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2019 country report Portugal

Lisbon, 26th March 2019

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Macroeconomic Context, Public Finances, Financial Sector

Christian Weise, DG ECFIN

Lisbon, 26th March 2019

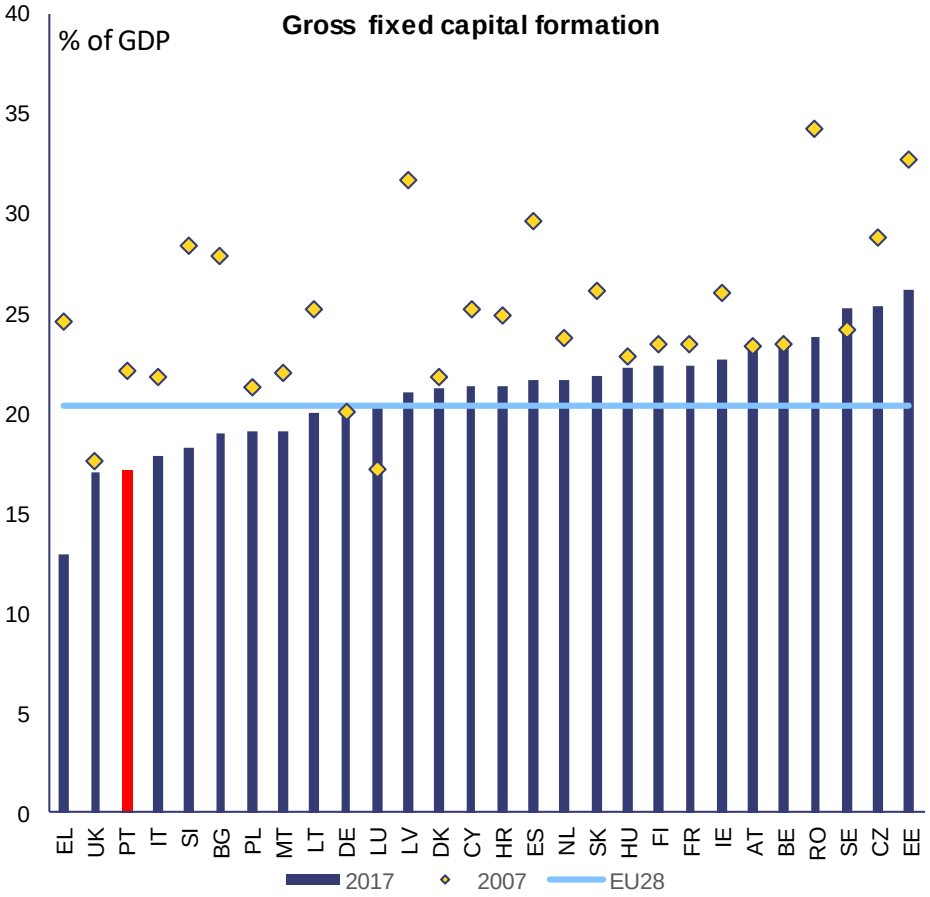
Achievements of the Portuguese economy

- Growth above the Euro area average
- Headline deficit moving to balance
- Unemployment below the Euro area average
- High stocks of macroeconomic imbalances are decreasing

→ ***However, structural weaknesses persist.***

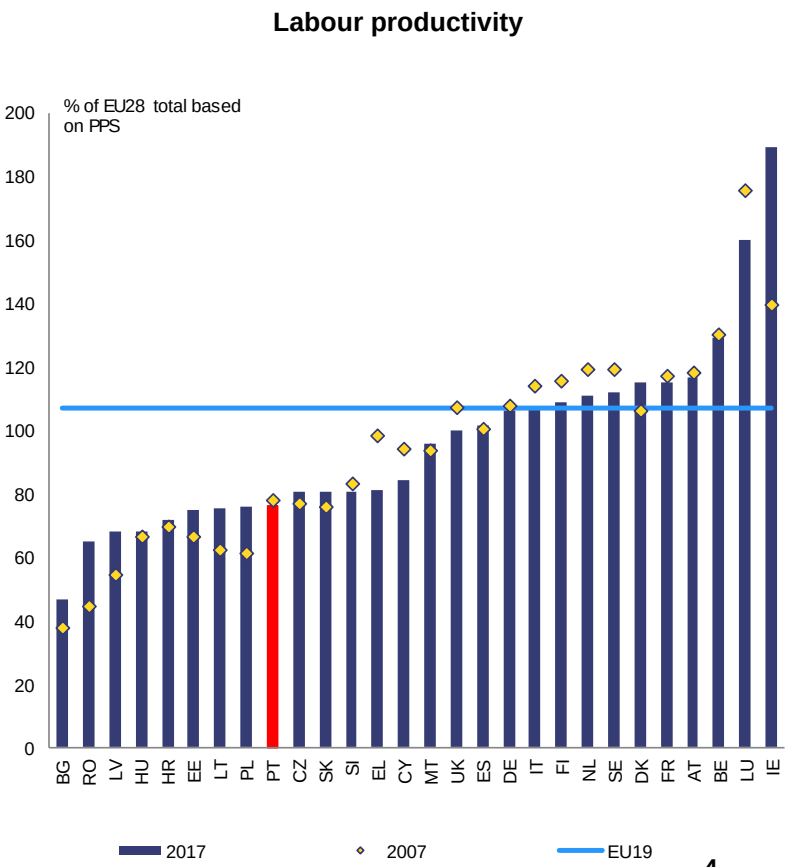
Productivity and Investment

- Portugal has one of the lowest investment ratios in the EU, held back by multiple macroeconomic and structural factors.



Source: European Commission

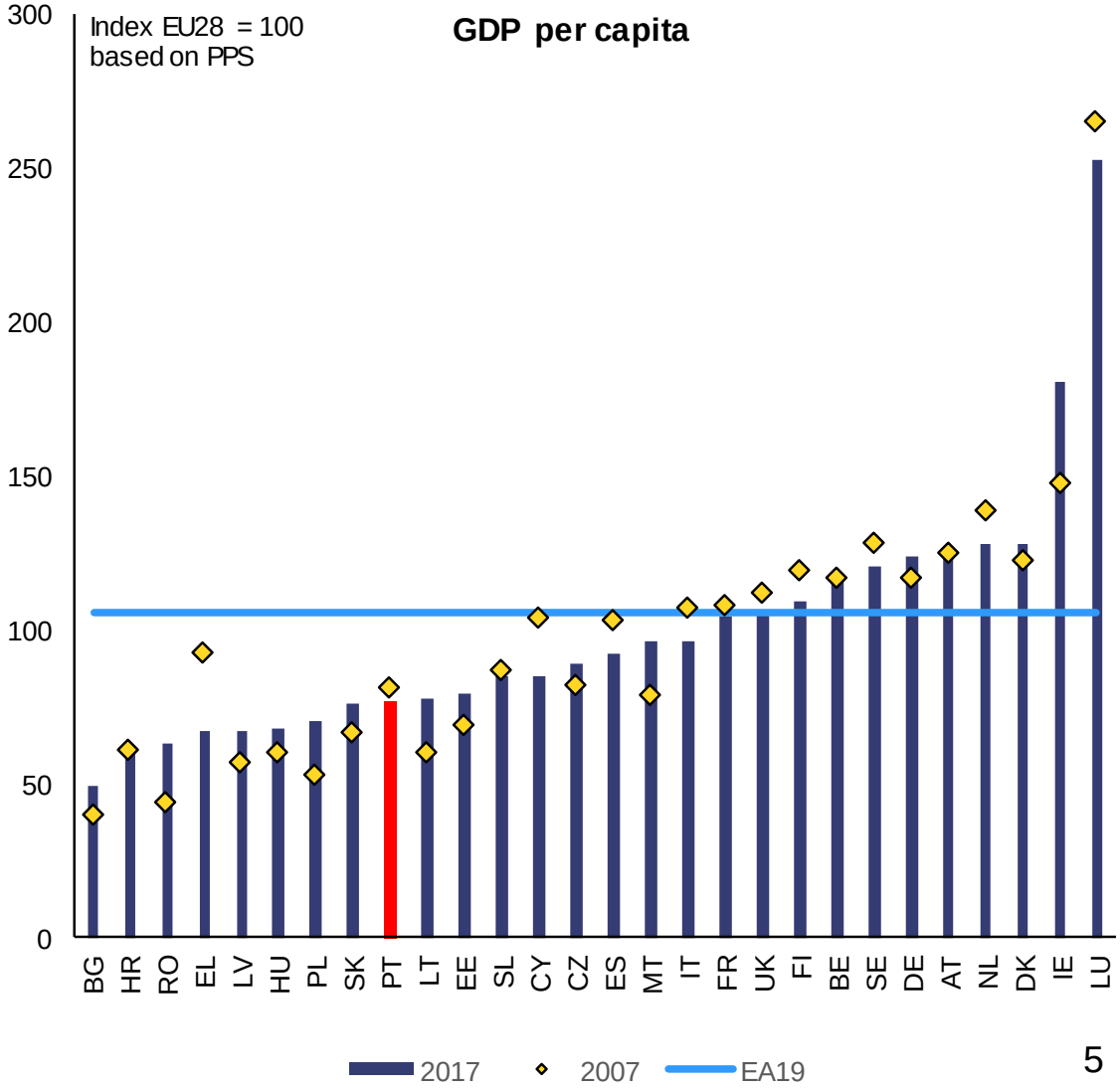
- Low investment leads to weak productivity growth. The labour productivity gap with the EU average shows no signs of closure.



