NOVA SCHOOL OF BUSINESS & ECONOMICS

SEMINAR IN EUROPEAN ECONOMICS

THE EXPERIENCE OF THE PORTUGUESE ECONOMY WITH THE EURO

PRACTICAL CLASS 9

2024-2025 S2

1. Economic performance before and after EMU

In the years leading to EMU:
- robust growth;
- lower inflation;
- reduced budget deficits;
- growing current account deficits

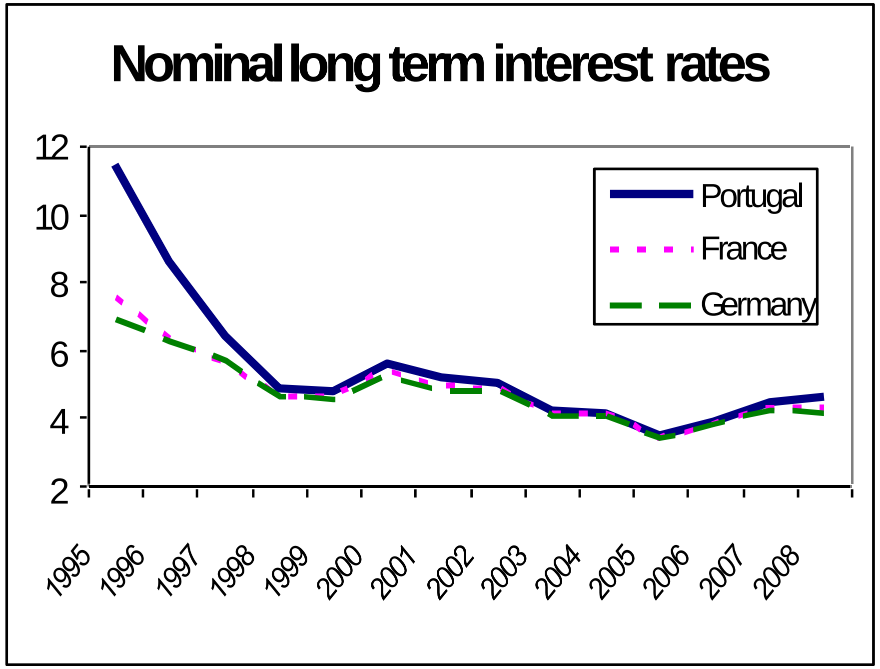
After 2000's
- subdued growth;
- deteriorated fiscal performance;
- current account deficit still high (weak competitiveness)

Economic Indicators	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
(real change in percentage)														
Real GDP	4,3	3,6	4,2	4,7	3,9	3,9	2,0	0,8	-0,8	1,5	0,9	1,4	1,8	0,0
Domestic demand	4,1	3,5	5,5	7,0	5,8	3,3	1,7	0,1	-2,0	2,5	1,5	0,8	1,5	0,9
Private consumption	0,6	3,3	3,6	5,3	5,2	3,7	1,3	1,3	-0,2	2,5	1,9	1,9	1,6	1,7
Gross fixed Investment	6,6	5,6	14,3	11,7	6,2	3,5	1,0	-3,5	-7,4	0,2	-0,9	-0,7	2,8	-1,7
Exports	8,8	5,8	6,2	8,5	3,0	8,4	1,8	1,4	3,9	4,0	2,1	8,7	7,5	-0,4
Imports	7,4	5,1	9,8	14,2	8,6	5,3	0,9	-0,7	-0,9	6,7	3,5	5,2	5,6	2,1
(in % of GDP)														
Current account deficit	-3,5	-4,2	-5,9	-7,0	-8,5	-10,2	-9,9	-8,1	-6,1	-7,6	-9,5	-10,1	-9,9	-12,1
Budget (excl. one-off measures)	-5,5	-4,8	-4,0	-3,2	-2,7	-3,2	-4,3	-4,2	-5,2	-5,4	-6,1	-3,9	-2,6	-2,6
Structural budget balance			-2,4	-2,7	-2,9	-4,1	-5,4	-5,2	-5,1	-5,1	-5,5	-3,8	-3,2	-4,6
Unemployment rate	7,3	7,3	6,8	4,9	4,4	3,9	4,0	5,0	6,3	6,7	7,6	7,7	8,0	7,6
Inflation	4,1	3,1	2,2	2,2	2,2	2,8	4,4	3,7	3,3	2,5	2,1	3,0	2,4	2,7

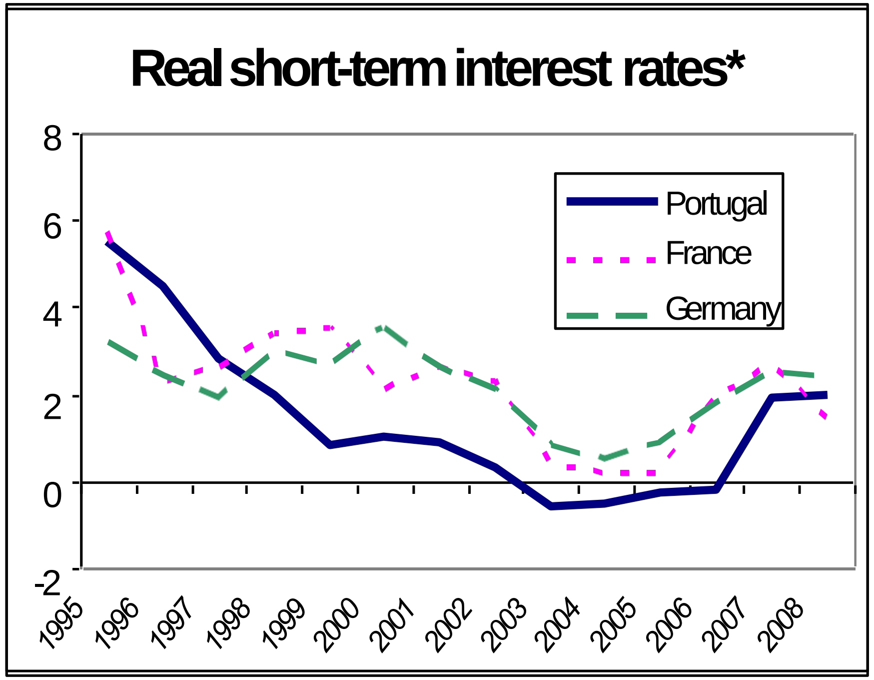
Source: Banco de Portugal, European Comission, IMF.

What explains this performance?

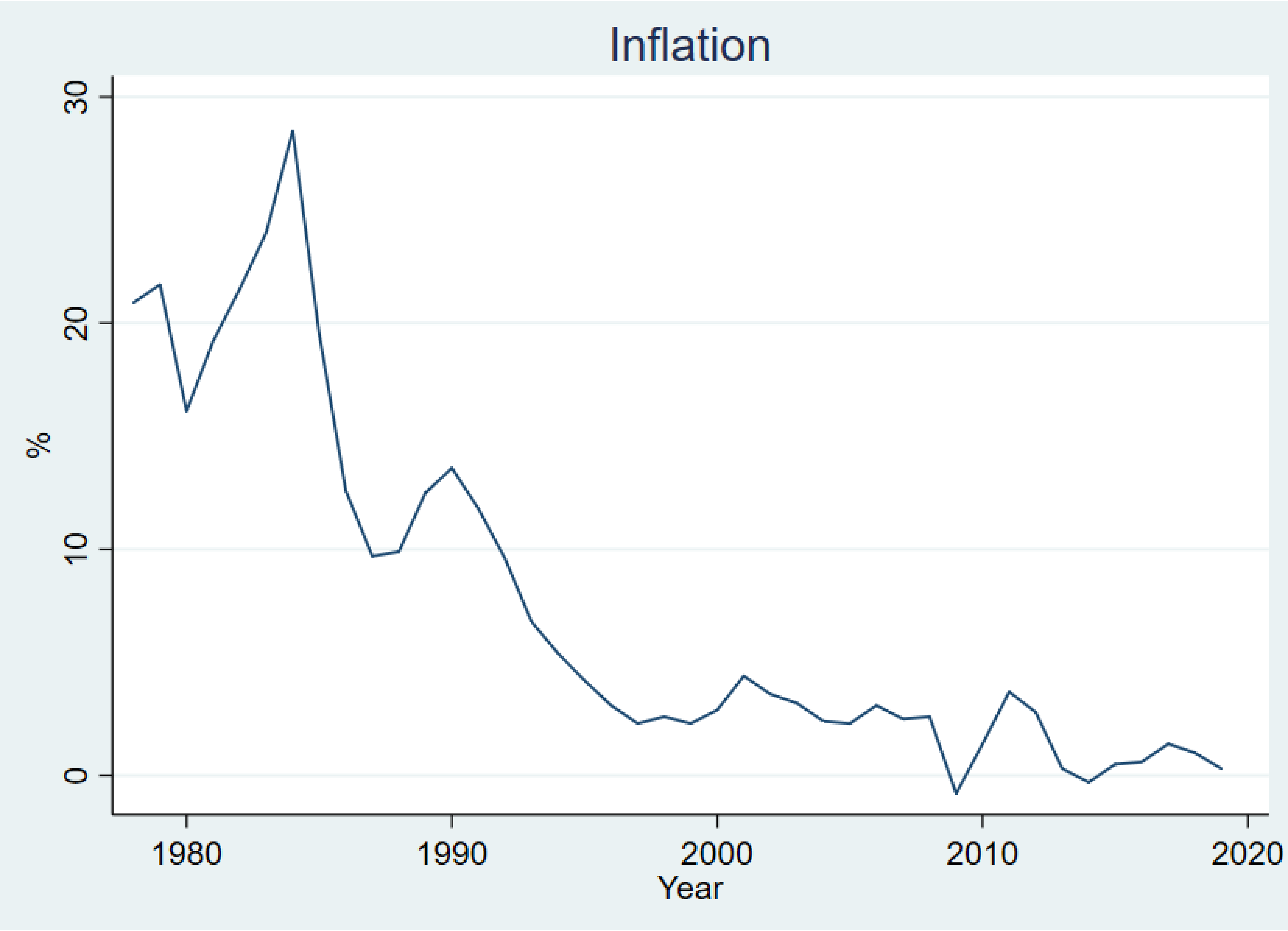
- Reforms and stabilization policies (since joining EEC in 1986) and prospect of euro adoption ➡ anchor for expectations
  ➢ low inflation and interest rates



