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Post-Programme Surveillance Report

Portugal, Winter 2015/2016

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European Commission
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Post-Programme Surveillance Report

Portugal, Winter 2015/2016

EUROPEAN ECONOMY Institutional Paper 022

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This Report reflects information available up until 23 February 2016.

ABBREVIATIONS

AMT: Autoridades Metropolitanas de Transportes

AWG: Ageing Working Group

BACH: Bank for the Accounts of Companies Harmonized

Banif: Banco Internacional do Funchal

BES: Banco Espírito Santo

BFL: Budget Framework Law

CCB: Capital conservation buffer

CCyB: Countercyclical capital buffer

CET1: Common Equity Tier 1

CIT: Corporate Income Tax

CoCos: Contingent convertibles

CP: Comboios de Portugal

CSRs: Country specific recommendations

CT1: Core Tier 1

DB: Draft Budget

DBP: Draft Budgetary Plan

DFI: Development Financial Institution

DGAL: Directorate-General for Local Administration

DMO: Debt Management Office

DSA: Debt Sustainability Analysis

EBITDA: Earnings before interest, taxes, depreciation and amortisation

EC: European Commission

ECB: European Central Bank

EDP: Excessive Deficit Procedure

EFSF: European Financial Stability Fund

EFSM: European Financial Stability Mechanism

EGF: Empresa Geral do Fomento

EPC: Economic Policy Committee

ESA2010: European System of Accounts 2010

ESI: Economic Sentiment Indicator

ESM: European Stability Mechanism

GDP: Gross Domestic Product

GVA: Gross value added

HICP: Harmonised Index of Consumer Prices

IAPMEI: Instituto de Apoio às Pequenas e Médias Empresas

IDR: In-depth review

IGCP: Agência de Gestão da Tesouraria e da Dívida Pública

IGF: Inspeção-Geral de Finanças

IMF: International Monetary Fund

IP: Infraestruturas de Portugal

MIP: Macroeconomic Imbalance Procedure

MTO: Medium-term objective

NEET: Not in education, employment or training

NHS: National Health Service

NPL: Non-performing loans

OECD: Organisation for Economic Co-operation and Development

O-SIIs: Other systematically important institutions

PER: Processo Especial de Revitalização de Empresas

PIT: Personal Income Tax

PPM: Post-programme monitoring

PPPs: Public-private partnerships

PPS: Post-programme surveillance

PSC: Point of Single Contact

PSPP: Public sector purchase programme

RoA: Return on assets

RoE: Return on equity

SB: Structural balance

SDR: Special Drawing Rights

SGP: Stability and Growth Pact

SIREVE: Sistema de Recuperação de Empresas por Via Extrajudicial

SITAF: Sistema Informático dos Tribunais Administrativos e Fiscais

SMEs: Small and medium-sized enterprises

SOEs: State-owned enterprises

SPB: Structural primary balance

SRB: Single Resolution Board

TeSP: Técnicos Superiores Profissionais

UTAM: Unidade Técnica de Acompanhamento e Monitorização do Setor Público Empresarial

UTAP: Unidade Técnica de Acompanhamento de Projetos

VAT: Value-added tax

VET: Vocational and Educational Training

WF: Winter forecast

EXECUTIVE SUMMARY

This report presents the findings of the third post-programme surveillance (PPS) mission of Commission staff, in liaison with ECB staff, to Lisbon between 25 January and 2 February 2016. This visit also served as specific monitoring in the framework of the EU Macroeconomic Imbalance Procedure. Economic conditions in Portugal have remained broadly stable since the conclusion of the second post-programme surveillance mission in June 2015. However, the economic recovery continues to be held back by high public and private debt and rigidities in labour and product markets. While the authorities have committed to comply with European budgetary rules, the change in the structural balance has so far fallen short of the recommended fiscal effort. Progress in structural reforms lost momentum during 2015. Reforms need to be stepped up to further enhance medium-term growth prospects, job creation and competitiveness.

The Portuguese economy is set to continue its moderate domestic demand-led recovery while risks stem from a weakening external environment, high fiscal imbalances and financial market volatility. Low interest rates, expansionary fiscal measures, the rise in the minimum wage and improvements in confidence continue to support domestic demand growth. On the other hand, the weakening external environment is weighing on export prospects. Overall, according to the Commission's winter forecast, real GDP is expected to slightly accelerate to 1.6% in 2016 and 1.8% in 2017. While the recovery of the Portuguese labour market continues, the absorption of the large pool of young and long-term unemployed remains a challenge. Job creation is expected to slow down, thereby becoming more aligned with the economic expansion, having outpaced GDP growth in 2013 and 2014. Low external price pressures and persistent slack in the economy are expected to constrain consumer price inflation in the short-term.

The general government headline deficit is estimated to have exceeded 4% of GDP in 2015, while the projections for 2016 point to a risk of a significant deviation from the required structural adjustment of 0.6% of GDP. The Commission's winter forecast projects a clear breach of the 3% of GDP headline deficit threshold in 2015 and a deterioration of the structural balance by around half a percentage point in 2015. For 2016, based on the Draft Budgetary Plan complemented with the additional measures announced on 5 February (that were not yet included in the Commission Winter Forecast), the government plans a structural adjustment between 0.1% and 0.2%, as compared to the required structural adjustment of 0.6% of GDP. However, in view of the budgetary projections in the winter forecast and the Commission's assessment of implementation risks of some of the additional measures, there remains a risk of significant deviation from the recommended effort. The Eurogroup, in its statement of 11 February, therefore welcomed the commitment of the Portuguese authorities to prepare as of now additional measures to be implemented when needed to ensure that the 2016 budget will be compliant with the Stability and Growth Pact. Portuguese SGP compliance is going to be thoroughly analysed on the basis of Eurostat validated data on the 2015 budgetary outcome, the upcoming Stability Programme and the Commission's spring forecast.

Fiscal-structural reforms are progressing, albeit at a slow pace and with reversals in some areas. While the long-term sustainability of the pension system has been improved in recent years, a comprehensive pension reform, as announced in the 2015 Stability Programme, to address the system's short to medium term sustainability challenges is no longer on the agenda. Health care system reforms with a view to ensure the sustainability of the National Health Service (NHS) are progressing, but clearing the arrears in state-owned hospitals remains a challenge also with respect to the transposition of the late payments directive that became fully applicable to the health sector on 1 January 2016. The revised Budget Framework Law is set to fully enter into force only in September 2018. Public administration reforms at regional and local levels are proceeding. The renegotiations of several public-private partnerships (PPPs) were formally concluded in 2015. However, important parts of the public administration reforms at central level decided under the financial assistance programme, such as the increase in working time, the single supplement scale or the requalification scheme, are set to be reversed. The operating balance of state-owned enterprises (SOEs) improved considerably since 2011, but recent

measures in the transport sector and the full reversal of urban transport concessions and partial reversal of the privatisation of the flagship aviation company TAP may entail fiscal risks.

Banks posted profits in 2015 but high levels of non-performing loans weigh on profitability and solvency. While the banking sector remains overall stable, recent developments, in particular the resolution of Banif and the transfer of some senior bonds from Novo Banco back into the perimeter of the resolved BES, influenced international investors' confidence towards Portugal's banking system. Bank lending has continued to trend downward while aggregate deposits in the banking system have reached an all-time high. Banks continue to hold large and growing exposures to non-performing loans, foreclosed assets and troubled real estate investments. These holdings of problem assets need to be addressed. Generating capital from internal sources is a challenge, also in the light of the still high operating costs in the sector and exposures to Angola, which for some banking groups became a burden in terms of capital allocation. Banks may need to further increase their own funds levels to gain flexibility in provisioning and write-offs of problem assets([1]). The corporate debt overhang remains excessive despite the downward trend in lending to firms and an increase in the share of equity as a source of funding. The authorities could encourage a more ambitious approach to corporate deleveraging by enhancing and complementing the measures already in place, such as higher provisioning, faster resolution of assets which are non-performing for longer periods of time. The macro-prudential toolkit of the central bank was recently broadened through the introduction of the capital conservation buffer, the counter-cyclical capital buffer (to be revised on a quarterly basis), and the O-SII (other systemically important institutions) capital buffer.

The reform momentum has stalled since the end of the financial assistance programme in June 2014, and some policy actions have in fact even reversed past reform efforts. Since the end of the programme, there were only a few cases where some progress has been observed in the implementation of growth-enhancing structural reforms already initiated under the programme. Efforts have been enhanced to monitor the housing market reforms, evaluate reform measures undertaken during the programme, foster the business environment, monitor education outcomes and active labour market policies, and some liberalisation and competition measures in the energy and transport sectors have been advanced. On the other hand, institutional bottlenecks, implementation barriers and weak enforcement remain in key areas, notably the labour market, network industries, services and regulated professions and the public administration, including the judicial system. Persistent rigidities in product, factor and service markets and an inefficient judicial system pose barriers to investment and to the development of the Portuguese economy. Returning to the reform momentum seen under the programme is needed to further remove these obstacles.

Risks for Portugal's capacity to service its debt to the European Financial Stability Mechanism (EFSM) and European Financial Stability Fund (EFSF) remain low in the short-term. However, the cash position has been waning since the end of the second PPS mission, and the end-2016 cash buffer is likely to be much smaller than at the end of the programme. In the medium to long-term, debt servicing risks will remain contained if Portugal shows greater resolve in fiscal consolidation and growth-enhancing structural reforms. The debt sustainability analysis shows that following a moderate decline in the short term, the public debt-to GDP ratio stabilises in the medium-term at a high level and is vulnerable to macro-economic and financial-market shocks. Borrowing conditions for Portugal remain favourable, driven largely by European and global factors. However, financial markets have recently become more volatile, making financing the high levels of sovereign debt more of a challenge for the government.

According to the assessment of the Commission, Portugal has made some progress with the implementation of 2015 country-specific recommendations (CSRs). Under the 2015 Macroeconomic Imbalance Procedure (MIP), the Commission found that Portugal has macroeconomic imbalances

([1]) Problem assets represent in nominal value as much as all of the Common Equity Tier 1 capital of the Portuguese banking sector

requiring specific monitoring and decisive policy action. The execution of MIP-relevant Council recommendations is monitored through PPS. Overall, the Commission concludes that Portugal has made some progress in addressing the imbalances in the areas of public and private debt, unemployment and external competitiveness.

The next PPS mission will most likely take place before the summer.

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1. INTRODUCTION

Staff from the European Commission (EC), in liaison with the European Central Bank (ECB), undertook the third post-programme surveillance (PPS) mission to Portugal between 25 January and 2 February 2016. The mission was coordinated with the IMF's post-programme monitoring (PPM) mission. The European Stability Mechanism (ESM) participated in the meetings on aspects related to its own Early Warning System. PPS aims at a broad monitoring of economic, fiscal and financial conditions with a view to assessing the repayment capacity of a country having received financial assistance([2]). While there is no policy conditionality under PPS, the Council can issue recommendations for corrective actions if necessary and where appropriate. PPS is biannual in terms of reporting and missions.

The PPS mission included specific monitoring under the MIP. The 2015 in-depth review (IDR) carried out under the macroeconomic imbalance procedure (MIP) for Portugal concluded that remaining excessive imbalances require decisive policy action and specific monitoring([3]). In the context of the specific monitoring under the MIP and the European Semester more generally, the European Commission assesses there has been some progress in addressing CSR 1 on implementing fiscal structural measures, CSR 2 and CSR3 on labour market and active labour market policies as well as with enforcing CSR 4 on corporate deleveraging. A detailed overview of the progress made with the 2015 MIP-tagged CSRs is provided in Annex 1.

([2]) PPS is foreseen by Article 14 of the two-pack Regulation (EU) N°472/2013. It started after the expiry of the EU/IMF financial assistance programme and lasts at least until 75% of the financial assistance has been repaid.

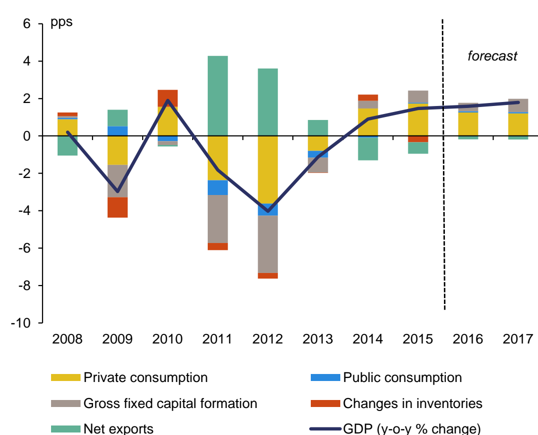
([3]) See communication from the Commission to the European Parliament, the Council and the Eurogroup:'2015 European Semester: Assessment of growth challenges, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011', http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_comm_en.pdf.

2. RECENT ECONOMIC DEVELOPMENTS

Macroeconomic situation and outlook

Portugal's real GDP grew by 1.5% in 2015, in line with the Commission winter forecast 2016. The cyclical economic recovery lost momentum in the second semester of 2015 when real GDP grew by 1.4% y-o-y, as opposed to an increase by 1.6% y-o-y during the first half of 2015. While all components grew less buoyantly, the main reason for the recent slowdown was a decline in investment growth. However, due to the strong first half of the year gross fixed capital formation grew solidly by about 4% in 2015 as a whole. Private consumption strengthened in 2015 amid a significant drop in household savings and favourable labour market developments. Net external demand continued to contribute negatively to annual real GDP growth, but to a lesser extent than in the first semester of 2015 due to a deceleration of imports.

Graph 2.1: Contributions to real GDP growth



Source: European Commission

High frequency economic indicators point to the continuation of the gradual economic recovery, mainly supported by domestic demand. The Commission Economic Sentiment Indicator (ESI) increased at the beginning of 2016, due to improvements in all components but retail trade. The mixed picture of consumer spending indicators highlights the uncertainty surrounding the short-term projection of private consumption. Having deteriorated in the final quarter of 2015, construction confidence improved slightly at the beginning of 2016. Trade activity remained feeble at the end of 2015, reflecting the weak external environment particularly in emerging markets.

