2018
ARTICLE IV
CONSULTATION

TOPICS

- Selected Economic Indicators
- Annexes I, II , IV
- Policy discussion
    - A. Macro-financial issues and policies
    - B. External balance and policies & Annex III
    - C. Fiscal issues and policies
    - D. Structural issues: investment and growth
    - Authorities' View
- Conclusion

Selected Economic Indicators

Background and predictions

REAL GDP GROWTH

Trajectory:

- 2.7% in 2017
- 2.3% in 2018
- 1.8% in 2019

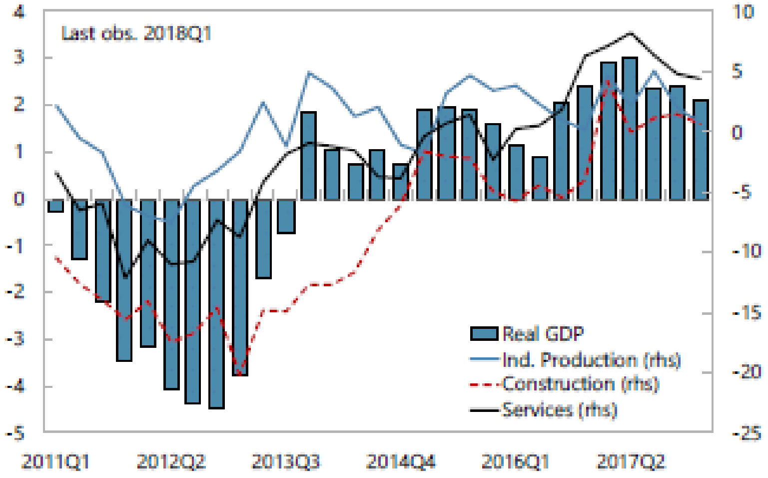
And it will moderate over the medium term

Drivers:

- Investment
- Exports

Reason of decline in 2018: weaker exports

Real GDP
(Year-on-year percentage change)



Portugal: Selected Economic Indicators
(Year-on-year percent change, unless otherwise indicated)

		Projections	
	2017	2018	2019
Real GDP	2.7	2.3	1.8
Private consumption	2.3	1.9	1.6
Public consumption	-0.2	1.9	1.0
Gross fixed capital formation	9.2	7.6	6.3
Exports	7.9	6.2	4.7
Imports	7.9	6.8	5.5
Contribution to growth (Percentage points)			
Total domestic demand	2.9	2.9	2.4
Foreign balance	-0.2	-0.4	-0.5
Resource utilization			
Employment	3.3	1.9	1.2
Unemployment rate (Percent)	8.9	7.3	6.7
Prices			
GDP deflator	1.4	1.6	1.6
Consumer prices (Harmonized index)	1.6	1.7	1.6
Money and credit (End of period, percent change)			
Bank credit to non-financial private sector	-3.1	0.1	0.8
Broad money	7.5	3.4	2.9
Fiscal indicators (Percent of GDP)			
General government balance	-3.0	-0.7	-0.3
Primary government balance	0.9	2.8	3.1
Structural primary balance (Percent of potential GDP)	3.4	3.0	2.9
General government debt	125.7	120.8	117.2
Current account balance (Percent of GDP)	0.5	0.2	-0.1
Nominal GDP (Billions of euros)	193.1	200.6	207.5

Sources: Bank of Portugal; Ministry of Finance; National Statistics Office (INE); Eurostat; and IMF staff projections.

Employment

The average unemployment will decline:

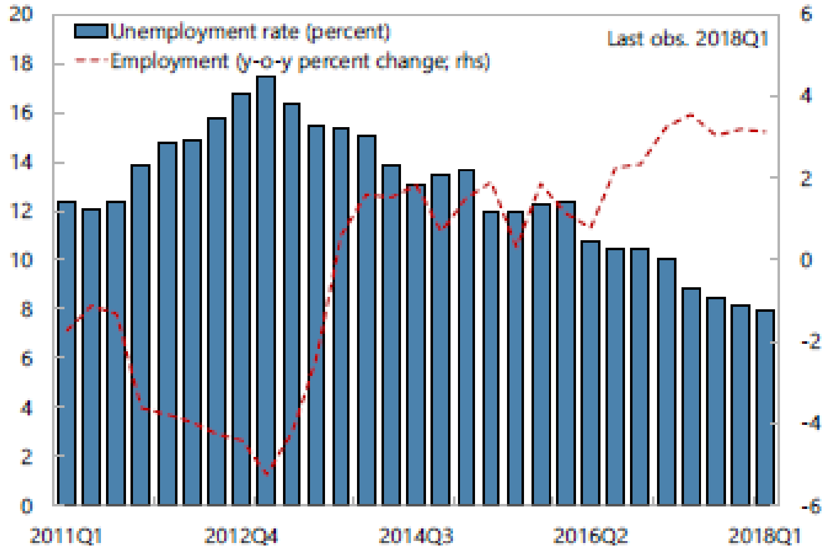
- 8,9% in 2017
- 7.3% in 2018
- 6.7% in 2019

This was due to employment growth

Which however will decelerate:

- 1.9% in 2018
- 1.2% in 2019

Employment



Portugal: Selected Economic Indicators
(Year-on-year percent change, unless otherwise indicated)

		Projections	
	2017	2018	2019
Real GDP	2.7	2.3	1.8
Private consumption	2.3	1.9	1.6
Public consumption	-0.2	1.9	1.0
Gross fixed capital formation	9.2	7.6	6.3
Exports	7.9	6.2	4.7
Imports	7.9	6.8	5.5
Contribution to growth (Percentage points)			
Total domestic demand	2.9	2.9	2.4
Foreign balance	-0.2	-0.4	-0.5
Resource utilization			
Employment	3.3	1.9	1.2
Unemployment rate (Percent)	8.9	7.3	6.7
Prices			
GDP deflator	1.4	1.6	1.6
Consumer prices (Harmonized index)	1.6	1.7	1.6
Money and credit (End of period, percent change)			
Bank credit to non-financial private sector	-3.1	0.1	0.8
Broad money	7.5	3.4	2.9
Fiscal indicators (Percent of GDP)			
General government balance	-3.0	-0.7	-0.3
Primary government balance	0.9	2.8	3.1
Structural primary balance (Percent of potential GDP)	3.4	3.0	2.9
General government debt	125.7	120.8	117.2
Current account balance (Percent of GDP)	0.5	0.2	-0.1
Nominal GDP (Billions of euros)	193.1	200.6	207.5

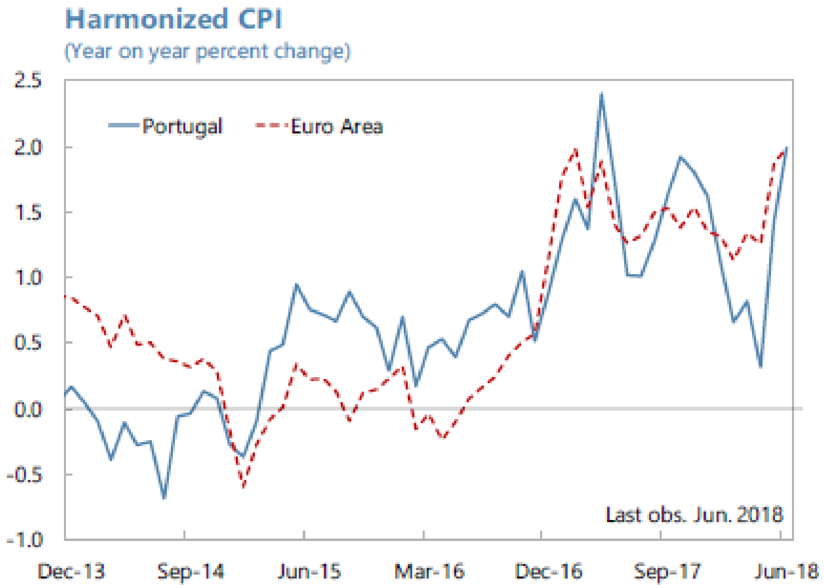
Sources: Bank of Portugal; Ministry of Finance; National Statistics Office (INE); Eurostat; and IMF staff projections.

Inflation

Trajectory:

- 1.7% in 2018
- 1.6% in 2019
- 2.1% over the medium term

Important driver: energy prices



Portugal: Selected Economic Indicators

(Year-on-year percent change, unless otherwise indicated)

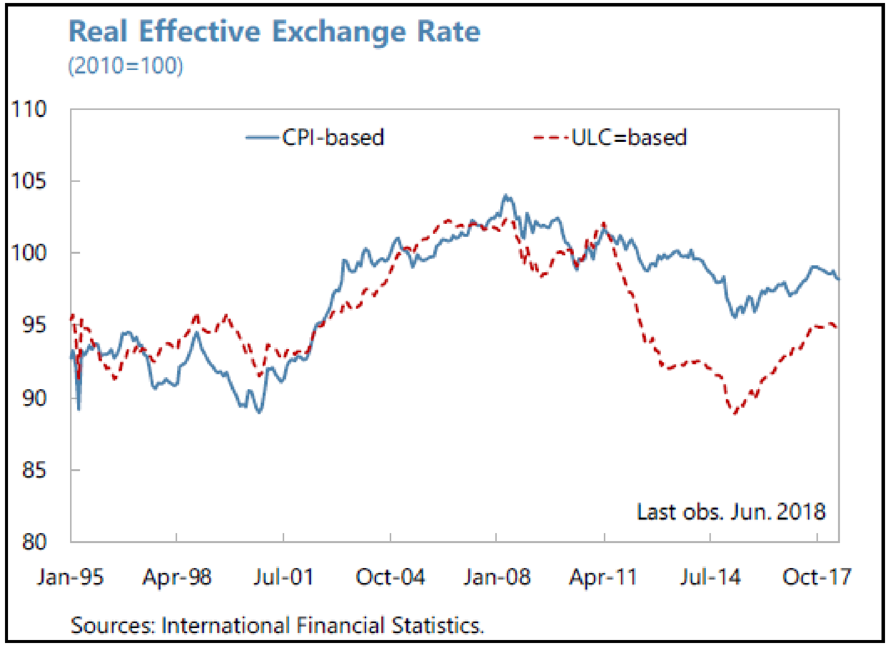
		Projections	
	2017	2018	2019
Real GDP	2.7	2.3	1.8
Private consumption	2.3	1.9	1.6
Public consumption	-0.2	1.9	1.0
Gross fixed capital formation	9.2	7.6	6.3
Exports	7.9	6.2	4.7
Imports	7.9	6.8	5.5
Contribution to growth (Percentage points)			
Total domestic demand	2.9	2.9	2.4
Foreign balance	-0.2	-0.4	-0.5
Resource utilization			
Employment	3.3	1.9	1.2
Unemployment rate (Percent)	8.9	7.3	6.7
Prices			
GDP deflator	1.4	1.6	1.6
Consumer prices (Harmonized index)	1.6	1.7	1.6
Money and credit (End of period, percent change)			
Bank credit to non-financial private sector	-3.1	0.1	0.8
Broad money	7.5	3.4	2.9
Fiscal indicators (Percent of GDP)			
General government balance	-3.0	-0.7	-0.3
Primary government balance	0.9	2.8	3.1
Structural primary balance (Percent of potential GDP)	3.4	3.0	2.9
General government debt	125.7	120.8	117.2
Current account balance (Percent of GDP)	0.5	0.2	-0.1
Nominal GDP (Billions of euros)	193.1	200.6	207.5

Sources: Bank of Portugal; Ministry of Finance; National Statistics Office (INE); Eurostat; and IMF staff projections.

