IN-DEPTH ANALYSIS

Structured Dialogue with the Commission on suspension of European Structural and Investment Funds to Spain and Portugal

Following the Council decision of 12 July 2016 establishing that Spain and Portugal did not take effective action under the Excessive Deficit Procedure, the Commission shall make a proposal to suspend, part or all, of the commitments or payments for the programmes related to the European Structural and Investment Funds for these two Member States. In this context, the European Parliament invited the Commission for a structured dialogue.

This note is structured as follows: Section 1 presents the link between the European Semester and the European Structural and Investment Funds. Section 2 gives an overview of the Excessive Deficit Procedure for Spain and Portugal; Section 3 presents the economic and social situation for Spain and Portugal. Section 4 provides an overview of the banking sector developments in these two Member States. Finally, Annexes 1 and 2 show economic and social indicators for Spain and Portugal respectively; Annexes 3 and 4 the respective MIP Scoreboards; Annexes 5 and 6 present the respective progress on EU2020 indicators; and Annexes 7 and 8 give an overview of Country Specific Recommendations for Spain and Portugal.

1. Suspension of European Structural and Investment Funds under the European Semester

ESI Funds and Economic Governance

The **European Structural and Investment Funds** (ESI Funds) provide support to deliver the Union strategy for smart, sustainable and inclusive growth. At the same time, the ESI Funds are also to deliver the Fund-specific objectives established by the TFEU. These objectives include economic, social and territorial cohesion while taking into account, in particular, Europe 2020 Integrated Guidelines and Country Specific Recommendations (CSRs) addressed by the Council to Member States under the European Semester. In other words, under the 2014-2020 Multiannual Financial Framework, ESI Funds are geared towards the priorities set out under the EU2020 Strategy.

Box 1: European Structural and Investment Funds

The ESI Funds are the EU's main investment policy tool to support economic development within 28 Member States as, under the current Multiannual Financial Framework, Funds objectives are aligned with the EU2020 Strategy. The ESI Funds have an overall budget of EUR 454 billion over the period 2014-2020 (though spending period runs until 2023) and consist of five EU funds, namely:

- European Regional Development Fund (ERDF);
- European Social fund (ESF);
- Cohesion fund (CF);
- European Agricultural Fund for Rural Development (EAFRD);
- European Maritime and Fisheries Fund (EMFF).

The ESI Funds cover 11 thematic objectives directly derived from the Union strategy for smart, sustainable and inclusive growth (see Article 9 of Regulation (EU) 1303/2013).

For more information on relations between cohesion policy and the European Semester, see a separate DG IPOL Policy Department B Study (Chapter 2).

Authors: M. Hradiský, J. Angerer, A. Zoppè, M. Magnus, J. Vega Bordell and M. Ciucci

In this context, the **Regulation (EU) No 1303/2013**[1] (laying down common provisions for ESI Funds, hereafter **the Common Provisions Regulation - "CPR"**) has established a closer link between the "new generation" of ESI Funds, on the one hand, and economic governance procedures, on the other hand. In accordance with Recital 24 of the CPR, this link aims at ensuring that expenditure under the ESI Funds are aligned with the economic policies coordinated at the EU level. To this end, Article 23, in particular, foresees two mechanisms, namely:

(1) Reprogramming of ESI Funds (i.e. "preventive arm") via a review and amendments to Partnership Agreements and programmes, as defined under Article 23(1-6), to support the implementation of relevant Council recommendations or to enhance the impact of the available ESI Funds where Member States are receiving financial assistance;

(2) Suspension, partial or total, of commitments or payments (i.e. "corrective arm") for the programmes where a Member State fails to take effective action in the context of:

- Reprogramming of ESI Funds, as outlined in Article 23(6-8); or
- The economic governance process, including under the Excessive Deficit Procedure (EDP) and Macroeconomic Imbalance Procedure (MIP), as set out in Article 23(9-14).

Note that *the focus is here on a suspension (rather than a fine, as under the EDP): the suspended funds are re-budgeted after the Member State concerned took corrective action (see below).*

Suspension of ESI Funds: Conditions

In accordance with Article 23(9) of the CPR, the Commission (COM) shall make a proposal to the Council to suspend part or all of the commitments or payments for the programmes of a Member State if conditions specified herein are fulfilled. In other words, *the "corrective arm" is triggered automatically under certain conditions:* these include the Council decision establishing that no effective action has been taken under the EDP, based on Article 126(8) of the TFEU (as specified under Article 23(9a)). The Council adopted such a decision for both Spain and Portugal on 12 July 2016 (see Section 2 for further information).

When making its proposal, the COM should take into account all relevant information and give due consideration to any elements arising from, and opinions expressed through, the **structured dialogue with the European Parliament** as defined under Article 23(15) (see below).

The COM proposal is deemed adopted by the Council unless the Council decides to reject it by means of qualified majority (this must be done within one month of the submission of the COM proposal). The suspension applies only to commitments from 1 January of the year following the decision to suspend (i.e. 2017, if the Council adopts a COM proposal before the end of 2016).

In line with Article 23(15), **the COM must immediately inform the European Parliament** when a Member State fulfils the conditions for suspension of structural funds and **provide details of the ESI Funds and programmes** concerned by this suspension. In the letter of 14 July 2016 from Vice-President Katainen to President Schultz, the COM did provide a list of these programmes, without specifying the amounts involved.

[1] Regulation (EU) No 1303/2013 of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

Scope and level of suspension: Definition

In accordance with Article 23(11) of the CPR, **the scope and level of a suspension is to:**

- *Be proportionate*;
- *Respect equality of treatment* between Member States;
- *Take into account the economic and social circumstances* of the Member State concerned, in particular the level of unemployment as well as the possible overall impact on country's economy (see Sections 3 and 4 below);
- *Take into account the impact of suspension of programmes of critical importance* to address economic and social conditions.

Furthermore, Article 23(11) provides that, *in the first case of non-compliance with an EDP*, **the ceiling for suspension is equal to the *lowest* of[2]***:*

(1) A maximum of 50% of the commitments relating to the next financial year for the ESI Funds;

(2) A maximum of 0.5% of nominal GDP.

Subsequently, **Annex III of the CPR specifies, among others, "mitigating factors"** as regards both the level (point 1) and scope (point 2) of suspension of commitments:

- **Point 1 (level): The maximum level of suspension is to be reduced** in line with the conditions specified herein. These conditions refer to the unemployment rate[3], the proportion of people at risk of poverty or social exclusion, a contraction of real GDP for two or more consecutive years (preceding the trigger event) and the financial year (commitments for years 2018, 2019 and 2020 benefit from specific reductions). *The overall reduction cannot exceed 50% of the maximum level of suspension.*
- **Point 2 (scope)** specifies that a suspension of commitments is to affect, in a proportional manner, all programmes and priorities. However, some programmes and priorities cannot be suspended: see Annex III, Point 2 for a full list (e.g. programmes of critical importance, namely those under the Youth Employment Initiative - YEI[4])

Conditions for lifting the suspension

As set out in Article 23(12), **the COM must lift the suspension, without delay,** if:

1) The EDP is held in abeyance in line with Article 9 of Council Regulation (EC) No 1467/1997[5]; or
2) The Council decides to abrogate the decision on the existence of the excessive deficit under Article 126(12) of the TFEU.

When lifting the suspensions, the COM must re-budget the suspended commitments to following financial years in line with Article 8 of Council Regulation (EU, EURATOM) No 1311/2013[6].

Role of the European Parliament (EP)

In accordance with Article 23(15), the COM is to keep the EP informed of the implementation of Article 23. In particular, when conditions for a suspension of financing are met, the COM is to

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[2] The third ceiling specified under Article 23(9c) does not apply to the present case of Spain and Portugal.

[3] For example, the degree of reduction depends, among others, on the magnitude of the difference between the unemployment rate in the Member State concerned and the EU average.

[4] The COM may consider that programmes or priorities supporting investments related to implementation of CSRs addressed to the Member States concerned under the European Semester and aimed at (1) structural reforms; or (2) priorities supporting poverty reduction or (3) financial instruments for the competitiveness of SMEs are also of critical importance, and thereby fall outside the scope of suspension.

