Conselho das Finanças Públicas
Portuguese Public Finance Council

Public finance in Portugal – an overview of current and future issues

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Meeting of the Association
of former members of the
European Court of Auditors

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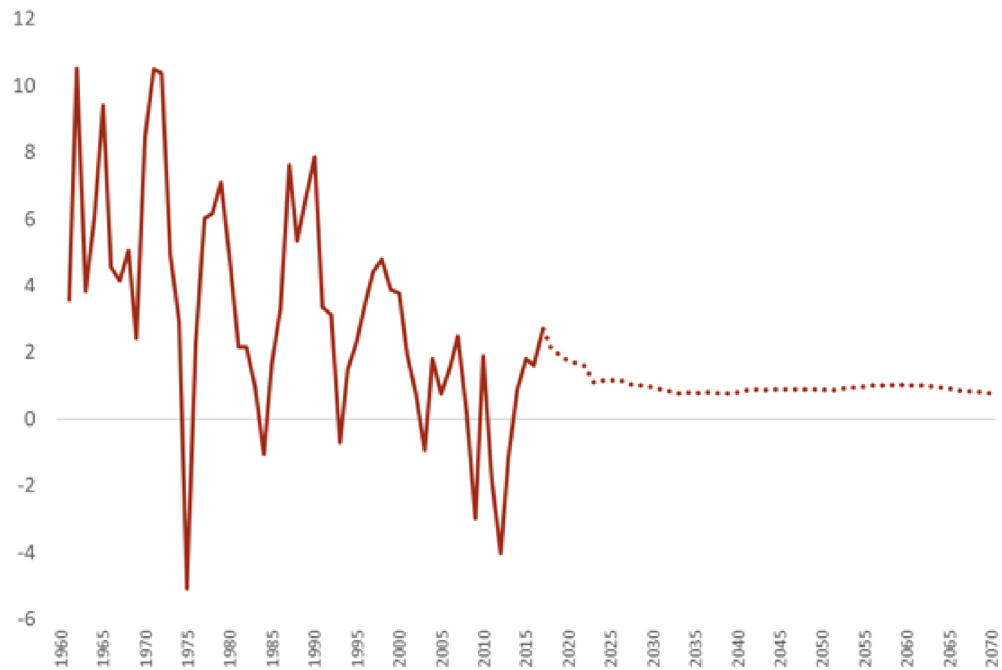
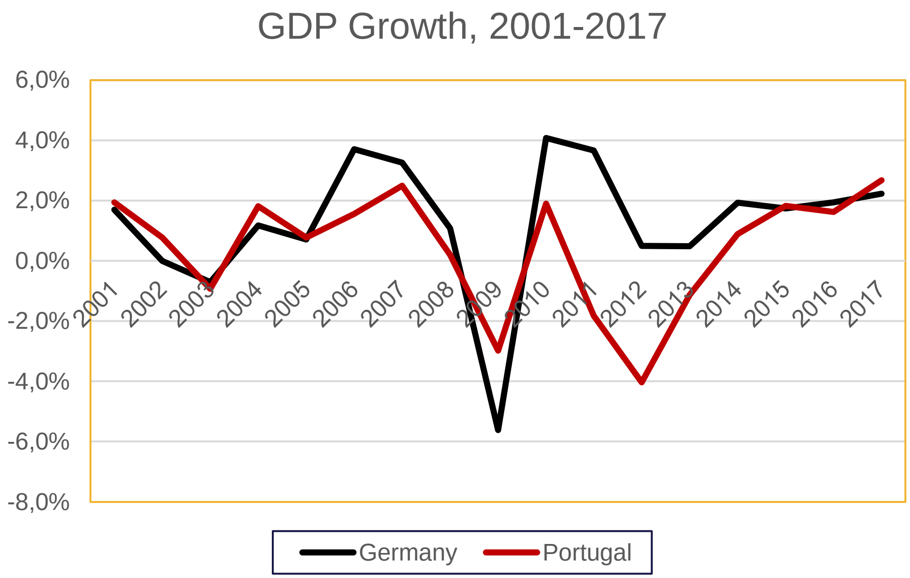
All opinions expressed here are my own and do not reflect the official position of any institution.

1. Recent economic performance – an overview
2. Some weaknesses
3. The risks – there may be trouble ahead
4. Some policy conclusions

Chart 1 – Portuguese real GDP growth rate (change %)



Source: European Commission (AMECO) (1961 to 2017); CFP (2018 to 2022); *Ageing Report 2018* (2023-2070).



Portugal is not growing more than most of other countries in Europe or in the euro area.

The path left behind is one of strong divergence.