Source: Eurostat

Income Convergence

- Low investment and weak productivity dynamics help to explain the absence of income convergence with the EU average.
- The recent positive economic performance has stabilised the country's per capita income relative to the EU average, but is still insufficient to bring a noticeable convergence. This income gap is likely to remain broadly stable.
- There are significant regional differences in GDP per capita.



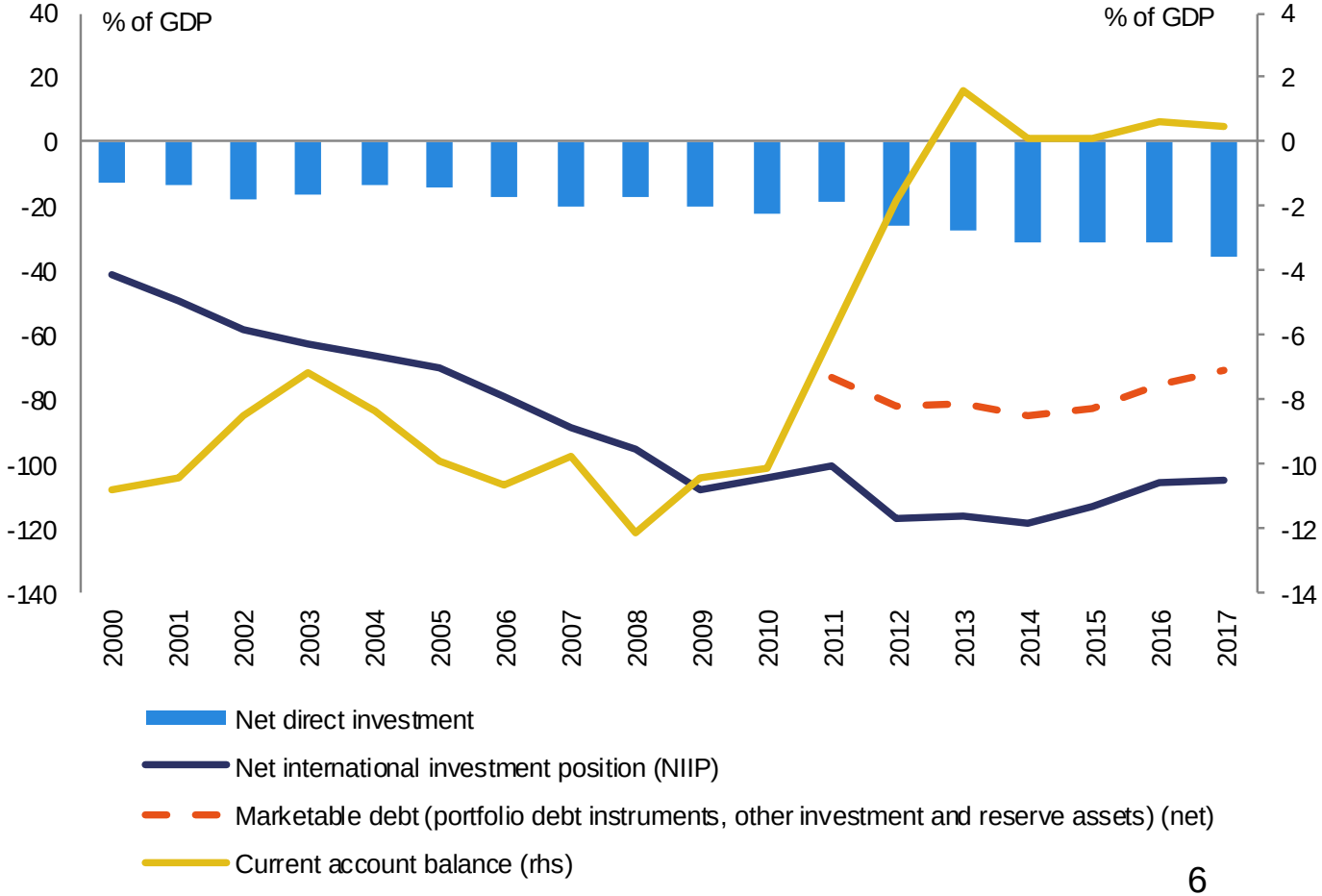
Source: Eurostat

External Debt

- NIIP remains a source of vulnerability, being one of the largest in the EU, and going beyond prudential and fundamental thresholds.

- The CA is projected below the benchmark for closing the gap to the NIIP prudential level over a 10-year period.
- Greater FDI inflows improve NIIP structure.

Current Account (CA) and Net International Investment Position (NIIP)

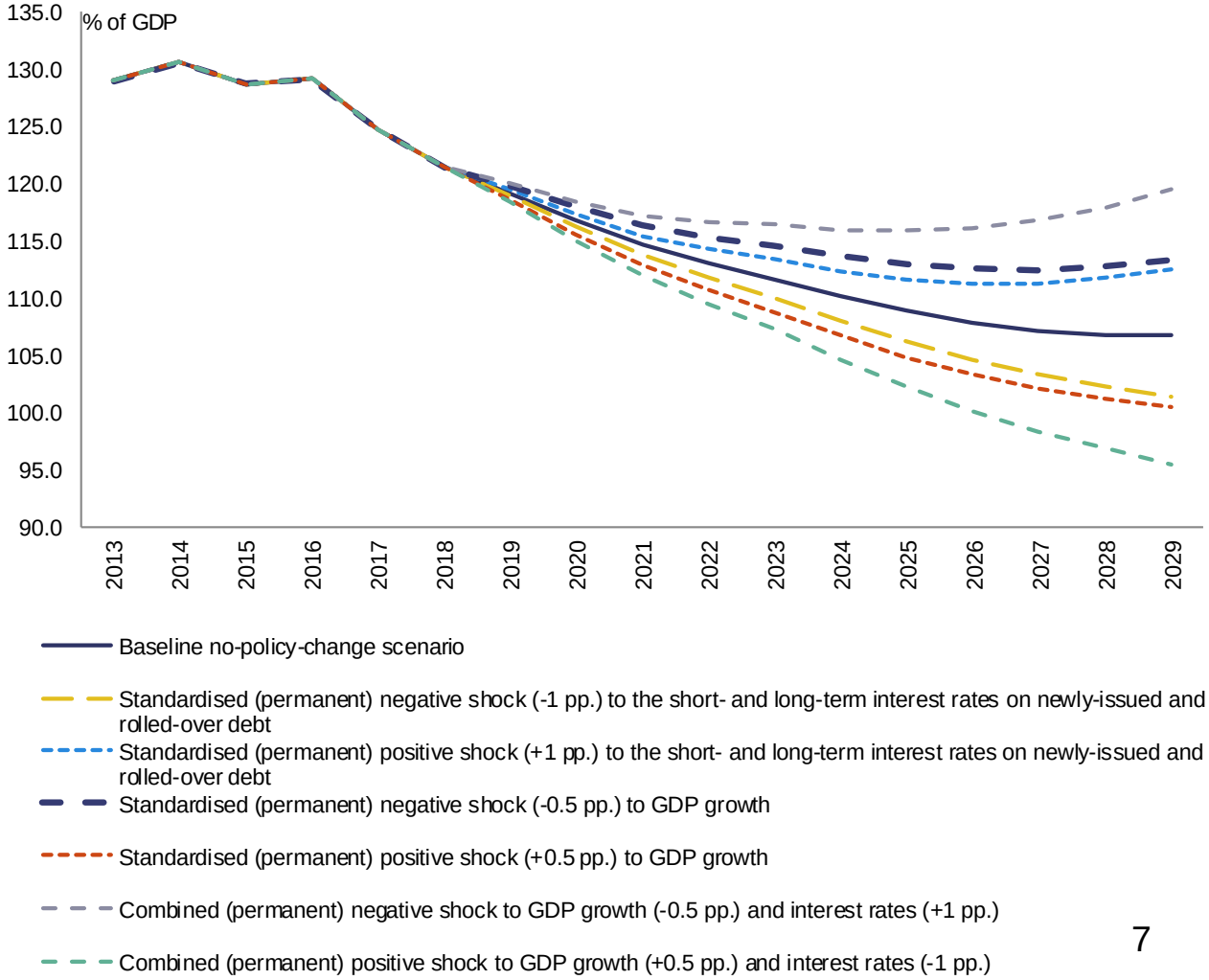


Source: European Commission

Public Finances

- Public finances have continued improving, while strongly relying on higher revenue, declining interest expenditure and relatively low public investment.
- Public debt started to decrease but remains high, along with medium-term fiscal sustainability risks.