[5] Council Regulation (EU) No 1469/1997 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure.

[6] Council Regulation (EU, EURATOM) No 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014-2020.

immediately inform the EP and provide details of the ESI Funds and programmes which could be subject to a suspension.

The EP may invite the COM for a structured dialogue on the application of Article 23.

The COM is to transmit the proposal for suspension of commitments or payments or the proposal to lift such a suspension to the EP and the Council immediately after its adoption. The EP may invite the COM to explain the reasons for its proposal.

Finally note that:

(1) Spain is set to receive about EUR 37.5 billion from the ESI Funds over the period 2014-2020 as outlined in the "Partnership Agreement" of October 2014;

(2) Portugal is set to receive more than EUR 25.0 billion euro the ESI Funds over the period 2014-2020 as outlined in the "Partnership Agreement" of July 2014.

2. EDP decisions relating to Spain and Portugal: State of play

Recent decisions by the COM and the Council

The Council decided on 12 July 2016 (based on COM proposals of 7 July 2016 for Spain and Portugal) under Art. 126(8) that Spain and Portugal failed to take effective action in response to the Council Recommendations of 21 June 2013 under the EDP:

- The assessment of effective action points that Spain's public deficit was 5,9 % of GDP in 2014 and 5,1 % of GDP in 2015, above the intermediate targets set by the Council of 5,8 % and 4,2 % of GDP. Furthermore, the country is not forecast to correct its deficit by 2016 as required; the COM also stated that the fiscal effort fell significantly short by all metrics of what was recommended by the Council, and that the fiscal stance in 2015 was even relaxed;
- The assessment of effective action of Portugal found that the 2015 deadline to correct the effective deficit was missed. Even the deficit net of one-off measures related to the financial sector (resolution of Banif) would have remained above 3% of GDP. The assessment of effective action also found that the cumulative improvement in Portugal's structural balance in the 2013-15 period is estimated by the COM at 1.1% of GDP, significantly below the 2.5% recommended by the Council; when adjusted in the light of revised potential output growth and revenue windfalls or shortfalls, it is even slightly negative.

Based on the COM proposals of 27 July 2016, the Council decided on 8 August 2016 **not to impose fines on Spain and Portugal** for their failure to take effective action to correct their excessive deficits. The COM assessed positively (see here for Spain and here for Portugal) reasoned requests submitted by both countries, which have not been published. The COM decided to postpone a possible proposal on a (partial) suspension of the ESI Fnds under Reg. 1303/2013 (Art. 23, para 15) until it has had a **structured dialogue** with the EP.

On 8 of August 2016, the Council stepped up the EDP for both countries, setting **new correction deadlines and giving notice** of measures to be taken under 126(9) TFEU. The Council decisions establish the deadlines of **15 October 2016** for Spain and Portugal to take effective action and to submit a report to Council and COM. The reports shall include information on the actions being taken in response to the following requests of the notices:

- Spain: (1) the country shall put an end to the present excessive deficit situation by 2018; (2) it shall reduce the general government deficit to 4,6 % of GDP in 2016, to 3,1 % of GDP in 2017 and to 2,2 % of GDP in 2018; this improvement in the general government deficit is considered consistent with a deterioration of the structural balance by 0,4 % of GDP in 2016 and an improvement of 0,5 % of GDP in both 2017 and 2018 (...); (3) in addition to the savings already included in the updated COM 2016 spring forecast, Spain shall adopt and fully implement consolidation measures for the amount of 0,5 % of GDP in both 2017 and 2018; (4) Spain shall stand ready to adopt further measures should risks to the budgetary plans materialise (...);

- Portugal: (1) the country shall put an end to the present excessive deficit situation by 2016; (2) the country shall reduce the general government deficit to 2,5 % of GDP in 2016; this target does not include the impact of the direct effect of potential bank support; this improvement in the general government deficit is considered consistent with an unchanged structural balance with respect to 2015, based on the COM 2016 spring forecast; (3) Portugal shall also use all windfall gains to accelerate the deficit and debt reduction; (4) in addition to the savings already included in the COM 2016 spring forecast, Portugal shall adopt and fully implement consolidation measures for the amount of 0,25 % of GDP in 2016. In particular, Portugal shall implement fully the consolidation measures incorporated in the 2016 Budget (...).

Previous decisions and assessments

On 12 July 2016, the Council adopted the 2016 CSRs in the framework of the European Semester, which included opinions on the 2016 Stability and Convergence programmes (SCPs), based on Article 126 of the TFEU ("corrective arm of the SGP"):

- **Spain** (see recital 5 of the Council and COM recommendations) is assessed to have missed the required fiscal effort and headline targets in 2014 and 2015. A more comprehensive analysis is presented in the ECFIN Staff Working Document of 26 May 2016: *In 2015, Spain achieved a headline deficit of 5.1% of GDP, exceeding the target under the EDP by 0.9% of GDP. Moreover, the required fiscal effort has not been delivered either on the basis of all metrics (...). The planned improvement in the structural balance in 2016 falls short of the effort required by the Council in the latest EDP recommendation, on the basis of both the unadjusted and the adjusted changes in the structural balance. Based on bottom-up method, the effort is also below the requirement in 2016. The same conclusion could be drawn on the basis of the COM 2016 spring forecast."* (p. 22)
- **Portugal** (see recitals 5 of the Council and COM recommendations) is assessed not to have corrected the excessive deficit by the 2015 deadline and not to have delivered the fiscal effort recommended by the Council. According to the more detailed ECFIN Staff Working Document of 26 May 2016 (p. 14): "*In 2015, Portugal achieved a headline deficit of 4.4% of GDP, which was above the recommended target of 2.5% of GDP and above the Treaty reference value of 3% of GDP. Therefore, Portugal did not correct its excessive deficit by the 2015 deadline recommended by the Council. The fiscal effort indicators also point to a shortfall in the structural effort, based on the change in both the unadjusted and adjusted structural balance in 2015 and in cumulative terms over 2013-2015, as well as on the permanent consolidation measures taken under the programme and thereafter.*" (p. 23)

The COM already proposed in the draft 2016 CSRs extensions of one year to correct the excessive deficits for Spain and Portugal, while this was not formally part of the EDP. The proposed extension of one year for Spain was not taken up in the CSR adopted in July 2016 by the Council (its text did not mention at all a correction deadline). However, the Council decided in August 2016 under the EDP to extend this deadline by two years (i.e. until 2018).

On 9 March 2016, the COM noted in a **separate recommendation to Spain** that the cumulative structural effort between 2013 and 2015 had been **0.8% of GDP, while the Council had requested a 2.7% of GDP** effort in its latest EDP recommendation. For 2016, the COM noted that the **fiscal effort of 1.5% of GDP recommended by the Council was not expected to be met since on the basis of any COM forecast**:

- The unadjusted change of the structural balance was forecast to be unchanged;
- The structural balance change adjusted by potential output revisions and revenue shortfalls was forecast to deteriorate by 0.2% of GDP;
- The bottom-up analysis of measures taken indicated that no fiscal effort was projected to be delivered by Spain in 2016.

In autumn 2015 (and February 2016, in the case of Portugal), the COM issued **opinions on the 2016 Draft Budgetary Plans** (DBPs) of euro area Member States:

- **Spain** was assessed not to meet its nominal fiscal targets both in 2015 in 2016 and not to have taken effective action in structural terms each of these years.
- **Portugal:** The COM assessed that the structural adjustment planned by the Portuguese authorities for 2016 amounts to 0.1%-0.2% of GDP, so that the estimated deviation from the recommended structural adjustment of 0.6% of GDP would be below 0.5% of GDP and therefore not significant; nevertheless, the COM assessed that the gap might eventually get bigger than 0.5% of GDP, notably due to implementation risks.

Next steps

In accordance with above mentioned EDP Council decisions under Art. 126(9), Portugal and Spain have a deadline of 15 October 2016 to take effective action regarding the measures included in the decisions and to submit a report to Council and COM. All possible subsequent steps (incl. the abeyance of the procedures, if Portugal and Spain act in compliance with the EDP Council decisions under Art. 126(9)) under Art. 126 TFEU and Council Regulation 1467/97 governing the corrective arm of the SGP are presented in boxes 2 and 3.

