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Post-programme Surveillance - Portugal, autumn 2022

Accompanying the document

COMMUNICATION FROM THE COMMISSION

Post-programme Surveillance - Portugal, autumn 2022

{C(2022) 8552 final}

1. INTRODUCTION

Staff from the European Commission (EC), in liaison with staff from the European Central Bank (ECB), undertook the sixteenth post-programme surveillance (PPS) mission to Portugal. The mission took place in Lisbon during 12-13 September 2022. The European Stability Mechanism (ESM) participated in the meetings on aspects related to its own Early Warning System. IMF staff also participated in the meetings. PPS monitors economic, fiscal and financial conditions to assess the repayment capacity of a country that has received financial assistance. ([1])

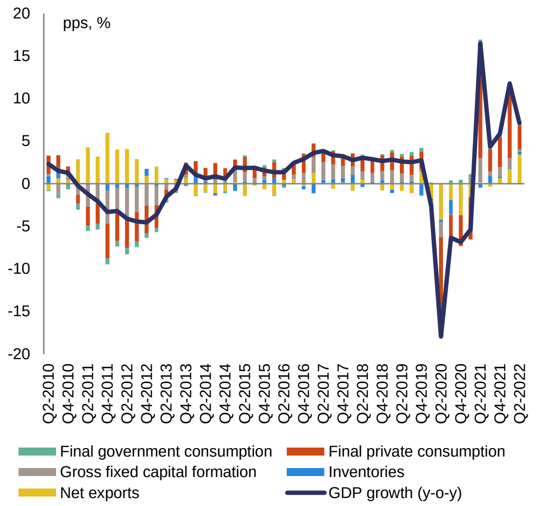
This report reflects information available and policy developments that have taken place until 31 October 2022. The macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2022 autumn forecast released on 11 November 2022 (with cut-off date 31 October 2022).

([1]) 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, which is expected in 2035.

2. ECONOMIC DEVELOPMENTS

Portugal's economy continued its strong recovery from the pandemic in early 2022 although growth slowed substantially in spring in the face of a new external shock. In year-on-year terms, growth was supported by a large carryover effect and picked up from 5.5% in 2021 to 12.0% in Q1-2022 before moderating to 7.4% in Q2-2022. In quarter-on-quarter terms, growth slowed from 2.4% in Q1-2022 to 0.1% in Q2-2022 as Russia's war of aggression against Ukraine triggered a substantial disruption in global supply chains, particularly on energy and food markets. Consequently, economic sentiments dropped substantially across Europe. Despite Portugal's low direct exposure to the conflict region, investments were heavily affected and contracted by 3.7% in Q2-2022 (q-o-q). Private consumption retained a positive growth rate but slowed to 0.7% (q-o-q). On the supply side, construction and industrial production faced significant setbacks while the service sector retained strong growth, helped by the steep rebound in foreign tourism.

Graph 2.1: **Real GDP growth and components**

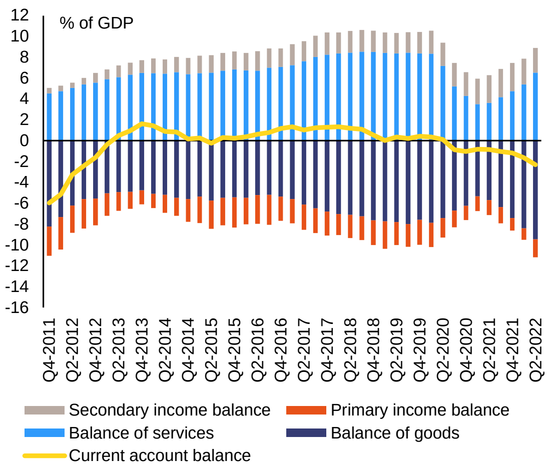


Source: INE

High-frequency indicators in Q3-2022 point to a continued weakness in the economic performance. Construction and industrial production started to recover from the initial shock but the service sector moderated in the summer months after the initial impetus from the expiry of pandemic measures had weakened. In addition, many sectors continued to face pressure from record-high energy prices while private demand was further constrained by the rising cost of living, reflecting not only energy costs but a substantial increase in food prices, exacerbated by the severe drought in Portugal.

Overall, growth is expected to face significant challenges over the short term in the context of high energy and food prices. According to the Commission 2022 autumn forecast, GDP is set to increase by 6.6% in 2022 and 0.7% in 2023. Risks to the growth outlook remain significantly on the downside as a result of Russia's war of aggression against Ukraine and related uncertainty in global demand and security of supplies. Portugal is also facing country-specific risks related to the severe drought on the Iberian Peninsula that may have prolonged repercussions on domestic food supplies. Rising interest rates across Europe, in the context of monetary policy normalisation, are also posing downside risks to investments though a large number of projects are benefiting from EU funding and therefore have limited exposure to market volatilities.

Graph 2.2: **Current account balance**



Source: Banco de Portugal

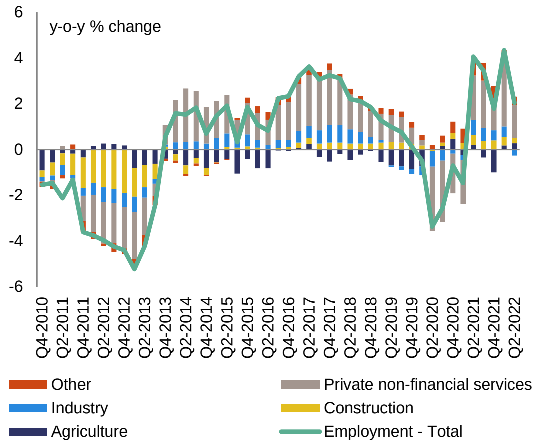
The current account deficit deteriorated further in the first half of 2022, according to balance of payments data. The deficit widened from 1.2% of GDP in 2021 to 2.1% for the 12-month period ending in June 2022. The change was exclusively driven by price dynamics, mostly in energy imports, leading to very negative terms of trade in the balance of goods. On the other hand, a strong rebound in foreign tourism pushed up travel receipts to a historical high in Q2-2022. Taking into account the seasonally high weight of travel receipts in Q3-2022 and the assumed moderation in energy prices in the following years, the current account deficit is projected to gradually improve over the medium term but to remain somewhat above the last pre-pandemic year (2019).

The net international investment position (NIIP) continued improving in relative terms. Reflecting the large trade deficit, the NIIP deteriorated in absolute values in the first half of 2022 but its share in GDP continued to improve, moving from -94.7% of GDP at the end of 2021 to -90.6% as of end-June 2022. In addition to the negative trade flows, the NIIP was adversely affected by price valuations in the stock of assets and liabilities (- EUR 4.8 billion) but benefited from currency valuations (+ EUR 3.8 billion). In light of the expected upward dynamics in nominal GDP, the NIIP is set to retain its favourable path in relative terms over the medium term.

Unemployment stabilised around 6% in the summer months. The monthly unemployment rate stayed unchanged at 6% from May until August, marginally above the rates reported earlier in the year but still below pre-pandemic levels. Employment growth meanwhile slowed from 5% (y-o-y) in January to 1% (y-o-y) in August. The job vacancy rate monitored on a quarterly basis reached a historical high of 1.4% in Q2-2022 but remained well below the EU average of 3%. Across sectors, services experienced the biggest problems in finding staff, particularly in the IT, accommodation and catering sectors where the highest job vacancy rates were recorded. While the IT sector was facing persistent hiring difficulties over the past years, accommodation and catering was strongly affected by the evolution of the pandemic as the job vacancy rate in the sector rose from 0.5% in Q1-2020 to 2.7% in Q2-2022.

The labour market is expected to remain resilient. Although employment growth slowed substantially with the economic slowdown in Q2-2022, the Commission's economic sentiment indicator for Q3-2022 shows that employment expectations, particularly in the service sector, remain broadly favourable. The labour market is therefore expected to remain resilient over the medium term though sectors with high exposure to energy prices may face challenges to maintain staff while employment in tourism-related sectors is set to increase.