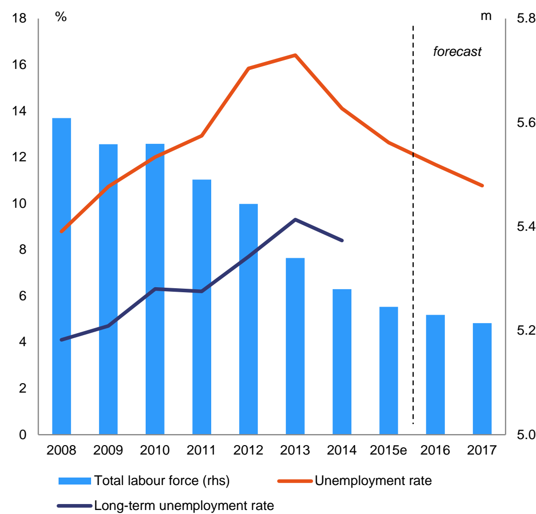
The yields for 10-year Portuguese government bonds increased significantly during early February, partly due to policy uncertainties. This resulted in widening the sovereign risk premia with respect to the German bund but also against Italian and Spanish sovereigns.

According to the Commission's winter forecast, real GDP is projected to slightly accelerate to 1.6% in 2016 and 1.8% in 2017, mainly driven by domestic demand. Private consumption is expected to continue growing robustly by around 2% in 2016-2017, supported by policy measures such as expansionary fiscal policy measures and the increase in the minimum wage. The development of private consumption is expected to broadly reflect trends in real household disposable income but also a slight reversal of the historically low household saving rate. The expansion of gross fixed capital formation is forecast to be limited in 2016 due to corporate deleveraging pressures and the weak external environment. In 2017, investment growth should gain momentum again, supported by public investment. Exports are projected to grow broadly in line with foreign demand, but imports are expected to counterbalance exports on the back of firms' domestic demand. As a result, the contribution of net trade to GDP growth is forecast to remain mildly negative over the forecast horizon. Risks to the macroeconomic outlook are tilted to the downside and have become more pronounced since the release of the winter forecast. In particular, persistent deleveraging pressure in the corporate and household sectors could turn out to be a stronger drag on growth, while policy uncertainty could increase risk premia.

Employment creation is set to slow down in the short-term, thereby becoming more aligned with GDP growth. Job creation slowed over the second half of 2015 and employment increased by 1.1% in the year as a whole. The unemployment rate fell to 12.6% in 2015 as a consequence of improving labour market conditions and a shrinking labour force (-0.6%), reflecting negative demographic and migration trends. The expectation of a further moderate decrease in the labour force, coupled with employment growth

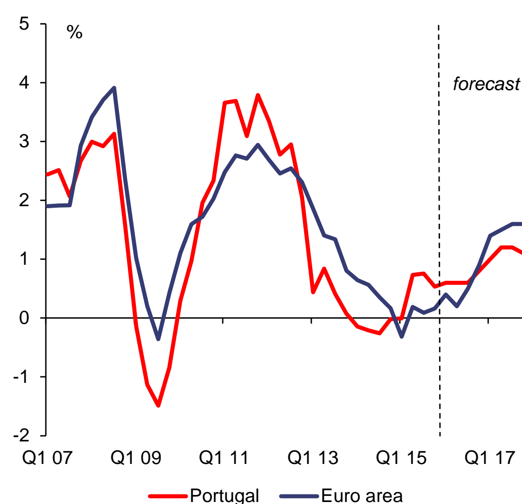
forecast around 1%, is expected to bring unemployment down to 11.7% in 2016 and 10.8% in 2017.

Graph 2.2: Labour market developments



Source: European Commission

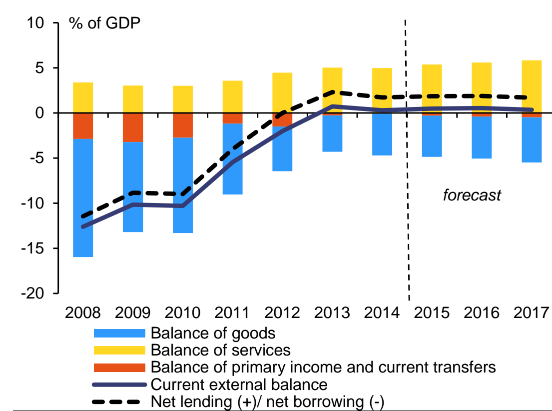
Graph 2.3: Quarterly HICP: Portugal vs euro area



Source: European Commission

Consumer price inflation turned positive in 2015 and is projected to rise moderately during this year. The demand-driven economic recovery, some increases in indirect taxes and the weakening of the euro have exerted upward pressure on consumer prices last year. HICP inflation reached 0.5% in 2015 and is expected to rise marginally to 0.7% in 2016 amid low external price pressures and persistent slack in the economy. However, additional increases in indirect taxes in 2016 pose some upward risks to the HICP inflation forecast in this year.

Graph 2.4: Current account drivers



Source: European Commission

The latest Commission forecast is less optimistic than the government's macroeconomic scenario underlying the 2016 Draft Budget (DB) sent to Parliament. The authorities project real GDP growth of 1.8% in 2016, compared to 1.6% in the Commission winter forecast 2016, due to a stronger growth in domestic demand, in particular investment (+4.9% as opposed to +3.0% in the winter forecast). In addition, the Commission is less optimistic with respect to private consumption growth in 2016 (+1.9% compared to +2.4%). The Commission forecast considers that the strong rebound in durables consumption or purchases that were postponed in previous years will not be maintained in the near term. In addition, still high unemployment and high household debt levels are forecast to maintain upward pressure on household savings. The authorities' export outlook is in line with the latest Commission forecast. A significant discrepancy between both projections also appears on the nominal side, as the Commission estimates a markedly lower increase in the GDP deflator (+1.5% compared to +2.0% in the DB). Overall, the mission assessed the authorities' macroeconomic scenario as rather optimistic taking into account the substantial deleveraging needs in both the corporate and households sector and policy uncertainty.

Table 2.1: **Comparison between the Commission winter forecast 2016 and the macroeconomic scenario underlying the Draft Budget 2016**

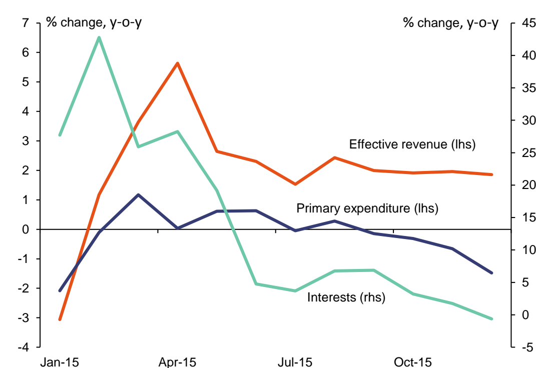
	WF 2016 final			*Differences (pps)*		DB 2016	
	2015	2016	2017	*2015*	*2016*	*2015*	*2016*
Real GDP (% change)	1.5	**1.6**	1.8	*0.0*	***-0.2***	1.5	**1.8**
Private consumption (% change)	2.6	**1.9**	1.8	*0.0*	***-0.5***	2.6	**2.4**
Public consumption (% change)	0.3	**0.4**	0.4	*1.0*	***0.2***	-0.7	**0.2**
Gross fixed capital formation (% change)	4.3	**3.0**	4.7	*0.0*	***-1.9***	4.3	**4.9**
Exports of goods and services (% change)	4.9	**4.3**	5.3	*-0.2*	***0.0***	5.1	**4.3**
Imports of goods and services (% change)	6.5	**4.9**	6.0	*-0.4*	***-0.6***	6.9	**5.5**
Employment (% change)	1.1	**0.8**	0.7	*0.0*	***0.0***	1.1	**0.8**
Unemployment rate (%)	12.6	**11.7**	10.8	*0.3*	***0.4***	12.3	**11.3**
Labour productivity (% change)	0.4	**0.8**	1.1	*0.0*	***-0.2***	0.4	**1.0**
HICP inflation (%)	0.5	**0.7**	1.1	*0.0*	***-0.5***	0.5	**1.2**
GDP deflator (% change)	1.7	**1.5**	1.3	*-0.2*	***-0.5***	1.9	**2.0**
Current external balance (% of GDP)	0.7	**1.1**	1.1	*0.1*	***0.2***	0.6	**0.9**
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.1	**2.4**	2.4	*0.1*	***0.2***	2.0	**2.2**

Source: European Commission; Portugal's 2016 Draft Budget from 5 February

Public finances

In cash terms, provisional budget execution up to end-December was overall in line with the 2015 budget. Overall tax revenue reached the amount targeted in the 2015 budget. There were, however, some significant deviations from budget figures at the level of individual taxes. As regards direct taxes, a shortfall compared to the budget of close to EUR 0.5 billion for Personal Income Tax (PIT) was more than compensated by revenue from Corporate Income Tax (CIT) close to EUR 0.6 billion above budget. As regards indirect taxes, VAT collection exceeding the budgetary target by more than EUR 340 million compensated to a large extent the shortfall of around EUR 430 million in other indirect taxes, in particular in excises on tobacco (EUR -260 million) and petroleum products (EUR -70 million). On the other hand, there have been significant shortfalls in non-tax revenue, in particular as regards social security contributions (EUR -0.4 billion) and capital revenue (EUR -0.7 billion). A further shortfall in other current revenue (EUR -0.6 billion) is largely compensated by positive consolidation differences([4]) of the same size. The high consolidation differences however point to the still provisional character of the cash execution data.

Graph 2.5: **General Government consolidated accounts (cash-data)**



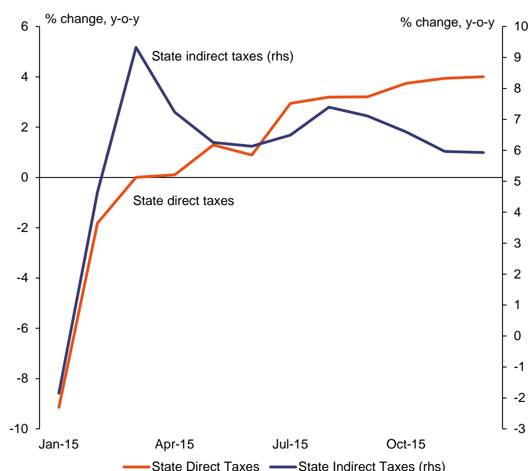
Source: Direcção-Geral do Orçamento

The shortfall in non-tax revenue was more than compensated by lower-than-budgeted expenditure execution. Unemployment benefit payments remained EUR 0.3 billion below the budget, investment recorded an under-execution of EUR 0.4 billion and interest payments stayed below the budget by EUR 0.5 billion. While considerable expenditure slippages occurred for acquisition of goods and services (EUR 0.6 billion) and compensation of employees (EUR 0.3 billion), they were overall covered by the use of contingency reserves. It should be noted that the capital injections for the purpose of the Banif resolution (EUR 2.2 billion) and into state-owned

([4]) For the general government consolidated accounts all operations between entities within the general government perimeter are to be eliminated. This requires that the same amounts recorded as expenditure by the paying entity are recorded as revenue of the receiving entity, which is not always the case, thus leading to consolidation differences.

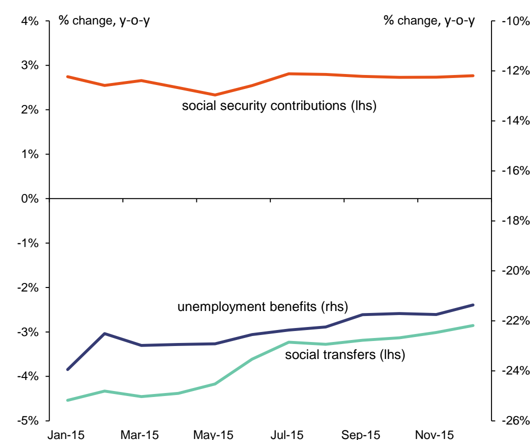
enterprises are not reflected in the budgetary execution as they are considered financial transactions in cash terms. As regards the sectoral breakdown, all subsectors of general government recorded a provisional cash balance overall in line with the budget 2015 targets.

Graph 2.6: **State budget execution: Revenue (cash-data)**



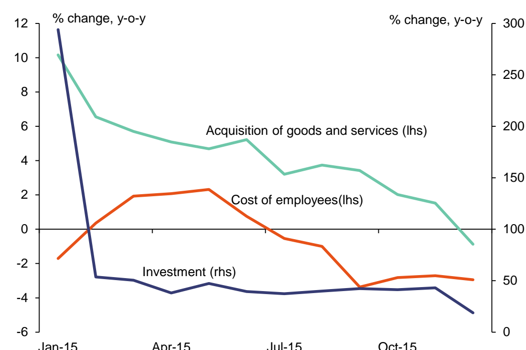
Source: Direcção-Geral do Orçamento

Graph 2.7: **Budgetary outturn for Social Security (cash-data)**



Source: Direcção-Geral do Orçamento

Graph 2.8: **Central administration budget execution (cash-data)**



Source: Direcção-Geral do Orçamento

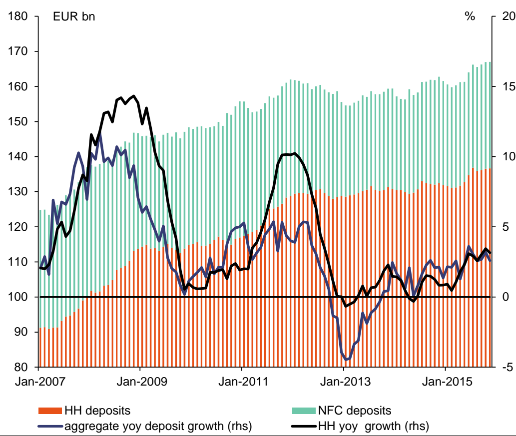
The stock of arrears declined by a third in 2015 but pressure remains high on the national health system to proceed with its full clearance. Following a small rebound in January 2015 the stock of arrears has declined steadily throughout the last year. Public sector arrears were thus reduced by around EUR 0.6 billion in 2015 to EUR 0.9 billion at the end of 2015. This decline was mostly due to the reduction of arrears in Madeira (by around EUR 0.3 billion) and at local government level (by around 0.2 billion), with a relatively minor reduction for state-owned hospitals by EUR 0.1 billion. While the recapitalisation operation for state-owned hospitals has thus succeeded in preventing the accumulation of new arrears in 2015, arrears reduction has been significantly below the injected funds of almost EUR 0.3 billion in 2015. The stock of arrears of the National Health Service remains high with EUR 455 million by the end of 2015. The recurrent under-budgeting of state-owned hospitals remains a challenge for the year ahead, even more so as the decree-law transposing the late payments' directive([5]) eventually became fully applicable to the health sector in January 2016.