Furthermore, the Eurogroup confirmed on 9 September 2016 that the euro area Member States should **submit their draft budgetary plans for 2017 between 1 and 15 October** this year, as such a timeframe will ensure that draft budgetary plans are assessed on a comparable set of macroeconomic assumptions. A pragmatic solution will be found for countries that have a caretaker government (as is the case for Spain).

Box 2: Selected TFEU provisions on the EDP

Article 126 TFEU

(...)

9. **If a Member State persists in failing to put into practice the recommendations of the Council**, the Council may decide to give notice to the Member State to take, within a specified time limit, measures for the deficit reduction which is judged necessary by the Council in order to remedy the situation. In such a case, the Council may request the Member State concerned to submit reports in accordance with a specific timetable in order to examine the adjustment efforts of that Member State.

10. The rights to bring actions provided for in Art. 258 and 259 [see below] may not be exercised within (...) paragraphs 1 to 9 of this Art.

11. **As long as a Member State fails to comply with a decision taken in accordance with paragraph 9, the Council may decide to apply or, as the case may be, intensify one or more of the following measures**:

- to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities,
- to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned,
- to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Union until the excessive deficit has, in the view of the Council, been corrected,
- to impose fines of an appropriate size.

The President of the Council shall inform the European Parliament of the decisions taken.

12. The Council **shall abrogate some or all of its decisions or recommendations referred to in paragraphs 6 to 9 and 11** to the extent that the excessive deficit in the Member State concerned has, in the view of the Council, been corrected. If the Council has previously made public recommendations, it shall, as soon as the decision under paragraph 8 has been abrogated, make a public statement that an excessive deficit in the Member State concerned no longer exists.
(...)

Article 258 TFEU: If the COM considers that a Member State has failed to fulfil an obligation under the Treaties, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations. If the State concerned does not comply with the opinion within the period laid down by the COM, the latter may bring the matter before the Court of Justice of the EU.

Article 259 TFEU: A Member State which considers that another Member State has failed to fulfil an obligation under the Treaties may bring the matter before the Court of Justice of the EU. Before a Member State brings an action against another Member State for an alleged infringement of an obligation under the Treaties, it shall bring the matter before the COM. The COM shall deliver a reasoned opinion after each of the States concerned has been given the opportunity to submit its own case and its observations on the other party's case both orally and in writing. If the COM has not delivered an opinion within three months of the date on which the matter was brought before it, the absence

Box 3: Selected Council Regulation 1467/1997 provisions on the EDP

Council Regulation 1467/97: Articles 5-12

5 (1a): Following a Council notice under **Art. 126(9) TFEU**, the Member State concerned shall report to the Council and the COM on action taken in response thereto. The report shall include the targets for the government expenditure and revenue and for the discretionary measures on both the expenditure and the revenue side, as well as information on the actions being taken in response to the specific Council recommendations so as to allow the Council to take, if necessary, a decision in accordance with Art. 6(2) of this Regulation. The Member State shall make the report public.

5 (2): If effective action has been taken in compliance with a notice under **Art. 126(9) TFEU** and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that notice, the Council may decide, on a recommendation from the COM, to adopt a revised notice under **Art. 126(9) TFEU**. The revised notice, taking into account the relevant factors referred to in Art. 2(3) of this Regulation may, in particular, extend the deadline for the correction of the excessive deficit by one year as a rule. The Council shall assess the existence of unexpected adverse economic events with major unfavourable consequences for government finances against the economic forecasts in its notice. In the case of a severe economic downturn in the euro area or in the Union as a whole, the Council may also decide, on a recommendation from the COM, to adopt a **revised notice under Art. 126(9)**, on condition that this does not endanger fiscal sustainability in the medium term.

6(1): The Council, when considering whether effective action has been taken in response to its notice made in accordance with **Art. 126(9) TFEU**, shall base its decision on the report submitted by the Member State (...) in accordance with Art. 5(1a) of this Regulation and its implementation, as well as on any other publicly announced decisions by the government of the Member State concerned. (...)

6(2): Where the conditions to apply Art. 126(11) are met, the Council shall impose sanctions in accordance with that Article. Any such decision shall be taken no later than four months after the Council decision under **Art. 126(9)** giving notice to the participating Member State concerned to take measures.

7: If a participating Member State fails to act in compliance with the successive acts of the Council in accordance with **Article 126(7) and (9)**, the decision of the Council under Art. 126(11) TFEU to impose sanctions shall be taken as a rule within 16 months of the reporting dates established in Art. 3(2) and (3) of Reg. (EC) No 479/2009. Where Art. 3(5) or Art. 5(2) of this Regulation is applied, the 16-month deadline shall be adjusted accordingly. An expedited procedure shall be used in the case of a deliberately planned deficit which the Council decides is excessive.

8: Any Council decision under Article 126(11) TFEU to intensify sanctions shall be taken no later than two months after the reporting dates pursuant to Regulation (EC) No 479/2009. Any Council decision under Article 126(12) TFEU to abrogate some or all of its decisions shall be taken as soon as possible and in any event no later than two months after the reporting dates pursuant to Regulation (EC) No 479/2009.

9(1): The excessive deficit procedure shall be held **in abeyance**:

— if the Member State (...) acts in compliance with recommendations made in accordance with Art 126(7) ,

— if the participating Member State (...) acts in compliance with notices given **in accordance with Art. 126(9)**

(...)

10(1): The Council and the COM shall regularly **monitor the implementation of action taken**:

— by the Member State concerned in response to recommendations made under Art. 126(7),

— by the participating Member State **concerned in response to notices given under Art. 126(9)**

10(2): If action by a participating Member State is not being implemented or, in the Council's view, is proving to be inadequate, the Council shall immediately take a decision under **Art. 126(9)** and (11) respectively.

10(3): If actual data pursuant to Regulation (EC) No 479/2009 indicate that an excessive deficit has not been corrected (...) within the time limits specified either in recommendations issued under Art 126(7) **or notices issued under Art. 126(9)**, the Council shall immediately take a decision under **Art. 126(9)** or Art. 126(11) respectively.

11: Whenever the Council decides under Art. 126(11) TFEU to impose sanctions on a participating Member State, a fine shall, as a rule, be required. The Council may decide to supplement such a fine by the other measures provided for in Art. 126(11) TFEU.

12 (1): The amount of the fine shall comprise a fixed component equal to 0,2 % of GDP, and a variable component. The variable component shall amount to one tenth of the absolute value of the difference between the balance as a percentage of GDP in the preceding year and either the reference value for government balance or, if non-compliance with budgetary discipline includes the debt criterion, the government balance as a percentage of GDP that should have been achieved in the same year according to the notice issued under **Art. 126(9) TFEU**.

12 (2): In each year following that in which a fine is imposed, until the decision on the existence of an excessive deficit is abrogated, the Council shall assess whether the participating Member State concerned has taken effective action in response to the Council notice in accordance with **Art. 126(9)**. In this annual assessment the Council shall decide, in accordance with Art. 126(11) TFEU, to intensify the sanctions, unless the participating Member State concerned has complied with the Council's notice. (...)

12 (3): No single fine referred to in paragraphs 1 and 2 shall exceed 0,5 % of GDP.

3. Economic and social situation

Spain

The Spanish economy has returned to growth since 2014 on the back of strengthening domestic demand. For 2016 and 2017, the COM expects growth to lose some momentum, but still remain robust. From the macroeconomic perspective, the country is experiencing imbalances, in particular in terms of large stock of net external liabilities, elevated public and private sector indebtedness. Unemployment remains at high levels despite the recent declines.

Spain successfully exited the ESM programme for the recapitalisation of domestic banking sector at the end of 2013. Since then, it is subject to post-programme surveillance (PPS)[7].

After contracting by around 9% between 2008 and 2013, the Spanish economy has returned to growth, expanding by 1.4% in 2014 and 3.2% in 2015[8]. This upturn has been driven by domestic demand on the back of positive labour market developments, improving financing conditions for households and companies, return of confidence and low energy prices. According to the Spring 2016 COM forecast, the Spanish economy is set to grow at a more moderate, yet still robust, pace in 2016 and 2017 (2.6% and 2.5% respectively) as the expansion in both private consumption and investment are projected to somewhat decelerate.

