



# PORTUGAL

October 2024

## 2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PORTUGAL

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Portugal, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 25, 2024, consideration of the staff report that concluded the Article IV consultation with Portugal.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 25, 2024, following discussions that ended on June 28, 2024, with the officials of Portugal on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 6, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Portugal.

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**International Monetary Fund**  
**Washington, D.C.**



## IMF Executive Board Concludes 2024 Article IV Consultation with Portugal

FOR IMMEDIATE RELEASE

**Washington, DC – October 2, 2024:** On September 25, 2024, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Portugal.<sup>1</sup>

Portugal recovered strongly from the successive shocks that hit the global economy since the pandemic. Growth in 2023 continued to exceed the euro area average, driven by strong private consumption, net exports, and investment supported by EU funds. Increasing labor force participation and net positive migration led to higher hours worked while unemployment remains at historically low levels. Inflation has decelerated fast. A large fiscal surplus was achieved in 2023, and public debt was reduced to 99 percent of GDP—a remarkable 36 percentage points of GDP since 2020. The external position strengthened, supported by vigorous exports including tourism, EU funds, and improved terms of trade. Financial stability indicators improved, reflecting a reduction in systemic risks. Growth is projected to remain robust in the near term, and inflation is projected to decelerate further. However, low productivity growth, population aging, and subdued investment remain constraints to higher growth and better living standards over the medium term.

### Executive Board Assessment<sup>2</sup>

Executive Directors commended Portugal's remarkable recovery from successive shocks, with economic growth exceeding its pre-Covid trend and euro area growth, while public debt was impressively reduced. Nevertheless, Portugal still faces long-standing structural issues from demographic pressures, insufficient investment, and subdued productivity that constrain potential growth. Directors encouraged the authorities to maintain prudent fiscal policy, closely monitor risks in the financial sector, and promote greater productivity and green transition, including through continued leveraging of EU funds.

Directors agreed that the targeted small fiscal surpluses, combined with the ECB's gradual monetary policy loosening, are appropriate to achieve a soft landing of the economy, while a neutral fiscal stance over the medium term would further reduce debt and rebuild fiscal buffers. Careful calibration of the new tax cuts and spending increases, complemented as needed by offsetting measures, will be important. Directors considered that a comprehensive tax reform to simplify the tax system and reduce tax expenditure could generate significant

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

<sup>2</sup> At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.

fiscal space for higher public investment. They also underscored the importance of improving spending efficiency and addressing aging-related spending pressures.

Directors welcomed the decline of systemic financial risks, while calling for continued vigilance, particularly regarding risks stemming from the real estate sector. They encouraged the authorities to stand ready to recalibrate their macroprudential tools as needed. As high interest rates strained borrowers' repayment capacity, Directors welcomed the introduction of sectoral systemic risk buffer for household loans secured by residential properties. They encouraged the authorities to consider introducing a positive neutral countercyclical capital buffer to further strengthen financial stability in potential downturns. Further improvements to the AML/CFT framework will be critical to safeguard the integrity of the financial system.

Directors stressed that reforms are needed to increase productivity and promote a faster income convergence with the euro area. They emphasized that product market reforms, including streamlining regulations at all levels of government, reforms for a more flexible labor market, digitalization, and upskilling the labor force remain key. Directors appreciated the authorities' ambitious targets for the green transition, which could be achieved by continued progress toward carbon tax adjustments, further reducing fuel subsidies, and the planned broadening of the EU emission trading system coverage.

<b>Table 1. Portugal: Selected Economic Indicators</b> (Percent, year-over-year, unless otherwise indicated)			
	Projections		
	2022	2023	2024
Real GDP	6.8	2.3	1.9
Private consumption	5.6	1.6	1.7
Public consumption	1.4	1.0	2.1
Gross fixed investment	3.0	2.6	3.5
Exports	17.4	4.1	2.8
Imports	11.1	2.2	3.3
Contribution to Growth			
Total domestic demand	4.5	1.4	2.1
Foreign balance	2.3	0.9	-0.2
Resource utilization			
Employment	1.7	0.9	1.0
Unemployment rate (percent, average)	6.2	6.6	6.5
Prices			
GDP deflator	5.0	7.1	2.8
Consumer prices (HICP)	8.1	5.3	2.5
Fiscal indicators (percent of GDP)			
General government balance	-0.3	1.2	0.2
Primary government balance	1.5	3.1	2.2
General government debt	112.4	99.1	94.4
Current account balance	-1.1	1.4	2.0
Nominal GDP (billions of Euros)	242.3	265.5	278.1
Sources: BdP, Eurostat, INE, Haver Analytics, Portugal's Ministry of Finance, and IMF staff calculations/projections.			





# PORTUGAL

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

September 6, 2024

### KEY ISSUES

**Context.** Portugal achieved a remarkable recovery from the successive shocks that hit the global economy since the pandemic. Growth exceeded the euro area (EA) average. Inflation decelerated fast. The fiscal position improved substantially, achieving a large surplus in 2023 and an impressive public debt reduction by 36 percentage points of GDP since 2020 to 99 percent of GDP. The external position strengthened, buoyed by vigorous exports including tourism, EU funds, and, more recently, better terms of trade. Financial stability indicators improved, reflecting a reduction in systemic risks. At this juncture, a soft landing is within reach. However, subdued productivity growth, population aging, and low investment remain key constraints to higher medium-term growth and better living standards.

#### Policy Recommendations

**Fiscal Policy.** An expansionary fiscal stance in 2024 followed by a neutral stance thereafter, consistent with small surpluses throughout the short and medium terms as targeted by the government, will help achieve a soft landing of the economy, reduce debt, rebuild buffers, and lower vulnerability to changes in market sentiment. The impact of new expansionary measures should be offset to durably meet the targets. The fiscal composition should be reoriented toward more public investment. Space can be achieved by reducing tax expenditures, resuming carbon tax adjustments, increasing public sector efficiency, and containing pressures from aging and public wages.

**Financial Sector Policies.** As the banking sector rebuilt buffers, systemic risks decreased and are now moderate. Still, continued vigilance, notably on risks from the real estate market, is needed. The introduction of a sectoral systemic risk buffer for household loans secured by housing properties is welcome. Depending on the evolution of risks in the residential real estate sector, as well as broader macro-financial risks, the authorities should be ready to adjust the stance of macroprudential policies. The introduction of a positive neutral countercyclical capital buffer could be considered.

**Productivity-Enhancing Reforms.** Product market reforms, including to streamline bureaucracy, greater labor market flexibility, efforts to upskill the workforce, digitalization, and the green transition remain key priorities to raise productivity and potential growth. Steady implementation of the recovery and resilience plan (RRP), which covers most of these areas, is critical.

Approved By  
**Oya Celasun (EUR)**  
**and Anna Ivanova**  
**(SPR)**

The mission took place in Lisbon during June 17-28, 2024. The team (all EUR) comprised Mr. Jean-François Dauphin (head), Ms. Gohar Minasyan, Mr. Ippei Shibata, and Ms. Hannah Winterberg (remotely). Mr. Paul Tershakovec and Ms. Sharon Smith-Tohu (both EUR) supported the mission from headquarters. Ms. Ana Rita Mateus (OED) joined the mission meetings. Mr. Federico Giammusso (OED) joined the concluding meetings. The mission met with Mr. Joaquim Miranda Sarmento (Minister of State and Finance), Mr. Mario Centeno (Governor of Banco de Portugal), Mr. José Maria Brandão de Brito (Deputy Minister and Secretary of State for the Budget), Ms. Marisa Garrido (Secretary of State for Public Administration), Ms. Cláudia Reis Duarte (Secretary of State for Tax Affairs), Mr. Hélder Reis (Secretary of State for Planning and Regional Development), other senior officials, and representatives of the private sector, trade unions, banking community, and civil society.

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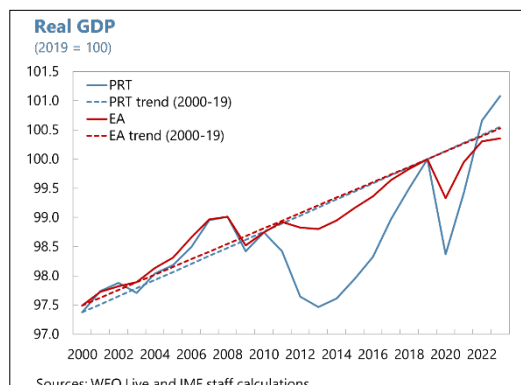
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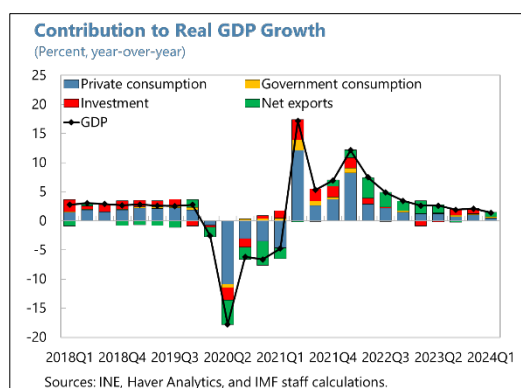
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## RECENT DEVELOPMENTS

**1. Portugal recovered strongly from successive shocks.** The economy grew by 5.9 percent cumulatively during 2019-23, exceeding its pre-covid trend and euro area (EA) growth (3.3 percent). This performance was largely driven by private consumption boosted by excess savings accumulated during the pandemic and a resilient labor market, strong net exports of services including tourism, and investment under the RRP.

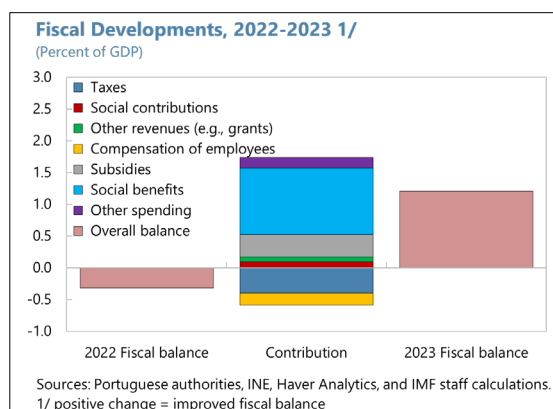


**2. Growth moderated in 2023, while inflation decelerated** (Figure 1). Tighter financial conditions weighed on the economy, including private investment, and growth fell to 2.3 percent in 2023 from 6.8 percent in 2022. In 2024Q2, growth was at 1.5 percent y/y. Headline inflation decelerated to 1.9 percent y/y in December 2023 from a peak of 10.6 percent in October 2022. After a transitory bump in May 2024 mostly due to base effects (a temporary reduction of VAT for basic food items was introduced in May 2023) and the impact on service prices of a large cultural event, it returned to 1.8 percent in August 2024. Core inflation also decelerated, to 2.6 percent y/y in July 2024 from a peak of 8.2 percent in April 2023.

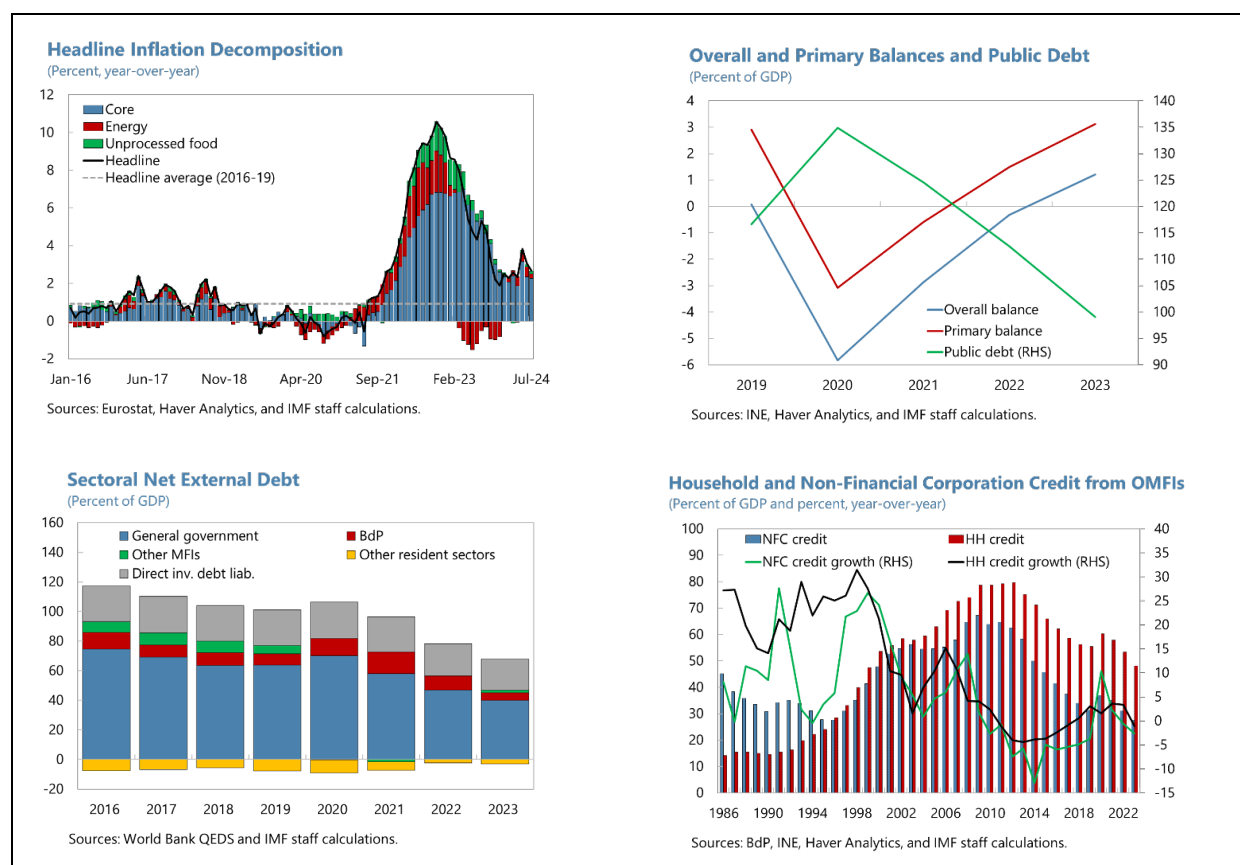


**3. The labor market remained resilient and tight, and real wages continued growing.** Total hours worked continued rising, bolstered by a sustained increase in labor force participation and net migration inflows. With the unemployment rate remaining at historically-low levels, the labor market remained tight, contributing to real wages growth (Figure 2).

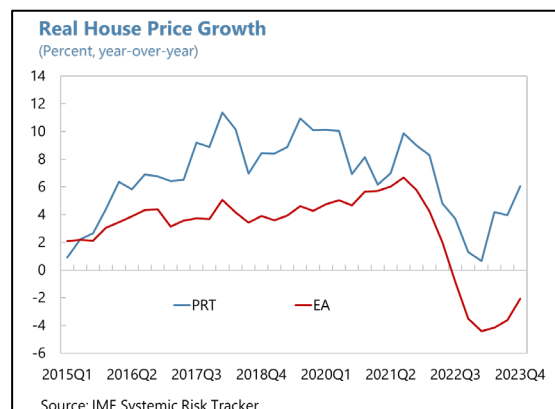
**4. The fiscal position strengthened significantly in 2023, comparing favorably to the EA** (Figure 3). The fiscal balance recorded a surplus of 1.2 percent of GDP in 2023 (EA average: -3.4 percent of GDP) up from -0.3 percent of GDP in 2022. This was supported by a decline in social benefits (one percentage points (ppt) of GDP) and subsidies (0.4 ppt of GDP) as COVID-19 measures were fully withdrawn and the cost-of-living support was reduced. Driven by growth, inflation, and a large primary surplus, public debt fell from a peak of 135 percent in 2020 to 99 percent of GDP in 2023. It now stands close to the 75<sup>th</sup> percentile of public debt levels in EA.



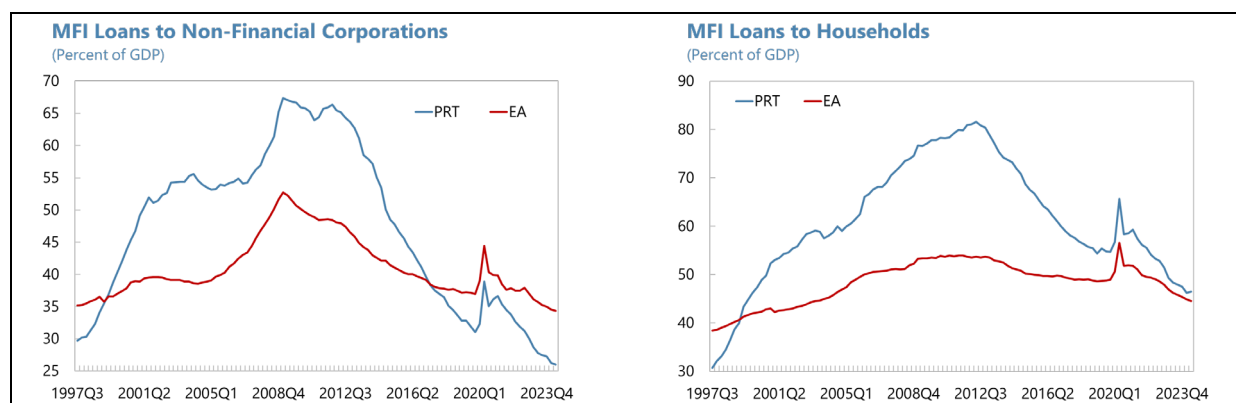
**5. The external position improved substantially and was assessed to be moderately stronger than implied by medium-term fundamentals and desirable policies in 2023** (Annex I). The current account improved from -1.1 percent of GDP in 2022 to a surplus of 1.4 percent of GDP in 2023, driven by a 20 percent increase in tourism-related revenues, as well as improved terms of trade and EU transfers. The net international investment position (NIIP)-to-GDP ratio increased from -84 percent in 2022 to -73 percent in 2023, and continued to improve in 2024, supported by improvements of most of its components (Figure 4).



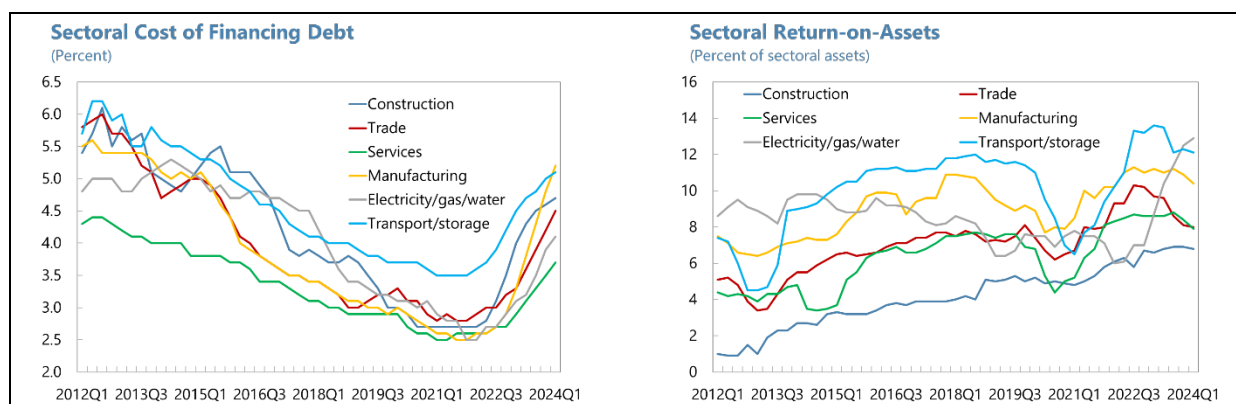
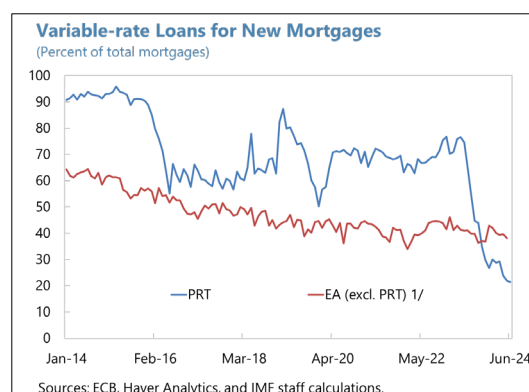
**6. Housing prices continued to rise, further deteriorating housing affordability.** Prices increased by 111 percent from 2015 to 2023Q4, significantly more than the EA average of 42 percent. In 2023, while housing prices started decreasing in real terms in most EA countries (by 3.6 percent on average), they rose further in Portugal (by 3.7 percent). In addition to residents' demand, this increase likely reflected the demand for high-end units through Portugal's golden visa program, and the conversion of dwelling units into



short-term touristic rentals, while supply remained unresponsive to price signals.<sup>1</sup> As a result, a median-income household no longer qualifies for a mortgage loan to purchase an average-priced home since 2023 (Annex II).

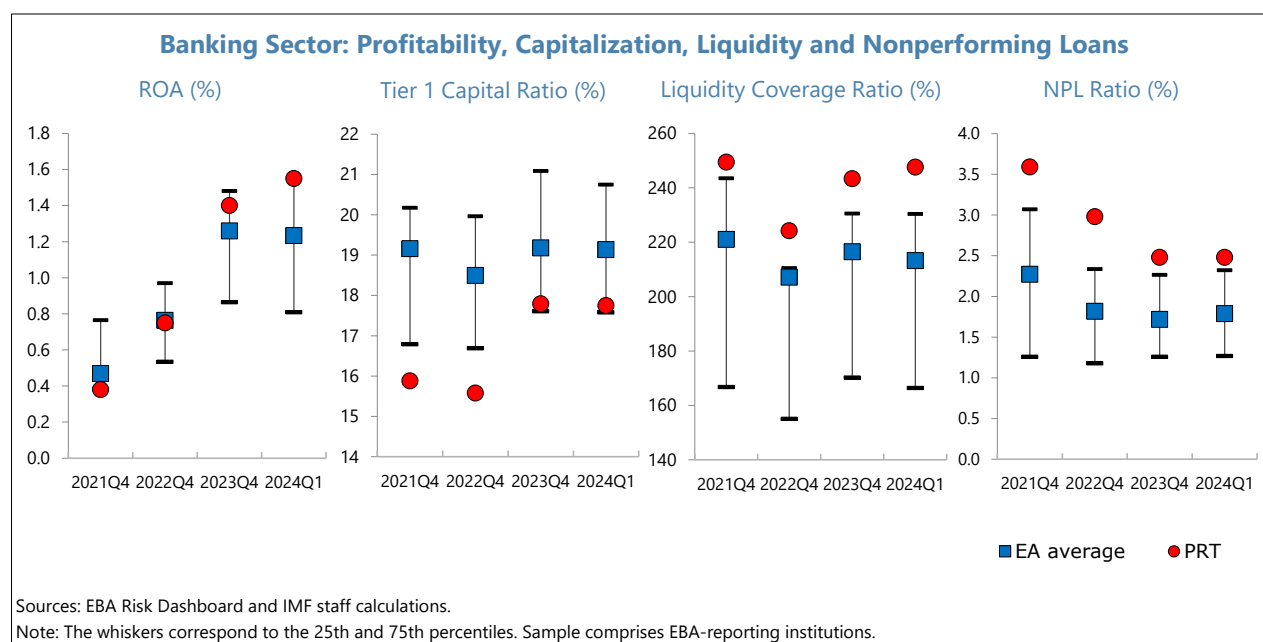


**7. Tight financial conditions reduced real credit flow and strained borrowers' repayment capacity** (Figure 5). Reflecting lower demand, credit to non-financial corporations (NFCs) and households contracted, respectively by 7 percent and 2.2 percent y/y in 2023Q4 in real terms. The loans-to-GDP ratio of NFCs and households continued to decline from their pre-sovereign debt crisis peaks of 67 and 80 respectively, to 29 and 50 in 2023, below or close to EA peers. As higher interest rates weighed on households' mortgage costs, many households opted to convert their mortgages from variable rates to mixed-rate contracts (fixed for a few years, then variable); still, the overall stock of mortgage loans remains mostly at variable rates. The cost of financing debt also increased sharply for NFCs, although their profitability remains historically high.



<sup>1</sup> Non-resident residential real estate buyers accounted for 8 percent of transactions and 13 percent of their values in 2023 (BdP, 2024).

**8. The banking sector's stability metrics improved considerably** (Figure 6). The fast pass-through of policy to loan interest rates and a slower adjustment in deposit rates led to soaring profits and higher capitalization of banks. The return on assets (ROA) reached 1.4 percent in 2024Q1, up from 0.7 percent in 2022Q4, and the common-equity tier 1 (CET1) capital ratio increased to 17.1 percent from 15.4 percent. Consequently, several large banks saw their ratings improve, some by multiple notches. The stock of nonperforming loans (NPLs) continued to decline, reaching 2.7 percent of total assets in 2023Q4 from 3.0 percent in 2022Q4, while their provisioning increased.



## OUTLOOK AND RISKS

**9. A soft-landing is within reach.** Growth is projected to slow but remain robust at 1.9 percent in 2024, reflecting weak external demand while domestic demand would be supported by a tight labor market and expansionary fiscal policies. As financial conditions ease, growth is projected to increase to 2.3 percent in 2025. Headline inflation is expected to decelerate to 2.5 percent on average in 2024 and reach about 2 percent by end-2025. Although receding, core inflation may be stickier due to positive real wage growth and is projected to reach 2.8 percent and 2.3 percent on average in 2024 and 2025, respectively.

**10. Long-standing challenges from an aging population and relatively low public investment and productivity weigh on the medium-term outlook.** Large positive net migration has more than mitigated a shrinking domestic working-age population, resulting in a positive working-age population growth in 2023. However, the rapidly aging population remains an issue as working-age population is projected to decline faster than the EA average ([Ageing Report 2024](#), Figure 9). Moreover, despite recent increases supported by RRP funds, public investment and

productivity have been lower than in most EA countries. Growth is thus projected to slow to 1.9 percent over the medium term.

**11. The current account is expected to remain in surplus, although narrowing over the medium term.** The current account is expected to improve further, to 2.0 percent of GDP in 2024, mostly due to expected higher EU transfers. Over the medium term, strong exports, particularly of services, are expected to continue supporting current account surpluses of about 1½ percent of GDP and sustained improvement in the NIIP.

**12. Risks to the outlook are broadly balanced** (Annex III). Escalation of geopolitical tensions could further impact the macro-financial environment through higher commodity prices, further economic fragmentation, and lower external demand. Monetary policy could either hinder disinflation if loosened prematurely or cause a hard landing if kept tight for longer than warranted. Lower-than-expected global growth could dampen tourism. Domestically, a new center-right minority government was formed in April 2024 following snap elections, but its lack of parliamentary majority may hamper policymaking and increase uncertainty. Upside risks to inflation may come from stickier-than-expected core inflation, notably if wage growth continues to outpace productivity growth. Slow implementation of the RRP may lead to lower medium-term growth. Conversely, faster-than-expected easing of financial conditions with inflation falling faster to target may boost private consumption and investment. Labor market resilience and tourism momentum are also mitigating downside risks.

### **Authorities' Views**

**13. The authorities broadly shared staff's assessment of the outlook and risks, albeit with somewhat different views on the medium-term outlook.** They expected growth in 2024 to remain robust, driven by continued exports growth, accelerated absorption of RRP funds, and resilient private consumption. They agreed that headline inflation would continue decelerating to around 2 percent in 2025 despite the temporary pickup in May 2024 and expect core inflation to remain stickier amid tight labor markets. The government believes that medium-term growth could be somewhat higher than projected by the staff. The authorities noted that recent wage growth reflected an improved skill mix and will be beneficial for retaining skills in the economy. Views on risks and the external sector assessment were broadly aligned.

## **POLICY DISCUSSIONS**

*In the near term, fiscal policy should be consistent with a policy mix that helps achieve a soft landing and further lower debt. Over the medium term, a sustained reduction of public debt remains a priority. It should be supported by a comprehensive tax reform, measures to contain pressures from aging, and greater spending efficiency, which would also help make space for more productivity-enhancing investment to raise potential growth. Financial sector policies should focus on further strengthening buffers and remain vigilant on potential systemic risks, notably from the real estate market. Reforms remain critical to increase productivity, potential growth, and income levels.*



## A. Fiscal Policy

**14. The government appropriately targets small fiscal surpluses in 2024–25, which will help achieve a soft landing and further debt reduction.** In 2023, higher-than-expected tax revenues and lower-than-expected cost-of-living support measures resulted in an unexpected large fiscal contraction, with the cyclically-adjusted primary balance (CAPB) increasing by 1.8 ppt of GDP to 2.2 percent of GDP. This enabled a fast debt reduction and supported monetary policy in curbing inflation more rapidly than in other EA countries. At this juncture, fiscal policy needs to balance ensuring the deceleration of inflation toward target and not further dampening growth. The government's 2024 fiscal target would lead to an expansionary fiscal stance, with a projected 0.6 ppt of GDP decline in the CAPB. Considering the significant decline in inflation from its peak, the high pass-through of still-tight monetary policy, slowing growth, and the lag effect of the contractionary stance of 2023, this stance is broadly appropriate. It should not be further loosened considering positive real wage growth, upside risks to inflation, and the expected gradual loosening of ECB's monetary policy, as well as the need to keep reducing debt. A soft landing of the economy could then be achieved with a neutral stance in 2025, consistent with a small positive overall balance, which would also further reduce debt.

**15. Temporarily-stronger revenue performance will likely help achieve fiscal targets, but new tax reductions and wage and pension increases need to be carefully calibrated.** The 2024 budget,

adopted by the previous government, included personal income tax (PIT) cuts for middle-income and young workers (0.6 percent of GDP), corporate income tax (CIT) incentives to promote investment and innovation (0.1 percent of GDP), and pension and public wage

increases to support disposable income (1.4 percent of GDP); this was partly offset by the withdrawal of cost-of-living measures (0.8 percent of GDP). The new government announced further tax cuts and current expenditure increases. Parliament approved in June additional PIT tax cuts (0.14 percent of GDP). Aiming to retain talents in the country, the government plans to replace the PIT tax cuts for youth included in the 2024 budget with a more costly preferential PIT flat rate for people up to

Fiscal Measures, 2024 (Percent of GDP)			
	2024 Budget	New Measures 1/	Total
Total measures	2.2	0.4	2.6
Revenue	-0.4	-0.1	-0.6
VAT (incl. VAT reduction termination in food items)	0.1		0.1
ISP (incl. carbon tax and ISP reduction suspension)	0.1		0.1
Other indirect taxes	0.1		0.1
Personal income tax (PIT)	-0.6	-0.1	-0.7
PIT for the young	-0.1		-0.1
PIT reform (rate reduction and level updates, etc.)	-0.5	-0.1	-0.6
Other housing and rent fiscal measures package	-0.1	-0.01	-0.1
Corporate income tax (CIT)	-0.1		-0.1
Expenditure	1.8	0.2	2.0
Personal expenditure (incl. salary increase, progression, and promotion)	0.6	0.01	0.6
Social benefits	1.1	0.1	1.3
Pensions (regular update and other measures)	0.8	0.1	0.9
Other	0.3		0.3
Other expenditure	0.1	0.1	0.2
Interest subsidy	0.02		0.02
Other	0.1		0.1
Public expenditure review	-0.04		-0.04

Sources: Portugal's 2024 budget, Portuguese authorities, and IMF staff calculations.

1/ Staff's estimate is preliminary as the calibration and the implementation date have not been decided for all measures.

35 years old, starting in 2025.<sup>2</sup> It announced a PIT flat tax rate for foreigners of 20 percent (not applying to pensions and dividends) to attract qualified foreign professionals and companies. It plans a CIT tax rate reduction by 6 ppts to 15 percent over three years by 2027 and, for small and medium-sized enterprises, from 17 percent to 12.5 percent, as well as tax reductions for R&D to boost investment and innovation. Wages for teachers are now set to increase to compensate for previous salary and promotion freezes, and wage increases were also granted to armed forces, and are being negotiated in other professions. The government also relaxed the eligibility criteria for the minimum income for pensioners so they can receive the minimum income irrespective of income of their adult children. Staff estimates that the targeted fiscal surpluses are likely to be achieved in 2024 and 2025, in part owing to the cyclical increase in revenue, notably CIT from banks that registered exceptionally-high profits in 2023–24.<sup>3</sup>

**16. Over the medium term, a prudent fiscal policy, backed by offsets of recent expansionary measures, remains key to public debt reduction while fiscal composition should become more growth-friendly**

(Annex IV). A broadly neutral fiscal stance, with continued small fiscal surpluses over the medium term, as intended by the government, is appropriate. It would ensure a sustained debt reduction, with debt reaching 60 percent of GDP within 15 years, thereby rebuilding buffers for contingency risks and reducing vulnerability to changes in market sentiments. Yet, given the permanent negative impact of some of the revenue and expenditure measures decided in 2024, additional offsetting measures will be needed to achieve the targets and create additional space for growth-enhancing investment in infrastructure and human capital. These should include a comprehensive tax reform that would also reduce distortions and measures to address pressures from aging and increase spending efficiency. A more favorable fiscal composition toward public investment would also result in a faster debt reduction by boosting growth.