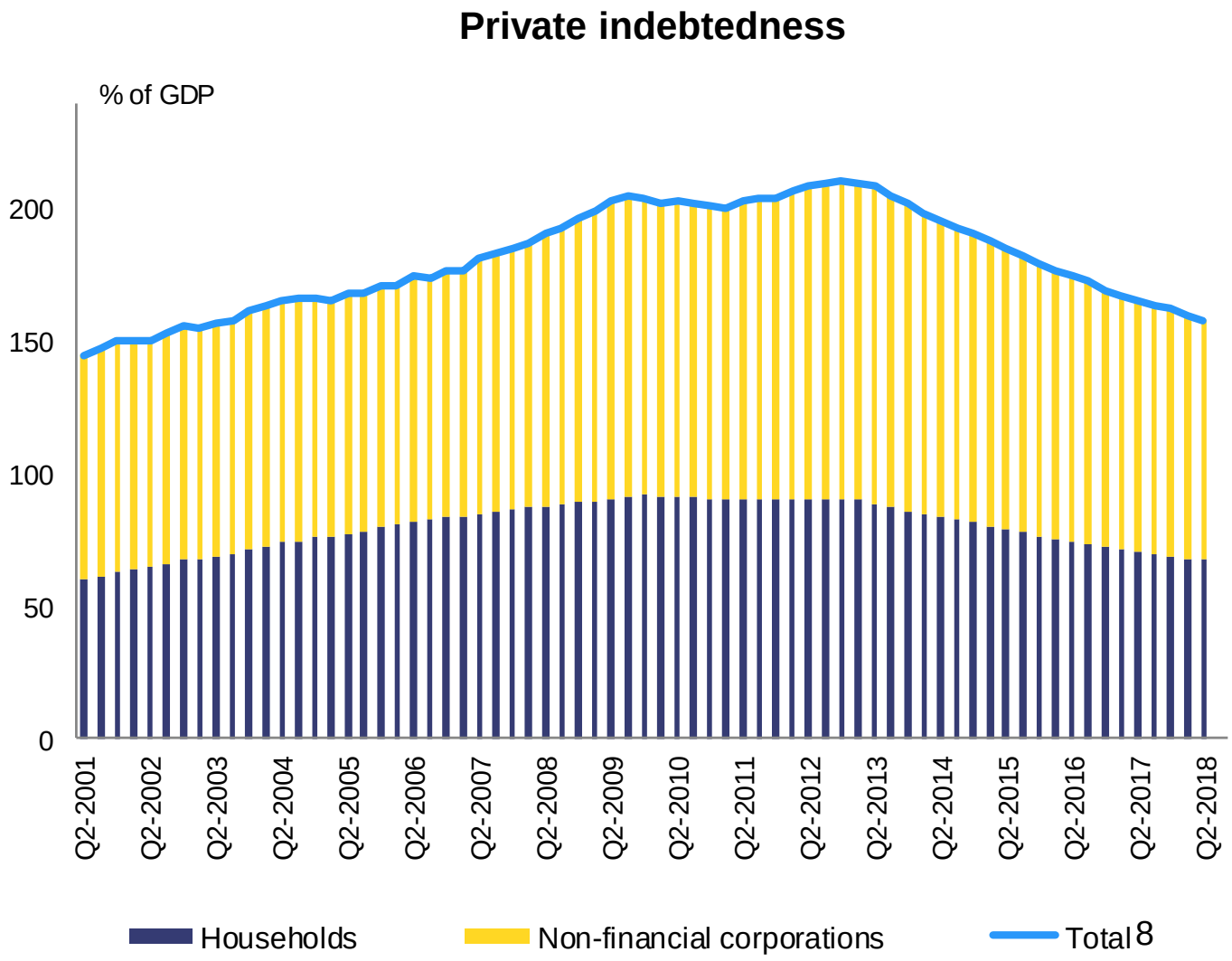
General government gross debt projections under baseline and alternative GDP growth and interest rate scenarios



Source: European Commission

Financial Sector

- Private indebtedness has been decreasing, with a favourable outlook.
- Ratios remain above prudential and fundamental thresholds.



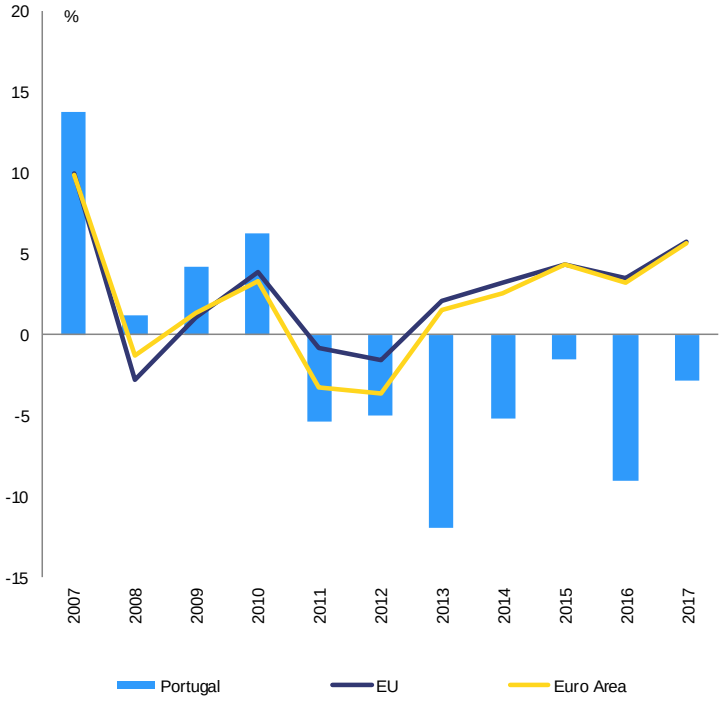
Source: Banco de Portugal

Financial Sector

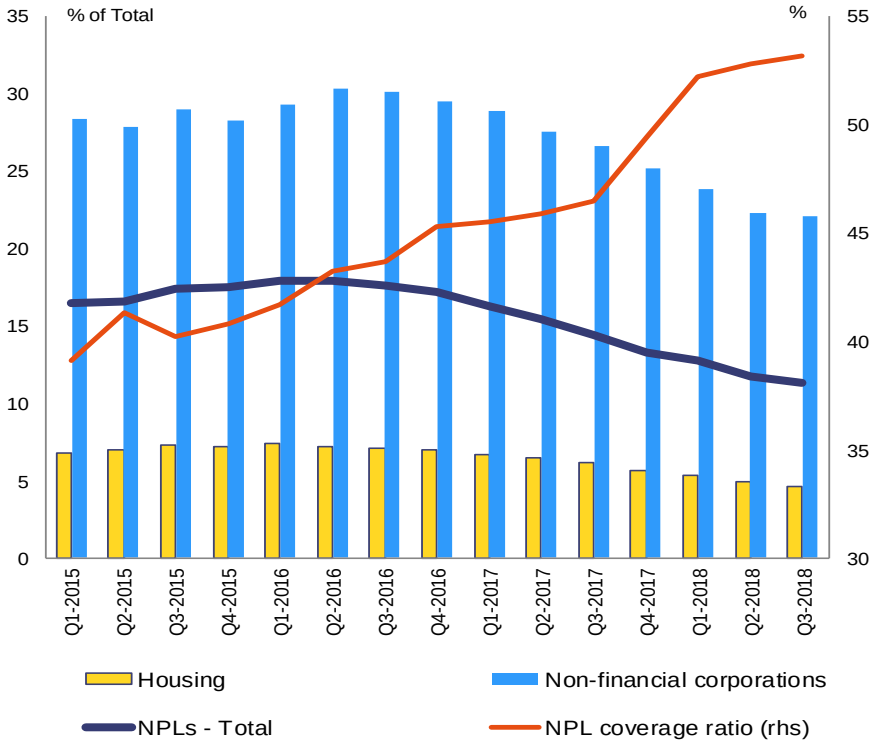
- Financial performance is improving, with increasing profitability…

- …and decreasing NPLs (even if still significantly above EU average).

Return on equity (%), domestic banks



NPLs and coverage ratios



Source: European Commission

Key takeaways

- **Low levels of investment and productivity remain a challenge** for advancing income convergence with EU average**.**
- **Portugal's net international investment position remains a significant source of vulnerability.** It is one of the most negative in the EU and goes beyond the estimated prudential and fundamentally-explained thresholds.
- **Public debt has been declining.** Yet, it is still far too high. Fiscal sustainability risks are significant in the medium term.
- **Private debt has been decreasing but remains above prudential and fundamental benchmarks,** both for corporate and household debt.