([5]) Directive 2011/7/EU on late payment of commercial debts by the public administration.

Financial stability

Portuguese banks reached profitability in 2015 but face many headwinds. In the first three quarters of 2015 the banking system recorded positive profitability levels. Both the return on assets (RoA) and the return on equity (RoE) improved significantly, respectively amounting to 0.3% and 3.6% in September 2015, which compares with -1.5% and -19.8%([6]) in September 2014 (Table 2.2). Better profitability comes mainly from a better net intermediation margin as the cost of deposits halved compared to one year earlier. Similarly, in the same timeframe, the cost of risk([7]) also halved and fell to 87 basis points in September 2015. Consequently, fewer new loan loss provisions and a drop in the Cost/Income ratio to 58.8% also helped profitability.

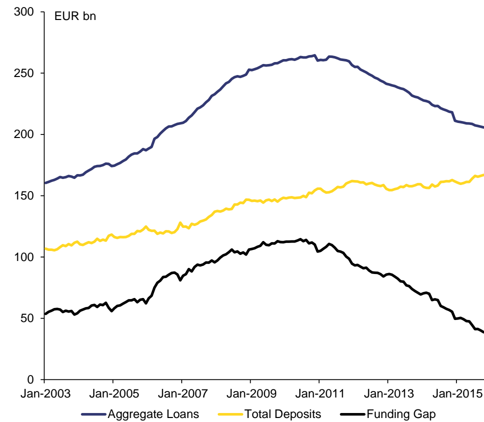
Graph 2.9: **Deposits reach new all-time highs**



Source: Banco de Portugal

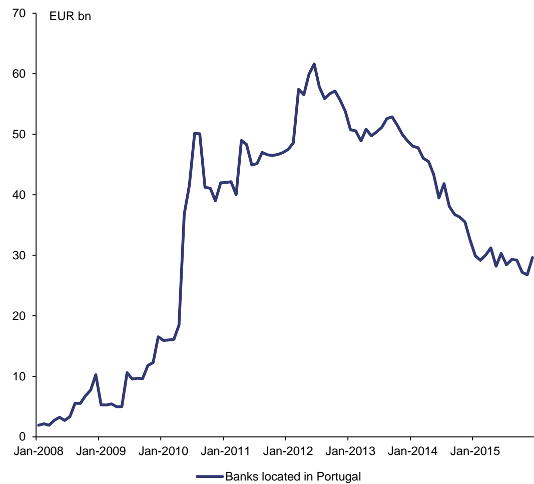
Deposits grew to new all-time highs despite ever lower remuneration. The stock of deposits reached nearly EUR 167 billion in November 2015 (Graph 2.9). New deposits are remunerated with 50 basis points while the stock yields on average 82 basis points. This increase combined with overall deleveraging – driven predominantly by lower credit – reduced the gap between aggregate deposits and total loans on the balance sheet (the commercial gap) to a third of where it stood at the programme inception (Graph 2.10). In view of this decreasing gap the borrowing from the central bank continued to shrink, staying below EUR 30 billion in the second half of 2015 (Graph 2.11).

Graph 2.10: **Funding gap fell by two thirds**



Source: Banco de Portugal

Graph 2.11: **Borrowing from the central bank stays below EUR 30 billion**



Source: Banco de Portugal

Aggregate bank lending continued to trend downwards, reflecting the deleveraging of the private sector. Different loan categories declined at a different pace**,** mirroring the average maturity of the typical loan contract.

Household take out twice as many mortgages as during the crisis. Newly granted mortgages reached EUR 375 million per month in the second half of 2015, which is more than twice the 2012-

([6]) The bulk of the aggregate losses in 2014 stems from the losses of Banco Espírito Santo 2014Q2.
([7]) The cost of risk is calculated by comparing the total adjustments on impaired assets included in the income statement with the overall outstanding of loans to the customers.

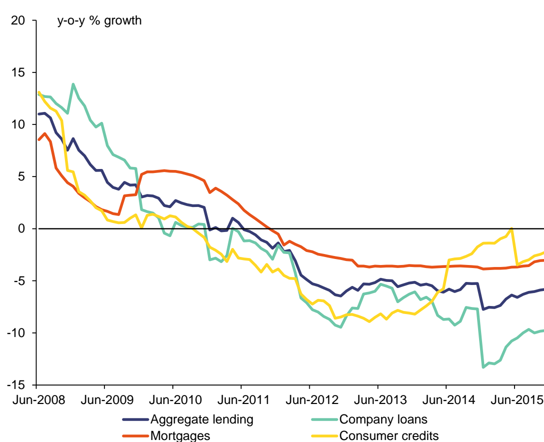
Table 2.2: **Financial stability indicators**

%	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3
Return on Equity (1)	-5.4	-3.7	-8.0	-7.5	-11.0	-0.4	-24.8	-19.8	-17.9	6.4	6.0	3.6
Return on Assets	-0.3	-0.3	-0.5	-0.5	-0.7	0.0	-1.8	-1.5	-1.3	0.5	0.5	0.3
Capital Adequacy Ratio (2)	12.6	13.0	13.1	13.4	13.3	12.3	12.0	13.0	12.3	12.0	12.5	12.6
CT1/CET1 Ratio (3)	11.3	11.7	11.7	12.0	11.9	12.2	10.6	12.0	11.3	11.1	11.6	11.6
Loan-to-deposit ratio	127.9	124.0	122.6	120.7	116.9	117.2	113.9	111.9	107.2	106.9	106.0	104.2
Non-Performing Loans (4)	9.8	10.4	10.6	11.2	10.6	10.8	11.2	12.0	12.0	12.3	12.6	12.9
Coverage Ratio	56.5	53.3	53.1	53.0	51.6	55.0	55.9	56.6	60.8	62.5	60.7	60.4

(1)Income before minority interests/Average shareholders' equity.
(2)Excluding the banks resolution.
(3)The Core Tier 1 ratio according to Programme definition up to 2013Q4 and Common Equity Tier 1 ratio afterwards; excluding the banks in resolution.
(4)New NPL ratio in line with international practices. On a consolidated basis.
Source: Banco de Portugal

2014 average monthly production but still less than a third of the average amount granted in the period between 2003 and 2007. Since November 2011, mortgage redemptions outweighed new production and the mortgage stock slimmed ever faster, reaching a decline of 3.9% year on year in March 2015 (Graph 2.12). Since then, the speed of decline faltered to about 3.0% in November 2015. Nonetheless the mortgage stock in Portugal fell below EUR 100 billion for the first time since 2007. New mortgages are attributed with an average interest rate of 2.1%.

Graph 2.12: **Corporate lending fell by 30% since Programme start**



Source: Banco de Portugal

About half of new consumer loans were made for car purchases. The recent increase in car loans has mitigated the overall decrease in consumer loans. The decline in that market segment decelerated to -2.2% in November 2015, compared to as much as -8.8% two years earlier. The average interest rate for new consumer loans is currently less than 8%, for the first time since statistics cover this loan category. Consumer loans in aggregated terms represent EUR 21.6 billion, down from EUR 27.6 billion at start of the financial assistance programme.

Corporates deleverage further. Company loans fell by 30% since the programme inception and now aggregate to less than EUR 84 billion. In the third quarter of 2015, the speed of reduction of the corporate loans stock decelerated to 10% year on year. Nevertheless, not all companies deleverage. The quartile of the least risky loans increased by 5% year on year, whereas the second, third and fourth quartiles decreased respectively by -3%, -5% and -10%([8]). This development indicates that a strong risk differentiation in the loan supply is taking place – a positive development given the high level of non-performing loans in the system. Nevertheless, competition in the least risky segment of the market puts pressure on interest margins.

Loan quality remains an issue, which needs to be addressed. In November 2015, 2.6% of mortgages, 10.7% of consumer credit and 16.3% of corporate loans were non-performing. The level of corporate NPL amounted to EUR 13.5 billion. More than half of them are classified as not performing since 2012 or earlier. Two thirds of defaulted loans were granted to micro-companies, about 20% to small enterprises and less than 1% to large companies. More than half of the exposure is to firms that are considered as inactive. Households' debt, equivalent to 85% of GDP is high but most of this debt is contracted to finance the purchase of the main dwelling. This type of mortgages is by nature associated with a low default probability. As opposed to the Spanish

([8]) Not only due to the lower new lending; gross loans also shrank because of write-offs.

case, the Portuguese housing market was not excessively overvalued in the run-up to the sovereign-debt crisis and mortgage NPLs never increased beyond 3%. Also, the record low interest rate environment has been beneficial for this type of loans – it allowed keeping a low default rate in this market segment with a NPL ratio of 2.9% and a percentage of overdue loans at 6.6% in mid-2015.

At system level, loss absorption capacity remains adequate. In the post-programme context, Portuguese banks strive to increase their capital levels. The aggregate Common Equity Tier 1 (CET1) ratio of the Portuguese banking sector was 11.6% at the end of the third quarter 2015 (Table 2.2), which is still low in European comparison. Many challenges such as reducing the large stock of problem assets, reducing exposure to the Portuguese property sector and improving the structural profitability lie ahead and may hamper banks' capacity to generate capital organically. Furthermore, at the current juncture, many banks try to divest from their Angolan ventures, now considered a more precarious to do business due to the adverse impact of the low oil price on the Angolan economy. This may impact capital levels of banks, even though Angola undoubtedly will remain a significant portfolio and direct investment destination for Portuguese banks and firms. In its recent financial stability report, Banco de Portugal confirms that from a macro-prudential perspective it is paramount that the value of exposures to the sovereign, to Angola and to the property sector are appropriately assessed and registered.

3. POLICY ISSUES

Public finances

The Commission winter forecast estimates the general government headline deficit at 4.2% of GDP in 2015. The upward revision by 1.2% of GDP as compared to the autumn forecast was due to the direct public support by the same amount in the Banif bank resolution operation. Pending the final recording of public guarantees also granted in this one-off operation, its impact may further increase by 0.4% of GDP. The authorities, however, consider this unlikely as no further losses are expected in view of the transferred assets' estimated market value. During the PPS mission, in the framework of the consultations regarding the DBP 2016, the authorities informed the Commission about misaligned timing of revenue and expenditure recording in National Accounts terms for EU funds related to the Transmontana PPP([9]). The correction of this misalignment is expected to lead to a decrease of general government revenue in 2015 by EUR 164 million, i.e. close to 0.1% of GDP, which would increase the overall headline deficit to 4.3% of GDP. This deficit figure coincides with the updated 2015 headline deficit projection the authorities included in the 2016 Draft Budget sent to Portuguese Parliament on 5 February.

The 2015 headline deficit net of one-offs is expected to have been above 3% of GDP. The 2015 headline deficit without one-off operations was estimated at 3.0% of GDP in 2015 in the winter forecast. In line with the expected upward revision of the headline deficit by 0.09% of GDP due to the Transmontana PPP misalignment correction, the estimate for the headline deficit net of one-offs is also to be revised upwards to 3.1% of GDP. Moreover, in the context of the consultations on the 2016 DBP, the authorities also provided detailed information on an operation to be classified as a deficit-improving revenue one-off in 2015: EUR 130 million collected from banks in 2015 for a planned transfer to the Single Resolution Board (SRB) are to be considered as one-off revenue in 2015 following cancellation of the transfer([10]). The consideration of this revenue as a positive one-off operation of 0.07% of GDP in 2015 would accordingly lead to a revised estimate of the 2015 headline deficit net of one-offs of 3.2% of GDP.

The Commission winter forecast points to a substantial deterioration in the structural balance in 2015 by 0.5% of GDP, well below the recommended improvement of 0.5% of GDP. The cumulative change in the structural balance over 2013-2015, at 1.2% of GDP altogether, also falls markedly short of the recommended 2.5% of GDP. Taking into account the new information on the two operations impacting the headline deficit (upward revision by 0.09pp to 4.3% of GDP due to the Transmontana correction) and the deficit net of one-offs (upward revision by 0.07pp to 3.2% of GDP due to the cancelled SRB transfer revenue peak), the structural balance in 2015 also worsens by an additional 0.16% of GDP as compared to the winter forecast. The structural balance would accordingly have deteriorated by 0.6% in 2015, which would reduce the cumulative improvement in the structural balance over 2013-2015 to 1.0% of GDP. The latest estimates by the Portuguese authorities for the variation of the structural balance (as included in the Draft Budget sent to Parliament on 5 February) are pointing to a deterioration by 0.6% of GDP in 2015 and a cumulative improvement by 0.9% of GDP over the 2013-2015 period, i.e. basically in line with the Commission estimates.

The Commission winter forecast projects a headline deficit of 3.4% of GDP in 2016 and a deterioration of the structural balance by 1 pp, based on the Draft Budgetary Plan submitted

([9]) In 2015 Infraestruturas de Portugal received EUR 164 million in EU funds for the Transmontana PPP that were not transferred to the subconcession in the same year. In view of the principle of budget neutrality of EU funds in national accounts, the revenue however has to be recorded together with the expenditure, leading to a downward correction of the 2015 revenue by the corresponding amount and accordingly to an upward revision of the 2015 headline deficit by 0.09% of GDP.

([10]) EUR 130 million were collected from Portuguese banks in 2015 to be transferred as a contribution to the SRB and were recorded as state revenue. However, following the Banif resolution in December 2015, Portugal is to benefit from an 8-year waiver for the contributions to the SRB, which led to a cancellation of the planned transfer of the EUR 130 million in January 2016. The EUR 130 million already collected in 2015 thus represent a revenue peak in 2015 that will not occur in the following years. As this revenue peak is of temporary and non-recurrent nature, resulting directly from an 'exceptional event' beyond the control of the government, it was classified as a one-off in line with the Commission classification principles.