Graph 2.3: **Employment evolution by sectors**



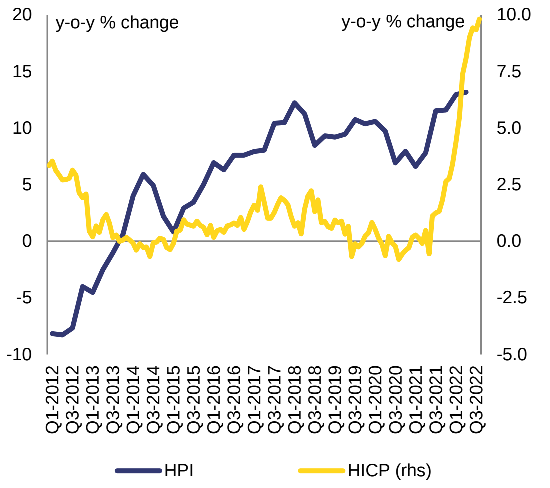
Source: Eurostat

Inflation grows above expectations. The HICP inflation in Portugal, like in other Member States, has been significantly higher than expected so far in 2022. As of September 2022, inflation in Portugal increased to 9.8% (y-o-y) relative to 9.9% for the euro area. For the third quarter of the year, inflation averaged 9.5% (y-o-y) in Portugal and 9.3% in the euro area. The steep rise in energy prices, driven by Russia's war of aggression against Ukraine, is the main factor behind the high inflation. Prices of energy in Portugal increased by 25.9% (y-o-y) in Q3-2022 after a peak of 28.9% (y-o-y) in Q2-2022. This also triggered pass-through effects to other goods and services. In addition, further disruptions in global supply chains pushed up international prices of many non-energy commodities, particularly on the food markets.

Portugal's inflation is also affected by country-specific factors related to the extreme drought. As of August, about 40% of the territory of Portugal was ranked as experiencing extreme drought conditions, which is the worst level in the ranking, and the remaining part of the country was in severe drought conditions. The situation improved only marginally in September. Consequently, unprocessed food prices in Portugal increased by 18.1% in September (y-o-y) as compared to 12.7% in the euro area.

Inflation is expected to gradually moderate. Taking into account the international energy futures as well as the downward shift in non-energy commodities in the second half of 2022, inflation in Portugal is expected to moderate somewhat in 2023 and more significantly in 2024, broadly in line with the projection for the euro area. The inflation drivers over the forecast period are gradually expected to shift from supply to demand, where wage adjustments and compensations for higher energy costs would keep price pressure on non-tradable goods and services.

Graph 2.4: **HICP and House Price Index**



Source: Eurostat

House prices keep growing at a high but diminishing real rate. Following an increase by 9.6% in 2021, house prices rose by 12.9% (y-o-y) in Q1-2022 and 13.2% (y-o-y) in Q2-2022. However, the deflated house price index, adjusted by the private consumption deflator, slowed down from 9.0% (y-o-y) in Q1-2022 to 7.1% (y-o-y) in Q2-2022. While rising interest rates on mortgage loans are expected to constrain somewhat demand for properties, the slowdown in the construction sector as well as the increased price of construction materials are expected to keep the price pressure on the side of property supply.

3. PUBLIC FINANCES

3.1. FISCAL PERFORMANCE AND OUTLOOK

Portugal's public deficit is expected to continue improving in 2022. For the first half of 2022, the general government balance (in national accounts) registered a surplus of 0.8% of GDP, compared with a deficit of 5.7% of GDP for the same period in 2021. Public revenue increased by 12.4% y-o-y during the first half of 2022. Noteworthy were the positive contribution of taxes on production and imports (6.5 pps.), propelled by the recorded increase in inflation alongside the positive developments in private consumption, of current taxes on income and wealth (4.2 pps.) and of social contributions (2.4 pps.), that compensated the contraction in the contribution of other current revenues (0.6 pps.) and capital revenues (0.1 pps.), the latter related to EU funds transfers. At the same time, public expenditure contracted by 3% y-o-y, mainly owing to the negative contribution of subsidies (4.4 pps.) – reflecting the phase-out of COVID-19 measures –, interest expenditures (0.6 pps.) and other capital expenditures (2 pps.). These developments more than compensated the positive contributions of social benefits (1.3 pps), intermediate consumption (0.9 pps.) and compensation of employees (0.8 pps.), amid the increase in the number of public employees, and to a lower extent the increases in public investment (0.6 pps.) and other current expenditure (0.4 pps.).

Assuming unchanged policies, Portugal's public deficit is projected to continue declining in the coming years. According to the Commission 2022 autumn forecast, Portugal's public deficit is forecast to reach 1.9% of GDP in 2022, below the 2.9% of GDP recorded in 2021, on the back of the strong economic recovery and the phase-out of crisis-related fiscal policy measures. The public deficit is projected to further contract in 2023 and 2024 to 1.1% and 0.8% of GDP, respectively. This compares with deficits of 1.9% and 0.9% of GDP in 2022 and 2023, respectively, planned in Portugal's 2023 Draft Budgetary Plan.

The Portuguese public-debt-to-GDP ratio is expected to remain on a downward path. In 2021, the Portuguese public debt-to-GDP ratio resumed its pre-pandemic downward path – after reaching a peak in 2020 of 134.9% – and recorded 125.5%, resulting from the debt-reducing impact of the favourable nominal growth-interest rate differential (translating the differential between the average interest rate and nominal GDP growth) (6.4% of GDP) and stock-flow adjustments (reflecting the difference between the change in debt and the deficit) (3.5% of GDP). According to the Commission 2022 autumn forecast, Portugal's public debt-to-GDP ratio is projected to further decrease in 2022 to 115.9%, already below its pre-pandemic levels, due to a favourable nominal growth-interest rate differential (9.7% of GDP) – with a strong nominal GDP growth benefitting from a high inflation environment coupled with a projected containment in interest expenditures in 2022 (2.1% of GDP) –, and a slightly positive primary balance (0.2% of GDP), offsetting the unfavourable stock-flow adjustment (0.2% of GDP). For 2023 and 2024, the public debt-to-GDP ratio is forecast to further contract to 109.1% and 105.3%, respectively. These public debt-to-GDP developments compare with the projections included in the Portuguese 2023 Draft Budgetary Plan of 115% and 110.8% for 2022 and 2023, respectively.

Challenges to Portugal's fiscal outlook remain. Contingent liabilities, related to publicly guaranteed credit lines, ongoing negotiation processes of public-private partnership (PPPs) rebalancing requests, persisting vulnerabilities in some public corporations and upward pressures on current expenditure – in particular, on the public wage bill and those emerging from the rising inflation and demographic ageing – are possible challenges to Portugal's fiscal outlook.

3.2. POLICY ISSUES

The quality and composition of Portugal's public finances remains critical. On 12 July 2022, the Council adopted a recommendation delivering an opinion on Portugal's 2022 Stability Programme ([2]). For 2023, Portugal was recommended to ensure a prudent fiscal policy, while expanding public investment for the green and digital transitions, and for energy security, considering EU instruments as the REPowerEU

([2]) Council Recommendation of 12 July 2022 on the 2022 National Reform Programme of Portugal and delivering a Council Opinion on the 2022 Stability Programme of Portugal OJ C 334, 1.9.2022, p. 181–189.

initiative, the Recovery and Resilience Facility and other Union funds. For the period beyond 2023, Portugal was recommended to pursue a fiscal policy aimed at achieving prudent fiscal positions and ensuring credible gradual debt reduction and fiscal sustainability over the medium-term, through gradual consolidation, investment, and reforms. Moreover, in line with the recommendations the Council adopted for 2022 and 2023, there is scope to improve the effectiveness of both the tax and social protection systems. Therefore, priority should be given to fiscal-structural reforms which are aligned with the above-mentioned policy priorities and contribute to both medium- and long-term sustainability and resilience of public finances.

Portugal has adopted measures to counteract the impact of the rise in energy prices. By the cut-off date of this report, Portugal has introduced a set of fiscal policy measures aimed at counteracting the negative impact of the spike in energy prices on households and firms. Firm-specific measures notably include a subsidy for gas-intensive firms, a subsidy to energy prices for the agriculture and fisheries sector, support for the energy efficiency and energy transition and a tax deduction under the corporate income tax for the transport sector. Portugal also introduced measures directed to households, notably a one-time payment of EUR 125 per adult and EUR 50 per children in October 2022, a one-time supplement to pensioners corresponding to 50% of the pension payable in October 2022. Cross-cutting measures notably include a reduction of the fuel tax, the suspension of the increase in the carbon tax and a reduction of VAT for electricity. Most of these measures have been announced as temporary, expiring by the end of 2023, and do not appear targeted while preserving the price signal to reduce energy demand and increase energy efficiency. The budgetary impact of the total set of energy-related fiscal policy measures implemented amounts to 2.1% of GDP in 2022 and 0.9% of GDP in 2023. In line with the Council recommendations on 12 July 2022, it is important for such energy-related fiscal policy measures to be increasingly focused on the most vulnerable households and exposed firms, to preserve incentives to reduce energy demand, and to be withdrawn as energy price pressures diminish.