Potential Impact of Selected Recommended Fiscal Measures (Percent of GDP)	
	Yield per year
1. Lowering tax expenditure policy gap to EA average 1/	0.27-0.56
2. Controlling wage pressure 2/	0.05
3. Bringing property tax to OECD Average 3/	0-0.06
4. Carbon price reform 4/	0.23 - 0.27
Sources: European Commission, GTAP, and IMF staff estimates.	
1/ Direct cross-country comparisons of the value of tax expenditures need to be interpreted with caution. Tax expenditures are departures from country-specific benchmark tax systems and their aggregation can result in over- or underestimation.	
2/ Measures to bring wage spending to pre-COVID period.	
3/ Measures to bring property tax revenue to 2022 OECD average (1.8 percent of GDP).	
4/ See 2022 PRT selected issues paper, "Reducing Greenhouse Gas Emission in Portugal: the Road Ahead" for details.	

**17. Tax measures should be designed within a comprehensive tax reform aiming at simplifying the system and significantly reducing exemptions.**

- **PIT** revenue and its average rate are below the EA average ([BdP, 2023](#)). Considering investment and debt reduction needs, PIT revenue should not fall further. While adjustments in progressiveness may achieve redistribution objectives, greater use of means-tested social spending could be considered to reduce inequality, as its contribution to fiscal redistribution in

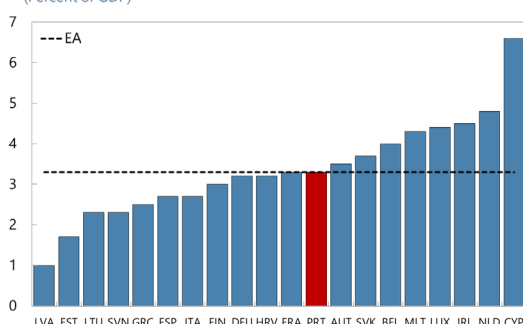
<sup>2</sup>The PIT tax reduction for youth introduced in the 2024 budget allows people between 18 and 26 years old with qualifications to receive exemptions that gradually phase out over five years.

<sup>3</sup> Corporate income tax revenue increased 35 percent in Jan-July 2024 compared to the same period in 2023.

Portugal is below that of EA peers. Age-based preferential tax rates are costly and raise threshold and equity issues while their effectiveness in curbing emigration is uncertain. Reintroducing preferential tax rates for foreign professionals may attract additional skilled workers but will further distort the tax system and may exacerbate housing affordability issues.

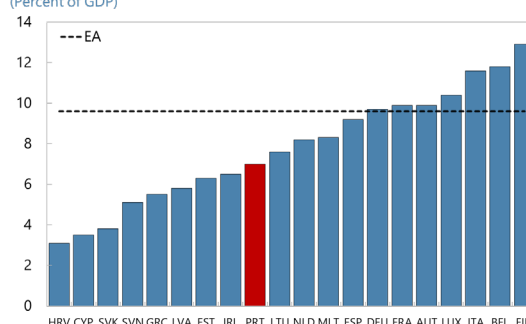
- While **CIT** revenue is broadly at the EA average, its combined statutory tax rate is higher than in EA peers. Instead of reducing the base rate, priority should be given to reducing progressive and local surcharges, which would help align the average CIT rate with the EA average while encouraging corporate growth.
- **Tax expenditure** has been increasing in recent years, exceeding 6 percent of GDP in 2023. In this context, the new tax unit, “U-TAX”, created in February 2024, is welcome; it is expected to conduct a comprehensive assessment of existing tax benefits by end-2025.
- Over the medium term, as housing affordability concerns subside, a **property tax** increase could be considered to raise its revenue closer to the OECD average.
- The **carbon tax adjustment mechanism**, which was suspended in September 2023, should resume.

**Corporate Income Tax Revenue, 2022**  
(Percent of GDP)



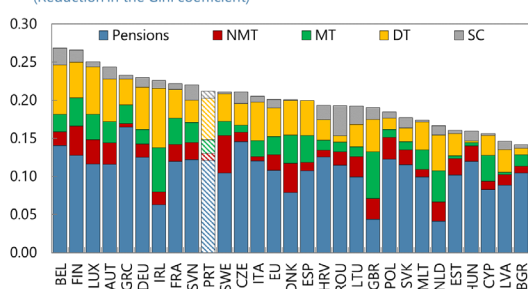
Source: Eurostat.

**Personal Income Tax Revenue, 2022**  
(Percent of GDP)



Source: Eurostat.

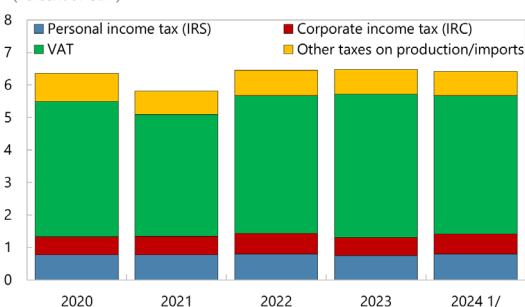
**Fiscal Redistribution by Instrument, 2020 1/**  
(Reduction in the Gini coefficient)



Sources: Euromod and IMF staff calculations.

1/ SC = social Contributions, DT = direct taxes, MT = means-tested social spending, and NMT = non-means-tested social spending

**Tax Expenditure Composition**  
(Percent of GDP)



Sources: Portuguese authorities and IMF staff calculations.

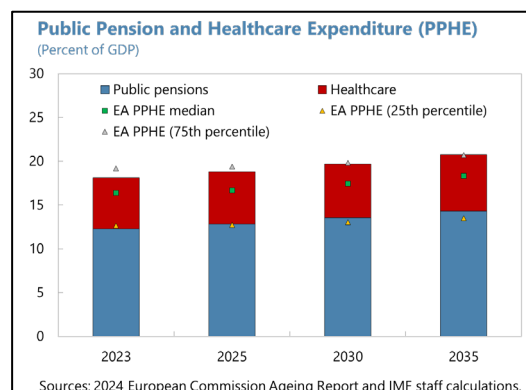
1/ projected

**18. An increase in public investment in infrastructure and human capital would enhance growth prospects.** Public investment is below the EA average notwithstanding a faster RRP execution than in most EU countries (Figure 3). Increasing investment, notably through the full utilization of RRP funds, will be critical for the green and digital transitions and a more sustainable and resilient economy ([Shibata, 2023](#)).

**19. Containing rising aging-related spending pressures remains a priority.** Pension and health spending is projected to increase by 0.14 and 0.04 ppts of GDP annually over 2025-30 (EA median: 0.06 and 0.02 ppts of GDP, respectively) ([Ageing Report 2024](#)).

Further adjustments to the pension system, including linking the minimum age of early retirement to life expectancy, would help mitigate rising pressures ([IMF 2022](#); [IMF, 2023](#); [OECD, 2021](#); [OECD, 2023](#)). The

ongoing update of the “green book” that assesses the pension system can inform further reforms. The National Health System (NHS) remained in deficit in 2023 from rising costs of wages, medicines, and medical services, requiring budgetary transfers.<sup>4</sup> Reforms to improve NHS’ transparency, monitoring, and governance, with more accountable and performance-oriented management (8. OECD, 2023) could make space for rising needs.



**20. Greater public sector efficiency would strengthen fiscal sustainability.** A comprehensive review of public employment and the compensation structure could help contain the wage bill growth. The integration of spending reviews into the budgetary process and the recent enhancements of the information system are welcome and should continue, while the 2015 Budgetary Framework Law needs to be fully implemented (now slated for 2026) to improve spending efficiency. A public investment management assessment (PIMA) could be considered to inform measures to increase investment efficiency. The fiscal council could take a greater role in supervising efficiency improvements and assessing fiscal risks and fiscal sustainability. Efforts to strengthen the financial situation of state-owned enterprises (SOEs) should continue, along with the planned privatization of the national airline company. Safeguards on the use of public-private partnerships should be strengthened to promote a robust assessment of contingent liabilities and appropriate sharing of risks and benefits.

### **Authorities’ Views**

**21. The authorities emphasized their commitment to continuing debt reduction and maintaining small fiscal surpluses in 2024 and beyond.** They highlighted that the primary goal of their fiscal measures, including CIT reductions, preferential tax rates for youth and foreign skilled workers, is to boost productivity by promoting investment by firms and retaining and attracting

<sup>4</sup> A preliminary estimate of the loss is 0.16 percent of GDP in 2023, compared with 0.5 percent of GDP in 2022.

skilled talent. They believe that for youth, this will help retain a young skilled labor force because emigration becomes more difficult as people settle in their life, often with a family and home ownership. They noted that reducing CIT surcharges may not be feasible at this stage, while agreeing with staff's view on the positive economic impact it would have on corporate growth. They do not plan at this stage to engage in pension reform. The authorities believe that higher productivity growth, higher tax revenues from higher corporate profits, the reversal of energy tax reductions, and some increase in carbon taxation should be sufficient to meet the fiscal targets, even in the medium term.

**22. The authorities also highlighted their fiscal reform efforts.** They noted that the new tax unit's assessment of the tax system will guide a reduction of tax expenditures. They stressed their recent efforts toward the full implementation of Budgetary Framework Law, including the integration of spending reviews into the regular budgetary process, the ongoing upgrade of the information system, green budgeting, the recent enhancements of the treasury management system, and the implementation of new accounting reforms. Enhancing governance, financial performance, and efficiency of SOEs, including NHS, remains a key fiscal priority.

## B. Financial Sector Policies

**23. Systemic risks have declined and appear moderate at this stage.** The improvement in banking sector stability indicators reflects a welcome buildup of financial buffers. Still, Portugal's capital adequacy and asset quality indicators are lower than those of most EA peers, indicating room for improvement. The contraction in real credit to the private sector prolonged the long-trend deleveraging of the economy. Risks from the bank-sovereign nexus also fell as the fiscal deficit turned into surplus and debt levels declined. Furthermore, structural features of the Portuguese banking sector help reduce vulnerabilities, including the reliance on a traditional deposit-based business model with a share of non-deposit funding at about half of the EA average, the stable size and concentration of the sector in recent years, and the relatively low interconnectedness of banks (Figure 7). The non-bank financial sector remains small, with total nonbank financial institutions (NBFI) assets amounting to about 10 percent of the banking sector. As some NBFI segments such as investment funds have started to grow from a low base in recent years, improvements in transparency and reporting to relevant regulators are welcome and should continue.

Systemic Risk														
	Household & NFC Vulnerabilities						Housing Cycle		Banking Resilience				Business & Credit Cycle	
	DSTI	Employment Sentiment	NFC loans-to-GDP	Price-To-Rent	Price-to-Income	House Prices Real Growth	NPL	Coverage Ratio	Profits Before Taxes (% of Assets)	CET1	Out Of Which Buffer	Output Gap	Credit-to-GDP gap from trend	HH loans-to-GDP
2014	0.3	104.2	54.18	97.8	99.6	2.3	16.6	37.9	-0.1	11.3	6.8	-6.8	-25.9	73.3
2015	0.2	106.6	47.83	101.6	100.3	4.4	17.5	40.6	0.2	12.4	7.9	-5.1	-36.2	68.7
2016	0.2	108.5	43.43	107.0	103.7	6.8	17.2	45.4	-0.7	11.4	6.9	-3.6	-44.4	64.2
2017	0.2	114.4	38.84	117.5	108.8	8.9	13.3	49.9	0.3	13.9	9.4	-1.1	-45.8	60.2
2018	0.2	114.5	35.54	125.1	113.4	8.4	9.4	52.4	0.6	13.2	8.7	0.3	-47.6	57.3
2019	0.2	111.9	32.68	133.6	119.8	10.1	6.1	51.7	0.7	14.1	9.6	1.4	-45.1	56.2
2020	0.2	103.0	34.59	141.4	138.4	8.1	4.9	55.4	0.2	15.4	10.9	-4.8	-23.1	57.8
2021	0.2	111.3	36.32	154.8	143.3	9.0	3.6	52.6	0.6	15.5	11.0	-2.3	-24.9	59.1
2022Q1	0.2	111.5	34.09	159.6	143.9	8.3	3.6	53.5	0.2	14.9	10.4	1.8	-26.9	56.7
2022Q2	0.2	110.2	33.45	163.4	144.1	4.8	3.4	52.8	0.5	15.0	10.5		-29.8	55.6
2022Q3	0.2	108.6	32.38	166.8	144.7	3.7	3.2	53.7	0.7	14.6	10.1		-31.7	54.7
2022Q4	0.3	108.9	31.04	167.0	142.3	1.3	3.0	55.4	1.0	15.3	10.8		-33.9	53.3
2023Q1	0.3	107.7	29.94	167.1	140.5	0.7	3.1	56.4	0.4	15.6	11.1	1.6	-36.3	51.6
2023Q2	0.3	107.0	29.04	170.0	141.3	4.2	3.1	57.1	0.8	16.4	11.9		-37.4	50.2
2023Q3	0.3	105.8	28.08	171.2	140.7	4.0	2.9	57.0	1.3	16.4	11.9		-36.5	49.0
2023Q4	0.3	106.7	27.57	171.5	140.1	6.0	2.7	56.3	1.8	17.1	12.6		N/A	48.1
Euro area most recent	N/A	100.9	27.0	122.6	110.2	-2.1	1.9	43.0	0.8	16.2	11.7	-2.2	-27.5	37.83

Sources: BIS, FBA risk dashboard, Haver Analytics, OECD, WEO, and IME staff calculations

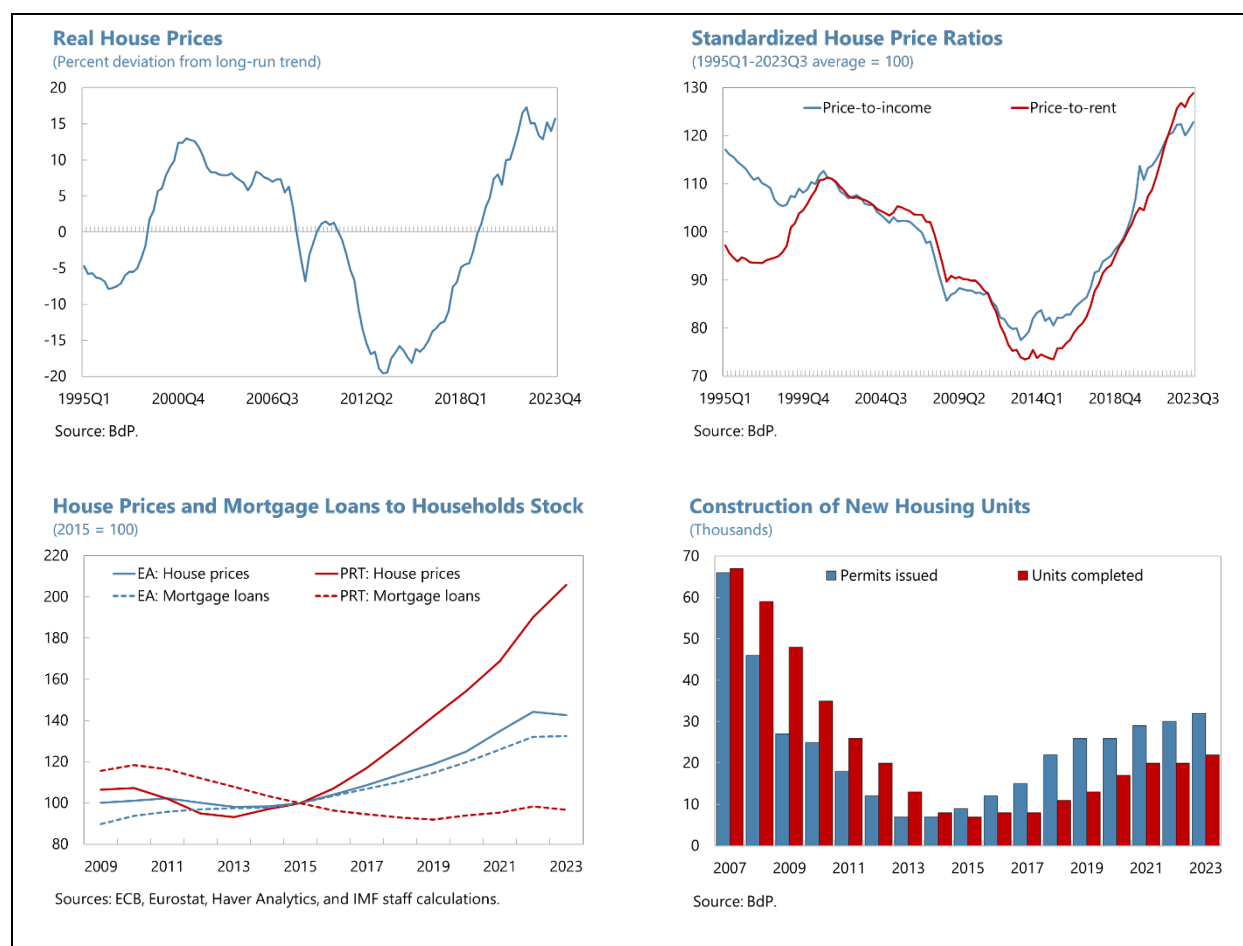
Sources: BIS, EBA risk dashboard, Haver Analytics, OECD, WEO, and IMF staff calculations.

## 24. Continued monitoring of real estate borrower repayment capacity is important.

Households' debt-service-to-income (DSTI) ratios continued to increase without impacting loan impairment. Interest subsidies and easier loan restructurings provided some relief, and the expected monetary loosening will help alleviate pressures on households. Yet, the nonperforming loans ratio for residential real estate (RRE), while falling, remains among the highest in the EA (at 2.5 percent in 2023Q4), as does the share of stage 2 loans (11.9 percent). Also, asset quality may deteriorate as the postponement of principal amortization could have delayed the emergence of vulnerabilities. Banks' exposure to commercial real estate (CRE) loans is relatively small (6.8 percent of total loans) and CRE prices have increased more moderately than for RRE. Nevertheless, the share of NPLs in the CRE sector is the highest in the EA at 8.9 percent (EA average 4.6 percent) and warrants close monitoring.

## 25. Risks of a real estate market correction appear contained, while policies to increase housing supply would help alleviate pressures. Estimates of RRE price overvaluation

range 15– 30 percent.<sup>5</sup> The role of credit in driving the doubling of house prices since 2015 appears limited, as the stock of mortgage loans did not increase concurrently, contrary to the euro area as a whole, where house prices and mortgage loans increased in tandem. Meanwhile, structural constraints in the construction sector seem to have kept housing supply low compared to historical trends. There are now some signs of cooling in the market as the number of RRE transactions started to decline in 2023, and staff expect RRE prices to gradually moderate over the medium term. Still, the end of the “golden visa” program for RRE investments may create tension in the higher end of the market while a sharper price correction could happen should large downside risks to growth materialize. To alleviate real estate market imbalances, the government’s appropriate focus on increasing housing supply will require relaxing construction regulations, repurposing underused public buildings, and fostering public-private partnership for large-scale housing programs.



<sup>5</sup> 15 percent reflects the real house price deviation from long-term trend and 30 percent is based on house price-to-income and price-to-rent ratios relative to average. These estimates may not adequately capture the role of external demand and thus overestimate the overvaluation.

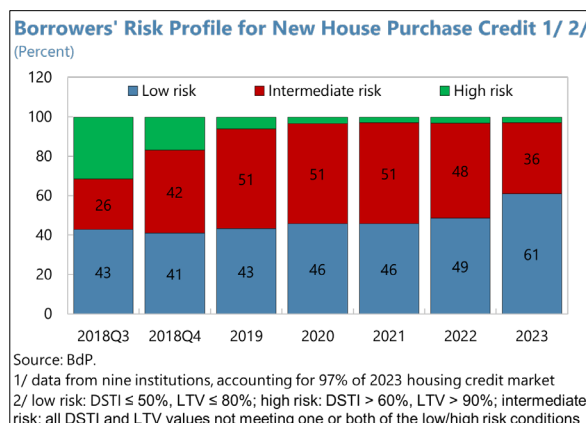


**26. Recent macroprudential policy action to reduce risks related to real estate is welcome while further tightening could be considered if risks do not abate.**

BdP announced the introduction of a sectoral systemic risk buffer (sSyRB) for household loans secured by housing properties (for institutions using the internal ratings-based (IRB) approach), effective October 2024, in line with IMF recommendations (Annex V).

The sSyRB will complement the borrower-based measures in place since 2018, which have helped reduce vulnerabilities by continuously improving

the risk profile of RRE loans. Monitoring the evolution of RRE risks is important to ensure that the calibration of the sSyRB (currently, at 4 percent systemic risk buffer) and borrower-based measures remains adequate. Considering the concentration of systemic risk in the RRE sector, no change to the countercyclical capital buffer (CCyB) appears necessary at this stage. At the same time, given the current comfortable capital position of banks, BdP could consider implementing a positive neutral CCyB to help lock-in banks' temporarily high profits into releasable capital.



**27. Initiatives to contain transnational money laundering risks should continue as discussed in recent staff reports (IMF, 2022; IMF, 2023).** A comprehensive national risk assessment study is underway including the assessment of risks related to legal persons and virtual assets. Continued efforts are required to monitor non-resident deposits in the banking sector and their financial flows, and foreign beneficial ownership as some foreign-direct investment avenues for golden visa programs (e.g., capital and private equity investment and company creation) remain. The AML/CFT framework should be further upgraded, including to ensure timely access to adequate, accurate and up-to-date beneficial ownership information, in line with the revised international standard, and the authorities should continue to leverage AML tools to tackle tax evasion and support domestic revenue mobilization.

### **Authorities' Views**

**28. The authorities highlighted the reduction in vulnerabilities in the financial sector as the deleveraging in the economy continued.** They underlined that banks' capital position improved significantly over the last year and that banks have become a source of stability in the economy. The authorities concurred with the need for continued prudent risk management practices, especially in the areas of credit quality and real estate market risks, in an environment of high global uncertainty. They felt that with low housing supply and pent-up demand, the probability of a sharp fall in house prices was small and therefore assessed financial stability risks from the real estate market as limited. The authorities noted ongoing efforts to further strengthen the AML/CTF framework and their undertaking of a comprehensive national risk assessment.

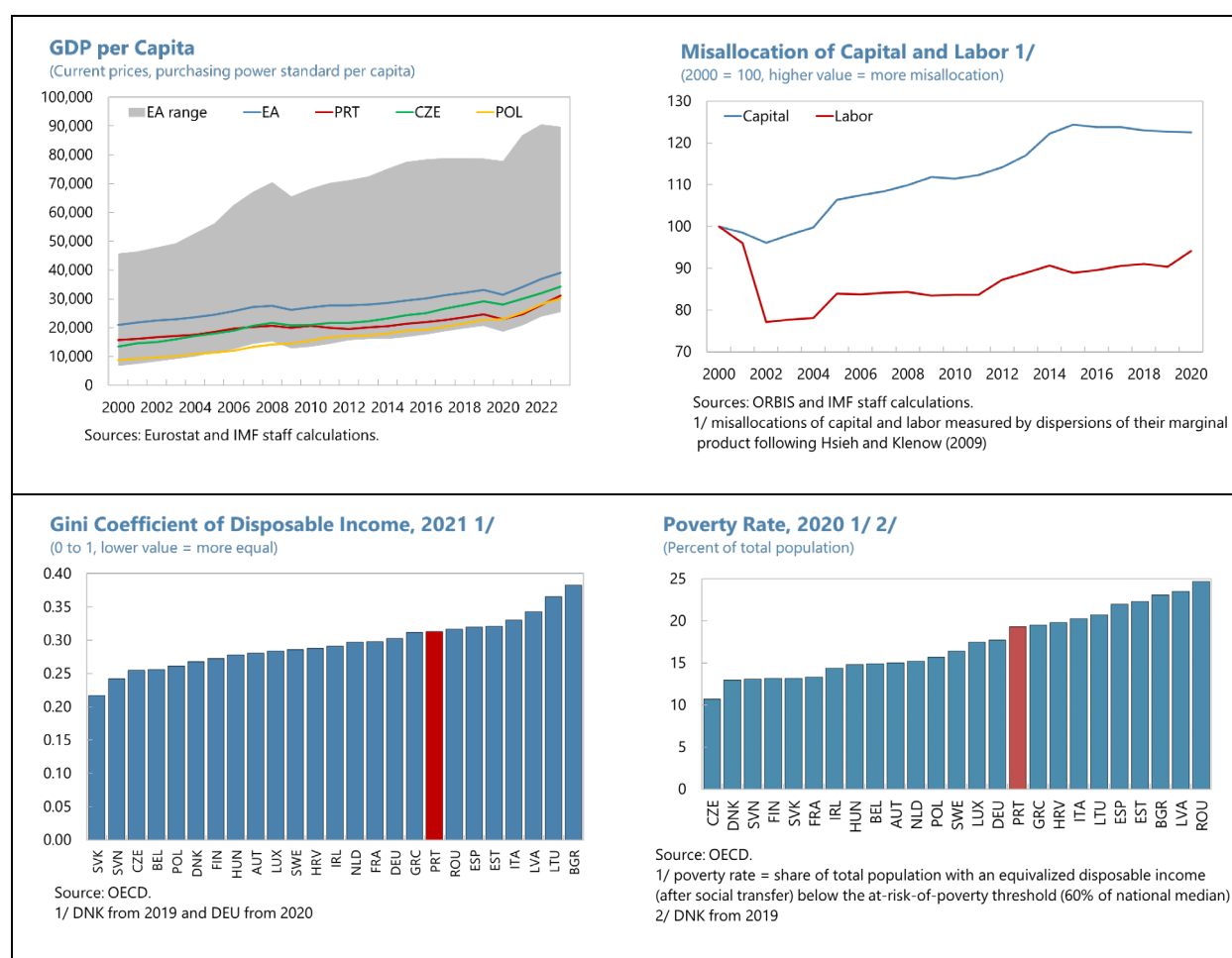
**29. The authorities emphasized the significant recent progress made on macroprudential policy.** They noted that banks' compliance with recommended borrower-based measures reduced the riskiness of their loan portfolio. They assess that the introduction of the sSyRB will further



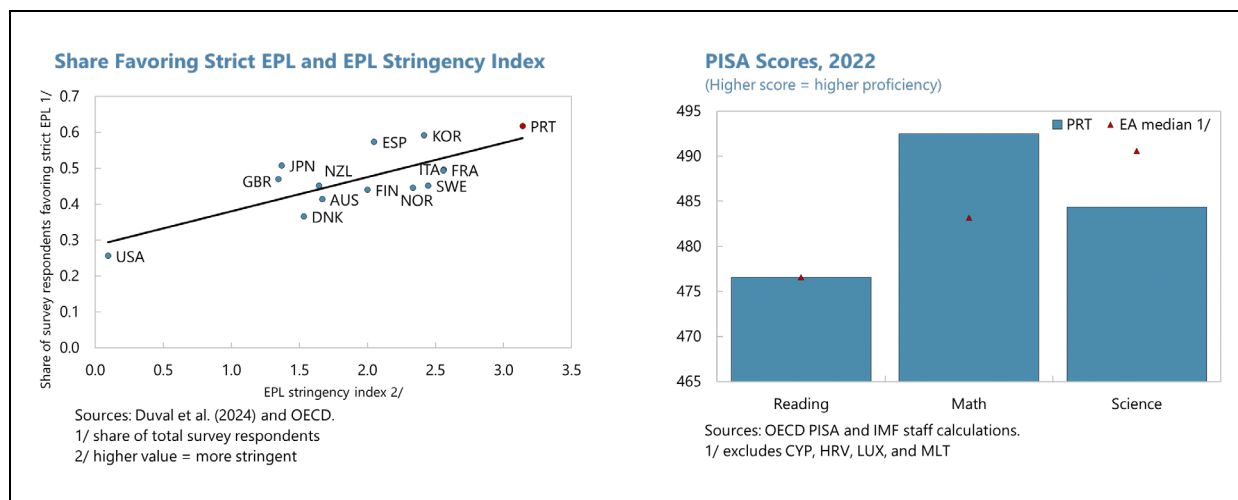
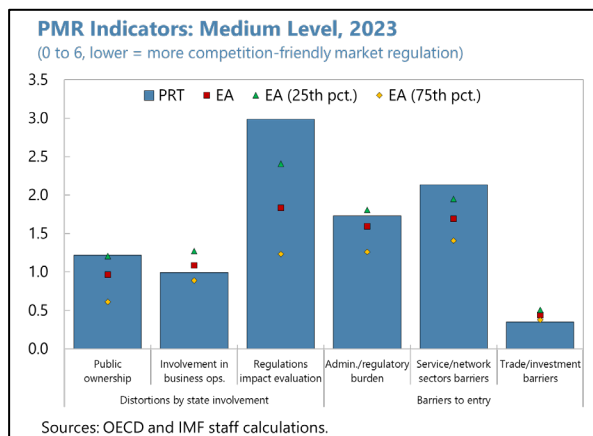
enhance the resilience of the IRB banks to systemic risks from the residential real estate market and that the impact on banks will be limited given the existing capital headroom. The authorities also noted that they are considering the pros and cons of introducing a positive CCyB in a neutral cyclical systemic risk environment.

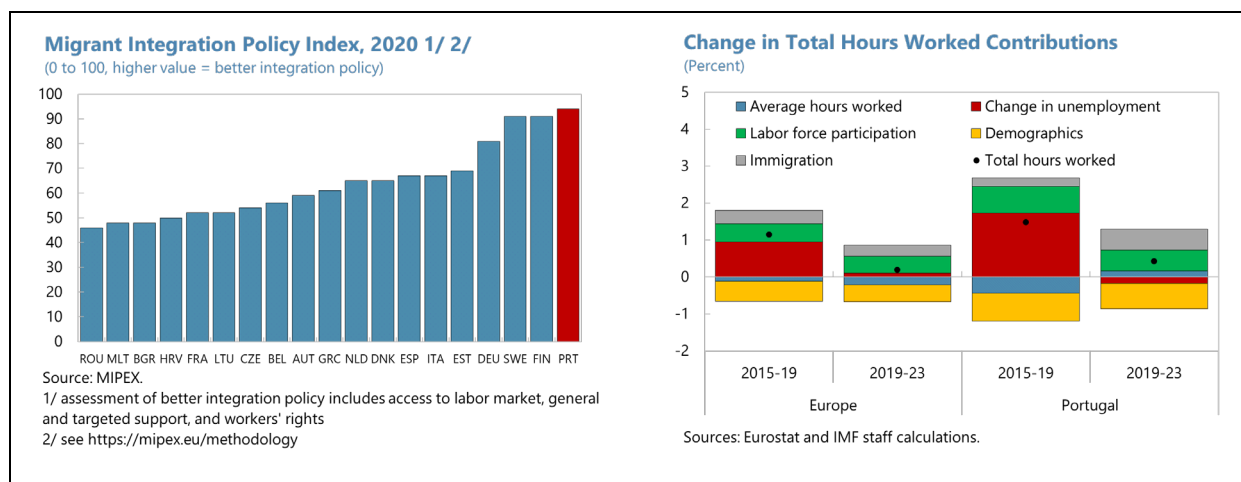
## C. Reforms to Increase Productivity and Potential Growth

**30. Portugal is lagging EA peers in productivity and GDP per capita and suffers from higher inequality and poverty.** Portuguese firms tend to be smaller, less capitalized, and less productive than in other OECD countries ([OECD, 2021](#)). Resource reallocation in labor is likely hindered by labor market duality (open-ended vis-à-vis fixed-term contracts), and there is some evidence that resource misallocation in capital and labor has deteriorated in recent years. The share of skilled in the labor force, although improving among the young, and artificial intelligence preparedness are lower than the EA average. Also, Portugal's inequality and poverty indicators are worse than in EA peers. Beyond tapping into RRP funds effectively (Annex VI), reforms are needed to help raise potential growth and income levels.