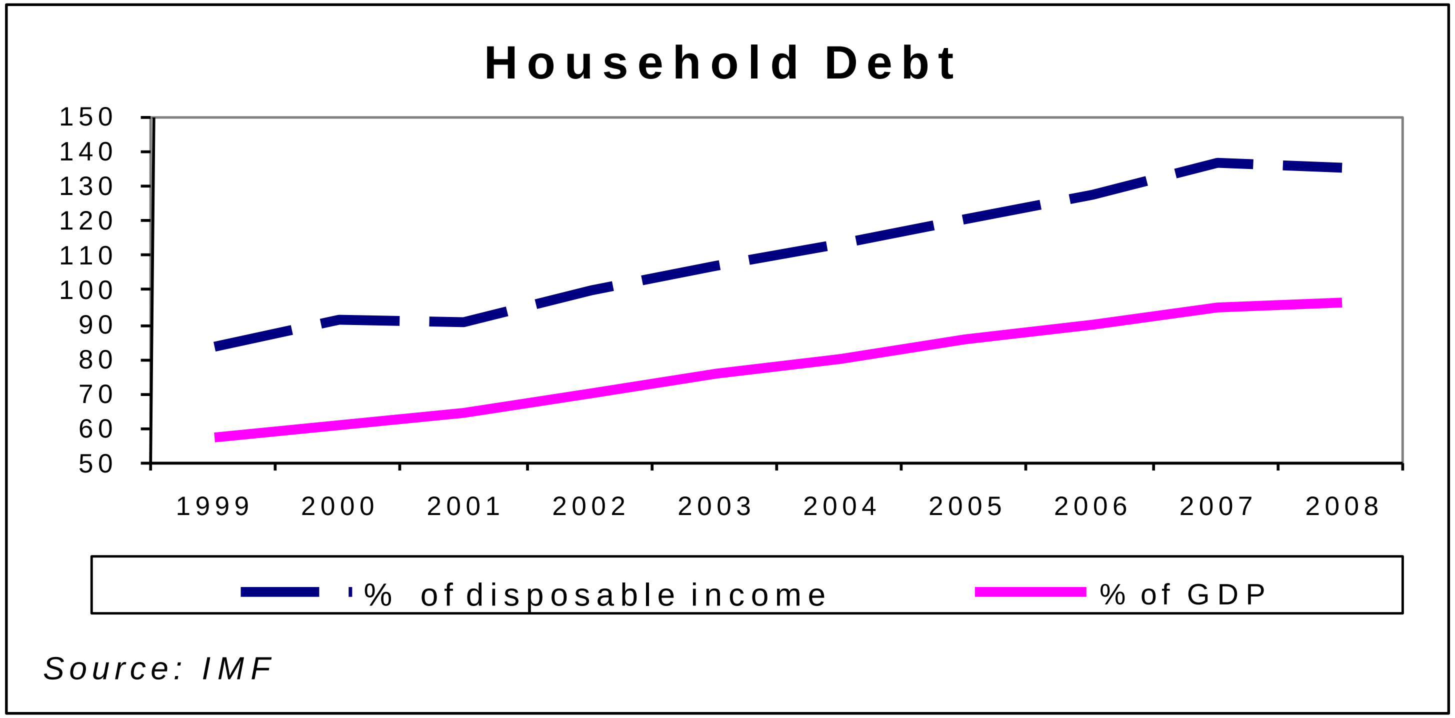
Source: EU Commission



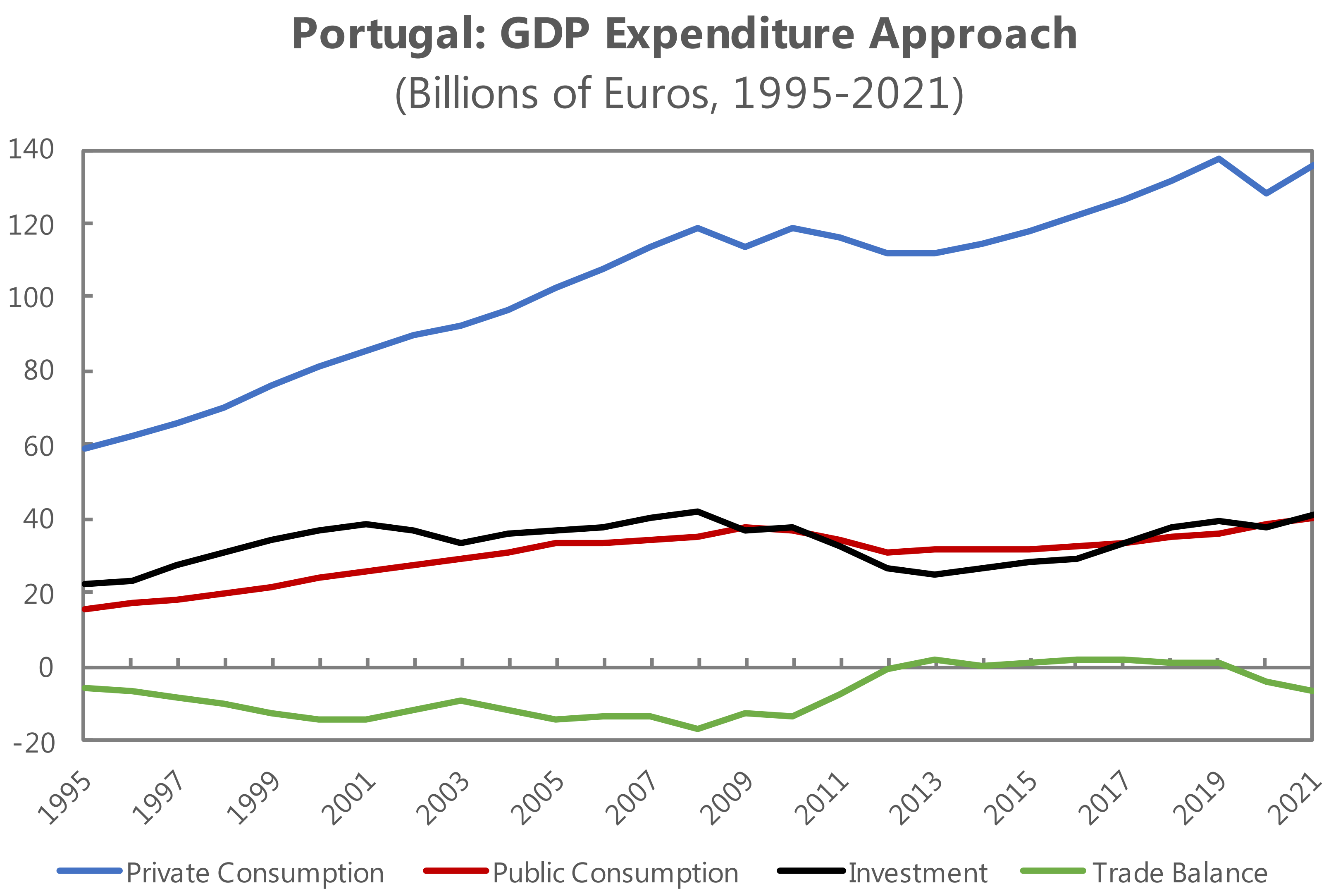
*Source: EU Commission; * Nominal interest rates minus*


Inflation
30
20
%
10
0
1980
1990
2000
2010
2020
Year

Easier access to financing led to credit growth

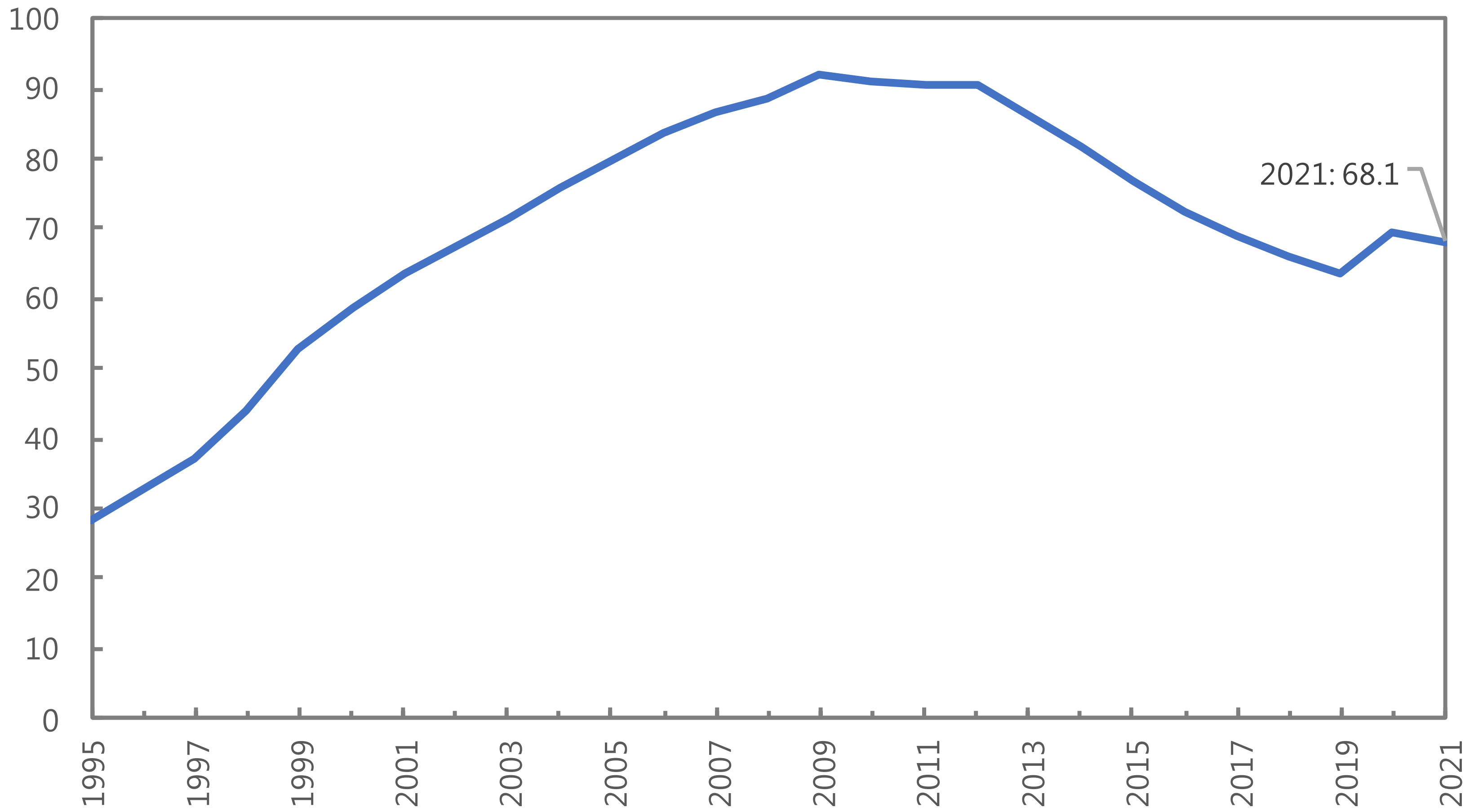


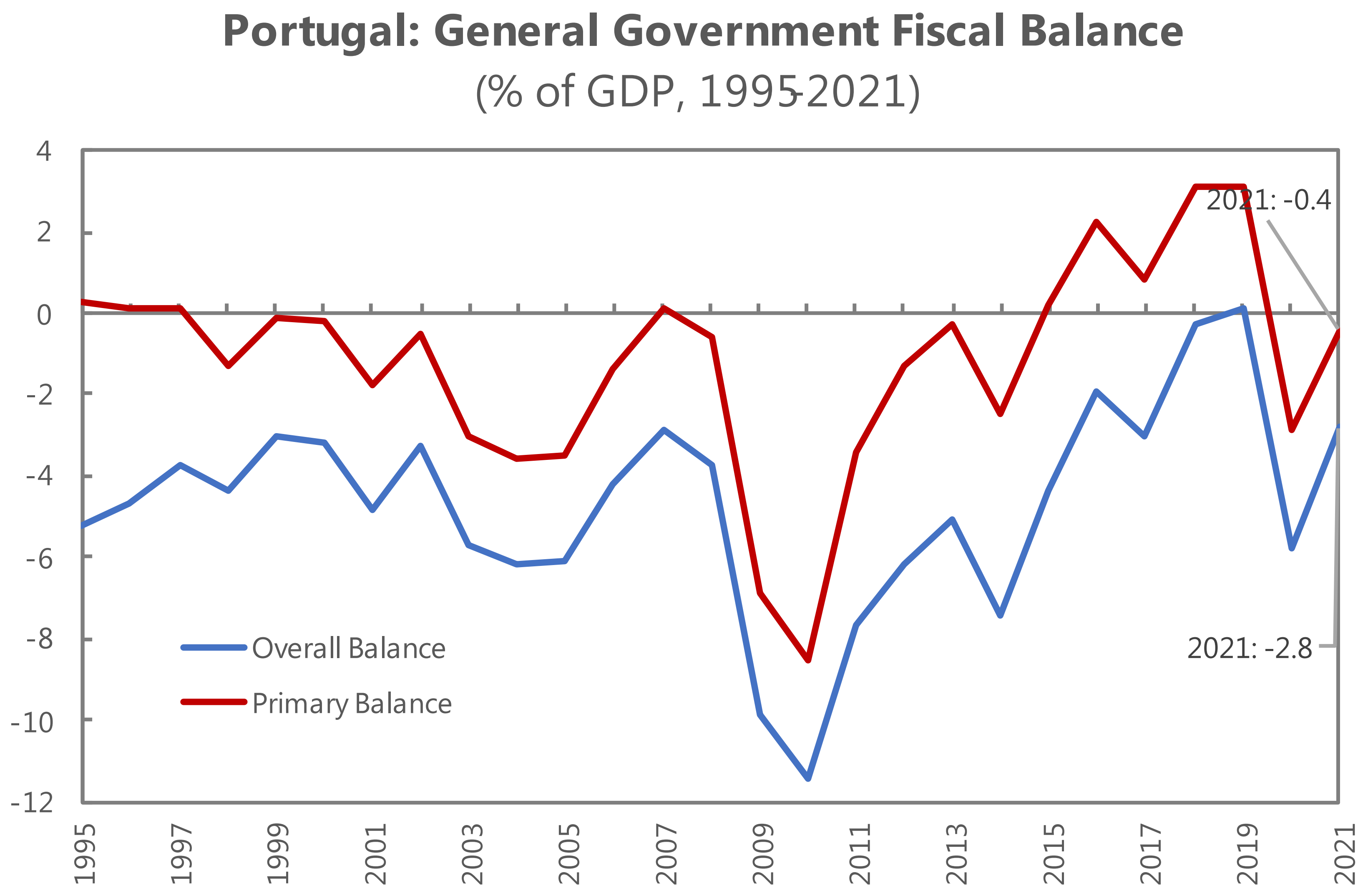
- Low interest rates & easier access to financing (financial liberalization and increased competition among banks)
  - ➢ strong household credit growth


Portugal: GDP Expenditure Approach
(Billions of Euros, 1995-2021)
140
120
100
80
60
40
20
0
-20
1995
1997
1999
2001
2003
2005
2007
2009
2011
2013
2015
2017
2019
2021
Private Consumption
Public Consumption
Investment
Trade Balance

Portugal: Household Debt

(% of GDP, 1995-2021)





Portugal: General Government Fiscal Balance
(% of GDP, 1995-2021)
4
2
0
-2
-4
-6
-8
-10
-12
2021: -0.4
2021: -2.8
Overall Balance
Primary Balance
1995
1997
1999
2001
2003
2005
2007
2009
2011
2013
2015
2017
2019
2021

Demand driven by easier financial conditions

- Consumption grew, as households adjusted to fall in interest rates;
- domestic investment also grew, reflecting favourable expectations and the easing of financing conditions;
- The dynamic economic activity led to a rapid increase in employment (mostly in fixed term contracts);
- decline of the unemployment rate, from over 7% in 1995 to 4% in 2000;
- A relatively tight labour market contributed to wage increases, which further fuelled the demand-led growth;
- Progress in convergence of real incomes (GDP in PPS grew from about 57% of EU in 1986 to 75% in 1999).