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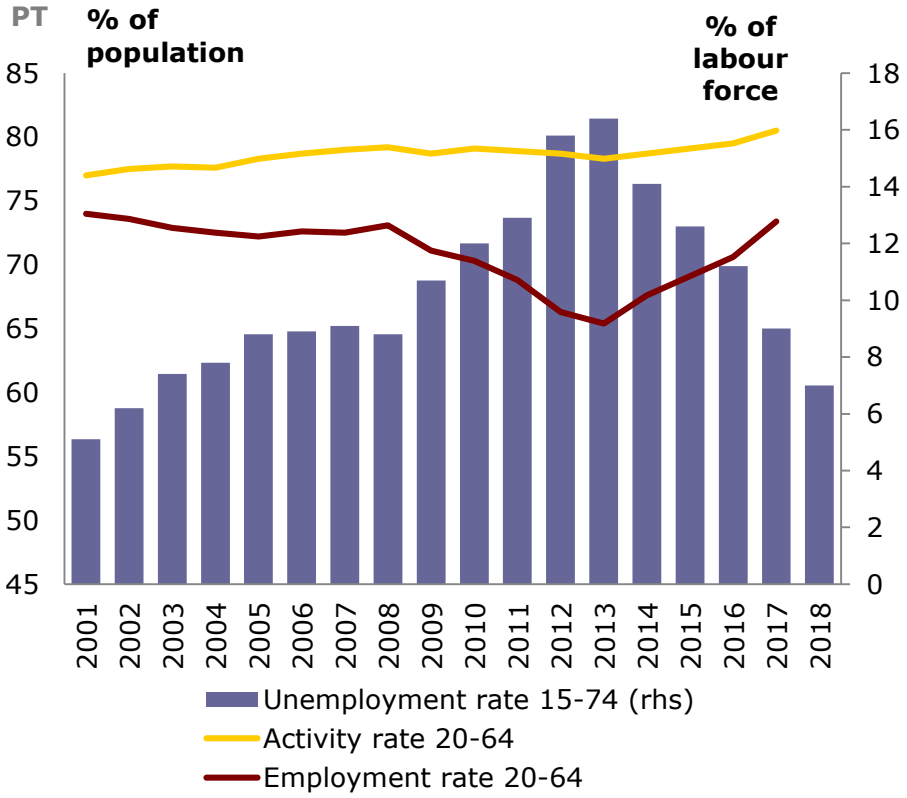
Labour Market, Education and Social Policies

Andriana Sukova, DG EMPL

Lisbon, 26th March 2019

Labour market recovery, with strong job creation and significant fall in unemployment

- UR down from 9.0% in 2017 to 7.0% in 2018 (6.9% in Jan 2018)
- YUR (15-24) down to 19.1% in Q4-2018, from >40% in 2013
- LTU (20-64) down from 4.3% in Q3-2017 to 3.0% in Q3-2018
- ER (20-64) at 75.4% in Q3-2018, above Europe 2020 target of 75%

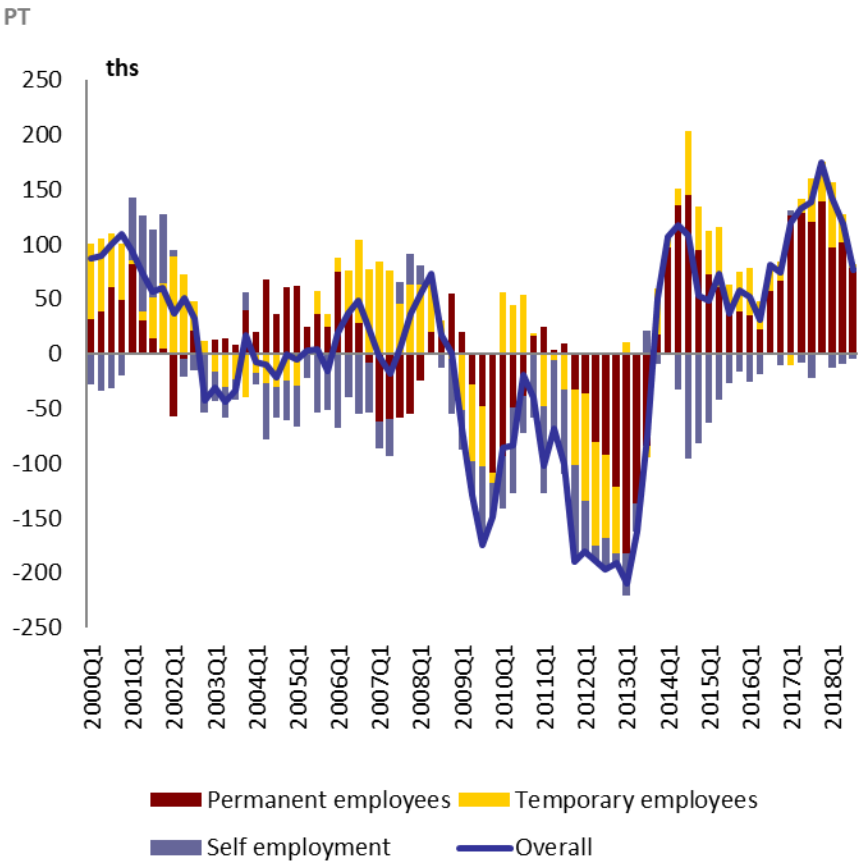


Active labour market policies

- There is scope for wider coverage and focus on upskilling going forward.
- Effectiveness of measures to long-term unemployment remains a challenge.
- There is still limited cooperation of PES with other stakeholders, but authorities are working to improve their matching function.

Many permanent jobs created but temporary contracts didn't decrease

- About 78.000 permanent jobs created during the year to the 3rd quarter of 2018 (20-64)
- However the share of workers with temporary contracts only decreased by 0.1% from 2016 (21.6% in Q3-2018)
- Government and the majority of social partners signed a tripartite agreement to tackle labour market segmentation



Education

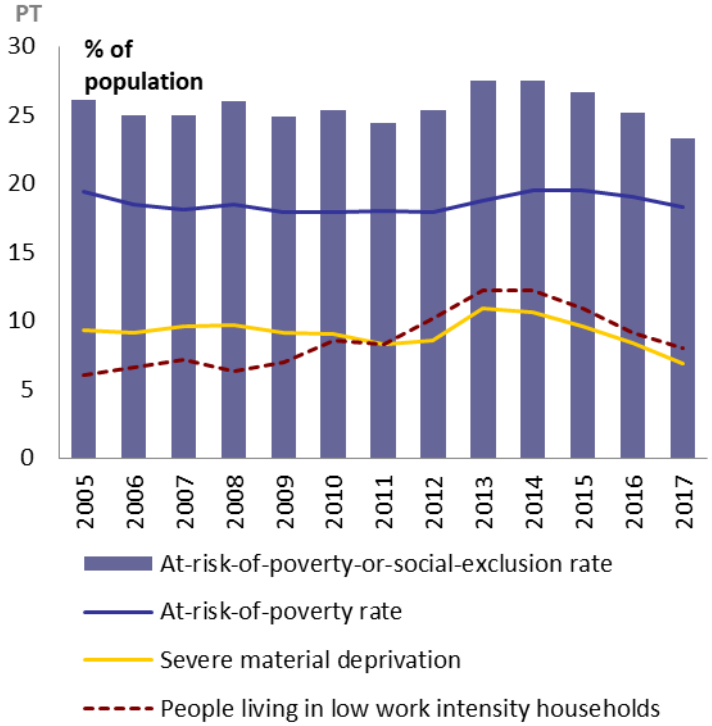
- Considerable progress over the last decade in reducing early school leaving: from 28.3 % in 2010 to 12.6 % in 2017. However, significant regional disparities are observed in Madeira and Azores (over 20%)
- Tertiary educational attainment level among 30-34 year olds is still below the EU average (33.5% against 39.9%)
- The share of total graduates in information and communication technologies was well below the EU average (1.2% against 3.4 %)
- This may affect the country's innovative capacity and productivity growth.

Training and Skills

- About 52 % of the population aged 25-64 has low educational attainment levels, well above the EU average of 22.5 % in 2017
- The QUALIFICA programme and the recent reprogramming of the ESF is an important tool to upskill the low-skilled adult population.
- In 2017, 50 % of the Portuguese population still did not have basic digital skills, and 30 % had no digital skills at all. This compares with an EU average of 43 % and 17 % respectively.
- INCoDe.2030 is Portugal national initiative to improve digital skills and competences.

Continuing some improvement in poverty and social exclusion indicators

- AROPE down from 25.1% in 2016 to 23.3 % in 2017 (EU average 22.4 %)
- According to national statistics, further down to 21.6% in 2017
- Labour market recovery is key driver of improvement
- Monetary poverty also reducing, but at slower pace



…but challenges remain

- Income inequality is reducing, but remains high
  - S80/S20 at 5.7 in 2017 (EU average 5.1)
- In-work poverty remains stable yet high
  - 10.8% in 2017 (EU average 9.6%);
  - Issue in particular for temporary workers and families with children
- The impact of social transfers (other than pensions) on poverty reduction remains limited
- Demographic ageing puts pressure on the efficiency and quality of the public services with particular challenges in health and long-term care

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Competitiveness Reforms and Investment

Francesco Morandotti, DG GROW

Lisbon, 26th March 2019

Competitiveness and Investment – Highlights

- **Productivity growth and investment patterns exhibit significant sectorial differences.** Exports' growth has been moderately accompanied by an upward move in value chains.

- In general**, increased profitability** has been recorded over the recent years across sectors and firms' size class.