Price competitiveness

(not in the table)

- It has been deteriorating since mid-2015
- It appears to have stabilized in the last 2 years



Portugal: Selected Economic Indicators
(Year-on-year percent change, unless otherwise indicated)

		Projections	
	2017	2018	2019
Real GDP	2.7	2.3	1.8
Private consumption	2.3	1.9	1.6
Public consumption	-0.2	1.9	1.0
Gross fixed capital formation	9.2	7.6	6.3
Exports	7.9	6.2	4.7
Imports	7.9	6.8	5.5
Contribution to growth (Percentage points)			
Total domestic demand	2.9	2.9	2.4
Foreign balance	-0.2	-0.4	-0.5
Resource utilization			
Employment	3.3	1.9	1.2
Unemployment rate (Percent)	8.9	7.3	6.7
Prices			
GDP deflator	1.4	1.6	1.6
Consumer prices (Harmonized index)	1.6	1.7	1.6
Money and credit (End of period, percent change)			
Bank credit to non-financial private sector	-3.1	0.1	0.8
Broad money	7.5	3.4	2.9
Fiscal indicators (Percent of GDP)			
General government balance	-3.0	-0.7	-0.3
Primary government balance	0.9	2.8	3.1
Structural primary balance (Percent of potential GDP)	3.4	3.0	2.9
General government debt	125.7	120.8	117.2
Current account balance (Percent of GDP)	0.5	0.2	-0.1
Nominal GDP (Billions of euros)	193.1	200.6	207.5

Sources: Bank of Portugal; Ministry of Finance; National Statistics Office (INE); Eurostat; and IMF staff projections.

Credit

Credit is increasing

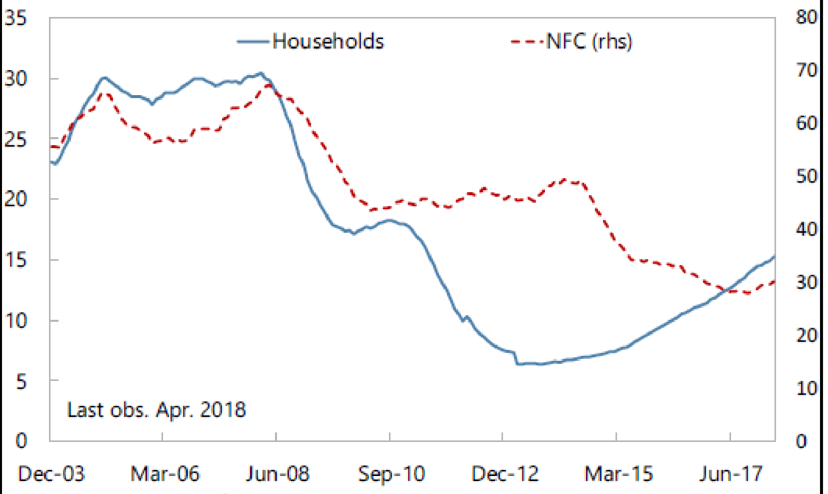
- New loans to:
    - households and
    - non-financial corporate sector

  (-3.1%, 0.1%, 0.8%)

However, it continues to lag the economy

New Loans to Households and NFC

(Billion of euros, 12-month rolling sum)



Source: Haver Analytics.

Portugal: Selected Economic Indicators

(Year-on-year percent change, unless otherwise indicated)

		Projections	
	2017	2018	2019
Real GDP	2.7	2.3	1.8
Private consumption	2.3	1.9	1.6
Public consumption	-0.2	1.9	1.0
Gross fixed capital formation	9.2	7.6	6.3
Exports	7.9	6.2	4.7
Imports	7.9	6.8	5.5
Contribution to growth (Percentage points)			
Total domestic demand	2.9	2.9	2.4
Foreign balance	-0.2	-0.4	-0.5
Resource utilization			
Employment	3.3	1.9	1.2
Unemployment rate (Percent)	8.9	7.3	6.7
Prices			
GDP deflator	1.4	1.6	1.6
Consumer prices (Harmonized index)	1.6	1.7	1.6
Money and credit (End of period, percent change)			
Bank credit to non-financial private sector	-3.1	0.1	0.8
Broad money	7.5	3.4	2.9
Fiscal indicators (Percent of GDP)			
General government balance	-3.0	-0.7	-0.3
Primary government balance	0.9	2.8	3.1
Structural primary balance (Percent of potential GDP)	3.4	3.0	2.9
General government debt	125.7	120.8	117.2
Current account balance (Percent of GDP)	0.5	0.2	-0.1
Nominal GDP (Billions of euros)	193.1	200.6	207.5

Sources: Bank of Portugal; Ministry of Finance; National Statistics Office (INE); Eurostat; and IMF staff projections.

Fiscal Balances

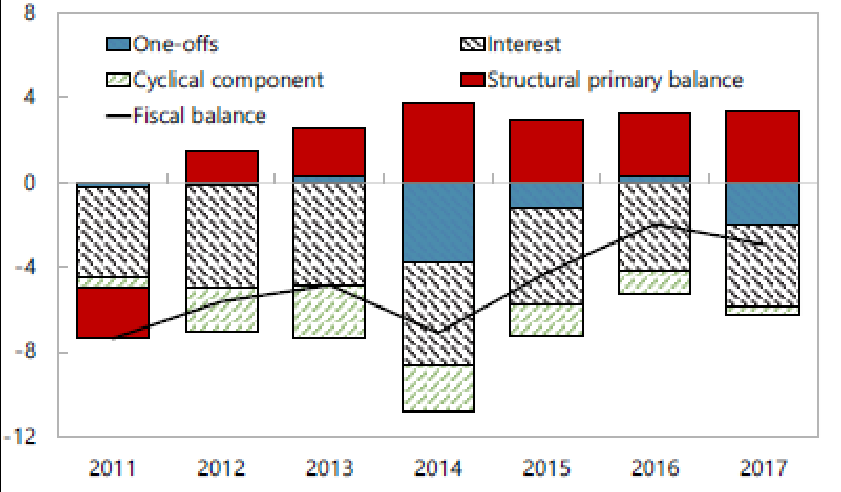
General government balance:

- -3.0% in 2017
- -0.7% in 2018 (-0,5%)
- -0.3 in 2019

However, structural primary balance is positive

Fiscal balance = Cyclical component + one offs + structural primary balance - interest

Fiscal Balance
(Percent of GDP)



Source: IMF staff calculations.

Portugal: Selected Economic Indicators
(Year-on-year percent change, unless otherwise indicated)

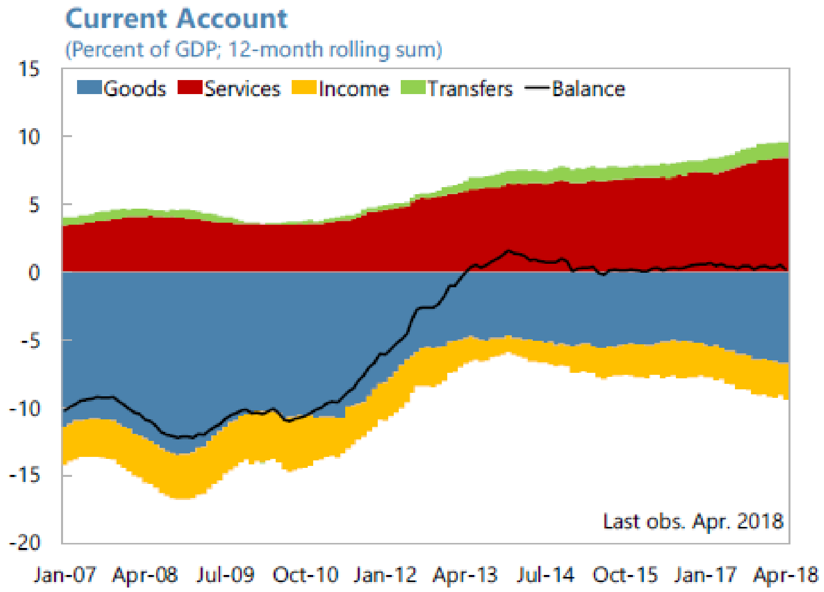
		Projections	
	2017	2018	2019
Real GDP	2.7	2.3	1.8
Private consumption	2.3	1.9	1.6
Public consumption	-0.2	1.9	1.0
Gross fixed capital formation	9.2	7.6	6.3
Exports	7.9	6.2	4.7
Imports	7.9	6.8	5.5
Contribution to growth (Percentage points)			
Total domestic demand	2.9	2.9	2.4
Foreign balance	-0.2	-0.4	-0.5
Resource utilization			
Employment	3.3	1.9	1.2
Unemployment rate (Percent)	8.9	7.3	6.7
Prices			
GDP deflator	1.4	1.6	1.6
Consumer prices (Harmonized index)	1.6	1.7	1.6
Money and credit (End of period, percent change)			
Bank credit to non-financial private sector	-3.1	0.1	0.8
Broad money	7.5	3.4	2.9
Fiscal indicators (Percent of GDP)			
General government balance	-3.0	-0.7	-0.3
Primary government balance	0.9	2.8	3.1
Structural primary balance (Percent of potential GDP)	3.4	3.0	2.9
General government debt	125.7	120.8	117.2
Current account balance (Percent of GDP)	0.5	0.2	-0.1
Nominal GDP (Billions of euros)	193.1	200.6	207.5

Sources: Bank of Portugal; Ministry of Finance; National Statistics Office (INE); Eurostat; and IMF staff projections.

Current account balance

Deterioration of current account balance:

- 0,5% in 2017
- 0,2% in 2018
- -0,1% in 2019



Portugal: Selected Economic Indicators
(Year-on-year percent change, unless otherwise indicated)

		Projections	
	2017	2018	2019
Real GDP	2.7	2.3	1.8
Private consumption	2.3	1.9	1.6
Public consumption	-0.2	1.9	1.0
Gross fixed capital formation	9.2	7.6	6.3
Exports	7.9	6.2	4.7
Imports	7.9	6.8	5.5
Contribution to growth (Percentage points)			
Total domestic demand	2.9	2.9	2.4
Foreign balance	-0.2	-0.4	-0.5
Resource utilization			
Employment	3.3	1.9	1.2
Unemployment rate (Percent)	8.9	7.3	6.7
Prices			
GDP deflator	1.4	1.6	1.6
Consumer prices (Harmonized index)	1.6	1.7	1.6
Money and credit (End of period, percent change)			
Bank credit to non-financial private sector	-3.1	0.1	0.8
Broad money	7.5	3.4	2.9
Fiscal indicators (Percent of GDP)			
General government balance	-3.0	-0.7	-0.3
Primary government balance	0.9	2.8	3.1
Structural primary balance (Percent of potential GDP)	3.4	3.0	2.9
General government debt	125.7	120.8	117.2
Current account balance (Percent of GDP)	0.5	0.2	-0.1
Nominal GDP (Billions of euros)	193.1	200.6	207.5

Sources: Bank of Portugal; Ministry of Finance; National Statistics Office (INE); Eurostat; and IMF staff projections.