In 2015, Spain's nominal GDP stood at EUR 1 075 billion and the total population amounted to around 46.5 million. In terms of standards of living, as measured by GDP per capita in purchasing power parities, the average income per person stood 8% below the EU 28 average in 2015, while it was 3% above the EU 28 average before the onset of the financial crisis in 2007.

Prices have been on a subdued downward trend over the last two years, predominantly reflecting declines in energy and transport sector prices. Annual inflation, as measured by headline Harmonised Index of Consumer Prices (HICP) stood at -0.2% in 2014 and -0.6% in 2015. Looking ahead, the COM projects only marginally negative inflation for 2016 (-0.1%) before it picks up in 2017 (1.4%) as negative base effects in energy prices progressively fade out and the economy closes the output gap. According to the latest Eurostat data, annual HICP inflation came in at -0.3% in August 2016.

The current account turned into surplus in 2013 and has remained in the positive territory since then, as positive trade balance more than offset (diminishing) outflows in primary and secondary incomes. The current account surplus came in at 1.4% of GDP in 2015 and is projected by the COM to hover around this level over the next two years (1.5% in 2016 and 1.3% in 2017).

After peaking at 26.1% in 2013, the unemployment rate has been steadily decreasing, to 4.5% in 2014 and 22.1% in 2015, as the economy returned to growth and wage moderation has kept helped contain unit labour costs. Given that the average EU 28 unemployment rate was 9.4% in 2015, **the level of suspension is to be reduced by 50% in line with the condition defined in the Annex III, point 1(c) of the CRP[9]**. The latest Eurostat data show that Spain's unemployment rate edged further down to 19.6% in July 2016 and remains the second largest within the EU 28 (after Greece). In particular, the youth unemployment continues to stand at very high levels (43.9% in July 2016) despite substantial declines over the last two years or so[10].

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[7] See a separate EGOV document (Financial Assistance to EU Member States) for more details. In particular, the COM concluded following the June 2016 review that "*favourable economic environment has not been used to put the public finances onto a sounder path and, given the political situation, recently there has been little or no progress in the structural reform agenda, including measures to improve innovation and skills in order to boost non-cost competitiveness and improving the business environment*".

[8] Consequently, the condition outlined in Annex III, Point 1(e) for reduction of the maximum level of suspension is not fulfilled. This condition provides that where the Member State experiences a contraction of real GDP for two or more consecutive years preceding the trigger event referred to in Article 23(9), the maximum level of suspension shall be reduced by 20 %.

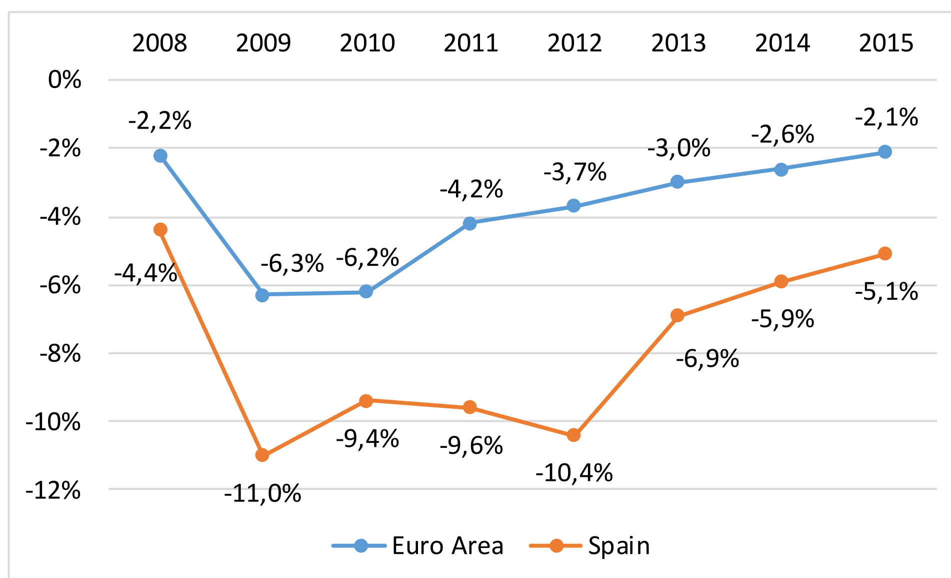
[9] Annex III, point 1(c) provides that if the unemployment rate in the Member State for the year preceding the trigger event [i.e. 2015] referred to in Article 23(9) exceeds the average rate for the Union by more than eight percentage points [22.1% - 9.4% = 12.7%], the maximum level of suspension shall be reduced by 50%.

[10] The youth unemployment peaked at 56.0% in April 2013.

As to **social indicators targeted under the EU2020 Strategy** (see Annex 5), the employment rate has steadily increased from its recent low of 65.4% of population aged 20-64 in 2013 to 69.1% in 2015 on the back of improving economic environment (the target being set at 75%) On the other hand, 28.6% of total population was at risk of poverty or social exclusion in 2015, namely 13.175 million of persons (the second highest level on record since the start of series in 2004). This is 2.8 million of persons more than in 2008 (the reference year under the EU2020 for this indicator), while the intended target specifies a reduction of 1.4 million of persons over the period 2008-2020. Regarding tertiary education attainment among citizens aged 30-34, it has continued its upward trend to stand at 40.9% of total population in 2015 (the EU2020 target being set at 44%).

The **public deficit has been on a downward path since 2012** and narrowed to 5.1% of GDP in 2015 on the back of improved macroeconomic conditions. According to the COM Spring 2016 forecast, it is set to further decline to 3.9% in 2016 and 3.1% in 2017 (under the customary no-policy change assumption). However, this projected reduction relies on favourable macroeconomic outlook as the structural deficit is set to further deteriorate over the forecast horizon[11]. The public debt stood at 99.2% of GDP in 2015 and is expected to breach 100% in 2016 (100.3%) before it edges down to 99.6% a year later.

Figure 1: General government balance in Spain and the euro area



Source: Eurostat.

Portugal

Portugal's economy has been on a moderate recovery path since mid-2013, driven by domestic demand and improving financing conditions. Nevertheless, the country is experiencing excessive macroeconomic imbalances: large stocks of net external liabilities, private and public debt and a high share of elevated non-performing loans risk to hamper growth in a context of elevated unemployment.

In July 2014, Portugal exited an economic adjustment programme started in May 2011, under which it received 76 billion euro as financial assistance by the EU and the IMF. Since, the country is under specific monitoring by the EU and the IMF.

In 2015, Portugal nominal GDP was around 180 billion euros and the total population amounted to around 10 million. In terms of living standards, measured by GDP pro capita in purchasing parities, the average income per person stood 23% below the EU 28 average.

[11] Structural deficit is projected to stand at 2.9% in 2015, 3.1% in 2016 and 3.2% in 2017.

The recent conclusions of the IMF Board on Portugal read "*The economic recovery in Portugal is losing momentum. The slowdown in economic activity that began in the second half of 2015 has persisted, despite still-favorable cyclical tailwinds and supportive macroeconomic policy settings. The fiscal loosening in place since last year and the ECB's appropriately supportive monetary policy stance have translated into robust consumption growth. However, overall GDP growth is being held back by weaker export growth and sluggish investment, with the latter being weighed down by uncertainty, high levels of corporate debt, and still-pronounced structural bottlenecks. Accordingly, output is expected to increase by only 1.0 percent in 2016*".

According to the COM Spring forecast, GDP growth is expected to be at 1.5% in 2016 and slightly increase to 1.7% in 2017. In 2015, investments, also supported by EU funds, grew solidly by 3.9%; private consumption increased at a rate of 2.4% and is expected to grow in 2016 and 2017, although at a slower pace. Risks to the macroeconomic outlook are related to policy uncertainty, financial market developments and deleveraging in the private sector.

Imports exceed exports, and the current account was in slight deficit in 2015, forecast to become positive (0.3% of GDP) in 2016 and to be 0.5% of GDP in 2017.