Table 3.1: Evolution of deficit projections since the 2016 DBP submission

Year	2015			2016		
Document	DBP 22 Jan*	WF 2016**	DB 5 Feb***	DBP 22 Jan*	WF 2016**	DB 5 Feb***
Headline budget deficit	-4.2	-4.2	-4.3	-2.6	-3.4	-2.2
Budget deficit, net of one-offs	-2.5	-3.0	-3.2	-1.6	-3.5	-2.3
Structural balance (SB)	-1.3	-1.9	-2.0	-1.1	-2.9	-1.8
Fiscal effort (Variation of SB)	n.a.	-0.5	-0.6	0.2	-1.0	0.3

* Draft budgetary plan for 2016 submitted to the Commission and the Eurogroup on 22 January
** Commission winter forecast 2016 (cut-off date 22 January)
*** Draft budget for 2016 submitted to Parliament on 5 February

Source: Portugal's 2016 Draft Budgetary Plan from 22 January; European Commission; Portugal's 2016 Draft Budget from 5 February

on 22 January 2016([11]**).** The difference in the headline deficit projection of 0.8% of GDP as compared to the 22 January's DBP's projection of 2.6% of GDP was due to the less optimistic macroeconomic scenario in the winter forecast, which explained close to half of the difference, as well as differences in the estimated yield of the planned deficit-reducing measures. In particular the freeze of intermediate consumption and the efficiency gains in other current expenditure were not included in the Commission forecast as they were not sufficiently specified in the DBP. According to the Commission winter forecast, risks to the fiscal outlook are tilted to the downside, linked to uncertainties surrounding the macroeconomic outlook, possible spending slippages and the possible lack of agreement on necessary consolidation measures. The mission discussed in particular potential upcoming fiscal risks emanating from the planned reduction of the workweek for civil servants and the reversal of privatisations.

After inclusion of the additional fiscal consolidation measures announced on 5 February, the measures in the Draft Budget sent to Parliament are expected to reduce the deficit by around 0.3% of GDP compared with an expected deficit-increasing impact by 0.2% of GDP in the DBP of 22 January. Thus, while the fiscal measures in the DBP submitted on 22 January implied a pro-cyclical expansionary fiscal policy stance, the measures in the Draft Budget as sent to Parliament imply a moderate anti-cyclical fiscal consolidation effort([12]). More precisely, revenue-decreasing measures of around 0.3% of GDP (notably the partial reversal of the PIT surcharge and the reduction of the VAT rate for restaurants) are more than compensated by revenue-increasing measures of around 0.5% of GDP, of which about two thirds relate to revenue increases from indirect taxes (on petroleum products, tobacco, vehicles and from the stamp tax) complemented by a series of smaller measures concerning direct taxes and increasing compliance in terms of taxes and social security contributions. Expenditure-increasing measures worth 0.4% of GDP (mostly for the gradual reversal of the public sector wage cuts, increases in a series of social benefits and the unfreezing of pension indexation) are planned to be more than compensated by expenditure-decreasing measures of close to 0.5% of GDP (most of which relate to the nominal freeze of intermediate consumption (except for PPPs), efficiency gains in other current expenditure, expenditure control in social transfers and a new civil servants rotation policy (2:1 replacement rule)). Most measures on the expenditure side, in particular concerning not further specified efficiency gains, are however subject to considerable implementation risks.

The Commission 2016 winter forecast projects the gross debt-to-GDP ratio to have slightly fallen by around 1pp in 2015 to 129.1%. The fall of the public debt ratio in 2015 is estimated to have been slower than previously expected mainly due to the postponement of the Novo Banco sale, the impact of the Banif resolution and some statistical revisions. The ratio is expected to fall only slightly

([11]) Due to the earlier cut-off date the winter forecast projection did not yet include the additional consolidation measures announced by Portugal on 5 February 2016.

([12]) The present analysis only refers to new fiscal measures for 2016, not taking into account the carry-over effect of certain tax measures decided in earlier years. The analysis only sums up the direct deficit-improving or deteriorating impact of the new fiscal measures and does not correspond to an analysis of the overall change in the structural balance.

Table 3.2: **Fiscal adjustment 2010-17**

	2010	2011	2012	2013	2014	2015	2016	2017
Balance - EDP	-11.2	-7.4	-5.7	-4.8	-7.2	-4.2	-3.4	-3.5
Budget deficit, net of one-offs	-8.5	-7.2	-5.6	-5.1	-3.4	-3.0	-3.5	-3.5
Structural balance	-8.1	-6.1	-3.0	-2.5	-1.4	-1.9	-2.9	-3.5
Primary balance	-8.2	-3.1	-0.8	0.0	-2.3	0.5	1.2	0.9
Structural primary balance	-5.2	-1.8	1.8	2.4	3.5	2.9	1.7	0.9
Fiscal adjustment	0.1	3.4	3.6	0.5	1.1	-0.6	-1.2	-0.8
Fiscal effort (EDP definition)	0.1	2.0	3.1	0.6	1.1	-0.5	-1.0	-0.6

(1) Fiscal adjustment is measured as the change in the structural primary balance; fiscal effort defined as the change in the structural balance.
Source: European Commission 2016 winter forecast

to 128.5% in 2016, as a result of a projected increase in Treasury deposits. The authorities project the debt-to-GDP ratio to have reached 128.8% at the end of 2015 and forecast a slightly stronger decrease to 127.7% by the end of 2016, mainly reflecting their lower headline deficit projection. Annex 2 provides an updated debt sustainability analysis on the basis of the winter forecast.

Fiscal-structural issues

While the long-term sustainability of the pension system has been improved in recent years a comprehensive pension reform to address the system's short to medium term sustainability challenges is no longer on the agenda. Recent pension reforms adjusting pension benefits to the increase in life expectancy and thereby increasing labour market participation have positive effects on the system's long-term sustainability. Planned measures to reduce the impact of the sustainability factor on early retirement applications could, however, put this achievement at risk. The new government has not carried on with the comprehensive pension reform that was included in the 2015 Stability Programme and which aimed at addressing the system's short to medium sustainability challenges. The current contributions to the public pension systems cover less than 75% of pension-related expenditure; following the Constitutional Court ruling in 2014, temporary measures on pensions at payment were mostly reverted without being replaced by any permanent compensation measure. Plans to introduce an adjustment factor linking pension developments to the short-run balance of the system have been put on hold and the freeze on early retirements for workers at the age of 60 and with at least 40 years of contributory career was lifted in the 2015 budget. The pension system faces the challenge of spreading the burden more evenly between different cohorts of citizens and generations (both active and retired) while at the same time containing public pension spending in the short to medium term. This challenge should be addressed with a comprehensive pension reform.

Portugal has made efforts to ensure access to quality healthcare in a sustainable manner and the financial sustainability of the National Health Service (NHS) improved notably since 2011, but considerable challenges remain. Despite additional cost compression foreseen for the year ahead and increased budget transfers, less revenues from lower moderating fees and additional labour cost pressures (including the restitution of previous wage cuts and the reduction of working time to the 35 hours/week) are expected to again result in a highly negative operating balance of the NHS in 2016. The recurrent under-budgeting of state-owned hospitals remains a challenge and decisive action will have to be taken to ensure state-owned hospitals achieve operating balance and thus effectively halt new arrears. Public spending in medicines is expected to continue its declining trend since 2010 towards the 1% of GDP target (expected to have reached 1.17% of GDP in 2015). Generics market volume increased by another 3.1% in the first nine months of 2015 and the total generics share in the NHS market increased by 0.6pps to a 46.9%. Savings in 2016 are expected from new measures in medicines and medical devices purchasing. Additional structural measures for 2016 include the full implementation of the health technology assessment widening the centralised purchase

system, the full rollout of the electronic prescription, the improvement of the fraud prevention and detection system and the launch of the electronic health record. The government remains committed to continue with the reorganisation of the national health system focusing on primary and long-term care with a view to divert demand from more expensive hospital services while improving the benchmarking of different health units and gradually introducing the concept of freedom of choice within the NHS. By end-November 2015, 1 million persons remained without a family doctor. To improve access to primary care authorities are now focused in ensuring an adequate number of both physicians and nurses covering the entire population based on the concept of family teams.

Public Finance Management reforms are progressing. The reformed Budget Framework Law (BFL) entered into force in September 2015; an assessment is ongoing as to whether it has effectively transposed the Fiscal Compact. The new single public sector accounting framework is being implemented, and the Commitment Control Law was amended in 2015 to improve its effectiveness. It is important that the new government has taken ownership of these reforms, in particular as the implementation of the BFL will take several years. However, the timely approval of several decree-laws related to the BFL is not yet ensured, and close monitoring of their implementation will be key to ensure the ambitious rollout plans are not jeopardised.

Important parts of the public administration reforms decided under the financial assistance programme are set to be reversed. The new single supplement scale, aiming at improving transparency and fairness in the remuneration of civil servants, was expected to enter into force in January 2016. However, the new government is now reassessing the whole process. The requalification scheme was already frozen with the re-integration of the first set of employees that were bound to be dismissed by February because they did not find a new job in public administration one year after their previous job was discontinued. A working group was appointed to present its assessment and propose draft legislation until March to revise this scheme. A gradual reversal of the temporary public sector wage cuts throughout 2016 has also been decided. In addition, the government decided to return to the 35 hours working week for public employees. At the end of 2015, public employment was 9.5% below its end of 2011 level. However, 2015 was also the first year since 2011 that saw an increase in public employment (by 0.4% compared to 2014), presumably also because fewer public employees retired in 2015 as a result of recent pension reforms. The three sectors with largest increases in public employment during 2015 were education, health and transportation.

Progress in local administration reforms is mixed. Continued budget surpluses since 2013 have led to a steady decrease of local debt and arrears. The *Aproximar* programme, aiming at reorganising the public services network at local level, is being rolled out at a fast pace. The government is studying alternatives to implement shared services for groups of municipalities and thus deliver efficiency gains and savings. The newly-created Municipal Support Fund, aiming at helping highly-indebted municipalities to reduce their debt, is expected to soon start disbursing once the Court of Auditor's has approved the first loan agreements. Since becoming operational in January 2014([13]), the Fiscal Consolidation Council has not yet delivered on its main objective of supporting municipalities in drafting their budgets. Its role is now being reassessed. In addition, the Directorate-General for Local Administration (DGAL) needs to improve its monitoring of SOEs and PPPs owned or operated at local level, as foreseen in its organic law([14]). Finally, the government started to re-assess the merger of parishes (*freguesias*) that took place during the financial assistance programme.

The Autonomous Region of Madeira regained market access, securing all 2016 financial needs in advance. Compliance with programme conditionality, including budget targets that were met throughout 2013-2015, and arrears settlement of about EUR 1 billion allowed for a better control of Madeira's public debt burden, which was reduced by EUR 1.8 billion to about EUR 0.85 billion between 2012 and 2015. The success in closing the programme was crowned by a EUR

([13]) Law 73/2013, which entered into force in January 2014.
([14]) Implementing Decree 6/2014, which amends the implementing Decree 2/2012.

185 million bond issuance, not backed by guarantees, in December 2015 that finances all needs in 2016. Public finances in the Autonomous Region of Azores remain sound, with a budget broadly in balance and a debt stock of less than 40% of the regional GDP, as revenues are projected on the basis of prudent assumptions and public spending is tightly controlled.

Revenue administration reforms are focusing on further improving tax compliance. Organisational reforms are under way in the tax administration, including the recently launched integration of local tax offices into the *Aproximar* programme. Efforts to combat tax fraud in the housing market have been enhanced. A central office for invoice checking is providing data to inform taxpayers of potential mismatches and thus trigger voluntary fulfilment of tax obligations, with the tax affairs' inspectorate taking over in case they remain non-compliant. The current three-year plan for combating tax evasion and fraud is set to be replaced by an annual plan. In parallel, a monitoring system for the handling of tax fraud cases is being implemented. Further organisational reforms are planned to reduce double-requests by the public administration for tax-relevant information from citizens. This would contribute to avoid tax evasion by reducing compliance costs and the administrative burden for taxpayers, which is among the highest in the EU.

Information on the financial status of state-owned enterprises (SOEs) is scarce. The task force set up within the Ministry of Finance for SOEs monitoring (UTAM) has significantly expanded its activities since June 2015. However, quarterly reporting on SOEs at central government level and the support provided to DGAL in order to enable similar reporting on local SOEs are being delayed. Limited information as regards SOE's financial performance in 2015 and the absence of a 2016 income and balance sheet forecast for SOEs do not allow an informed assessment of the state-of-play of SOE reforms. Mid-2015 data suggests that the comprehensive SOE restructuring initiated during the financial assistance programme has delivered considerable savings without major negative impacts on service provision. Nevertheless, the operating balance([15]) fell short of the budget 2015 forecast for the same period by 25%. This slippage is mainly explained by state-owned hospitals, which delivered a EUR 69 million operating loss. SOEs debt until June 2015 evolved as foreseen in the 2015 budget, declining by 3% compared to Q2-2014, while equity injections and debt to equity conversions in 2015 fell short by EUR 2.3 billion compared to what was foreseen at the last PPS mission. In addition, the government decided to unfreeze the companies' contributions to complementary private pension systems in 2016, which is expected to have a negative impact of around EUR 17 million mainly in the transport sector. The recently merged rail and road infrastructure manager *Infraestruturas de Portugal* (IP) is expected to have improved end-2015 EBITDA by above 30% compared to the 2014 outturn of the previously separated companies. The equity injections contributed to double its equity in 2015 to just above EUR 3 billion. A new framework for the company with a view to ensure its financial sustainability in the medium to long term has yet to be approved.

([15]) Measured by earnings before interest, taxes, depreciation and amortisation (EBITDA).

The authorities remain committed to the overall goal of the water and sewerage sector reform. While the new government will allow municipalities to opt out from the recent merger of 19 regional water and sewerage bulk service systems into five, it is committed to merging municipal retail management services and promoting the integration of bulk and retail activities. The government set an ambitious timeline to proceed with this second stage of the reform in view of undertaking legal changes in time for the approval of the bulk services' tariffs for 2017. The reform will allow for further tariff harmonisation and economies of scale and scope stemming from higher synergies in the value chain.

The new approach towards privatisation in general and increased private management participation in areas like urban transportation raises risks for public finances and economic efficiency. SOE restructuring agreed under the financial assistance programme included the privatisation of several companies, merging the management of Lisbon and Porto urban transportation SOEs and tendering of their service sub-concessions to private operators. The urban transport services' concessions would have introduced competition in the market and ensured better design and closer monitoring of public

service obligations. While some privatisations proceed as planned or were concluded by the new government (CP Carga and EGF), the reversal of urban transport concessions in Lisbon and Porto, as well as the re-purchase of shares to regain control over 50% of the flagship aviation company TAP could increase fiscal risks, including litigation risk. Re-nationalisations and reversals of concessions should include concrete and credible plans to offset their potential negative fiscal impact.