Banking System

Banks' balance sheet has strengthened:

- Average CET1 ratio: 13.9% at end-2017 (increased by 2.5%)
- NPLs: 13.3% of gross loans (reduced by EUR 9.4 billion)
- Profitability: Most banks posted profits
- Impairment coverage ratio: 49.4% in end-2017 (increased from 45.3%)
- Liquidity coverage ratio: 173% at end-2017 (minimum that required is 100%)

Public Debt

Access to market financing has been improved → more favorable borrowing terms

S&P and FITCH both upgraded Portugal to investment grade in 2017

Based on some assumptions, the following predictions have been produced:

- 121% of GDP at end-2018
- Further decline to 103% of GDP by 2023

Risks

The risks that have identified are relative to:

- Growth in Euro area
- Global financial conditions
- Protectionism
- Labor costs
- Exports
- Reforms

AUTHORITIES' VIEWS

Growth

above 2% in coming years

RISKS

Growth in EU:
slowdown in EU → uncertainty in European markets

Spreads: strong policies → lower spreads

Public debt ratio: high, but in declining trend

NPLs: high level, but declining trend

Non-price competitiveness:
non-price competitiveness benefits → Pt less vulnerable to fluctuations in price competitiveness

Global conditions:
Global economic slowdown + tighter global financial conditions → less exports

Annexes

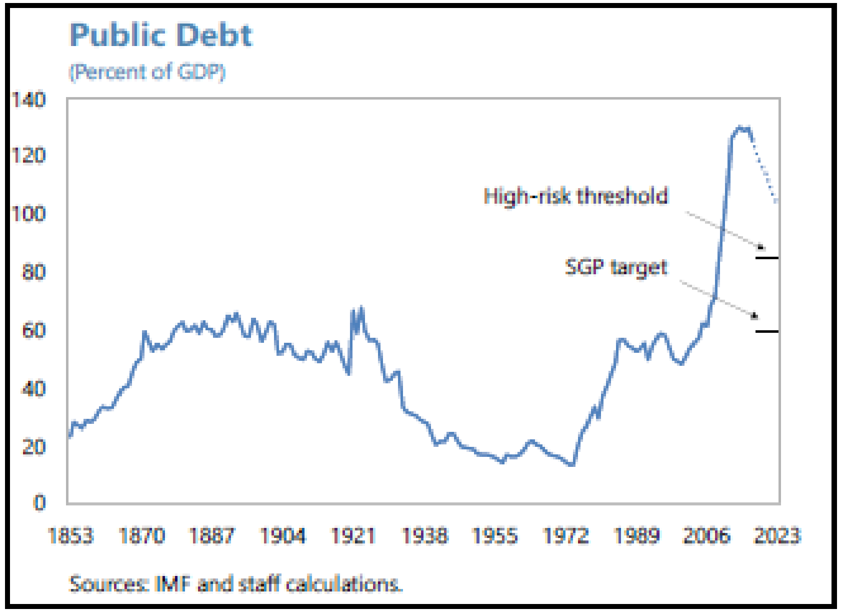
I. Public debt sustainability analysis (DSA)

Assessment Criterion

- Criterions introduced by the theory for public debt sustainability:
    - PV of all future public income ≥ PV of all future spending + initial value of outstanding debt
    - Debt to GDP ratio is stable

- Criterion used by IMF:
    - focuses on two indicators and their thresholds:
        - Gross Nominal public debt (% of GDP) - 85%
        - Public Gross Financing Needs (% of GDP) - 20%

Past developments



Debt fell by 4.2 of GDP in 2017

- Contributors to the fall in debt:
  - GDP growth (primary driver)
  - Decline in interest bill
  - Use of cash deposit

However debt remains very high:

- Above 85% (high risk threshold for the market access)
- Above 60% (target mandated in the stability and growth pact

Predictions - The main reasoning

Assumptions:

1. Real GDP growth
2. Inflation
3. Primary Balance
4. Effective interest rate

Projections:

1. Gross Nominal Public Debt
2. Public Gross Financing Needs

Set of Scenarios

The set of scenarios is the following:

- Baseline scenario
- Historical scenario
- Constant primary balance scenario

Baseline scenario – Assumptions

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	2.3	1.8	1.5	1.4	1.4	1.4
Inflation	1.6	1.6	1.7	1.7	1.7	1.6
Primary Balance	2.8	3.1	3.1	3.1	3.1	3.1
Effective interest rate	2.9	2.9	2.8	2.8	2.7	2.8

Baseline scenario – Projections

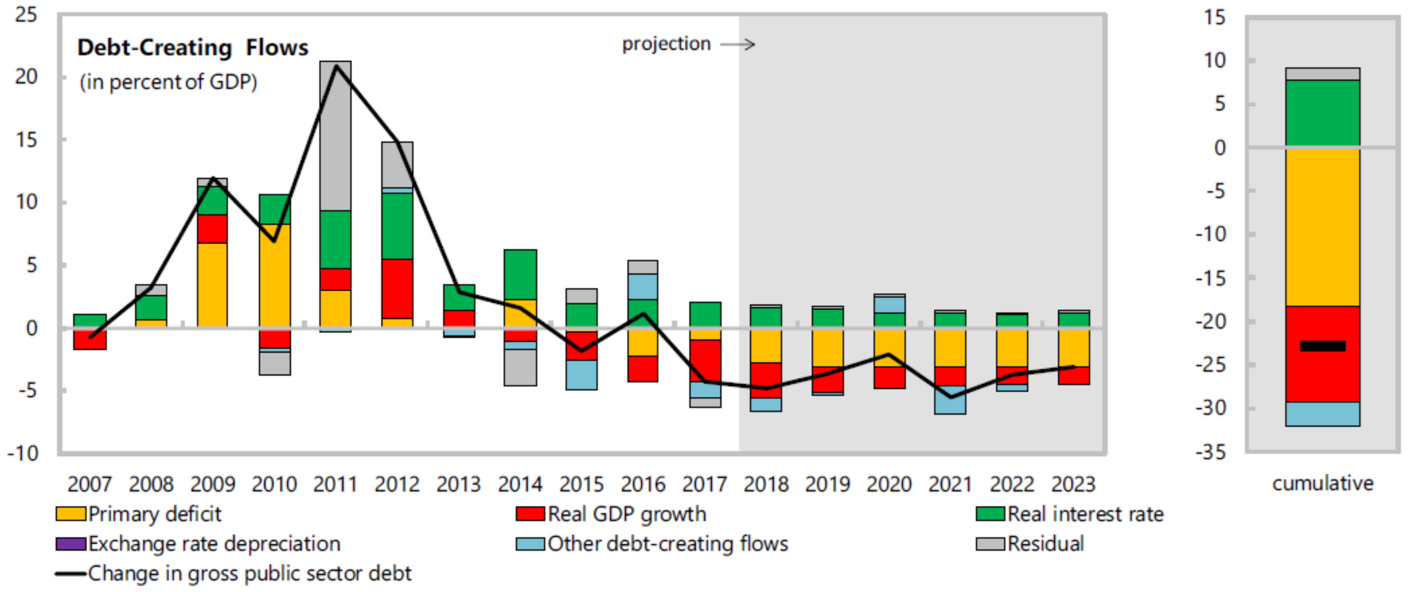
- Debt will exceed the high-risk threshold for market access countries (85% of GDP) throughout the forecast horizon

- Government gross financing needs are expected to remain below the equivalent high-risk threshold (20% of GDP)

	Actual			Projections					
	2007-2015 2/	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	104.5	129.9	125.7	120.9	117.3	115.2	109.6	105.9	102.8
Public gross financing needs	25.1	21.3	21.2	13.0	13.9	13.0	16.6	13.8	11.5

Baseline scenario – Notes

Contribution to changes in Public debt



Source: IMF staff.

The main contributors are:

Primary balance →reduction of debt by 19% of GDP
Real GDP growth → reduction of debt by 11% of GDP
Interest bill → increase of debt by 3.9% (2017) – 2.9% (2023)

Baseline scenario – Notes

Risks:

- Risks from:
  - short term debt and
  - the stock of debt are low
- Total economy external financing requirements of 50% of GDP vulnerability to external conditions
- Because of the high debt levels:
  - Relative minor negative shocks or
  - A deterioration in global risk sentiment

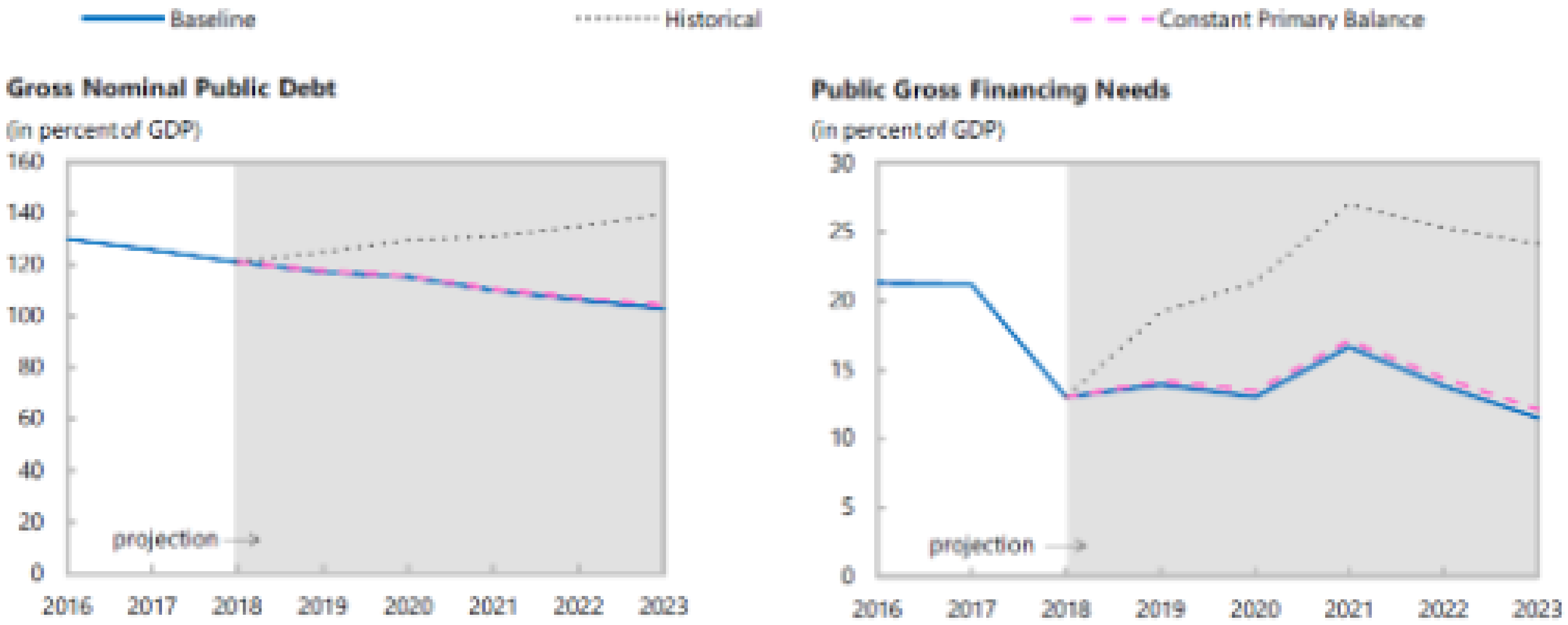
→ a loss of confidence + adverse equilibria (→ need to raise the structural primary balance → build resilience and create policy space)