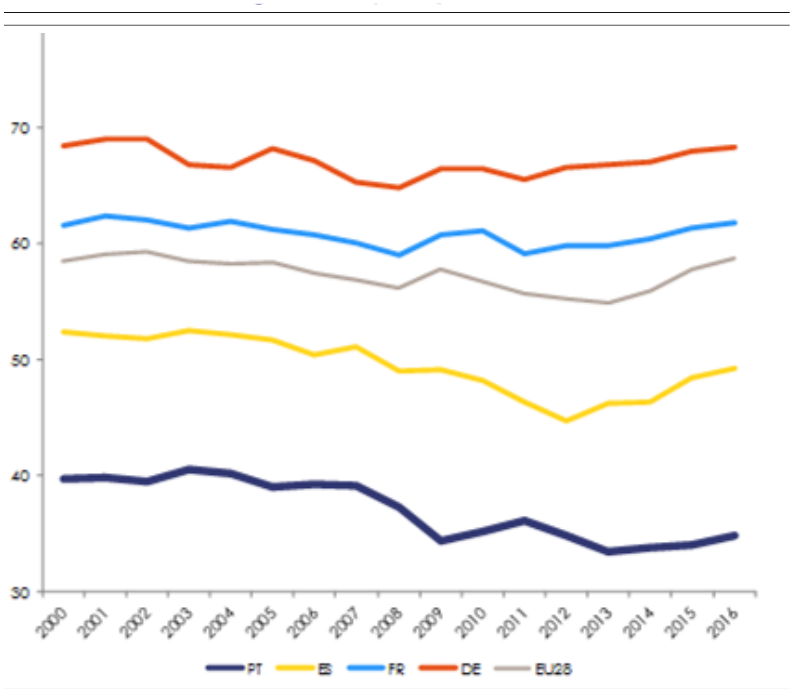
- **Increased innovation capacity and pursuing structural reforms to address investment barriers** would be key to boost productivity growth and increase the competitiveness of the Portuguese economy.

- **Main investment barriers identified:**
  - *Small average size of companies facing challenges to grow and innovate, such skills shortages and regulatory footprint;*
  - *Low capital per worker, allocative inefficiencies (access to finance) and underdeveloped capital markets;*
  - *Institutional components: complex taxation, administrative burden, licensing and judicial system;*
  - *Restrictions in professional business services weighing on competition;*
  - *Scarce planning capacity in public procurement*

Innovation and skills

In some sectors, technological intensity increased, but low share of high and high-tech manufacturing exports, reflecting low level of innovation capacity. At the same time, low levels of investment in intangibles.

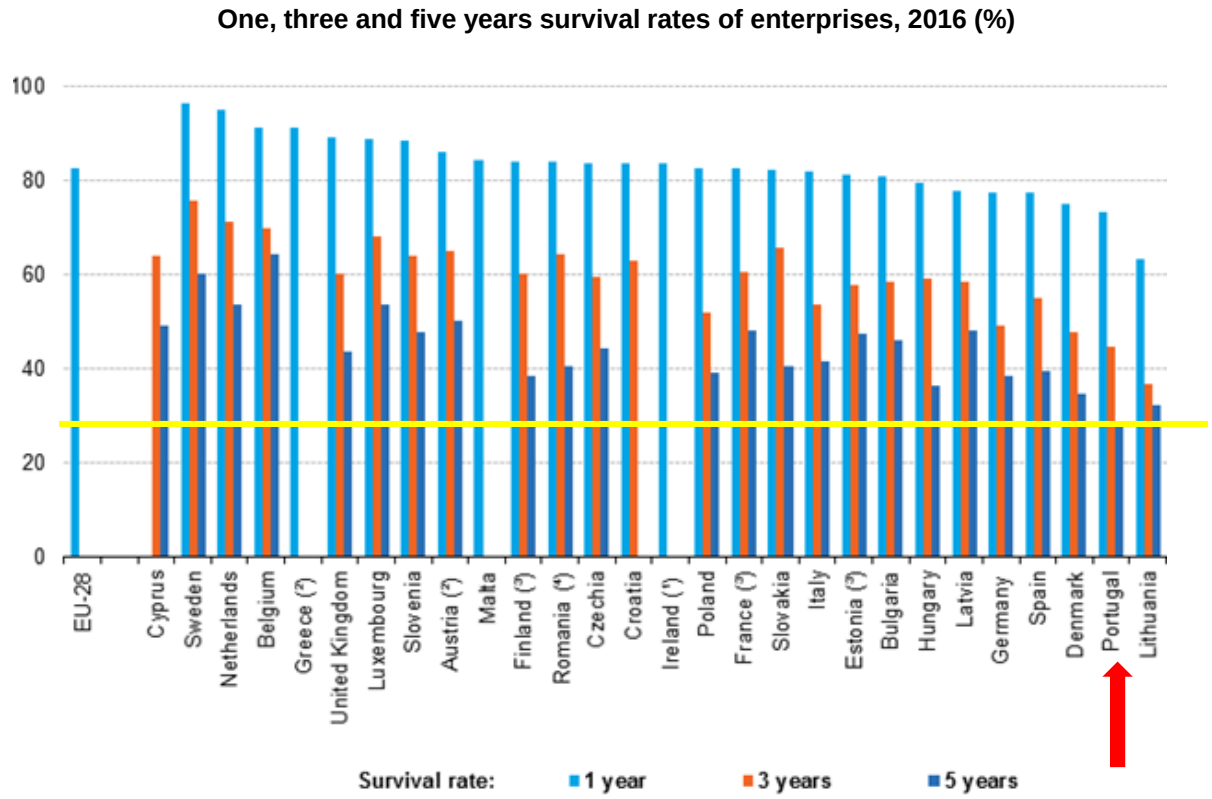
Share of Medium High and High Tech Exports



- Increasing the innovation base of the Portuguese economy would be key to increase value added in exports and fostering an upward move in value chains.
- To improve innovation capacity it is key to address a number of structural challenges and barriers to investment.
- Skills gaps and mismatches in the labour force compromise the ability to upgrade into knowledge intensive sectors.

Source: Eurostat

Barriers to investment: firms' size and difficulties to scale-up



- Portuguese firms are smaller than EU average with a higher proportion of micro-firms (95.1%)
- High business creation accompanied by low survival rates suggests limited effectiveness of scale-up policies, scarce managerial skills, financial literacy and limited digitization
- Overall, in the period 2012-2016 the death rate of firms was 14.6%, almost doubling the EU average (8.4%)

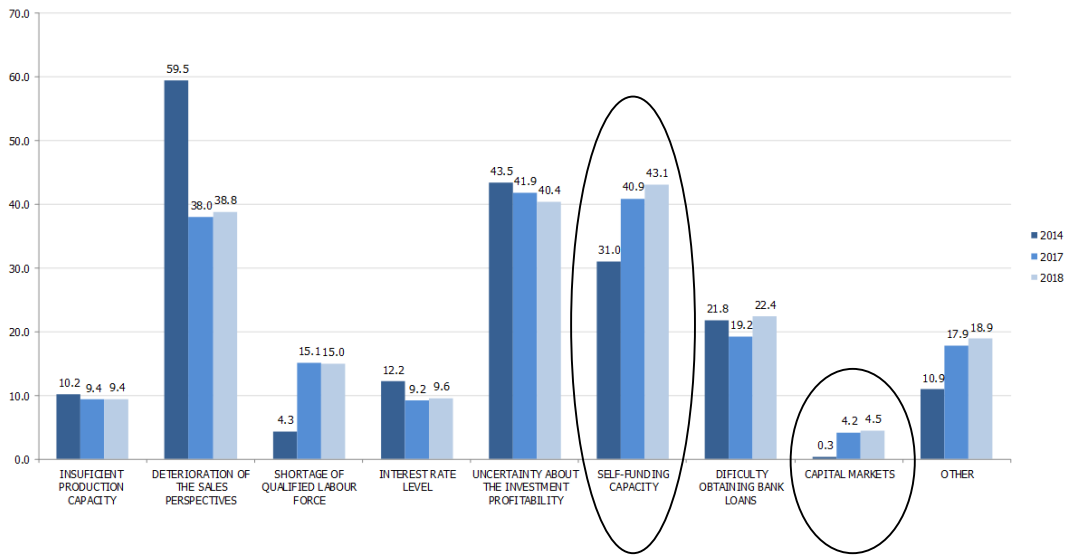
Portugal is the EU country with the lowest survival rate of enterprises after 5 years

Source: Eurostat

Barriers to investment – Low levels of capital per worker

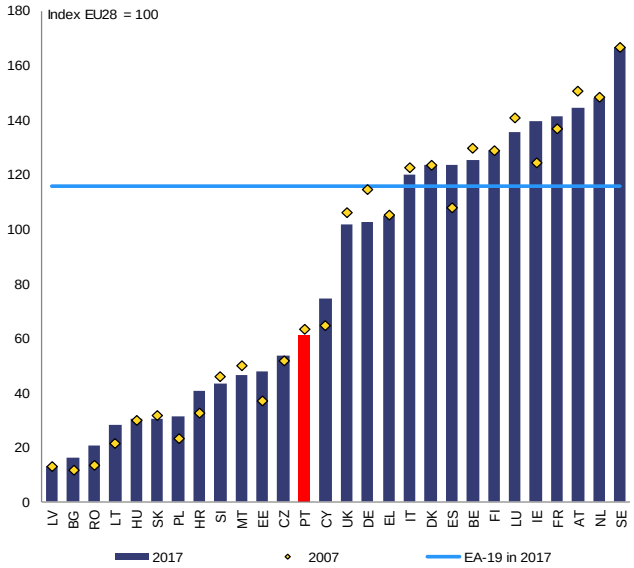
While **progress** has been recorded in access to finance, Portuguese firms often rely on own resources to finance investment, including firms with growth potential or at early stage. In parallel venture capital and equity remain close to pre-crisis level.