Renegotiations of nine motorway public-private partnerships (PPPs) were concluded in the last quarter of 2015. Net savings throughout the lifecycle of those PPPs are now expected at about EUR 2 billion or 13% of the cost implicit in the base scenario. In addition, another seven road PPPs and one security PPP renegotiations are heading towards the final approval. Dealing at the same time with the renegotiations of road PPPs and port concessions as well as with monitoring PPPs, the resources of the Ministry of Finance's taskforce for PPPs (UTAP) remain stretched, but the value added of this highly skilled taskforce is widely acknowledged. Existing legislation does not empower UTAP to cover concessions, regional and local PPPs or even central government PPPs and concessions in the water/sewerage/waste businesses (or any concession given to SOEs by law in an in-house relationship). The authorities are aware of these loopholes and agree there is a need to find a solution but no concrete suggestions or timeline have yet been proposed.

Financial sector

The Resolution Fund resumes the sale process of Novo Banco. Following the transfer of some senior bonds worth EUR 1.9 billion to BES, the Resolution Fund is re-launching the sale process of Novo Banco. At present, Novo Banco's capital position stands well above the regulatory minima. The second attempt to sell the bridge bank is looking at various options how to recuperate maximum value from the bridge bank. Meanwhile, the Resolution Fund balance sheet grew with the recent resolution of Banif to over EUR 5 billion. It currently holds on its liability side two loans from the Treasury (EUR 3.9 billion related to Novo Banco and EUR 0.5 billion related to Banif) and about EUR 0.7 billion in loans stemming from banks. On the assets side, the Resolution Fund holds 100% of Novo Banco and Oitante, the Special Purpose Vehicle that received EUR 2.2 billion in assets (prior to valuation haircuts) carved out from Banif and financed through a EUR 750 million bond issued by Oitante with the guarantee of the Resolution Fund and the counter-guarantee of the Portuguese Republic. If these assets (Novo Banco and Oitante) yield more than their respective book value the difference would be a gain of the Portuguese Resolution Fund.

The central bank introduced new measures to enhance its macroprudential toolkit and implemented changes to the legal framework under which credit institutions operate. Marked by the resolution of two systemically important banks, the past two years have been particularly challenging from a financial stability standpoint. Nevertheless, the banking sector as a whole remained stable (see Table 3.2), though undeniably more vulnerable. Against that backdrop, the capital conservation buffer (CCB) of 2.5%, which aims to accommodate losses from a potential adverse scenario, was frontloaded to January 2016, instead of being gradually implemented between January 2016 and 2019. The countercyclical capital buffer (CCyB), which is supposed to contain the risks of system-wide stress generated by excessive credit growth, was set at 0% for 2016Q1 and will be reviewed on a quarterly basis. In addition, several Portuguese lenders were identified as 'other systemically important institutions' (O-SIIs), and higher capital requirements between 0 and 2% have been deemed appropriate. The higher solvency requirements should compensate for the higher risk that these institutions present to the financial system due to their size or business complexity, importance for the economy and/or the degree of interconnection with other institutions in the financial sector and, in the event of insolvency, the potential contagion emanating from these institutions to the rest of the non-financial and financial sectors. Overall, these measures are geared to increase the financial resilience of the system. The legal framework of credit institutions is also changing for lenders classified as savings banks and cooperatives. Lastly, the law regulating the access and activities of property appraisers providing services to entities within the Portuguese financial system has also been reviewed recently.

The private debt overhang remains excessive. Despite some acceleration of the deleveraging in 2014 and 2015, the stock of private debt in the Portuguese economy remains excessively high, at over 230% of the GDP on a non-consolidated basis. The high ratio of corporate debt to GDP, at around 146%([16]) in the third quarter of 2015, is of a particular concern. This ratio still points to Portuguese firms as being among the most-indebted in the EU, which constrains business investment and pushes firms to default or delay debt payments (see Box 3.1). Currently, one third of all Portuguese firms has overdue loans and on average one third of the firms' EBITDA is needed to service debt. With levels of non-performing debt over 20% in the corporate segment, low inflation and sluggish GDP growth it will be very difficult for Portuguese firms to grow out of debt. There have been a number of positive changes to the PER and SIREVE frameworks, which should encourage firms to seek assistance when signs of over-indebtedness emerge rather than to wait for insolvency. However, bottlenecks persist in several areas. Firstly, banks may need to continue increasing their own funds levels in order to be able to face increased provisioning and accelerated write-offs of corporate debt. Secondly, the authorities may need to consider ways to accelerate the process of debt deleveraging, while at the same time encouraging earnings retention and equity injections in Portuguese firms. Lastly, more work needs to be done to accelerate debt workout procedures in courts. This would encourage investors to bid for non-performing assets on banks' balance sheets, which in turn would free resources that could be allocated to viable projects. The Development Financial Institution (DFI) structure is now in place but not yet fully operational. The DFI has the mandate to target market segments where market failure or market inefficiencies have been identified.

([16]) Corporate debt on a consolidated basis accounted for 111% of GDP in October 2015.

Structural reforms

Labour market and education

While the recovery of the Portuguese labour market continues, the absorption of the large pool of young and long-term unemployed remains a challenge. The average unemployment rate reached 12.6% in 2015, its lowest level since 2011. Outward migration has been a channel of labour market adjustment during the recession, but it is weighing on the long-term growth prospects of the Portuguese economy. Since 2011, net emigration has led to a decline in the working age population at twice the rate consistent with demographic trends. Moreover, almost one third of economically active young people are unemployed and at risk of disengagement from the labour market. The long-term unemployment rate remains persistently high at 6.9% of the labour force in the third quarter of 2015, which entails the risks of human capital and skills erosion. Effective Active Labour Market Policies could mitigate these risks while the transition from active labour market schemes into regular employment needs to be carefully monitored. The government intends to allocate more resources towards measures which have proven effective in terms of sustainable job creation, reinforce the NEETs ([17]) outreach networks and create incentives for firms to hire long-term unemployed and young people. However, concrete information on the measures to be taken is still not available.

Collective bargaining remains highly centralised and recent reforms seem not to be effective in fostering firm level wage setting. While collective bargaining is picking up, the number of workers covered by company agreements remains low. Out of the total of workers covered by collective agreements, only less than 5% are covered by firm level agreements. The temporary suspension of sectoral collective agreements at firm level is possible, but this requires the agreement of the original signatories, potentially limiting its effective application. Collective agreements have been suspended in only two cases since the law allowing for this possibility was adopted. The rules for extending collective agreements have been eased in 2014 with the new rules allowing for an extension to be

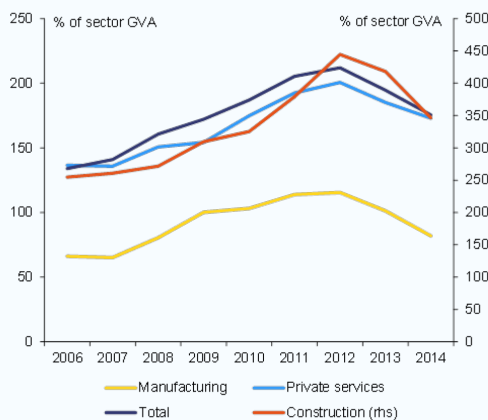
([17]) NEET: Not in education, employment or training.

Box 3.1: The financial performance of Portuguese firms: a sectoral analysis

The financial performance of Portuguese firms has differed widely across sectors during the different phases of the economic cycle. Their consolidated financial and income statements until 2014 show that construction has been the worst performer in terms of indebtedness levels, profitability and financial performance indicators since Portugal emerged from the recession. In contrast, the financial developments in manufacturing were more favourable than in the aggregate corporate sector.

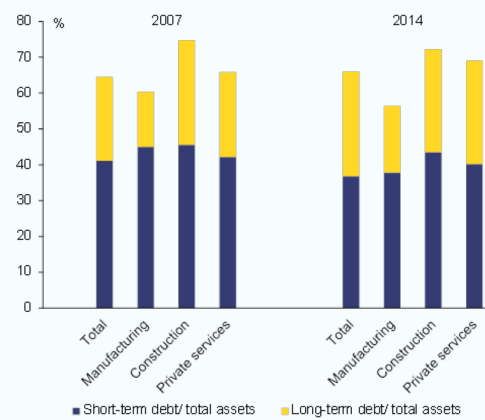
Easy credit conditions, but also the legal and tax framework, before and during the early stages of the financial crisis have contributed to the accumulation of financial debt of Portuguese companies, which are still among the most indebted in the euro area. While, between 2006 and 2012, net financial debt as a share of GVA increased steeply in manufacturing and construction, the manufacturing sector continued to be one of the less indebted sectors in the Portuguese economy. During the ongoing corporate deleveraging process, Portuguese companies across all main sectors have reduced their indebtedness ratios (Graph 1). The deleveraging has been particularly strong in the construction sector, which has also shown the weakest investment performance. In contrast, manufacturing has performed better although this sector still posted negative investment rates in 2014. Persistent deleveraging needs in Portugal's corporate sector are an important obstacle to much needed higher private investment (See European Commission Country Report 2016 on Portugal, Box 1.2 Investment challenges).

Graph 1. Net financial debt as % of GVA



Source: European Commission, BACH database

Graph 2. Financial structure



Source: European Commission, BACH database

The financial structure of Portuguese firms indicates that despite some recent improvements, particularly in manufacturing, the ratio of short-term debt to total assets remains high at close to crisis levels in all sectors. This still reflects the strong reliance on trade payables and short-term credit lines. The higher proportion of short-term with respect to long-term debt could put some upward pressures on financing costs, as short-term debt usually bears higher interests. Since 2010, long-term debt has gained prominence across all sectors but it remains at lower levels in manufacturing than in construction and services (Graph 2).

To maintain profitability during the recession period, Portuguese corporates went through a significant cost adjustment process. Total costs peaked in 2008 but declined by almost 15% until 2014 (Graph 3). Total expenses in the construction sector almost halved from 2008 until 2014 helping to maintain operating profitability. The manufacturing sector experienced minor declines

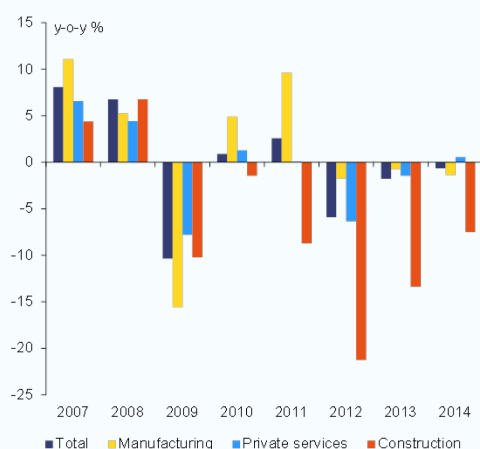
(Continued on the next page)

Box (continued)

in total costs in 2012-14. However, staff-related expenses in manufacturing were down by 11% in 2014 since their peak in 2008, due to employment reduction and wage moderation.

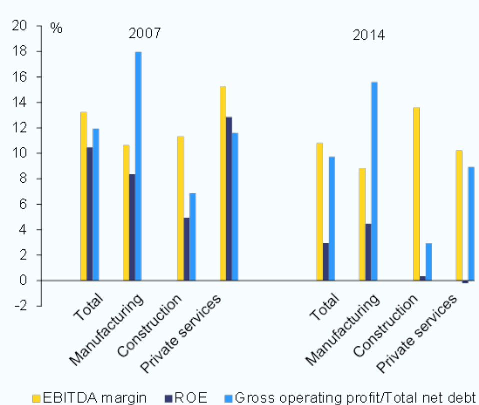
In 2014, the operating profitability in manufacturing, as measured by the EBITDA margin, was still lower than in construction and private services. However, a different picture emerges when profitability is measured as return on equity (RoE), with manufacturing presenting a higher return than construction and services in 2014, even though the indicator still ranks below the pre-crisis ratio (Graph 4). Better relative RoE contributed to the higher attractiveness of the manufacturing sector relative to the non-tradable sectors and supported a sustainable rebalancing of the economy.

Graph 3. Total costs



Source: European Commission, BACH database

Graph 4. Profitability and debt repayment ratios



Note: EBITDA margin is calculated dividing EBITDA (Earnings before interest, taxes, depreciation and amortisation) by total net turnover.
Source: European Commission, BACH database

Portuguese corporates still face difficulties to repay their debt, as EBITDA has not grown as much as net debt. Consequently, the debt service indicators have deteriorated vis-à-vis the results in 2007 (Graph 4). In 2014, construction firms faced the highest financial pressure with net financial debt accounting for 9 times their EBITDA due to a significant increase of their already high leverage. Despite some worsening of the debt leverage indicators during 2007-2014, manufacturing remains the least leveraged sector and the most capable to meet its debt service requirements.

Overall, the manufacturing sector has been outperforming other, in particular non-tradables, sectors in terms of corporate profitability. This bears testimony to the ongoing rebalancing of the Portuguese economy towards the tradables sector.

requested as long as at least 30% of the firms signing the agreement are SMEs. The number of extensions in 2015 was three times higher than in 2014, though still below figures reached in the early 2000s. The government now plans new policy measures in this area that would change collective bargaining rules. There are however no concrete plans to foster decentralisation. On the contrary, the general intention seems to be in the direction of reinforcing the centralised nature of the wage bargaining system. First, the government intends to further promote the extensions of collective agreements, which would contribute to this result. Conversely, preventing quasi-automatic extensions, facilitating the pick-up of the temporary suspensions of sectoral collective agreements at firm level, and providing incentives to firm-level bargaining (also through the establishment of work councils) would facilitate the matching of firm-specific wages with productivity. Secondly, the Portuguese authorities have expressed their intention to revoke the possibility of an individual bank of hours introduced in the 2012 revision of the Labour Code. Leaving this possibility open only under collective agreement would further limit the adjustment capacity of firms to external shocks. Thirdly, the government is exploring options for changing the rules regarding the expiry and survival of collective agreements. Any changes that would imply a prolongation of the survival period could reduce in practice the incentives of social partners to negotiate, and have a negative impact on the capacity of firms to adjust to new economic conditions.

Hiring on permanent contracts has recently been significant but labour market segmentation remains high. The last two years saw robust hiring on permanent contracts, for the first time in more than a decade and in contrast with previous episodes of job growth driven by increases in temporary contracts. This might be seen as a first indication that the reforms of employment protection legislation may have had an effect in supporting the labour market recovery through an increase in regular employment; however, this assessment would require further monitoring. In any case, the strong growth in permanent contracts has also to be seen in the light of the massive destruction of permanent jobs during crisis years and the still high share of temporary contracts. Labour market segmentation remains significant, as in 2014 Portugal had the fourth highest share of temporary workers in the EU and a low transition rate towards permanent contracts. It is still not certain if the positive trend will last as from mid-2015 some negative signs were visible with an increase in the proportion of workers with temporary contracts. This calls for an assessment of the effectiveness of the most recent labour code reforms in reducing segmentation. The Portuguese authorities commissioned a detailed study on this issue to the OECD and are planning new incentives for employers to hire under permanent contracts. Once the results of the study are available in spring 2016 and the planned incentives are in place, the government will need to assess a possible way forward to ensure that segmentation is addressed. Those considerations should not exclude a priori issues related to Employment Protection Legislation, in particular as concerns the different stringency of regulation between permanent and temporary contracts.