Inflation, as measured by the HICP, was 0.5 in 2015 and forecast to be 0.7 and 1.2 in 2016 and 2017 respectively, mainly driven by higher indirect taxes, against an EA indexes of 0 in 2015, 0.2 in 2016 and 1.4 in 2017.

Unemployment was 12.6 in 2015, expected to decrease to 11.6% in 2016 and to 10.7 in 2017. Consequently, in line with the condition defined in the Annex III, point 1(a) of the CRP, and given that the average EU 28 unemployment rate was 9.4% in 2015, **the maximum level of suspension is to be reduced by 15%[12].** Long-term unemployment was at 7.2% in 2015, slightly down from 8.4 in 2014, and youth unemployment was at 32%, down from its peak of 38.1% in 2013. **The employment** rate in Portugal is 69.3%, expected to increase by 0.8% in 2016 and 0.5% in 2017, still far from the EU2020 target of 75%.

As to **social indicators targeted under the EU2020** strategy (see Annex 6), in 2015, 27.6% of total population was at risk of poverty or social exclusion: this represents 7000 people more than in 2008, but 114000 less than in 2013; the EU2020 objective of -200 thousand people with respect to 2008 seems not reachable. Tertiary education attainment among citizens aged 30-34 has increased from 22% in 2008 to 32% in 2015, nearing the EU 2020 objective of 40%. Among women, such shares increased from 26% to 40%.

The **public deficit** was 4.4% of GDP in 2015, compared to a target of 2.7% set by the authorities in 2014. It is projected to reach 2.7% of GDP in 2016 (below the Treaty reference value of 3%) and 2.3% of GDP in 2017; the government plans to correct the excessive deficit and reach a headline deficit of 2.25% of GDP in 2017. In terms of structural deficit (net of cyclical fluctuations and one-off operations) however, Portugal is not meeting its commitments, as it is projected to increase in 2016 and 2017, and the Medium Term Objective of a structural surplus of 0.25% of GDP is not expected to be achieved within 5 years. The public debt is forecast to decrease from 129.0% of GDP in 2015 to 126.0% in 2016 and to 124.5% in 2017 and to continue declining to 110% in 2020[13]. In June 2016, long-term government bonds yields were 3.2%, when the euro area average was 0.82%. In 2015, Portugal spent 4.6% of GDP in interests on its debt, compared to an average in the euro area of 2.4% (source: ECB).

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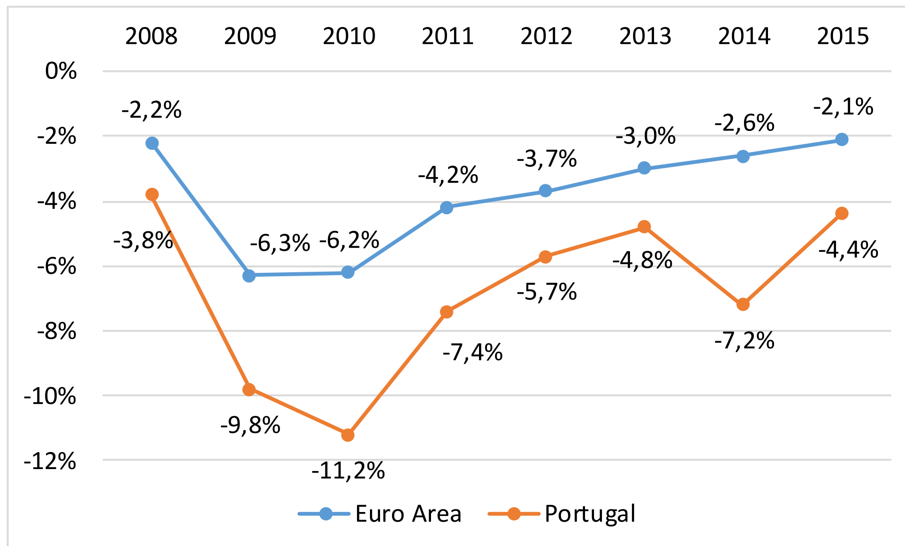
[12] Annex III, point 1(a) provides that if the unemployment rate in the Member State for the year preceding the trigger event [i.e. 2015] referred to in Article 23(9) exceeds the average rate for the Union by more than two percentage points [12.6% - 9.4% = 3.2%], the maximum level of suspension shall be reduced by 15%.

[13] All major credit rating agencies have downgraded Portugal bonds to below the investment status, with the only exception of the DBRS (a Canadian rating agency), which is going to revise its rating in October 2016.

Figure 2: General government balance in Portugal and the euro area



Source: Eurostat.

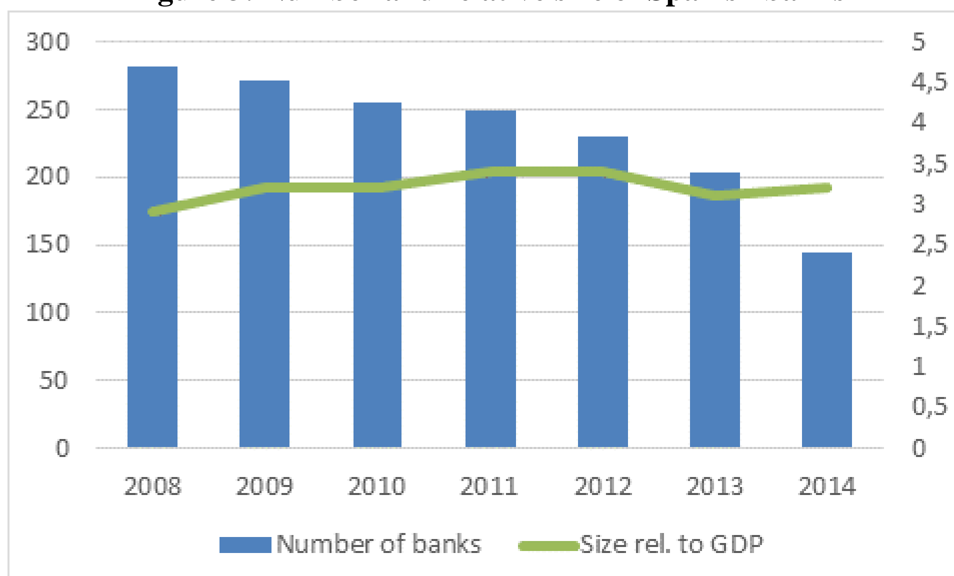
4. The banking sector in Spain and Portugal - status quo

Spain

Structure: Since the country's banking crisis took hold, Spain has substantially restructured its financial sector, in particular with regard to its savings banks (cajas), as many smaller cajas were merged and formed larger new entities. Overall, the number of Spanish banks was roughly halved. Out of the remaining 144 domestic Spanish banks[14], the largest 14 banking groups are directly supervised by the ECB's supervisory arm, all others by Banco de España. Banco Santander, holding total assets well above EUR 1.0 trillion, is by far the largest Spanish bank, twice as big as its nearest competitor.

In contrast, in terms of size the Spanish banking sector has not shrunk in recent year but increased: the size ratio, as measured by total assets of domestic banks in relation to GDP, increased from 2.9 in 2008 to 3.2 in 2014.

Figure 3: Number and relative size of Spanish banks



Source: EGOV calculations based on the data in the ECB Report on financial structures October 2015 (p.59 and p.61).

[14] Number of credit institutions as per year end 2014 according to the ECB Report on financial structures October 2015

Conceding that it is difficult to establish an "optimal" threshold above which the size of the financial sector is harmful and below which it is beneficial for the society[15], the development in Spain is at least not in line with the general trend in the euro area, where the average size ratio has during the same period substantially decreased from 3.0 to 2.4.