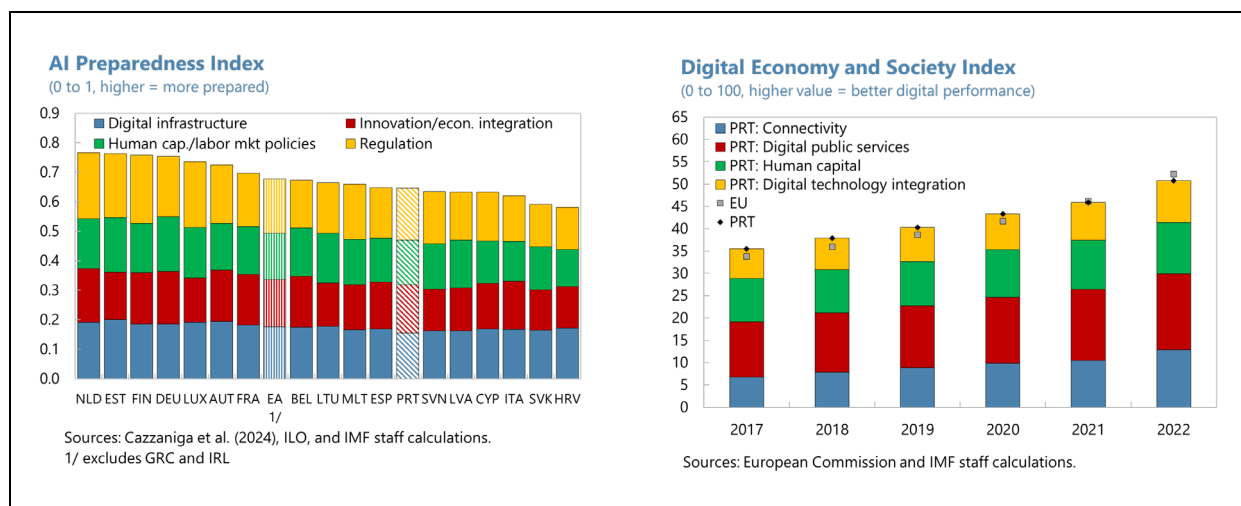


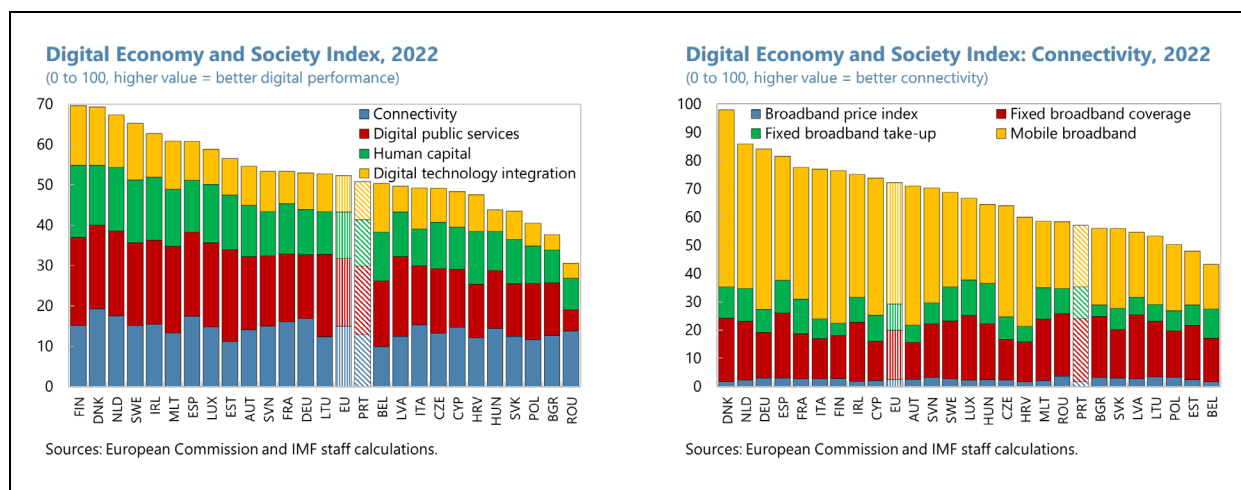
- Product markets.** Product market reforms (PMR) to promote a more competitive environment could help boost productivity by stimulating investment, corporate growth, and resource reallocation. Key areas for improvement include better evaluating the impact of regulations on competition, interacting more effectively with stakeholders in the regulatory process, and streamlining administrative and regulatory burdens particularly in the service and construction sectors. The government's plan to streamline red tape is welcome and should extend to all levels of government. Catching up half-way to the top five EU performers in PMR indicators could raise total factor productivity by an estimated 2¼ percent in the steady state (Annex VII).
- Labor markets.** Portugal has one of the most stringent employment protection legislations, which is widely supported by population. Recent reforms sought to improve working conditions and promote greater usage of open-ended contracts by limiting the duration and renewability of fixed-term contracts. Reforms to make open-ended contracts more flexible, supported by effective communication on their benefits, would help reduce labor market duality by incentivizing the use of open-ended contracts and promote growth (Duval et al., 2024; IMF, 2016). Minimum wage increases proposed by the new government (to €1,000 monthly by 2028 from €820 in 2024) would help alleviate in-work poverty (Detragiache et al., 2020) and inequality (Autor et al., 2016; Oliveira, 2023), but should be paced along with productivity growth to ensure that competitiveness is preserved.





- Labor skills.** Continuing to upskill the labor force will increase productivity. The share of high-skilled labor (with tertiary education) in the total working age population (29.9 percent in 2023) lags EA peers (35.7 percent), as do PISA scores in science. Although more educated on average than natives, immigrants (15 percent of the population, close to the EA median) have higher unemployment rates, even though Portugal's integration policies rank top among peers ([MIPI, 2020](#)). Active labor market policies, including the Sustainable Employment Commitment ([Recuperar Portugal](#)) which was adopted in 2024 to encourage hiring young people and persons with disabilities and promote gender equality, will help improve the allocation of resources, maintain labor supply and skill levels, and counterbalance the declining working-age population (Figure 9).
- Digitalization.** Portugal's performance on integrating digital technology improved considerably in recent years, in line with the EU average, although its mobile broadband capacity is still lagging peers. The RRP appropriately focuses on further improving digitalization along all dimensions.





**31. The authorities are committed to achieving carbon neutrality by 2045, five years ahead of the EU target.** The National Energy and Climate Plan (NECP 2030) is being revised in consultation with the European Commission, setting more ambitious targets for the reduction of emissions by 2030 and for increasing the share of renewables in gross final energy consumption. To help achieve these goals, the carbon tax adjustment mechanism should be reactivated, and the coverage of the carbon tax be gradually expanded. Operationalization of EU ETS2 in 2027, which will extend the emissions trading mechanism to the transport and buildings sectors, will be important for Portugal, where the transport sector accounts for about 30 percent of total GHG emissions. ETS2 will also incentivize investment in energy-efficient transportation and buildings, contributing to a further reduction of carbon intensity. In this respect, appropriate sectoral policies will be important. The new Social Climate Fund, which will be financed from ETS and ETS2 auction revenues and national contributions, can help mitigate the impact of ETS2 implementation on the most vulnerable.

### **Authorities' Views**

**32. The government underscored its priority to boost productivity.** It highlighted its commitment to accelerate the implementation of the RRP and stressed recent progress, including the receipt in June 2024 of the remaining €700 million from the fourth payment, and the submission of the fifth payment request in July 2024. The government emphasized its intent to streamline red tape and continue implementing the National Strategy for Smart Specialization ([National Agency for Innovation, 2022](#)) to boost productivity and innovation. It noted that active labor market policies combined with vocational training helped upskill the workforce while the Decent Work Agenda ([Government of Portugal, 2023](#)) aimed at strengthening job security especially for younger workers. It noted that wage growth so far has not hampered competitiveness and will help retain young talent, as will new measures to support the youth including tax reduction, housing and healthcare-support, student accommodation subsidies, and scholarships for student workers.

**33. The government emphasized that important progress has been made and is underway toward a successful green transition.** The phase-out of coal-fired powered plants through removal of subsidies and application of the carbon tax is being followed by effective integration of

renewables and incentive schemes for renewable projects, including for green hydrogen and other green gases, in part supported by RRP funds. The government stressed its intention to pursue green taxation and energy decarbonization. To that effect, it noted that the reactivation of the carbon tax adjustment mechanism and the return of the excise tax on fuel to pre-energy crisis level need to be sequenced carefully, considering the evolution of fuel prices and the price of auctioned greenhouse-gas emission licenses. It emphasized that, as a guiding framework, the National Climate Law envisages green fiscal and budgetary principles, including phasing out fuel subsidies by 2030, increasing and broadening the coverage of the carbon tax, and earmarking green tax revenues for financing decarbonization and climate change adaptation.

## STAFF APPRAISAL

**34. The economy is expected to achieve a soft landing, with moderate growth and declining inflation.** Growth is projected to slow but remain robust in 2024, supported by exports, strong private consumption backed by a resilient labor market, and public investment under RRP. It is expected to accelerate slightly in 2025 as financial conditions gradually ease. Over the medium term, an aging population, relatively low investment, and subdued productivity will weigh on growth. Inflation is expected to further decline, reaching around 2 percent in 2025. The external position in 2023 is assessed to be moderately stronger than implied by medium-term fundamentals and desirable policies.

**35. Risks to the outlook are broadly balanced.** An escalation in geopolitical tensions could cause further economic fragmentation, lower external demand, and increase commodity prices and market volatility. Core inflation may become even stickier if wage growth continues outpacing productivity growth. On the upside, labor market resilience and stronger tourism momentum may provide an additional boost to growth.

**36. Targeted small fiscal surpluses are appropriate.** Combined with the gradual loosening of the ECB's monetary policy, they will help achieve a soft landing of the economy while continuing to reduce debt. Considering upside risks to inflation, additional relaxation of fiscal policy should be avoided. Planned new tax cuts and spending increases should thus be carefully designed and, as needed, supplemented by measures to achieve the target. Over the medium term, a neutral fiscal stance will achieve the needed continuous reduction of debt, rebuilding fiscal buffers against future shocks and reducing vulnerability to changes in market sentiment.

**37. Fiscal policy should gradually make room for more public investment through well-designed tax and expenditure reforms.** A comprehensive tax reform to reduce tax expenditure could generate significant savings. Age-based preferential PIT rates will lead to revenue losses and raise equity issues, while their effectiveness is uncertain; also preferential PIT rates for foreign professionals could further distort the tax system and risk exacerbating housing shortages. Reducing the CIT surcharges would help align tax policies with EA peers while promoting corporate growth. As housing affordability concerns subside, the property tax rate could be increased. On the expenditure

side, continued efforts are needed to increase the efficiency of spending and address growing spending pressures from aging.

**38. Systemic financial risks have declined and are moderate, but continued vigilance is needed, and BdP should stand ready to further recalibrate its macroprudential tools.** The private and public sectors continued to deleverage. High net-interest margins led to soaring profits and increased capitalization of banks while NPLs declined. Still, risks remain. Borrowers' repayment capacity was strained by high interest rates and NPLs may increase with a lag. Although the sharp RRE price increase largely reflects housing supply constraints and the risk of an abrupt correction appears limited barring significant growth slowdown, the sector's imbalance requires close monitoring. In this context, the introduction of sSyRB for household loans secured by housing properties is welcome. A positive neutral CCyB could also be considered to support financial stability in potential downturns. Meanwhile, the government's focus on increasing housing supply is appropriate to reduce imbalances and improve housing affordability. Efforts to contain risks from transnational money laundering should continue.

**39. Reforms are needed to foster higher living standards and faster income convergence with the EA.** PMRs, including streamlining red tape and regulations at all levels of government, are needed to facilitate a more competitive environment, stimulate investment, encourage corporate growth, and reorient resources toward more productive firms. Further labor market reforms to make open-ended contracts more flexible would help reduce the use of fixed-term contracts. Continuing to integrate well immigrants into the labor market and to prioritize digitalization, upskilling the labor force, and boosting AI preparedness, is key for boosting productivity.

**40. The authorities' ambitious targets for the green transition are commendable.** They should be supported by the reactivation of the carbon tax adjusting mechanism and further reduction of fuel subsidies, together with the planned broadening of the EU emission trading system coverage.

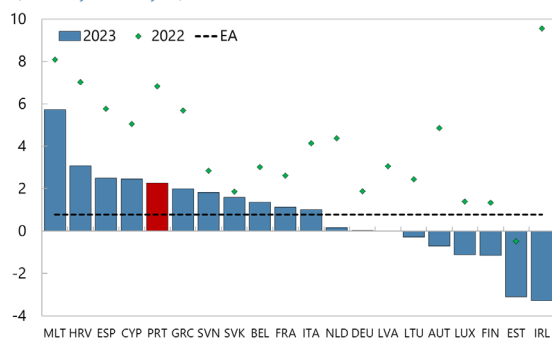
**41. The next Article IV consultation is proposed to take place on the standard 12-month cycle.**

**Figure 1. Portugal: Macroeconomic Developments**

*Although decelerating, growth in 2023 has been stronger than in most other EA peers...*

**Real GDP Growth**

(Percent, year-over-year)

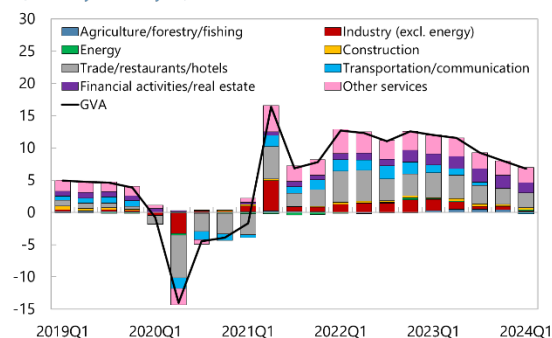


Sources: Eurostat, Haver Analytics, and IMF staff calculations.

*...with tourism and other service sectors contributing the most.*

**Gross Value Added Growth Decomposition**

(Percent, year-over-year)

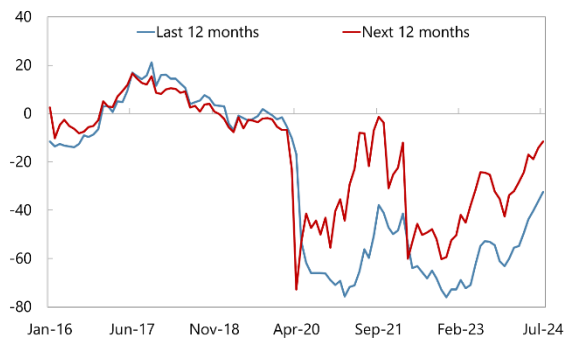


Sources: INE, Haver Analytics, and IMF staff calculations.

*Economic sentiment has been improving...*

**Country Economic Situation Sentiment**

(Index, 0+=increase, NSA)

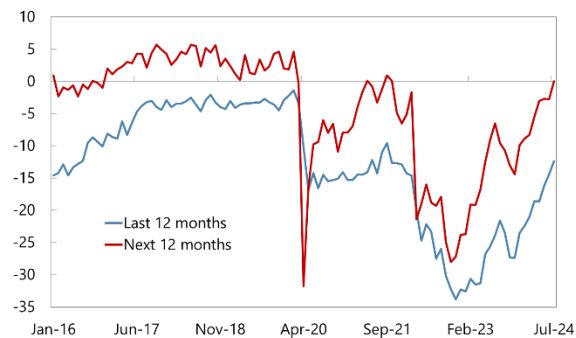


Sources: INE and Haver Analytics.

*...and households' financial situation has been recovering.*

**Household Financial Situation**

(Index, 0+=increase, NSA)

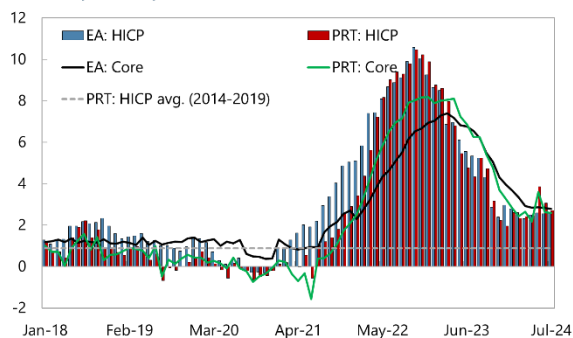


Sources: INE and Haver Analytics.

*Both headline and core Inflation are receding fast despite their temporary recent pickup in May 2024 ...*

**Inflation**

(Percent, year-over-year)

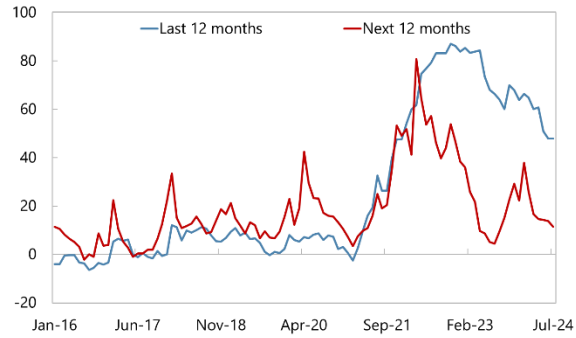


Sources: Eurostat and Haver Analytics.

*...while expectations of future inflation have declined.*

**Price Evolution Sentiment**

(Index, 0+=increase, NSA)



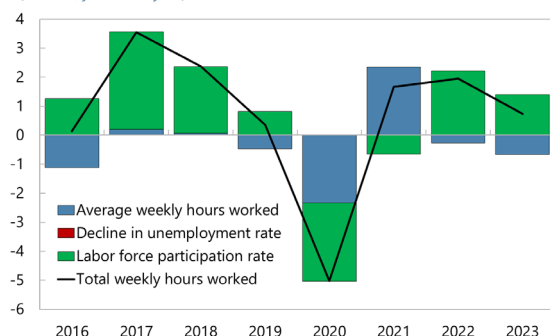
Sources: INE and Haver Analytics.



**Figure 2. Portugal: Labor Market**

*Total hours worked continued growing, supported by a rising labor force participation.*

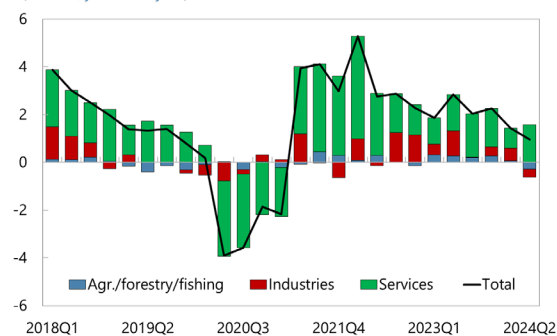
**Total Weekly Hours Worked Growth Composition**  
(Percent, year-over-year)



Sources: Eurostat and IMF staff calculations.

*Employment growth is mostly driven by services.*

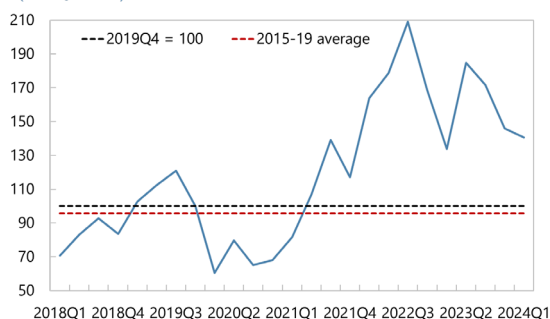
**Contribution to New Employment**  
(Percent, year-over-year)



Sources: INE, Haver Analytics, and IMF staff calculations.

*The labor market remains tighter than pre-COVID...*

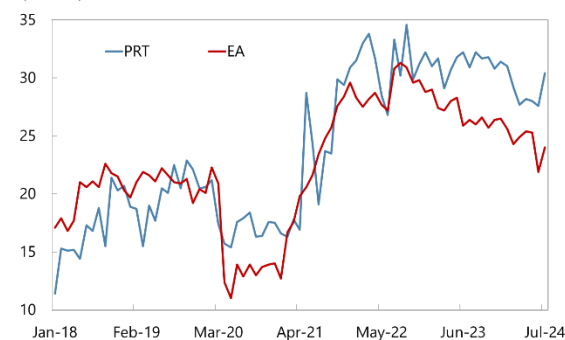
**Market Tightness 1/**  
(2019Q4 = 100)



Sources: Eurostat, Haver Analytics, and IMF staff calculations.  
1/ calculated by dividing job openings by unemployed

*...with labor shortage in the construction sector above the EA average.*

**Labor Shortage in Construction**  
(Percent)



Sources: European Commission and Haver Analytics.

*Both average and minimum real wage growth returned positive in 2023...*

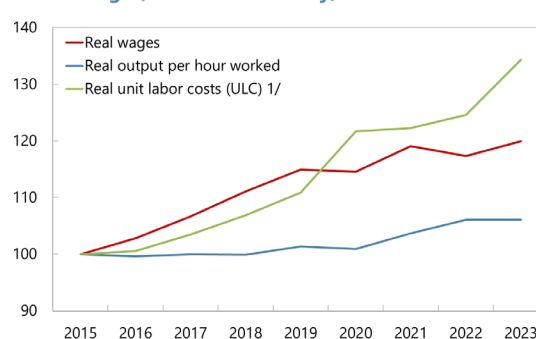
**Real Monthly Minimum Wage and Real Wage Growth**  
(Percent, year-over-year)



Sources: Eurostat, INE, Haver Analytics, and IMF staff calculations.

*...but real wage grew faster than labor productivity, pushing unit labor costs up.*

**Real Wages, Labor Productivity, and Real ULC**



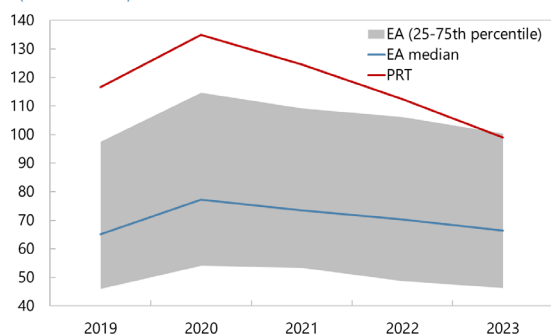
Sources: Eurostat, INE, Haver Analytics, and IMF staff calculations.  
1/ real wages per unit of output



**Figure 3. Portugal: Public Finances**

*Albeit still high, public debt has been declining fast and substantially...*

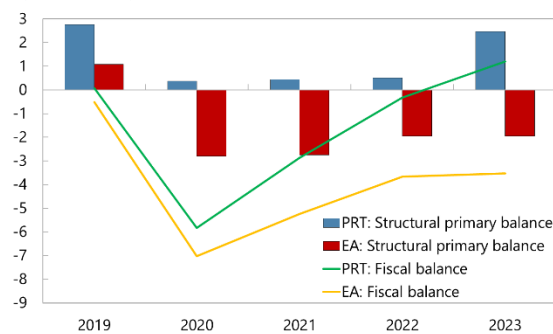
#### Public Debt (Percent of GDP)



Sources: WEO Live and IMF staff calculations.

*...supported by both strong growth, inflation, and a much higher primary balance than in EA peers.*

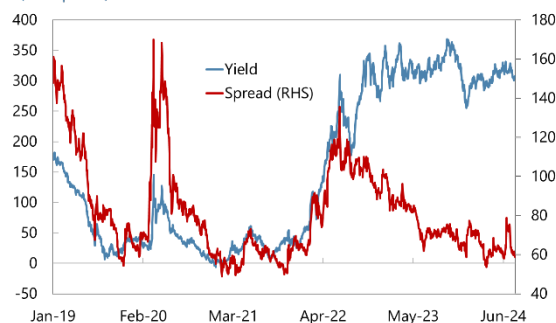
#### Fiscal and Structural Primary Balance (Percent of GDP)



Sources: WEO Live and IMF staff calculations.

*Borrowing costs remain elevated, but bond spreads continue declining.*

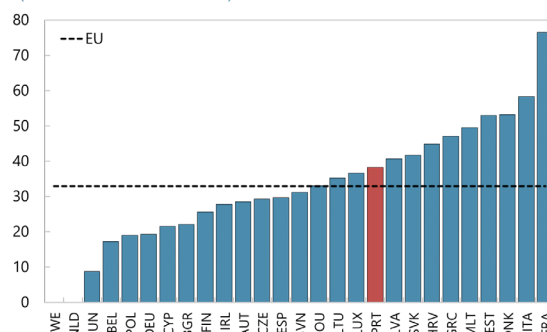
#### 10-year Government Bond Yield and Spread 1/ (Basis points)



Sources: Tullet Prebon Information, Haver Analytics, and IMF staff calculations.  
1/ spread = relative to German bunds

*RRP funds disbursement is above EU average, but implementation needs to accelerate.*

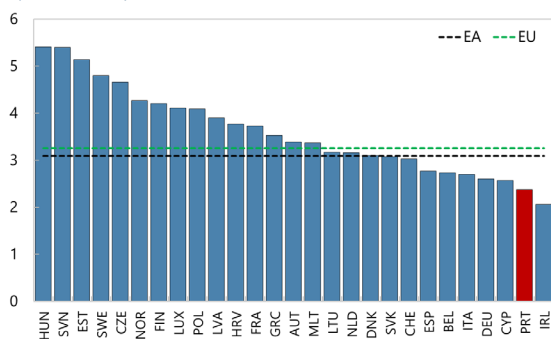
#### Recovery and Resilience Fund (RRF) Disbursement (Percent of total RRF allocation)



Sources: European Commission and IMF staff calculations.

*Public investment is lower than the EA average.*

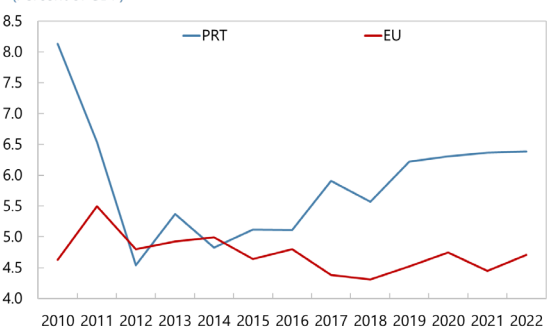
#### Public Investment, 2022 (Percent of GDP)



Source: Eurostat.

*Tax expenditure remains sizable and slightly increased recently.*

#### Foregone Tax Revenue 1/ (Percent of GDP)



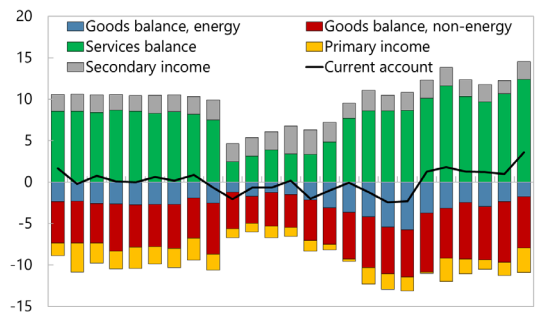
Source: GTED.  
1/ see <https://gted.taxexpenditures.org/methodology/>

**Figure 4. Portugal: External Sector**

*The current account was in surplus in 2023...*

**Current Account Decomposition**

(Percent of GDP)



2018Q1 2018Q4 2019Q3 2020Q2 2021Q1 2021Q4 2022Q3 2023Q2 2024Q1

Sources: BdP, INE, Haver Analytics, and IMF staff calculations.

*...reflecting normalizing commodity prices...*

**Nominal Goods Imports Growth Composition**

(Percent, year-over-year)



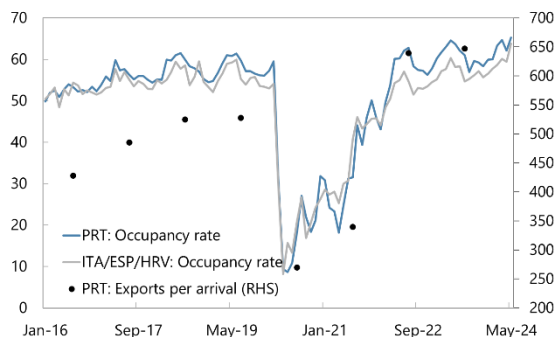
2018Q1 2018Q4 2019Q3 2020Q2 2021Q1 2021Q4 2022Q3 2023Q2 2024Q1

Sources: INE, Haver Analytics, and IMF staff calculations.

*...and strong revenues from tourism.*

**Occupancy Rate and Exports per Arrival**

(Percent and Euros)

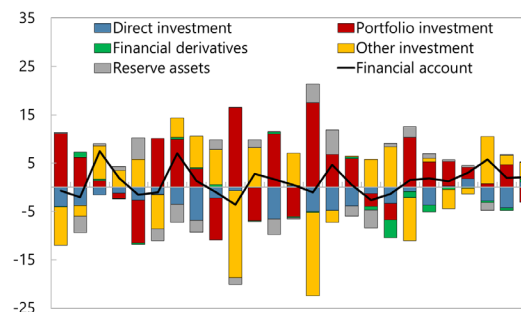


Sources: BdP, Eurostat, Haver Analytics, and IMF staff calculations.

*The financial account recorded a surplus...*

**Financial Account Decomposition**

(Percent of GDP)



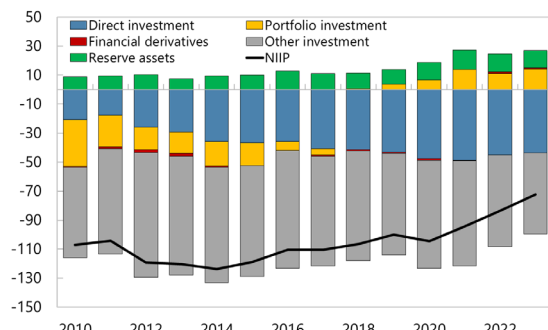
2018Q1 2018Q4 2019Q3 2020Q2 2021Q1 2021Q4 2022Q3 2023Q2 2024Q1

Sources: BdP, INE, Haver Analytics, and IMF staff calculations.

*...and the net international investment position continued to strengthen.*

**Net International Investment Position**

(Percent of GDP)

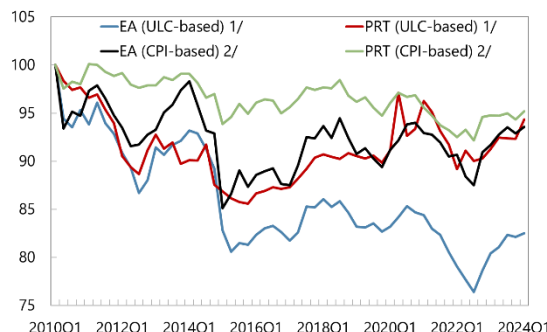


Sources: BdP, INE, Haver Analytics, and IMF staff calculations.

*The real effective exchange rate appreciated slightly in 2023.*

**Real Effective Exchange Rate**

(2010Q1 = 100, increase = appreciation)

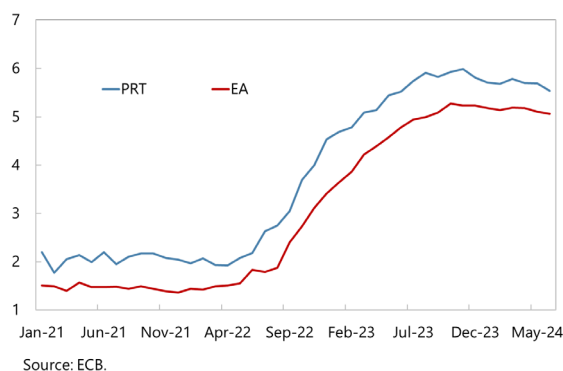


Sources: ECB and IMF staff calculations.