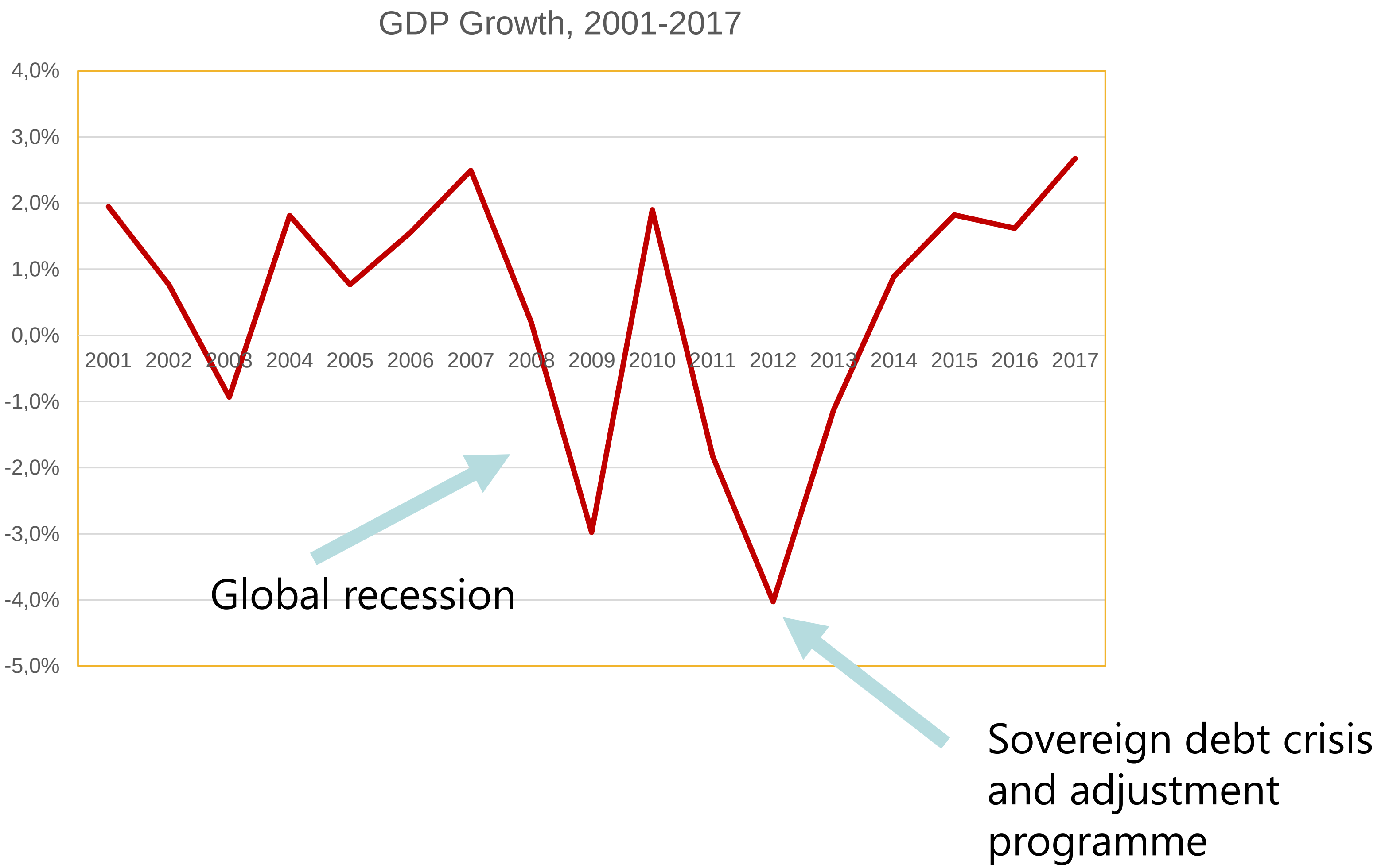
Global great recession: GDP drop of 3 percent in Portugal in 2009, half of the GDP fall in Germany.

7th April 2011 - Financial help requested.

Joint EU/IMF financial assistance programme. € 78 billion conditional loans from the “troika” (the IMF, the European Commission and the European Central Bank).

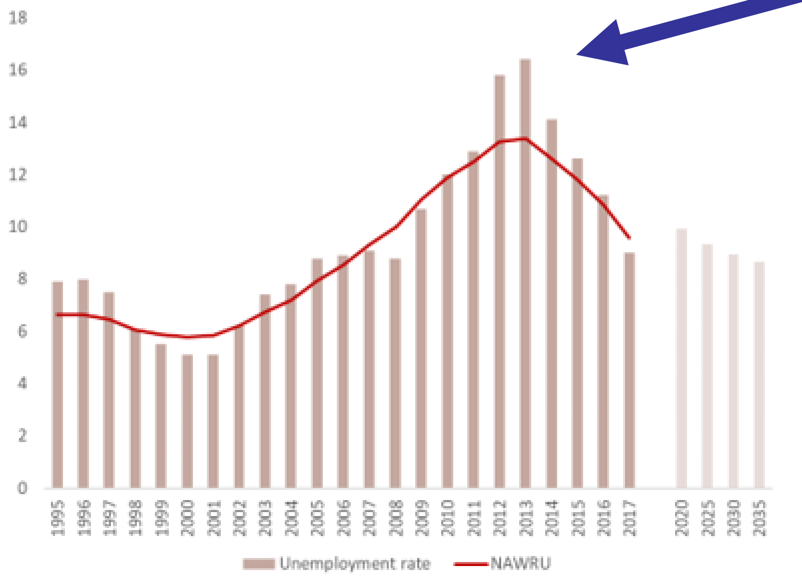
Set of policies (the “austerity measures”) directed towards:

- fiscal sustainability
- growth enhancing reforms, including liberalising the labour market, the housing market, and the goods and services market, increasing efficiency in the judicial system and fostering external competitiveness (“internal devaluation”).
- to provide support to banks and to the financial system.



GDP Growth, 2001-2017
4,0%
3,0%
2,0%
1,0%
0,0%
-1,0%
-2,0%
-3,0%
-4,0%
-5,0%
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
Global recession
Sovereign debt crisis and adjustment programme

Chart 5 – Unemployment rate and NAWRU (%)



Highest rate ever recorded.