...accompanied by imbalances and loose policies

- **Fiscal deficit**: from 5.5 % of GDP in 1995 to 2.7% in 1999.
  - (more the effect of economic dynamism and lower debt service costs: **no strong consolidation effort**). Structural deficit increased during that period
- **Current account deficit:** from 3% in 1995 to over 10% of GDP in 2000.
  - Could be partly explained by a **successful catching-up process** (a higher investment rate, enhanced financial integration and the easing of liquidity constraints, all lead to an increase of imports).
  - However, **other factors also contributed** (expansionary policies and wage increases, well in excess of productivity gains, leading to rising labour unit costs and to persistent inflation differentials with the euro area).

Downturn of economic activity

By the turn of the century:

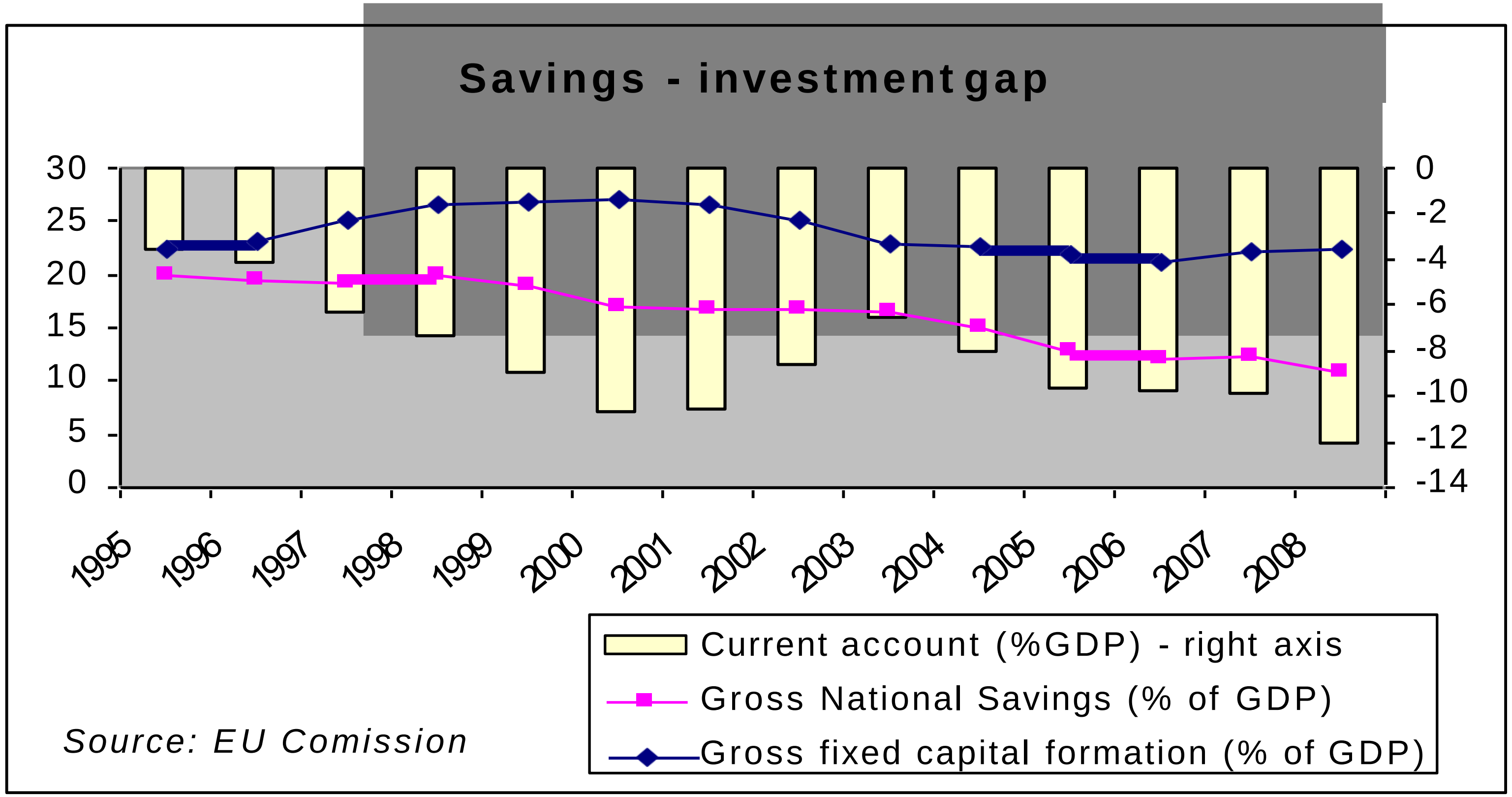
- Demand-led growth, unsustainable once the economy reached full-employment.
- Adverse external shocks (weakened external demand, as EU growth fell; increased competition in world trade)

As a result:

- Consumption growth declined, as households adjusted to high indebtedness levels,
- investment fell, reflecting slower demand and lower profits, (more than 15% in cumulative terms from 2002 to 2006),
- As a result, real GDP growth started to decline in 2001 and by 2003 the economy was in recession.

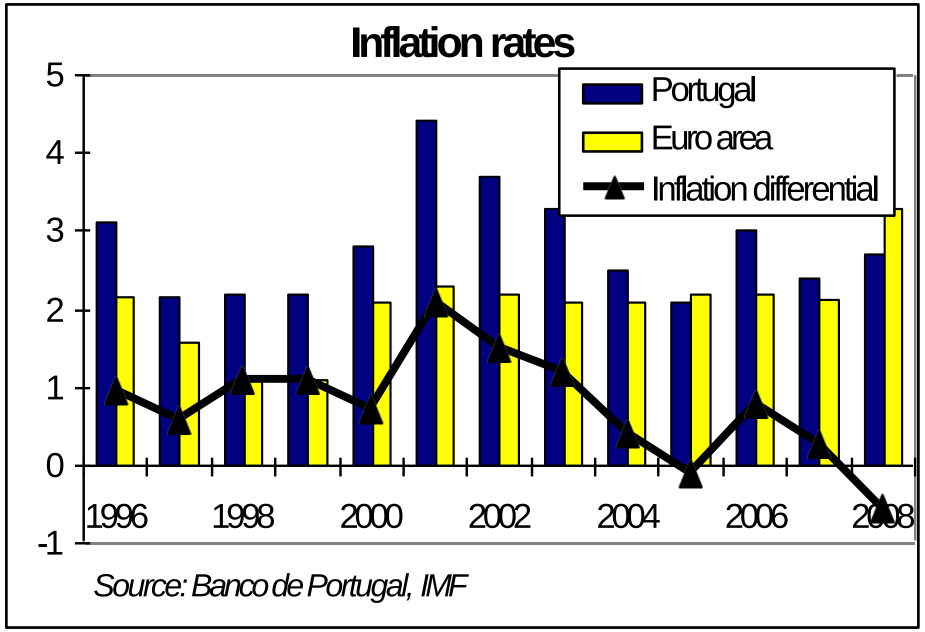
Downturn, but no improvement in current account

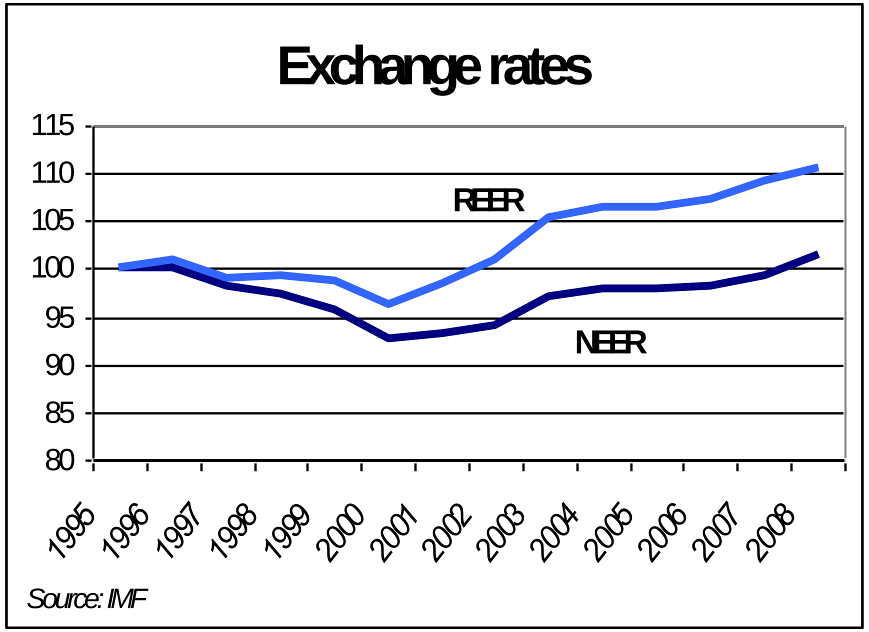
- Current account more the result of lower savings than increased investment



… and the real exchange rate appreciated

- Persistent inflation differentials with euro area
- The sharp nominal appreciation of the euro, starting in 2002, added to the appreciation of the exchange rate.





Could policies have avoided this outcome?

Outcome:

- Portuguese growth lower than that of the euro area reversing the initial process of convergence.
- Inflation higher than euro area
- Loss of export competitiveness
- Fiscal performance deteriorated until 2005 (excessive deficit procedure)

to some extent, developments reflect:

- the **adjustment of highly indebted economic agents** following a period of demand-led growth caused by a credit boom
- and the effect of **external shocks**.

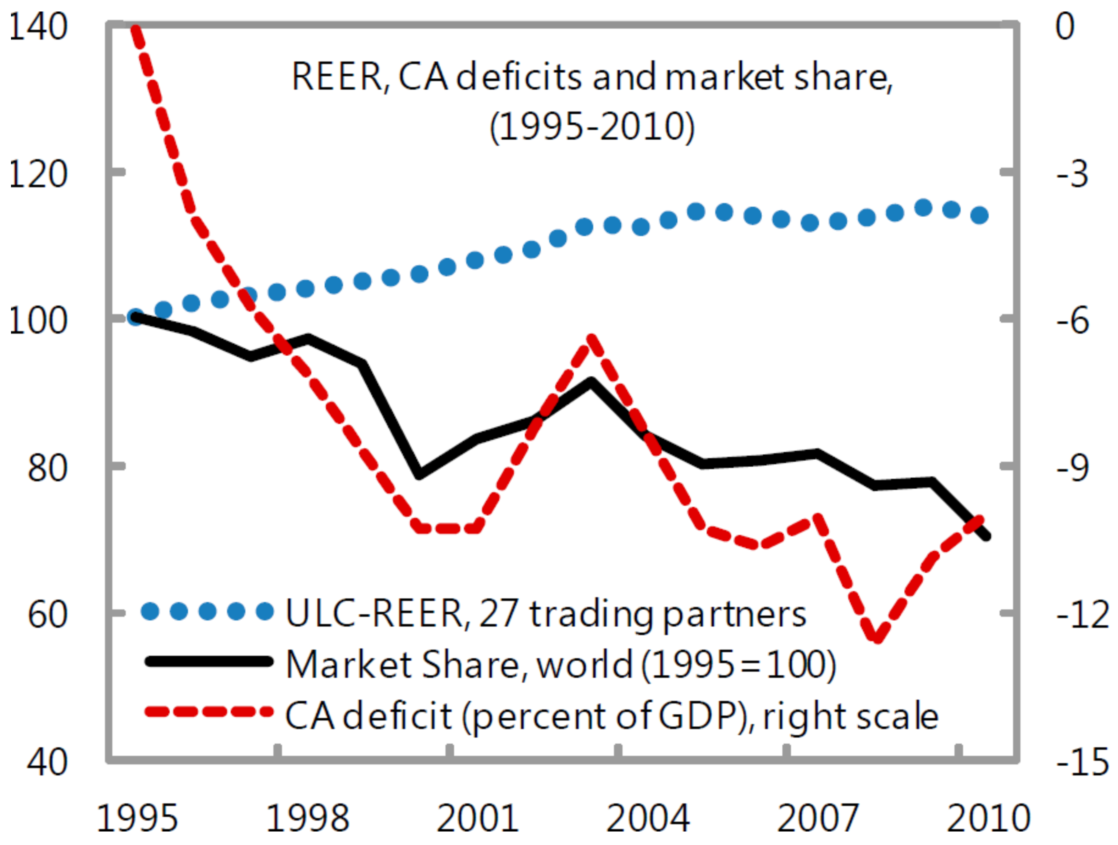
Could policies have avoided this outcome?