Continued increases in the minimum wage can have a negative impact on employment, competitiveness and affect the returns on skills investment. Starting with an increase from EUR 505 to EUR 530 in January 2016, the government plans to progressively increase the minimum wage up to EUR 600 per month in 2019 (paid 14 times per year). The recent and planned increases do not appear aligned to macroeconomic developments in terms of inflation, unemployment and overall productivity growth. In 2014, almost 42% of employees had a monthly income below EUR 600. Although this share is expected to decrease by 2019 (due to wage increases across the distribution), its magnitude suggests that the share of workers covered by the minimum wage might increase substantially. Such developments would lead to a strong compression of the wage structure, reducing returns on skills. They would also place upward pressure on the overall wage structure and, if not matched by productivity increases, risk affecting employment and competitiveness perspectives for labour intensive industries. Moreover, such a measure is particularly detrimental for the employability of the low-skilled workers, whose labour market prospects are already dismal as the continuously negative quarterly employment growth rates (compared to medium- and high-skilled) show. In addition, the prospects for a reduction in the persistent share of

long-term unemployed are not improving through further increases in the minimum wage.

The early school leaving rate has almost halved since 2009, but more should be done to decrease grade repetition which has reached maximum rates since 2004. The monitoring system to improve school performance, which was introduced in 2013, should now be assessed in terms of its effectiveness. It is being used for planning at government level but more should be done to ensure it is also fully used at school level. So far, the use of the monitoring tool at school level is not systematic and varies greatly across schools. The government is planning to close the vocational paths in lower secondary levels (13–15 years), which aimed at keeping those students in the education system who are at risk of early school leaving. Specific preventive measures and alternative paths should then be provided beforehand to reduce school failure and prevent drop out. An assessment made by the Portuguese Court of Auditors of the measures undertaken during the financial assistance programme shows that savings in the education system affected mainly the number of teachers, which saw a reduction of 21%, while the number of auxiliary staff decreased only by 2.5%. Efficient spending in education should head towards a more balanced impact.

Stronger cooperation between universities and business remains a challenge to increase the employability of graduates in all sectors and foster competitiveness. Businesses report serious problems in matching vacancies with available candidates and perceive universities as too bureaucratic structures to invest in(18). Portugal's tertiary education attainment rate for 30-34 year-olds has increased significantly over the past ten years, but challenges in terms of quality persist. The higher education system is becoming less successful in turning entrants into graduates as the number of students who enter higher education and successfully graduate as a percentage of all entrants has fallen by 19 pps since 2008. Portuguese academics and university representatives assess the barriers to university-business cooperation to be among the highest in Europe(19). A comprehensive strategy to address these barriers is lacking as well as proper incentives for academics to engage in cooperation with industry.

Quality of and enrolment to Vocational and Educational Training (VET) have improved significantly but the offer needs to be streamlined. Enrolment in apprenticeships increased by 60% between 2011 and 2014 and in 2015 the enrolment in the new short-cycle higher technical courses (TeSP) increased almost seven times compared with the previous year. Yet the number of modalities of VET programmes (i.e. different options for students and parents to choose from different education objectives), remains large and comprises overlaps playing against students' awareness and financial efficiency. The 2015 OECD skills diagnosis report sets the need for Portugal to make the VET system more coherent, better communicated and well-aligned to the needs of the labour market, mainly by strengthening the work-based learning component and streamlining the programme proposals. Finally, the attractiveness of VET could be increased by building new bridges between VET paths and Higher Education.

Measures are being put in place to improve the skills of the workforce, but a national skills strategy is still missing. Some measures are planned by the authorities to support and reinforce the skills and employability of unemployed with a university degree. These measures will include the development of advanced training programmes directed at strengthening specific and transversal skills and competencies that enhance employability by orienting skills towards sectors with higher labour demand. The National Qualification Anticipation Strategy presented in the 2015 National Reform Programme is now fully implemented. The next step is to ensure its effectiveness in identifying skill needs and tailoring the qualification programmes to those needs. However, there are still no concrete plans to set up a national skills strategy that would address the weaknesses identified in the Skills Diagnosis Report.

(18) Hays Global Skills Index 2015 and The State of University-Business Cooperation in Portugal (2013), European Commission, DG EAC.

(19) Research and Innovation Observatory Country Report Portugal 2014, JRC Science and Policy Report.

Business framework conditions and network industries

Adequate staffing of the new transport regulatory authority (AMT) remains critical to ensure the best performance of the market. The framework law for AMT which undertook the regulatory functions of several transport authorities (rail, ports and road) was adopted in 2014 and further amended in February 2015. However, the existing staff is still too small to effectively deal with all the tasks assigned to AMT and some administrative steps are still missing. A speeding up of this set up process is needed to ensure that AMT can fulfil its role as regulator in full. Transport responsibilities are now split between ministries and are no longer merged under the Minister of Economy. Close cooperation between responsible ministries is required to ensure an encompassing strategy for the whole transport sector can be put in place to make the best use of the sector to foster competition.

The port sector reform requires renewed impetus to ensure gains are effectively passed through to port users. Ensuring the implementation of the 2013 port labour law in all ports remains key for a more open and better performing labour market in the sector. In this respect, the full application of the new law needs to be continuously monitored. Most port concessions renegotiations are considerably delayed, the port of Leixões being the most pressing case since it is at the verge of reaching full capacity and thus requires new investments. The desired new framework law on concessions foreseen in the ports' chronogram is also still not in place. The implementation of the labour law and the renegotiation of port concessions with a view to effectively reduce ports' invoices, and therefore to pass on a greater portion of operating cost savings to port users, would considerably increase the competitiveness of activities resorting to sea trade.

The electricity tariff debt requires further attention to prevent an increased burden of the energy bill. Although household electricity prices are among the highest in Europe, Portugal still has a very large tariff debt implying an upward pressure on electricity prices until its complete elimination. Remaining incentives for overinvestment need to be removed and risk sharing between grid operators and consumers needs to be increased. Also, the remuneration of any new scheme to support renewable electricity needs to avoid overcompensation and have a cost-reflective perspective. The elimination of the tariff debt should be achieved without raising electricity prices significantly. The Portuguese authorities committed during the financial assistance programme to not increase electricity prices by more than 1.5 percentage points per year relative to the consumer price inflation. The second and third packages of measures to reduce the electricity tariff debt are being implemented but no new measures are foreseen to ensure the elimination of the tariff debt by 2020. Moreover, while liberalisation is progressing as planned, incumbents still seem to be favoured when consumers switch to the liberalised tariffs.

Evidence on the efficiency of the judicial system is fragmented. The authorities have recently restarted to publish data on the length of proceedings and the resolution rate in civil courts as well as the enforcement of civil claims, which show positive trends([20]), although the length of proceedings and the resolution rate remain very high. The quality of the database for tax courts (SITAF) is still poor, however, which is of a particular concern because of the relatively long duration of tax court proceedings and high number of pending cases. Efficiency improvements of tax administrative courts are crucial for the business environment, as these courts deliver licenses and settle disputes with tax authorities or with national regulatory bodies. Recently announced needs to change the judicial map agreed during the financial assistance programme by reopening some courts could reverse past achievement and are therefore a matter of concern.

Measures to increase administrative transparency are advancing, but there is scope to improve public award datasets. The authorities are making efforts to provide detailed data on all public procurement contracts on the BASE portal, but data gaps remain. There are persistent shortcomings (e.g. same entities with more than one tax number) and inconsistencies

([20]) The relevant statistics are available at the following link: http://www.dgpj.mj.pt/sections/siej_pt/destaques4485/estatisticas-trimestrais3544/downloadFile/file/AcoesCiveis_trimestral_20160211.pdf?nocache=1455542974.55

(e.g. between price included in the tender notice and contract price) undermining the reliability of the BASE dataset. Decisive actions are needed to improve BASE, including through the interconnection with other relevant databases (tax, customs).

There is still a significant number of direct awards, which requires close attention. In the area of public procurement, a strengthened control over the direct awards should be effectively implemented, with a sound and coherent control system. It would be advisable to introduce adequate safeguards to avoid the strategic division of contracts, in order to prevent malpractice that could eventually circumvent the applicability of the European public procurement law. Decisive actions are also required to enlarge the spectrum of possible bidders at least to three market providers to ensure that there is no preferential treatment when granting public awards, as well as to limit extreme urgency cases to exceptional circumstances non-attributable to the contracting authority. It is also essential to implement additional measures to ensure that the local and regional authorities are obliged to report to the National Court of Auditors and the National Auditor (IGF) on their internal control mechanisms. Improved governance and the simplification of procedures in public procurement would contribute to the fight against fraud and corruption.

The authorities need to step up efforts to fight fraud and corruption within the public administration. The implementation of transparency requirements and the effective prevention of corruption within the Portuguese public administration, in particular by local and regional authorities, remain challenging. A large number of public entities have set up anti-corruptions plans, but there is still the need to improve the evaluation of corruption risks and identify staff in charge of plan implementation. The legal provisions regarding conflict of interest should be more strictly enforced, including by better preventing the phenomenon of 'revolving doors'. The memorandum of understanding recently signed between the tax administration, the public prosecutor's office and the Bank of Portugal is expected to strengthen the institutional cooperation within the relevant public entities, thus easing access to relevant data.

The implementation and monitoring of the housing market reform is advancing, although evidence of its impact remains scarce. It is not possible yet to fully ascertain the impact of the urban lease reform undertaken under the financial assistance programme. Housing statistics are still under-developed, complicating a comprehensive evaluation of the overall legislative framework, including some amendments introduced after the end of the programme and a recent constitutional court ruling. However, rental price increases above the rate of the HICP increase suggest that the rental market is becoming more dynamic. Past reforms might have contributed to this by making rental conditions more flexible and judicial proceedings regarding rental contracts easier. This notwithstanding, given the long transition period in which the old contracts remain valid, the reform will overall only take effect very gradually. Against this background, a further extension of the transition period (or the increase of the universe of firms to which it applies) would have a detrimental effect on the functioning of the housing market.

The authorities have implemented a housing monitoring tool. It relies on the collection of data on signed lease agreements and includes information from various data sources (buildings' registry, utilities' contracts, means testing of households), based on the mandatory issuing of electronic income receipts through the Ministry of Finance's portal. By the end of January 2016, the number of registered contracts on the portal exceeded 750 000 (of which 254 000 are new contracts). New contracts have already yielded over EUR 8 m in stamp duty, and the new database based on the e-rental invoice will be a rich source of information, enabling the tax affairs office to tackle tax evasion and fraud in the commercial and housing lease market. In this respect, a comprehensive study on the shadow economy in the rental market, which was requested under the programme, has not been yet conducted.

Administrative and regulatory barriers to competition remain in non-tradable sectors such as professional services. After the publication of all outstanding professional bodies' by-laws, service providers, in particular cross-border operators, still face important restrictions regarding some professional services (especially the legal professions), in particular as regards access to those professions by both natural and

legal persons, multidisciplinary practices and advertising that could affect fees. In terms of service legislation, there is still the need to amend the higher education legislation to tackle restrictive regulation, thus ensuring compliance with the EU Service Directive. Further efforts are therefore necessary to eliminate entry barriers in regulated professions and services to foster competition and investment in those sectors. However, limited new actions have been taken beyond those stemming from past reforms, with some of the most recent reforms even countering previous more ambitious reforms. Regrettably, the government concluded that there is no need for further amendments to the exiting legislation.

High administrative burden and still cumbersome licensing weigh on Portugal's attractiveness as an investment location. Key administrative simplification initiatives initiated during the financial assistance programme have not been completed. This concerns the approval of the methodology for the impact assessment of legislation, the implementation of the one-in/one-out principle and the roadmaps to tackle the regulatory burden in some sectors such as tourism, construction and agriculture. Moreover, the scope of those simplification measures is still limited to the central public administration, thus excluding local and regional authorities. Licensing regimes have been streamlined, but there are some bottlenecks in their implementation, in particular at a local level. More precisely, there are still shortcomings of the commercial licensing law that contains provisions potentially entailing unnecessary administrative burden and high and disproportionate fees for larger retail areas, thus impeding new players to enter the Portuguese market. High administrative fees are still imposed also on construction service providers. The Point of Single Contact (PSC), the e-government portal for businesses set up under the EU Service Directive framework, has been improved in scope and quality, but not all relevant information and services are available on this e-platform and access to these procedures for foreign service providers is still very limited.

Late payments are hampering the business and investment environment. According to the European Payment Report 2015 published by Intrum Justitia([21]), Portugal had the third longest delay in public sector payments in Europe (94 days on average) in 2015, after Italy and Spain (respectively 144 and 103 days). Late payments by the Portuguese public sector to firms can give rise to tighter financial conditions hampering investment, and even force some firms to exit the market. As regards the implementation of Directive 2011/7/EU on combating late payment in commercial transactions, the provisions of decree-law 62/2013 transposing the said directive into the national legislation did not apply from 16 March 2013 until 31 December 2015 to public entities that are part of the National Health Service, unless the creditor was a micro or small business whose status was certified by IAPMEI. Discussions with the Portuguese authorities are ongoing to assess the actual full implementation of the directive, gather information on the financial impact of the derogation granted to the entities of the National Health Service, namely in terms of potential interests, fees and cost of compensation applied as a consequence of late payments.

Ex-ante and ex-post assessments of the impact of structural reforms are progressing. Portugal has taken important steps to evaluate structural reforms, by legally tasking the Ministry of Finance with the evaluation of structural reforms and systematic and comprehensive ex ante and ex post impact assessments of regulatory measures. The first ex-post assessment of judicial and education reforms is ongoing. Still, ex-ante evaluation has not yet become part of the legislative process. A conceptual framework for a consistent assessment of planned measures is needed.

([21]) Available at: https://www.intrum.com/Press-and-publications/European-Payment-Report/.