Factors Limiting Investment



Source: INE, Investment Survey

Net capital stock per person employed



Source: European Commission

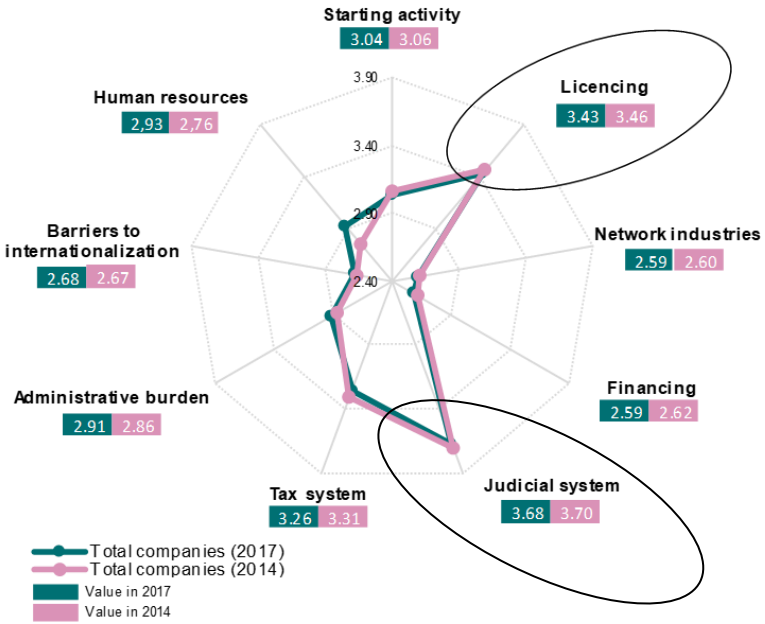
- The deleveraging process may reduce growth potential if resources are not enough re-channelled towards more productive firms and sectors.

- The low level of capital per worker is a major obstacle hindering investment and productivity growth

Barriers to investment – Institutional aspects

SIMPLEX+ programme and its yearly measures overall represents policy progress in reducing administrative burden, but…

Global framework regulation costs indicator



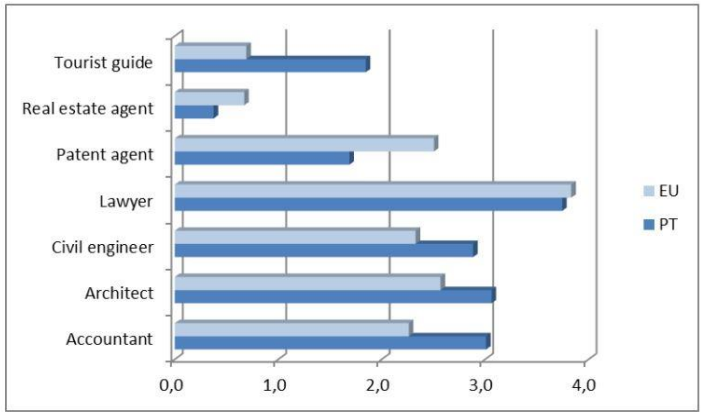
- The **complexity and stability of the tax system and administrative burdens** are a major factor preventing investments (Eurobaromater – 76% and 73% of respondents, respectively)
- Limited achievements recorded in reducing **sector-specific barriers to licensing,** which negatively affect investment decisions in numerous sectors.
- The costs and time to deal with the **judicial system** are perceived as a major deterrent to invest.

Source: INE – Framework regulation costs survey

Barriers to investment – Competition in Professional Services

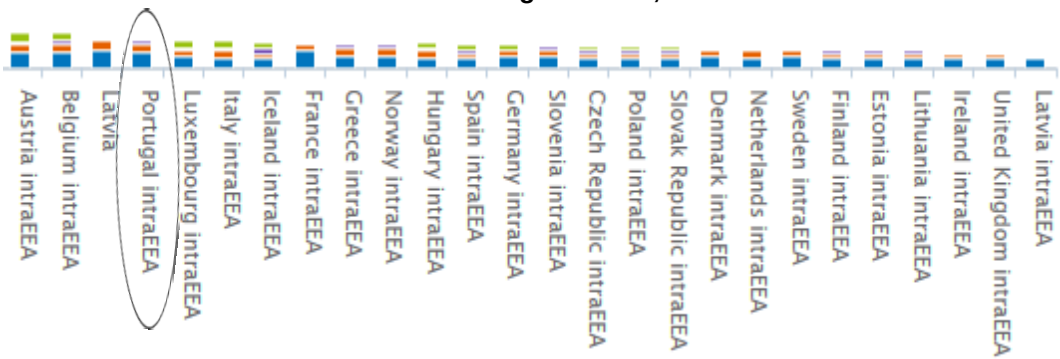
- Barriers to accessing and providing **professional services** (in the form of reserves of activities, incompatibility rules, shareholding requirements, legal form, management and multidisciplinary restrictions) raise concerns over **negative effects** on competition, consumer prices, choice and innovation.
  - The new **OECD Intra-EEA STRI** shows high regulatory restrictiveness for a series of service sectors (such accountancy, legal services, construction and distribution services);
  - OECD and Portuguese Competition Authority **«Competition Assessment reviews» (2018)** covering 13 key professions;
  - **European Commission Restrictiveness Indicator (2017)** shows higher regulatory restrictiveness in 4 out of the 7 professions analysed (accountants, civil engeineers, architects and tourist guides).

Restrictiveness indicator, 2016, Portugal and the EU



Source: European Commission

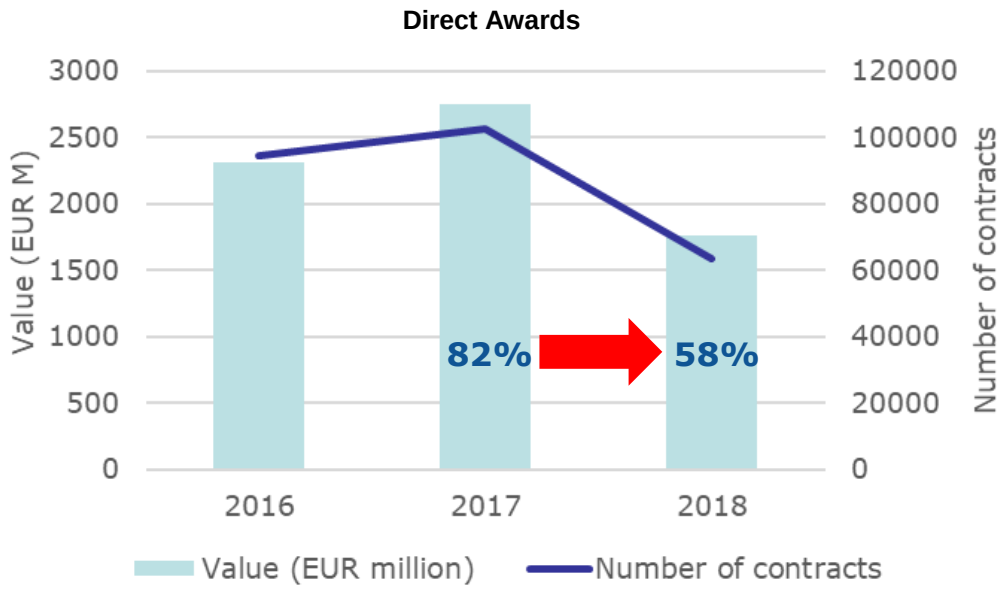
Intra EEA Service Trade Restrictiveness Indicator, Accounting Services, 2018



Source: OECD

Barriers to investment: competition in public procurement

- Reduction of the share of direct awards are following the entry into force of the new Procurement Code in January 2018
- Improvements in transparency and reliability - control bodies have direct access to databases, the contract manager reinforces supervision of contracts' execution



However…

- Lack of appropriate, structured and quantified planning in procurement (broad interpretation of extreme urgency)
- Efficiency and competition in public procurement procedures leave scope for improvement

Source: Own calculation from BASE, Transparency International 2017, IMPIC reports 2018