Alternative scenarios – Assumptions

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	2.3	-0.1	-0.1	-0.1	-0.1	-0.1
Inflation	1.6	1.6	1.7	1.7	1.7	1.6
Primary Balance	2.8	-1.8	-1.8	-1.8	-1.8	-1.8
Effective interest rate	2.9	2.9	3.0	3.1	3.2	3.5

Constant Primary Balance Scenario						
Real GDP growth	2.3	1.8	1.5	1.4	1.4	1.4
Inflation	1.6	1.6	1.7	1.7	1.7	1.6
Primary Balance	2.8	2.8	2.8	2.8	2.8	2.8
Effective interest rate	2.9	2.9	2.8	2.8	2.7	2.8

Alternative scenarios – Projections



Set of stress tests

The set of stress tests is the following:

- Real GDP growth shock
- Primary balanced shock
- Real interest rate shock
- Real exchange rate shock
- Contingent liability shock
- Combined shock
- Combined Macro-Fiscal and Contingent Liability shock

Stress tests – Assumptions

Underlying Assumptions

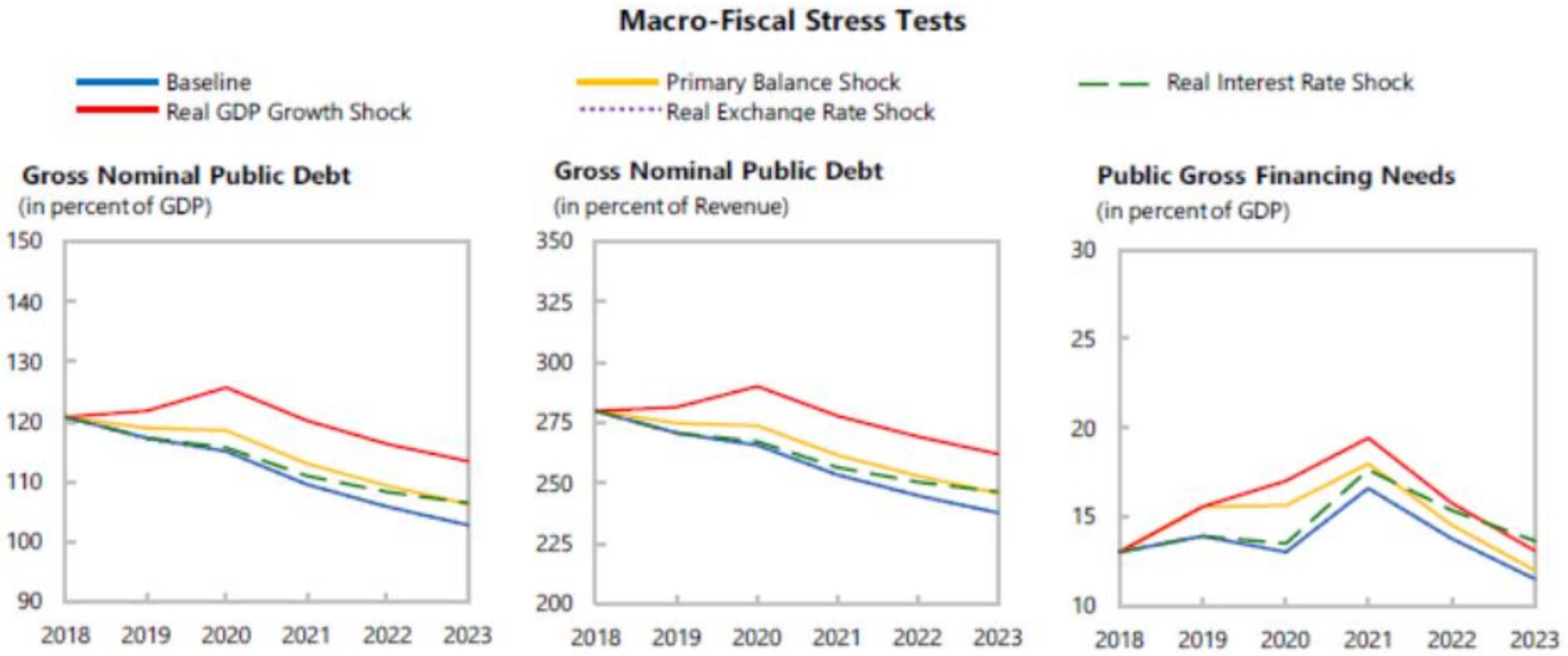
(in percent)

Primary Balance Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	2.3	1.8	1.5	1.4	1.4	1.4
Inflation	1.6	1.6	1.7	1.7	1.7	1.6
Primary balance	2.8	1.4	1.4	3.1	3.1	3.1
Effective interest rate	2.9	2.9	2.9	2.9	2.8	2.9
Real Interest Rate Shock						
Real GDP growth	2.3	1.8	1.5	1.4	1.4	1.4
Inflation	1.6	1.6	1.7	1.7	1.7	1.6
Primary balance	2.8	3.1	3.1	3.1	3.1	3.1
Effective interest rate	2.9	2.9	3.3	3.5	3.7	4.1
Combined Shock						
Real GDP growth	2.3	-0.5	-0.8	1.4	1.4	1.4
Inflation	1.6	1.0	1.2	1.7	1.7	1.6
Primary balance	2.8	1.4	0.7	3.1	3.1	3.1
Effective interest rate	2.9	2.9	3.3	3.6	3.8	4.2
Contingent Liability Shock						
Real GDP growth	2.3	1.8	1.5	1.4	1.4	1.4
Inflation	1.6	1.6	1.7	1.7	1.7	1.6
Primary balance	2.8	-6.9	3.1	3.1	3.1	3.1
Effective interest rate	2.9	2.9	2.7	2.7	2.7	2.8

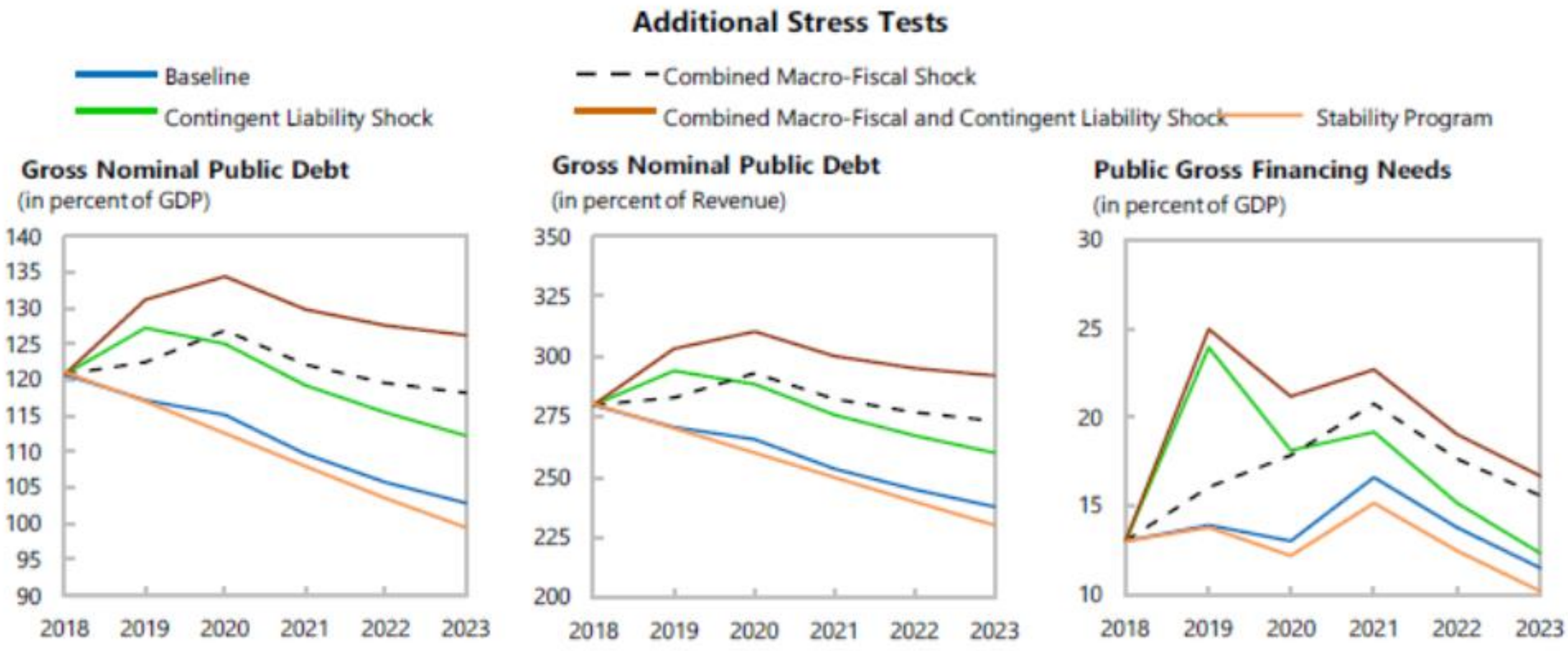
Real GDP Growth Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	2.3	-0.5	-0.8	1.4	1.4	1.4
Inflation	1.6	1.0	1.2	1.7	1.7	1.6
Primary balance	2.8	1.9	0.7	3.1	3.1	3.1
Effective interest rate	2.9	2.9	2.9	2.9	2.8	2.9
Real Exchange Rate Shock						
Real GDP growth	2.3	1.8	1.5	1.4	1.4	1.4
Inflation	1.6	1.7	1.7	1.7	1.7	1.6
Primary balance	2.8	3.1	3.1	3.1	3.1	3.1
Effective interest rate	2.9	2.9	2.8	2.8	2.7	2.8
Combined Macro-Fiscal and Contingent Liability Shock						
Real GDP growth	2.3	-0.5	-0.8	1.4	1.4	1.4
Inflation	1.6	1.0	1.2	1.7	1.7	1.6
Primary balance	2.8	-7.5	2.4	3.1	3.1	3.1
Effective interest rate	2.9	2.9	3.4	3.7	3.9	4.3

Source: IMF staff.