4. SOVEREIGN FINANCING AND CAPACITY TO REPAY

Financing needs have been considerably revised upwards since the end of the second PPS mission. The financing needs for 2015 were substantially increased due to the postponement of the Novo Banco sale and the Banif resolution. As regards 2016, the Debt Management Office (DMO) has factored into its recent projections (underlying the 2016 draft budget) a substantially higher cash deficit (by EUR 2.9 billion as compared to the 2015 Stability Programme) and considerably higher net acquisition of financial assets (EUR +2.8 billion) as compared to June 2015 projections. Gross financing needs (including redemption of medium and long-term debt) amount to around EUR 21.5 billion for 2016 (including early repayments to the IMF of EUR 4.6 billion, see below). Gross financing needs for 2017 to 2019 are projected at a level of EUR 18 billion per year.

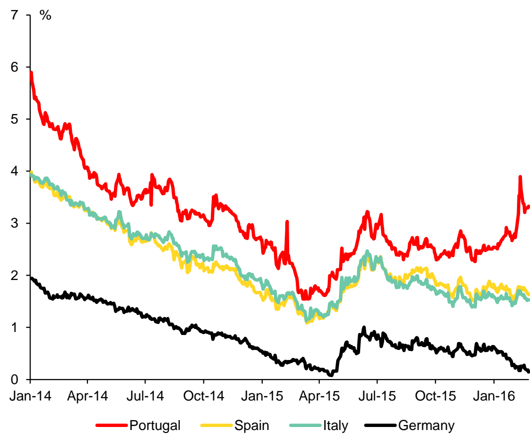
The cash position has been waning since the end of the second PPS mission, and the end-2016 cash buffer is likely to be much smaller than at the end of the programme. Excluding cash-collateral and the outflow of EUR 2.2 billion related to Banif, the cash position at end-2015 stood at EUR 6.6 billion (down from EUR 13.5 billion in May 2015 and 12.4 billion at the end of 2014). Current DMO estimates for 2016 consider a more cautious approach on potential cash inflows related with the financial sector, assuming no reimbursement of the loans to the Resolution Fund related with Novo Banco and Banif, nor of additional CoCos. In this context, the ambitious intentions of the 2015 Stability programme regarding the amount to be repaid early to the IMF have been downsized by the new government to EUR 4.6 billion in 2016([22]) of which EUR 2 billion were already reimbursed in February. The timing of the reimbursement of the further EUR 2.6 billion will depend on market conditions and the sale of financial assets and has tentatively been scheduled for the end of the year. The reduced repayment amount for 2016 would still be covered by the first waiver of the pari-passu clause on proportional repayment by the European creditors as cumulative repayments would not yet exceed the amount of the first waiver. Early repayments of IMF loans are expected to result in interest savings, as the assumed rate for the replacement bonds is 3.0%, while the interest rate on the IMF loans exceeding 300% of the quota was 4.05% (on SDR). Under current assumptions, the end-2016 cash position is estimated at EUR 7.4 billion. This is a much lower buffer than at the end of the programme (about EUR 15 billion), when the size of the buffer was large enough to cover about 12 months financing horizon. The current reduced size of the buffer may just cover a 6 months financing horizon.

Funds are regularly raised in the sovereign debt markets and under favourable conditions, supported by ECB policies. In 2015, Portugal could finance itself with the lowest interest rates ever – benefitting from the ECB's public sector purchase programme (PSPP). Portugal managed to put short-term T-bills (e.g. 3, 6, 12 months) with negative yields in six operations in 2015, indicating that T-bills are less risky and preferred by investors over depositing the money in banksat a negative rate. Medium and long-term bond auctions and syndications also occurred regularly and at relatively low rates. The 10-year government bond yields have been moving up slowly since their trough of 2.04% in February 2015 (at an auction of EUR 1.5 billion), with the latest issuance on 14 January 2016 placing around EUR 4 billion of 10-year bonds at a yield of 2.97%. The issuance, however, met a strong demand and covers almost a fifth of the financing needs for the whole year. Overall, since the end of the second PPS mission, the market conditions have remained relatively stable, despite some moments of market volatility. Rates moved up temporarily in the context of uncertainty related to Greece in early summer and in view of the internal political impasses in Portugal after the October elections, but dropped on the back of the ECB announcement to expand the PSPP until March 2017, which further postpones possible future funding pressures. The Eurosystem bought EUR 11.2 billion in Portuguese bonds by end-2015 within the PSPP, and with the longest average maturity of the whole programme (10.4 years). Analysts consider that these transactions have clearly helped to keep yields at low levels. Recent market evolutions since the second week of February have pushed Portuguese 10-year bond yields considerably above 3.0% (Graph 4.1). In this context, Portugal has issued short-term 3-

([22]) Portugal made early repayments to the IMF in 2015 totalling EUR 8.4 bn.

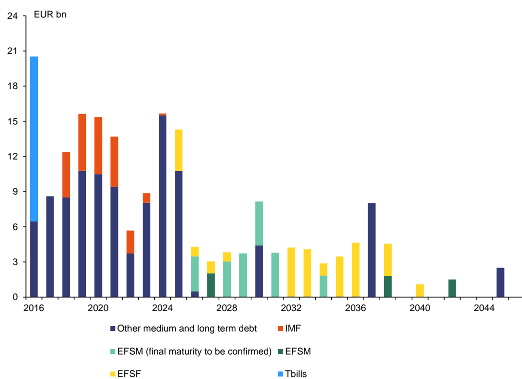
month and 11-month T-bills on 17 February at slightly increased yields as compared to previous operations, with the yield turning slightly positive also for the 3-month maturity. Risks for Portugal's capacity to service its debt to the European Financial Stability Mechanism (EFSM) and European Financial Stability Fund (EFSF) remain low in the short-term. However, medium-term financing needs remain high and medium-term debt dynamics are susceptible to changes in the macroeconomic outlook, the fiscal consolidation path and market access on favourable terms.

Graph 4.1: **10-year government bond yields**



Source: Data Insight

Graph 4.2: **Redemption profile**



Source: IGCP, last update: 26 January 2016

ANNEX 1

Specific monitoring in the framework of the Macroeconomic Imbalance Procedure

State of Play of the implementation of relevant country-specific recommendations

The European Commission identified imbalances that require decisive policy action and specific monitoring in the areas external competitiveness, public debt, private debt and unemployment. It will conduct the required 'specific monitoring' *uno actu* with the post-programme surveillance. In this context, this annex presents progress with the implementation of relevant country-specific recommendations as assessed by the European Commission.

Commitments	**European Commission summary assessment**([23])
2015 Country specific recommendations (CSRs)	
CSR1: Ensure a durable correction of the excessive deficit in 2015 by taking measures as necessary. Achieve a fiscal adjustment of 0,6% of GDP towards the medium-term budgetary objective in 2016. Use windfall gains to accelerate the deficit and debt reduction. Enforce the commitment control law to better control expenditure. Improve the medium-term sustainability of the pension system. Safeguard the financial sustainability of state-owned enterprises. Further improve tax compliance and the efficiency of the tax administration.	Portugal has made **some progress** in addressing CSR 1 (this overall assessment of CSR 1 excludes an assessment of compliance with the Stability and Growth Pact): There has been **some progress** in enforcing the commitment control law as arrears have continued to fall. In the health sector, however, under budgeting by hospitals continues to prevent arrears from falling faster. There has been **some progress** towards making the pension system more sustainable in the medium-term. In the short to medium term, public finances are under pressure as the current contributions to the public pension systems cover less than 75% of the pension-related expenditure. There has been limited progress in developing new comprehensive measures as part of the ongoing pension reform. However, some previously decided measures are starting to have positive effects on medium and long-term sustainability such as the movable old-age pension that depends on life expectancy at the age of 65. The statutory retirement age, set at 66 in 2015, will now rise each year by 2/3 of the increase in life expectancy measured two years previously. The sustainability factor introduced in the calculation mechanism that determines the amount of early retirement pension entitlements

([23]) The following categories are used to assess progress in implementing the 2015 country-specific recommendations of the Council Recommendation: No progress: The Member State has neither announced nor adopted any measures to address the country-specific recommendation. This category also applies if a Member State has commissioned a study group to evaluate possible measures. Limited progress: The Member State has announced some measures to address the country-specific recommendation, but these measures appear insufficient and/or their adoption/implementation is at risk. Some progress: The Member State has announced or adopted measures to address the country specific recommendation. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases. Substantial progress: The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the country-specific recommendation. Fully addressed: The Member State has adopted and implemented measures that address the country-specific recommendation appropriately.

	has also started to contribute to medium- and long-term sustainability. The S1 indicator of fiscal sustainability reveals that there is a high risk in the medium term, relating mainly to the debt requirement. There has been **some progress** concerning the financial sustainability of state-owned enterprises (SOEs). As a result of rationalisation measures and mergers between companies, the operating performance of SOEs has been improving. Equity operations carried out by the state have also strengthened several companies' financial position. Partial reversal of the privatisation of the air carrier TAP may imply additional fiscal risks. Cancelling the award of urban transport concessions in Lisbon and Porto will have an immediate fiscal impact during 2016, as the savings these concessions were supposed to deliver will not materialise. Political choices in the transport sector will need to go hand-in-hand with measures to ensure that these SOEs are financial sustainable. There has been **some progress** on improving tax compliance and making the tax administration more efficient. The planned integration of local tax offices into the Aproximar programme is under way. Measures are being taken to combat tax fraud in the housing market, improve arrangements for sharing information with financial institutions, and strengthen the anti-money-laundering framework.
CSR2: Promote the alignment of wages and productivity, in consultation with the social partners and in accordance with national practices, taking into account differences in skills and local labour market conditions as well as divergences in economic performance across regions, sectors and companies. Ensure that developments relating to the minimum wage are consistent with the objectives of promoting employment and competitiveness.	Portugal has made **some progress** in addressing CSR 2: **Some progress** on promoting the alignment of wages and productivity. The most recent data available show that wage developments have been moderate and in line with productivity over a medium-term horizon. Collective bargaining at sectoral level has been supportive of this process. However firm-level bargaining is not picking up, potentially limiting the scope for wage differentiation according to the dimensions mentioned in the CSR. **No progress** as regards the minimum wage. It was further increased in January 2016 from EUR 505 to EUR 530, in a context of low inflation and high unemployment, putting upward

	pressures on the overall wage structure with the risk of affecting employment and competitiveness perspectives.
CSR3: Improve the efficiency of public employment services, in particular by increasing outreach to non-registered young people. Ensure effective activation of benefit recipients and adequate coverage of social assistance, in particular the minimum income scheme.	Portugal has made **some progress** is addressing CSR 3: **Some progress** has been made in increasing outreach to non-registered young people but challenges in its implementation still persist. A broad network of partners engaged in the implementation of the Young Guarantee has been set to reach out to young people aged under 30 and not in employment, education or training (NEET). Another positive step has been the creation of a Youth Guarantee online platform where NEETs can register. **Some progress** has been made in improving the efficiency of the public employment services through a reinforced performance management and an ongoing shift towards digital services. While partnerships with municipalities, training organisations and social economy actors are well developed, there has been limited progress in binding partnerships with private employment services. The two pilot projects of partnership with private employment services in Lisbon and Porto have been delayed and a tender procedure has yet to be launched. There has been **some progress** in ensuring adequate coverage of social assistance, in particular through the minimum income scheme. There have been changes to the eligibility criteria of the minimum income scheme which may extend its coverage. Further measures in this area include an increase in child benefits, including for single parents households. No new specific measures have been taken on activation for minimum income scheme recipients.
CSR4: Take further measures to reduce the corporate debt overhang, to address the corporate non-performing loans ratio in banks and to reduce the debt bias for corporates under tax provisions. Improve the efficiency of debt restructuring tools for viable companies by introducing incentives for banks and debtors to engage in restructuring processes at an early stage.	**Some progress** has been made on reducing the corporate debt overhang and allowing the private sector to deleverage This includes the well advanced implementation of the corporate deleveraging strategy, which includes the revamping of the PER and SIREVE insolvency tools and changes in the tax treatment of debt financing. However, at close to 190% of GDP Portugal's private sector debt (corporate and household) is one of the highest in the EU.

	Moreover, access to credit remains costly and difficult for businesses, in particular SMEs. Therefore, there is still the need to continue to pay attention to the problem of high indebtedness and to encourage the banking sector to raise capital in order to be able to clean its balance sheet from the high burden of corporate non-performing credit.

ANNEX 2
Debt sustainability analysis

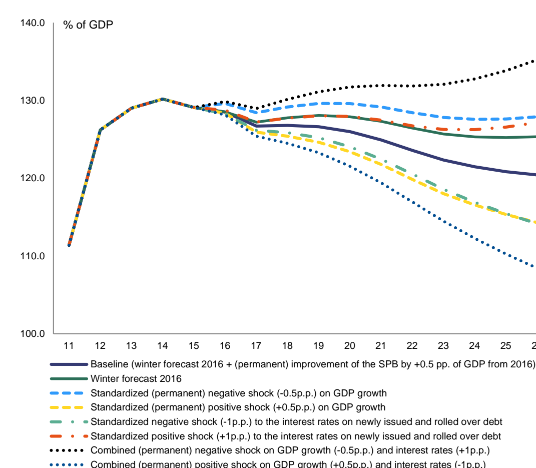
The present Debt Sustainability Analysis (DSA) uses the winter forecast as a starting point to ensure cross-country consistency and to take into account second-round macroeconomic effects. Furthermore, the 0.5% of GDP in additional structural fiscal consolidation measures announced by the government on 5 February (and reflected in the draft budget sent to Parliament) have been taken into account. Their full implementation would lead to a permanent improvement of the structural primary balance (SPB) by 0.5pp of GDP from 2016 onwards as compared to the winter forecast.

The DSA for the outer years is based on technical assumptions. In particular, it is assumed that (i) the structural primary fiscal balance remains unchanged at a surplus of 1.4% of GDP as from 2018 under the no-fiscal policy change assumption, (ii) inflation converges linearly to 2.0% by 2020 (year of output gap closure) and the nominal long-term interest rate on new and rolled-over debt converges linearly to 5% by the end of the 10-year projection horizon in line with the assumptions agreed with the Economic Policy Committee's (EPC) Ageing Working Group (AWG), (iii) real GDP grows at the rate projected by the EPC's Output Gap Working Group until t+10 and thereafter according to the AWG's projections (level of around 1-1.5%); and (iv) ageing costs develop according to the Commission and EPC's 2015 Ageing Report.