A stronger budgetary framework remains key. The full and effective implementation of the 2015 Budgetary Framework Law (BFL), which has been systematically delayed, would strengthen overall budgetary planning and monitoring through a stronger medium-term focus and enhanced transparency. The Portuguese RRP contributes to the full an effective implementation of the 2015 BFL and the associated structural changes in terms of budgeting, accounting, and information systems.

The financial situation of the National Health Service (NHS) continues to be challenging. The already existent upward pressures in spending of Portugal's NHS on wages, medicines and medical services, alongside the inner weaknesses in budgetary planning and cost-efficiency, were enhanced by the outbreak of the COVID-19 pandemic. This was reflected in a deterioration of the NHS balance to a deficit of 0.5% of GDP, resulting in the need for additional transfers from the State budget in 2021. During the first half of 2022 arrears returned to an increasing path. The upward pressures on NHS spending are expected to continue and lead to a deficit for the year of approximately 0.5% of GDP in 2022. Gradual steps are being undertaken to strengthen the efficiency and financial sustainability of the NHS, particularly in the context of the RRP, which provides for the deployment of the NHS' comprehensive plan designed in 2019. A new management contract template for state-owned enterprises (SOEs) operating in the NHS entered into force in July 2022 ([3]), in order to strengthen management accountability and encourage performance-based practices, progress has been made in the establishment of Integrated Responsibility Centres in the hospitals of the NHS, and the implementation of the exclusivity work regime for health professionals in the NHS.

After the impact of the COVID-19 crisis, the financial situation of SOEs shows mild signs of recovery. The already challenging financial situation of SOEs was enhanced by the COVID-19

([3]) Government Order No 167-B/2022 of 30 June 2022, establishing the rules regarding eligibility, composition, determination, and attribution to public managers, who exercise executive functions in public business entities integrated in the National Health Service, of a variable remuneration associated with the recognition and encouragement of sound management practices management.

crisis in 2020 and 2021, particularly affecting those operating in the health and transport sectors. Rescue aid to TAP Air Portugal (the Portuguese flag carrier line) and SATA Air Açores was granted in 2021 and 2022, totalling to 0.4% and 0.3% of GDP, respectively. The financial situation of non-financial SOEs improved during the first half of 2022, reflected in a higher level of turnover, on the back of the economic recovery, and the amelioration of net income. The debt-to-GDP ratio of non-financial SOEs stood at 19.8% of GDP at end Q2-2022. To strengthen the financial sustainability of SOEs, a new management contract introducing a system of incentives to support manager's performance and good governance entered into force in December 2021 ([4]). Liquidations and mergers of SOEs have taken place in 2022, potentially leading to efficiency gains. In the area of public-private partnerships (PPPs), COVID-19 related financial rebalancing requests to the State are under assessment.

([4]) Government Order No 317-A/2021 of 23 December, establishing the rules regarding eligibility, composition, determination and attribution to public managers, who exercise executive functions in public companies of the State Corporate Sector, of a variable remuneration associated with the recognition and encouragement of sound management practices in state-owned enterprises.

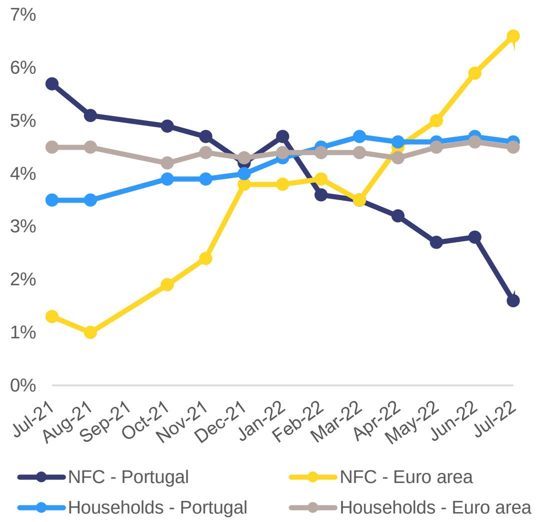
4. FINANCIAL SECTOR

4.1. RECENT TRENDS

The first half of 2022 was marked by major improvements in Portugal's banks profitability. Both the return on equity (ROE) and the return on assets (ROA) increased beyond their respective pre-pandemic levels. In the first half 2022 banks recorded a ROE of 8.6% and a ROA of 0.7% against 4.3% and 0.5%, respectively in 2019). These positive developments were driven by higher revenues, low levels of new provisioning and better overall cost-efficiency of the sector. Banks' net interest income started increasing on the back of rising interest rates, while aggregate net fees and commissions income maintained its increasing trend. New loan impairments were limited as asset quality remained largely stable. Banks progressed further in their restructuring plans, succeeding to further reduce their operating costs thus lowering the cost-to-core income ratio from over 60% pre-pandemic down to 55.1% at end-June 2022. Over the coming quarters, banks expect to further benefit from higher interest rates. Their, as well as Banco de Portugal's, estimates point to net interest income offsetting potential asset devaluations and a possible increase in credit risk. Nevertheless, higher levels of uncertainty support a cautious stance of maintaining adequate provisions and capital buffers.

Lending increased but at very disparate pace across segments. Bank lending to the corporate sector clearly lost momentum in the first half of 2022 and increased only by 1.6% y-o-y in July 2022, the lowest value since March 2020. This figure is fully aligned with the long-term deleveraging trend of the Portuguese corporate sector but in clear contrast to the dynamic NFC loan growth ratio of 6.6% for the Euro Area (y-o-y, July 2022). Several reasons may explain this muted demand for corporate credit. While the challenging macroeconomic situation has certainly weakened the appetite of companies to launch and finance new investments, firms have also increased their financing from other sources and accessed the liquidity accumulated to counter the rising interest rates (rising interest rates for banking loans to NFC from 1.9% in January 2022 to 2.63% at July 2022). Furthermore, the reimbursement of NFC loans resumed its normal pace after moratoria, reducing the outstanding stocks of loans.

Graph 4.1: **Loans to NFC and Households - Annual Growth Rate**



Source: ECB

Table 4.1: **Financial stability indicators**

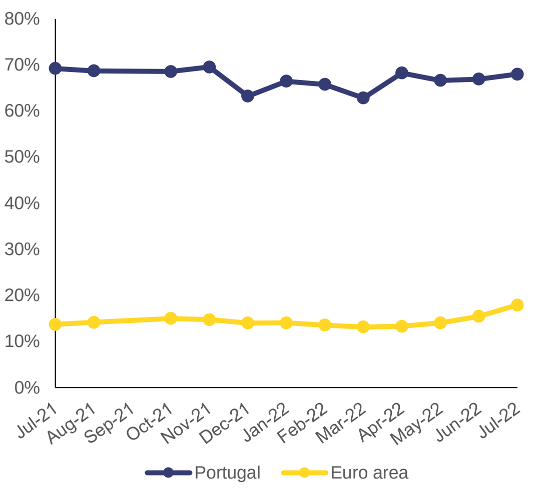
in %	Portugal										Euro area	EU
	Q4-2017	Q4-2018	Q4-2019	Q4-2020	Q1-2021	Q2-2021	Q3-2021	Q4-2021	Q1-2022	Q2-2022	Q2-2022	Q2-2022
Non-performing loans	13,3	9,4	6,1	4,9	4,6	4,3	4,0	3,6	3,6	3,4	1,8	1,8
o/w NFC sector	25,2	18,5	12,3	9,8	9,3	8,7	8,4	8,1	8,0	7,6	3,4	3,4
o/w HH sector	7,1	5,1	3,7	3,4	3,4	3,1	3,1	2,8	2,7	2,6	2,2	2,2
Coverage ratio	49,9	52,4	51,7	55,4	55,4	55,8	56,0	52,6	53,5	52,8	45,5	45,4
Return on equity(1)	-0,8	2,7	4,3	0,0	4,1	4,6	4,7	4,9	8,5	8,6	6,2	6,3
Return on assets(1)	0,0	0,3	0,5	0,0	0,4	0,4	0,4	0,4	0,7	0,7	0,4	0,4
Total capital ratio	15,2	15,2	16,7	18,1	17,7	17,8	17,8	18,0	17,5	17,5	18,6	18,8
CET 1 ratio	13,9	13,2	14,1	15,4	15,2	15,3	15,2	15,5	14,9	15,0	15,3	15,5
Loan to deposit ratio	78,9	76,2	76,4	72,1	70,3	69,7	69,5	68,9	68,4	68,0	85,0	87,9