Regional dimension

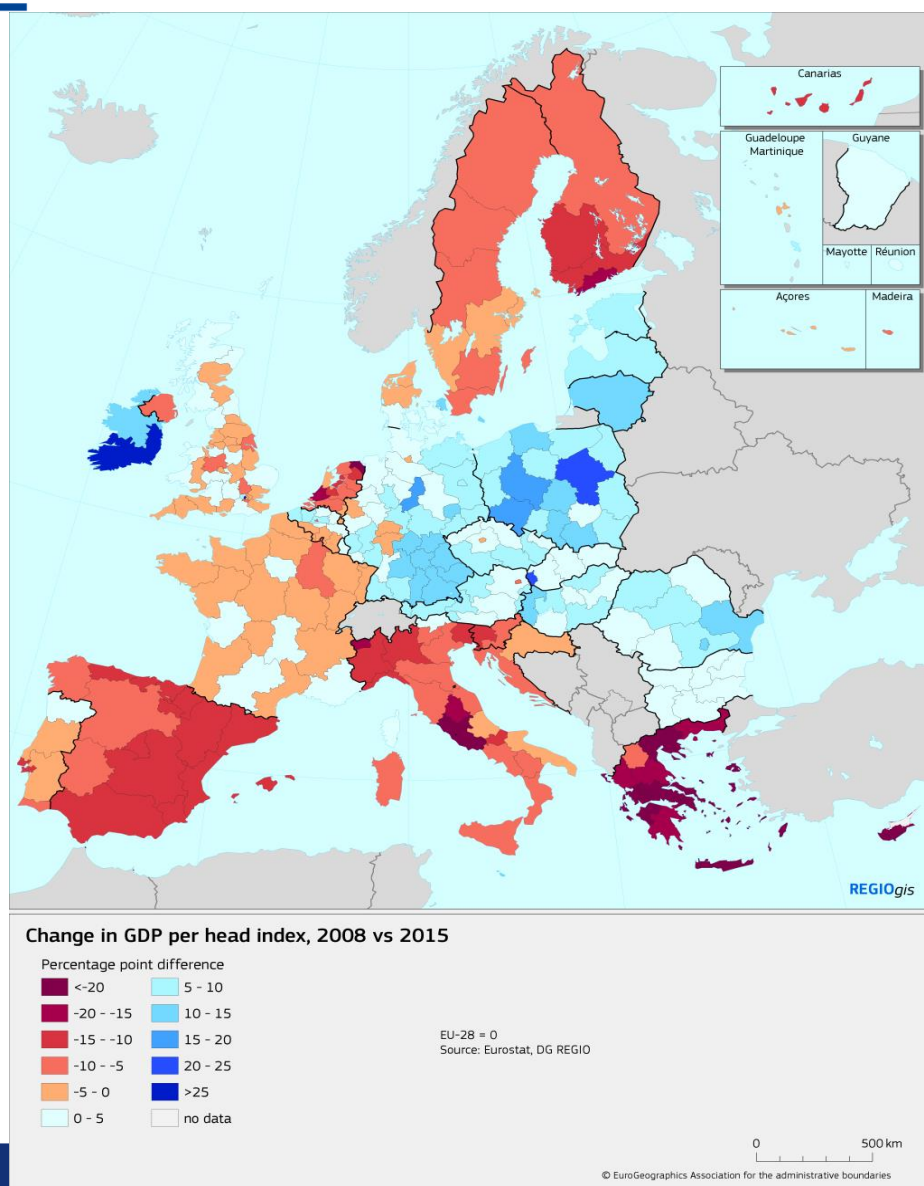
Rudolf Niessler, DG REGIO

Lisbon, 26th March 2019

EU Cohesion

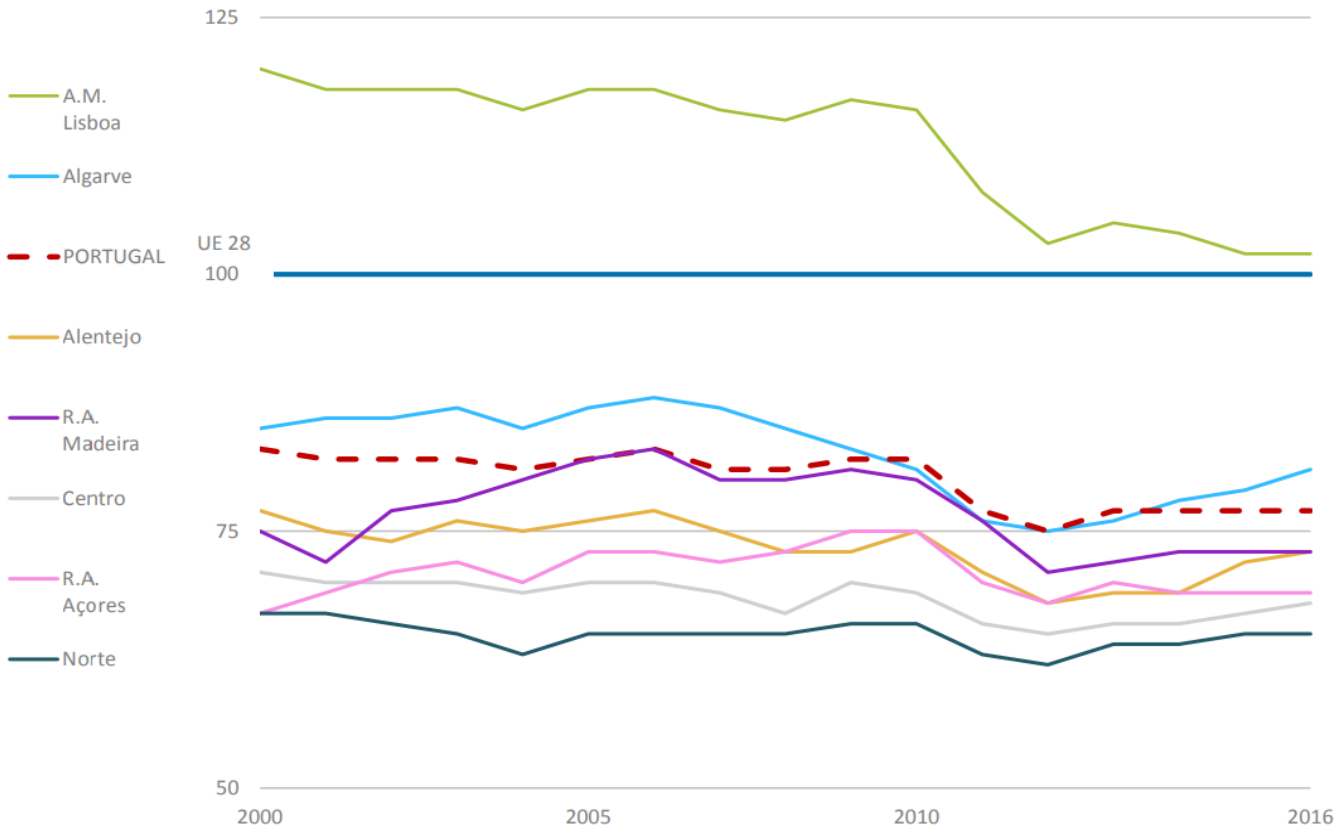
- *Regional disparities are narrowing again*

- *Regions in eastern Member States have converged to the EU average; Portuguese, Spanish, Greek and Italian regions have fallen back*