Commulated GDP growth, 2000-2017

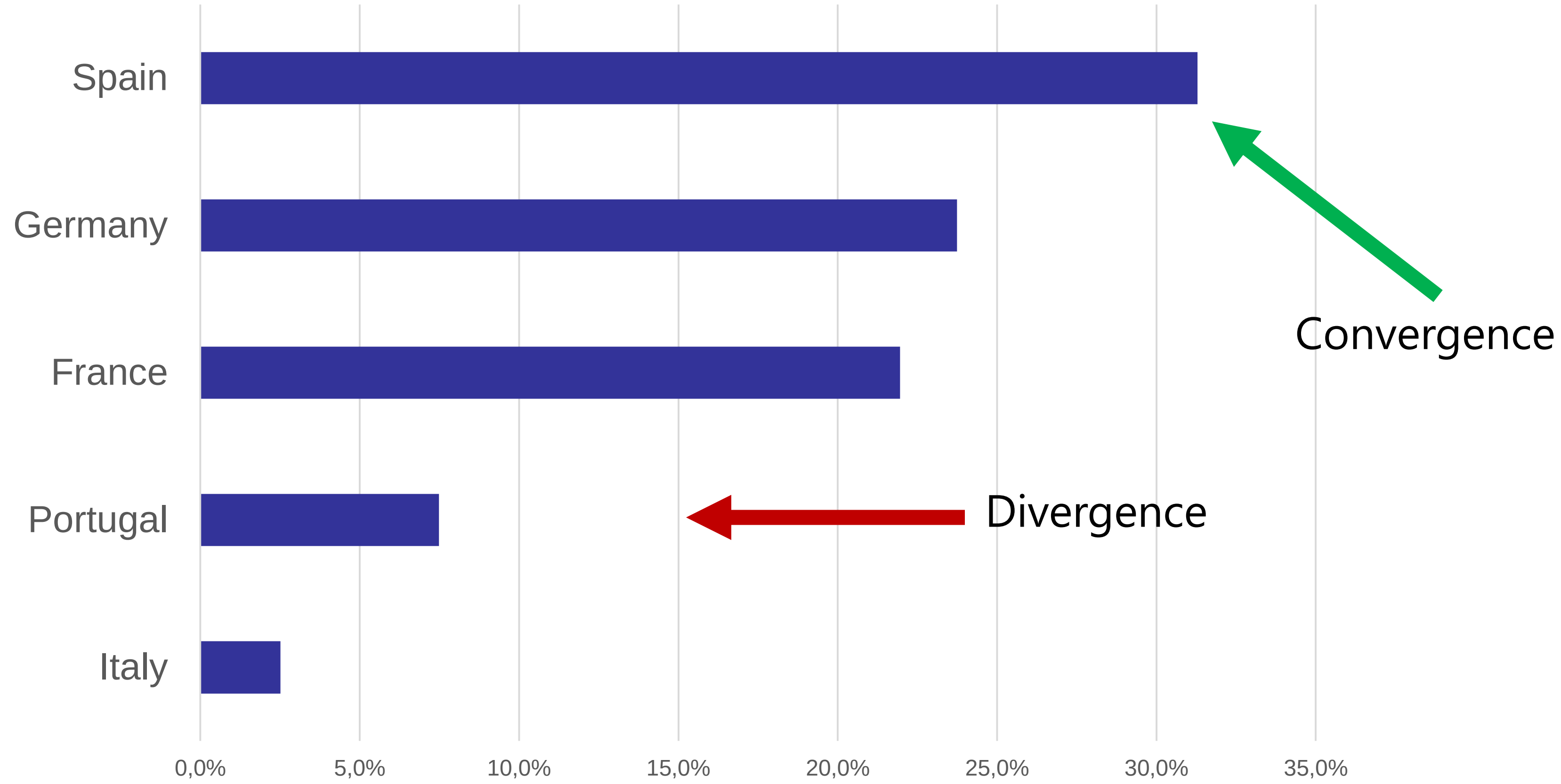
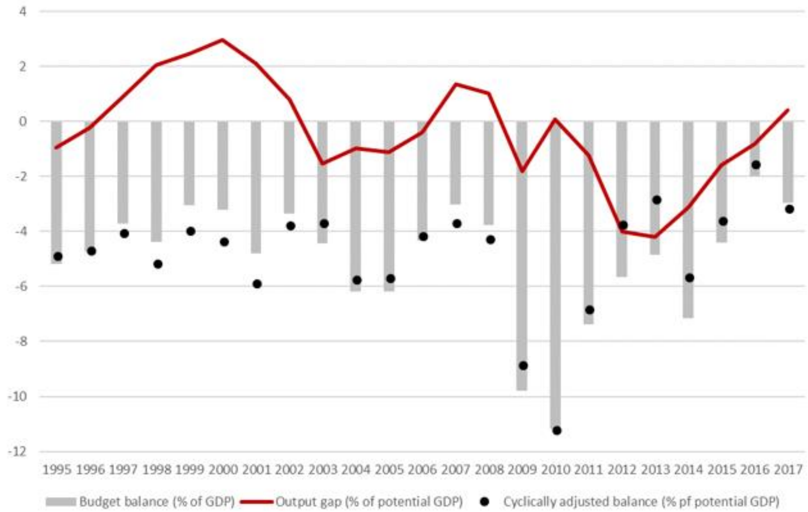


Chart 11 – General government budget balance, cyclically adjusted balance and output gap

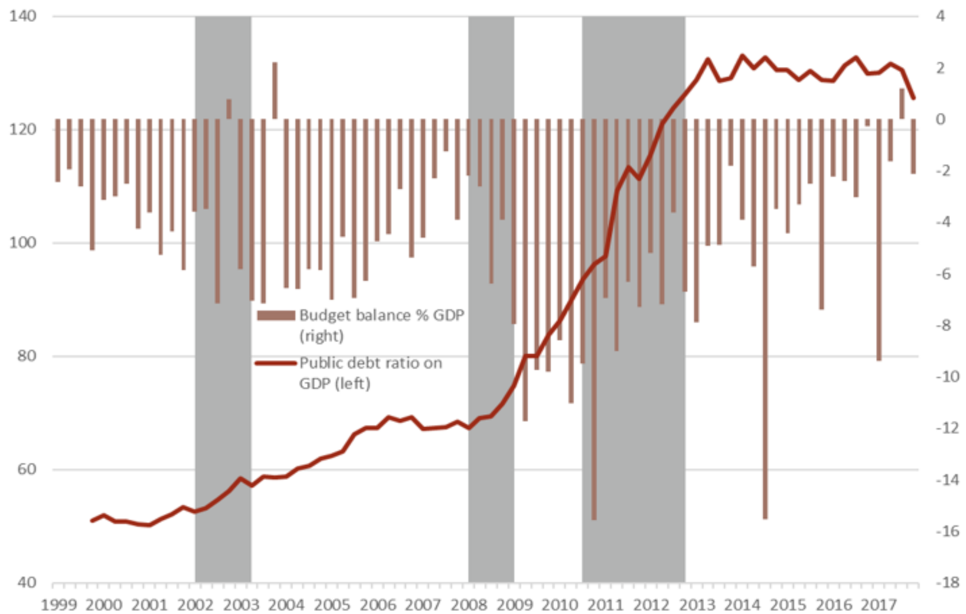


Sources: INE, CFP and European Commission (AMECO).

The adjusted budget deficit decreased from 7.2 percent of GDP in 2009 to 0.5 in 2018:

- wage and benefits freezing and decreases
- declining investment
- tax increases

Chart 13 – Government balance and public debt, 1999-2017 (% of GDP)



Note: The shaded areas represent recession periods in Portugal during the sample period.

Sources: INE (quarterly national accounts by institutional sector), Bank of Portugal and CFP calculations.

Budget deficit reduction was accompanied by a significant public debt *increase*.