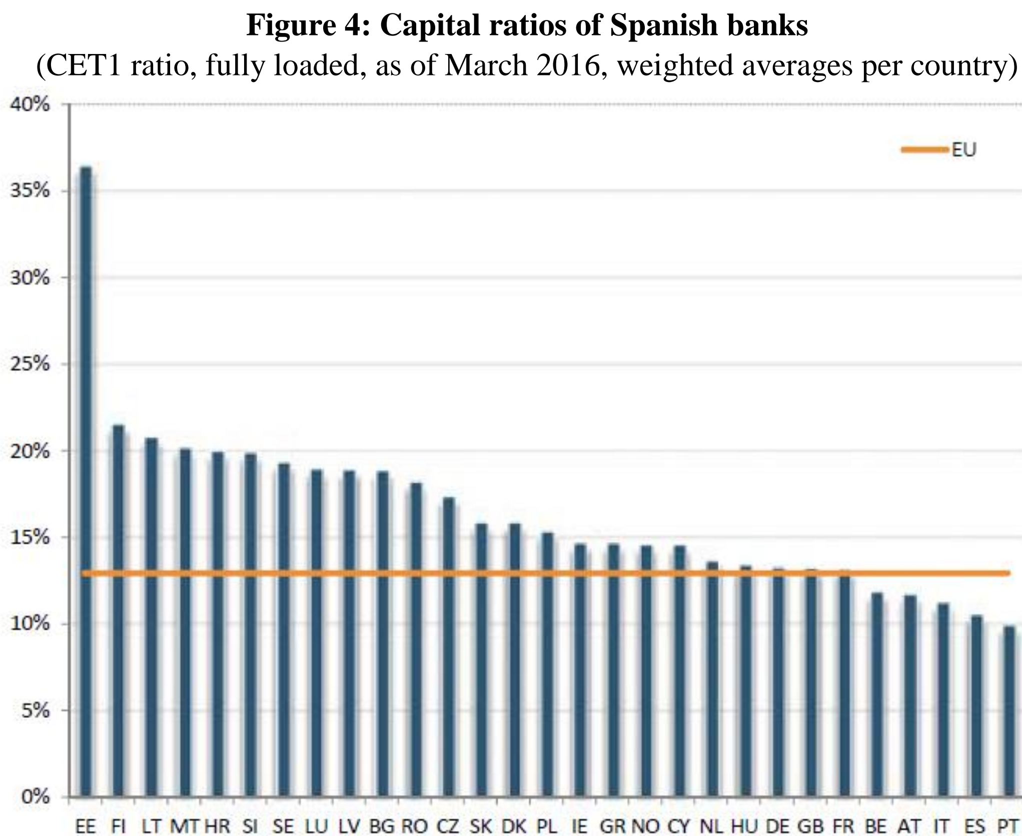
Financial soundness: The capital ratio and the ratio of non-performing loans (NPLs) are two key indicators for the financial soundness of banks, indicating the size of the "cushion" that a bank has to absorb losses before becoming insolvent, respectively indicating how many clients are in in some sort of financial difficulties (a loan is generally considered nonperforming when a client's payments of interest and principal are past due by 90 days or more).

Due to stricter capital requirements, the capital ratios of banks have in recent years generally improved, inside and outside of Europe; the recapitalisation of the Spanish banking sector was state supported, funded by a financial assistance programme of the European Stability Mechanism that to this end disbursed EUR 41.3 billion.

Even though the Spanish banking sector is now better capitalized, the capital ratios still rank at the lower end if compared to the capital ratios of other European banks, as shown in recent publications by the European Banking Authority (EBA):

Figure 4: Capital ratios of Spanish banks

(CET1 ratio, fully loaded, as of March 2016, weighted averages per country)



Source: EBA risk dashboard Q1 2016 (p. 9).

The NPL ratios of Spanish banks, on the other hand, have recently improved, following the pick-up in economic growth. In March 2016, the NPL ratio of Spanish bank stood on average at a level of 6.3% according to EBA data, still somewhat higher but not markedly different than the EU average of 5.7% (the figures reported in the COM Spring 2016 Post-Programme Surveillance Report for Spain are higher, though; in general, NPL figures across Europe are widely dispersed).

[15] See, for example "Has the financial sector grown too big?", speech given on 15 April 2010 by Lorenzo Bini Smaghi, at that time Member of the Executive Board of the ECB

Stress testing: EBA has recently conducted an EU-wide stress test exercise of European banks (also see the EGOV briefing on bank stress test exercises) and published the results of the stress test on 29 July 2016. In its related press statement, Banco de España deems that the Spanish banks have shown "*an appreciable degree of resilience*", a view that is broadly shared by Moody's but not by Reuters.

Portugal

Structure: Alike Spain, Portugal received financial assistance from the EU, using part of the financial package that was agreed in 2011 to strengthen its financial sector by recapitalisations. However, Portugal has not seen a comparable ambitious restructuring approach to its financial sector nor a considerable change in the number of domestic banks: In 2014, its financial system still counted 130 domestic banks[16], down from 147 in 2008; among those are in particular 88 Mutual Agricultural Credit Banks[17]. Portugal has therefore nearly as many domestic banks as Spain, although the size of its economy is considerably smaller (less than one fifth of the Spanish GDP). Four Portuguese banking groups are, due to their size, directly supervised by the ECB's supervisory arm (Banco BPI, Banco Comercial Português BCP, Caixa Geral de Depósitos CGD, and Novo Banco), all other banks are supervised by Banco de Portugal.

Novo Banco, the remaining entity of Banco Espírito Santo (BES), formerly the second largest private bank in Portugal that in 2014 had to be restructured and split into two parts, after "*management acts seriously detrimental to the interests*" of the bank incurred losses so significant that they completely wiped out the bank's capital (for more details, see Banco de Portugal's publication on BES).

In 2015, the COM opened an in-depth investigation regarding the aid given by the state to Banco Internacional do Funchal (Banif), at that time the eighth-largest commercial bank in Portugal, based on persistent doubts about the viability of its business and restructuring plan. In the wake of the COM's in-depth investigation, Banco de Portugal concluded that Banif was not a viable business on a stand-alone basis and hence decided that Banif had to be restructured by selling it in parts to a suitable buyer (for more details, see Banco de Portugal's publication on Banif).

While the structure of the Portuguese financial system remained rather unchanged, its relative size has slightly decreased and is below the EU average: the ratio of domestic banks' total assets relative to GDP has come down from 2.1 in 2008 to 2.0 in 2014 (while the EU average stood at 2.4 in 2014).

Financial soundness: In absolute numbers, the capital ratios of Portuguese banks have in recent years improved, not least due to state supported recapitalisations, as in Spain. In relative terms, however, Portuguese banks are on average still not comfortably capitalised (also see Figure 2). There are different ways to measure the solvency of banks, yet for three out of the four indicators used in EBA's latest risk dashboard (Tier 1 capital ratio, Total capital ratio, and fully loaded CET1 ratio) Portuguese banks rank last, and only with regard to their CET1 ratio as a solvency indicator they rank second to last (in which case Italian banks bring up the rear).

The fact that Portuguese banks have on average less room to cope with losses than other European banks becomes even more important when looking at the second key indicator of financial soundness, namely the level of NPLs. Subir Lall, the IMF mission chief for Portugal highlighted in an interview of 1 April 2016 that "*Since the end of the crisis, Portuguese banks have remained burdened by a large stock of legacy assets, some of which are of weak quality*". According to EBA data, the average level of NPL's of Portuguese banks as at March 2016 stands at 19.2%[18], which is more than three times the average level in the EU (5.7%).

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[16] See ECB Report on financial structures October 2015.
[17] See publication by the Portuguese Banking Association.
[18] The figures reported in the European Commission's Spring 2016 Post-Programme Surveillance Report for Portugal published in April 2016 are considerably lower, though, in the order of magnitude of 12% to 13%.

Fitch Ratings points out in a statement released on 22 September 2016 that the sluggish operating environment makes it difficult for Portuguese banks to build up capital, deliver adequate profits and boost capital through earnings retention. Considering that the unreserved portion of problem assets exceeds 100% of capital at both CGD and BCP, those two large banks are currently in the process of strengthening their capital position. According to Fitch, CGD is not facing regulatory capital shortfalls and its current efforts to boost its capital by EUR 5.0 billion - which is said to involve a EUR 2.7 billion capital injection from the state and conversion of state-held EUR 900 million contingent convertible bonds into equity - reflect a drive to grow lending and support economic growth. Fitch is, on the other hand, more critical about the capital position of the second large bank, BCP, saying it is vulnerable and weighting on the bank's rating.