However:

- **less expansionary fiscal and incomes policies and structural reforms** aimed at enhancing economic efficiency and expanding potential output could have:
  - minimized domestic and external imbalances
  - and increased the resilience of the economy to shocks.

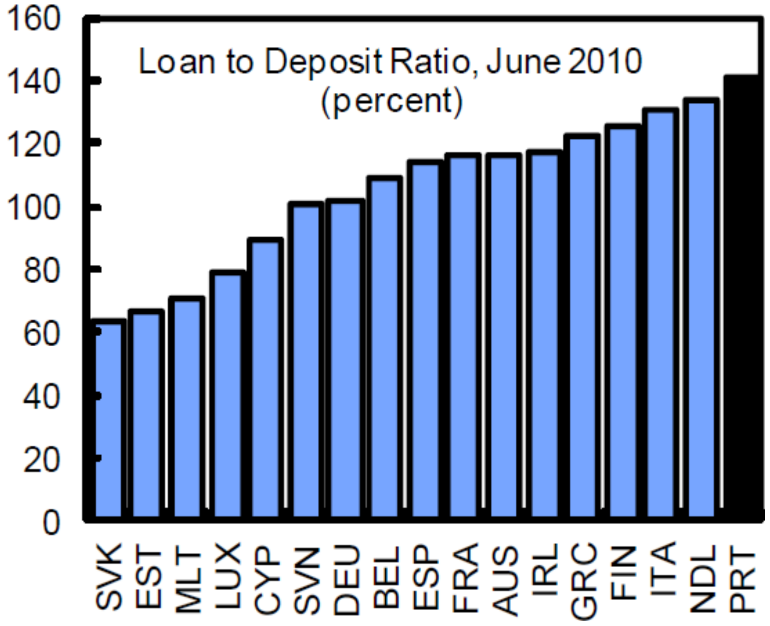
	Reforms:
1980's early90's	Liberalization of capital flows; privatization of banking system; improved management of monetary policy
Since Mid-1990's	Infrastructure: roads and motorways What was lacking?: Measures to enhance: competition in labour and product markets, efficiency in public administration; education; legal system…