Table 1 – Debt dynamics

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
debt (in p.p. of GDP)	**71,7**	**83,6**	**96,2**	**111,4**	**126,2**	**129,0**	**130,6**	**128,8**	**129,9**	**125,7**
Change in debt (in p.p. of GDP)	**3,2**	**11,9**	**12,6**	**15,2**	**14,8**	**2,8**	**1,6**	**-1,8**	**1,1**	**-4,2**
Primary deficit	0,7	6,8	8,2	3,1	0,8	0,0	2,3	-0,2	-2,2	-0,9
Dynamic effect (snow ball effect)	1,8	4,4	0,8	6,4	10,0	3,5	2,8	-0,3	0,2	-1,2
- interest effect	3,1	3,0	2,9	4,3	4,9	4,9	4,9	4,6	4,2	3,9
- growth effect	-1,3	1,4	-2,1	2,1	5,1	-1,4	-2,1	-4,9	-3,9	-5,1
Stock-flow adjustment	0,8	0,7	3,5	5,8	4,0	[illegible]	-3,5	-1,4	3,1	-2,1

Source: CFP, Portugal

Recession

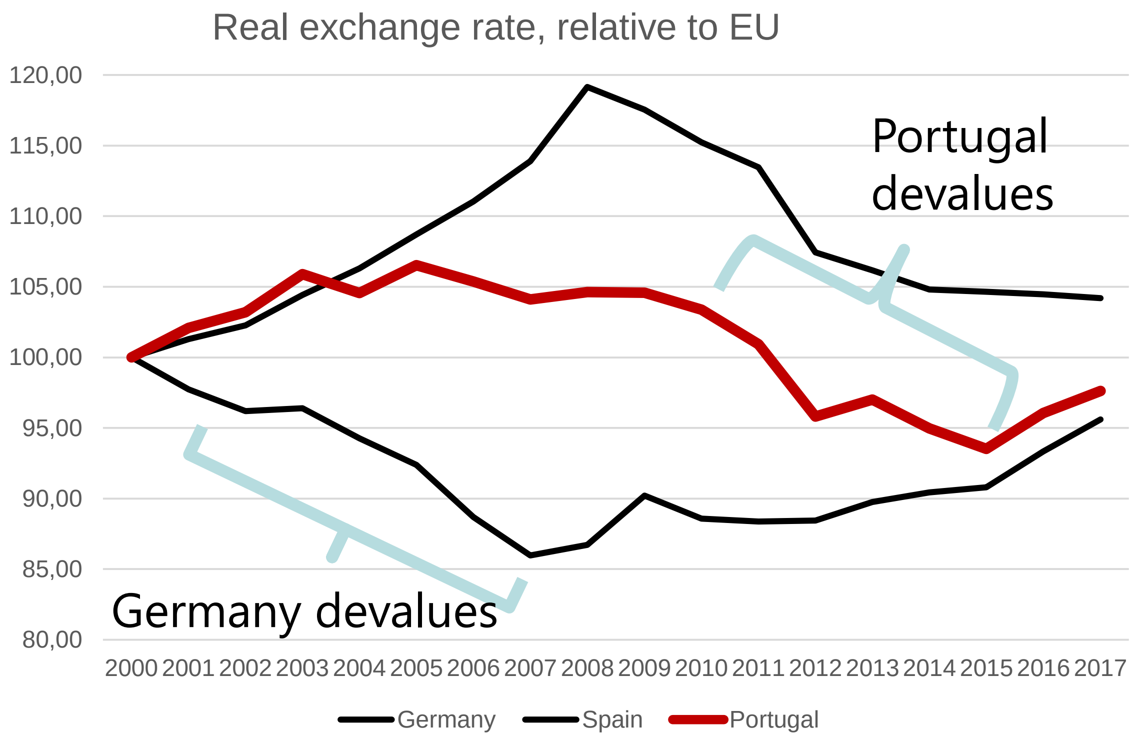
- Assumption of debt previously in state companies
- Aid to the banking sector
- ...

Highest rate recorded since World War II

Internal devaluation was successful in promoting net exports…

… exports were also stimulated by the lack of domestic demand and the entrepreneurship of domestic producers in finding new clients abroad.

It could be the case that a more open economy was to result from these changes.



Internal devaluation mechanism:

- fiscal contraction
- aggregate demand contraction
- recessionary environment
- higher unemployment
- public sector wage cuts