Stress tests – Projections



Stress tests – Projections



Annexes

II. Risk Assessment Matrix

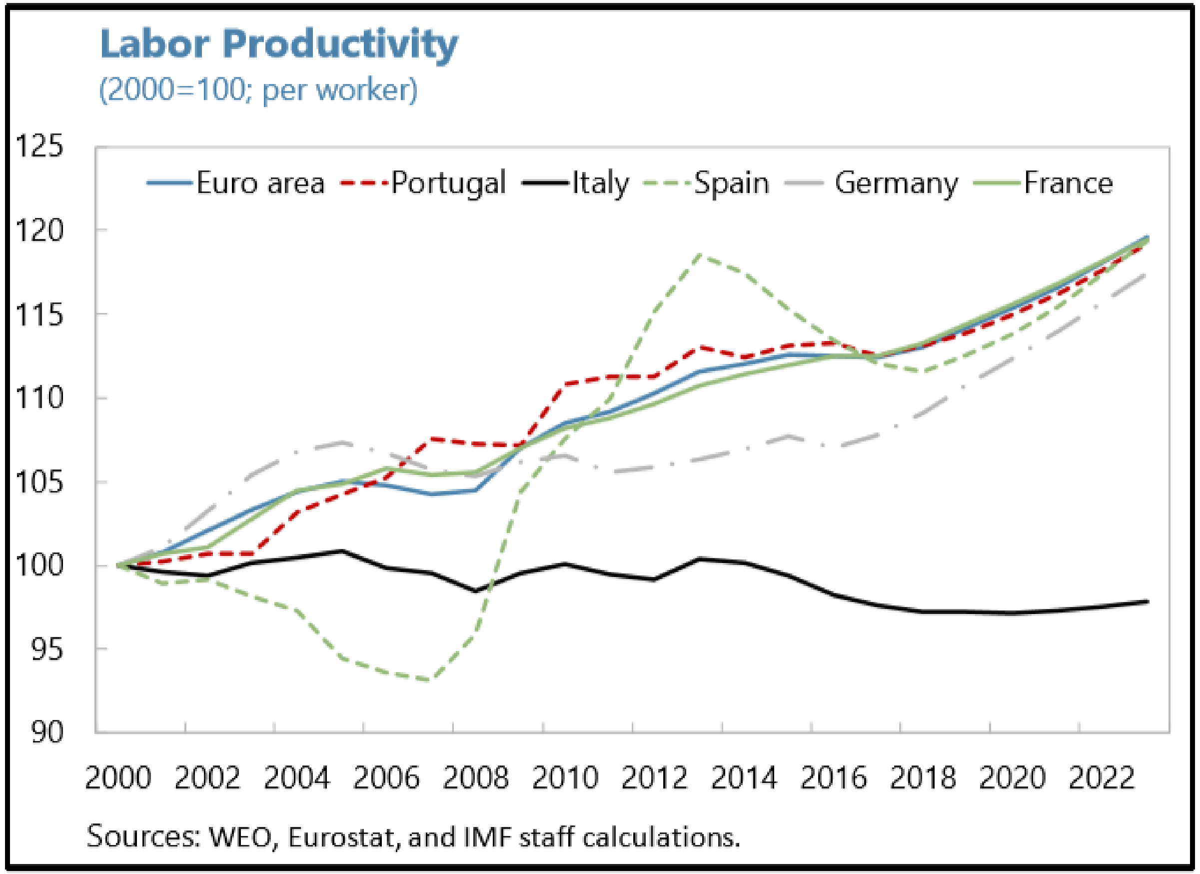
Source of Risks	Relative Likelihood	Impact	Policy response
Loss of investor confidence. Weaker structural and fiscal policy efforts, and reform reversals, or other negative surprises, potentially including difficulties in the banking system.	Low	High Increase in sovereign bonds yields and reduction in foreign direct investment. Significant funding distress, higher public and private borrowing costs.	Strengthen policy buffers and avoid backtracking on reforms. Continue to implement policies that support growth, lasting fiscal adjustment, and a strong banking system, to foster investor confidence, and favorable financing conditions.
Rising protectionism and retreat from multilateralism. Global imbalances and fraying consensus about the benefits of globalization lead to escalating and sustained trade actions and spreading isolationism. This threatens the global trade system, regional integration, labor mobility, as well as global and regional policy and regulatory collaboration. In the short term, increased uncertainty about growth triggered by escalating trade tensions leads to increased financial market volatility. Negative consequences for growth are, in turn, exacerbated by adverse changes in market sentiment and investment.	High	High Weaker economic environment and expectations would have broad negative effects for a small open economy like Portugal, both for the near-term upswing, and for medium-term growth prospects.	Stronger macro-financial and structural policies to support investment, sentiment, growth, and resilience of the economy.
Weaker-than-expected global growth. Euro Area: Progress on fiscal adjustment, on addressing legacy banking-sector problems, and on other structural reforms slows or reverses, raising debt sustainability concerns, steadily pushing up borrowing costs, and undermining medium-term growth prospects.	Medium	High Lower growth and investment would imperil debt dynamics in all sectors. With the euro area accounting for 60 percent of total exports, the current account balance and IIP would be at risk	Step up structural reforms to improve competitiveness and reduce indebtedness. Step up efforts to clean up corporate and bank balance sheets, to minimize drag on investment and growth.

Annexes

IV. Labor Market Developments and Productivity

Labor Productivity

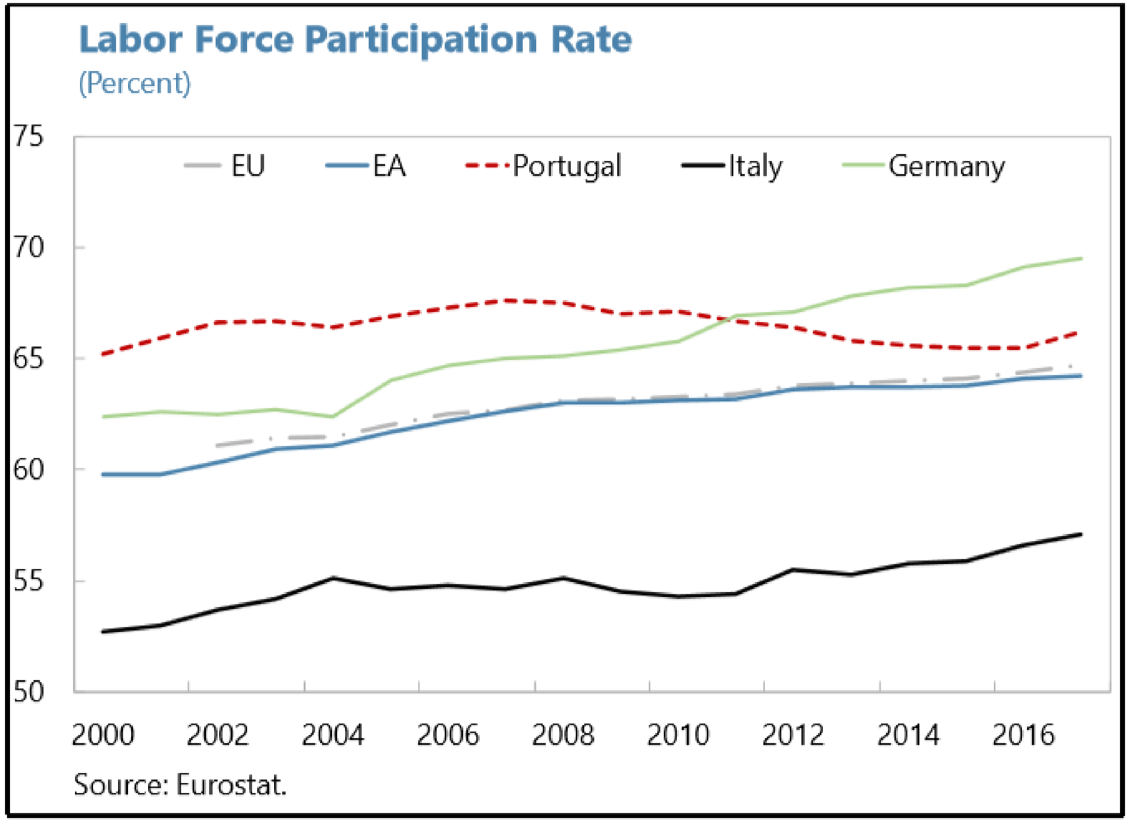
The improvements in education + reduction of lower-skilled self-employed → supports labor productivity



Labor Force Participation

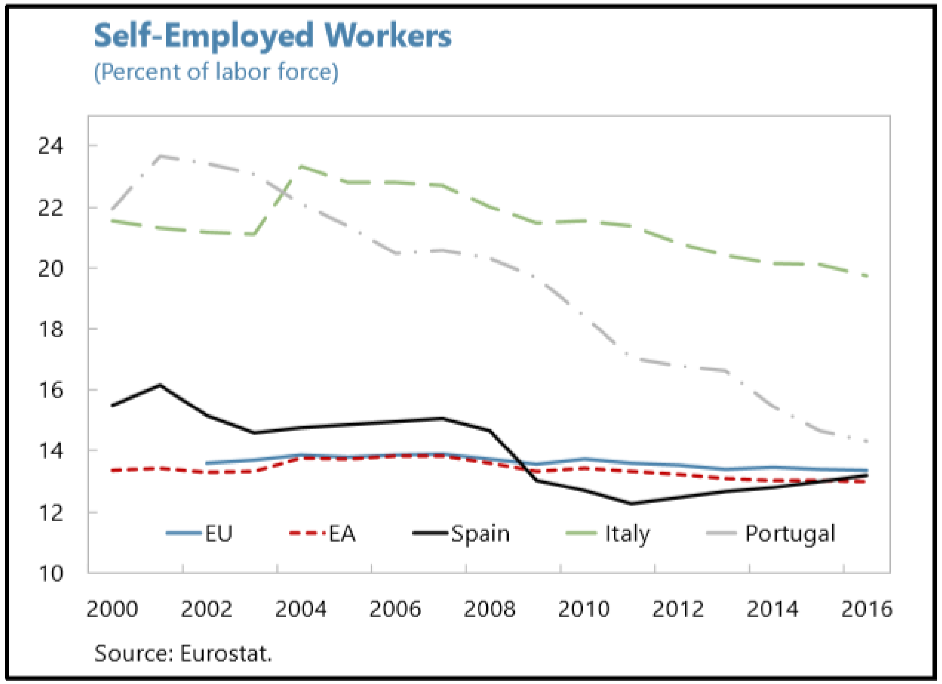
- Labor force participation started to recover in 2017. It was above that one of EU and EA

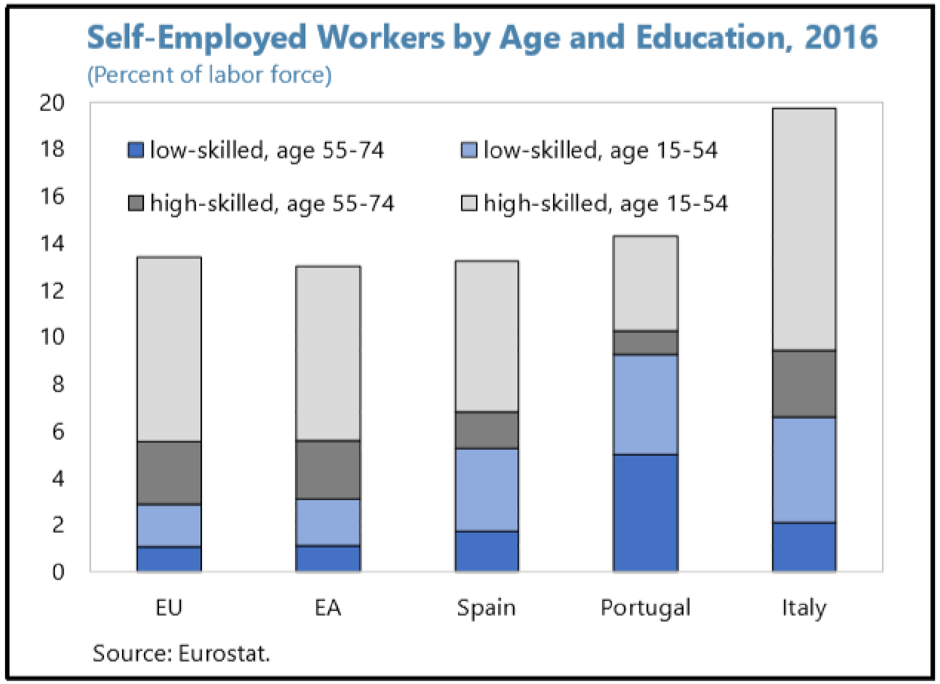
- It is projected to recover further towards pre crisis levels



Self Employment

- Continuing reduction of self employment, approaching the EU average
- As elder cohorts age + rise of general education attainment → self employment will continue to fall





Recommendations

- Labor market reforms + human capital development → address demographic pressure going forward → reduction of pressure on social programs, pensions and health system

- Addressing labor market segmentation + fostering skill formation → more inclusive growth

POLICY DISCUSSIONS

A. Macro-Financial Issues

Pace of deleveraging is slowing amid financial conditions

- Positive Net Flow Of Loans
- Positive Net Flow Of Financial Debt For NFC
- Savings Are Low (5,4% of disposable income in 2017)

High Leverage makes Portuguese households and firms become vulnerable to:

1. negative shocks in income
2. spikes in interest rates
3. floating rate loans
4. long maturities for mortgages

Macroprudential measures to prevent the financial sector from taking excessive risk

Main provision of the measures:

1) loan-to-value ratio to new mortgages cannot exceed 90%
2) DSTI ratio should not exceed 50%
3) restrictions about maturity of loans
4) restriction about new loans

The problem of Non-Performing Loans

In 2017 they corresponded to **13,3%** of total loans with **50%** of NLP being covered by provisions.