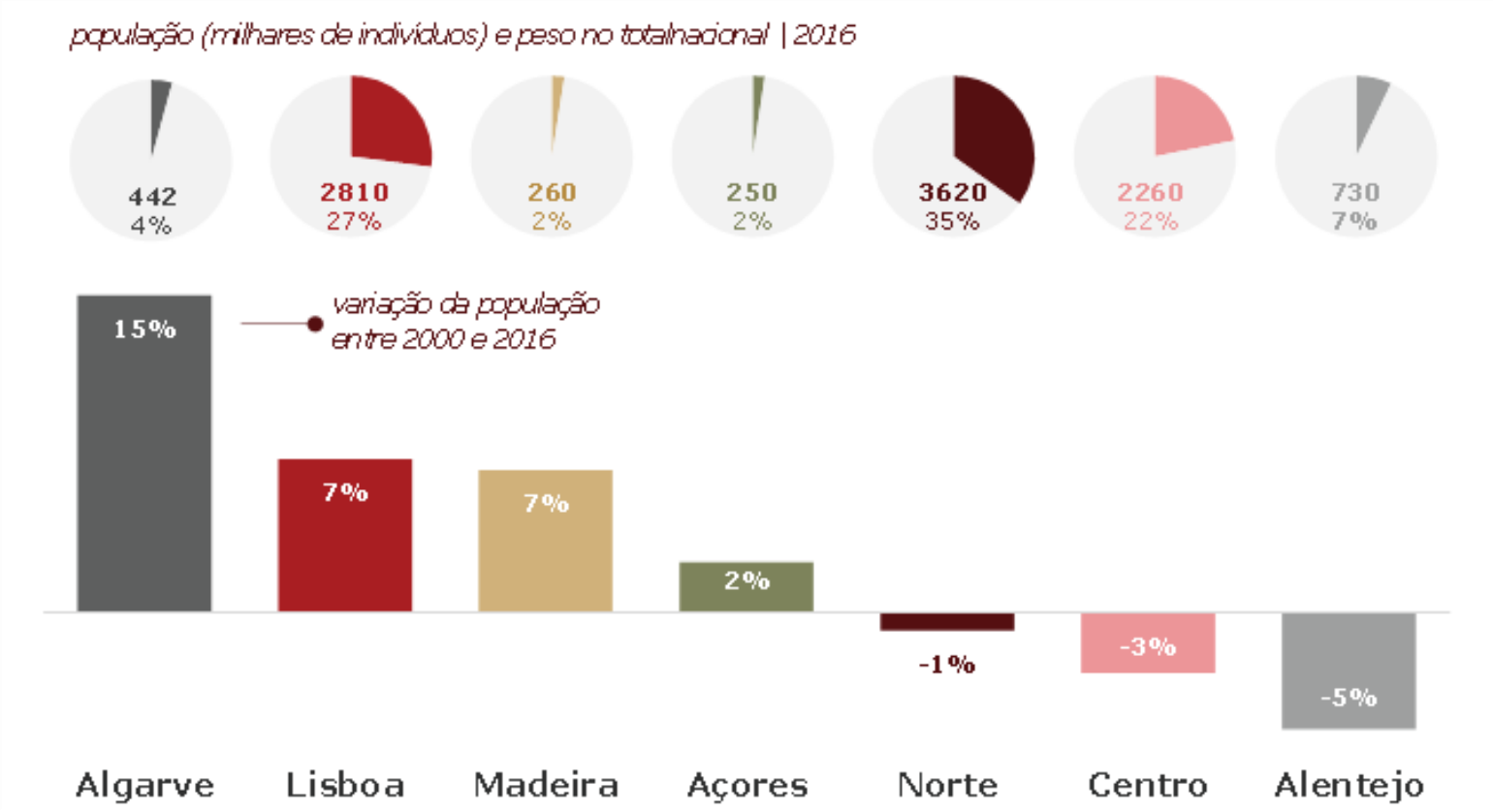


The convergence trajectory of the Portuguese regions

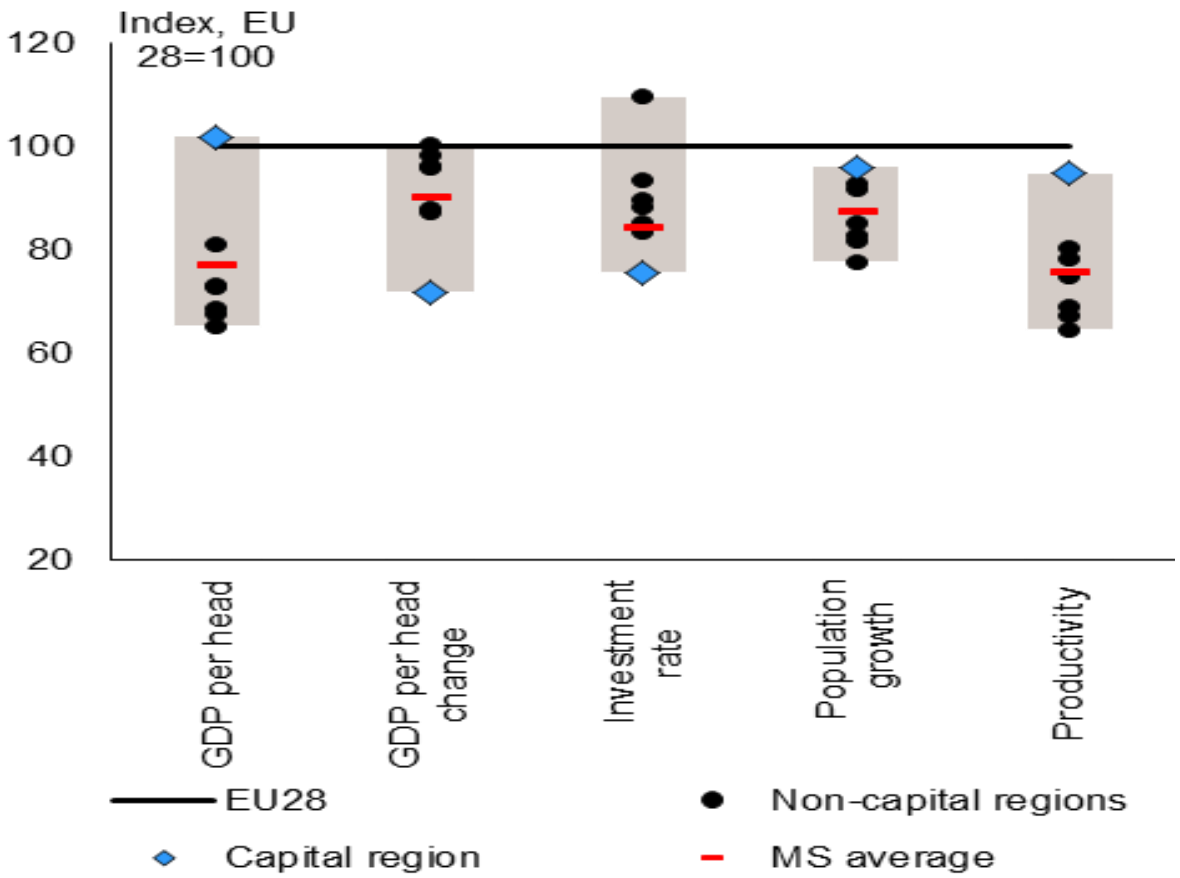
GDP per head in PPS (2000-2016) in % of the EU average



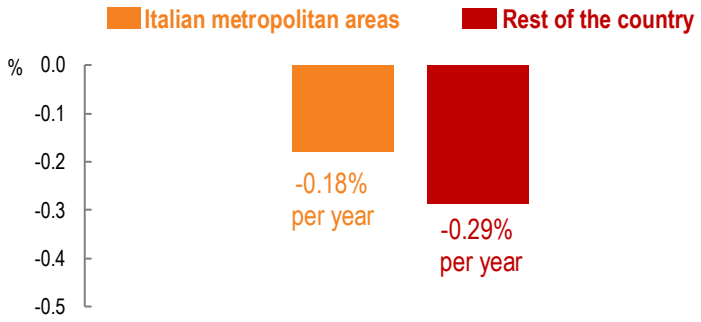
Regional convergence trajectory influenced by demographic change (2000-2016)

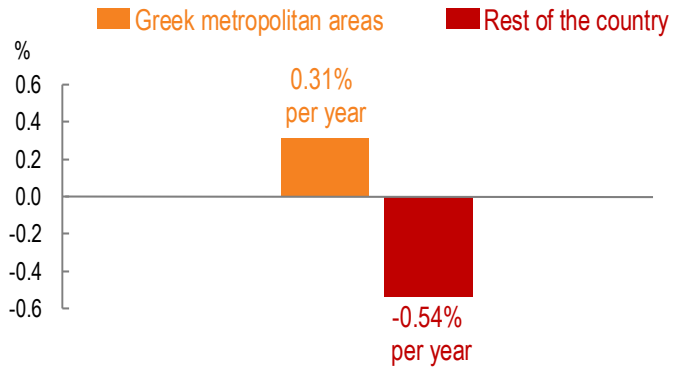


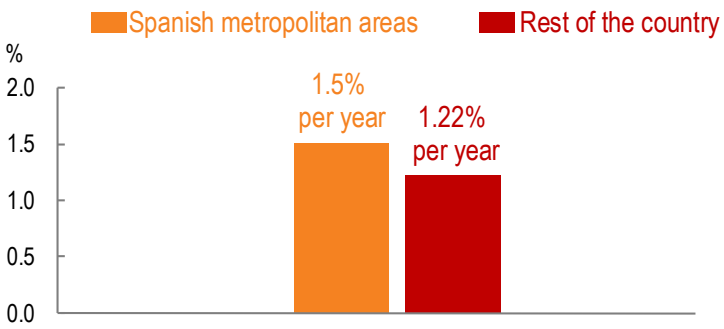
Economic convergence of the Portuguese regions
Head indicators

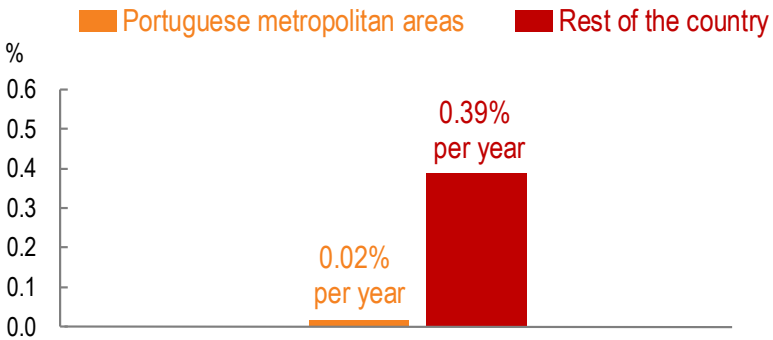


GDP growth in metropolitan areas, 2000-2016









Risk: Middle-income trap

- *Regions that do not move into the higher value added activities*
- *Face growing competition from less developed regions*
- *Innovation remains spatially concentrated*

Country	Δ GDP (2015 prices)	
	2008–2012	2008–2016
Portugal	-12%	-5%
Greece	-29%	-33%
Spain	-13%	-7%
Italy	-9%	-7%
EU–28	-6%	2%
Germany	1%	12%
France	-2%	3%
United Kingdom	-7%	2%

Key takeaways

- ***Low levels of investment and productivity remain a challenge*** *for advancing income convergence with EU average.*

- ***Demography****: declining population and ageing require special attention in the investment strategy for Portugal.*

- ***Strategic investments*** *must address* ***national competitiveness*** *and* ***regional specificities*** *must be taken into account to favour sustainable growth and cohesion.*