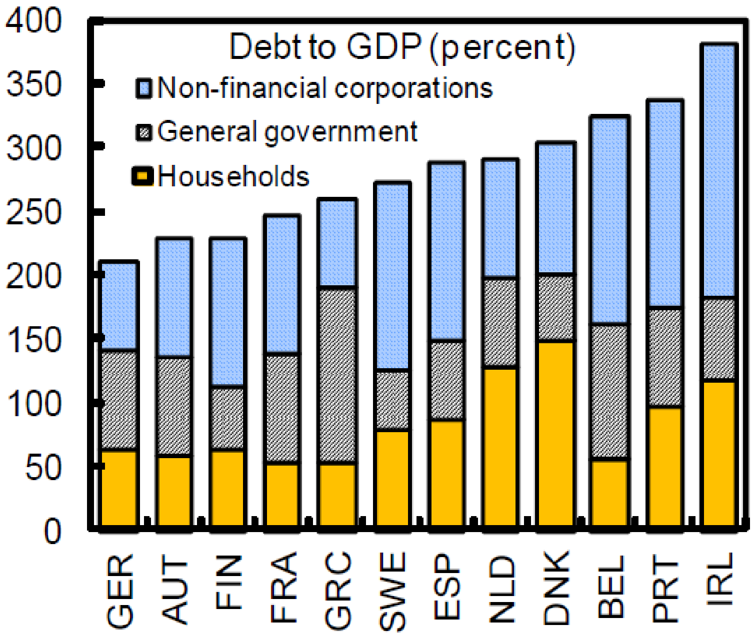
Loss of competitiveness



Source: IMF

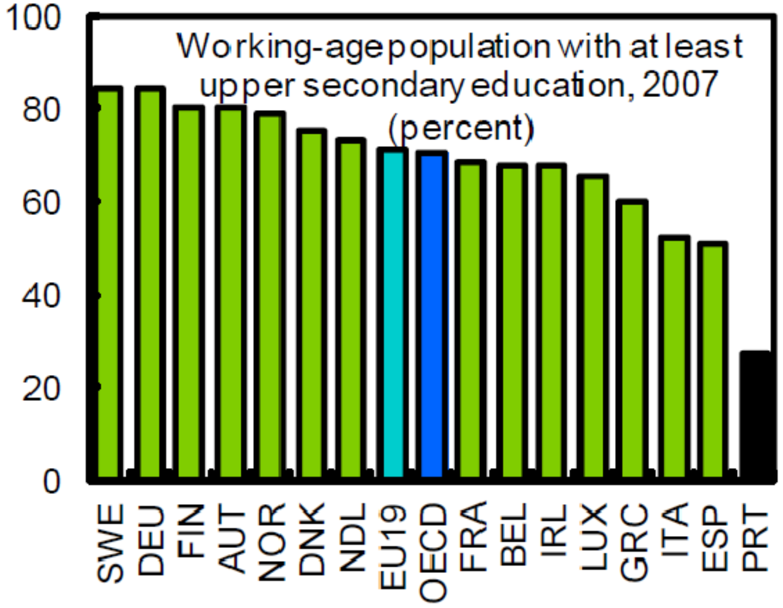
Leverage and indebtedness

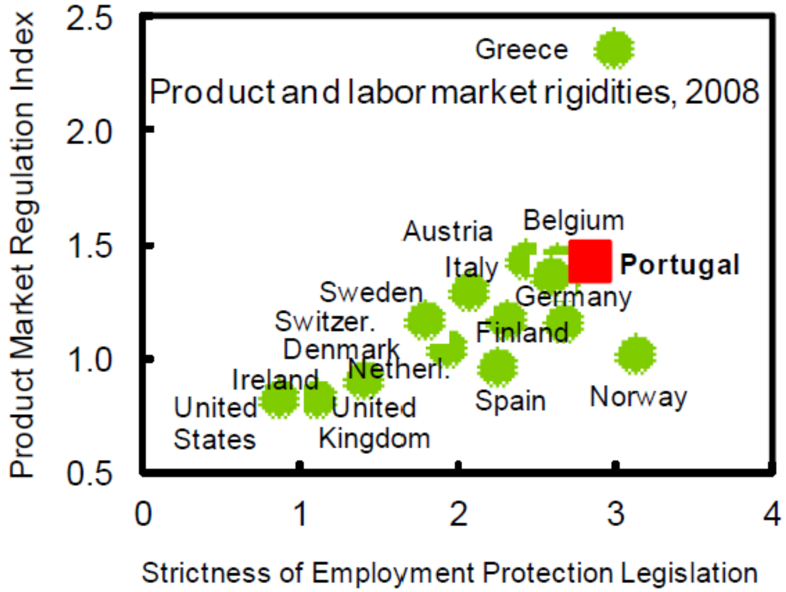




Source: IMF

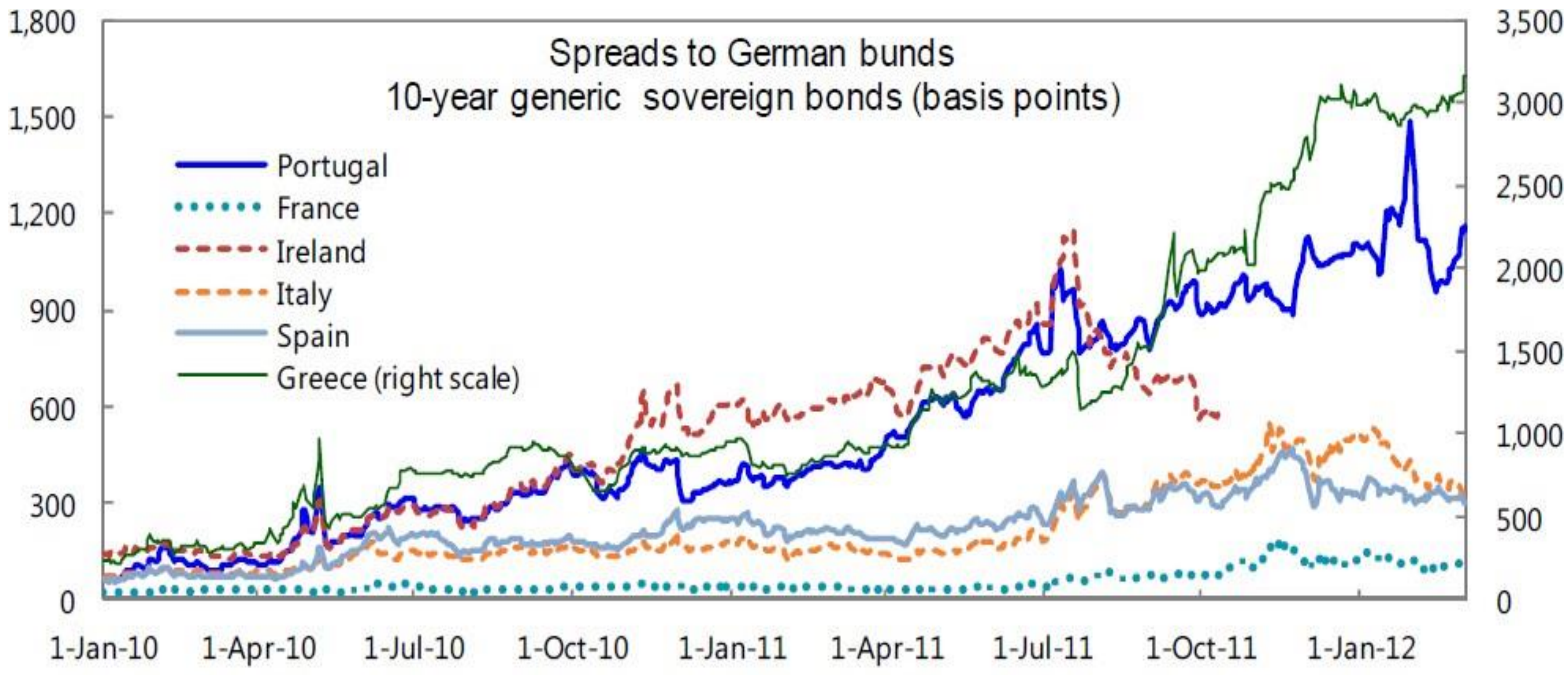
Structural rigidities



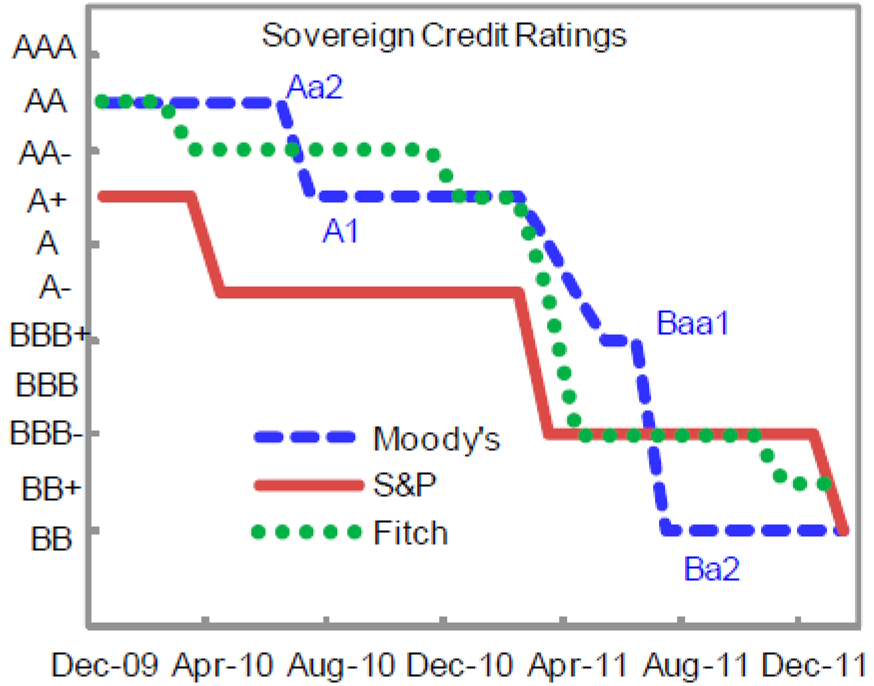


Source: IMF

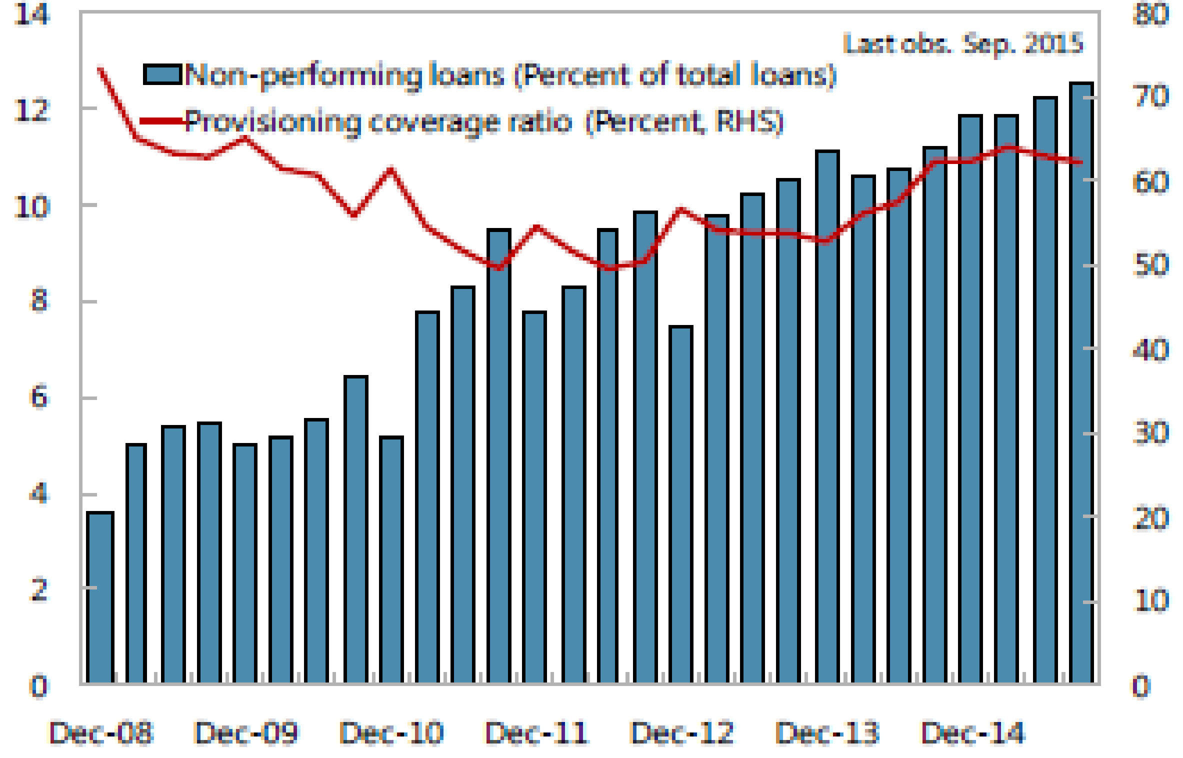
Sovereign debt crisis: loss of access to international financial markets when markets became more aware of risks

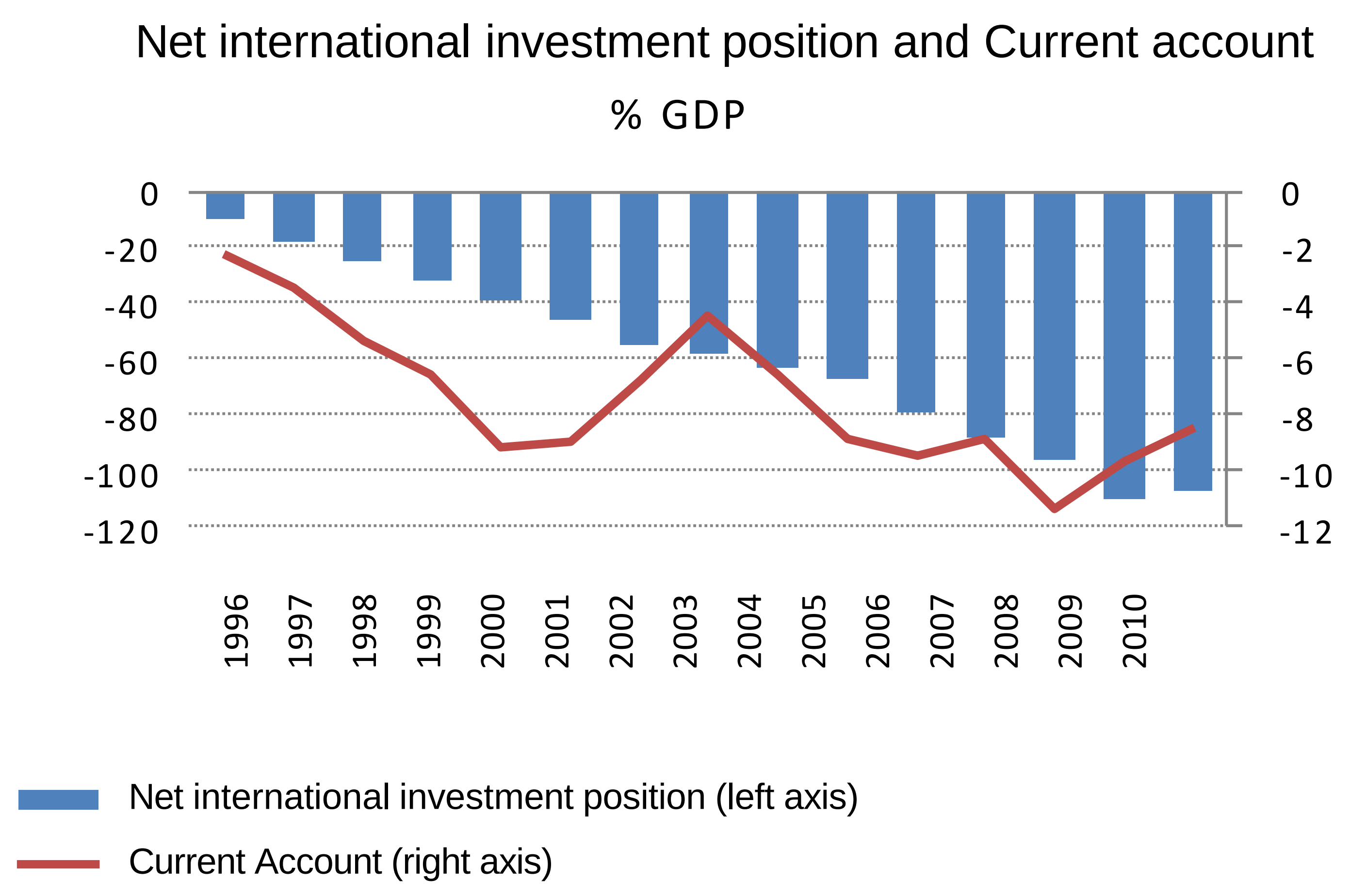


Source: Bloomberg.


Sovereign Credit Ratings
AAA
AA
AA-
A+
A
A-
BBB+
BBB
BBB-
BB+
BB
Aa2
A1
Baa1
Ba2
Moody's
S&P
Fitch
Dec-09
Apr-10
Aug-10
Dec-10
Apr-11
Aug-11
Dec-11

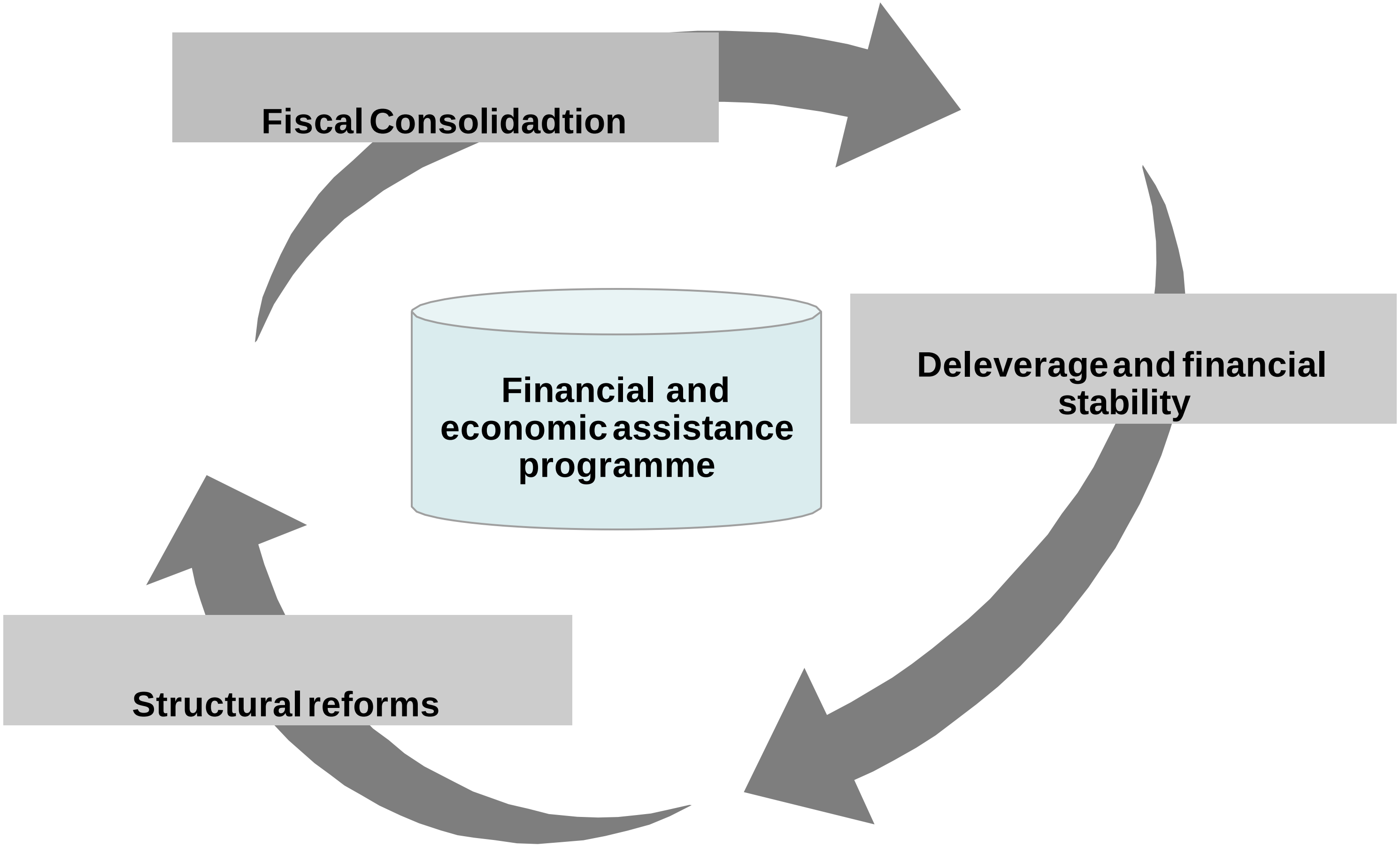
Non-Performing Loans and Provisioning





Net international investment position and Current account
% GDP
0
-20
-40
-60
-80
-100
-120
0
-2
-4
-6
-8
-10
-12
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
Net international investment position (left axis)
Current Account (right axis)

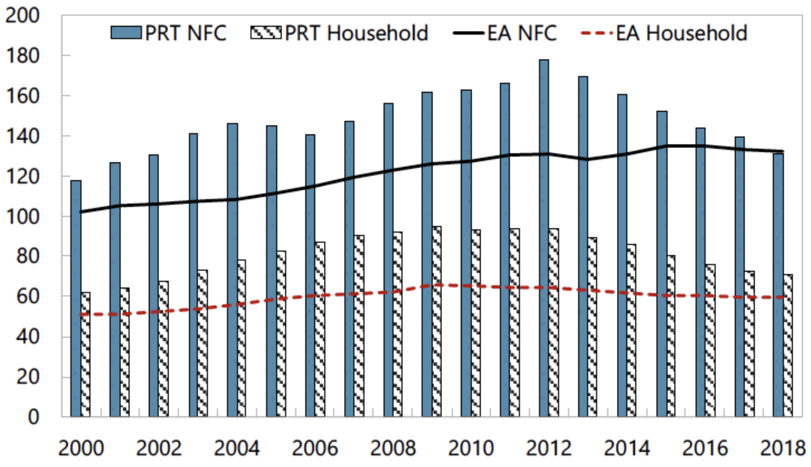
Financial and economic assistance programme (2011-14)



Post programme performance: deleveraging and access to international financial markets

NFC and Household Debt

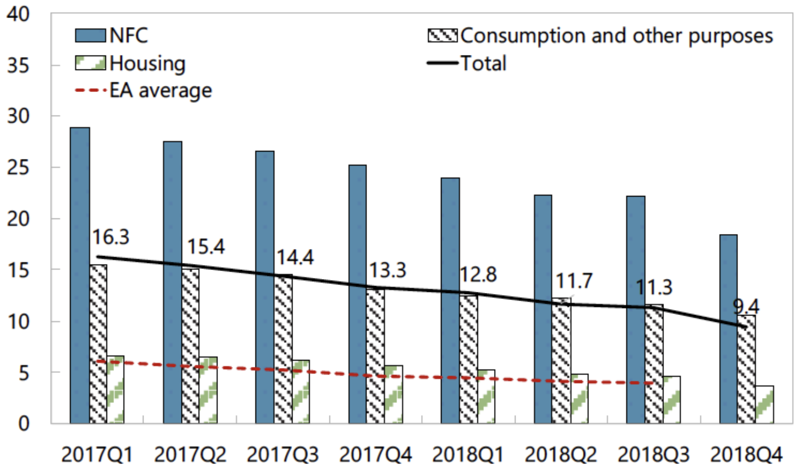
(Percent of GDP)



Source: Haver Analytics.