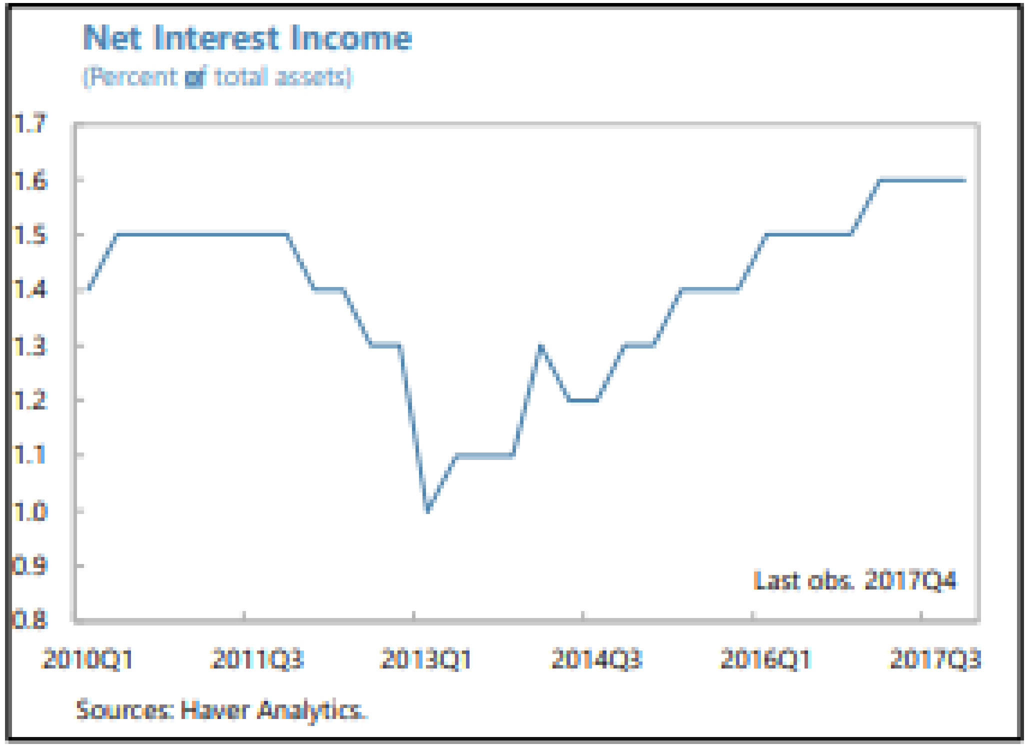
Strategies to pursed NPLs are based in three pillars:

- Supervisory actions
- Legal, judicial and fiscal reforms
- Measures to improve management of non performing loans and develop secondary markets for troubled loans

The challenge of generating strong and sustained bank profitability

Net interest income remains moderate.

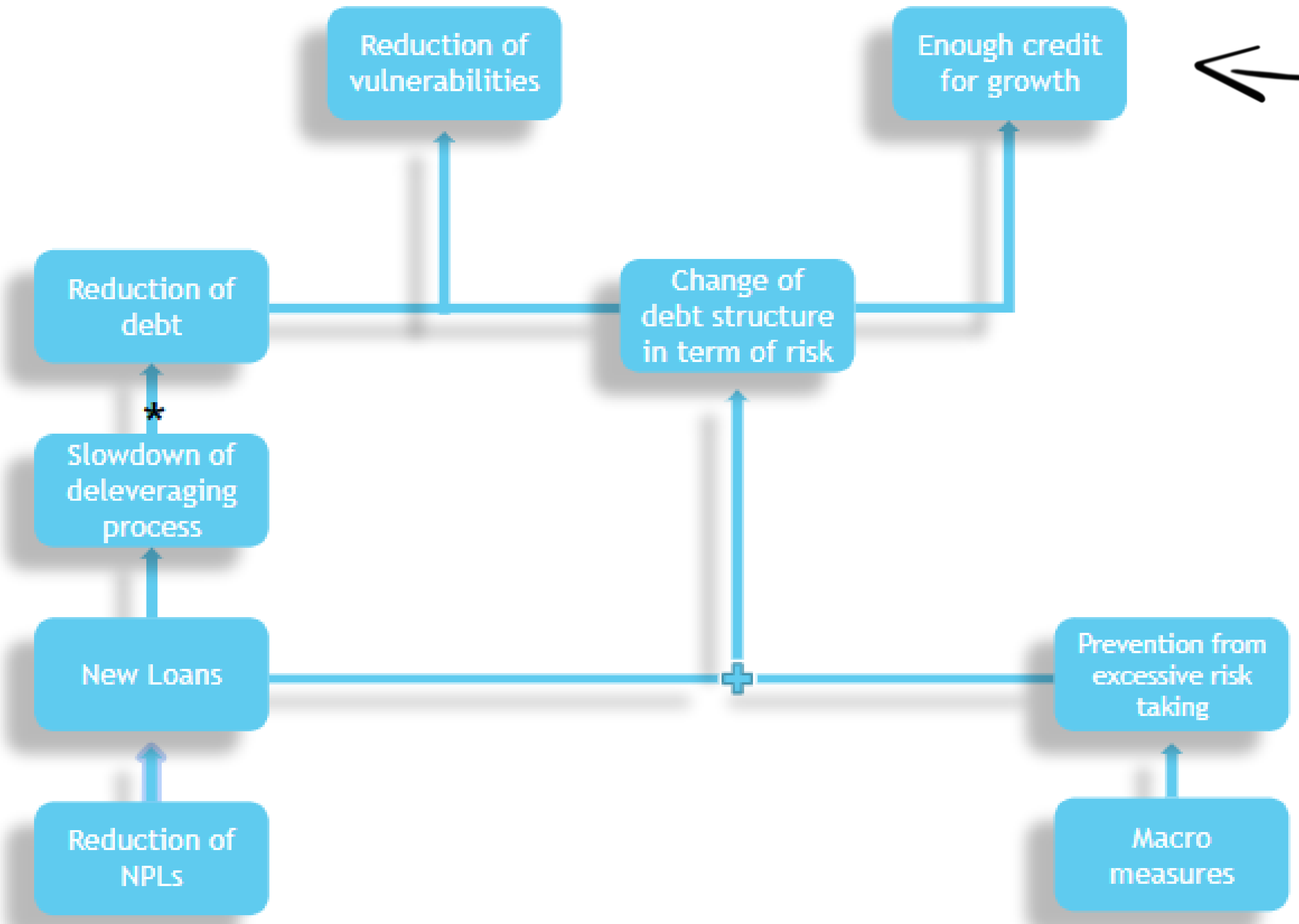
High non performing assets still affect profitability and updating business models will be likely to involve upfront costs as closing bank branches.



Increase in Housing prices

Housing prices increased by **20%** in 2013

Share of housing transactions financed by Portuguese mortgages reached **41%** in the last quarter of 2017 and keeps growing



Objectives

Measures

*Slowdown of deleveraging process is an obstacle to reduction of debt

POLICY DISCUSSIONS

B. External Balance and Policies

External Balance and Policies

Problem: Portugal's external position remained weaker than consistent with medium-term fundamentals and desirable policy settings in 2017

Possible solution: Continued and sustained quality upgrades and innovation, supported by appropriate structural, fiscal, and financial policies, would contribute to stronger external balances, as would the maintenance or improvement in price competitiveness.

Annex III

Overall Assessment:

A strong improvement to a more sustainable NIIP position would require sustained current account surpluses for a long period. In 2018 the CA is projected to deteriorate somewhat with rising import demand.

Potential Policy Responses:

- Sustained fiscal consolidation and structural reforms are going to improve Portugal's competitiveness and potential growth

- To encourage investment we can:
    - Enhance business conditions;
    - Stream regulations;
    - Increase the flexibility and responsiveness of institutions and markets.

POLICY DISCUSSIONS

C. Fiscal issues and policies

IMF Recommendation

Portuguese government should take advantage of favorable economic environment with *front-loaded fiscal plans*:

They could consider a one percent of GDP tightening of the structural primary balance cumulatively over 2018-2019

Structural Reforms : Fiscal Consolidation

Structural reforms to public employment and pensions to achieve lasting consolidation:

- Improve the level and composition of public expenditure
- Increase in pensions spending to reduce the risk of old-aged poverty
- Reduction in pensions of the better off ones