**Figure 5. Portugal: NFC and Households Lending**

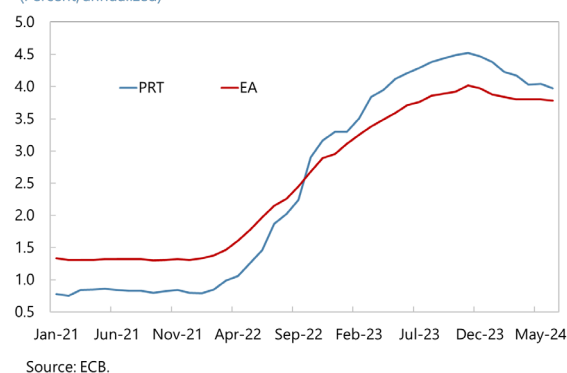
*NFCs pay higher interest rates than their European counterparts...*

**Non-financial Corporation Borrowing Cost for Total New Loans**  
(Percent, annualized)



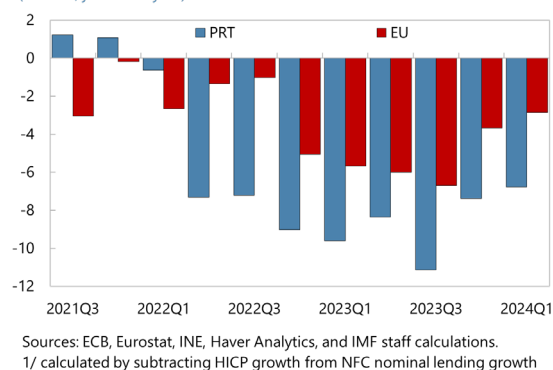
*...while households' borrowing cost fluctuate more due to the prevalence of flexible-rate lending.*

**Household Borrowing Cost for Total New Mortgages**  
(Percent, annualized)



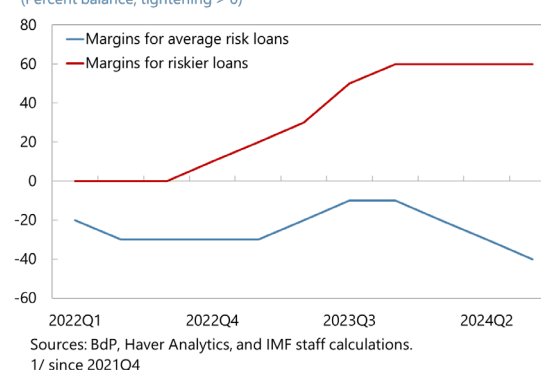
*NFC lending contracted in real terms...*

**Non-financial Corporation Real Lending Growth 1/**  
(Percent, year-over-year)



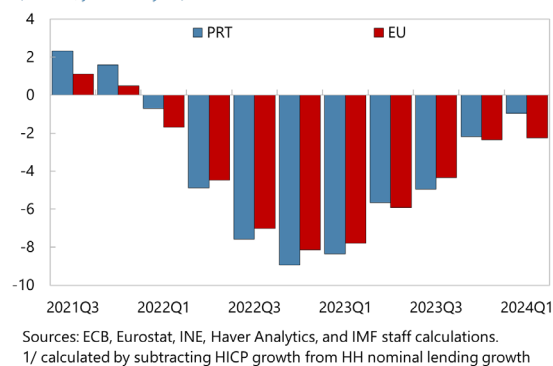
*...as banks kept margins on riskier loans high during 2023.*

**Cumulative Change in Loan Margins to NFCs 1/**  
(Percent balance, tightening > 0)



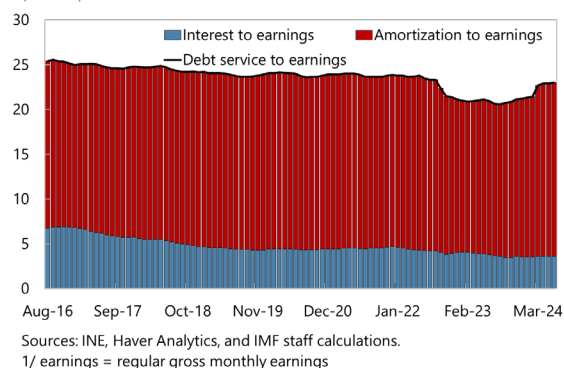
*Household lending contracted, but less strongly than NFC lending...*

**Household Real Lending Growth 1/**  
(Percent, year-over-year)



*...mortgage costs increased for households who adapted by extending the loan period.*

**Household Mortgage Cost Burden 1/**  
(Percent)

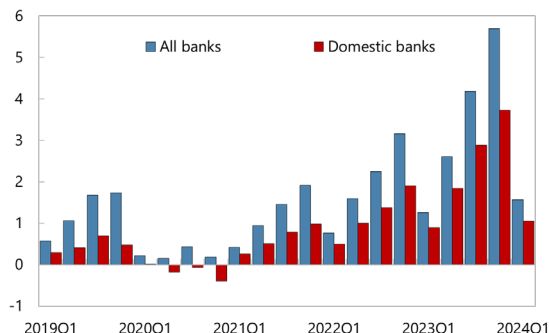


**Figure 6. Portugal: Interest Rate Pass-Through and Bank Profits**

2023 saw record profits for Portuguese banks...

#### Profit/Loss from Continued Operations

(Billions of Euros)

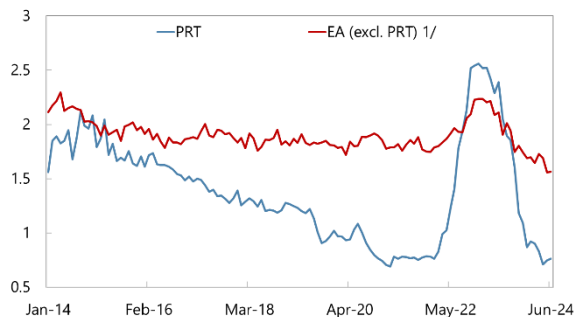


Sources: ECB, Haver Analytics, and IMF staff calculations.

...resulting from temporarily high margins, as increases in deposit rates lagged the rise in lending rates.

#### Lending Margin

(Percent)



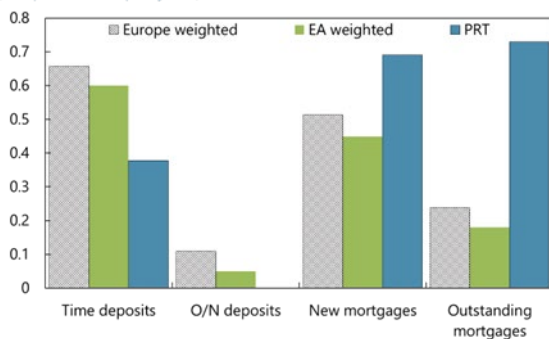
Sources: ECB, Haver Analytics, and IMF staff calculations.

1/ excludes HRV after Dec. 2022

Interest rate pass-through to mortgages was exceptionally high and very low for deposits.

#### Household Pass-through During Post-pandemic Tightening

( $\Delta$  deposit rate /  $\Delta$  policy rate)

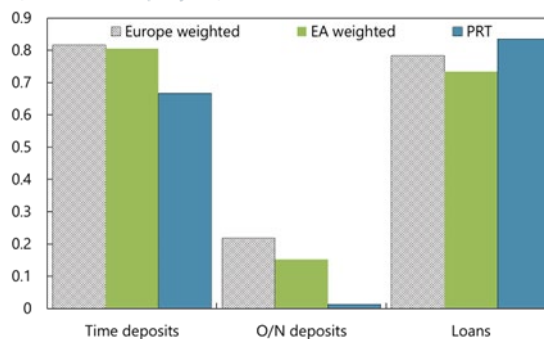


Source: IMF staff calculations based on Beyer et al. (2024).

For NFCs, the pass-through has been higher than for households.

#### NFC Pass-through During Post-pandemic Tightening

( $\Delta$  interest rate /  $\Delta$  policy rate)

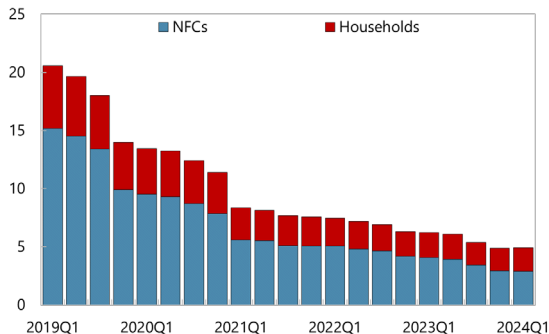


Source: IMF staff calculations based on Beyer et al. (2024).

NPLs continued to decline...

#### Non-performing Loans

(Billions of Euros)

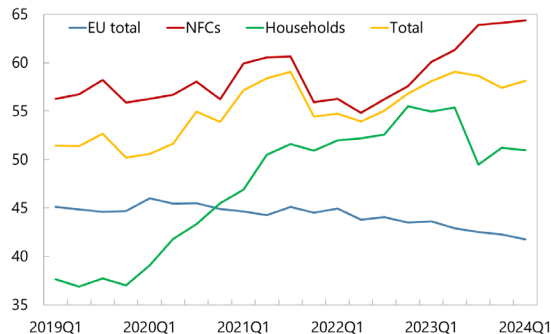


Sources: EBA and Haver Analytics.

...with improving coverage.

#### Non-performing Loan Coverage Ratios

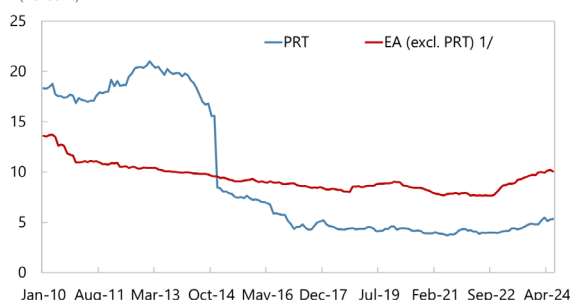
(Percent)



Sources: EBA and Haver Analytics.

**Figure 7. Portugal: Systemic Risks in the Financial Sector***Banks' business model relies on deposit funding...***Non-deposit Funding Rate**

(Percent)



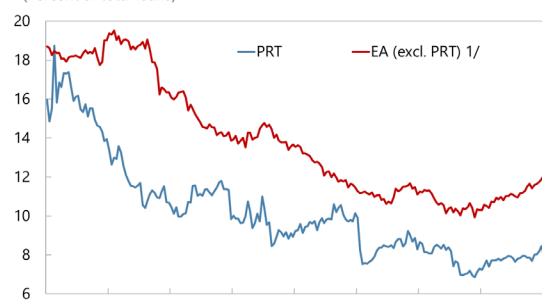
Jan-10 Aug-11 Mar-13 Oct-14 May-16 Dec-17 Jul-19 Feb-21 Sep-22 Apr-24

Sources: ECB, Haver Analytics, and IMF staff calculations.

1/ data unavailable for FRA, HRV (before Dec. 2010), LVA (before Sep. 2010), and LTU (before Jun. 2010)

*...and is less interconnected than European peers.***Interbank Loans**

(Percent of total loans)



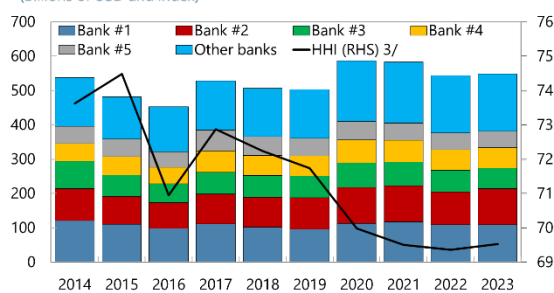
Jan-07 Mar-09 May-11 Jul-13 Sep-15 Nov-17 Jan-20 Mar-22 May-24

Sources: ECB, Haver Analytics, and IMF staff calculations.

1/ excludes FRA, HRV (before Dec. 2010), and LVA (before Sep. 2010)

*The banking sector size and concentration are stable...***Banking Sector Size and Concentration 1/ 2/**

(Billions of USD and index)



Source: Orbis.

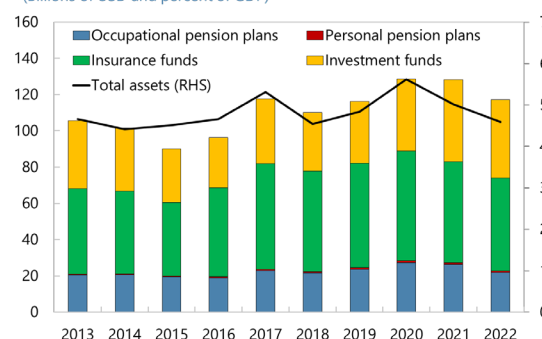
1/ latest available data used for each year

2/ Banks #1-5 = largest five banks in PRT for the given year

3/ Herfindahl-Hirschmann index

*...and NBFIs are small, although investment funds saw some growth recently.***Non-bank Financial Institution Assets**

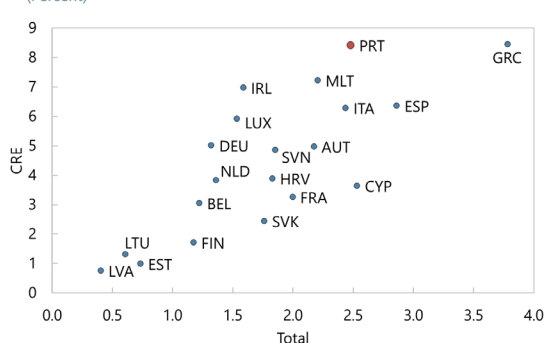
(Billions of USD and percent of GDP)



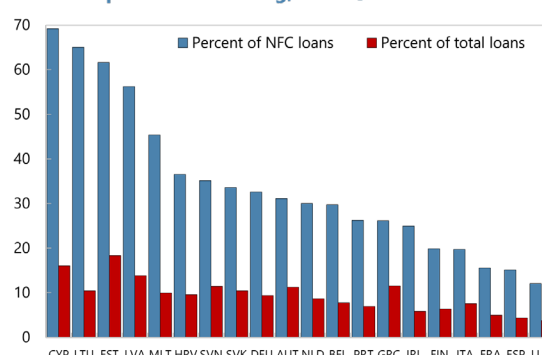
Sources: ECB, Eurostat, OECD, Haver Analytics, and IMF staff calculations.

*CRE loans tend to default more frequently in Portugal than in other EA countries...***CRE and Total Non-performing Loan Ratios, 2024Q1**

(Percent)



Source: EBA.

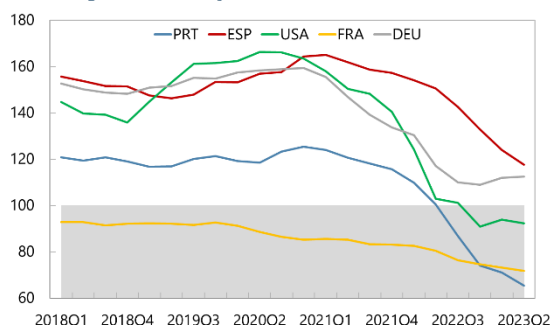
*...but banks' exposure to CRE lending is smaller than for most EA countries.***CRE Exposures in Lending, 2024Q1**

Source: EBA.

**Figure 8. Portugal: Housing Affordability and Supply**

*Housing affordability is a significant concern...*

**Housing Affordability Index 1/**



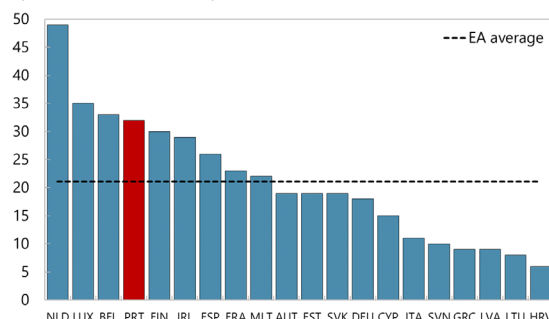
Source: Biljanovska, et al. (2023).

1/ 100 = median income household meets exact income requirement to qualify for mortgage loan on average-priced home

*...and strongly tied to interest costs since many households finance housing with mortgages.*

**Households with Mortgages, 2020 1/**

(Percent of total households)

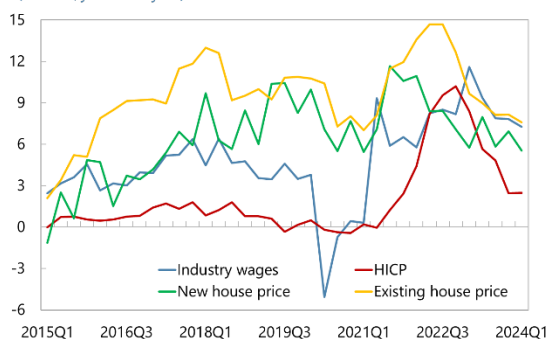


Sources: OECD, Compare Your Country, and IMF staff calculations.

1/ or latest available

*House price increases slowed but remain above inflation.*

**Wages, Headline Inflation, and House Prices Growth**  
(Percent, year-over-year)

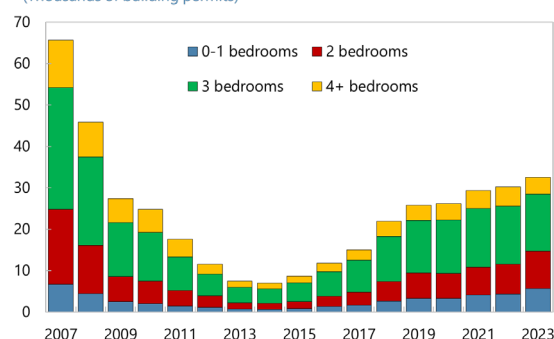


Sources: INE and Haver Analytics.

*Construction permits only grew slowly and were increasingly for smaller units...*

**Housing Building Permits by Dwelling Size**

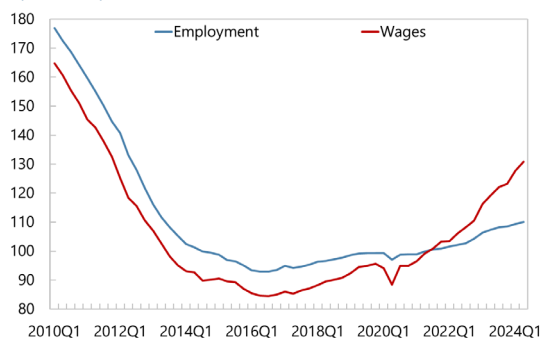
(Thousands of building permits)



Sources: INE, Haver Analytics, and IMF staff calculations.

*...while labor is another bottleneck for housing supply.*

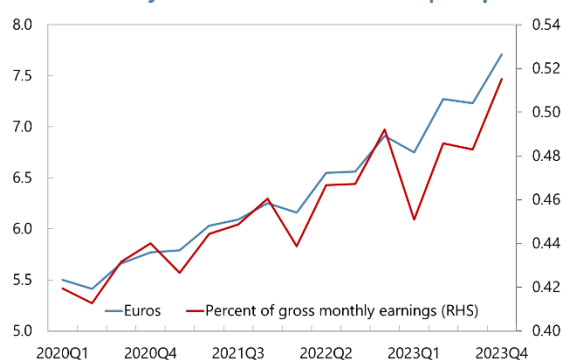
**Construction and Public Works Employment and Wages**  
(2021 = 100)



Sources: INE and Haver Analytics.

*Renting also became more expensive.*

**Median Newly Leased House Rental Value per sq. Meter**



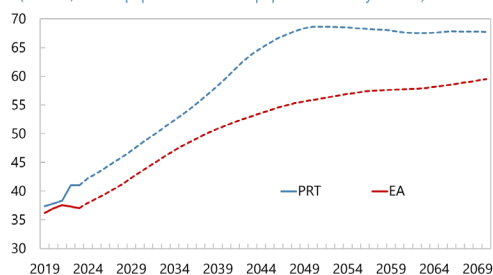
Sources: INE, Haver Analytics, and IMF staff calculations.

**Figure 9. Portugal: Aging and Role of Immigrants in Labor Markets**

*The dependency ratio is projected to increase much faster than the EA median...*

#### Old Age Dependency Ratio 1/

(Percent, ratio of population 65+ over population 20-64 years old)

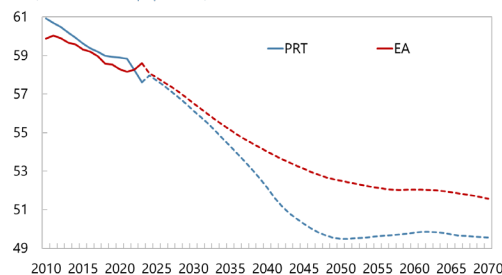


Sources: 2024 European Commission Ageing Report, Eurostat, Haver Analytics, and IMF staff calculations.  
1/ dashed line = projected

*...with the working age population projected to decline faster than the EA median.*

#### Working Age Population (ages 20-64) 1/

(Percent of total population)

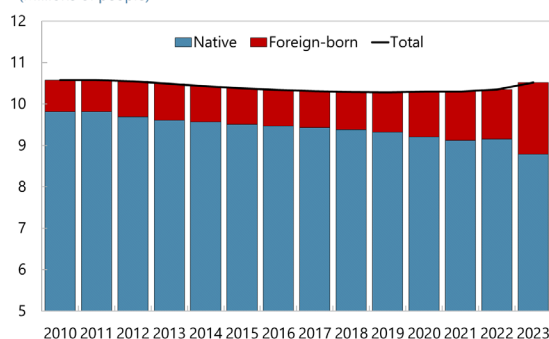


Sources: 2024 European Commission Ageing Report, Eurostat, Haver Analytics, and IMF staff calculations.  
1/ dashed line = projection

*Portugal's total population would have been declining without inflows of immigrants.*

#### Total Population

(Millions of people)

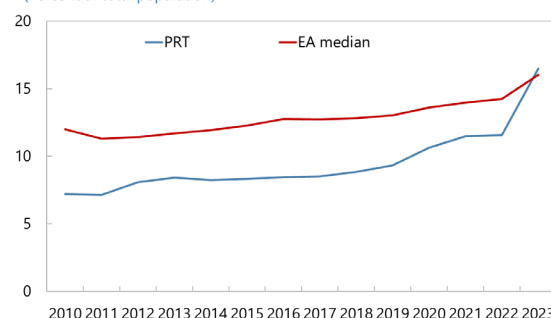


Sources: Eurostat and IMF staff calculations.

*The share of foreign-born population increased to the EA median by 2023.*

#### Foreign-born Population 1/

(Percent of total population)



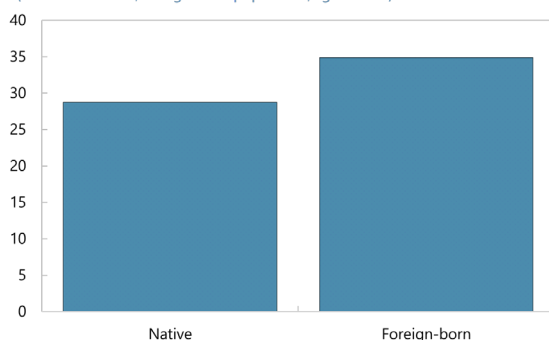
Sources: Eurostat and IMF staff calculations.

1/ 2010-2012 excludes HRV

*Labor force survey data suggest immigrants are on average more educated than the native population.*

#### Population with Tertiary Education, 2023

(Percent of native/foreign-born population, ages 20-64)

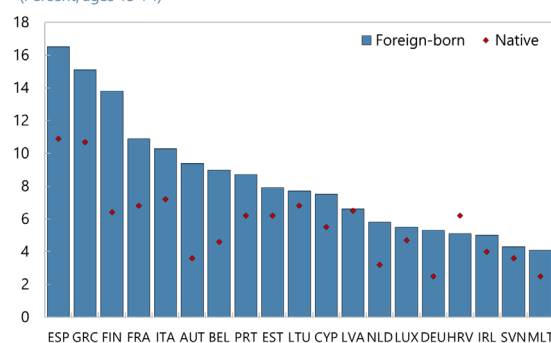


Sources: Eurostat and IMF staff calculations.

*Immigrants' unemployment rate is higher than that of natives.*

#### Unemployment Rates by Country of Birth, 2023

(Percent, ages 15-74)



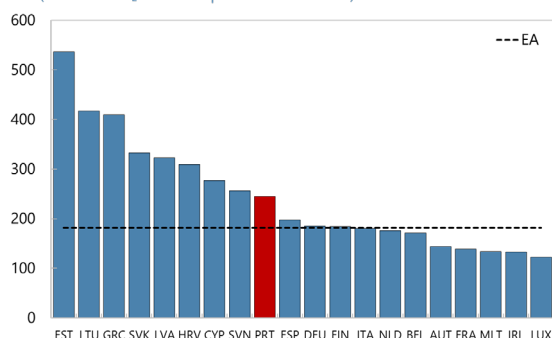
Source: Eurostat.

**Figure 10. Portugal: Carbon Pricing, Subsidies, and Environmental Taxes**

*Carbon intensity is above the EA average...*

#### Carbon Intensity, 2022

(Grams of CO<sub>2</sub> emissions per Euro of real GDP)

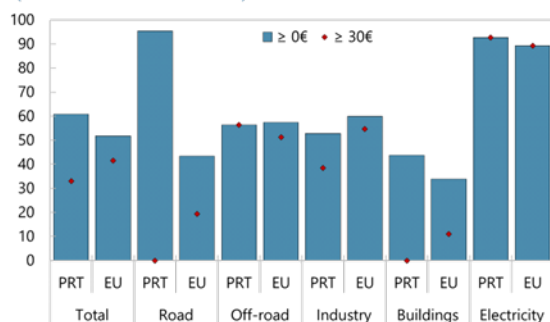


Sources: Eurostat, Haver Analytics, and IMF staff calculations.

*Emissions pricing coverage is higher in Portugal than the EU average, but coverage at above €30 is lower...*

#### Emissions Pricing Coverage, 2021 1/

(Percent of sector total emissions)



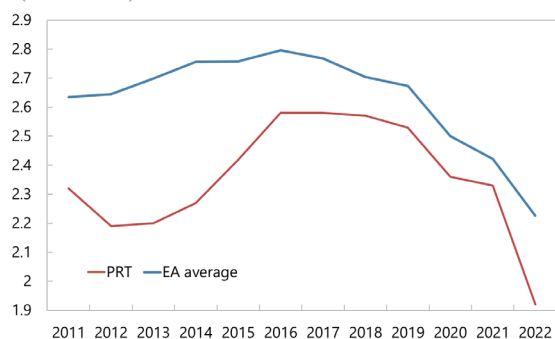
Source: OECD.

1/ EU data excludes BGR, HRV, MLT, and ROU

*Environmental tax revenue fell more drastically in Portugal than the EU average in the recent years...*

#### Environmental Tax Revenue

(Percent of GDP)

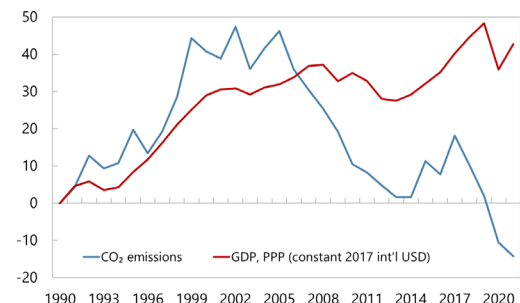


Source: Eurostat.

*...but GDP and emissions paths have decoupled in recent years.*

#### Change in CO<sub>2</sub> Emissions per Capita and GDP per Capita 1/

(Percent)



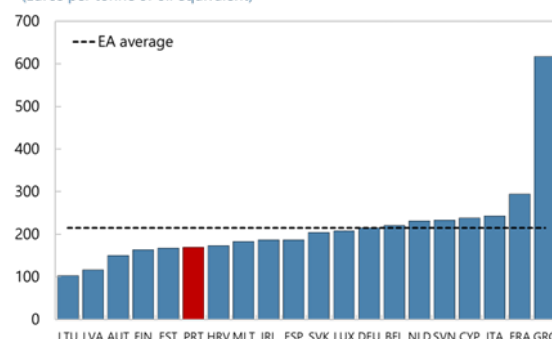
Source: World Bank and Our World in Data.

1/ since 1990

*...and the implicit tax rate on energy is relatively low.*

#### Implicit Tax Rate on Energy, 2022

(Euros per tonne of oil equivalent)

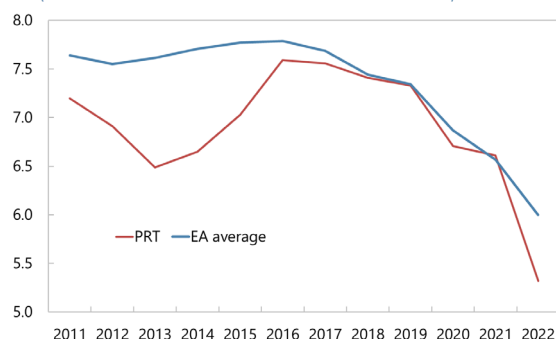


Sources: Eurostat and IMF staff calculations.

*...and as a share of public revenue was significantly lower than the EU average in 2022.*

#### Environmental Tax Revenue

(Percent of total revenue from taxes and social contributions)



Source: Eurostat.



**Table 1. Portugal: Selected Economic Indicators, 2019–29**  
(Percent, year-over-year, unless otherwise indicated)

	2019	2020	2021	2022	2023	Projections					
						2024	2025	2026	2027	2028	2029
Real GDP	2.7	-8.3	5.7	6.8	2.3	1.9	2.3	2.0	1.9	1.9	1.9
Total domestic demand	3.1	-5.4	5.9	4.4	1.4	2.1	2.3	2.1	2.1	2.0	2.0
Private consumption	3.3	-7.0	4.7	5.6	1.6	1.7	1.9	1.9	1.9	1.9	1.9
Public consumption	2.1	0.3	4.5	1.4	1.0	2.1	2.3	2.7	3.1	2.2	1.8
Gross fixed investment	5.4	-2.2	8.1	3.0	2.6	3.5	3.9	2.1	1.6	2.3	2.6
Private	6.2	-4.8	7.5	4.1	1.2	1.7	3.8	2.3	3.4	2.5	2.8
Government	-1.5	21.3	12.0	-4.6	13.5	15.6	4.1	0.9	-8.9	1.2	1.1
Exports	4.1	-18.6	12.3	17.4	4.1	2.8	3.0	2.4	2.0	1.9	1.9
Imports	4.9	-11.8	12.2	11.1	2.2	3.3	2.9	2.6	2.3	2.1	2.1
Contribution to Growth											
Total domestic demand	3.0	-5.3	6.1	4.5	1.4	2.1	2.3	2.1	2.1	2.0	2.0
Private consumption	2.1	-4.5	3.1	3.6	1.0	1.1	1.2	1.2	1.2	1.2	1.2
Public consumption	0.4	0.1	0.8	0.3	0.2	0.4	0.4	0.4	0.5	0.4	0.3
Gross fixed investment	0.6	-0.4	1.5	0.6	0.5	0.7	0.7	0.4	0.3	0.4	0.5
Stockbuilding	-0.3	-0.5	0.6	0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net exports	-0.3	-3.0	-0.3	2.3	0.9	-0.2	0.1	-0.1	-0.1	-0.1	-0.1
Savings-investment balance (percent of GDP)											
Gross national savings	18.6	17.9	19.9	19.5	21.0	21.5	21.7	21.6	21.1	20.8	20.9
Gross domestic investment	18.5	19.1	20.6	20.7	19.6	19.5	19.7	19.6	19.4	19.3	19.5
Growth of credit to private non-financial sector	0.5	4.8	3.1	1.9	-1.6	0.2	1.9	2.5	3.2	3.5	3.9
Resource utilization											
Potential GDP	1.6	-2.4	3.0	2.6	2.5	2.5	2.4	2.3	2.2	2.1	2.1
Output Gap (percent of potential GDP)	1.4	-4.8	-2.3	1.8	1.6	1.0	0.9	0.6	0.4	0.2	0.0
Labor											
Employment	0.8	-1.8	1.9	1.7	0.9	1.0	0.4	0.4	0.3	0.3	1.2
Unemployment rate (percent, average)	6.7	7.1	6.7	6.2	6.6	6.5	6.4	6.3	6.2	6.2	6.2
Prices											
GDP deflator	1.7	2.0	1.9	5.0	7.1	2.8	2.4	1.9	1.9	2.0	2.0
Consumer prices (HICP)	0.3	-0.1	0.9	8.1	5.3	2.5	2.1	2.0	2.0	2.0	2.0
Consumer prices excl. energy and food	0.5	0.0	0.3	6.2	6.3	2.8	2.3	2.1	2.0	2.0	2.0
Fiscal indicators (percent of GDP)											
General government balance	0.1	-5.8	-2.9	-0.3	1.2	0.2	0.2	0.2	0.2	0.2	0.2
Primary government balance	2.9	-3.1	-0.6	1.5	3.1	2.2	2.2	2.2	2.1	2.1	2.1
General government debt	116.6	134.9	124.5	112.4	99.1	94.4	89.8	86.2	82.8	79.4	76.2
External sector (percent of GDP)											
Trade balance (goods and services)	0.8	-1.9	-2.6	-1.9	1.2	1.2	1.8	1.7	1.6	1.5	1.3
Current account balance	0.4	-1.0	-0.8	-1.1	1.4	2.0	2.3	2.2	1.8	1.5	1.5
Savings-investment balance (percent of GDP) 1/	0.1	-1.2	-0.8	-1.1	1.4	2.0	2.0	2.0	1.6	1.4	1.4
Net international investment position	-100.0	-104.6	-94.4	-83.6	-72.5	-64.6	-57.2	-50.8	-46.4	-42.5	-38.7
REER based on ULC (2010 = 100) 2/	95.6	99.4	104.2	101.9	102.8	102.1	101.4	101.2	100.9	100.7	100.8
REER based on CPI (2010 = 100) 3/	96.4	97.2	95.5	92.7	93.4	93.2	93.0	93.0	93.1	93.1	93.1
Nominal GDP (billions of Euros)	214.4	200.5	216.1	242.3	265.5	278.1	291.5	303.0	314.9	327.2	340.0

Sources: BdP, Eurostat, INE, Haver Analytics, Portugal's Ministry of Finance, and IMF staff calculations/projections.