(1) Annualised data

Source: ECB – CBD2 – Consolidated Banking Data; own calculations

Unlike for firms, households' borrowing activity continued to pick up through the first half of 2022 buoyed by the dynamic real estate market. Housing loans increased by 4.6% y-o-y in July 2022, despite interest rates rising from 0.81% in January 2022 to 1.88% in July 2022. Growth in the consumer credit segment was even stronger, accelerating during the first half of 2022, with the annual rate of change reaching 5.5% in July (from just 2.4% in December 2021), in line with recent dynamic developments in private consumption. Despite the rising lending aggregates, the ratio of private sector indebtedness (excluding the financial sector) to GDP continued on its downward trend (since the beginning of 2021). It shrunk from 202.9% of GDP at end-2021 to 194.3% in June 2022, though still remaining above its end-2019 levels of 192.1% of GDP. The drop in the private indebtedness ratio resulted from the denominator effect (i.e., the rapid pace of nominal GDP growth).

Graph 4.2: **Share of new loans for house purchase with a floating rate or an initial rate fixation period of ≤1 year**



Source: ECB

Non Performing Loans (NPL) ratios continue decreasing across all sub-segments of the loan book. Lenders took advantage of the recovering profitability and managed to further reduce the average NPL ratio down to 3.4% in June 2022 (i.e., some 30 bps less than the end-2021 figure). The decrease in gross NPLs was mainly the result of write-offs (contributing 16 bps to the ratio's decrease) and sales of NPLs (9 bps) whereas the increase in total loans contributed 9 bps to the decrease in the NPL ratio through the denominator effect. In parallel, the gross NPL impairment coverage ratio remained quite stable (at 52.8%) but continued to increase for sectors most affected by the pandemic and rising commodity prices (coverage of up to 86%). The possible cliff effect at the end of the credit moratoria (most of which expired in September 2021) did not materialise, with only a slight increase of NPL and forborne ratios over the past nine months. The geopolitical uncertainty may however increase credit risk in the sectors most affected by the pandemic as well as those particularly exposed to commodity price inflation. Lastly, the secondary market for NPLs remains open and active, however, given the uncertainty going forward and increasing interest rates, both volumes and prices have declined.

Liquidity remains at comfortable levels whereas Minimum Requirement for own funds and Eligible Liabilities (MREL) issuance slowed down. Lenders have ample liquidity, with an average Liquidity Coverage Ratio (LCR) of 262% as at June 2022, at historic highs. Portuguese banks have significantly rebalanced their funding profiles, and deposits account for the bulk of their funding structure. All institutions have binding final MREL targets for 2024 in place, while intermediate targets (for January 2022) have been successfully met. The current context of uncertainty has increased market volatility, reduced risk appetite and increased the cost of financing for banks. As a result, the issuance of MREL eligible instruments decreased in the first half of 2022 relative to a year earlier. Going forward, banks will need to roll over existing stocks and continue issuing instruments in a more challenging environment. The decrease in the common equity tier 1 ratio to 15% (June 2022), down by 50 bps since end-2021, mainly reflects the resumption of dividend payments and the increase in sovereign debt yields. Overall, Portuguese banks' capital and liquidity positions provide, for the time being, sufficient cushioning to withstand a period of market turmoil.

4.2. OUTLOOK AND RISKS

The direct impact of Russia's invasion of Ukraine on Portuguese banks remains limited but second-round effects raise challenges. The ensuing energy crisis, which boosted worldwide energy prices and inflation more broadly, together with the acceleration of central banks' tightening of monetary policy, strongly impacted consumers' purchasing power and confidence, as well as market sentiment. So far, Portugal benefitted both from its geographical distance from the conflict zones, which supported a strong recovery in tourism, and from a relatively low energy-intensity of the economy. Nevertheless, increased costs of financing, together with an overcast economic outlook, pose significant risks for the quality of banks' loan books going forward. Furthermore, more severe impacts of Russia's war of aggression against Ukraine on other European countries could also affect Portuguese exports, with potentially dire effects on the solvency of NFCs. Mortgages, instead, show a more positive outlook as high collateral levels and contained loan-to-value ratios, reduce the exposure of banks to stark corrections in housing prices. In this respect, the implementation of borrower based measures helped improving credit quality. However, the recently ongoing interest rate increases are likely to be stronger than the ones foreseen under the stressed debt service-to-income indicator, and real disposable income could also come under pressure.

The medium-term outlook for Portugal's banks is marked by uncertainty. Despite the set of encouraging data posted in the first half of 2022, the confluence of various exogenous shocks weighs on the future profitability of the financial sector. The key aspect is the uncertainty surrounding geopolitics that is noticeably weakening the economic outlook in Portugal and internationally, further fuelling the rise in inflation, and eroding consumer and business confidence. While the normalisation of monetary policy has rapidly translated into increasing market interest rates, generating a positive effect on net interest income, it will eventually negatively influence both credit risk and valuations of the asset side of banks' balance sheets. In particular, the increasing yields are already dampening sovereign and corporate debt prices and, going forward, may affect the value of real estate and other assets. In parallel, banks' business models are undergoing a major structural shift with increasing focus on digitalisation, cybersecurity and transition towards climate sustainable investments. This adjustment brings both new opportunities but also major challenges through increasing competition and substantial investments.

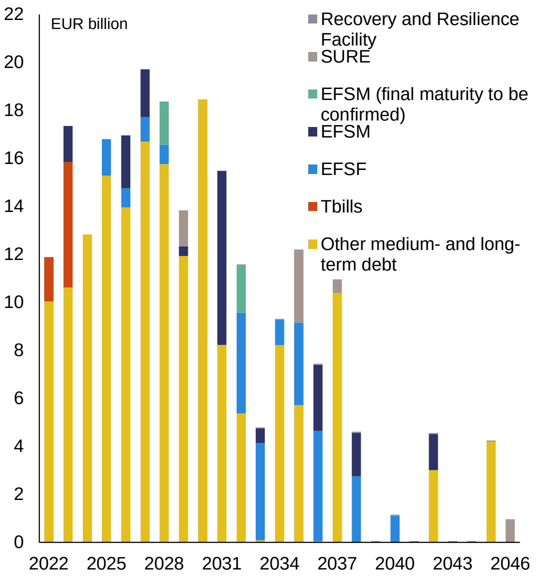
5. SOVEREIGN FINANCING AND CAPACITY TO REPAY

Portugal's financing needs in 2022 are projected to be below the levels in 2020 and 2021. The government's policy response to the COVID-19 crisis weighed on Portugal's financing needs for 2020 and 2021. Financing needs reached a historical peak of EUR 26.6 billion (12.4% of GDP) in 2021, EUR 2.1 billion higher than in 2020, driven by the increase in debt redemption of EUR 5.1 billion, that offset the better-than-planned budget balance for 2021. In 2022, Portugal's financing needs are projected to decline by EUR 4.7 billion to EUR 21.9 billion (9.3% of GDP), on the back of the expected improvement in the budget balance that, coupled with a reduction in the planned net acquisition of financial assets, is expected to more-than-compensate the increase in debt redemptions by approximately EUR 0.8 billion for the year. Portugal's cash buffer is planned to increase slightly to EUR 16.1 billion (6.8% of GDP) by the end of 2022, EUR 0.6 billion more than in 2021, reflecting the reduced weight of deposits as a source of funding for the year. This would bring the cash buffer to levels close to the pre-pandemic period, while still covering more than one-third of the year's financing needs.

Portugal's active debt management strategy continues to target the smoothening of the debt redemption profile (see Graph 5.1). Liability management operations, as debt buy-back transactions and bond exchange offers, contributed to lengthening the average debt maturity of Portuguese public debt and to contain interest expenditures. The average residual maturity of Portugal's public debt is expected to remain broadly stable at around eight years in 2022. The issuance of Portuguese government bonds remains the country's main funding instrument. The composition of the investors' base is stable and diversified across regions and type of investors, with the Eurosystem and private banks being the main holders of Portuguese government bonds.