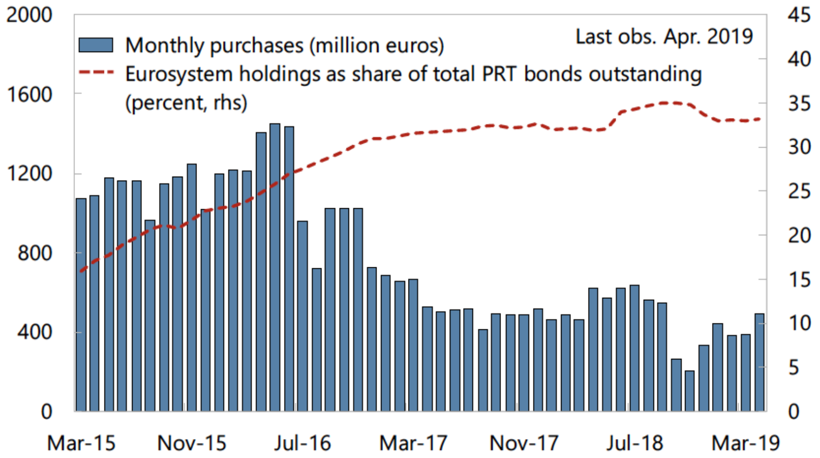
Portugal: Non-Performing Loans Ratio

(Percent)



Sources: Banco de Portugal and ECB.

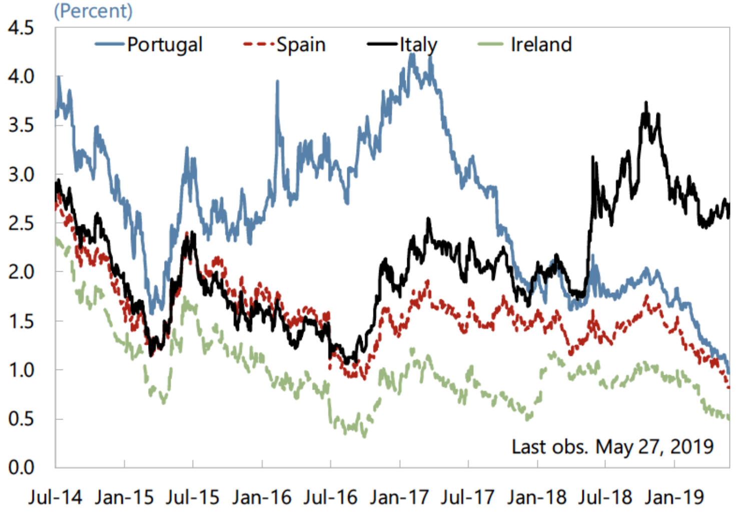
Monthly PSPP Purchases of Portugal Sovereign Debt



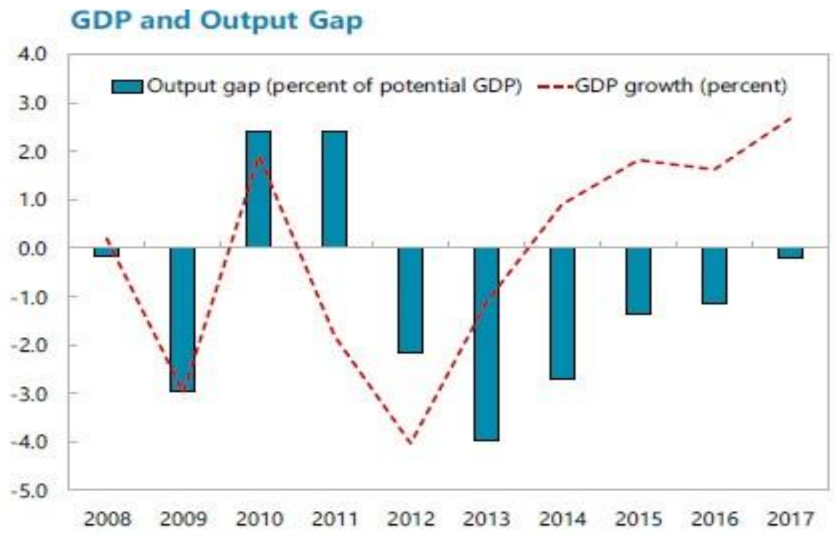
Note: Data on Eurosystem holdings through the SMP is available up to December 2018. These calculations assume unchanged holdings over January–April.

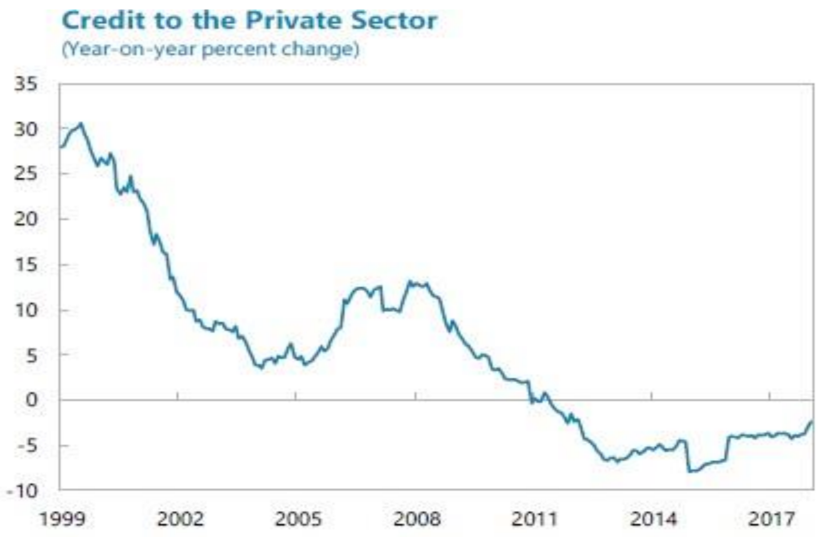
10 Year Government Bond Yields

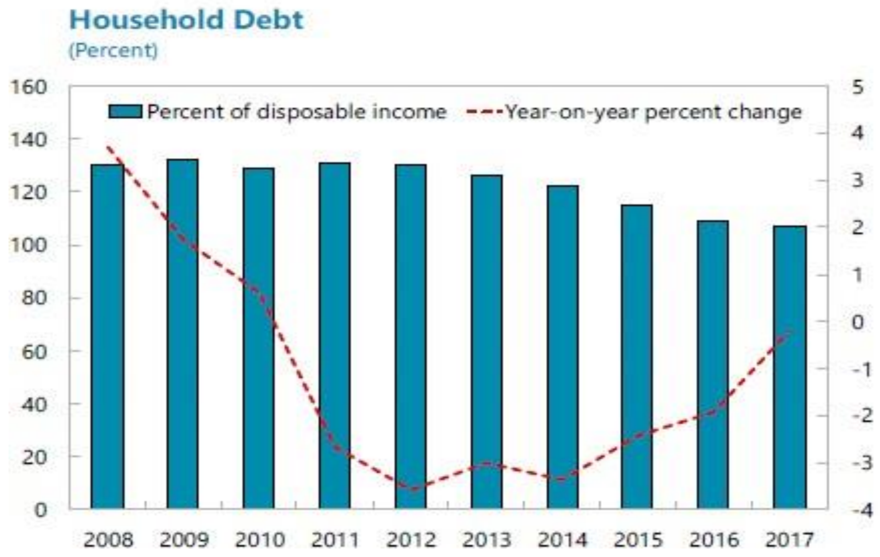
(Percent)



Recent performance

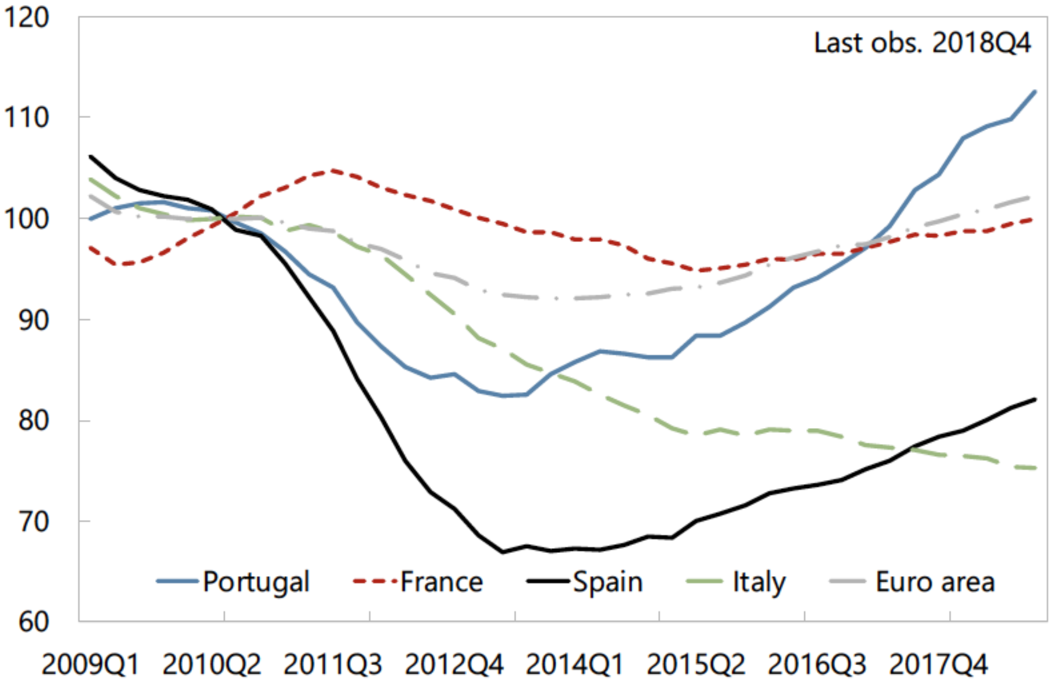






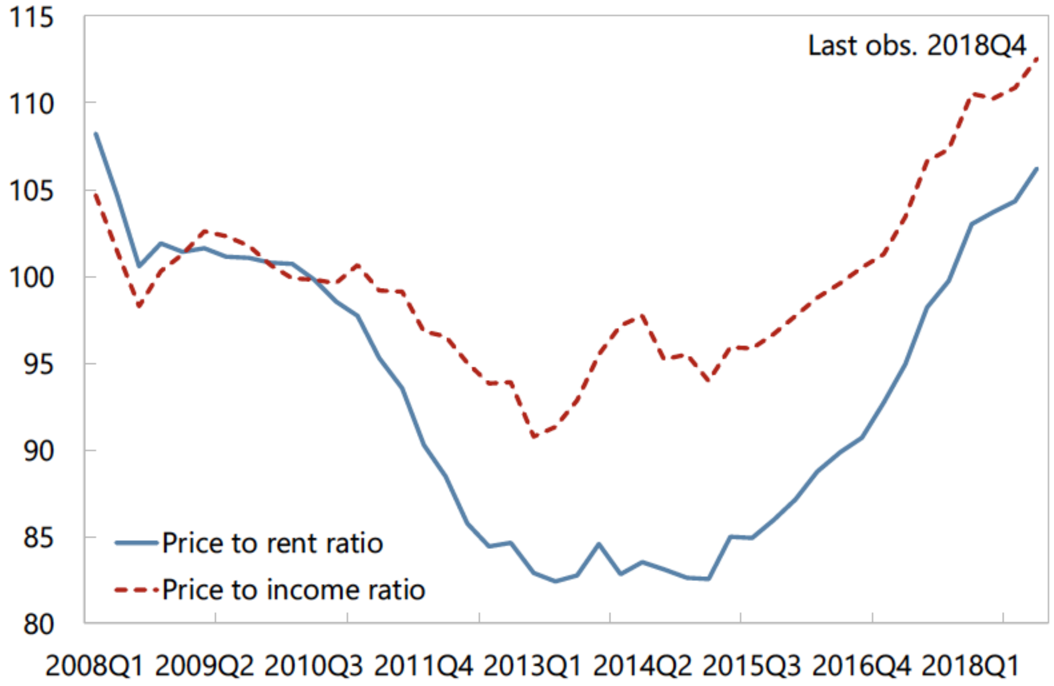
Real House Prices

(2010=100)