The baseline scenario results in an annual average decrease of the gross debt-to-GDP ratio by around 1pp of GDP and thus ensures a declining path down to 120% of GDP by 2026. By contrast, the winter forecast scenario without the 0.5pp SPB improvement had only led to a slight decline in the debt ratio in the short-term followed by a stabilisation at a level above 125% by the end of the projection horizon. This mainly reflected the winter forecast's projection of a significantly lower structural primary surplus of 0.9% of GDP in 2017 (last forecast year value) as compared to previous projections. The difference between the winter forecast and the baseline scenario highlights the importance of the additional permanent consolidation measures introduced on 5 February, not only for the 2016 outcome but for the mid-term debt reduction path; this also underlines the need to ensure a structural improvement of the budget balance.

The declining debt-to-GDP trajectory in the baseline scenario is sensitive to financial market volatility and vulnerable to negative economic developments. Graph A2.1 presents a sensitivity analysis with respect to macro-economic and financial market risks as well as the effect of alternative fiscal consolidation paths. More precisely, the graph illustrates the sensitivity of the debt trajectory to a shock to real GDP growth and hikes in interest rates as from 2016. The analysis suggests that a lower GDP growth rate by 0.5 percentage points or a one percentage point increase in the interest rate on maturing and new debt would both prevent the debt-to-GDP ratio from declining but instead stabilise it at around 128% of GDP by 2026. Moreover, a combined negative growth and interest shock could put debt-to GDP ratio on an accelerating path. Conversely, a positive shock to medium and long-term growth, for instance as a result of structural reforms undertaken, or permanently lower interest rates would result in a visibly more solid path of debt reduction([24]) by around 1.4 percentage points per annum to around 114% of GDP in 2026. A combination of higher GDP growth and lower interest rates could further accelerate the pace of the debt ratio reduction to around 2 percentage points per year, thereby allowing for a fall below 109% of GDP in 2026.

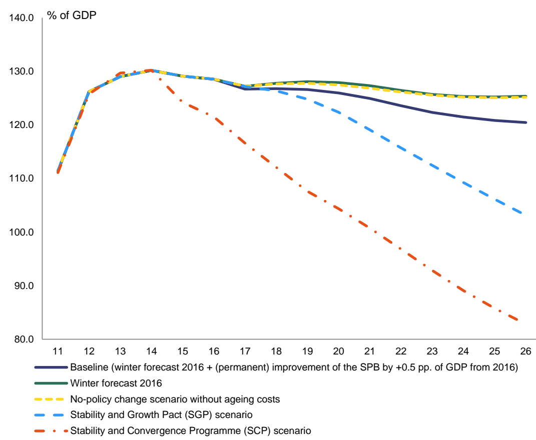
Graph A2.1: Macroeconomic risks: growth and interest rates



Source: European Commission

([24]) Not even taking into account the positive second round effects of the higher GDP growth on the fiscal balance.

Graph A2.2: **Fiscal consolidation and ageing costs**



Source: European Commission

Additional fiscal consolidation would clearly accelerate the debt reduction path (Graph A2.2). Thus, already the full implementation of the 0.5% of GDP in additional structural fiscal consolidation measures announced on 5 February ensures a clear downward path of the debt-to-GDP ratio as compared to the mere medium-term stabilisation in the winter forecast scenario. Full compliance with the requirements of the Stability and Growth Pact (SGP) would considerably further accelerate debt reduction. The SGP scenario assumes convergence to the Medium-Term-Objective (MTO) according to the matrix of required fiscal adjustment in Annex 2 of the January 2015 Communication on flexibility in fiscal rules([25]). This would imply a MTO of a structural balance of -0.5% of GDP reached in 2020 with a fiscal effort of 0.6% of GDP every year from 2017 to 2020, reaching a primary surplus of 3.6% in 2020. Maintaining the MTO over the longer term horizon will require structural primary surpluses of around 3.7% until the end of the projection horizon. Under these assumptions, the debt-to-GDP ratio would markedly accelerate its decline to around 3 percentage points per annum as from 2020, falling to 103% by 2026. In view of the high starting point of the debt-to GDP ratio, aiming at a more ambitious MTO (of zero percent or above) within the SGP scenario could further accelerate debt reduction. The 2015 Stability Programme scenario had assumed a significant fall of the debt-to-GDP ratio to 124.2% already in 2015, in particular due to large stock-flow adjustments (mainly related to potential Novo Banco sales proceeds), and an achievement of the MTO of a structural balance of -0.5% of GDP already in 2016 in particular due to a strong decrease in interest expenditure. The strong reduction of the debt ratio by around 4.5% per annum assumed in the 2015 Stability Programme for 2017-2019 and around 3.5% in the projection thereafter would allow the ratio to fall below 83% of GDP by 2026.

Overall, the debt sustainability analysis shows that in the baseline scenario the debt-to GDP ratio moderately declines in the short and medium-term. However, it would still be at a high level and is vulnerable to macro-economic and financial-market shocks. On the other hand, a solidly declining trajectory of the debt-to-GDP ratio can be achieved by maintaining fiscal discipline over the medium to long-term horizon. In addition, the solid reduction path crucially hinges on medium and long-term economic growth, which points to the necessity of persevering with the implementation of structural reforms.

([25]) COM(2015) 12.

ANNEX 3

European Commission macroeconomic and fiscal projections (2016 winter forecast)

Table 1: Use and supply of goods and services (volume)

Annual % change	2014	2015	2016	2017
1. Private consumption expenditure	2.2	2.6	1.9	1.8
2. Government consumption expenditure	-0.5	0.3	0.4	0.4
3. Gross fixed capital formation	2.8	4.3	3.0	4.7
4. Final domestic demand	**1.8**	**2.4**	**1.8**	**2.0**
5. Change in inventories	--	--	--	--
6. Domestic demand	**2.1**	**2.1**	**1.8**	**2.0**
7. Exports of goods and services	3.9	4.9	4.3	5.3
7a. - of which goods	3.6	5.7	4.4	5.4
7b. - of which services	5.0	2.7	4.0	5.2
8. Final demand	**2.7**	**2.9**	**2.5**	**3.0**
9. Imports of goods and services	7.2	6.5	4.9	6.0
9a. - of which goods	6.7	7.2	5.0	6.3
9b. - of which services	10.3	2.5	3.9	4.5
10. Gross domestic product at market prices	**0.9**	**1.5**	**1.6**	**1.8**
Contribution to change in GDP				
11. Final domestic demand	1.8	2.4	1.8	2.0
12. Change in inventories + net acq. of valuables	0.3	-0.3	0.0	0.0
13. External balance of goods and services	-1.2	-0.6	-0.2	-0.2

Table 2: Use and supply of goods and services (value)

Annual % change	2014	2015	2016	2017
1. Private consumption expenditure	2.9	3.1	2.7	2.9
2. Government consumption expenditure	-1.0	0.4	2.0	1.7
3. Gross fixed capital formation	2.6	4.5	3.4	5.2
4. Final domestic demand	**2.1**	**2.8**	**2.6**	**3.0**
5. Change in inventories	--	--	--	--
6. Domestic demand	**2.5**	**2.5**	**2.6**	**3.0**
7. Exports of goods and services	3.2	4.3	3.9	6.5
8. Final demand	**2.7**	**3.0**	**3.0**	**4.1**
9. Imports of goods and services	4.9	2.6	2.8	6.4
10. Gross national income at market prices	1.9	3.0	3.1	3.2
11. Gross value added at basic prices	1.3	2.8	2.9	3.2
12. Gross domestic product at market prices	**1.9**	**3.1**	**3.1**	**3.2**
Nominal GDP, EUR bn	173.4	178.9	184.4	190.3

Table 3: Implicit price deflators

% change in implicit price deflator	2014	2015	2016	2017
1. Private consumption expenditure	0.6	0.5	0.7	1.0
2. Government consumption expenditure	-0.6	0.1	1.6	1.3
3. Gross fixed capital formation	-0.2	0.1	0.4	0.5
4. Domestic demand	**0.3**	**0.3**	**0.8**	**1.0**
5. Exports of goods and services	-0.7	-0.5	-0.4	1.1
6. Final demand	**0.0**	**0.1**	**0.5**	**1.0**
7. Imports of goods and services	-2.1	-3.6	-2.0	0.3
8. Gross domestic product at market prices	**1.0**	**1.7**	**1.5**	**1.3**
HICP	**-0.2**	**0.5**	**0.7**	**1.1**

Table 4: Labour market and cost				
Annual % change	2014	2015	2016	2017
1. Labour productivity (real GDP per employee)	-0.5	0.4	0.8	1.1
2. Compensation of employees per head	-1.4	0.1	1.6	1.4
3. Unit labour costs	**-0.9**	**-0.3**	**0.8**	**0.3**
4. Total population	-0.5	-0.5	-0.5	-0.5
5. Population of working age (15-74 years)	-0.7	-0.5	-0.4	-0.4
6. Total employment (fulltime equivalent)	1.4	1.1	0.8	0.7
7. Calculated unemployment rate - Eurostat definition (%)	**14.1**	**12.6**	**11.7**	**10.8**

Table 5: External balance				
levels, EUR bn	2014	2015	2016	2017
1. Exports of goods (fob)	50.3	52.9	54.9	58.5
2. Imports of goods (fob)	58.3	60.0	61.6	65.7
3. Trade balance (goods, fob/fob) (1-2)	**-8.0**	**-7.1**	**-6.7**	**-7.1**
3a. p.m. (3) as % of GDP	***-4.6***	***-4.0***	***-3.6***	***-3.8***
4. Exports of services	19.2	19.6	20.4	21.7
5. Imports of services	10.5	10.6	11.0	11.5
6. Services balance (4-5)	**8.6**	**9.0**	**9.4**	**10.1**
6a. p.m. 6 as % of GDP	***5.0***	***5.0***	***5.1***	***5.3***
7. External balance of goods & services (3+6)	**0.7**	**1.9**	**2.7**	**3.0**
7a. p.m. 7 as % of GDP	***0.4***	***1.0***	***1.5***	***1.6***
8. Balance of primary incomes and current transfers	-0.2	-0.5	-0.8	-0.9
8a. - of which, balance of primary income	*-2.3*	*-2.6*	*-2.7*	*-2.8*
8b. - of which, net current Transfers	*2.2*	*2.1*	*2.0*	*1.9*
8c. p.m. 8 as % of GDP	*-0.1*	*-0.3*	*-0.4*	*-0.5*
9. Current external balance (7+8)	**0.5**	**1.3**	**1.9**	**2.1**
9a. p.m. 9 as % of GDP	***0.3***	***0.7***	***1.1***	***1.1***
10. Net capital transactions	2.5	2.5	2.5	2.5
11. Net lending (+)/ net borrowing (-) (9+10)	**3.0**	**3.8**	**4.4**	**4.6**
11a. p.m. 11 as % of GDP	***1.7***	***2.1***	***2.4***	***2.4***

Table 6: Fiscal accounts				
	2014	2015	2016	2017
		% of GDP		
Taxes on production and imports	14.2	14.5	14.7	14.6
Current taxes on income, wealth, etc.	10.9	11.0	10.2	10.0
Social contributions	11.7	11.6	11.3	11.2
Other (residual)	7.7	6.9	6.9	6.8
Total revenue	**44.5**	**44.0**	**43.2**	**42.6**
Compensation of employees	11.8	11.2	11.1	10.9
Intermediate consumption	5.8	6.0	6.0	5.9
Social payments	19.7	19.1	18.9	18.7
Subsidies	0.7	0.5	0.4	0.4
Gross fixed capital formation	2.0	2.1	2.0	2.2
Other (residual)	6.8	4.7	3.5	3.6
Interest expenditure	4.9	4.8	4.6	
Total expenditure	**51.7**	**48.2**	**46.6**	**46.2**
General Government balance (ESA2010)	**-7.2**	**-4.2**	**-3.4**	**-3.5**
Primary balance	-2.3	0.5	1.2	-3.5
		% change		
Taxes on production and imports	5.5	5.6	4.4	2.6
Current taxes on income, wealth, etc.	-2.3	3.4	-4.3	1.5
Social contributions	-0.4	1.6	1.2	1.6
Other (residual)	-2.3	-6.8	3.4	
Total revenue	**0.6**	**1.9**	**1.2**	**1.9**
Compensation of employees	-3.9	-2.3	2.0	1.5
Intermediate consumption	4.9	6.2	3.7	1.7
Social payments	-2.0	0.0	2.2	
Subsidies	17.3	-27.0	-7.7	1.5
Gross fixed capital formation	-4.8	5.8	0.8	13.8
Other (residual)	85.8	-29.1	-22.0	-100.0
Interest expenditure	3.0	0.0	-0.8	-1.0
Total expenditure	**5.5**	**-3.8**	**-0.5**	**2.3**
Nominal GDP, EUR bn	**173.4**	**178.9**	**184.4**	**190.3**

Table 7: Government debt developments

	2014	2015	2016	2017
ESA2010 deficit (% of GDP)	**-7.2**	**-4.2**	**-3.4**	**-3.5**
ESA2010 gross debt (% of GDP)	130.2	129.1	128.5	127.2
	levels, EUR bn			
ESA2010 deficit	**-12.4**	**-7.6**	**-6.2**	**-6.7**
Gross debt	225.8	230.9	237.0	242.0
Change in gross debt	6.1	5.2	6.1	5.0
Nominal GDP	173.4	178.9	184.4	190.3
Real GDP	168.7	171.2	173.9	170.8
Real GDP growth (% change)	**0.9**	**1.5**	**1.6**	**1.8**
Change in gross debt (% of GDP)	3.5	2.9	3.3	2.6
Stock-flow adjustments (% of GDP)	-3.6	-1.3	-0.1	-0.9
	% of GDP			
Gross debt ratio	**130.2**	**129.1**	**128.5**	**127.2**
Change in gross debt ratio	1.2	-1.1	-0.6	-1.3
	Contribution to change in gross debt			
Primary balance	2.3	-0.5	-1.2	-0.9
"Snow-ball" effect	2.5	0.7	0.6	0.4
of which				
Interest expenditure	*4.9*	*4.8*	*4.6*	*4.4*
Real growth effect	*-1.2*	*-1.9*	*-2.0*	*-2.3*
Inflation effect	*-1.2*	*-2.1*	*-1.9*	*-1.7*
Stock-flow adjustments	**-3.6**	**-1.3**	**-0.1**	**-0.9**
Implicit interest rate	*3.9*	*3.8*	*3.7*	*3.5*

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