Portugal is servicing its debt to official creditors. Having fully repaid its financial assistance loan to the International Monetary Fund (IMF) in December 2018, Portugal carried out a first repayment of EUR 2 billion to the European Financial Stability Facility (EFSF) on 17 October 2019 and of EUR 0.5 billion to the European Financial Stability Mechanism (EFSM) on 4 April 2022 [5]. After these repayments, the outstanding debt to the EFSF and EFSM amounts to EUR 25.3 billion and EUR 23.8 billion, respectively.

Graph 5.1: **Redemption profile of public debt**



(1) Last update: 14-09-2022
Source: Portuguese Treasury and Debt Agency (IGCP)

The EU's financial instruments remain a relevant financing source. The Recovery and Resilience Facility, a performance-based funding programme, supports financially the Portuguese recovery and resilience plan (RRP) [6] and provided for a total financial contribution of EUR 16.6 billion (about 8% of GDP) – of which, EUR 13.9 billion in grants or non-repayable support and EUR 2.7 billion in loans – with payments to be made by 31 December 2026 [7]. Portugal received on 3 August 2021, a pre-financing of EUR 2.2

(5) Commission Decision of 26 August 2019 relating to the waiving under the mandatory proportionate repayment clause to the EFSM Loan Agreement between the Union and the Portuguese Republic, C(2019) 6264 final.

(6) Council Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Portugal (ST 10149/21+ADD 1 REV 1).

(7) Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, OJ L 57, 18.2.2021, p. 17–75.

billion (1.1% of GDP) – of which, EUR 1.8 billion in grants and EUR 0.4 billion in loans – corresponding to 13% of the original total financial allocation. Following the Commission's endorsement of a positive preliminary assessment of Portugal's payment request on 25 March 2022, a total of EUR 1.16 billion (0.5% of GDP), net of pre-financing – of which, EUR 0.55 billion in grants and EUR 0.61 in loans – was disbursed to Portugal on 9 May 2022 ([8]). On 30 September 2022, Portugal submitted to the Commission its second payment request under the Recovery and Resilience Facility for the disbursement of EUR 1.8 billion (0.8% of GDP), net of pre-financing – of which, EUR 1.7 billion in grants and 0.1 billion in loans. The financial allocation in grants to Portugal under the Recovery and Resilience Facility increased by EUR 1.6 billion (0.7% of GDP) ([9]). Under the Support to mitigate Unemployment Risks in an Emergency (SURE), Portugal was granted a loan for a maximum of EUR 5.9 billion (about 3% of GDP) ([10]) ([11]), with an average maturity of approximately 15 years, directed to finance public expenditure in relation to short-term work schemes or similar measures, as well as health related measures, as an ancillary. The total maximum amount of the loan has already been fully disbursed to Portugal, of which EUR 3 billion on 1 December 2020, EUR 2.4 billion on 25 May 2021 and EUR 0.5 billion on 29 March 2022. On 25 October 2022, the Council adopted an amendment to increase the total amount of financial assistance granted to Portugal under SURE by EUR 300 million (0.1% of GDP) ([12]).

Portugal's public debt-to-GDP ratio is expected to continue on a downward path. After reaching a peak of 134.9% in 2020, the ratio started declining in 2021 to 125.5%. According to the Commission autumn forecast, the public debt-to-GDP will further decline to 115.9% in 2022 and maintain its downward path over the forecast horizon, reaching 109.1% and 105.3% in 2023 and 2024, respectively (see Section 3). According to the Commission's debt sustainability analysis (see Annex 1), risks to Portugal's fiscal sustainability over the medium-term remain high, with public debt-to-GDP ratio developments being vulnerable to a worsening of economic and financing conditions.

Portugal's market financing conditions remained favourable by the cut-off date of this report. Since October 2018, Portuguese public debt has been classified with an 'investment' grade by the four major rating agencies. On 26 August 2022, DBRS upgraded Portugal's rating to 'A (low)' and updated the trend on the long-term rating to 'stable' from 'positive'. On 9 September 2022, Standard and Poor's upgraded Portugal's rating to 'BBB+' maintaining the long-term outlook 'stable'. Fitch also upgraded Portugal's rating to 'BBB+' on 29 October 2022 and updated the long-term outlook from 'positive' to 'stable'. The main factors behind these rating upgrades, as argued by the respective rating agencies, are the projected strong economic growth – with the economic impact of Russia's war of aggression against Ukraine assumed to be limited to the short-term – driven by the enhanced political stability, effective vaccine rollout, gradual return of tourism, expected positive productivity growth stemming from investments financed by the Recovery and Resilience Facility as well as the improvement of the fiscal outlook and the projected decline in the Portuguese debt-to-GDP ratio. Following a period of an accommodative monetary policy stance within the Eurosystem – including the set of

([8]) Positive preliminary assessment of the satisfactory fulfilment of milestones and targets related to the first payment request submitted by Portugal on 25 January 2022, transmitted to the Economic and Financial Committee by the European Commission.

([9]) Commission note to the Council and European Parliament on 30 June 2022 relating to the update of the maximum financial contribution as stipulated in Article 11(2) of the Recovery and Resilience Facility Regulation (Regulation (EU) 2021/241).

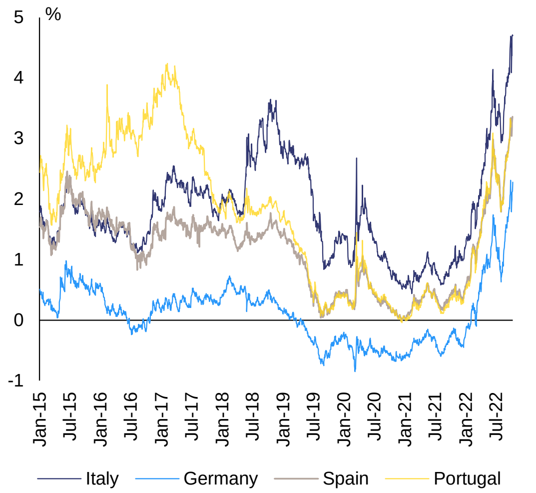
([10]) Council Implementing Decision (EU) 2020/1354 of 25 September 2020 granting temporary support under Regulation (EU) 2020/672 to the Portuguese Republic to mitigate unemployment risks in the emergency following the COVID-19 outbreak, OJ L 314, 29.9.2020, p. 49–54.

([11]) Council Implementing Decision (EU) 2022/99 of 25 January 2022 amending Implementing Decision (EU) 2020/1354 granting temporary support under Regulation (EU) 2020/672 to the Portuguese Republic to mitigate unemployment risks in the emergency following the COVID-19 outbreak, OJ L 17, 26.1.2022, p. 47–51.

([12]) Council Implementing Decision (EU) 2022/2083 of 25 October 2022 amending Implementing Decision (EU) 2020/1354 granting temporary support under Regulation (EU) 2020/672 to the Portuguese Republic to mitigate unemployment risks in the emergency following the COVID-19 outbreak.

monetary policy actions undertaken by the ECB in response to the COVID-19 crisis – since December 2021, the ECB started the path of monetary policy normalisation ([13]). It should be recalled, however, that the ECB has announced its intention to reinvest the principal payments from maturing securities under the Pandemic Emergency Purchase Programme (PEPP) and Asset Purchase Programme (APP). The tightening of financing conditions is also reflected in the raise of yields for the 10-year Portuguese government bonds (see Graph 5.2), while maintaining stable spreads vis-à-vis Portugal's main Euro Area peers. In 2021, the implicit interest rate on Portugal's public debt declined by 0.3 pps. as compared with 2020, reaching 1.9%, and, according to the 2023 Draft Budgetary Plan, it is expected to remain at similar levels in 2022, partly reflecting the long-term maturity structure of Portuguese debt.

Graph 5.2: **10-year government bond yields**



Source: European Commission

Risks to Portugal's capacity to service its debt to the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF) are low. In a context of a tightening of financing conditions, Portugal's high public debt-to-GDP ratio and inherent vulnerabilities continue to require close and regular monitoring. In the short-term, Portugal's capacity to repay is supported by its comfortable cash buffer, the maturity structure of its debt, stable financing sources and its debt currency denomination. In the medium to long term, ensuring a prudent and growth-friendly fiscal policy and adequate fiscal-structural reforms remain important to strengthen the sustainability and resilience of Portugal's fiscal sustainability and its capacity to repay.