1. Recent economic performance – an overview

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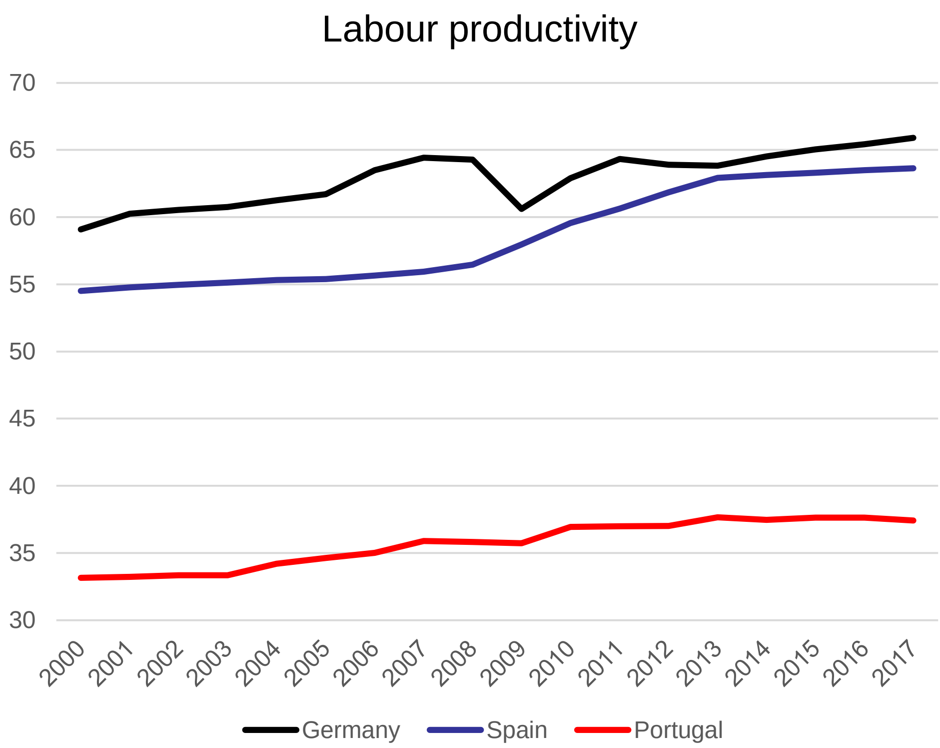
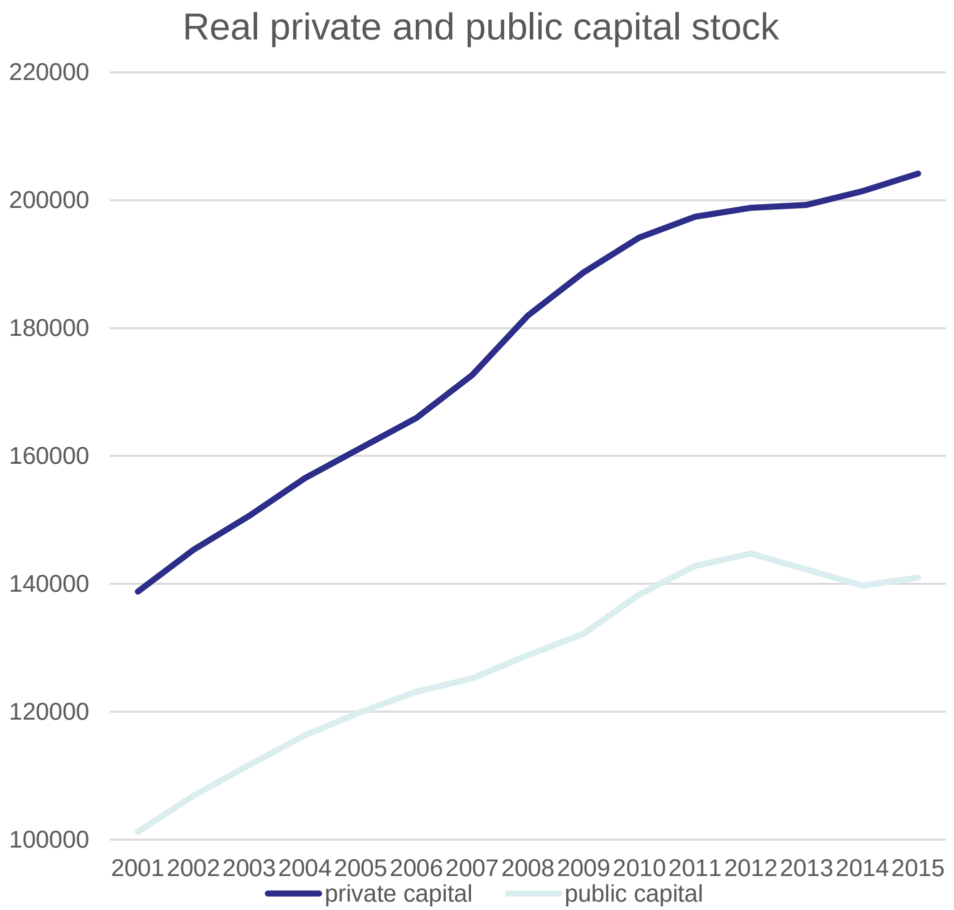


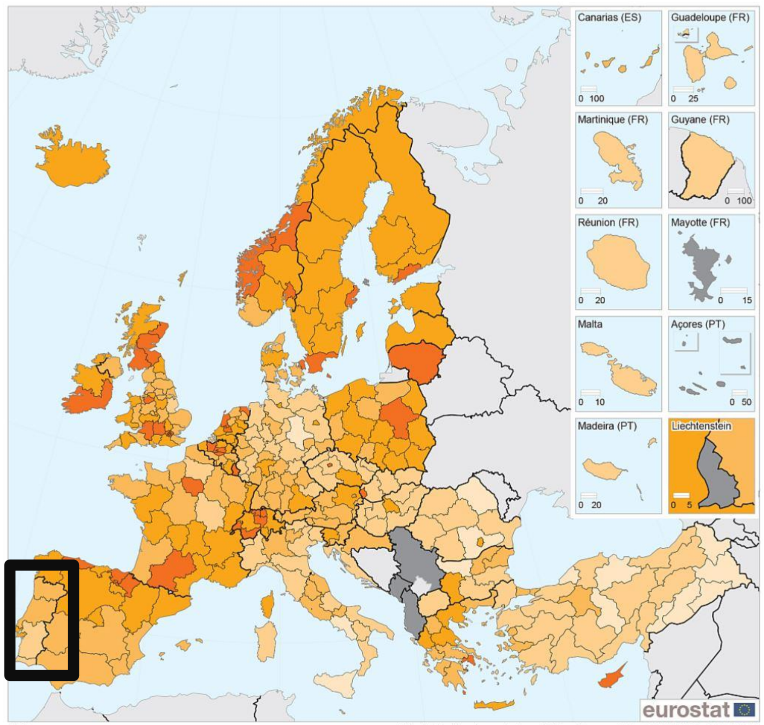
Portuguese economic growth remains fragile:

- previously idle employment is put into use
- there is no improved productivity



Lack of investment and of physical capital is one of the impediments to productivity growth.

Share of persons aged 30–34 with tertiary education (ISCED levels 5–8) attainment, by NUTS 2 regions, 2016
(%)



(%)

Administrative boundaries: © EuroGeographics © UN-FAO © Turkstat
Cartography: Eurostat - GISCO, 07/2017

EU-28 = 39.1

- < 20
- 20 – < 30
- 30 – < 40
- 40 – < 50
- >= 50
- Data not available

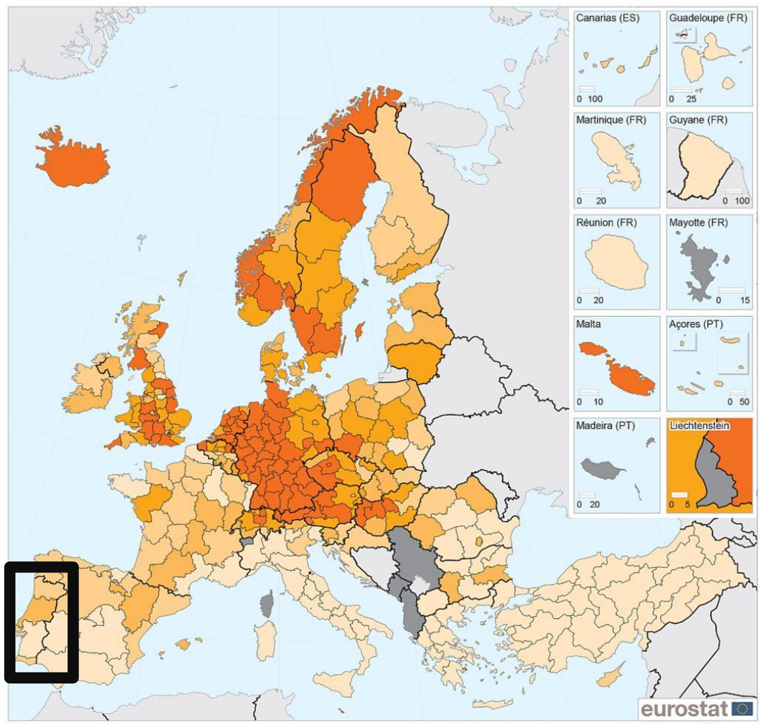
0 200 400 600 800 km

Note: Ionia Nisia (EL62), Ciudad Autónoma de Ceuta (ES63), Ciudad Autónoma de Melilla (ES64), Corse (FR83), Guyane (FRA3), Valle d'Aosta/Vallée d'Aoste (ITC2), Luxembourg (LU00): low reliability.
Source: Eurostat (online data code: edat_lfse_12)