Stress testing: None of the Portuguese banks was included in EBA's sample for the 2016 EU-wide stress test exercise. The ECB conducted a stress test in parallel, focussing on those banks that are under its direct supervision but were not included in EBA's sample, using the same methodology. However, as the ECB considers that an internal supervisory exercise, the ECB decided not to publish the results.

While there was no publication of results by the ECB, one of the four directly supervised Portuguese banks chose to individually issue a press release on the outcome, namely Banco Comercial Português, explicitly mentioning that the ECB had not endorsed that publication. According to that press release, Banco Comercial Português' CET 1 capital ratio (fully loaded) would fall in the adverse stress test scenario in 2018 to 6.1%, which is comparatively low but not a cause for concern (in comparison: on average, the same ratio would in the other banks included in the EBA sample fall to a level of 9.2%).

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Annex 1: Spain's key economic indicators

	2012	2013	2014	2015 (e)	2016(f)	2017 (f)
GDP Growth (%)						
Spain	-2.6	-1.7	1.4	3.2	**2.6**	**2.5**
EU	-0.5	0.2	1.4	2.0	**1.8**	**1.9**
General government balance (% of GDP)						
Spain	-10.4	-6.9	-5.9	-5.1	**-3.9**	**-3.1**
EU	-4.3	-3.3	-3.0	-2.4	**-2.1**	**-1.8**
Structural balance (% of GDP)						
Spain	-3.4	-2.0	-1.9	-2.9	**-3.1**	**-3.2**
EU	-2.7	-1.8	-1.7	-1.6	**-1.7**	**-1.7**
General government gross debt (% of GDP)						
Spain	85.4	93.7	99.3	99.2	**100.3**	**99.6**
EU	85.2	87.3	88.5	86.8	**86.4**	**85.5**
Inflation (% change)						
Spain	2.4	1.5	-0.2	-0.6	**-0.1**	**1.4**
EU	2.6	1.5	0.5	0.0	**0.3**	**1.5**
Unemployment (% of labour force)						
Spain	24.8	26.1	24.5	22.1	**20.0**	**18.1**
EU	10.5	10.9	10.2	9.4	**8.9**	**8.5**
Youth Unemployment (% of labour force)*						
Spain	52.9	55.5	53.2	48.3	**n.a.**	**n.a.**
EU	23.3	23.7	22.2	20.4	**n.a**	**n.a**
Current account balance (% of GDP)						
Spain	-0.4	1.5	1.0	1.4	**1.5**	**1.3**
EU	1.0	1.5	1.6	2.0	**2.2**	**2.1**
Exports (% change)						
Spain	1.1	4.3	5.1	5.4	**4.5**	**5.2**
EU	2.3	2.2	4.0	5.3	**3.5**	**4.6**
Imports (% change)						
Spain	-6.2	-0.3	6.4	7.5	**5.8**	**5.8**
EU	-0.3	1.6	4.7	5.9	**4.7**	**5.1**
Domestic demand (% change)						
Spain	-4.7	-3.1	1.6	3.8	**3.0**	**2.6**
EU	-1.5	-0.1	1.5	2.1	**2.2**	**2.1**
Investments (% change)						
Spain	-7.1	-2.5	3.5	6.4	**4.7**	**5.0**
EU	-2.5	-1.7	2.7	3.4	**3.0**	**3.8**
Income Inequality Gini Coefficient (% change)*						
Spain	34.2	33.7	34.7	34.6	**n.a**	**n.a**
EU	30.4	30.5	30.9	n.a	**n.a**	**n.a**
People at risk of social exclusion (% total)*						
Spain	27.2	27.3	29.2	28.6	**n.a**	**n.a**
EU	24.7	24.6	24.4	n.a.	**n.a**	**n.a**
Unit labour cost (% change)						
Spain	-2.9	-0.2	-0.8	0.3	**0.7**	**0.6**
EU	1.9	1.0	0.7	0.7	**1.3**	**1.3**

Sources: European Commission (Spring 2016 forecast) and Eurostat (data marked with *, as of 27 September 2016).

Annex 2: Portugal's key economic indicators

	2012	2013	2014	2015 (e)	2016(f)	2017 (f)
GDP Growth (%)						
Portugal	-4.0	-1.1	0.9	1.5	**1.5**	**1.7**
EU	-0.5	0.2	1.4	2.0	**1.8**	**1.9**
General government balance (% of GDP)						
Portugal	-5.7	-4.8	-7.2	-4.4	**-2.7**	**-2.3**
EU	-4.3	-3.3	-3.0	-2.4	**-2.1**	**-1.8**
Structural balance (% of GDP)						
Portugal	-3.1	-2.5	-1.4	-2.0	**-2.2**	**-2.5**
EU	-2.7	-1.8	-1.7	-1.6	**-1.7**	**-1.7**
General government gross debt (% of GDP)						
Portugal	126.2	129.0	130.2	129.0	**126.0**	**124.5**
EU	85.2	87.3	88.5	86.8	**86.4**	**85.5**
Inflation (% change)						
Portugal	2.8	0.4	-0.2	0.5	**0.7**	**1.2**
EU	2.6	1.5	0.5	0.0	**0.3**	**1.5**
Unemployment (% of labour force)						
Portugal	15.8	16.4	14.1	12.6	**11.6**	**10.7**
EU	10.5	10.9	10.2	9.4	**8.9**	**8.5**
Youth Unemployment (% of labour force)*						
Portugal	38.0	38.1	34.7	32.0	**n.a**	**n.a**
EU	23.3	23.7	22.2	20.4	**n.a**	**n.a**
Current account balance (% of GDP)						
Portugal	-2.0	0.7	0.0	-0.1	**0.3**	**0.5**
EU	1.0	1.5	1.6	2.0	**2.2**	**2.1**
Exports (% change)						
Portugal	3.4	7.0	3.9	5.2	**4.1**	**5.1**
EU	2.3	2.2	4.0	5.3	**3.5**	**4.6**
Imports (% change)						
Portugal	-6.3	4.7	**7.2**	7.4	**4.3**	**5.6**
EU	-0.3	1.6	4.7	5.9	**4.7**	**5.1**
Domestic demand (% change)						
Portugal	-7.3	-2.0	2.2	2.4	**1.5**	**1.9**
EU	-1.5	-0.1	1.5	2.1	**2.2**	**2.1**
Investments (% change)						
Portugal	-16.6	-5.1	2.8	3.9	**1.6**	**4.9**
EU	-2.5	-1.7	2.7	3.4	**3.0**	**3.8**
Income Inequality Gini Coefficient (% change)*						
Portugal	34.5	34.2	34.5	34.0	**n.a**	**n.a**
EU	30.4	30.5	30.9	n.a	**n.a**	**n.a**
People at risk of social exclusion (% total)*						
Portugal	25.3	27.5	27.5	26.6	**n.a**	**n.a**
EU	24.7	24.6	24.4	n.a.	**n.a**	**n.a**
Unit labour cost (% change)						
Portugal	-3.2	1.8	-0.9	-0.6	**1.0**	**0.3**
EU	1.9	1.0	0.7	0.7	**1.3**	**1.3**

Sources: European Commission (Spring 2016 forecast) and Eurostat (data marked with *, as of 27 September 2016).