([13]) The announcement that net purchases under the pandemic emergency programme (PEPP) would conclude in March 2022 was followed by the curtailment and the eventual cessation of net purchases under the asset purchase programme (APP) by the start of the third quarter of 2022, as well as the ECB's communication on the likely timing of interest rate lift-off, in line with its forward guidance. In July 2022 the ECB then raised the three key rates for the euro area (interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility) by 50 basis points and approved the Transmission Protection Instrument (TPI). Subsequently, the ECB increased the three key rates by 75 basis points in September 2022, and by a further 75 basis points in October 2022.

ANNEX 1
European Commission debt sustainability analysis

This Annex assesses fiscal sustainability risks for Portugal over the short-, medium- and long-term. It follows the same multi-dimensional approach as the 2021 Fiscal Sustainability Report, updated based on the Commission 2022 autumn forecast. ([14])

A1.1. SHORT-TERM RISKS

Portugal is assessed to face low fiscal sustainability risks in the short-term. The Commission's early-detection indicator (S0) does not signal major short-term fiscal risks. Government gross financing needs are expected to remain significant at around 10% of GDP in the short-term (i.e. over 2023-2024), although declining compared with the recent peak in 2020 (Table 1). Financial markets' perceptions of sovereign risk are investment grade, as confirmed by the main rating agencies By the cut-off date of this report, three out of the four major rating agencies – DBRS, Standard and Poor's and Fitch – upgraded Portugal's rating (see Section 5) during the second half of 2022.

A1.2. MEDIUM-TERM RISKS

Medium-term fiscal sustainability risks for Portugal appear high overall. According to the Commission DSA for Portugal, under the baseline, is expected to substantially decrease over the medium-term, yet remaining above the 60% of GDP threshold in 2033 (at 95.4% of GDP), (Graph 1). ([15]) These baseline projections rest on a 'no-fiscal policy change' assumption where no additional fiscal measures are incorporated beyond the forecast horizon (2024). The assumed structural primary balance (SPB) before ageing costs is projected to remain constant over 2025-2033 with a surplus forecast of 1.4% of GDP. ([16]) At the same time, the baseline projections up to 2033 still benefit from a favourable nominal interest-growth rate differential, notably thanks to the favourable impact of Next Generation EU, with real GDP growth at around 0.8% of GDP over 2025-2033. Government gross financing needs are expected to stabilise over the projection period, reaching 12% of GDP in 2033, close to the level forecast for 2024.

These baseline projections are stress-tested against alternative assumptions. Four alternative scenarios around the baseline illustrate the impact of changes in key assumptions (Graph 1). ([17])

Reverting to historical fiscal trajectories under the 'historical structural primary balance' scenario would imply less favourable developments of the government debt ratio. If the structural primary balance (SPB) gradually converged to a broadly balanced budget (its historical average), deteriorating the SPB with respect to the baseline, the projected debt-to-GDP ratio would be about 7.2 pps higher than in the baseline in 2033.

Stress tests scenarios would lead to worse developments of the debt-to-GDP ratio. If a one-year episode of financial stress pushed up market

([14]) The assumptions underlying the Commission's 'no-fiscal policy change' baseline notably comprise: (i) a structural primary surplus, before ageing costs, of 1.4% of GDP as of 2024; (ii) inflation converging linearly towards the 10-year forward inflation-linked swap rate 10 years ahead (which refers to the 10-year inflation expectations 10 years from now); (iii) the nominal short- and long-term interest rates on new and rolled over debt converging linearly from current values to market-based forward nominal rates by T+10 (as for all Member States); (iv) real GDP growth rates from the Commission 2022 autumn forecast until 2024, followed by EPC/OGWG 'T+10 methodology projections between T+3 and T+10, i.e. for 2025-2032 (on average 0.7%); (v) ageing costs in line with the 2021 Ageing Report (European Commission, Institutional Paper 148, May 2021). For information on the methodology, see the Fiscal Sustainability Report 2021 (European Commission, Institutional Paper 171, April 2022).

([15]) The baseline debt projections shows the projected government debt and its breakdown into the primary balance, the snowball effect (the combined impact of interest payments and nominal GDP growth on the debt dynamics) and the stock-flow adjustment.

([16]) Based on the available past historical performance, this value and falls within the higher range of the structural primary balance distribution.

([17]) The 'historical SPB' scenario assumes that the structural primary balance (SPB) gradually returns to its past (15 years, i.e. 2007-2021) average level. In the 'lower SPB' scenario, the SPB level is permanently reduced by half of the cumulative forecast change (i.e. over 2022-2024) in the Commission 2022 autumn forecast. The 'adverse interest-growth rate' scenario assumes a less favourable snowball effect than in the baseline (i.e. the differential between market interest rates and nominal GDP growth is permanently 1 pp. higher). In the 'financial stress' scenario, the country temporarily (one year) faces higher market interest rates in 2023 (i.e. market interest rates are assumed to increase temporarily by 2.6 pps. in 2023). Moreover, a risk premium is added for those countries with a debt-to-GDP ratio exceeding 90% of GDP in 2022. This risk premium is equal to 0.06 times the excess of the 2022 debt level over 90% of GDP.

interest rates by 2.6 pps in 2023, as reflected in the ‘financial stress ‘scenario, the public debt-to-GDP ratio by 2033 would entail a debt ratio about 1.7 pps. of GDP higher than in the baseline in 2033. A permanent worsening of the macro-financial conditions, as reflected under the ‘adverse interest-growth rate differential’ scenario would result in a persistently higher government debt-to-GDP ratio, by around 8.2 pps. of GDP by 2033, as compared with the baseline scenario. The ‘lower structural primary balance’ scenario would also lead to a higher government debt-to-GDP ratio by 2033 (+9.7 pps of GDP) compared with the baseline.

Stochastic projections show a high sensitivity of these projections against plausible unforeseen events. ([18]) These stochastic simulations point to a 23% probability of the debt-to-GDP ratio in 2027 being greater than in 2022, entailing medium risk given the starting position. In addition, such shocks point to significant uncertainty surrounding the baseline projections of the government debt (Graph 2). ([19])

Moreover, the large fiscal effort required to bring the debt ratio below 60% of GDP within 15 years confirms the high risk classification. The S1 indicator shows that, compared to the baseline, the SPB would need to improve by 3.2 pps. of GDP, in cumulated terms over 5 years, to bring the debt-to-GDP ratio to the Treaty reference value of 60% by 2039. ([20]) This result is mainly driven by the high level of the Portuguese government debt ratio (contribution of 3.1 pps. of GDP), and to a lower extent, to the projected ageing-related public spending (contribution by 1.4 pps. of GDP) (Table 2 and 3).

A1.3. LONG-TERM RISKS

Long-term fiscal sustainability risks for Portugal appear medium overall. The S2 indicator points to low fiscal sustainability risks. ([21]) The indicator shows that, relative to the baseline, the SPB would not need to improve to ensure debt stabilisation over the long term. This result is underpinned by the projected decrease in ageing-related costs (contribution of -1.1 pps. of GDP) compounded by the favourable initial budgetary position (-1.0 pp. of GDP). Ageing costs’ developments are primarily driven by the projected decrease of public pension expenditure (contribution of -2.9 pps. of GDP), though after reaching a peak of 14.6% of GDP in 2035. ([22]) Health and long-term care spending is instead projected to increase over the projection period (joint contribution of 1.7 pps. of GDP) (Table 2 and 3). Yet, combined with debt vulnerabilities, as highlighted by the DSA, long-term risks are assessed as medium.

Finally, several additional risk factors need to be considered in the assessment. Risk-decreasing factors notably include Portugal’s comfortable cash buffer (see Section 5), the maturity structure of its debt, the stable financing sources, the debt’s currency denomination as well as a debt management strategy targeting the smoothening of the debt redemption profile. Risk-increasing factors notably include contingent liabilities risks related to publicly guaranteed credit lines and ongoing negotiation processes of public-private partnerships (PPPs) (see Section 3).

([18]) The stochastic projections show the joint impact on debt of 2000 different shocks affecting the government’s budgetary position, economic growth, interest rates and exchange rates. The cone covers 80% of all the simulated debt paths, therefore excluding tail events.

([19]) The level of uncertainty is measured by the difference between the 10th and 90th debt distribution percentiles.

([20]) S1 measures the consolidation effort, in terms of the 5-year cumulative change in the structural primary balance compared to the baseline, needed to bring debt to 60% of GDP in 15 years. The risk classification based on S1 depends on the amount of consolidation required. If the S1 value (in pps. of GDP) is negative, the country is deemed at ‘low risk’; if S1 value is between 0 and 2.5, the country is assigned ‘medium risk’; and if S1 value is above 2.5, the country is assigned ‘high risk’.