1/ National Accounts concept. Differences between the savings-investment balance and the current account in the balance of payments arise from a set of factors, including a different statistical treatment given to special purpose entities in the national accounts and the balance of

2/ Real effective exchange rate as a ratio of a country's unit labor cost in the manufacturing sector to a weighted average of the unit labor cost

3/ Real effective exchange rate for all IMF members adjusted for relative changes in consumer prices.

**Table 2A. Portugal: General Government Accounts, 2019–29 1/**  
(Billions of Euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	Projections					
						2024	2025	2026	2027	2028	2029
Revenue	91.2	87.0	96.3	106.1	115.6	120.9	126.0	130.4	134.3	139.7	145.2
Taxes	52.9	49.3	53.1	62.0	66.9	69.0	71.8	74.2	77.0	79.7	82.9
Taxes on production and imports	32.1	29.2	32.3	36.3	38.5	40.9	42.9	44.9	46.7	48.5	50.4
Current taxes on income, wealth, etc. and capital taxes	20.8	20.1	20.7	25.7	28.4	28.1	28.9	29.3	30.2	31.2	32.5
Social contributions	25.3	25.6	27.3	29.6	32.7	34.2	35.7	37.1	38.6	40.1	41.7
Grants and other revenue	13.0	12.1	16.0	14.4	16.0	17.7	18.6	19.0	18.8	19.8	20.6
Property income	1.8	1.5	1.7	1.7	1.9	2.0	2.1	2.2	2.3	2.4	2.5
Sales of goods and services	7.4	6.6	6.7	7.7	8.1	8.4	8.9	9.2	9.6	9.9	10.3
Other current revenue	3.1	3.3	5.1	3.5	3.5	3.9	4.1	4.3	4.3	4.7	4.9
Capital transfers and investment grants	0.7	0.7	2.6	1.5	2.5	3.3	3.5	3.3	2.6	2.8	2.9
Expenditure	91.0	98.7	102.5	106.9	112.4	120.3	125.4	129.7	133.6	138.9	144.4
Expense	92.7	99.8	102.9	107.3	112.5	119.5	124.6	129.0	134.0	139.3	144.8
Compensation of employees	22.9	23.9	25.0	25.8	27.8	29.3	30.8	32.2	33.7	35.2	36.7
Use of goods and services	11.1	11.3	12.4	13.4	14.0	14.7	15.0	15.5	16.1	16.8	17.4
Consumption of fixed capital	5.6	5.6	6.0	6.3	6.9	7.2	7.6	7.9	8.2	8.5	8.8
Interest	6.3	5.8	5.2	4.7	5.8	6.2	6.7	6.8	6.8	7.0	7.3
Subsidies	0.9	3.7	4.3	2.7	2.0	2.0	1.9	1.8	1.7	1.7	1.4
Social benefits	38.7	40.3	41.6	44.8	46.3	50.1	52.5	55.1	57.9	60.7	63.7
Grants and other expense	7.1	9.1	8.5	9.7	9.7	10.0	10.2	10.4	10.7	11.0	11.4
Other current expense	4.7	5.0	5.8	6.3	6.3	6.8	6.9	7.2	7.4	7.7	8.0
Capital transfers	2.4	4.2	2.6	3.4	3.4	3.2	3.3	3.3	3.2	3.3	3.4
Unidentified saving measures to meet budget target	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.7	-1.1	-1.5	-1.7
Net acquisition of nonfinancial assets	-1.7	-1.1	-0.4	-0.5	-0.1	0.7	0.8	0.7	-0.4	-0.4	-0.4
Gross fixed capital formation	3.9	4.8	5.6	5.8	6.8	7.9	8.4	8.6	7.8	8.1	8.4
Gross Operating Balance	4.1	-7.1	-0.6	5.0	10.0	8.6	9.0	9.2	8.5	8.9	9.2
Net lending (+)/borrowing (-)	0.2	-11.7	-6.2	-0.8	3.2	0.6	0.7	0.7	0.7	0.8	0.8
<i>Memorandum items:</i>											
Primary balance	6.2	-6.2	-1.3	3.6	8.3	6.1	6.6	6.7	6.8	6.9	7.2
Structural balance	-0.2	-4.7	-4.0	-3.2	1.3	-1.0	-0.9	-0.4	0.1	0.4	0.8
Structural primary balance	5.9	0.8	1.0	1.2	6.4	4.5	5.0	5.6	6.1	6.6	7.2
Debt at face value (EDP notification)	250.0	270.5	269.1	272.4	263.1	262.5	261.9	261.2	260.5	259.8	259.1
Nominal GDP	214.4	200.5	216.1	242.3	265.5	278.1	291.5	303.0	314.9	327.2	340.0

Sources: BdP, Eurostat, INE, Haver Analytics, Portugal's Ministry of Finance, and IMF staff calculations/projections.

1/ GFSM 2001 presentation.

**Table 2B. Portugal: General Government Accounts, 2019–29 1/**  
(Percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	2023	Projections					
						2024	2025	2026	2027	2028	2029
Revenue	42.5	43.4	44.6	43.8	43.5	43.5	43.2	43.0	42.7	42.7	42.7
Taxes	24.7	24.6	24.6	25.6	25.2	24.8	24.6	24.5	24.4	24.4	24.4
Taxes on production and imports	15.0	14.6	15.0	15.0	14.5	14.7	14.7	14.8	14.8	14.8	14.8
Current taxes on income, wealth, etc. and capital taxes	9.7	10.0	9.6	10.6	10.7	10.1	9.9	9.7	9.6	9.5	9.6
Social contributions	11.8	12.8	12.6	12.2	12.3	12.3	12.2	12.2	12.3	12.3	12.3
Grants and other revenue	6.1	6.1	7.4	6.0	6.0	6.4	6.4	6.3	6.0	6.1	6.1
Property income	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Sales of goods and services	3.5	3.3	3.1	3.2	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Other current revenue	1.4	1.7	2.3	1.5	1.3	1.4	1.4	1.4	1.4	1.4	1.4
Capital transfers and investment grants	0.3	0.3	1.2	0.6	0.9	1.2	1.2	1.1	0.8	0.8	0.8
Expenditure	42.4	49.2	47.5	44.1	42.3	43.2	43.0	42.8	42.4	42.5	42.5
Expense	43.2	49.8	47.6	44.3	42.4	43.0	42.7	42.6	42.5	42.6	42.6
Compensation of employees	10.7	11.9	11.6	10.7	10.5	10.6	10.5	10.6	10.7	10.7	10.8
Use of goods and services	5.2	5.6	5.8	5.5	5.3	5.3	5.1	5.1	5.1	5.1	5.1
Consumption of fixed capital	2.6	2.8	2.8	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Interest	3.0	2.9	2.4	1.9	2.2	2.2	2.3	2.2	2.2	2.1	2.1
Subsidies	0.4	1.8	2.0	1.1	0.8	0.7	0.7	0.6	0.5	0.5	0.4
Social benefits	18.1	20.1	19.3	18.5	17.5	18.0	18.0	18.2	18.4	18.6	18.7
Grants and other expense	3.3	4.6	3.9	4.0	3.7	3.6	3.5	3.4	3.4	3.4	3.4
Other current expense	2.2	2.5	2.7	2.6	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Capital transfers	1.1	2.1	1.2	1.4	1.3	1.1	1.1	1.1	1.0	1.0	1.0
Unidentified saving measures to meet budget target	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	-0.4	-0.5	-0.5
Net acquisition of nonfinancial assets	-0.8	-0.5	-0.2	-0.2	0.0	0.3	0.3	0.2	-0.1	-0.1	-0.1
Gross fixed capital formation	1.8	2.4	2.6	2.4	2.6	2.9	2.9	2.8	2.5	2.5	2.5
Gross Operating Balance	1.9	-3.5	-0.3	2.1	3.8	3.1	3.1	3.1	2.7	2.7	2.7
Net lending (+)/borrowing (-)	0.1	-5.8	-2.9	-0.3	1.2	0.2	0.2	0.2	0.2	0.2	0.2
<i>Memorandum items:</i>											
Primary balance	2.9	-3.1	-0.6	1.5	3.1	2.2	2.3	2.2	2.2	2.1	2.1
Cyclically-adjusted balance (percent of potential GDP)	-0.7	-2.7	-1.5	-1.4	0.3	-0.4	-0.3	-0.1	0.0	0.1	0.2
Cyclically-adjusted primary balance (percent of potential GDP)	2.2	-0.1	0.8	0.4	2.2	1.6	1.7	1.9	2.0	2.0	2.1
Structural balance (percent of potential GDP)	-0.1	-2.3	-1.8	-1.3	0.5	-0.4	-0.3	-0.1	0.0	0.1	0.2
Structural primary balance (percent of potential GDP)	2.8	0.4	0.4	0.5	2.5	1.6	1.7	1.9	2.0	2.0	2.1
Change in structural primary balance (percent of potential GDP)	-0.3	-2.4	0.1	0.1	2.0	-0.8	0.1	0.1	0.1	0.1	0.1
Debt at face value (EDP notification)	116.6	134.9	124.5	112.4	99.1	94.4	89.8	86.2	82.8	79.4	76.2
Nominal GDP (billions of Euros)	214.4	200.5	216.1	242.3	265.5	278.1	291.5	303.0	314.9	327.2	340.0

Sources: BdP, Eurostat, INE, Haver Analytics, Portugal's Ministry of Finance, and IMF staff calculations/projections.

1/ GFSM 2001 presentation.

**Table 3A. Portugal: Balance of Payments, 2019–29**  
(Billions of Euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	Projections					
						2024	2025	2026	2027	2028	2029
Current and Capital account	2.8	-0.1	2.1	-0.5	7.2	12.8	12.9	12.8	7.9	7.2	7.4
Current account	0.9	-2.1	-1.6	-2.8	3.6	5.6	6.6	6.6	5.5	4.9	5.1
Balance on goods and services	1.7	-3.9	-5.5	-4.7	3.3	3.5	5.2	5.2	4.9	4.9	4.4
Balance on trade in goods	-16.3	-12.5	-16.0	-26.4	-24.7	-25.7	-25.0	-25.8	-26.9	-27.6	-28.7
Exports, fob	58.0	52.1	62.1	75.9	74.6	77.8	79.7	82.4	85.2	88.1	92.8
Imports, fob	74.2	64.6	78.1	102.4	99.3	103.4	104.8	108.2	112.1	115.7	121.5
Balance on trade in services	17.9	8.6	10.5	21.8	28.0	29.1	30.2	31.1	31.8	32.4	33.1
Exports	35.7	22.3	27.5	44.6	51.7	53.9	56.1	58.0	59.7	61.5	63.9
Imports	17.8	13.7	17.0	22.9	23.7	24.8	25.9	26.9	28.0	29.1	30.8
<i>Of which:</i>											
Balance on tourism	13.2	5.0	6.5	15.6	18.8	19.5	20.1	20.6	21.0	21.4	22.2
Exports	18.3	7.7	10.1	21.1	25.1	26.2	27.3	28.2	29.1	29.9	31.4
Imports	5.1	2.7	3.6	5.5	6.3	6.7	7.2	7.6	8.0	8.5	9.2
Primary income, net	-5.1	-2.7	-1.7	-3.4	-4.8	-4.4	-4.2	-4.0	-3.4	-3.7	-2.6
Secondary income, net	4.4	4.5	5.7	5.3	5.2	6.5	5.6	5.3	4.0	3.7	3.3
Private remittances, net	5.7	5.8	6.1	6.6	6.8	6.7	6.5	6.3	6.1	5.9	5.7
Official transfers, net	-1.3	-1.3	-0.4	-1.3	-1.6	-0.2	-0.9	-1.0	-2.1	-2.2	-2.4
Capital account	1.9	2.0	3.7	2.3	3.6	7.3	6.2	6.2	2.3	2.3	2.3
Financial account	3.2	0.1	2.5	-0.3	8.0	12.8	12.9	12.8	7.9	7.2	7.4
Direct investment, net	-7.8	-4.9	-7.3	-5.5	-3.4	-2.6	-2.7	-2.8	-3.0	-2.8	-2.2
Direct investment assets	1.4	-1.5	-0.2	3.6	5.6	5.8	6.1	6.3	6.6	6.8	7.1
Direct investment liabilities	9.2	3.4	7.1	9.1	9.0	8.4	8.8	9.2	9.6	9.7	9.3
Portfolio investment, net	8.1	5.1	13.3	6.0	8.5	-6.8	-3.3	0.9	6.0	4.6	10.9
Financial derivatives	0.1	0.5	0.0	-4.4	-1.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other investment, net	5.0	-0.1	-7.0	3.5	4.4	22.2	18.9	14.8	4.9	5.5	-1.2
Reserve assets	-2.3	-0.4	3.5	0.2	-0.5	0.1	0.1	0.1	0.1	0.1	0.1
Errors and omissions	0.3	0.2	0.5	0.2	0.8	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>											
Nominal GDP	214.4	200.5	216.1	242.3	265.5	278.1	291.5	303.0	314.9	327.2	340.0

Sources: BdP, Eurostat, INE, Haver Analytics, Portugal's Ministry of Finance, and IMF staff calculations/projections.

**Table 3B. Portugal: Balance of Payments, 2019–29**  
(Percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	2023	Projections					
						2024	2025	2026	2027	2028	2029
Current and Capital account	1.3	-0.1	1.0	-0.2	2.7	4.6	4.4	4.2	2.5	2.2	2.2
Current account	0.4	-1.0	-0.8	-1.1	1.4	2.0	2.3	2.2	1.8	1.5	1.5
Balance on goods and services	0.8	-1.9	-2.6	-1.9	1.2	1.2	1.8	1.7	1.6	1.5	1.3
Balance on trade in goods	-7.6	-6.2	-7.4	-10.9	-9.3	-9.2	-8.6	-8.5	-8.5	-8.4	-8.4
Exports, fob	27.0	26.0	28.7	31.3	28.1	28.0	27.4	27.2	27.1	26.9	27.3
Imports, fob	34.6	32.2	36.1	42.2	37.4	37.2	35.9	35.7	35.6	35.4	35.7
Balance on trade in services	8.4	4.3	4.9	9.0	10.6	10.5	10.4	10.3	10.1	9.9	9.7
Exports	16.7	11.1	12.7	18.4	19.5	19.4	19.2	19.1	19.0	18.8	18.8
Imports	8.3	6.8	7.9	9.4	8.9	8.9	8.9	8.9	8.9	8.9	9.1
<i>Of which:</i>											
Balance on tourism	6.1	2.5	3.0	6.4	7.1	7.0	6.9	6.8	6.7	6.6	6.5
Exports	8.5	3.8	4.7	8.7	9.5	9.4	9.4	9.3	9.2	9.1	9.2
Imports	2.4	1.4	1.7	2.3	2.4	2.4	2.5	2.5	2.5	2.6	2.7
Primary income, net	-2.4	-1.4	-0.8	-1.4	-1.8	-1.6	-1.4	-1.3	-1.1	-1.1	-0.8
Secondary income, net	2.0	2.3	2.6	2.2	2.0	2.3	1.9	1.8	1.3	1.1	1.0
Private remittances, net	2.7	2.9	2.8	2.7	2.6	2.4	2.2	2.1	1.9	1.8	1.7
Official transfers, net	-0.6	-0.6	-0.2	-0.5	-0.6	-0.1	-0.3	-0.3	-0.7	-0.7	-0.7
Capital account	0.9	1.0	1.7	0.9	1.4	2.6	2.1	2.1	0.7	0.7	0.7
Financial account	1.5	0.1	1.2	-0.1	3.0	4.6	4.4	4.2	2.5	2.2	2.2
Direct investment, net	-3.6	-2.5	-3.4	-2.3	-1.3	-0.9	-0.9	-0.9	-1.0	-0.9	-0.7
Direct investment assets	0.7	-0.8	-0.1	1.5	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Direct investment liabilities	4.3	1.7	3.3	3.8	3.4	3.0	3.0	3.0	3.0	3.0	2.7
Portfolio investment, net	3.8	2.5	6.2	2.5	3.2	-2.4	-1.1	0.3	1.9	1.4	3.2
Financial derivatives	0.0	0.2	0.0	-1.8	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	2.4	-0.1	-3.3	1.4	1.7	8.0	6.5	4.9	1.6	1.7	-0.4
Reserve assets	-1.1	-0.2	1.6	0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.2	0.1	0.2	0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>											
Tourist receipts (percent of total exports)	19.5	10.4	11.2	17.5	19.9	19.9	20.1	20.1	20.0	20.0	20.0
Net international investment position	-100.0	-104.6	-94.4	-83.6	-72.5	-64.6	-57.2	-50.8	-46.4	-42.5	-38.7
Annual Change in NIIP valuation <sup>1/</sup>	-1.0	-0.5	1.7	5.0	3.9	0.0	0.0	0.0	0.0	0.0	0.0
Gross external debt	191.6	204.8	189.9	166.0	153.0	148.4	142.6	136.5	130.1	124.0	116.9

Sources: BdP, Eurostat, INE, Haver Analytics, Portugal's Ministry of Finance, and IMF staff calculations/projections.

<sup>1/</sup> end-of-period data

**Table 4. Portugal: Selected Financial Indicators of the Banking System, 2019–24**  
(Percent)

	2019	2020	2021	2022	2023			2024	
	2019Q4	2020Q4	2021Q4	2022Q4	2023Q1	2023Q2	2023Q3	2023Q4	2024Q1
Capital adequacy									
Regulatory capital to risk-weighted assets	16.9	18.0	18.0	18.2	18.4	18.9	18.9	19.6	19.6
Common Equity Tier 1 capital to risk-weighted assets	14.3	15.3	15.5	15.4	15.6	16.4	16.4	17.1	17.1
Regulatory tier 1 capital to risk-weighted assets	15.4	16.5	16.3	16.2	16.4	17.2	17.2	17.9	17.9
Capital to assets 1/	8.3	8.2	7.3	7.2	7.5	7.8	7.5	7.7	7.6
Asset composition and quality									
Non-performing loans to total gross loans	6.2	4.9	3.7	3.0	3.1	3.1	2.9	2.7	2.7
Sectoral distribution of loans									
Residents	93.3	93.4	93.5	92.9	92.6	92.1	92.0	91.2	...
Nonresidents	6.7	6.6	6.5	7.1	7.4	7.9	8.0	8.8	...
Earnings and profitability									
Return on assets	0.4	0.0	0.5	0.7	1.2	1.2	1.3	1.3	1.4
Return on equity	4.8	0.5	5.4	8.7	13.9	13.7	14.7	14.8	15.5
Interest margin to gross income	66.9	63.6	58.9	62.2	69.0	70.8	72.4	72.0	76.8
Noninterest expenses to gross income	59.2	56.0	51.6	48.8	38.6	37.5	36.5	35.9	38.8
Liquidity									
Liquid assets to total assets 2/	18.1	21.5	25.3	23.2	21.4	21.5	22.3	24.6	25.2
Liquid assets to short-term liabilities 2/	22.5	26.3	30.7	28.4	26.4	26.3	27.7	30.7	31.6
Loans to deposits 3/	87.1	84.7	81.1	78.2	79.9	79.6	79.2	78.0	76.7

Sources: BdP, ECB, and IMF staff calculations.

1/ On accounting basis; consolidated.

2/ National concept of asset quality.

3/ Data reflects the information from Instruction No 23/2004 of BdP (until 2015Q3). From 2015Q4, data is based on the ITS reporting framework.

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## Annex I. External Sector Assessment

<b>Overall Assessment:</b> <i>The external position improved in 2023 and was moderately stronger than the level implied by medium-term fundamentals and desirable policies.</i> The NIIP-to-GDP ratio further improved from -84 percent in 2022 to -73 percent in 2023. Under baseline assumptions, it is projected to fall to -39 percent by 2029, reflecting both an improvement in the current account balance and sustained GDP growth. The strong reduction in the NIIP reduces external sustainability risks, especially as the importance of tourism in the current account makes Portugal susceptible to external demand shocks. <b>Potential Policy Responses:</b> Further reducing external debt and keeping the current account in line with its norm will continue to require sustained tight fiscal policy. Structural reforms to improve Portugal's savings rate, competitiveness, diversification, and economic resilience remain warranted. Improvements in education outcomes, innovation, and real wage flexibility while reducing labor market duality would contribute to productivity gains. Public investments under the RRP provide an opportunity to transition to a greener, more competitive, and digital economy while associate grants boost the capital account. Private investment can be spurred by reforms to enhance business conditions—notably by streamlining regulations.					
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> The negative NIIP declined from its peak in 2014 of 124 percent of GDP to 73 percent of GDP in 2023, after a rebound to 105 percent in 2020, because of the pandemic-induced decline in GDP. The improvement in 2023 reflects a larger decrease in gross liabilities than in assets in percent of GDP, supported by a current account (CA) surplus of 1.4% of GDP. The gross external debt position has been declining but remains high at 143 percent at end-2023. Both the NIIP and gross external debt are expected to continue improving during the projection horizon, but at a decelerating rate as the CA surplus becomes smaller. <b>Assessment.</b> The large negative NIIP position has been reduced to a more moderate level, alleviating external sustainability concerns. Still, the external debt induces vulnerabilities, particularly from its substantial gross financing needs (estimated at an average 57 percent of GDP over 2024-29), and potential valuation changes. Past debt management efforts to reduce sovereign external risk, including by smoothing the profile for redemptions and lengthening the average maturity are important risk mitigants. Going forward, reflecting a sustained reduction in foreign liabilities, the NIIP is expected to continue improving and reach 38.7 percent of GDP by 2029, below the objective of reducing the negative NIIP below -50 percent of GDP discussed in previous staff reports, pointing to a CA broadly in line with its norm.				
	2023 (% GDP)	NIIP: -72.5	Gross Assets: 152.2	Debt Assets: 131.0	Gross Liab.: 224.7
<b>Current Account</b>	<b>Background.</b> The current account returned to a surplus in 2023. The CA was in surplus during 2013–19, after an extended period of deficits. The surpluses were driven by a significant improvement in the balance of trade in goods and services, including owing to strong growth in tourism, and a substantial improvement in the savings-investment balance from fiscal adjustment. During the pandemic, lower tourism service exports kept the current account in modest deficits. In 2023, the CA balance registered a surplus of 1.4 percent of GDP, improving by 2.5 pp relative to 2022, driven by a stronger increase in export volumes than in import volumes, and a fall in import prices as energy costs normalized. The services balance (of which tourism accounts for 67 percent) contributed positively to the CA surplus, while the goods balance was negative. <b>Assessment.</b> The EBA model estimates the cyclically adjusted CA balance at 2.0 percent of GDP. The EBA CA model suggests a norm of -0.6 percent of GDP. Accounting for uncertainty in the estimates, this implies a CA gap in the range of 1.9 to 3.3 percent of GDP, with a point estimate of 2.6 percent of GDP. Policy gaps, reflecting deviations of current policy settings in Portugal from their desired settings, contribute 0.8 percent while the unexplained residual represents 1.6 percent. The high reliance of the CA surplus on tourism suggests a vulnerability to external shocks, for which the successful reduction in external debt provides welcome buffers. To continue strengthening the external position, given the still high level of public debt, a sustained tight fiscal policy paired with structural reforms to support both saving and investment and improve external competitiveness remain key.				
	2023 (% GDP)	CA: 1.4	Cyclically adjusted. CA: 2.0	EBA Norm: -0.6	EBA Gap: 2.6



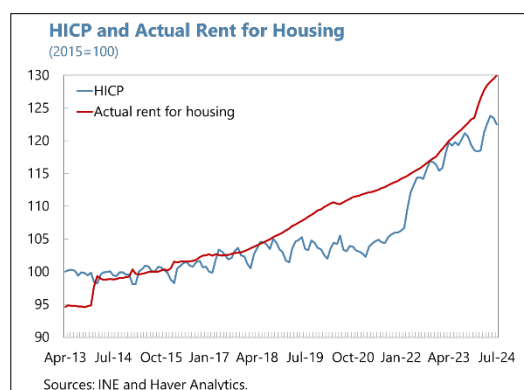
<b>Real Exchange Rate</b>	<p><b>Background.</b> Both the CPI-based real effective exchange rate (REER) and the unit labor cost (ULC)-based REER appreciated between 2022 and 2023, by 1.8 percent and 0.8 percent, respectively.</p> <p><b>Assessment.</b> Based on the staff-assessed CA gap range, the REER is undervalued in the range of 4.3 to 9.7 percent, with a midpoint of 7 percent (applying an estimated elasticity of the CA balance to the REER of 0.37). The EBA CPI-based REER index model suggests an undervaluation of 4.5 percent, in line with the level REER model's estimate of a 4.7 percent undervaluation in 2023.</p>
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Financing conditions became more challenging in 2023 due to the ECB's monetary tightening amid inflationary pressures. At the same time, Portugal has continued to reduce its public debt to just below 100 percent of GDP at end-2023. Overall, sovereign interest rates increased from an average of 2.16 in 2022 to 3.21 in 2023 while spreads relative to the bund fell from an average of 96 basis points in 2022 to 76 basis points in 2023. The financial account posted a surplus of 3.2 percent of GDP owing to portfolio investments. Portugal's credit ratings were improved by all major agencies between 2023 and early 2024, bringing them in the range of upper medium investment grade (as of August 2024, Portugal's ratings are: S&amp;P: A-, Moody's: A3, Fitch: A-, DBRS: A).</p> <p><b>Assessment.</b> Portugal's active debt management has not only helped support external financing rollover needs for the near term in the public sector but has also had positive spillover effects on the private sector. 2023 saw consistent rating upgrades not only for the sovereign, but also for the private sector, which lowered funding costs. Still, existing external financing needs leave Portugal exposed to market volatility, especially in a context of tight global financial conditions.</p>
<b>FX Intervention and Reserves</b>	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the Euro Area are typically low relative to standard metrics, but the currency is free floating.</p>

## Annex II. Housing Affordability<sup>1</sup>

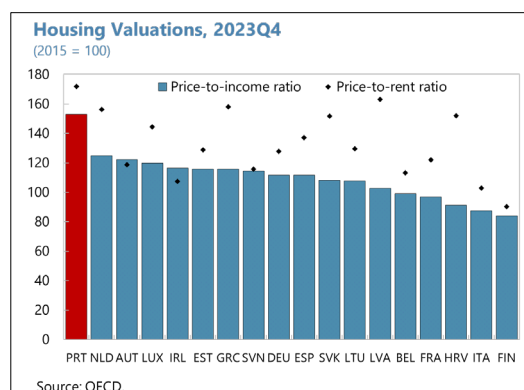
*Housing affordability significantly declined during the last decade. Mortgage holders have faced rising variable interest rates, tenants are burdened by rents that have increased substantially faster than CPI, and would-be homeowners struggled with both soaring residential estate prices and higher interest rates. Overcrowding is becoming more prevalent, especially in urban areas, as households adjust to rising costs by downsizing. Recent housing policies focused on the demand side and have produced mixed results. Addressing local housing supply shortages is essential to match household demand, with actions required to reduce regulatory and administrative barriers and address labor shortages in the construction sector.*

### A. Background

**1. Housing is an expensive part of households' budgets.** Likely reflecting a long period of low interest rates, demand for high-end units for golden visa purposes, and the conversion of units into short-term touristic rentals, housing prices in Portugal increased by 111 percent since 2015, vis-à-vis the EA average of 42 percent. Estimates of overvaluation range between 15 and 30 percent, (European Commission, 2024<sup>2</sup>; Valderrama, 2023<sup>3</sup>) although they should be interpreted with caution as they may not properly reflect external demand factors. The price for actual housing rentals (a component of HICP) increased by 29.5 percent between 2015 and June 2024, while total HICP increased by 23.5 percent over the same period.



**2. Mortgage holders, would-be owners, and tenants alike face higher housing costs, as housing affordability is deteriorating** (Figure 8). About 70 percent of dwellings are occupied by owners, while 30 percent are home to renters. For existing owners, housing affordability is strongly driven by the interest-rate environment as a large share of outstanding mortgages is at variable rates. As a result of monetary tightening and rising interest rates, average mortgage payments now represent 32.8 percent of average income, up from 23.8 percent four years ago. Furthermore, as measured by a new index of housing



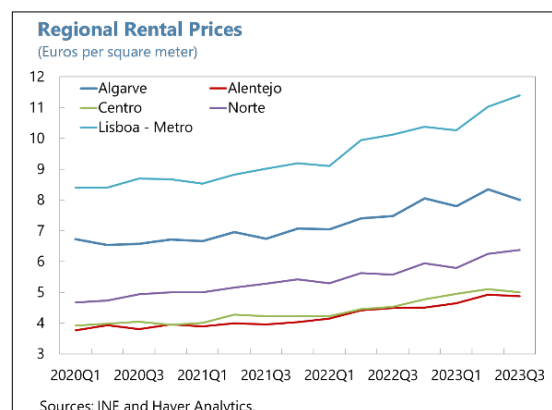
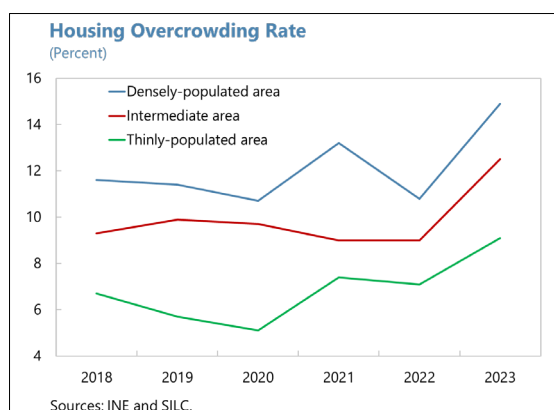
<sup>1</sup> Prepared by Hannah Winterberg and Gohar Minasyan.

<sup>2</sup> European Commission, 2024, "[In-Depth Review 2024 Portugal](#)" Institutional Paper 285.

<sup>3</sup> Valderrama, L., 2023, "[Household Vulnerabilities, Financial Stability, and the Role of Policies in Portugal](#)", IMF Selected Issues Paper No. 2023/046.

affordability (Biljanovska, et al, 2023<sup>4</sup>), a median-income household no longer qualified for a mortgage loan to purchase an average-priced home in 2023, contrary to the recent past. Reflecting rapidly rising housing prices, by 2023Q2, 1½ times the median income was needed to obtain a mortgage for an average-priced home. For renters, the median price of new rental agreements increased to €7.465 per sqm as of 2024Q1, a real increase of 12 percent over three years. From 2022 to 2023 alone, rents (as measured in the HICP basket) grew by 4.5 percent, compared to 2.9 percent in the EU.

**3. Overcrowding is becoming more prevalent in response to higher costs.** Considering housing deprivation indicators from the survey on income and living conditions, overburdened households have responded to higher costs by using less space, by moving in together or moving to smaller residential units or not moving to bigger homes when their family grew. In 2023, 12.9 percent of the population lived in dwellings where the number of habitable rooms was insufficient for the size and composition of the household, a 3.4 percentage points increase from the year before. Overcrowding increased across all age groups and more in urban than in rural areas.



## B. Underlying Trends

**4. Conditions in the real estate markets differ strongly by region.** Both home buyers and renters pay twice as much per square meter in Lisbon as their peers in Alentejo, and the gap increased in the last three years. As another manifestation of different regional mismatches between housing supply and households' needs, in aggregate, Portugal exhibits sizeable shares of both underoccupied dwellings and overcrowding.

