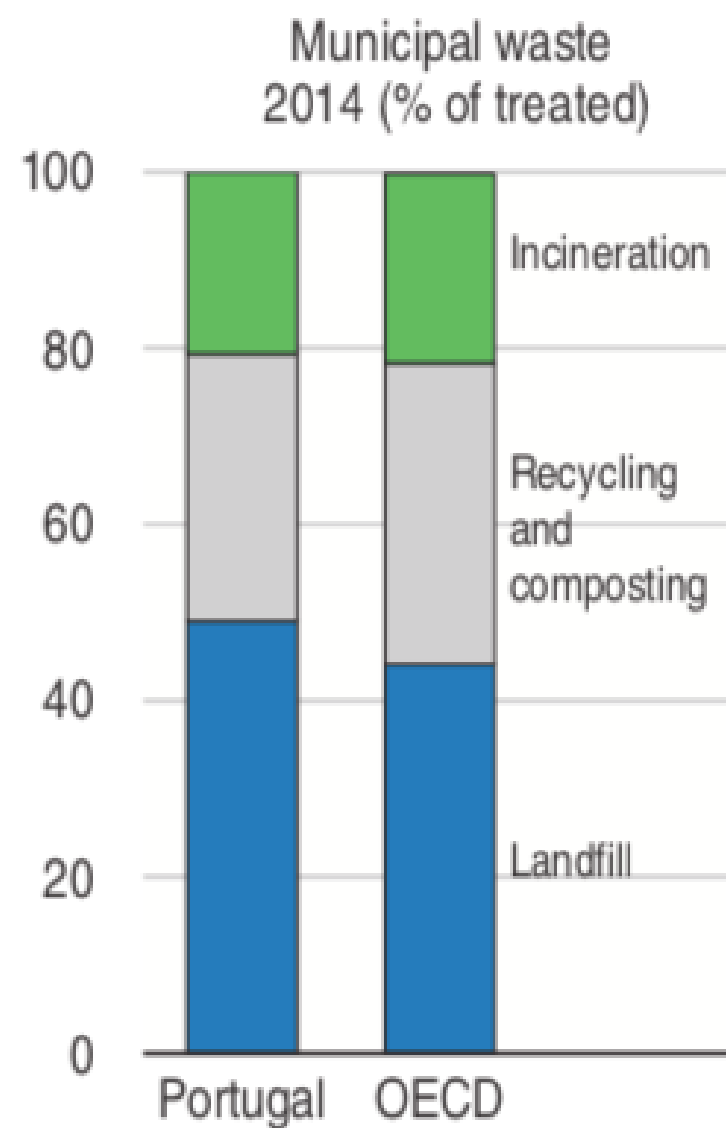


Figure 27. **Green-growth indicators: Portugal**



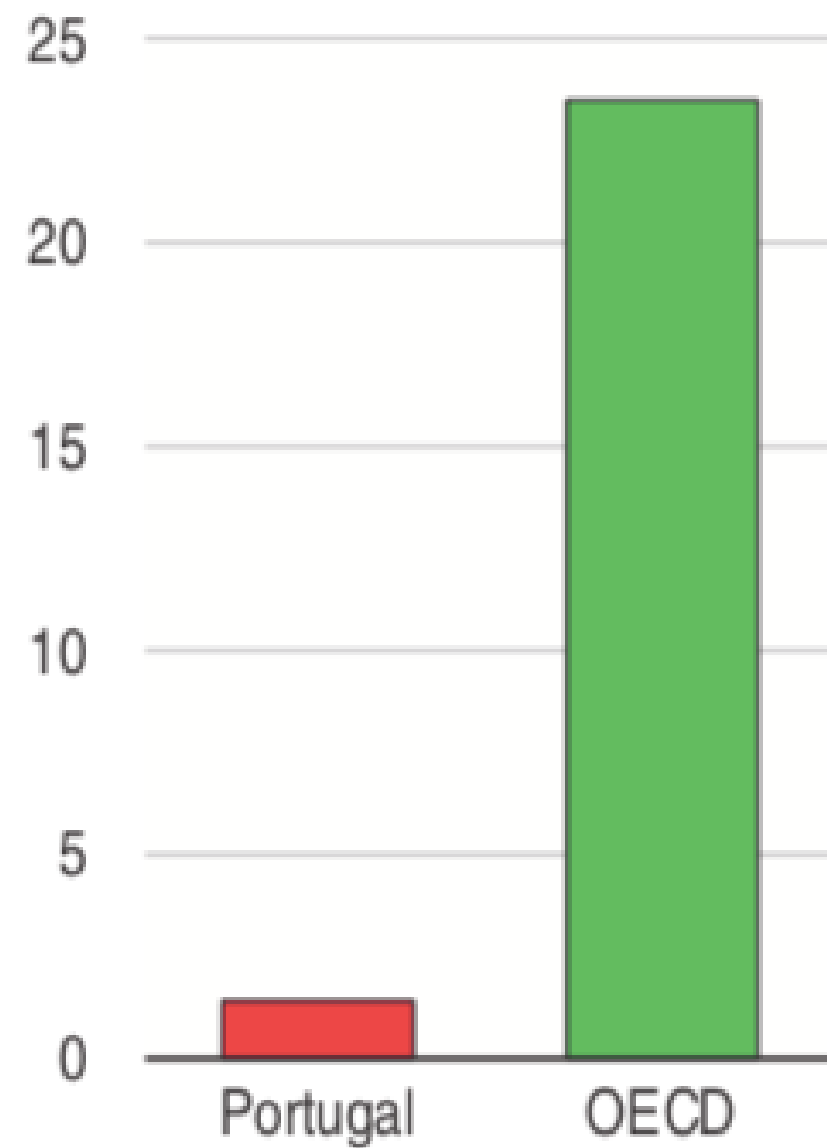


D. Municipal waste generation and recycling

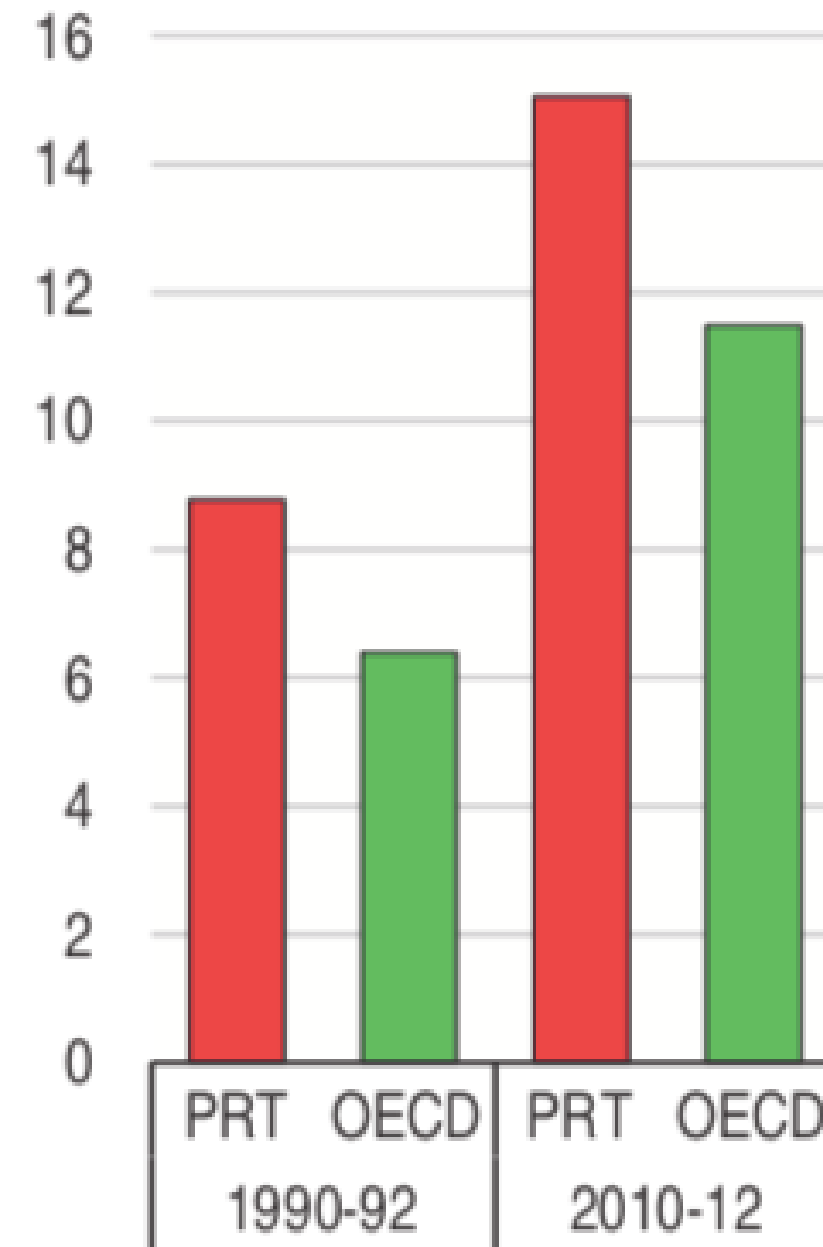


F. Environment-related technologies

Environment-related inventions
2010-12 (patents/million inhabitants)



% of all technologies



CONCLUSION

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- The outlook is becoming more challenging and vulnerabilities are rising
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- Raising skills
- Making growth more sustainable