The lower average of schooling years of the Portuguese labour force is increasing and slowly converging to the more developed economies levels.

There is no region in Portugal where the percentage of younger people, 30 to 34 years old, with tertiary education is above 30 percent.

Employment rate of recent graduates aged 20–34 with at least an upper secondary level of educational attainment (ISCED levels 3–8), by NUTS 2 regions, 2016
(%)



(%)

Administrative boundaries: © EuroGeographics © UN-FAO © Turkstat
Cartography: Eurostat - GISCO, 07/2017

EU-28 = 78.2

- < 70
- 70 – < 76
- 76 – < 82
- 82 – < 88
- >= 88
- Data not available

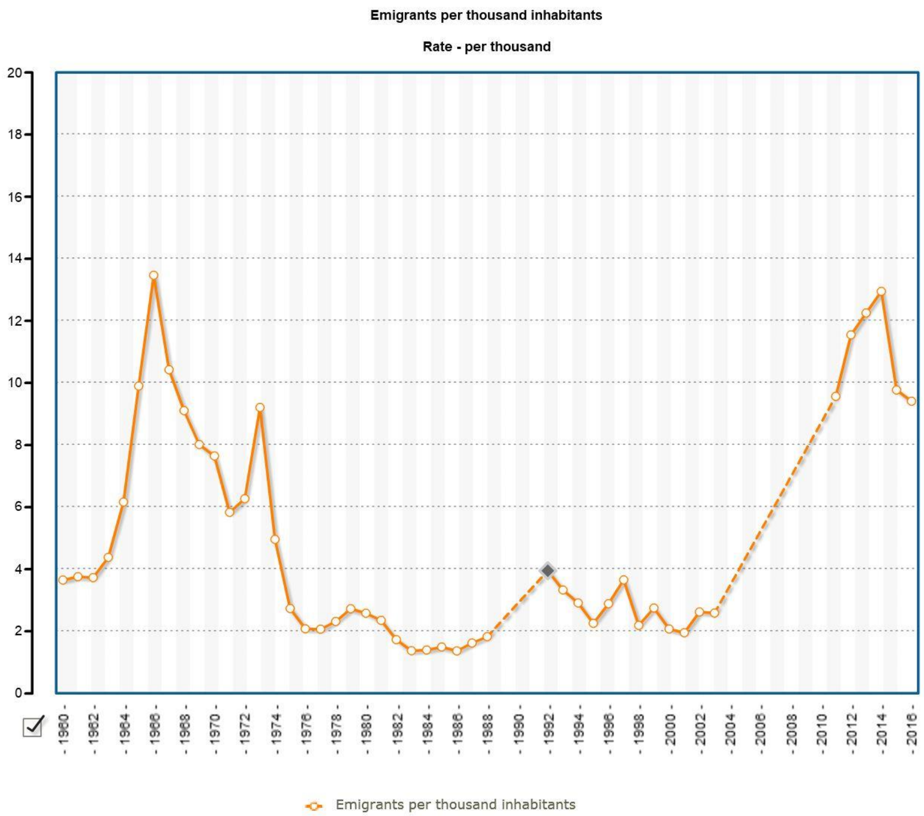
0 200 400 600 800 km

Note: Ciudad Autónoma de Melilla (ES64), North Eastern Scotland (UKM5) and Switzerland: 2015. Ciudad Autónoma de Ceuta (ES63): 2013. Severozapaden (BG31), Severen tsentralen (BG32), Voreio Aigaio (EL41), Notio Aigaio (EL42), Dytiki Makedonia (EL53), Ipeiros (EL54), Ionia Nisia (EL62), Peloponnisos (EL65), La Rioja (ES23), Ciudad Autónoma de Ceuta (ES63), Ciudad Autónoma de Melilla (ES64), Limousin (FR63),Guadeloupe (FRA1), Martinique (FRA2), Guyane (FRA3), Burgenland (AT11), Cornwall and Isles of Scilly (UKK3), North Eastern Scotland (UKM5), Highlands and Islands (UKM6): low reliability.

Source: Eurostat (online data code: edat_lfse_33)

Employment rate of graduates aged 20 to 34 with at least upper secondary education:

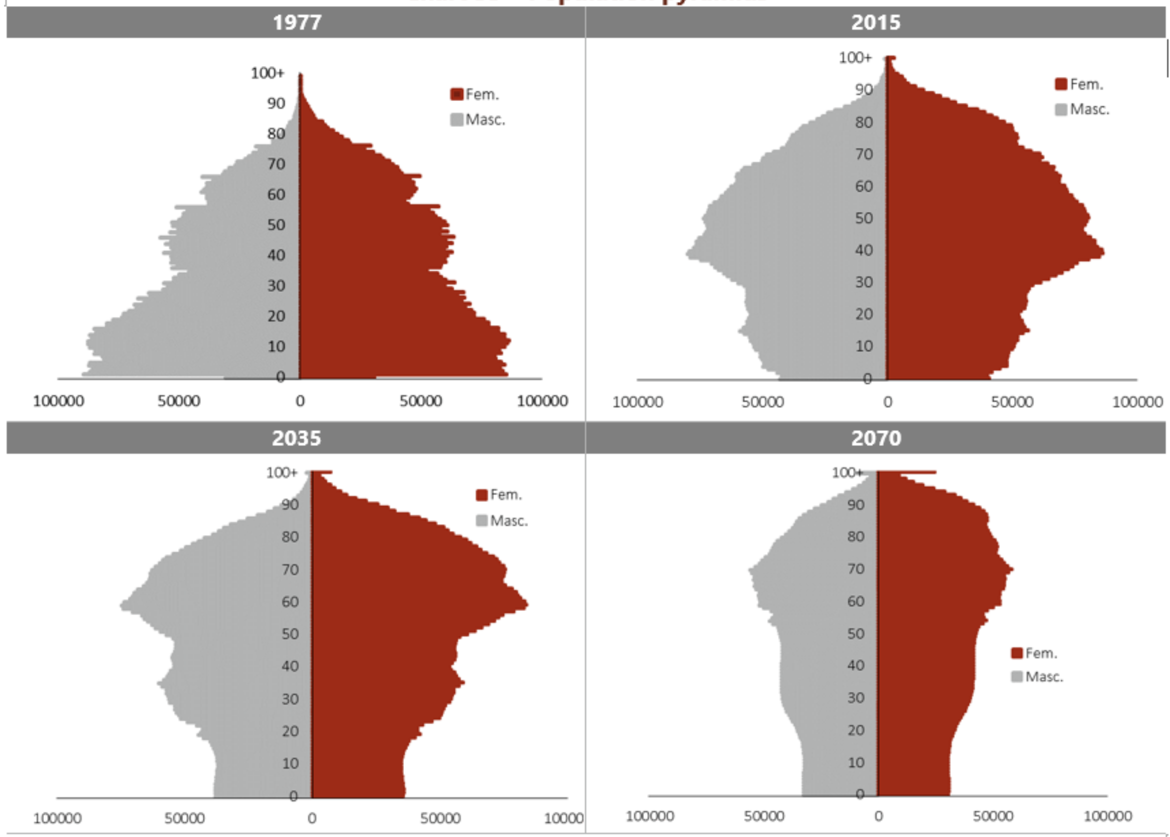
- all regions in Portugal are below the 82 percent threshold.
- this country is underusing its most important resources, educated young people.



The traditional emigration escape valve reappeared with full force:

- emigration rate above 12 per thousand in 2013,
- values not seen in Portugal since last century 60s and early 70s.
- this development has led to some concern about the future consequences of a Portuguese brain drain.

Chart 35 – Population pyramids



Sources: INE, Eurostat and CFP calculations.

Population in Portugal is decreasing at a considerable pace:
- emigration
- declining natality rates

Impressive aging tendency (pressure it puts on public accounts and on social security):
- 2016, a fifth of the Portuguese is older than 65.
- 2070, more than a third is older than 65.

1. Recent economic performance – an overview

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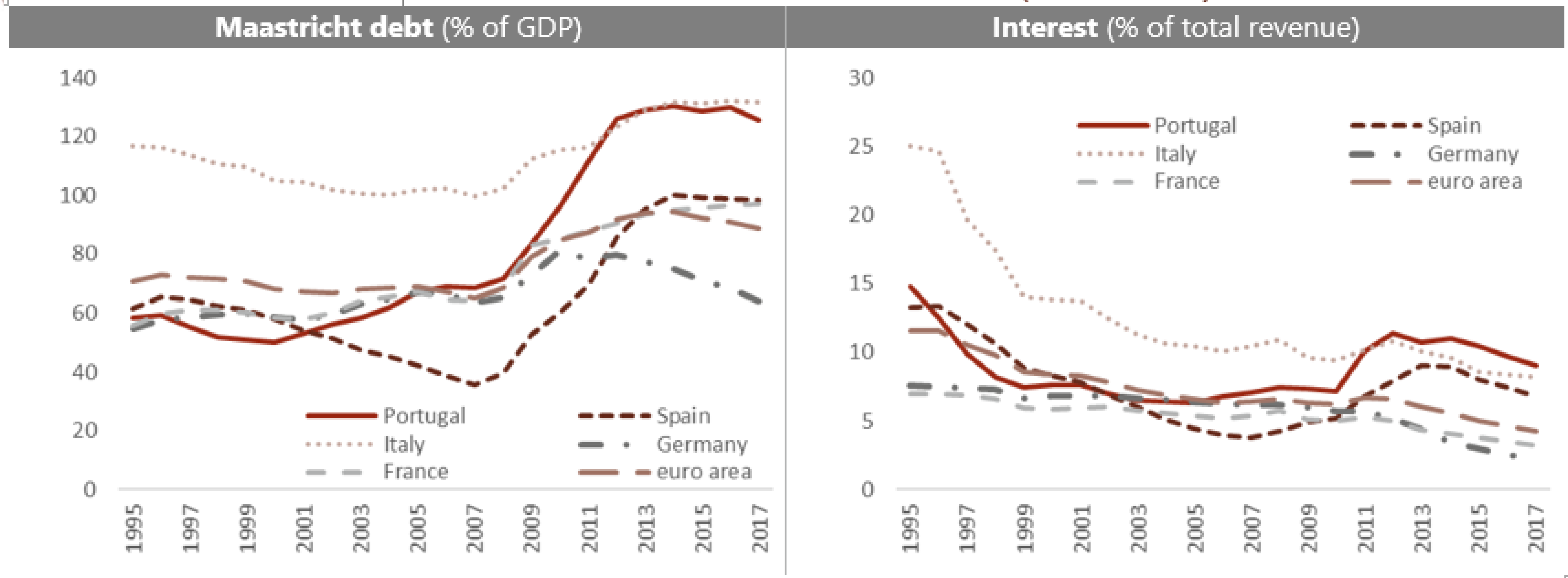
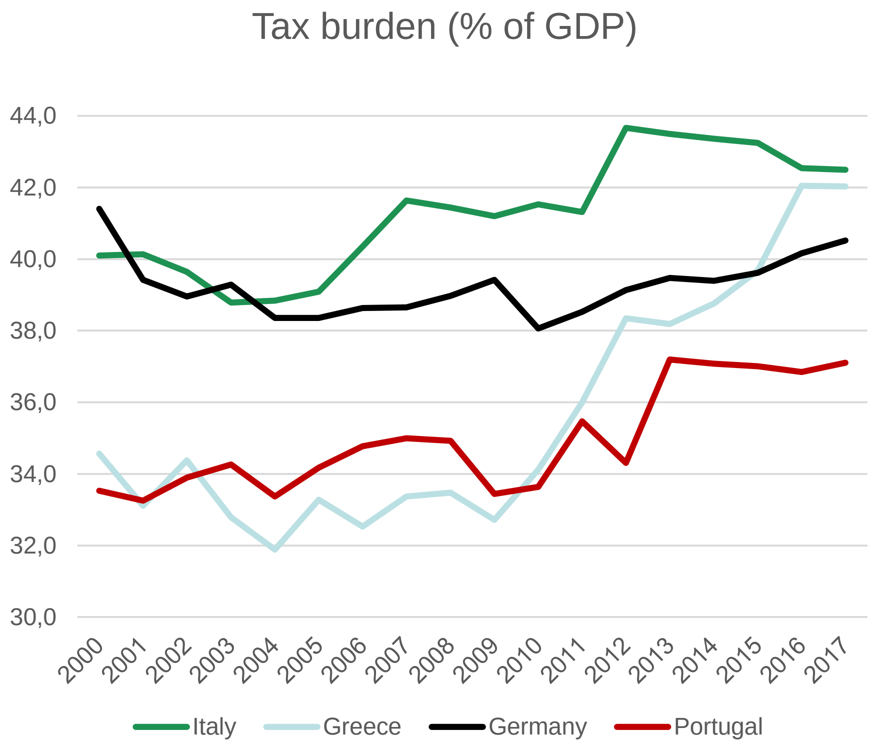
Chart 57 - Public finances in the euro area (in % of GDP)