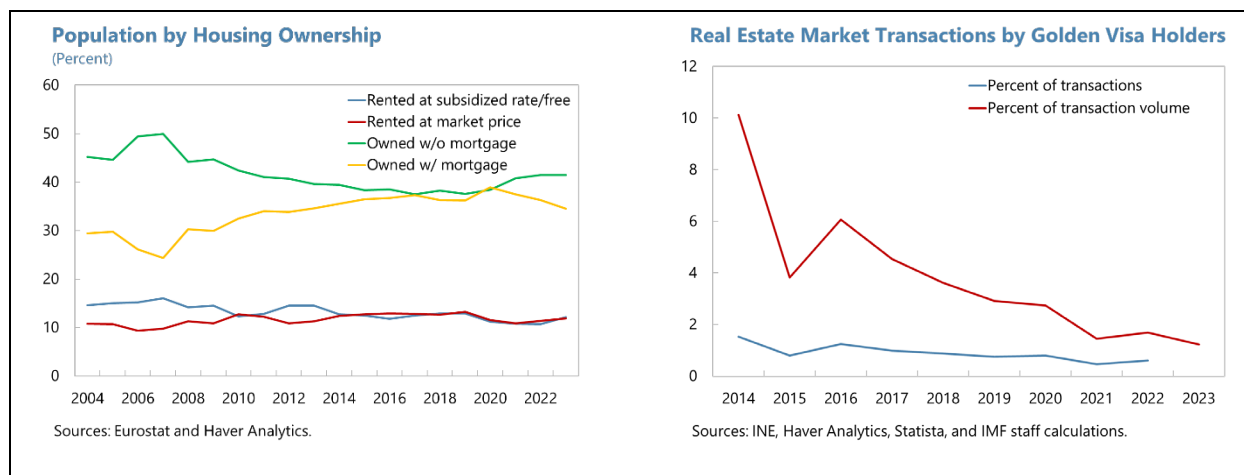
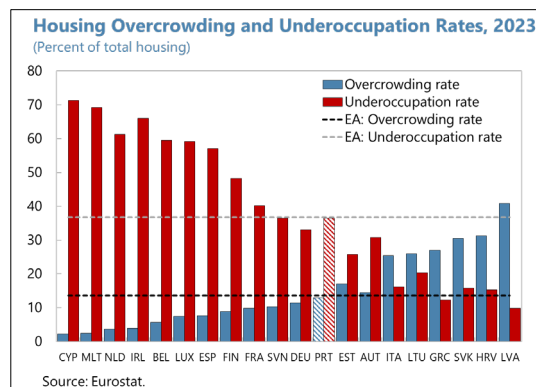
<sup>4</sup> Biljanovska, N., Fu, C., Igan, D.O., 2023, "[Housing Affordability: A New Dataset](#)" IMF Working Paper, 2023/247.

**5. Ownership is prevalent, and the share of owners reliant on mortgages has been increasing.**

The ownership rate fluctuated around 75 percent over the last two decades, modestly increasing to 78 percent during the negative interest rate environment. Among owners, the share of those with mortgages has been increasing since 2007, although there was a slight reversal of the trend in 2022.

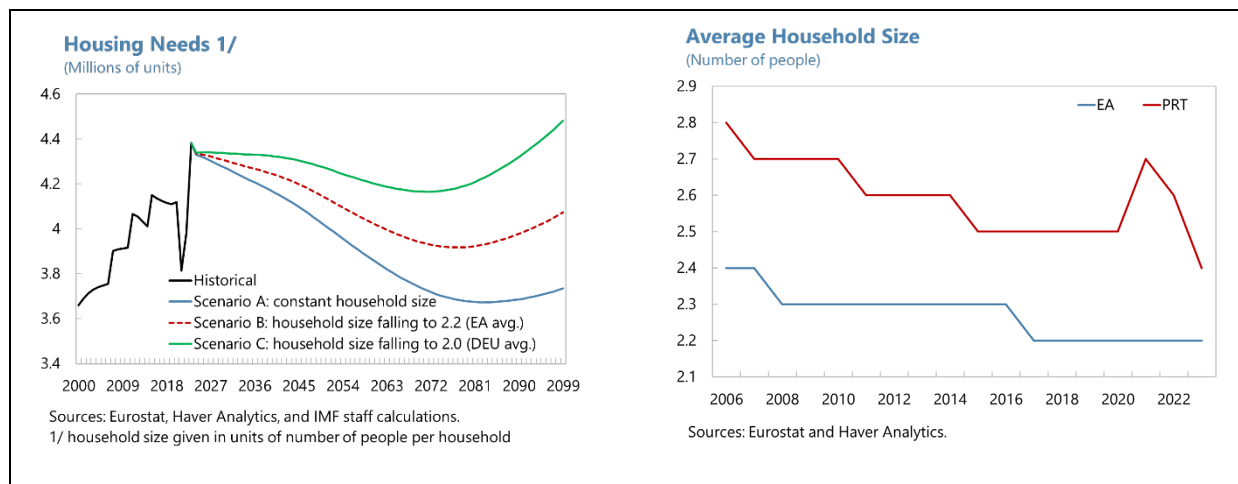
**6. Real estate purchases by investors seeking a residency permit for investors (“golden visas”) played a small but not negligible role in the real estate market.**

In recent years, these investors accounted for about 1 percent of transactions and about 2 percent of transaction values as these buyers targeted by design a highly-priced subset of the market (the minimum spending required to obtain such a visa was €350K for specific cases and €500K for most properties). It is likely that demand from foreign investors was highly concentrated in cities, mostly Lisbon, impacting these specific markets more strongly, but granular data is not available to ascertain this assumption. The government recently abolished the RRE component of its golden visas scheme. Given the limited scope of these buyers in the aggregate, this change is unlikely to have a material impact in aggregate but may affect some specific markets.



**7. Household composition effects could balance the expected fall in demand from demographic change over the next decades.** Portuguese households are becoming smaller, with on average 2.4 persons in 2022, down from 2.8 in 2006, which is still higher than the EA average of 2.2 persons. To estimate housing needs of the Portuguese population, staff considered three scenarios of how the size of households could evolve until the end of the century: (A) unchanged; (B) gradually falling to reach the EA average; and (C) falling to 2.0, the average size of German households in 2022. Under scenario A, housing needs would fall to a level similar to the early 2000s, at around 3.7 million units. They stabilize at over 4 million units under scenario B. Under scenario C,

they expand significantly to more than 4.4 million units by 2100. Depending on household compositions, different types of housing will be demanded.



## C. Recent Housing Policies and New Initiatives

**8. Recent housing policies had mixed success.** In response to deteriorating housing affordability, the authorities introduced measures to alleviate the housing cost burden, particularly for mortgage holders:

- **Early repayment fees were suspended to help borrowers restructure their debts.** This was recently extended through end-2024. The government also required banks to proactively offer a restructuring when a significant worsening of the “effort rate” (debt-service-to-income) was identified.
- **A temporary measure was to allow the postponement of amortization.** From October 2023 to March 2024, holders of mortgages on their primary residence were allowed to fix the monthly installments of their variable rate loans at a certain level for 24 months. Although causality to the policy measures cannot be attributed, households reduced their average monthly capital amortization from €215 in February 2022 to €155 in February 2024, thereby mitigating the impact of the higher interest rates on their housing cost.
- **An interest rate subsidy for vulnerable groups saw a low uptake and was recalibrated.** The subsidy, which is administered by the banks, was introduced in March 2022 and recalibrated in October 2023. In the recalibration, the eligibility criteria were streamlined and the formula for the size of the subsidy was simplified. Overall, 65 percent of applications were rejected.
- **The increase in annual rent was capped.** In 2023, the government capped the rent increases at 2 percent with some compensating tax measures for landlords. In 2024, the cap returned to previous year’s CPI inflation excluding housing, i.e., about 7 percent.

- ***‘Mais Habitação’ policy package was introduced by the previous government.*** The program came into effect in October 2023, mostly aiming to supply more homes on the rental market through tax incentives. These included a tax exemption for capital gains from property sales to the state, with the objective of increasing the supply of public housing, beneficial tax treatments for landlords, and rewards for switching vacation rentals to housing.

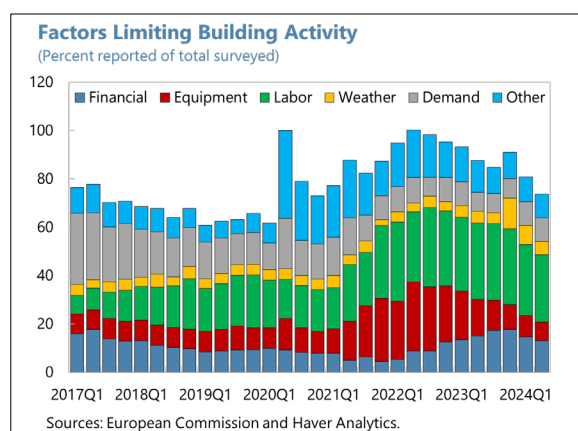
**9. Recent policy measures by the new government focus on direct support to certain population groups and promoting new construction, including:**

- ***A public guarantee for young first-time homebuyers was introduced.*** Individuals between 18 and 35 years of age with income up to the 8<sup>th</sup> income tax bracket applying for bank financing will be eligible for a public guarantee for up to 15 percent of the transaction value for properties valued up to 450 thousand euros.
- ***‘Construir Portugal’ will replace ‘Mais Habitação’.*** ‘Construir Portugal’ maintains the key elements of ‘Mais Habitação’ but places a stronger emphasis on new housing construction. It includes regulatory reforms to streamline the housing development process, revisions to zoning regulations, use of public land, and more extensive subsidies and grants for various demographics. Many of these reforms are supported by RRP.

## D. Conclusion

**10. Continued improvement in house supply where needed remains crucial to solving housing problems.** ‘Construir Portugal’ may help

address some of the root causes of housing shortages if it is successful in reducing regulatory barriers to construction. Subsidies and grants for various demographics would be helpful if they are properly targeted to vulnerable households. The age-based public guarantee benefit for first-time homebuyers will make it easier for the eligible category to obtain credit, but as all age-based measures, is prone to threshold issues. As labor shortages are consistently reported in survey results as a key factor limiting building activity, efforts to alleviate them remain important, both in general and in the construction sector, where shortages appear to be particularly acute.



## Annex III. Risk Assessment Matrix<sup>1</sup>

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
<b>External Risks</b>				
<b>Intensification of regional conflicts.</b> Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	<b>High</b>	<b>ST</b>	<b>Medium</b> A commodity price shock could slow growth and rekindle inflation. But if Portugal is seen as a safer destination, its economy could benefit from tourism diversion, which would mitigate the growth slowdown. Increased inflow of refugees could raise unemployment and may cause political polarization.	Make full use of automatic stabilizers to address the growth slowdown. Well-targeted and temporary support to vulnerable groups. Expand Active Labor Market Policies (ALMPs) to aid refugees in entering sectors with labor shortages.
<b>Commodity price volatility.</b> Supply and demand fluctuations (e.g., due to conflicts, export restrictions, and OPEC+ decisions, and green transition) cause recurrent commodity price volatility, external and fiscal pressures and food insecurity in EMDEs, cross-border spillovers, and social and economic instability.	<b>High</b>	<b>MT</b>	<b>High</b> Higher commodity price volatility may discourage investment and consumption and dampen growth.	In case of a persistent recession that impacts domestic demand, consider reintroducing temporary and well-targeted support to vulnerable households and struggling yet viable businesses. Tie the level of support for businesses to their achievement of energy efficiency goals. Accelerate the transition to renewable energy by increasing investment in this sector.
<b>Global growth slowdown.</b> Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate contraction, with adverse spillovers through trade and financial channels, triggering sudden stops in EMDEs.	<b>Medium</b>	<b>ST, MT</b>	<b>High</b> Negative spillover effects on Portugal through trade linkages and supply chains, especially lower tourism.	Automatic stabilizers should first be deployed. In a severe recession, temporary fiscal loosening may be needed to support the economy (depending on the ECB's monetary policy in this scenario), while credibly committing to return to a fiscal position consistent with the debt reduction goals as the economy

<sup>1</sup> The risk assessment matrix shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
<b>External Risks</b>				
				recovers. For the medium term, reduce the reliance on tourism by diversifying the economy or explore avenues to reduce its cyclicity to build a more resilient economy.
<b>Monetary policy calibration.</b> Amid high economic uncertainty, major central banks' stances turn out to be too loose, hindering disinflation, or too tight for longer than warranted, which stifles growth and triggers increased capital flow and exchange rate volatility in EMDEs.	<b>Medium</b>	<b>ST, MT</b>	<b>Medium</b> Prematurely loosening monetary policy could trigger inflation while delayed monetary loosening could overly restrict lending, amplify financial strains on both households and firms, and dampen growth.	With monetary policy setting beyond the direct control of the authorities, fiscal policy will need to adjust to the monetary policy (mis)calibration to help foster a soft landing of the economy. Financial sector policies should ensure close monitoring of financial conditions and make use of macro-prudential buffers to sustain credit provision in a healthy manner.
<b>Systemic financial instability.</b> High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty (including from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	<b>Medium</b>	<b>ST, MT</b>	<b>Medium</b> A sudden correction in house prices could increase bank losses on defaulted exposures. Banks' sizable exposure to housing mortgages imply that a worsening credit quality would shrink their capital. Lower bank capital could in this case unduly constrain credit.	Continue close monitoring of banks' capital positions and risk management practices to contain systemic risk. Further strengthen guidance on prudent lending standards. In the event of a sharp downturn, relax macroprudential buffers so that banks could keep credit flow.
<b>Sovereign debt distress.</b> Domino effects from high global interest rates, deteriorating debt sustainability in some AEs, unfunded fiscal spending, and/or disorderly debt events in some EMDEs spillover to other highly indebted countries, amplified by sovereign-bank feedback, resulting in capital outflows, rising risk premia, loss of market access, and contraction of growth and social spending.	<b>Medium</b>	<b>ST, MT</b>	<b>Medium</b> Considering Portugal's still-high debt level, a sovereign debt distress could result in higher spreads that would disrupt the debt reduction path. Lower investment due to lost confidence and higher financing costs would negatively impact the economy.	Remain committed to debt reduction in the medium-term budget planning to contain bond spreads from increasing.



Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
<b>External Risks</b>				
<b>Deepening geo-economic fragmentation.</b> Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	<b>High</b>	<b>MT</b>	<b>Medium</b>  Portugal is vulnerable to deglobalization due to its strong dependence on international trade and tourism.  EU/EA membership mitigates geo-economic fragmentation risk via possible opportunities associated with nearshoring.	Promote international cooperation via active participation in joint efforts to promote green transitions and policy coordination in Euro Area and beyond. Reduce regulatory barriers to provide an attractive environment for nearshoring.  Diversify the economy to reduce the dependence on tourism and external environment.
<b>Portugal-Specific Risks</b>				
<b>Political uncertainty.</b> Given the lack of a majority, the new government may face difficulties in implementing policies, including fiscal consolidation and structural reforms to support higher potential growth, energy security, climate transition and digital transformation.	<b>High</b>	<b>ST, MT</b>	<b>High</b>  Prolonged inaction in urgent policy areas may dampen economic outlook, weaken competitiveness, and result in social frictions. Deviating from the commitment to fiscal consolidation could result in substantial increases in borrowing costs.	Build political consensus.
<b>Lower absorption of NGEU funds.</b> Slow implementation of the NGEU investment and reform agenda.	<b>Medium</b>	<b>MT</b>	<b>Medium</b>  Delayed investment financed by NGEU funds could slow medium-term growth and delay the push for a more digital and greener economy.	Strengthen administrative capacity to implement projects. Build consensus on reforms that are milestones for fund disbursements.

## Annex IV. The Sovereign Risk and Debt Sustainability Assessment

*Supported by strong growth and fiscal position since COVID-19 pandemic, Portugal's public debt sharply declined from a peak of 135 percent of GDP in 2020 to 99 percent of GDP in 2023. Under the baseline scenario, the debt-to-GDP ratio is projected to continue declining and reach 76 percent of GDP by 2029, driven by sustained growth and a projected strong primary balance. The projected declining path could be jeopardized (i) negative growth shocks, (ii) the authorities not meeting announced fiscal target of 0.2 percent of fiscal surplus throughout the forecast horizon, (iii) higher-than-projected pension and health-related spending, (iv) slower ramp-up of public investment under the RRP, and (v) real wage pressures beyond productivity growth.*

### A. Background

**1. Public debt declined substantially since the Covid-19 recession, driven by economic growth and improving primary balances.** The Covid-19 recession and the fiscal response raised the debt-to-GDP ratio by more than 18 ppts to 135 percent of GDP in 2020. Subsequently, the debt-to-GDP ratio declined substantially reaching 99 percent of GDP by end-2023. The decline was driven by strong GDP growth during 2021-23 and high inflation in 2022 and 2023, which resulted in nominal GDP growth rate of 12.2 and 9.6 percent in 2022 and 2023, respectively, as well as improvements in the primary balance from a deficit of 3.1 percent in 2020 to a surplus of 3.1 percent by 2023. The latter was supported by a decline in social benefits and subsidies reflecting a full-withdrawal of COVID-19 measures and reduced cost-of-living-support measures.

### B. Baseline Scenario

**2. Under the baseline scenario, Portugal's debt is projected to continue declining over the medium term, mainly driven by economic growth and fiscal primary surpluses.** Public debt is projected to decline by an annual average of about 3.8 pp of GDP during 2024–29 to 76 percent by 2029, driven by (i) strong real GDP growth (accounting for about half of the total reduction of around 10.5 ppt of GDP), and (ii) primary balance surpluses.

- **GDP growth.** Staff's baseline scenario projects medium-term growth to converge to about 2 percent, bolstered by public investments and reforms under the RRP. However, medium-term TFP growth could deteriorate if the RRP and other productivity-enhancing reforms are not implemented as planned, monetary policy is not sufficiently counter-cyclical, global fragmentation risks materialize, corporate vulnerabilities risk manifests, regional conflict intensifies, and/or global economy slows down. On the upside, faster-than-expected improvement in financial conditions, coupled with a faster decline in inflation to its target, may boost private consumption and investment. Labor market resilience and tourism momentum also mitigate downside risks.
- **Fiscal deficit.** The overall balance is projected to remain in a small surplus in 2024 with personal and corporate income tax reductions and pension and public wage increases offset by the almost full withdrawal cost-of-living fiscal support measures. Assuming the achievement of the

targeted small fiscal surpluses, the overall balance is projected to be broadly balanced over the medium, as continued pension and health-related spending pressures due to a rapidly aging population and a slightly increasing public wage bill are expected to be largely offset by spending reductions in other items (e.g., subsidies). Thus, additional expansionary fiscal measures introduced by the new government need to be calibrated or offset by yet unidentified saving measures.

- **Gross financing needs (GFN):** Gross financing needs are expected to remain slightly below 10 percent of GDP over the medium and long term. Interest rates on Portuguese sovereign bonds are projected to gradually stabilize over the projection horizon. The effective interest rate is expected to rise to reach 2.5 percent by 2029 as more expensive long-term debt issued in recent years gradually replaces past debt that carried lower interest rates. The current debt amortization schedule includes some years with redemption above the 10-year average by over one standard deviation; the debt management office is expected to continue smoothing redemption profile going forward.

## C. Risk Assessment

**3. Although declining, public debt is expected to remain high under the baseline and its trajectory susceptible to shocks.** Large negative growth shocks, similar to the two deep recessions that Portugal experienced in the past decade (with a cumulative real GDP contraction of 6.6 percent during 2011–13 and 8.3 percent in 2020), could push debt up and sharply increase borrowing costs. Although a negligible share of foreign currency debt keeps foreign exchange rate risk low, higher-than-needed policy rates would increase yields and could generate vulnerabilities.

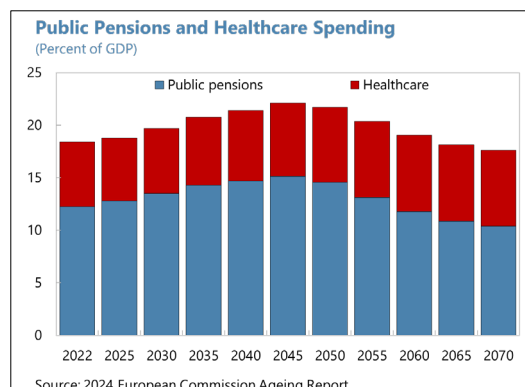
**4. Mitigating factors.** Despite the high debt and its sizable external financing profile under the baseline, important mitigating factors include: (i) the financing from the EU under the NGEU; (ii) a considerable share of debt to official creditors (around 26 percent of the total debt at end-2023); (iii) the relatively long tenure of the existing debt (around 7.5 years of average residual maturity); and (iv) the negligible share of foreign currency debt.

### 5. Realism of baseline assumptions.

- **Forecast track record:** In the past, forecast errors of debt-related variables for Portugal, including primary balance, r-g, and gross financing needs remained in the range of 25<sup>th</sup> to 75<sup>th</sup> percentile for one-year, three-year and five-year horizons, except for public debt, which is shown to be optimistic mainly due to the past two deep recessions Portugal experienced.
- **Contributing factors:** Realism analysis compares the contributions of public debt-creating flows between the past five years and the next five years. Real GDP growth and the primary balance are expected to be the largest drivers of the debt reduction.
- **Projected fiscal adjustment:** Portugal's three-year adjustment of the cyclically-adjusted primary balance (CAPB) is below the 50<sup>th</sup> percentile, rendering the projected fiscal adjustment feasible if government policies remain close to baseline projections.

**6. Fan chart:** The fan chart based on historical observations shows that public debt projections could deteriorate. The baseline projection for the debt path close to the lower end of the fan chart is mainly attributable to the two deep recessions that Portugal experienced in the past decade. Should such large negative growth shocks materialize, debt could derail from its downward path.

**7. Long-term risk assessment:** A long-term risk assessment includes debt-related stress that could materialize beyond the next five years. The impact of an aging population on pension and health spending could be an issue. The European Commission's 2024 Ageing Report<sup>1</sup> projects an increase in pension costs for Portugal, peaking in 2035 before gradually coming down. The gradual decline in pension spending in the outer years is partly explained by the projected increase in the employment rate among people aged between 55 and 74 and a corresponding gradual plateauing of the old-age dependency ratio toward the late 2040s. Healthcare expenditure is also expected to grow in Portugal, posing risks to public debt reduction over the long horizon. While the scenario is illustrative, it highlights the importance of reforms to address the impact of aging on pension and healthcare.



<sup>1</sup> European Commission, 2021, "[The 2021 Ageing Report: Economic and Budgetary Projections for the EU Member States \(2019-2070\)](#)", Institutional paper, 148

## Annex IV. Figure 1. Portugal: Risk of Sovereign Stress

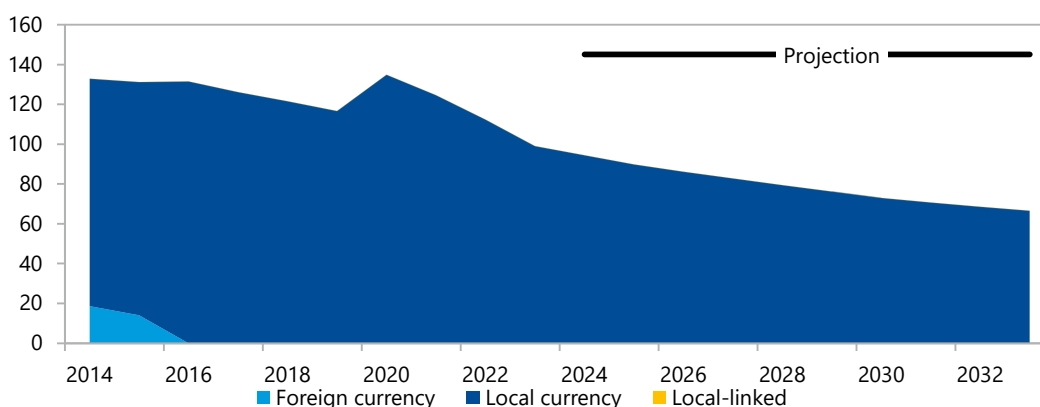
Horizon	Mechanical signal	Final assessment	Comments
<b>Overall</b>	...	<b>Moderate</b>	The overall risk of sovereign stress is moderate, a relatively low level of vulnerability in the near- and medium-term on the basis of a projected strong fiscal position, and moderate levels of vulnerability in the long-term horizons due to the still high debt level and age-related expenditures pressures.
<b>Near term 1/</b>			
<b>Medium term</b>	<b>Low</b>	<b>Low</b>	Medium-term risks are assessed as low in line with a mechanical low signal. Under the baseline, despite still high debt level and rising age-related expenditure pressures, the public debt continues its downward reduction. If adverse shocks materialize as in recent history, pressures on debt may arise.
Fanchart	<b>Moderate</b>	...	
GfN	<b>Low</b>	...	
Stress test		...	
<b>Long term</b>	...	<b>Moderate</b>	Long-term risks are moderate but will require addressing long-term aging-related expenditures on health and pension.
<b>Sustainability assessment 2/</b>	Not required for surveillance countries	Not required for surveillance countries	Not required for surveillance countries.
<b>Debt stabilization in the baseline</b>			Yes
<b>DSA Summary Assessment</b>			
<p>Commentary: Portugal is at a moderate overall risk of sovereign stress. Most indicators started to normalize as Portugal recovered from the COVID-19 shock and most of policy measures in response to inflationary pressures are projected to cease in 2024. However, medium-term liquidity risks as analyzed by fan chart are moderate. Over the longer run, Portugal should continue with reforms to tackle risks arising from rising aging-related spending and continued pressures to increase wages beyond the level consistent with productivity growth.</p>			
<p>Source: Fund staff.</p> <p>Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.</p> <p>1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.</p> <p>2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.</p>			

Annex IV. Figure 2. Portugal: Debt Coverage and Disclosures

Annex IV. Figure 2. Portugal: Debt Coverage and Disclosures										Comments								
1. Debt coverage in the DSA: 1/										CG	GG	NFPS	CPS	Other				
1a. If central government, are non-central government entities insignificant?															n.a.			
2. Subsectors included in the chosen coverage in (1) above:																		
Subsectors captured in the baseline										Inclusion								
CPS	NFPS	GG: expected	CG	1	Budgetary central government						Yes	Not applicable						
				2	Extra budgetary funds (EBFs)						No							
				3	Social security funds (SSFs)						Yes							
				4	State governments						Yes							
				5	Local governments						Yes							
				6	Public nonfinancial corporations						Yes							
				7	Central bank						Yes							
				8	Other public financial corporations						Yes							
3. Instrument coverage:										Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/				
4. Accounting principles:										Basis of recording		Valuation of debt stock						
										Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/				
5. Debt consolidation across sectors:										Consolidated		Non-consolidated						
Color code: <span style="background-color: #90EE90;"> </span> chosen coverage <span style="background-color: #FF0000;"> </span> Missing from recommended coverage <span style="background-color: #D3D3D3;"> </span> Not applicable																		
Reporting on Intra-Government Debt Holdings																		
Holder										Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
Issuer																		
CPS	NFPS	GG: expected	CG	1	Budget. central govt			20.6		0.5	1.6	70.4	6.4	99.6				
				2	Extra-budget. funds									0				
				3	Social security funds	0			0	0	0	0	0					
				4	State govt.								0					
				5	Local govt.	1.9		0			0.9	0.8	3.6					
				6	Nonfin pub. corp.	0.6							0.6					
				7	Central bank								0					
				8	Oth. pub. fin. corp								0					
Total										2.5	0	20.6	0	0.5	1.6	71.4	7.2	103.8
1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.																		
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.																		
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.																		
4/ Includes accrual recording, commitment basis, due for payment, etc.																		
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).																		
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.																		
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.																		
Commentary: A large fraction of central government's debt is held by the central bank and social security funds.																		

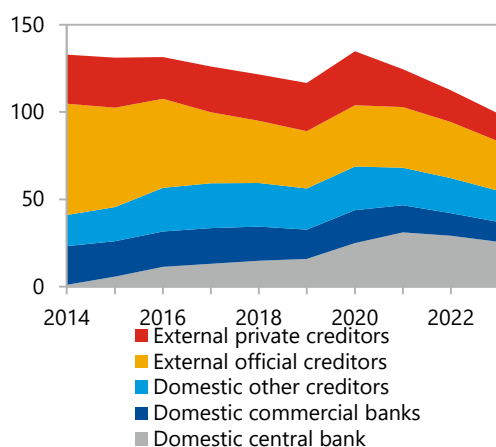
### Annex IV. Figure 3. Portugal: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



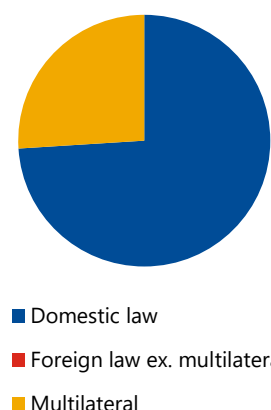
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



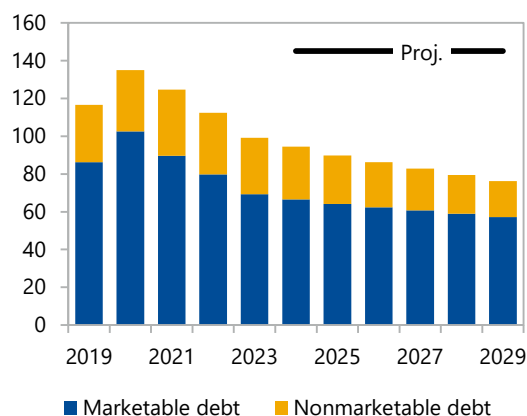
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



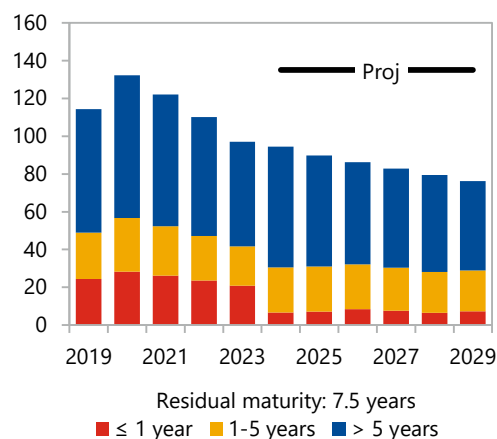
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

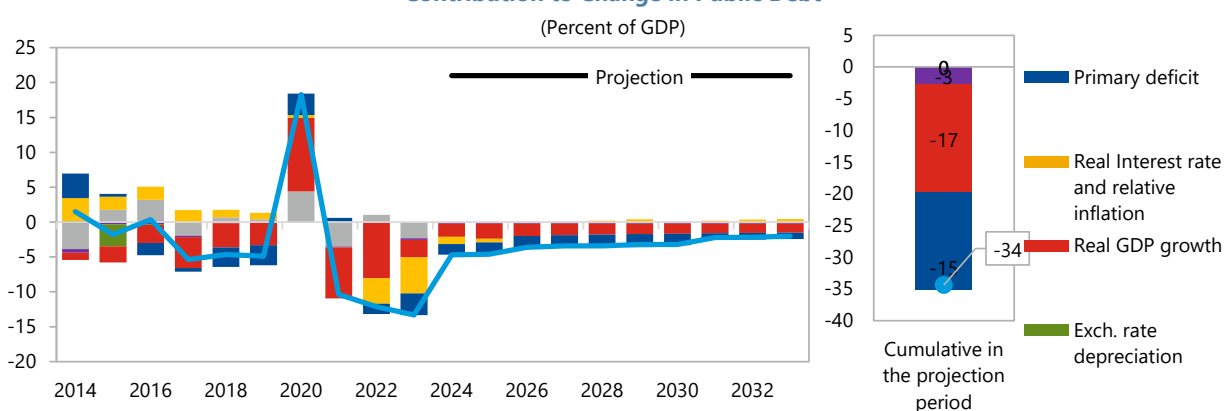
Commentary: Portugal's debt is local currency-denominated and is not exposed to exchange rate risks.