([21]) S2 measures the consolidation effort required to stabilise debt over an infinite horizon. If the S2 value (in pps of GDP) is lower than 2, the country is assigned ‘low risk’; if S2 is between 2 and 6, the country is assigned ‘medium risk’; and if S2 is above 6, the country is assigned ‘high risk’.

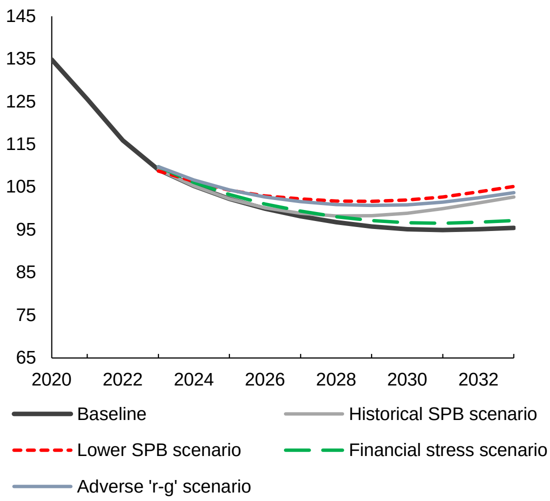
([22]) See 2021 Ageing Report, p.233.

Table A1.1: **Baseline debt projections**

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Gross debt ratio (% of GDP)	**134.9**	**125.5**	**115.9**	**109.1**	**105.3**	**102.2**	**99.9**	**98.2**	**96.8**	**95.8**	**95.2**	**94.9**	**95.1**	**95.4**
Change in debt	18.3	-9.4	-9.6	-6.8	-3.8	-3.0	-2.3	-1.8	-1.4	-1.0	-0.6	-0.2	0.2	0.3
of which														
Primary deficit	*2.9*	*0.5*	*-0.2*	*-1.4*	*-1.7*	*-1.4*	*-1.1*	*-0.9*	*-0.6*	*-0.4*	*-0.2*	*0.0*	*0.2*	*0.3*
Snowball effect	*10.9*	*-6.4*	*-9.7*	*-4.0*	*-2.0*	*-1.6*	*-1.2*	*-0.9*	*-0.8*	*-0.6*	*-0.4*	*-0.2*	*0.0*	*-0.1*
Stock-flow adjustment	*4.4*	*-3.5*	*0.2*	*-1.5*	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Gross financing needs (% of GDP)	20.8	12.3	12.0	9.9	9.6	10.2	10.6	10.7	10.5	10.4	10.0	12.3	12.2	12.0

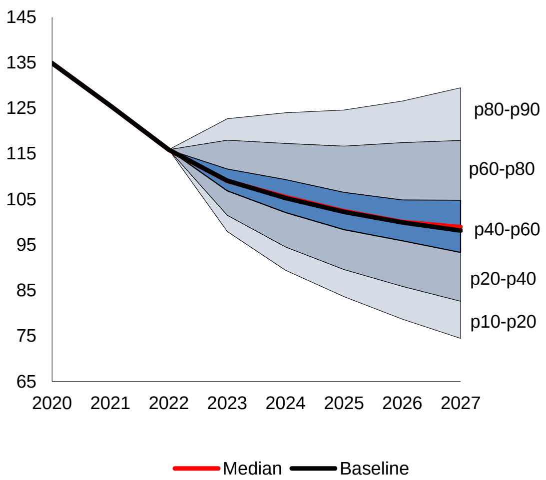
Source: European Commission

Graph A1.1: **Deterministic debt projections (% of GDP)**



Source: European Commission

Graph A1.2: **Stochastic debt projections (% of GDP)**



Source: European Commission

Table A1.2: **Breakdown of the S1 and S2 sustainability gap indicators**

			S1	S2
Overall index (pps. of GDP)			**3.2**	**-2.1**
of which				
	Initial budgetary position		-1.3	-1.0
	Debt requirement		3.1	
	Ageing costs		1.4	-1.1
	of which	*Pensions*	*1.0*	*-2.9*
		Health care	*0.5*	*1.3*
		Long-term care	*0.1*	*0.4*
		Others	*-0.1*	*0.2*

Source: European Commission

Table A1.3: **Heat map of fiscal sustainability risks for Portugal ([23])**

Short term	Medium term										Long term	
			Debt sustainability analysis (DSA)									
					Deterministic scenarios							
Overall (S0)	Overall (S1+DSA)	S1	Overall		Baseline	Historical SPB	Lower SPB	Adverse 'r-g'	Financial stress	Stochastic projections	S2	Overall (S2+DSA)
LOW	HIGH	HIGH	HIGH	Overall	HIGH	HIGH	HIGH	HIGH	HIGH	MEDIUM	LOW	MEDIUM
				Debt level (2033), % GDP	95	103	105	104	97			
				Debt peak year	2022	2022	2022	2022	2022			
				Fiscal consolidation space	34%	41%	44%	34%	34%			
				Probability of debt ratio exceeding in 2027 its 2022 level						23%		
				Difference between 90th and 10th percentiles (pps. GDP)						55		

(1) Debt level in 2033. Green: below 60% of GDP. Yellow: between 60% and 90%. Red: above 90%. (2) The debt peak year indicates wether debt is projected to increase overall over the next decade. Green: debt peaks early. Yellow: peak towards the middle of the projection period. Red: late peak. (3) Fiscal consolidtation space measures the share of past fiscal positions in the country that were more stringent than the one assumed in the baseline. Green: high value, i.e. the assumed fiscal position is plausible by historical standards and leaves room for corrective measures if needed. Yellow: intermediate. Red: low. (4) Probability of debt ratio exceeding in 2027 its 2022 level. Green: low probability. Yellow: intermediate. Red: high (also reflecting the initial debt level). (5) the difference between the 90th and 10th percentiles measures uncertainty, based on the debt distribution under 2000 different shocks. Green, yellow and red cells indicate increasing uncertainty.
Source: European Commission (for further details on the Commission's multidimensional approach, see the 2021 Fiscal Sustainability Report)

([23]) The heat map presents the overall fiscal sustainability risk classification. The *short-term risk category* is based on the S0 indicator, an early-detection indicator of fiscal stress in the upcoming year. The *medium-term risk category* is derived from the debt sustainability analysis (DSA) and the S1 indicator. The DSA assesses risks to sustainability based on several criteria: the projected debt level in 10 years' time, the debt trajectory ('peak year'), the plausibility of fiscal assumptions and room for tighter positions if needed ('fiscal consolidation space'), the probability of debt not stabilising in the next 5 years and the size of uncertainty. The *long-term risk category* is based on the S2 indicator and the DSA.

ANNEX 2

European Commission macroeconomic and fiscal projections

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

Annual % change	**2021**	**2022**	**2023**	**2024**
1. Private consumption expenditure	4.7	5.4	0.5	1.6
2. Government consumption expenditure	4.6	1.8	2.1	1.9
3. Gross fixed capital formation	8.7	4.0	3.5	3.6
4. Final domestic demand	**5.4**	**4.5**	**1.4**	**2.1**
5. Change in inventories	--	--	--	--
6. Domestic demand	**5.7**	**4.5**	**1.3**	**2.1**
7. Exports of goods and services	-18.6	16.6	2.3	2.4
7a. - of which goods	10.8	6.5	2.4	2.1
7b. - of which services	19.9	39.7	2.2	3.0
8. Final demand	**7.7**	**7.9**	**1.7**	**2.2**
9. Imports of goods and services	13.3	10.9	3.4	3.0
9a. - of which goods	12.7	9.3	3.2	3.0
9b. - of which services	16.4	18.6	4.5	3.0
10. Gross domestic product at market prices	**5.5**	**6.6**	**0.7**	**1.7**
Contribution to change in GDP				
11. Final domestic demand	5.5	4.6	1.4	2.1
12. Change in inventories + net acq. of valuables	0.3	0.0	0.0	0.0
13. External balance of goods and services	-2.9	2.0	-0.7	-0.4