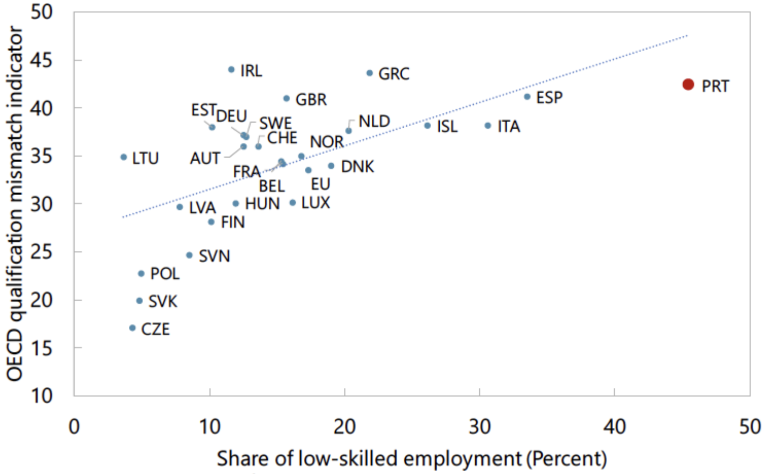


Price-to-Income and Price-to-Rent Ratios

(2010=100)



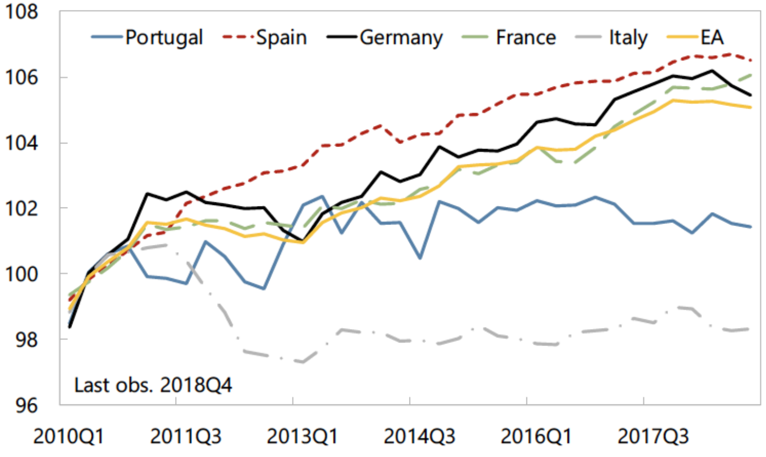
Low-skilled Employment and Qualification Mismatch, 2016



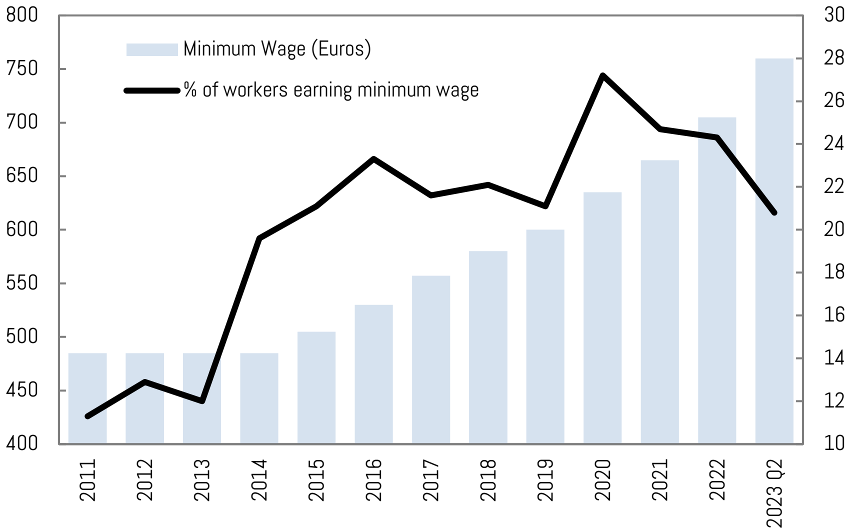
Sources: OECD and Eurostat.

Labor Productivity per Worker

(2010=100)

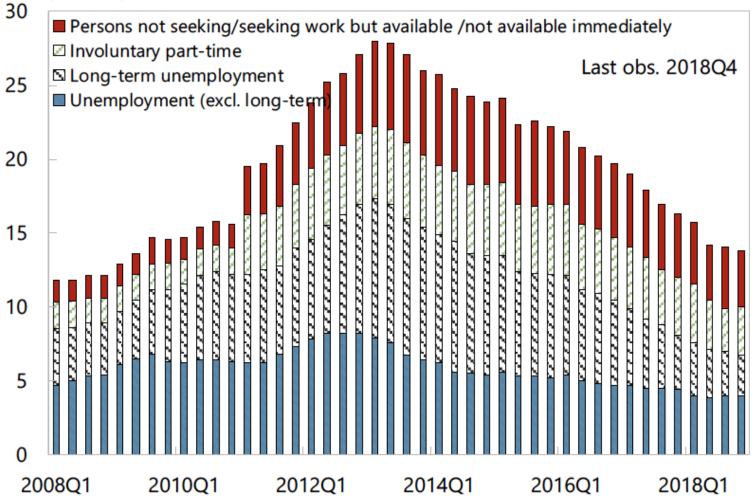


Source: Eurostat.



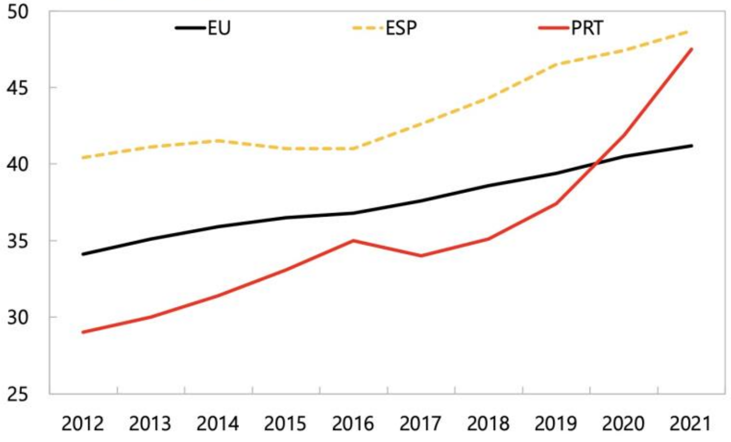
Labor Market Underutilization

(Percent)



Tertiary Education Attainment

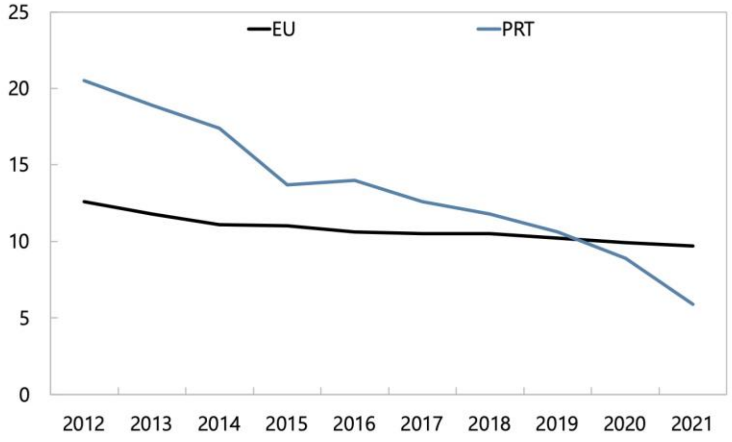
(Percent, ages 25-34 years)



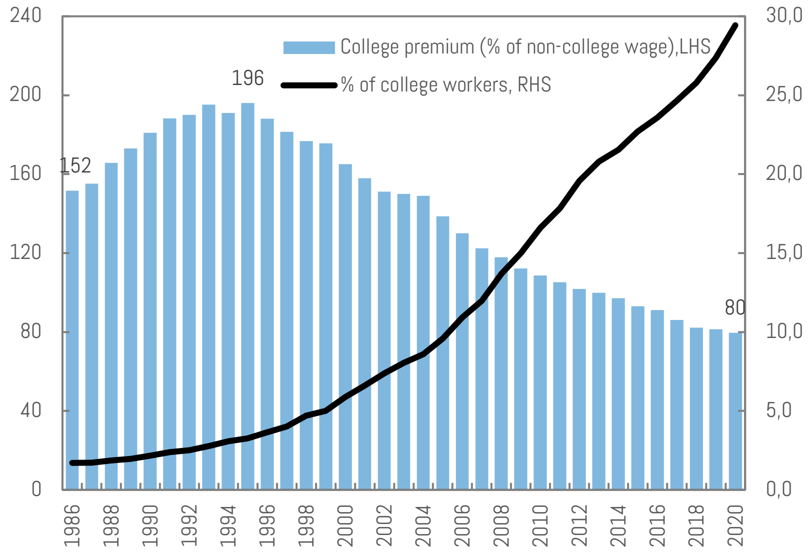
Source: Eurostat.

Early Leavers from Education and Training

(Percent, ages 18-24 years)

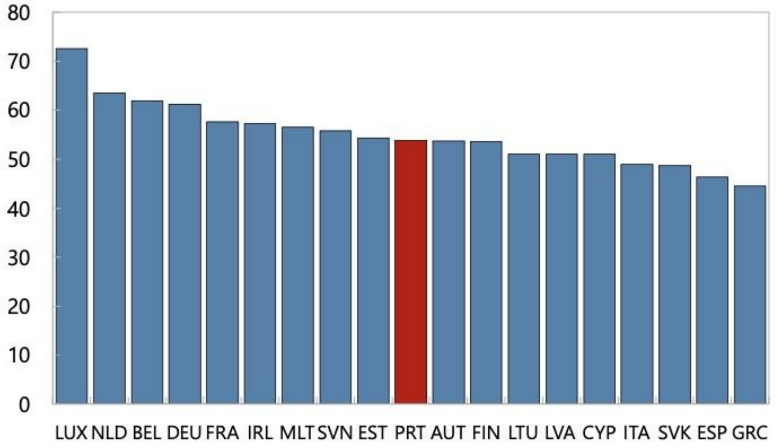


Source: Eurostat.



Digital Occupation Share of Employment 1/

(Percent)

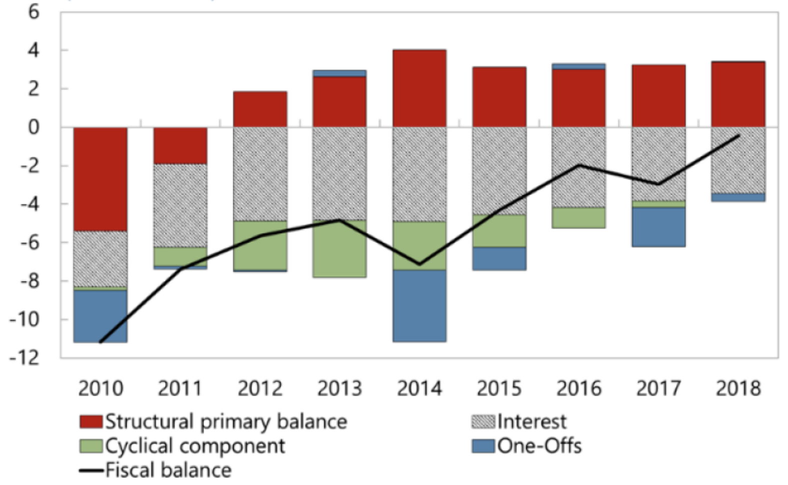


Sources: Eurostat and IMF staff calculations.