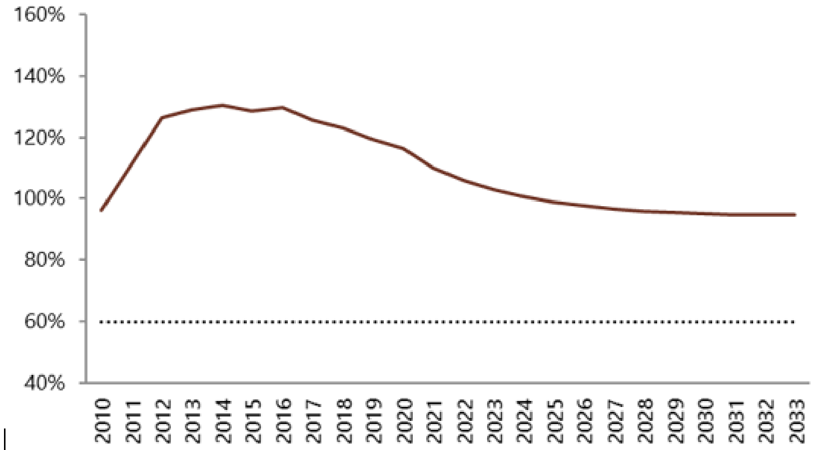
Source: European Commission. CFP calculations.

Portugal is the country where government interest payments are higher (about 4 percent of GDP).



Taxes have been increased recently. They are still a bit lower than in some other countries as a percentage of GDP.

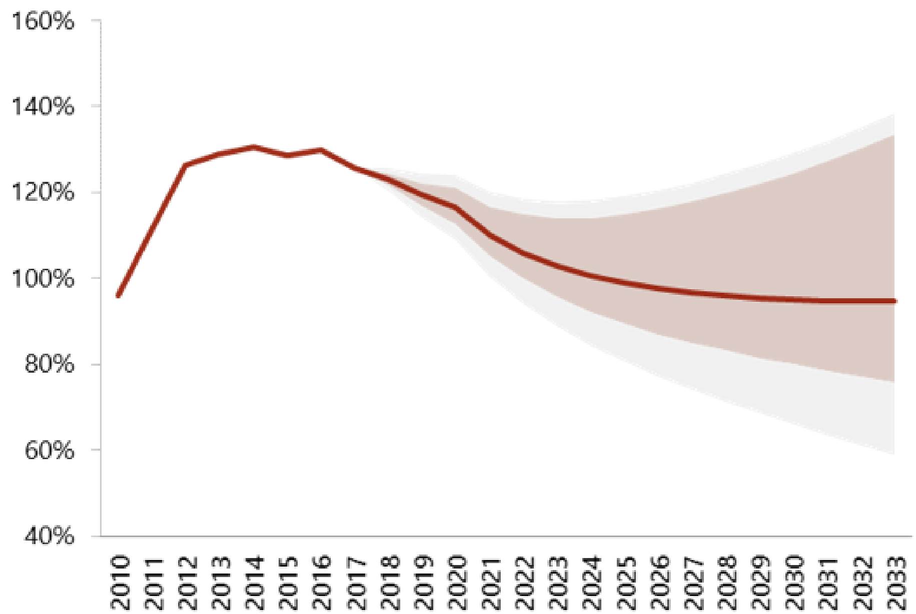
Chart 61 - CFP and EC no policy change scenario, Maastricht debt (in % of GDP)



Source: Bank of Portugal, European Commission, CFP, INE and MF. CFP calculations.

Portuguese public debt is to stay at high values for a long time. Adverse shocks (e.g. coming from the banking system) would possibly change this path to more dangerous avenues where finance would become difficult.

Chart 66 – Sensitivity analysis to a simultaneous shock (GDP, interest rate and PB) (in % of GDP)



Sources: Bank of Portugal, European Commission, CFP, IGCP, INE and MF. CFP projections and calculations.

Portuguese public debt is to stay at high values for a long time. Adverse shocks (e.g. coming from the banking system) would possibly change this path to more dangerous avenues where finance would become difficult.

Based on GDP developments from 1977 to 2017, the probability that Portugal is in recession in any one year is around 15%. Assuming the probability of a recession is independent every year, the probability of the Portuguese economy being in recession at any time over a five-year period is approximately 55%.

	Median value per m2 of dwellings sales, % change, 4th quarter 2017/1st quarter 2016
Total	13,9%
Porto	20,1%
Lisboa	30,0%

Low interest rates have led to investment in non-interest-bearing assets like housing. Prices have risen markedly in Lisbon and Porto.

Some observers and market participants refer to a housing bubble, especially in Lisbon, and relate these developments to the recent rise in tourism and the buying of houses for tourism local lodging.

1. **Recent economic performance – an overview**
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- Special care with fiscal policy. Spending pressures coming from ageing should be dealt with. And special attention to the education sector is necessary.

- Population decreasing and ageing is a problem. Policies to tackle a declining birth rate are necessary, as well as an effective migration policy.

- Investment spending both by government and the private sector are needed. This implies reducing red tape and taking good care of the tax system.

- Modernising and qualifying an aged public administration will also be important in fostering productivity growth in the economy at large.