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

Annual % change	**2021**	**2022**	**2023**	**2024**
1. Private consumption expenditure	6.1	11.7	4.4	3.8
2. Government consumption expenditure	6.1	3.8	7.3	4.0
3. Gross fixed capital formation	13.2	11.6	6.4	5.6
4. Final domestic demand	**7.4**	**10.2**	**5.3**	**4.2**
5. Change in inventories	--	--	--	--
6. Domestic demand	**7.8**	**10.2**	**5.3**	**4.1**
7. Exports of goods and services	20.1	33.2	5.4	3.8
8. Final demand	**11.1**	**16.8**	**5.3**	**4.0**
9. Imports of goods and services	21.7	31.2	4.1	3.5
10. Gross national income at market prices	7.3	10.1	6.0	4.3
11. Gross value added at basic prices	6.2	10.0	6.2	4.1
12. Gross domestic product at market prices	**7.0**	**10.4**	**5.9**	**4.3**
Nominal GDP, EUR bn	214.5	236.8	250.8	261.6

Table 3: Implicit price deflators

% change in implicit price deflator	2021	2022	2023	2024
1. Private consumption expenditure	1.4	6.0	3.9	2.1
2. Government consumption expenditure	1.4	2.0	5.1	2.0
3. Gross fixed capital formation	4.1	7.3	2.8	1.9
4. Domestic demand (incl. inventories)	**2.1**	**5.5**	**3.9**	**2.0**
5. Exports of goods and services	5.8	14.2	3.0	1.3
6. Final demand	**3.1**	**8.2**	**3.6**	**1.8**
7. Imports of goods and services	7.3	18.3	0.7	0.5
8. Gross domestic product at market prices	**1.4**	**3.6**	**5.2**	**2.5**
HICP	**0.9**	**8.0**	**5.8**	**2.3**

Table 4: Labour market and cost

Annual % change	2021	2022	2023	2024
1. Labour productivity (real GDP per employee)	3.5	5.6	0.5	1.2
2. Compensation of employees per head	4.1	4.6	4.3	3.0
3. Unit labour costs	**0.6**	**-0.9**	**3.8**	**1.7**
4. Total population	0.0	0.0	0.0	0.0
5. Population of working age (15-74 years)	0.1	0.1	0.1	0.1
6. Total employment	1.9	1.0	0.2	0.5
7. Calculated unemployment rate - Eurostat definition (%	**6.6**	**5.9**	**5.9**	**5.7**

Table 5: External balance

levels, EUR bn	2019	2020	2021	2022
1. Exports of goods (fob)	62.1	76.4	79.7	82.2
2. Imports of goods (fob)	78.7	103.0	106.1	109.4
3. Trade balance (goods, fob/fob) (1-2)	**-16.5**	**-26.6**	**-26.3**	**-27.2**
3a. p.m. (3) as % of GDP	**-7.7**	**-11.2**	**-10.5**	**-10.4**
4. Exports of services	27.1	42.4	45.4	47.7
5. Imports of services	17.0	22.5	24.5	25.8
6. Services balance (4-5)	**10.1**	**19.9**	**20.9**	**22.0**
6a. p.m. 6 as % of GDP	**4.7**	**8.4**	**8.3**	**8.4**
7. External balance of goods & services (3+6)	**-6.4**	**-6.7**	**-5.4**	**-5.3**
7a. p.m. 7 as % of GDP	**-3.0**	**-2.8**	**-2.2**	**-2.0**
8. Balance of primary incomes and current transfers	3.9	3.2	3.1	3.2
8a. - of which, balance of primary income	-2.6	-3.5	-3.7	-3.8
8b. - of which, net current Transfers	6.5	6.7	6.8	7.0
8c. p.m. 8 as % of GDP	1.8	1.3	1.3	1.2
9. Current external balance (7+8)	**-2.5**	**-3.5**	**-2.3**	**-2.1**
9a. p.m. 9 as % of GDP	**-1.2**	**-1.5**	**-0.9**	**-0.8**
10. Net capital transactions	3.7	4.6	5.5	5.5
11. Net lending (+)/ net borrowing (-) (9+10)	**1.2**	**1.1**	**3.2**	**3.4**
11a. p.m. 11 as % of GDP	**0.5**	**0.5**	**1.3**	**1.3**

Table 6: Fiscal accounts

	2021	2022	2023	2024
% of GDP				
Taxes on production and imports	15.1	15.4	15.2	15.4
Current taxes on income, wealth, etc.	9.7	9.8	9.9	9.9
Social contributions	12.7	12.2	12.1	12.0
Sales and other current revenue	6.3	5.6	5.6	5.4
Total current revenue	**43.7**	**43.1**	**42.8**	**42.7**
Capital transfers received	1.2	0.9	1.6	1.5
Total revenue	**44.9**	**44.0**	**44.4**	**44.2**
Compensation of employees	11.6	11.0	10.9	10.9
Intermediate consumption	5.8	5.7	6.0	6.0
Social transfers in kind via market producers	2.0	2.0	2.0	1.9
Social transfers other than in kind	17.4	17.0	16.5	16.5
Social payments	19.4	19.0	18.5	18.4
Interest paid	2.4	2.1	2.5	2.5
Subsidies	2.0	1.2	0.7	0.5
Other current expenditure	2.7	2.7	2.7	2.6
Total current expenditure	**44.0**	**41.6**	**41.3**	**40.9**
Gross fixed capital formation	2.6	2.6	3.0	3.1
Other capital expenditure	1.3	1.7	1.2	1.0
Other (residual)	4.0	4.4	3.9	3.6
Interest expenditure	2.4	2.1	2.5	2.5
Total expenditure	**47.8**	**45.9**	**45.5**	**45.0**
General government balance (ESA2010)	**-2.9**	**-1.9**	**-1.1**	**-0.8**
Primary balance	-0.5	0.2	1.4	1.7
% change				
Taxes on production and imports	11.0	12.6	4.5	5.8
Current taxes on income, wealth, etc.	3.1	12.5	6.1	4.8
Social contributions	6.5	6.2	5.0	3.5
Sales and other current revenue	19.2	-0.8	6.1	0.6
Total current revenue	**8.9**	**8.8**	**5.2**	**4.2**
Capital transfers received	162.6	-17.4	87.3	-2.1
Total revenue	**10.6**	**8.1**	**6.9**	**4.0**
Compensation of employees	4.3	3.8	5.9	3.8
Intermediate consumption	12.3	8.8	10.8	5.2
Social transfers in kind via market producers	3.8	10.5	5.7	3.3
Social transfers other than in kind	3.5	7.7	2.9	3.9
Social payments	3.5	8.0	3.2	3.8
Interest paid	-10.7	-1.8	24.9	2.0
Subsidies	17.4	-35.0	-40.9	-17.1
Other current expenditure	13.7	8.3	8.1	-0.4
Total current expenditure	**5.1**	**4.5**	**5.2**	**3.3**
Gross fixed capital formation	18.9	10.5	21.8	10.4
Other capital expenditure	-37.3	47.0	-23.8	-15.1
Total expenditure	**3.8**	**6.0**	**5.0**	**3.3**
Nominal GDP, EUR bn	**214.5**	**236.8**	**250.8**	**261.6**

Table 7: Government debt developments

	2021	2022	2023	2024
ESA2010 government balance (% of GDP)	**-2.9**	**-1.9**	**-1.1**	**-0.8**
ESA2010 gross debt (% of GDP)	125.5	115.9	109.1	105.3
ESA2010 government balance	**-6.2**	**-4.6**	**-2.9**	**-2.1**
Gross debt	269.2	274.4	273.6	275.4
Change in gross debt	-1.2	5.1	-0.8	1.8
Nominal GDP	214.5	236.8	250.8	261.6
Real GDP growth (% change)	**5.5**	**6.6**	**0.7**	**1.7**
Change in gross debt (% of GDP)	-0.6	2.2	-0.3	0.7
Stock-flow adjustments (% of GDP)	-3.5	0.2	-1.5	-0.1
Gross debt ratio	**125.5**	**115.9**	**109.1**	**105.3**
Change in gross debt ratio	-9.4	-9.6	-6.8	-3.8
Primary balance	-0.5	0.2	1.4	1.7
"Snow-ball" effect	-6.4	-9.7	-4.0	-2.0
of which				
Interest expenditure	*2.4*	*2.1*	*2.5*	*2.5*
Real growth effect	*-7.0*	*-7.8*	*-0.8*	*-1.9*
Inflation effect	*-1.8*	*-4.1*	*-5.7*	*-2.6*
Stock-flow adjustments	**-3.5**	**0.2**	**-1.5**	**-0.1**
Implicit interest rate	*1.9*	*1.9*	*2.3*	*2.4*