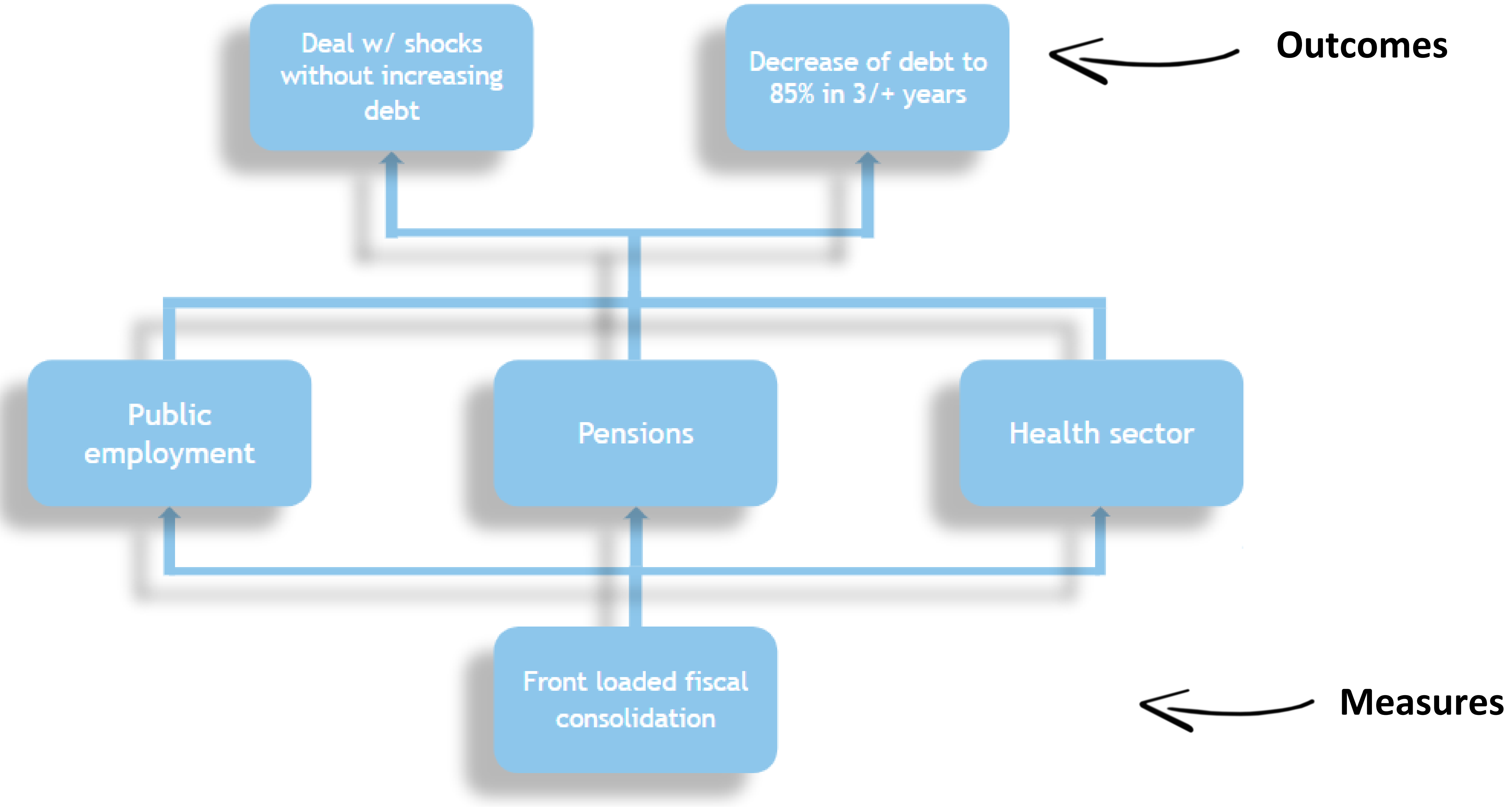
Health sector:

- improve the cost effectiveness and create a joint unit by health and financial ministries

Possible Outcomes

Portuguese Government would be more able to:

- Deal with potential shocks without provoking increase in debt
- Achieve the reduction of public debt to 85% in 3 or + years


Deal w/ shocks without increasing debt
Decrease of debt to 85% in 3/+ years
Outcomes
Public employment
Pensions
Health sector
Front loaded fiscal consolidation
Measures

POLICY DISCUSSIONS

D. Structural Issues
Investment and Growth

Convergence And Vulnerabilities

Convergence:

- **Past developments:**

Average income fell further behind the euro area core, during the crisis

- **Prediction:**

growth of GDP pc just above that in euro area → convergence is not expected

Vulnerabilities:
Large stock of public and private debt → vulnerabilities

Recommendation:
Faster growth → facilitation of both income convergence and further deleveraging

Potential Growth

Improvements:

- Reforms implemented (e.g. product market competition, effectiveness of judicial system)
- Shift of investment composition towards tradable sectors

Obstacles:

- ➢ Structural bottlenecks
- ➢ Unchanged policies
- ➢ Labor factor growth:
  - Decline in working age population
  - Contracting labor force

Prediction:

Potential growth at around 1.4% over the medium term (moderate growth)

Increase of Growth

Necessary condition:
stronger domestic saving → finance of additional private investment

More specifically:

- Need to reduce fiscal deficits → public investment is likely to remain constraint private investment should be the driving force → need of private saving to finance it

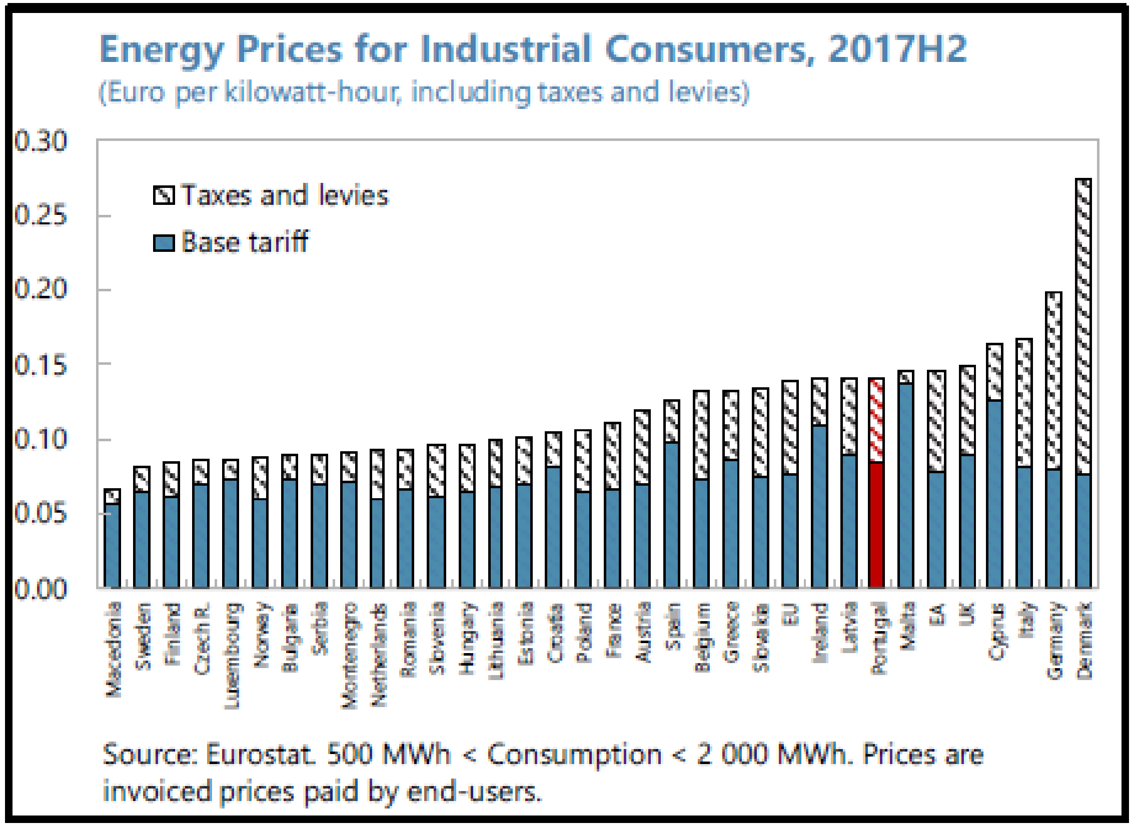
    - So, authorities should support:
        - ➢ Gross corporate saving and
        - ➢ Household saving

Relative structural reforms

Need to overcome significant structural challenges → boost investment + raise productivity

In particular:

- Uncertainty and regulation:
    - Stable regulatory and tax environment → limit uncertainty (deterrent to investment)
- Energy prices:
    - Review of existing tariff framework → reduction of energy prices → increase of competitiveness



Relative structural reforms

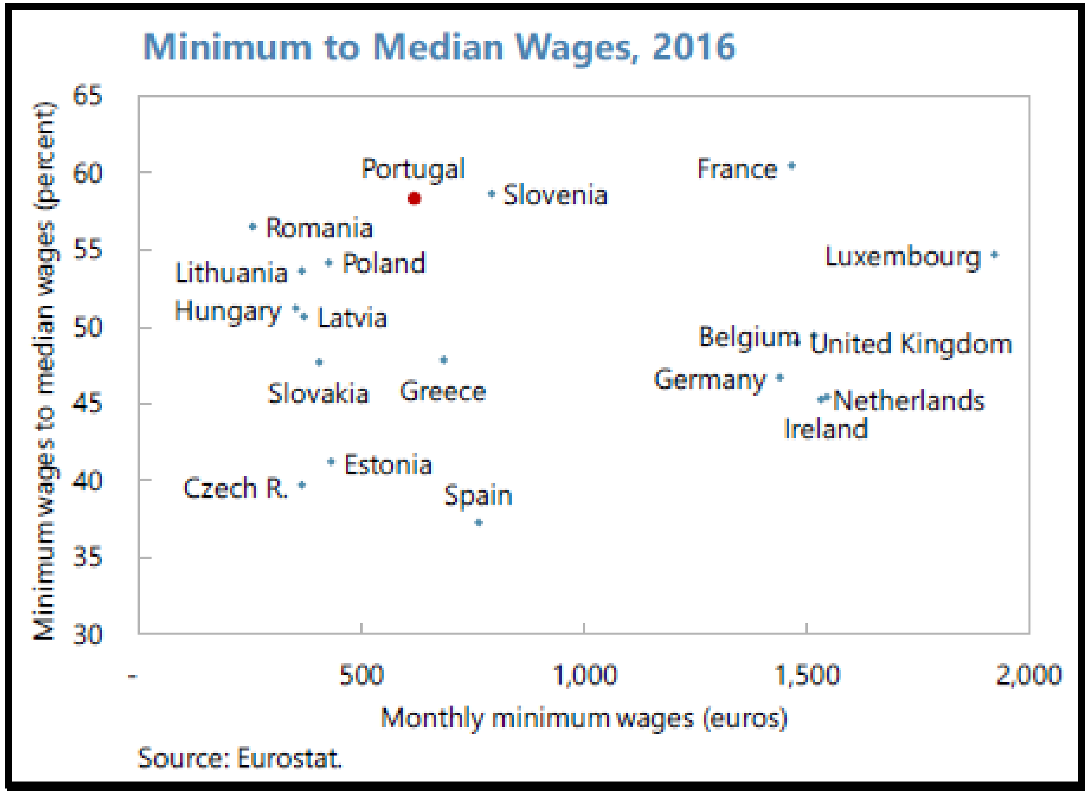
Need to overcome significant structural challenges → boost investment + raise productivity

In particular:

Wage growth and productivity:

- Tightening labor market: wage growth > productivity growth →

  increase of rigidities + reduction of competitiveness
- So, authorities should change this trajectory