## Annex IV. Figure 4. Portugal: Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection							Extended projection			
	2023	2024	2025	2026	2027	2028	2029		2030	2031	2032	2033
Public debt	99.1	94.4	89.8	86.2	82.8	79.4	76.2		73.0	70.7	68.6	66.6
Change in public debt	-13.3	-4.7	-4.6	-3.6	-3.4	-3.4	-3.2		-3.2	-2.2	-2.2	-2.0
Contribution of identified flows	-11.0	-4.7	-4.6	-3.6	-3.4	-3.4	-3.2		-3.2	-2.2	-2.2	-2.0
Primary deficit	-3.1	-1.5	-1.7	-1.6	-1.6	-1.8	-1.9		-1.6	-0.8	-0.9	-0.9
Noninterest revenues	43.3	43.2	43.0	42.8	42.4	42.4	42.4		42.4	42.4	42.4	42.4
Noninterest expenditures	40.2	41.7	41.3	41.2	40.8	40.6	40.6		40.8	41.6	41.5	41.5
Automatic debt dynamics	-7.6	-2.9	-2.6	-1.7	-1.6	-1.3	-1.1		-1.3	-1.2	-1.0	-0.8
Real interest rate and relative inflation	-5.1	-1.0	-0.5	0.0	0.1	0.2	0.4		0.1	0.2	0.3	0.5
Real interest rate	-5.1	-1.0	-0.5	0.0	0.1	0.2	0.4		0.1	0.2	0.3	0.5
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0
Real growth rate	-2.5	-1.9	-2.2	-1.8	-1.6	-1.5	-1.5		-1.4	-1.4	-1.3	-1.3
Real exchange rate	0.0	...	...	...	...	...	...		...	...	...	...
Other identified flows	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2		-0.2	-0.2	-0.2	-0.2
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2		-0.2	-0.2	-0.2	-0.2
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0
Contribution of residual	-2.3	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0
Gross financing needs	6.7	2.8	6.1	6.7	8.0	7.1	6.1		6.7	8.5	7.2	6.0
of which: debt service	10.1	4.6	8.1	8.6	9.8	9.1	8.2		8.6	9.6	8.4	7.2
Local currency	10.1	4.6	8.1	8.6	9.8	9.1	8.2		8.6	9.6	8.4	7.2
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0
Memo:												
Real GDP growth (percent)	2.3	1.9	2.3	2.0	1.9	1.9	1.9		1.9	1.9	1.9	1.9
Inflation (GDP deflator; percent)	7.1	2.8	2.4	1.9	1.9	2.0	2.0		2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	9.6	4.7	4.8	3.9	3.9	3.9	3.9		3.9	3.9	3.9	3.9
Effective interest rate (percent)	2.1	1.7	1.9	2.0	2.0	2.2	2.5		2.1	2.3	2.5	2.7

## Contribution to Change in Public Debt



Commentary: Public debt is projected to continue declining, supported by GDP growth and favorable development in primary balance.



### Annex IV. Figure 5. Portugal: Realism of Baseline Assumptions

#### Forecast Track Record 1/

Public debt to GDP

Primary deficit

 $r - g$ 

Exchange rate depreciation

SFA

t+1

t+3

t+5

#### Comparator Group:

Advanced Economies, Non-Commodity Exporter, Surveillance

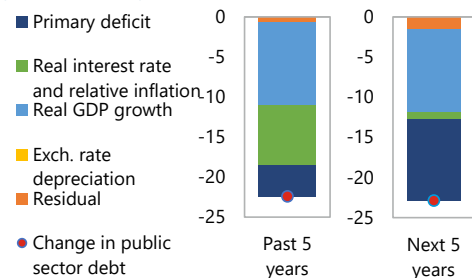
#### Color Code:

Optimistic ■ > 75th percentile  
■ 50-75th percentile  
■ 25-50th percentile  
Pessimistic ■ < 25th percentile

#### Historical Output Gap Revisions 2/

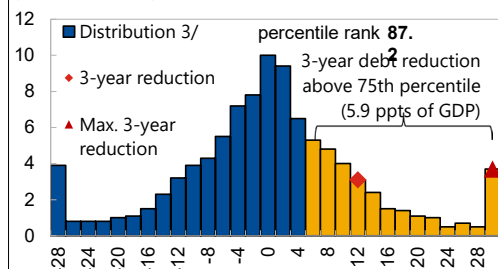
#### Public Debt Creating Flows

(Percent of GDP)



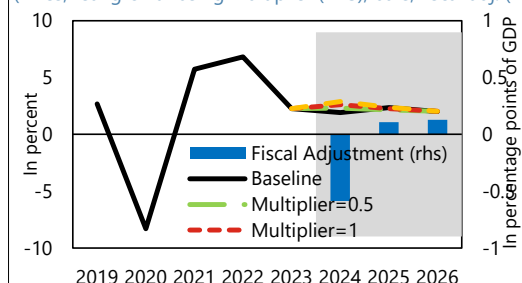
#### 3-Year Debt Reduction

(Percent of GDP)



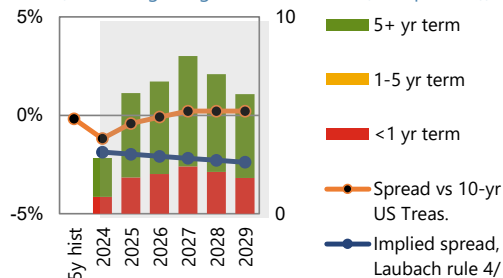
#### Fiscal Adjustment and Possible Growth Paths

(Lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS))



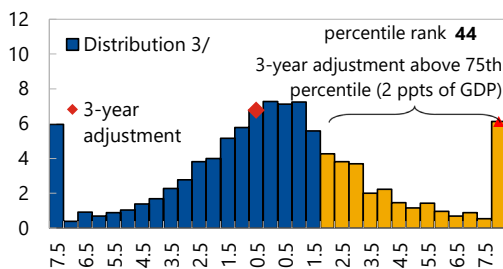
#### Bond Issuances (Bars, debt issuances (RHS,

%GDP); lines, avg marginal interest rates (LHS, percent))



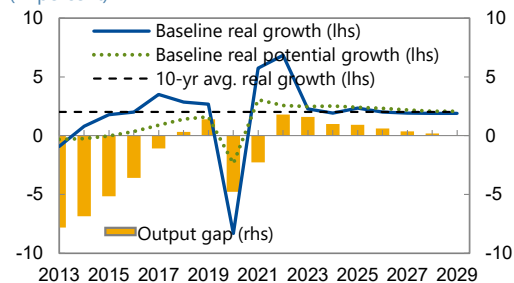
#### 3-Year Adjustment in Cyclically-Adjusted

Primary Balance (Percent of GDP)



#### Real GDP Growth

(In percent)



Commentary: Realism analysis shows that the public debt forecast is shown to be optimistic mainly due to the past two deep recessions Portugal experienced. Primary balance and  $r - g$  projections are well within norms. Public debt reduction in the past five years was supported by real GDP growth, real interest rate (inflation), and primary deficit. Over the next five year horizon, real GDP growth and primary deficit are projected to continue reducing the public debt. Three year debt reduction has been faster than other peers and is above the 80th percentile.

Source : IMF Staff.

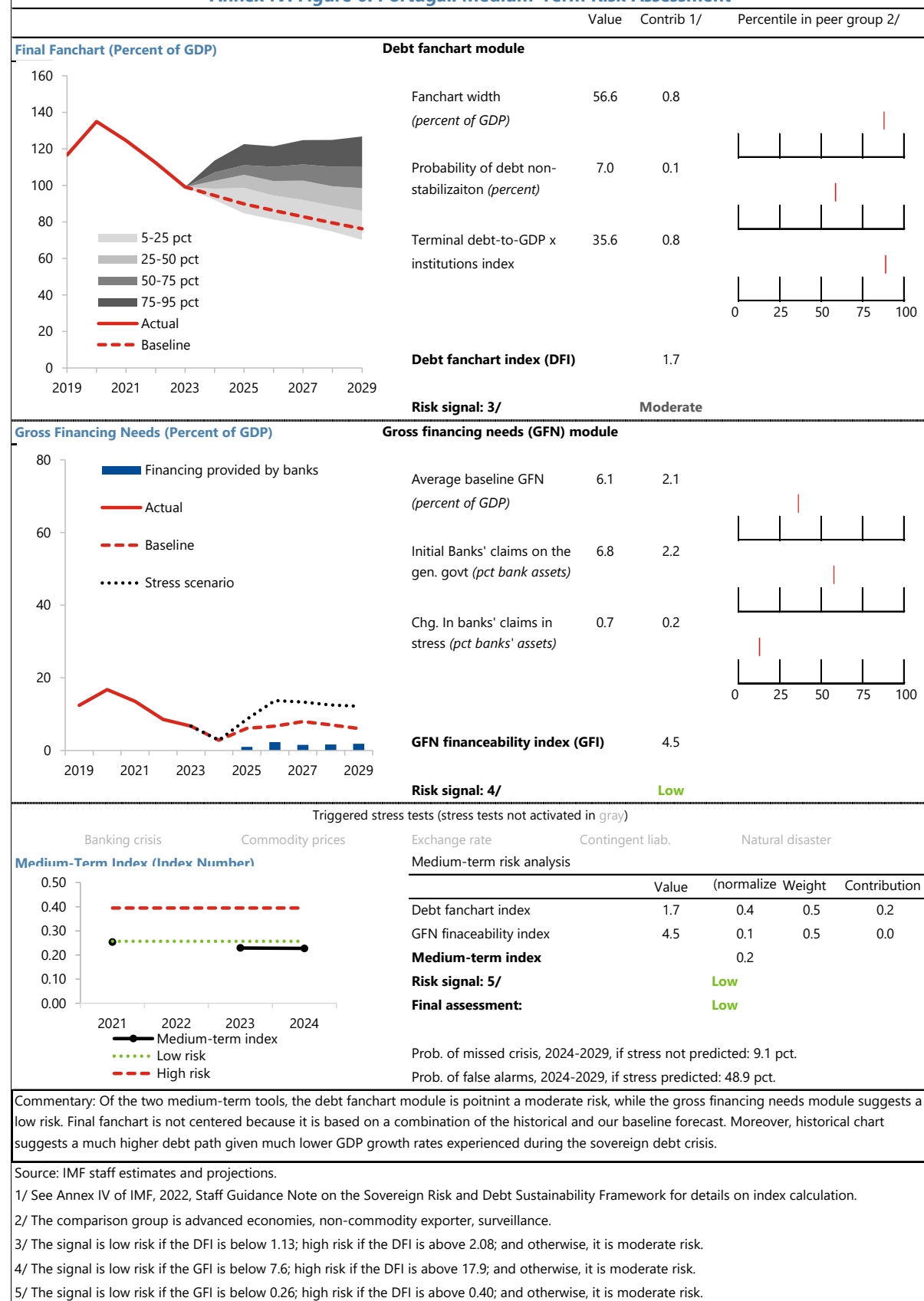
1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Annex IV. Figure 6. Portugal: Medium-Term Risk Assessment



## Annex IV. Figure 7. Portugal: Long-Term Risk Assessment

## Triggered Modules

Large amortizations

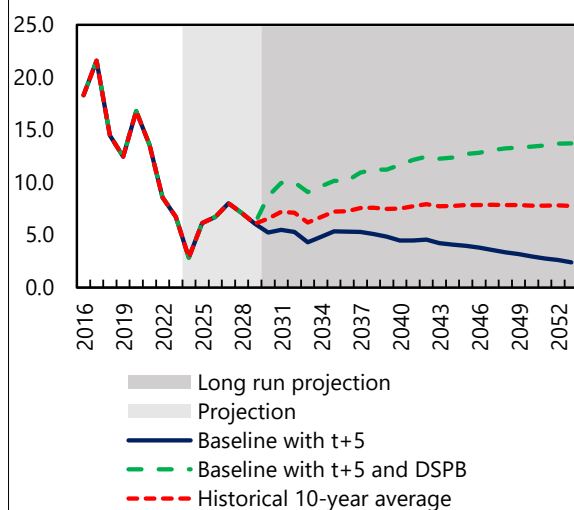
Pensions  
HealthClimate change: Adaptation  
Climate change: Mitigation

Natural Resources

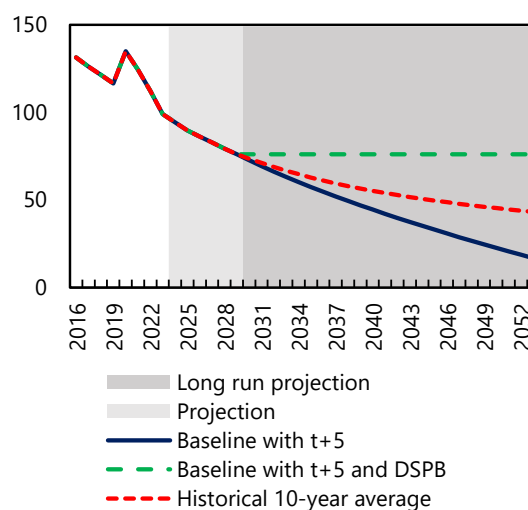
## Long-Term Risk Assessment: Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	<div></div>
	Amortization-to-GDP ratio	<div></div>
	Amortization	<div></div>
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	<div></div>
	Amortization-to-GDP ratio	<div></div>
	Amortization	<div></div>
Historical average assumptions	GFN-to-GDP ratio	<div></div>
	Amortization-to-GDP ratio	<div></div>
	Amortization	<div></div>
Overall Risk Indication		<div></div>

## GFN-to-GDP Ratio



## Total Public Debt-to-GDP Ratio



**Commentary:** Over the long-term, rising pensions and health pension spending are concerning as Portugal's age dependency ratio is projected to grow faster than their peers. The current debt amortization schedule includes some years with high redemption above the 10-years average by more than one standard deviation. However, the debt management office is expected to continue smoothing redemption profile going forward.

## Annex V. 2023 Article IV Recommendations

2023 Article IV Key Recommendations	Authorities' Actions
<b>Fiscal Policy</b>	
<p><b>Near term.</b> Maintaining a slightly contractionary fiscal policy stance in 2023 to build fiscal space and support monetary policy in reducing inflation pressures. If growth weakens appreciably, automatic stabilizers should be fully deployed; conversely fiscal overperformance must be saved. Further fiscal support should be reserved only for severe downside scenarios and designed to be temporary, non-price-distortionary, and targeted to the most vulnerable households.</p>	<p>The fiscal stance in 2023 was contractionary; the fiscal outcome surprised to the upside and the overperformance was saved, leading to a surplus of 1.2 percent of GDP. Most fiscal cost-of-living support measures were phased out. Interest and rental relief measures were targeted to the most vulnerable borrowers.</p>
<p><b>Medium term.</b> Build fiscal space and mitigate public debt risks further through a sustained consolidation effort. On the revenue side: simplify the tax system and eliminate tax distortions, roll back reduced VAT rates, reinstate carbon taxes and improve tax administration. On the expenditure side: implement pensions and health care reforms to contain age-related spending pressures. Increase the share of public investment relative to current spending. Strengthen the medium-term budgetary framework, the financial sustainability of SOEs, and the social safety net.</p>	<p>The previous government's stability program submitted to the EC targeted primary surpluses consistent with further reducing public debt to 79.8 percent of GDP in 2028. Public investment accelerated by further tapping the RRF (fourth installment in end-2023). While VAT exemptions for food and basic items were terminated by December 2023, the VAT reduction for electricity remains effective. A tax unit was formed in February 2024 and is assessing tax expenditures. Readjustment of carbon tax rates was reintroduced in May 2023 but suspended again in September 2023. A "green" book to assess the pension system is under preparation. Efforts to fully implement the 2015 Budgetary Framework Law continue. The NHS still has a deficit, but it is getting smaller.</p>
<b>Financial Policies</b>	
<p><b>Supervision.</b> As systemic risks have risen, banks and supervisors should continue to maintain vigilance on credit quality, market and interest rate risk, and liquidity management.</p>	<p>Supervisors are closely monitoring vulnerabilities and risks. Banks made significant efforts to improve the quality of their loan portfolio by reducing their exposure to non-performing loans and also further built capital buffers.</p>

2023 Article IV Key Recommendations	Authorities' Actions
<b>Financial Policies</b>	
<b>Macroprudential measures.</b> To address the build-up of vulnerabilities in the residential real estate sector, gradually phase in a sectoral systemic risk capital buffer. Over time, consider a positive neutral CCyB.	A sectoral systemic risk buffer for exposures to the residential real estate sector of IRB banks was introduced and will be effective in October 2024. The authorities are considering a positive neutral CCyB.
<b>Insolvency regime.</b> Continue to strengthen the private debt resolution regime including by restoring the duty to file for insolvency, which was suspended during the Covid pandemic.	The obligation to file for insolvency was restored in July 2023. Company management is under a general duty to file for insolvency within a 30-day period from the date they acknowledge that the company is legally insolvent.
<b>Anti-money laundering.</b> The termination of the Golden Visa should reduce money laundering risks. Improve the AML/CFT framework by ensuring the availability of relevant data such as beneficial ownership information.	The golden visa regime was terminated for real estate purchases but is maintained for other investment options, implying remaining risks. The register of beneficial ownership is based on self-declaration. Collection and verification of ownership information should be improved.
<b>Structural Reforms</b>	
<b>Labor market flexibility.</b> Alleviate labor market duality by allowing permanent contracts to be more flexible combined with a targeted strong social safety net.	The Decent Work Agenda, implemented in May 2023, aimed at promoting job security of fixed-term contract workers by further limiting the number of their renewals. However, it did not make open-ended contracts more flexible.
<b>Skills/digitalization.</b> Leverage digitalization to improve productivity, in particular among SMEs and the public sector. Improve digital skills of the workforce.	The RRP promotes upskilling and digitalization by focusing on projects related to digitalization.
<b>Effective carbon pricing.</b> Reinstate and increase the carbon tax while providing targeted relief for vulnerable households.	The carbon tax adjustment mechanism was reintroduced in May 2023 but was suspended again in September 2023 as energy prices rebounded.

## Annex VI. European Union Funds and Firms' Performance<sup>1</sup>

*Portugal has lagged its European peers in labor productivity over the last two decades, despite recent progress in upskilling the labor force, particularly among younger workers. This productivity gap is partially explained by resource misallocation and the predominance of small firms, while weak within-firm productivity remains a dominant factor. This annex studies the impact of EU funds on firm-level labor productivity using a propensity-score-matching technique and a difference-in-difference approach. Our results suggest that EU funds boost the labor productivity of recipient firms relative to those in the control group, with a larger impact on younger and smaller firms. Therefore, EU funds should continue to be leveraged to address long-standing low productivity.*

### A. Background

**1. Portugal lags its European peers in labor productivity including from resource misallocation, size, sectoral distribution and, predominantly, low within-firm productivity.** The larger portion of the gap is simply by lower within-sector-and-size productivity. Other factors include:

- *Misallocation of resources.* Misallocation of *capital*, as measured by the standard deviations of the marginal revenue product of capital has deteriorated in Portugal over the past two decades for both firms with large and with small capital. This trend has been more pronounced among the firms older than 10 years and firms with fewer than 10 employees. The deterioration in the misallocation of *labor* input was observed both among young and old firms but was more pronounced among firms with less capital and firms with a larger number of employees.
- *Small Firm Size and Sectoral Composition.* Moreover, firms in Portugal tend to be smaller than in European peers, and smaller firms in general tend to be less productive across most sectors (Berlingieri and others, 2018).<sup>2</sup> Also, the shares of accommodation and food service activities (sectors typically with lower productivity) in both employment and value added is higher in Portugal than on average in the European Union (10.5 percent and 7.3 percent for Portugal and the EU, respectively, for employment, and 4.3 percent and 2.3 percent, respectively, for value added). The firm size distribution and sectoral composition of the economy jointly explain about a quarter of the gap in labor productivity vis-à-vis European peers ([Bauer and others, 2020](#)).

<sup>1</sup> Prepared by Ippei Shibata and Hannah Winterberg.

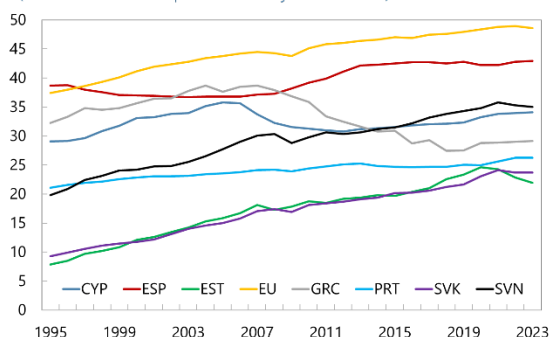
<sup>2</sup> In Portugal, 40 percent of employees work in enterprises with fewer than ten employees, while in the EU only 29 percent do. Firms with fewer than 50 employees employ 60 percent of the total Portuguese labor force, compared to 47 percent in the EU.

## Labor Productivity, Misallocation of Capital and Labor, Firm and Sectoral Compositions in Portugal

Portugal's labor productivity is lagging its EA peers.

### Labor Productivity

(GDP in constant 2015 prices divided by hours worked)

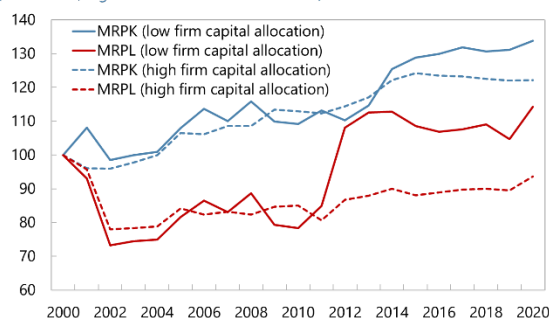


Sources: Eurostat, Haver Analytics, and IMF staff calculations.

The worsening of labor misallocation has been more pronounced among firms with large capital.

### MRP Standard Deviations by Firm Capital Allocation Size 1/

(2000 = 100, higher value = more misallocation)



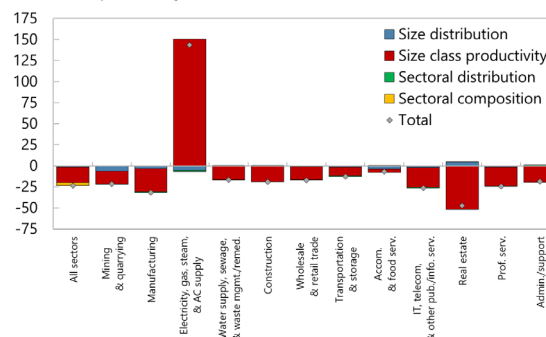
Sources: Orbis and IMF staff calculations.

1/ high firm capital allocation = 95-99th percentile firm capital allocation

The productivity difference vis-à-vis the EU is mainly due to within-sector-size productivity.

### Sectoral Productivity Differences Decomposition

(Percent of productivity difference between PRT and EU)

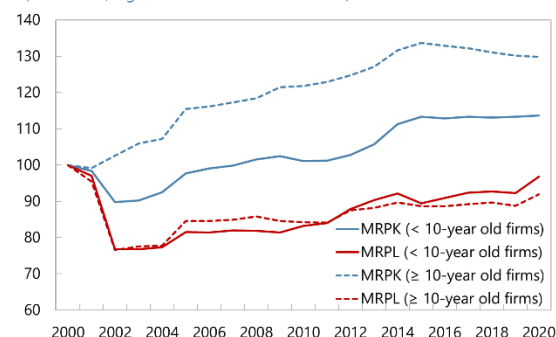


Sources: Eurostat and IMF staff calculations.

The worsening of capital misallocation is more pronounced among older firms.

### MRP Standard Deviations by Firm Age

(2000 = 100, higher value = more misallocation)



Sources: Orbis and IMF staff calculations.

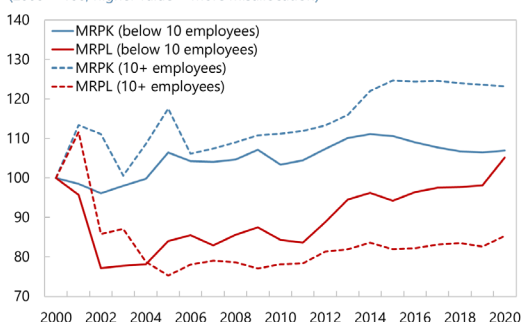
**2. EU Funds aim to lift potential output and labor productivity.** Portugal 2020 ("PT2020"), the focus of this annex, is part of the Europe 2020 Strategy and comprises five European structural and investment funds that were disbursed between 2014 and 2022. Its total value of € 26.5 billion is comparable to the total gross fixed capital formation in 2014 (€ 26 billion or 13.9 percent of GDP). It roughly represented an average of 1.5 percent of GDP annually. REACT-EU provided additional cohesion funds for crisis resolution related to the COVID-19 crisis. PT2020 funded 171,000 projects across 98,000 firms, with priorities covering (i) competitiveness and internationalization (41 percent of the total funds), (ii) social inclusion and employment (17 percent), (iii) human capital (17 percent), and (iv) sustainability and efficiency in the use of resources (25 percent). Over half of the total funds (58.5 percent) were disbursed to the administrative service (37.3 percent) and manufacturing sectors (21.2 percent) combined, followed by education (11.9 percent), and arts and recreation (5.9 percent).

## Misallocation of Capital and Labor, Firm and Sectoral Compositions in Portugal

The worsening of capital (labor) misallocation is more pronounced among smaller (larger) firms.

### MRP Standard Deviations by Firm Size (Employees)

(2000 = 100, higher value = more misallocation)

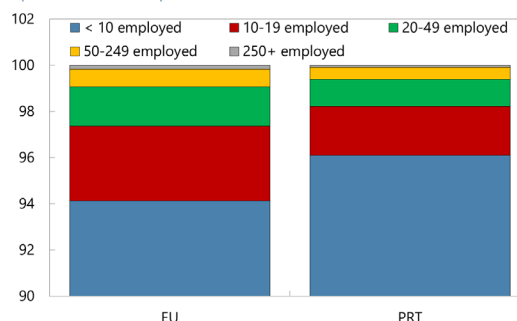


Sources: Orbis and IMF staff calculations.

Portuguese firms tend to be smaller than other European peers.

### Firm Composition by Firm Size

(Percent of total firms)

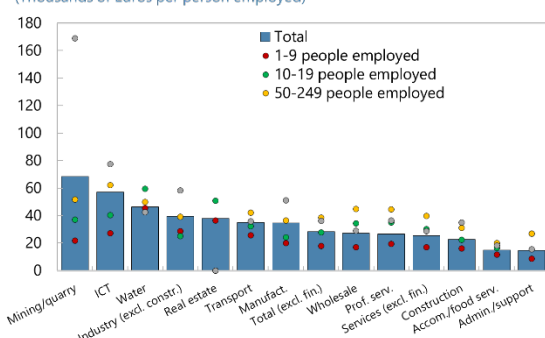


Sources: Eurostat and IMF staff calculations.

Smaller firms tend to be less productive across most industries in Portugal (as in other countries).

### Labor Productivity by Firm Size, 2021

(Thousands of Euros per person employed)

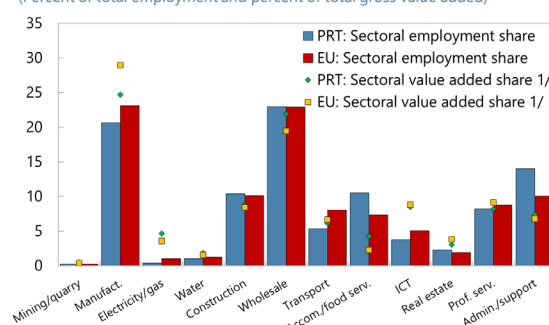


Sources: OECD and IMF staff calculations.

Portugal has higher shares of employment and value added in accommodation and food services and smaller shares in manufacturing than EU peers.

### Sectoral Employment and Value Added Shares, 2020

(Percent of total employment and percent of total gross value added)



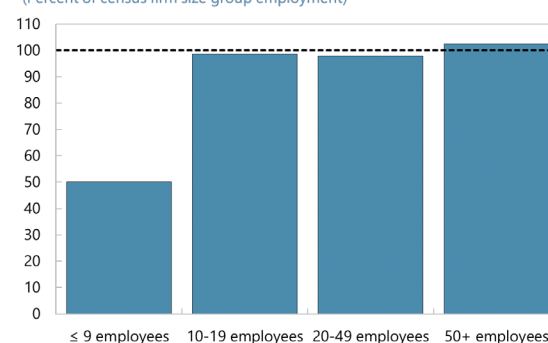
Sources: Eurostat and IMF staff calculations.  
1/ at factor costs

## B. Empirical Strategy

**3. To study the impact of EU funds on firm performance, we matched firm-level disbursement data with firm-level balance sheet data between 2014 and 2022.** Out of the 171,000 projects under the PT2020, about 91,000 projects were matched to firm-level data from the ORBIS database, which contains firms' balance sheet information including value added, assets, number of employees, and industries. This matched annual data spans 2014-22. The ORBIS data represents well the universe of Portuguese firms in census data. It covers close to 100 percent of employment for firms with 10 or fewer

### Census Employment Share Covered in Orbis by Firm Size

(Percent of census firm size group employment)



Sources: Orbis, 2020 Structural Business Statistics, and IMF staff calculations.



employees and about 50 percent of small-sized firms (with fewer than 10 employees). When comparing the universe of participating firms with the firms included in the final dataset, many of the entities excluded from the sample are government-associated entities and bodies, for which Orbis does not provide balance sheet data. Therefore, caution is warranted that the merged dataset underrepresents administrative firms compared to the industry coverage in the universe of funded projects. The median size of the funds per recipient firm is around € 10k, though the distribution is skewed with an average fund size of € 268k. Around 38 percent of all firms receive funding for a single project, while 32 percent receive two projects, and another 30 percent receive three or more funded projects. A few firms receive funding for several hundred projects, typically firms in the education sector that receive funding for each educational program separately. To simplify our analysis, our baseline analysis limits the sample to the firms that received EU funds for a single project, but we also conducted analyses on the sample including firms with multiple projects.<sup>3</sup>

**4. A propensity-score-matching approach allows us to compare recipients with similar firms.**<sup>4</sup> While the difference in labor productivity (value added per employee) tends to be smaller, the firms that received EU fund tend to be older, have more employees, assets, revenues, and returns on assets (ROA) than average firms in the dataset. These differences need to be accounted for when comparing treated and untreated firms. To appropriately account for these differences in the observable characteristics between treated and untreated firms, we use a propensity score matching approach. We match firms based on their assets to other untreated firms within their industry (on the 4-digit Nace level), age (fewer than 10 years old (young) or above (old)), and size group (as measured by the number of employees). In this process, each treated firm will receive at most three “neighbors”, which are then weighted accordingly. The final sample contains 2,419 treated firms and 6,696 firms in the control group.<sup>5</sup>

<sup>3</sup> As an example, we present the results for firms with multiple projects for the manufacturing sector.

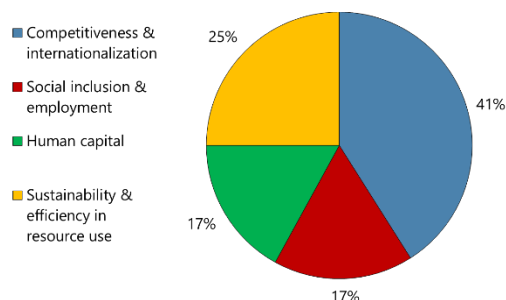
<sup>4</sup> Cabral and Campos (2023) also study the impact of EU funds on Portuguese firm performance. They look at the COMPETE program under the 2007-13 framework and use as control group the firms that unsuccessfully applied for the program. They also find a positive impact of EU funds on Portuguese firm performance.

<sup>5</sup> Firms in the resulting sample have comparable characteristics. For example, the average age of a treated firm is 25.5 years, while it is 26.9 for the average untreated firm. In terms of size, the average treated firm has 26 employees, while the average untreated firm has 23 employees.

## EU Funds

EU funds support five priorities, particularly competitiveness and internationalization.

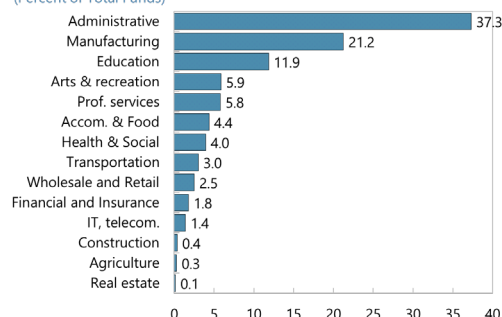
**Portugal 2020 Funds (2014-20)**  
(Percent of total Portugal 2020 funds)



Source: Portugal 2020.

The administrative services and manufacturing sectors receive a large share of EU funds.

**EU Funds by Sector**  
(Percent of Total Funds)



Sources: Agência para o Desenvolvimento e Coesão, I.P., ORBIS and IMF Staff Calculations.

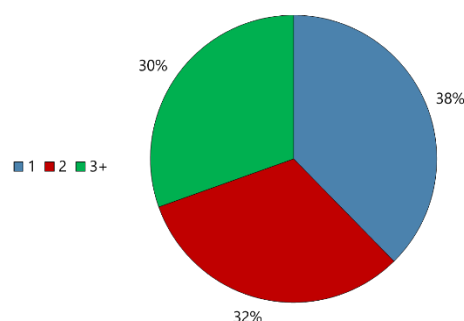
The EU fund disbursement distribution is skewed ....

**EU Funding Received per Recipient**  
(Euros)

	Funding allotted
25th percentile	3,702.96
Median	10,366.98
Mean	268,394.20
75th percentile	28,255.81

... with more than two-thirds of all firms having fewer than three projects.

**EU Funded Projects per Firm**  
(Percent of total firms)



Sources: AD&C and IMF staff calculations.