1/ Average of 2022Q1 and 2022Q2

Fiscal Balance

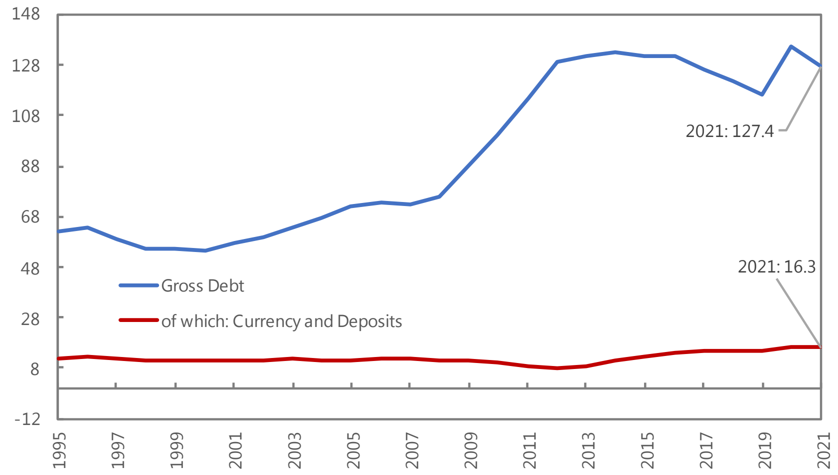
(Percent of GDP)



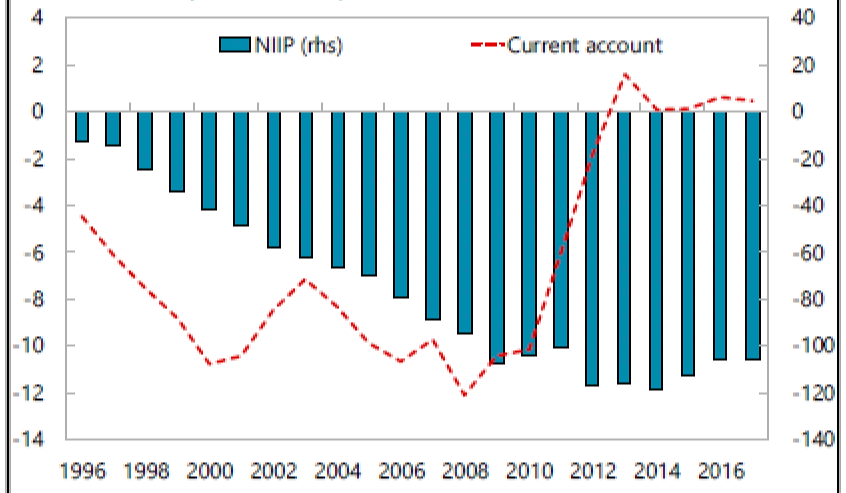
Source: IMF staff calculations.

Portugal: General Government Debt

(% of GDP, 1995-2021)



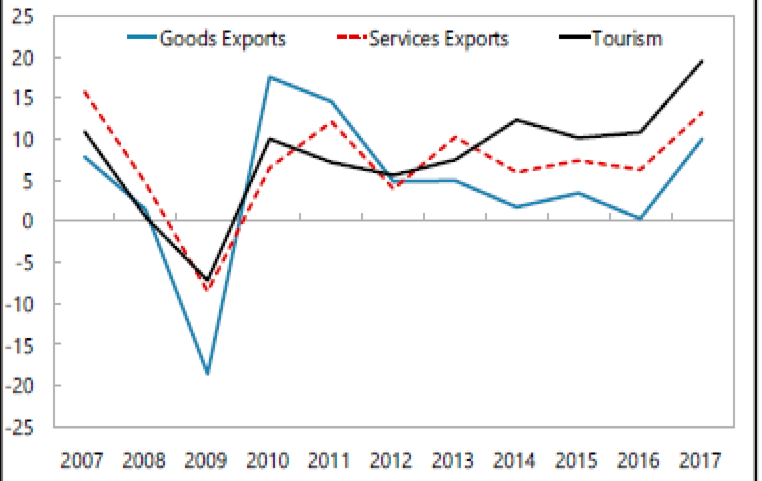
Current Account and Net International Investment Position (Percent of GDP)



Source: Haver Analytics.

Export Growth

(Percent)



Sources: Haver Analytics; and IMF staff calculations.

Post Programme performance

Adjustment effort under programme allowed:

- Regained access to international markets
- Reduction of macroeconomic imbalances
- Some reduction in indebtedness levels and NPLs

However:

- Indebtedness level was still high
- Growth remained subdued for many years
- Despite progress reforms still needed to improve labour and product markets flexibility, labour and management skills, the quality of public administration, and other inefficiencies that undermine productivity growth and the attraction of FDI

Useful Readings:

https://www.imf.org/external/pubs/ft/dp/2016/eur1602.pdf

http://journal.fsv.cuni.cz/storage/948_04_413-429.pdf

Resit 17th June 2019

1) The Portuguese economy underwent a current account crisis in recent years which ultimately resulted in an economic and financial assistance program.

a. Please briefly describe the vulnerabilities and the events which led to the crisis

- **High levels of deficit**
- **Twin deficits (current account deficit + budget deficit)**
- **Loss of competitiveness which was clearer after the EMU reform**

b. Please describe the main pillars of the economic and financial assistance program and any links between them.

- **3 pillars: restore fiscal balances, improve the solvency of the banking system, structural reforms**
- **Fiscal consolidations make it harder to embrace structural reforms (competition, housing, labour market, energy, judicial, education, transports, regulated professions)**
- **Competition and labour market reforms are linked**

Resit 17th June 2019

1) The Portuguese economy underwent a current account crisis in recent years which ultimately resulted in an economic and financial assistance program.

c. In your view, was the economic and financial assistance program successful in achieving its aims? Make reference to economic indicators in your answer.

- **The country regained access to the financial markets and some of the imbalances were corrected**
- **Better framing of the reforms**
- **Doubts regarding how much it affected the long-term output growth perspective**

Resit 17th June 2018

4) The Portuguese current account balance improved significantly since the signing of the Financial Assistance Programme with the IMF and the European Union institutions.

a. What factors led to the prior deterioration of the current account deficit?

- **Lower interest rates and lower led to a boost in consumption and investment (internal demand) => Increase in imports**
- **Low competitiveness (which was worsen when China became a member of the WTO and Central and Eastern European Countries became part of the EU) led to an unbalanced CA which required high levels of financing**
- **Moreover, fiscal policy was expansionary, adding to the external financing needs.**
- **Overall, prior to the crisis Portugal was facing a severe shortage of savings to finance investment, leading to current account deficits that generate a deterioration of the external investment position.**

And then COVID-19…

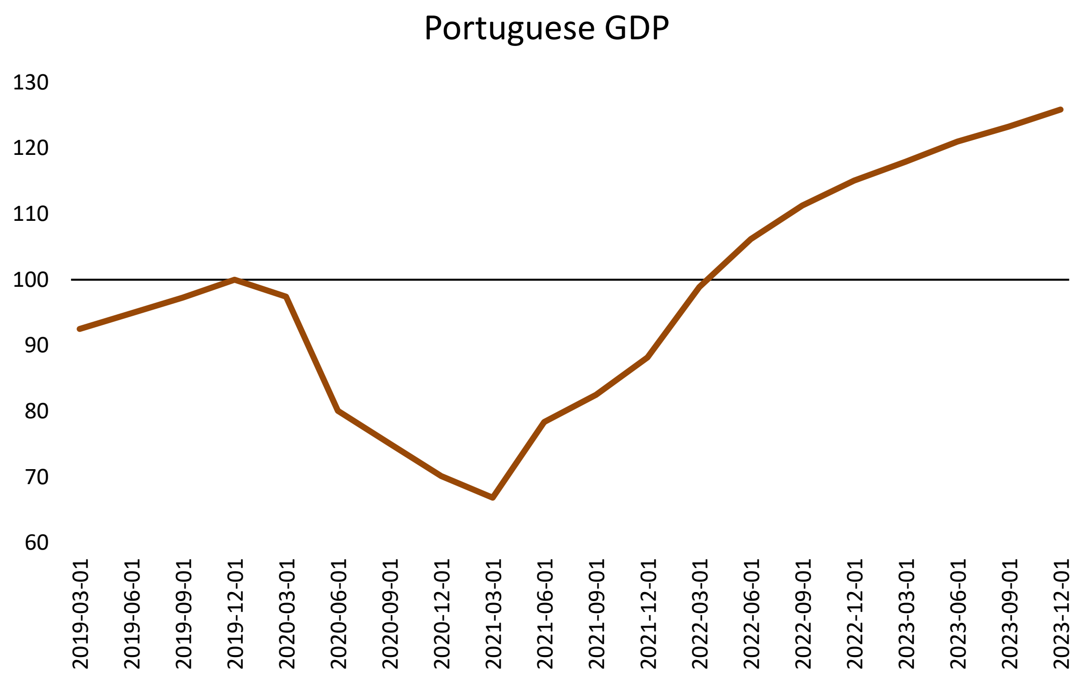
- Economic recession

- Increase of public expenditure leading to further increase of debt (when indebtedness was already very high)

- Despite a subsequent recovery, growth could likely remain subdued for many years

- Lack of structural reforms continue to undermine recovery and long-term growth prospects

- But Portuguese GDP caught up and surpassed pre-pandemic levels.



Index: 2019Q4=100
Source: INE

And now Inflation…

- Price increases somewhat eased during 2023, particularly in energy and food prices. Inflation will likely be close to 2% in 2025;

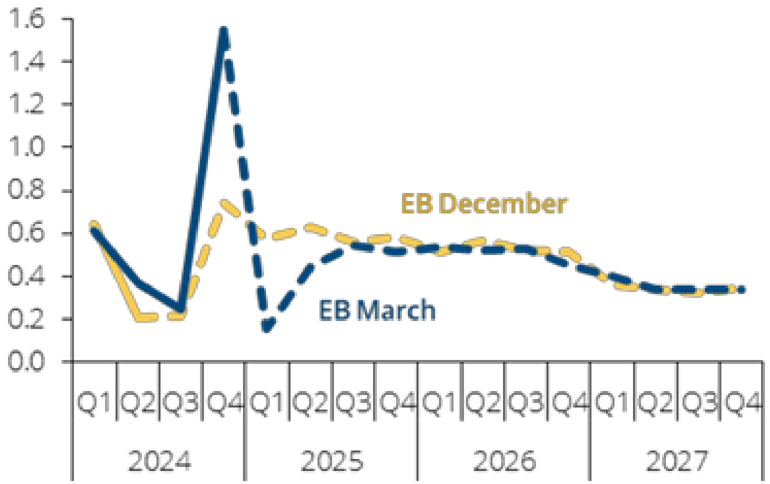
- The Portuguese economy will grow in a sustained manner (but at a low rate), benefiting from EU fund inflows and tourism;

- The rise in interest rates will help curb price increases and thus protect households' purchasing power;

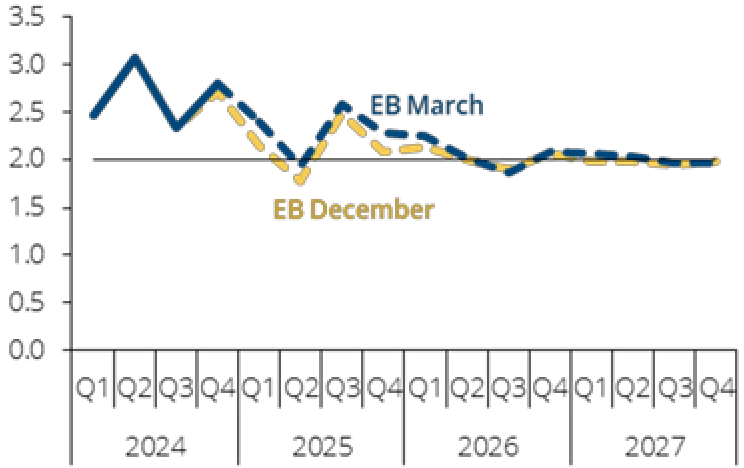
- Inflation is having a positive contribution to reduce public debt. By 2023, the debt-to-GDP ratio was already below 100%;

- Recent financial market events and persisting geopolitical tensions make the economic outlook more uncertain.

Panel A – GDP – quarter-on-quarter rate of change | Percentage



Panel B – HICP – Year-on-year rate of change | Percentage



Source: https://www.bportugal.pt/en/publicacao/economic-bulletin-march-2025