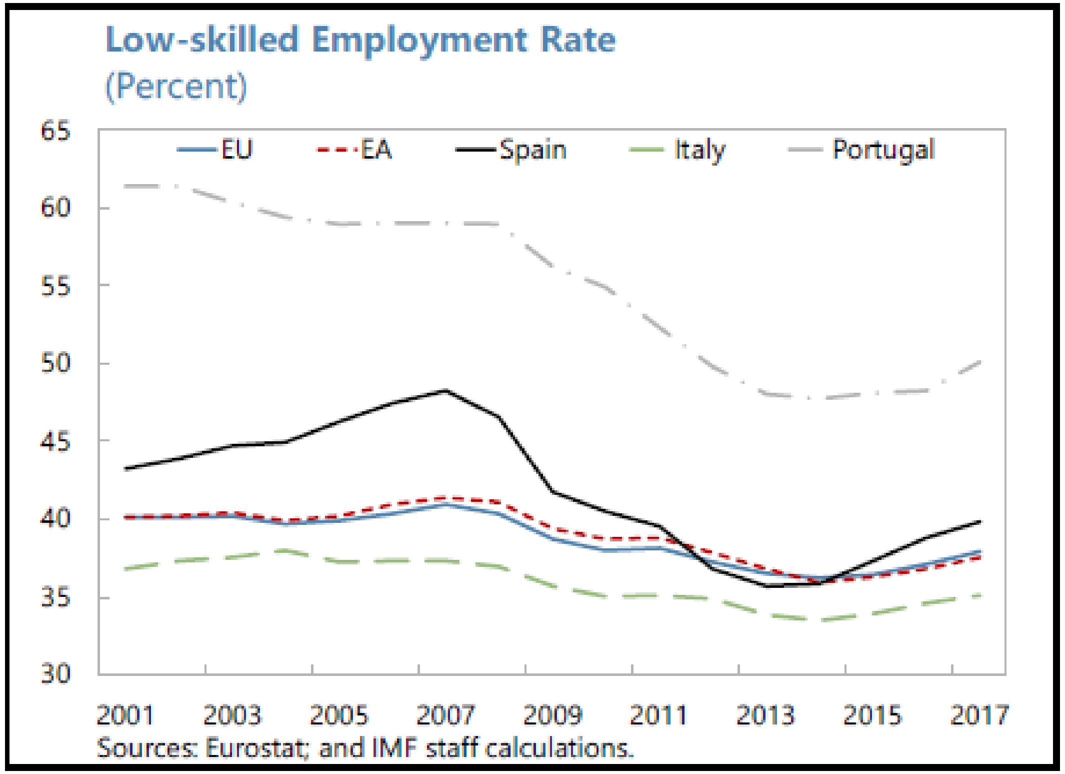
Relative structural reforms

Need to overcome significant structural challenges → boost investment + raise productivity

In particular:

Human capital development:

- Share of low skilled workers is still much higher
  than the EU average
- Gov. should support:
  - ➢ On- and off the job practice
  - ➢ Linkages between public education and industry



Relative structural reforms

Need to overcome significant structural challenges → boost investment + raise productivity

In particular:

- Legal and institutional framework for debt enforcement and insolvency
  - ➢ The reforms of legal and institutional framework for debt enforcement and insolvency → positive results on
    - resolution efficiency
    - Debt recovery
    - NPL resolution
- Staff recommends further actions in two areas:
  - ➢ Enable public creditors to participate more fully in debt restructuring
  - ➢ Prioritize addressing conditions allowing non viable insolvency to delay liquidation

Labor Market Regulations

Market flexibility → adoption of future shocks + support of productivity growth

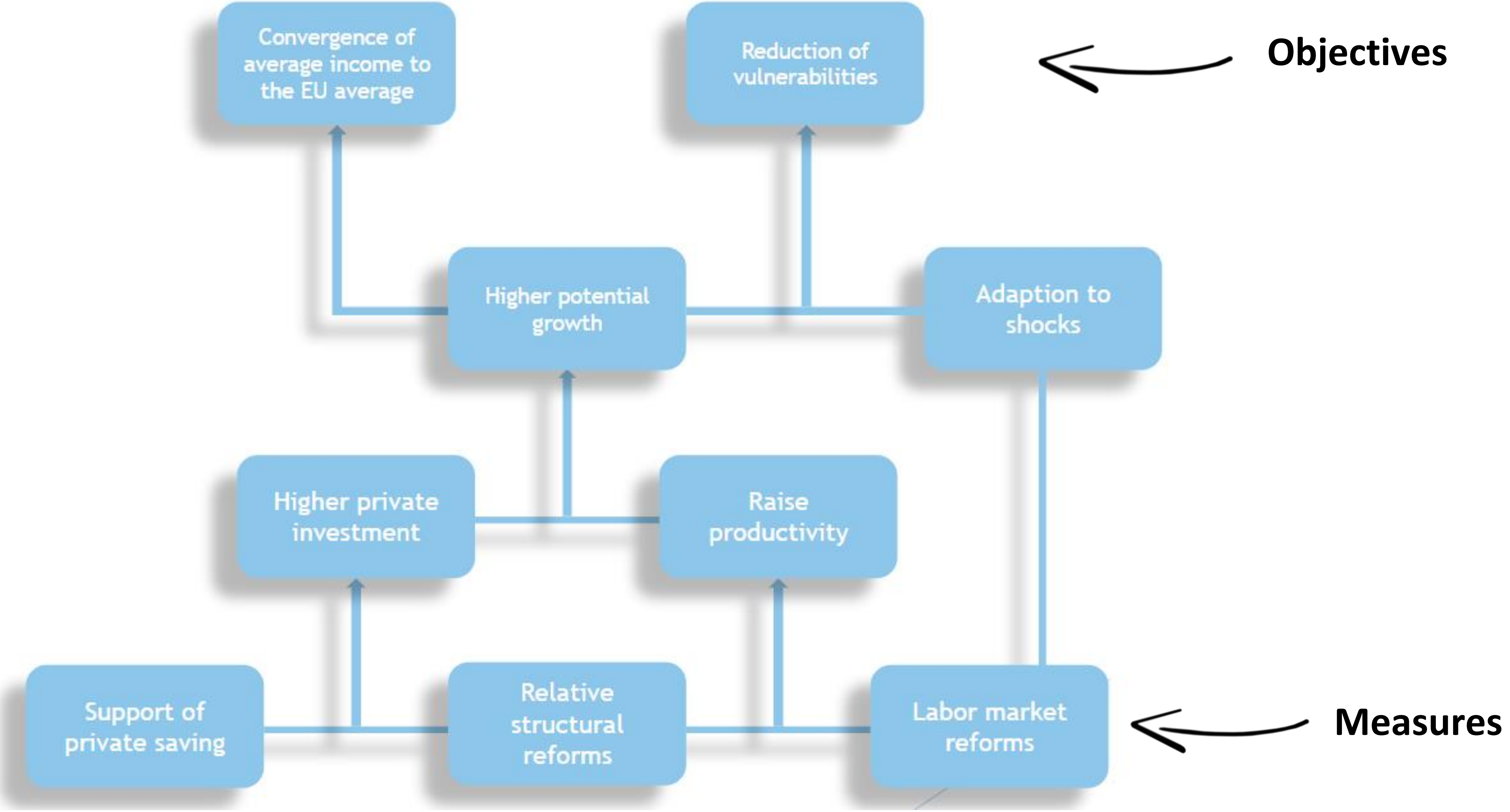
Temporary jobs in Portugal still present a large fraction of employment by European standards

So, the government coordinated tripartite negotiations on labor regulation → increase of job security + reduce segmentation

These reforms:

- Create constraints on temporary contracts
- Make permanent contracts more flexible

→ net effects on economic flexibility are hard to predict


Convergence of average income to the EU average
Reduction of vulnerabilities
Objectives
Higher potential growth
Adaption to shocks
Higher private investment
Raise productivity
Support of private saving
Relative structural reforms
Labor market reforms
Measures

Authorities' Views

AUTHORITIES' VIEWS

A. Macro-Financial Issues

1) Deleveraging in the non financial private sector to prevent future shocks
2) Creation of a common decision body between the tax authority and the social security administration to participate in restructuring negotiations
3) Ensuring strong and sustained bank profitability
4) Macro measures to prevent mispricing of risk and excessive risk taking

AUTHORITIES’ VIEWS

B. External Balance and Policies

DESIRABLE: A stonger NIIP position
HOW? Sustained Current Account Surpluses.

- They forecast a current account surplus implying an improvement in the medium-term.
- They expect that Portgal’s position continues to improve due to increased innovation, continued movement up the quality ladder, a well-educated labor force, and other factors improving non-cost competitiveness.

AUTHORITIES' VIEWS

C. Fiscal Issues and Policies

1) Sustained decline of current expenditure to 2,4% of GDP by 2022
2) Fiscal deficit decline to 0,7% of GDP in 2018
3) Reduction of public debt to 102% of GDP by 2022
4) Enhance of efficiency and inclusion of the most vulnerable groups:

AUTHORITIES' VIEWS

D. Structural Issues: Investment and Growth

Stability program 2018-22: potential growth of around two percent over the medium term
There is need

1) to boost investment and savings
2) business environment
3) better management skills
4) foster innovation in small businesses (migrants)

New measures implemented:

1) public post restructuring financing instrument
2) co investment initiatives
3) renewed credit facilities with mutual guarantee
4) new type of listed companies holding shares in unlisted Pt firms

THE END

Conclusion

First Part :

- Real GDP growth will decline, being moderate over the medium term;
- Unemployment will decline ;
- Inflation will be relatively stable, but there will be a small increase over the medium term;
- Price competitiveness has been stabilised;
- Credit is increasing but still lags the economy;
- General government is negative and declining, while structural primary balance is positive and increasing;
- Current account balance will deteriorate;
- Bank’s balance sheet has strengthened.

Conclusion for Policy Discussions

A. Macro-Financial Issues

1. Pace of deleveraging is slow amid financial conditions;

1. Banco of Portugal deployed macroprudential measures to prevent the financial sector from taking excessive risk;

1. Non-Performing Loans are still a concercern that are being pursued with specific strategies;

1. The challenge of generating strong and sustained bank profitability;

1. Housing prices continue to increase but with no significant overvaluation yet;

Conclusion for Policy Discussions

B. External Balance and Policies

- Portugal's external position remained weaker than consistent with medium-term fundamentals and desirable policy settings.
- The Net International Investment Position (NIIP) is still in deeply negative territory.
- It is expected that Portugal's external position will continue strengthening.

Sustained current account surpluses over the medium term.

Conclusion for Policy Discussions

C. Fiscal policy

1. Front loaded fiscal plans provide space to deal with potential shocks and lead to a faster reduction of debt

1. The fiscal consolidation should concentrate on the current balance, with structural reforms to public employment and pensions; improvements in health sector.

Conclusion for Policy Discussions

D. Structural Issues -Investment and Growth

- **Higher medium term growth is necessary for Portugal to converge to euro area standards of living and reduce vulnerabilities**
- **Potential growth in the medium term will remain moderate**
- **It is required stronger domestic saving to finance additional private investment in order to increase growth**
- **Portugal has to overcome significant structural challenges to boost investment and raise productivity**
- **Labor market flexibility is important for the economy to adapt to future shocks and to support productivity growth**

Conclusion

DSA

Trajectory of indexes:

- the baseline and constant primary balance scenario predict decline of debt close to 100% until 2023 and decline of financing needs close to 10%
- the historical scenario predicts quite higher values of the indexes

Comparison with high risk thresholds:

- in every case, Debt ratio will remain above the high risk threshold
- in the the baseline and constant primary balance scenario Financing Needs will remain below the high risk threshold, but in the historical scenario it will be above it

Risk:

- generally, public debt remains subject to significant risks as we can see from the stress tests

Conclusion

ANNEX II

Biggest threats

- Rising protectionism and retreat from multilateralism.
- Sharp tightening of global financial conditions

ANNEX IV - Labour Market Developments

- Labour market reforms and human capital development will promote more inclusive growth;
- They would help to address demographic pressures going forward and reduce pressure on social programs.