**5. We employ a difference-in-difference approach to assess the impact of the EU funds on labor productivity of firms.** Our empirical specification is as follows:

$$Y_{ikrt} = \sum_{T=-3}^5 \beta_T D_{iT} + \gamma_i + \theta_{kt} + \rho_{rt} + \delta_T + \varepsilon_{ikt}$$

where the dependent variable  $Y_{ikt}$  denotes firm  $i$ 's annual labor productivity in year  $t$ , industry  $k$ , and region  $r$ , measured as value added per employee (in logs).  $D_T$  is the treatment dummy equal to 1 if a firm  $i$  received EU funds with treatment reference year  $T$  where  $T=0$  is the year in which firm  $i$  has received EU funds and 0 otherwise (firms in control group).  $T$  denotes treatment time and matches the calendar year of treatment for participating firm with the calendar year of non-treated "neighboring" firms. Additionally,  $\gamma_i$  are firm fixed effects to capture the differences in permanent labor productivity across firms,  $\theta_{kt}$  are industry-year (Nace-2-level) fixed effects to control for industry-year specific trends and common factors,  $\rho_{rt}$  are region-year fixed effects to control for regional-specific time-varying differences in labor productivity, and  $\delta_T$  are treatment-time fixed

effects consistent with the matched groups to control for aggregate factors affecting treatment years. Finally, we employ heteroscedasticity-robust standard errors.

Portuguese Firm Characteristics					
	Mean	50th percentile	Standard deviation	25th percentile	75th percentile
Recipients					
Age (years)	24.9	22.0	17.6	13.0	31.0
Capital/assets(%)	45.3	41.5	27.5	22.7	66.6
Added value	905,443.4	96,722.5	9,995,875.4	31,738.5	340,394.0
Added value/employee	28,001.1	20,864.7	221,234.5	13,595.3	32,469.0
ROA (%)	9.2	8.6	725.3	3.1	17.1
Employees	21.4	5.0	171.5	2.0	13.0
Assets	4,994,891.1	306,899.0	150,000,000.0	95,519.0	1,169,280.0
Revenue	3,560,926.0	311,995.0	77,000,000.0	100,367.0	1,119,910.0
All firms					
Age (years)	21.9	20.0	14.3	12.0	28.0
Capital/assets(%)	46.1	42.3	31.2	20.4	70.8
Added value	458,575.2	56,873.0	11,000,000.0	19,307.0	159,427.0
Added value/employee	41,008.5	19,812.0	1,253,115.5	12,309.0	32,487.5
ROA (%)	4.6	7.6	6,483.3	1.8	17.4
Employees	10.8	3.0	114.9	1.0	6.0
Assets	2,977,020.3	212,392.0	110,000,000.0	72,493.0	674,513.0
Revenue	1,740,024.1	167,000.0	44,000,000.0	59,000.0	510,704.0
Sources: AD&C, Orbis, and IMF staff calculations.					

## C. Results

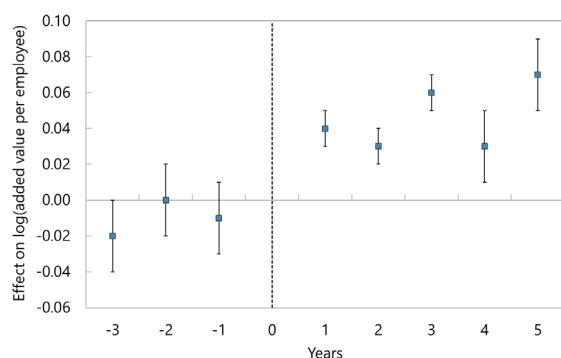
**6. Tapping EU funds helps boost firm's labor productivity.** Our baseline regression results confirm that EU funds indeed improve labor productivity for recipient firms relative to control groups. The labor productivity of recipient firms increases by close to five percent and remains stronger, reaching around 7 percent five years after the receipt of the funds. Including the larger sample of firms with multiple projects, and matching firms only within NUTS2 regions, we estimate an initial effect estimate of around 3 percent two years after the start of the supported projects in the manufacturing sector, which is smaller than in the baseline result for firms with single projects. Productivity gains are higher than in Cabral and Campos (2023), who consider a different set-up (non-successful applicants vs. successful applicants).

**7. The impact of EU funds on firm productivity is larger for smaller and younger firms.** When the sample is divided by the firm size—the smaller (fewer than 10 employees), medium (10 to 49 employees), and large (50 and + employees) firm sizes—we find that the EU funds have a greater impact on labor productivity in smaller firms compared to larger firms. Similarly, EU funds tend to boost labor productivity of younger firms more. Lastly, our baseline results seem to hold when we include in our sample firms with multiple projects for the manufacturing sector.

### Impact of EU Funds on Labor Productivity

EU funds boost labor productivity among recipient firms vis-à-vis control groups.

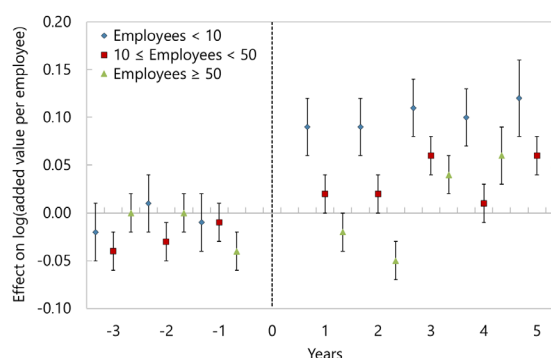
#### Impact on Labor Productivity



Sources: AD&C, Orbis, and IMF staff calculations.

The impact of EU funds on boosting labor productivity is greater for smaller and ...

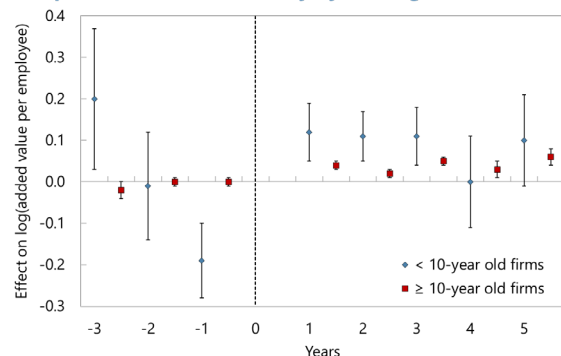
#### Impact on Labor Productivity by Firm Size



Sources: AD&C, Orbis, and IMF staff calculations.

...younger firms.

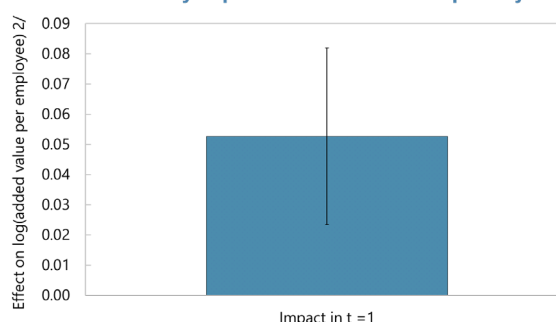
#### Impact on Labor Productivity by Firm Age



Sources: AD&C, Orbis, and IMF staff calculations.

Baseline results hold for firms with multiple projects.

#### Labor Productivity Impact for Firms with Multiple Projects 1/



Sources: AD&C, Orbis, and IMF staff calculations.

1/ error band = 90% confidence interval  
2/ in manufacturing sector

## D. Conclusion

**8. Portugal should continue reaping the benefits of EU funds to boost labor productivity, particularly among smaller and younger firms.** Portugal has continued to lag in labor productivity over the past two decades despite recent progress in upskilling its labor force, particularly among younger workers. While resource misallocation and size distributions partially explain the productivity gap compared to its European peers, within-firm productivity differences remain a predominant factor. Our empirical analysis suggests that EU funds boost the labor productivity of recipient firms, particularly smaller and younger firms, and that the benefits of EU funds should continue to be tapped.

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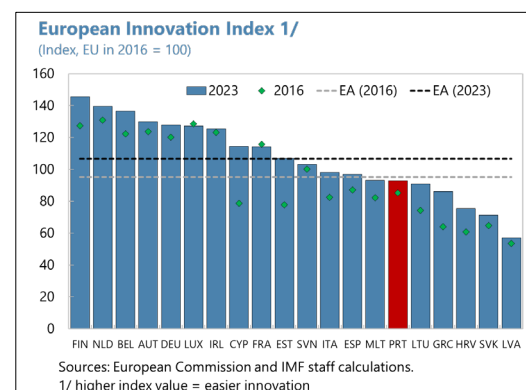
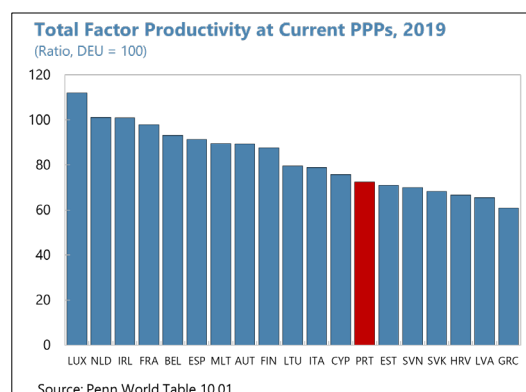
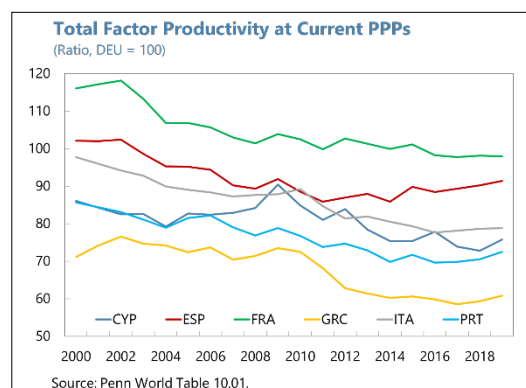
## Annex VII. Product Market Reforms to Boost Productivity<sup>1</sup>

Portugal's GDP per capita and productivity lag European peers. OECD's product market overall indicator for Portugal is in the least competitive quartile of EA countries, indicating notable room for improvement. Areas to focus attention include regulatory procedure complexity, evaluation of impact of the regulatory environment on competition, and effective engagement with stakeholders in the regulatory consultation process. Improving product market regulations by half-way to fifth performer in the EU could raise the total factor productivity by an estimated 2¼ percent in the steady state.

### A. Background

**1. Portugal lags its European peers in GDP per capita, productivity, and innovation.** Portugal's GDP per capita only slightly increased relative to EA peers, from 58 percent to 60 percent of the EA average between 2000 and 2019. Its total factor productivity (TFP), which was at around 86 percent of Germany's in 2000, fell to 73 percent by 2019. By 2019, Portugal's TFP was in the lower half of EA countries. Although Portugal made progress in improving its capacity to innovate, as measured by the European Innovation Index, its ranking fell slightly and remains below the EA average in 2023.

**2. Considering the aging population, productivity gains have a key role to play in lifting potential output.** The Portuguese population is aging faster than in other European countries. While the impact has been mitigated by large inflows of immigrants in recent years, labor supply contribution to potential output growth is expected to be limited going forward. Labor market reforms to address the labor market duality of open-ended vs. fixed-term job contract, efforts to upskill or reskill the labor force, and continuing to integrate well immigrants into employment, remain important to increase potential growth. Still, higher productivity growth is needed to boost GDP per capita and accelerate convergence toward the higher European income level. Further product market reforms can play an essential role.



<sup>1</sup> Prepared by Ippei Shibata and Paul Tershakovec.

## B. Product Market Regulations

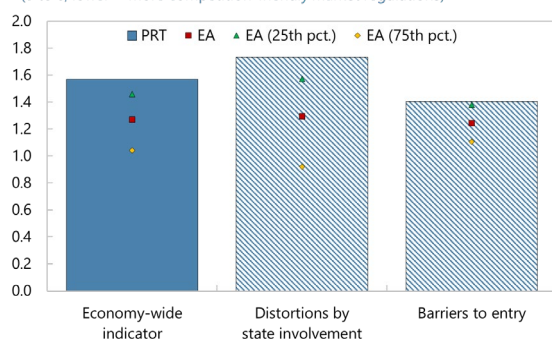
**3. Product markets can hinder productivity through multiple rigidities.** The OECD framework assesses weaknesses in product markets based on a comprehensive questionnaire with scores ranging from 0 (optimal) to 6 (least optimal). Its product market regulation (PMR) index<sup>2</sup> has four layers: (i) economy-wide, (ii) high level, (iii) medium level, and (iv) low level indicators. The two high-level categories assess distortions induced by state involvement and barriers to entry. Medium-level indicators cover six areas of product market distortions, including barriers in service and network sectors. The low-level indicators include 15 granular areas, such as price controls and regulatory procedure complexity (Annex VII. Table 1).

**Table 1. OECD Product Market Regulation Indicators**

Overall	Overall														
High level	Distortions by state involvement									Barriers to entry					
Medium level	Public ownership			Involvement in business ops.			Regulations impact evaluation			Admin./regulatory burden		Barriers in service & network sectors		Barriers to trade & investment	
Low level	Public ownership quality/scope	SOE governance	Retail price controls/regulation	Network sectors business ops. Involvement	Service sectors business ops. Involvement	Public procurement	Impact on competition assessment	Interaction with stakeholders	Admin. requirements for LLCs/personally-owned enterprises	Admin./regulatory burden communication/simplification	Service sectors barriers to entry	Network sectors barriers to entry	FDI barriers	Trade facilitation barriers	Tariff barriers

**PMR Indicators: Economy-wide and High Level, 2023**

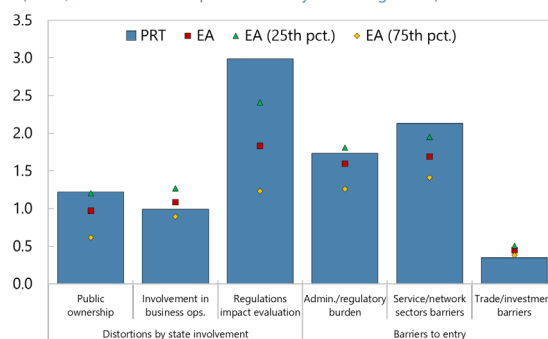
(0 to 6, lower = more competition-friendly market regulations)



Sources: OECD and IMF staff calculations.

**PMR Indicators: Medium Level, 2023**

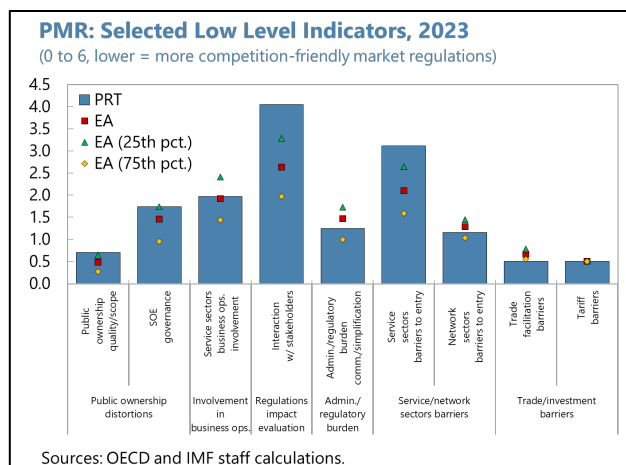
(0 to 6, lower = more competition-friendly market regulation)



Sources: OECD and IMF staff calculations.

<sup>2</sup> The OECD Product Market Regulations indicator measures *de jure* (not *de facto*) regulations and relies on a simple average across sub-indicators so that any different growth impact across sectoral regulations is not incorporated. Uncertainty bands around point estimates are not provided by the compiler.

**4. Portugal lags its European peers in having more competition-friendly market regulation, indicating room for improvement.** In 2023, Portugal's economy-wide PMR index, which measures the overall competition-friendliness of the product market, was in the least competitive quartile of EA countries. This mainly reflects its higher barriers to market entry and more distortions by state involvement. Specifically, cumbersome administrative and regulatory process required to start a new business, particularly in service sectors, are detrimental to entries of new corporates and competition. State involvement could also promote a pro-competition regulatory framework by better evaluating the impact of its regulatory environments on market competitiveness and more effectively engaging with stakeholders for regulatory consultation.



## C. Policy Recommendations

**5. Aligning product market regulations with the top five performers could boost productivity by improving firms' business operating conditions.** To promote a more pro-competitive environment to improve productivity and innovation in its economy, Portugal could focus on:

- streamlining administrative processes, notably those required to establish new businesses,
- improving methods for evaluating the influence of both new and existing laws and regulations on competitive dynamics,
- more effectively engaging stakeholders in the regulatory consultation process. Moreover, the management of state-owned enterprises could be more closely aligned with best practices to guarantee fair competition with private companies.

By catching up half-way to the top five performer in the EU in terms of the overall PMR indicator, Portugal could raise total factor productivity by 2¼ percent over the medium term, based on the estimates from [Barnes and others \(2013\)](#)<sup>3</sup>.

<sup>3</sup> Barnes, R.B. et al. 2013, "The GDP Impact of Reform: A Simple Simulation Framework" OECD Economics Department Working Paper.



## Annex VIII. Data Issues

**Table 1. Portugal: Data Adequacy Assessment for Surveillance**

A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	A	A	A	A	A		
Granularity 3/	A		A	A	A		
			A		A		
Consistency			A	A		A	
Frequency and Timeliness	A	A	A	A	A		
<p>Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.</p> <p>1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.</p> <p>2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF <i>Review of the Framework for Data Adequacy Assessment for Surveillance</i>, January 2024, Appendix I).</p> <p>3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.</p>							
A	The data provided to the Fund is adequate for surveillance.						
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.						
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.						
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.						
<p><b>Rationale for staff assessment.</b> Data provision is adequate for surveillance. Portugal's economic and financial statistics are comprehensive, generally of high quality, and are provided to the Fund in a comprehensive manner. The authorities regularly publish a full range of economic and financial data, as well as a calendar of dates for the main statistical releases. Portugal is also subject to the statistical requirements of Eurostat and the European Central Bank, including the timeliness and reporting standards, and it has adopted the European System of Accounts 2010. Portugal's relatively weak correlation between CPI and GDP deflator inflation can be attributed to its susceptibility to fluctuations in the terms-of-trade as an open, export-oriented economy.</p>							
<p><b>Changes since the last Article IV consultation.</b> No weaknesses were identified in the last consultation and no new weaknesses have emerged since then.</p>							
<p><b>Corrective actions and capacity development priorities.</b> N.A.</p>							
<p><b>Use of data and/or estimates different from official statistics in the Article IV consultation.</b> Staff do not use data and/or estimates different from official statistics.</p>							
<p><b>Other data gaps.</b> More detailed/recent data on commercial real estate would aid the team's assessment of the sector.</p>							

**Table 2. Portugal: Data Standards Initiatives**

Portugal adheres to the Special Data Dissemination Standard (SDDS) Plus since February 2015 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (<https://dsbb.imf.org/>).

**Table 3. Portugal: Table of Common Indicators Required for Surveillance**  
(As of July 29, 2024)

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data <sup>5</sup>	Frequency of Reporting <sup>6</sup>	Expected Frequency <sup>6,7</sup>	Portugal <sup>8</sup>	Expected Timeliness <sup>6,7</sup>	Portugal <sup>8</sup>
Exchange Rates	29-Jul-24	29-Jul-24	D	D	D	D	...	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	Jun-24	Jul-24	M	M	M	M	1W	NLT 1W
Reserve/Base Money	Jun-24	Jul-24	M	M	M	M	2W	2W
Broad Money	Jun-24	Jul-24	M	M	M	M	1M	1M
Central Bank Balance Sheet	Jun-24	Jul-24	M	M	M	M	2W	2W
Consolidated Balance Sheet of the Banking System	Jun-24	Jul-24	M	M	M	M	1M	1M
Interest Rates <sup>2</sup>	28-Jul-24	29-Jul-24	D	D	D	D	...	D
Consumer Price Index	Jun-24	Jul-24	M	M	M	M	1M	14D
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —General Government <sup>4</sup>	May-24	Jul-24	M	M	A/Q	Q	2Q/12M	1Q
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —Central Government	May-24	Jun-24	M	M	M	M	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	May-24	Jul-24	M	M	Q	Q	1Q	NLT 1Q
External Current Account Balance	May-24	Jul-24	M	M	Q	M	1Q	8W
Exports and Imports of Goods and Services	May-24	Jul-24	M	M	M	M	8W	41D
GDP/GNP	Q1-24	Jun-24	Q	Q	Q	Q	1Q	85D
Gross External Debt	Q1-24	Jun-24	Q	Q	Q	Q	1Q	NLT 3M
International Investment Position	Q1-24	Jun-24	Q	Q	Q	Q	1Q	NLT 3M

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

<sup>2</sup> Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

<sup>7</sup> Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

<sup>8</sup> Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (<https://dsbb.imf.org/>). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "...".



# PORTUGAL

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

September 6, 2024

Prepared By

European Department  
(In Consultation with Other Departments)

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# FUND RELATIONS

(As of July 29, 2024)

**Membership Status:** Joined: March 29, 1961; Article VIII

<b>General Resources Account:</b>	<b>SDR Million</b>	<b>Percent Quota</b>
Quota	2,060.10	100.00
Fund holdings of currency	1,563.96	77.37
Reserve position in Fund	466.27	22.63

<b>SDR Department:</b>	<b>SDR Million</b>	<b>Percent Allocation</b>
Net cumulative allocation	2,780.99	100.00
Holdings	2,816.20	101.27

**Outstanding Purchase and Loans:** None

## Financial Arrangements:

<b>Type</b>	<b>Approval Date</b>	<b>Expiration Date</b>	<b>Amount Approved (SDR Million)</b>	<b>Amount Drawn (SDR Million)</b>
EFF	May 20, 2011	June 30, 2014	23,742.00	22,942.00
Stand-By	Oct 07, 1983	Feb 28, 1985	445.00	259.30
Stand-By	Jun 05, 1978	Jun 04, 1979	57.35	0.00

## Projected Payments to Fund:<sup>1</sup>

(SDR Million; based on existing use of resources and present holdings of SDRs)

	<b><u>Forthcoming</u></b>				
	<b><u>2024</u></b>	<b><u>2025</u></b>	<b><u>2026</u></b>	<b><u>2027</u></b>	<b><u>2028</u></b>
Principal					
Charges/Interest		0.02	0.02	0.02	0.02
<b>Total</b>		<b>0.02</b>	<b>0.02</b>	<b>0.02</b>	<b>0.02</b>

<sup>1</sup> When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

## Exchange Rate Arrangement:

Portugal's currency is the euro. The exchange rate arrangement of the euro area is free floating. Portugal participates in a currency union (EMU) with 19 other members of the EU and has no separate legal tender. The euro, the common currency, floats freely and independently against other currencies. Portugal has accepted the obligations under Article VIII, Section 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, other than restrictions maintained solely for security reasons which have been notified to the Fund pursuant of Executive Board Decision No. 144 (52/51).

**Article IV Consultations:**

Portugal is on the standard 12-month consultation cycle. The previous consultation discussions took place during April 26-May 5, 2023, and the staff report (Country Report No. 23/218) was discussed on June 13, 2023.

**Safeguards Assessment:**

The first-time safeguards assessment of the Bank of Portugal (BdP), finalized in September 2011, found relatively strong safeguards in place. It recommended changes to the BdP Law to strengthen provision on BdP's autonomy and oversight, and to extend supervisory responsibilities of the Audit Board to other tasks such as oversight of internal control functions, financial reporting, and audit. The BdP implemented all safeguards recommendations, including formally proposing amendments to the BdP law; however, these have not been enacted.

**Statement by Federico Giammusso, Executive Director for Portugal, and Ana Rita Mateus,  
Advisor to Executive Director**

**September 25, 2024**

*The Portuguese economy has emerged strong from the successive shocks of recent years, benefiting from macroeconomic adjustments following the sovereign debt crisis and secular trends, notably in human capital growth. Despite those exogenous shocks, previous trends have continued, including the reduction of private and public leverage, improvement in the external position, and strengthening of the banking sector. In recent years, Portugal has converged with the euro area. The labor market has been dynamic, with historically high participation rates and low unemployment. But it is no time for complacency as geoeconomic fragmentation threatens trade and financial flows and the world transitions toward carbon neutrality and Artificial Intelligence-powered tools. The authorities recognize the need to address housing affordability concerns, long-term pressures, and low productivity. They are also focused on rebuilding buffers to prepare for future risks. They share many of staff's policy recommendations to continue strengthening macro-financial fundamentals and fostering productivity, and they are committed to doing so while promoting social cohesion.*

**Economic activity and outlook**

The authorities' projections are generally aligned with staff's, anticipating a slowdown in the real GDP growth rate to around staff's projection of 1.9 percent in 2024, followed by an acceleration in 2025 and 2026, culminating in the latter year with the peak of the Recovery and Resilience Plan (RRP) in terms of investment. In the medium-term, the authorities expect Portugal to continue converging with the euro area, driven by relatively more vigorous exports and investment, spurred by European funds. They foresee this trend persisting, supported by additional structural reforms and a higher proportion of high value-added sectors in the economy, leading to somewhat higher medium-term growth projections compared to staff's. The labor market is expected to remain dynamic, benefitting from higher participation rates, net immigration, and continued improvements in qualifications.

For nearly a year, the year-on-year inflation rate declined, hovering around the euro area's rate, with the latest reading at 1.8 percent in August. The authorities expect inflation to stabilize around 2 percent in 2025. They share staff's assessment of the balance of risks.

## **Fiscal policy**

The authorities welcome staff's acknowledgement of Portugal's impressive fiscal performance.

Following a significant general government surplus of 1.2 percent of GDP in 2023, fiscal policy will be expansionary in 2024. The authorities have begun alleviating the tax burden and reinforced social protection for the elderly with a one-off supplement in 2024. Additionally, they have implemented wage increases and updates for certain professional categories, notably to address past wage and promotion freezes. These measures can be accommodated within an envelope that entails a small surplus in 2024, given the robust tax collection expected for the year and the unwinding of inflation support measures.

Going forward, the authorities plan to further reduce the tax burden on both households and enterprises and will continue negotiations with other professional categories for wage updates. These measures aim to foster social cohesion, attract and retain qualified workers, and encourage private investment. While the authorities envision Personal Income Tax (PIT) incentives for young adults to live in Portugal, changes to this tax will be mindful of its relevance for tax revenue and income redistribution. As staff points out, Portugal's PIT revenue to GDP ratio is lower than the euro area average, due to lower disposable income per capita, but the average PIT tax rate is only slightly lower, due to a more progressive PIT framework. The authorities do not plan to increase property taxes, given the current housing affordability issues, but will phase out measures related to the increase in fuel prices and have started gradually resuming carbon price updates as of September. The newly established independent Tax Unit will assess tax expenditures against their goals, efficiency, and environmental impact, aiming to reduce inefficient tax benefits. Additionally, the authorities will continue to conduct an expenditure review to identify potential savings and improve public sector efficiency. Altogether, this strategy aims to preserve annual small surpluses and prudent net expenditure growth in the medium-term, in line with the EU governance framework.

In 2022, the public debt-to-GDP ratio was already below its pre-covid level, falling below the 100 percent mark in 2023. Moving forward, the authorities' strategy of maintaining sound finances and achieving more robust growth rates will allow for a steady decline in the public debt-to-GDP ratio, albeit at a slower rate than in recent years. Portugal, that now ranks within the 75-percentile interval of public debt ratios in the euro area, is expected to continue converging steadily toward the median. The authorities are cognizant of the aging population and other health and social pressures that will weigh on public accounts in the future. They are devising measures to tackle these challenges, with the downward path of the public debt ratio serving as a strong anchor and social acceptance that sound public finances are necessary to preserve a social compact with robust safety nets.

## Financial policies

The Portuguese banking system has made significant progress since the sovereign debt crisis, even amid the substantial exogenous shocks of recent years, thereby acting as a source of stability for the Portuguese economy. The trend of improving credit quality, marked by a downward trajectory in non-performing loans (NPL) ratios, has been accompanied by ample liquidity buffers and an increase in capital adequacy ratios, which now exceed those of the euro area for the first time. A prudent and preemptive macroprudential policy has further strengthened the sector's resilience.

The authorities agree with staff that systemic risks are moderate and have decreased since last year. Despite the recent slight increase in credit risk, as higher debt service pressures borrowers due to the rapid translation of higher interest rates to credit portfolios, total NPL ratios continued to decrease. These developments were supported by measures designed to alleviate the interest rate and rental burdens and to promote loan renegotiations, primarily aimed at financially stretched households. Additionally, all sectors of the economy continue to reduce indebtedness, further mitigating credit risk. In particular, households and corporates continue to deleverage, with an increase in households' disposable income and corporates' capital.

While the authorities broadly agree that real estate prices may be overvalued, the banking sector has several mitigants against a potential price correction. Most of the sector's exposure to real estate is indirect, through collateral of mortgage loans, which represent around 25 percent of total assets. Robust economic activity and high employment levels help mitigate credit risk in this portfolio. Furthermore, the rise in housing prices is not driven by domestic credit. In 2022 and 2023, around 46 percent of house purchases were financed with domestic credit, reducing to 33 percent in 2023 when excluding renegotiations and transfers. Additionally, since 2018, macroprudential measures like stressed Debt-Service to Income ratios and Loan-to-Value limits have concentrated new mortgages in higher-income households. Taking advantage of banks' high profitability levels, and to further safeguard against risks, the authorities have nonetheless introduced a sectoral systemic risk buffer (sSyRB) of 4 percent on this portfolio, effective from October 2024, for banks using the internal ratings-based (IRB) approach.

The authorities agree that risks in the financial sector warrant close monitoring, especially in light of geopolitical tensions and other factors that could deteriorate global and national macroeconomic conditions. They intend to continue defining the macroprudential policy stance holistically, considering all measures in place and the phase of the cycle. They are considering the pros and cons of introducing a positive Countercyclical Capital Buffer (CCyB) in a neutral cyclical systemic risk environment, benefitting from strong banking profitability that facilitates organic capital buildup.



## Structural policies

Raising productivity has long been a challenge for the Portuguese economy. To address this, the authorities intend to strengthen public investment, continue to enhance human capital, foster competitiveness and advance the green transition. The projected increase in public investment, which has been subdued since the sovereign debt crisis, will be boosted by the RRP and other EU funds, which have a focus on housing, digitalization, transportation and climate transition. This, along with lower corporate tax rates, is expected to stimulate private investment. For example, the RRP will promote partnerships between businesses and universities to drive innovation and R&D.

Over the past decades, the qualifications of the Portuguese population have significantly improved, with younger generations achieving higher education levels. Despite an aging Portuguese population, net immigration along with higher women participation rate and increasing retirement age has bolstered the labor force contributing to a dynamic labor market. The average age of immigrants in Portugal is lower than that of nationals. Most immigrants are employed in the labor market and, on average, possess higher qualifications than the Portuguese employed population, although this gap has been narrowing. The authorities continue to prioritize skilling and reskilling initiatives, and active labor market policies, as labor markets adjust to digital developments and artificial intelligence. The RRP includes reforms and investments to enhance digital skills, equip schools with digital technologies, and modernize the public administration. In terms of labor market regulations, significant progress has been made in making contracts more flexible and reducing the reliance on fixed-term contracts. The authorities will continue to assess measures to further decrease labor market duality.

Residential real estate (RRE) prices in Portugal have nearly doubled since 2016. Even as RRE prices began to decline across Europe, they continued to rise in Portugal, albeit at a slower rate of 8.2 percent in 2023. This trend has priced out much of the Portuguese population, highlighting a significant supply-demand mismatch. While demand from foreigners (whose numbers more than doubled) increased significantly, supply has been sluggish for a long time. The construction sector, hit hard by the sovereign debt crisis, has struggled to recover, recently further thwarted by labor shortages and high raw material costs, driving up prices. Additionally, bottlenecks in licensing and zoning laws have hindered the creation of new housing. To address these issues, the authorities plan to streamline licensing, adjust zoning laws, reduce red tape, and leverage digital tools to expedite processes. They also propose a tax benefit for individuals under 35, exempting them from property transfer tax and stamp duty. Furthermore, significant investments are being made to boost social housing, including through the RRP.

The Portuguese authorities would like to thank the Mission Chief, Mr. Jean-François Dauphin, and the team, Ms. Gohar Minasyan, Mr. Ippei Shibata, and Ms. Hannah Winterberg, for the productive

and engaging discussions. They value the continued dialogue on the Portuguese economy and the necessary public policies, particularly in this challenging global environment. They look forward to next Article IV Consultation and the beginning of the FSAP exercise in 2025.