Annex 3: Spain's Macroeconomic Imbalance Scoreboard

Indicators			Threshold	2007	2008	2009	2010	2011	2012	2013	2014	2015
External imbalances and competitiveness	**Current account balance (% of GDP)**	**3 year average**	-4/+6%	-8.7	-9.3	-7.7	-5.8	-3.8	-2.4	-0.6	0.8	1.3
		Year value	-	-9.6	-9.3	-4.3	-3.9	-3.2	-0.2	1.5	1.0	1.4
	Net international investment position (% of GDP)		-35%	-79.6	-80.2	-93.5	-88.6	-91.9	-90.0	-96.2	-95.6	-90.2
	Real effective exchange rate - 42 trading partners	**% change (3 years)**	± 5% €A	2.7	5.2	4.6	-0.3	-2.5	-5.3	-0.4	-1.0	-2.9
		% change y-o-y	-	1.6	2.5	0.4	-3.1	0.2	-2.4	1.9	-0.5	-4.2
	Share of world exports	**% change (5 years)**	-6%	-4.8	-14.3	-8.8	-11.4	-8.2	-17.6	-10.8	-11.7	-3.7
		% change y-o-y		5.0	-4.5	2.3	-9.6	-1.0	-5.8	3.9	1.2	-1.3
	Nominal unit labour cost	**% change (3 years)**	9% €A	11.3p	13.7p	11.8p	5.7p	-1.0p	-5.1p	-4.2p	-3.6p	-0.9p
		% change y-o-y	-	4.1p	5.7p	1.6p	-1.6p	-1.0p	-2.6p	-0.7p	-0.4p	0.2p
Internal imbalances	**House prices** (% change y-o-y deflated)		6%	6.3	-4.8	-5.8	-3.7	-9.8	-16.8	-10.0	0.1	4.1
	Private sector credit flow (% of GDP)		14%	26.5	11.7	-1.2	0.9	-3.7	-11.2	-10.3	-7.5	-2.8
	Private sector debt (% of GDP)		133%	191.2	195.7	201.4	200.3	196.2	187.8	177.1	166.0	154.1
	General government gross debt (EDP) (% of GDP)		60%	35.5	39.4	52.7	60.1	69.5	85.4	93.7	99.3	99.2
	Unemployment rate	**3 year average**	10%	8.6	9.3	12.5	16.4	19.7	22.0	24.1	25.1	24.2
		Year value	-	8.2	11.3	17.9	19.9	21.4	24.8	26.1	24.5	22.1
	Total Financial Sector Liabilities, non-consolidated (% change y-o-y)		16.5%	16.8	3.8	3.7	-2.0	2.8	3.1	-10.6	-1.7	-2.3
Employment indicators	**Activity rate % 15-64 total pop.** (3 year change)		-0.2%	2.9	2.7	2.0	1.7	1.2	1.2	0.8	0.3	0.0
	Long term unemployment active pop. 15-74 (3 year change)		0.5%	-1.8	-0.2	2.5	5.6	6.9	6.7	5.7	4.0	0.4
	Youth unemployment % active pop. 15-24 (3 year change)		0.2%	-3.9	4.9	19.8	23.4	21.7	15.2	14.0	7.0	-4.6

Source: Eurostat MIP Scoreboard indicators (data extracted on 26 September 2016 and therefore may not correspond to the 2016 AMR). A separate EGOV document provides an overview of the implementation of the MIP.

Note: Grey cells signal data falling outside the MIP thresholds; p = provisional and (:) = missing.

Annex 4: Portugal's Macroeconomic Imbalance Scoreboard

Indicators			Threshold	2007	2008	2009	2010	2011	2012	2013	2014	2015
External imbalances and competitiveness	**Current account balance (% of GDP)**	**3 year average**	-4/+6%	-10.1	-10.8	-10.8	-10.9	-8.9	-6.0	-2.1	-0.1	0.7
		Year value	-	-9.7	-12.1	-10.4	-10.1	-6.0	-1.9	1.5	0.1	0.5
	Net international investment position as % of GDP		-35%	-88.8	-95.1	-107.9	-104.3	-100.7	-116.6	-116.5	-114.4	-109.4
	Real effective exchange rate - 42 trading partners	**% change (3 years)**	± 5% €A	0.6	2.0	1.0	-3.1	-3.0	-4.0	-0.6	-1.8	-2.8
		% change y-o-y	-	1.0	0.6	-0.6	-3.1	0.7	-1.6	0.3	-0.5	-2.7
	Share of world exports	**% change (5 years)**	-6%	-3.3	-11.1	-8.0	-6.6	-8.2	-16.0	-6.8	-5.2	2.0
		% change y-o-y		4.4	-3.8	-0.1	-8.9	0.4	-4.6	6.8	1.6	-1.9
	Nominal unit labour cost	**% change (3 years)**	9% €A	5.1	4.5	6.6	4.2	-0.6	-6.3	-3.4	-2.7	0.0e
		% change y-o-y	-	1.0	2.8	2.7	-1.2	-2.0	-3.2	1.8	-1.3	-0.5e
Internal imbalances	**House prices** (% change y-o-y deflated)		6%	-1.9	1.0	1.0	-1.0	-6.5	-8.7	-2.7	3.6	2.4
	Private sector credit flow (% of GDP)		14%	18.2	15.9	5.3	5.3	-0.9	-4.4	-1.8	-5.5	-2.2
	Private sector debt (% of GDP)		133%	185.0	196.2	204.2	201.5	204.1	209.7	202.2	190.2	180.1
	General government gross debt (EDP) (% of GDP)		60%	68.4	71.7	83.6	96.2	111.4	126.2	129.0	130.2	129.0
	Unemployment rate	**3 year average**	10%	8.9	8.9	9.5	10.5	11.9	13.6	15.0	15.4	14.4
		Year value	-	9.1	8.8	10.7	12.0	12.9	15.8	16.4	14.1	12.6
	Total Financial Sector Liabilities, non-consolidated (% change y-o-y)		16.5%	10.2	4.4	8.9	11.5	-4.5	-1.6	-5.3	-7.4	-1.9
Employment indicators	**Activity rate % 15-64 total pop.** (3 year change)		-0.2%	1.2	0.7	-0.2	-0.2	-0.3b	0.0	-0.7	-0.4	0.0
	Long term unemployment active pop. 15-74 (3 year change).		0.5%	0.8	-0.1	0.3	1.9	2.6	3.5	3.6	2.2	-0.5
	Youth unemployment % active pop. 15-24 (3 year change)		0.2%	1.7	0.8	4.1	6.8	8.6	12.7	9.9	4.5	-6.0

Source: Eurostat MIP Scoreboard indicators (data extracted on 26 September 2016 and therefore may not correspond to the 2016 AMR). A separate EGOV document provides an overview of the implementation of the MIP.
Note: Grey cells signal data falling outside the MIP thresholds; p = provisional and (:) = missing.

Annex 5: Spain's progress towards EU2020 targets

Indicator	Spain			EU28	
Employment rate (% of population aged 20-64)	**74**		**Target 2020**	**75**	
	62.0		2015	70.1	
	59.9		2014	69.2	
	58.6		2013	68.4	
	59.6		2012	68.4	
Expenditure on R&D (% of GDP)	**2.0%**		**Target 2020**	**3**	
	n.a.		2015	n.a.	
	1.23		2014	2.03[b]	
	1.26		2013	2.03	
	1.28		2012	2.01	
Greenhouse gas emission[1]	**Total n.c.s.t.**[(1)] (Index 1990 = 100)	**Non-ETS 90**[(1)] (Index 2005 = 100)	**Target 2020**	**Total 80**[(1)] (Index 1990 = 100)	
	n.a.	n.a.	2015	n.a	
	117.54	n.a.	2014	77.05	
	116.87	n.a.	2013	80.24	
	126.58	84.36	2012	81.80	
Share of renewable energy (%)	**20**		**Target 2020**	**20**	
	n.a.		2015	n.a	
	16.2		2014	16.0	
	15.3		2013	15.0	
	14.3		2012	14.3	
Primary energy consumption (million tonnes of oil equivalent-TOE)	**119.8**		**Target 2020**	**1483**	
	n.a.		2015	n.a	
	112.6		2014	1,507.1	
	114.3		2013	1,569.1	
	122.1		2012	1,584.0	
Early school leaving (% of population aged 18-24)	**15**		**Target 2020**	**10**	
	20.0		2015	11.0	
	21.9[b]		2014	11.2[b]	
	23.6		2013	11.9	
	24.7		2012	12.7	
Tertiary educational attainment (% of population aged 30-34)	**44**		**Target 2020**	**40**	
	40.9		2015	38.7	
	42.3[b]		2014	37.9[b]	
	42.3		2013	37.1	
	41.5		2012	36.0	
Population at risk of poverty or social exclusion (thousand - % of total population)	**Reduction by 1,400 thousand**	**n.c.s.t.**	**Target 2020**	**Reduction by 20 million**	**n.c.s.t.**
	13,175	28.6	2015	n.a.	n.a.
	13,402	29.2	2014	122,258	24.4
	12,630	27.3	2013	122,685	24.6
	12,628	27.2	2012	123,601	24.7

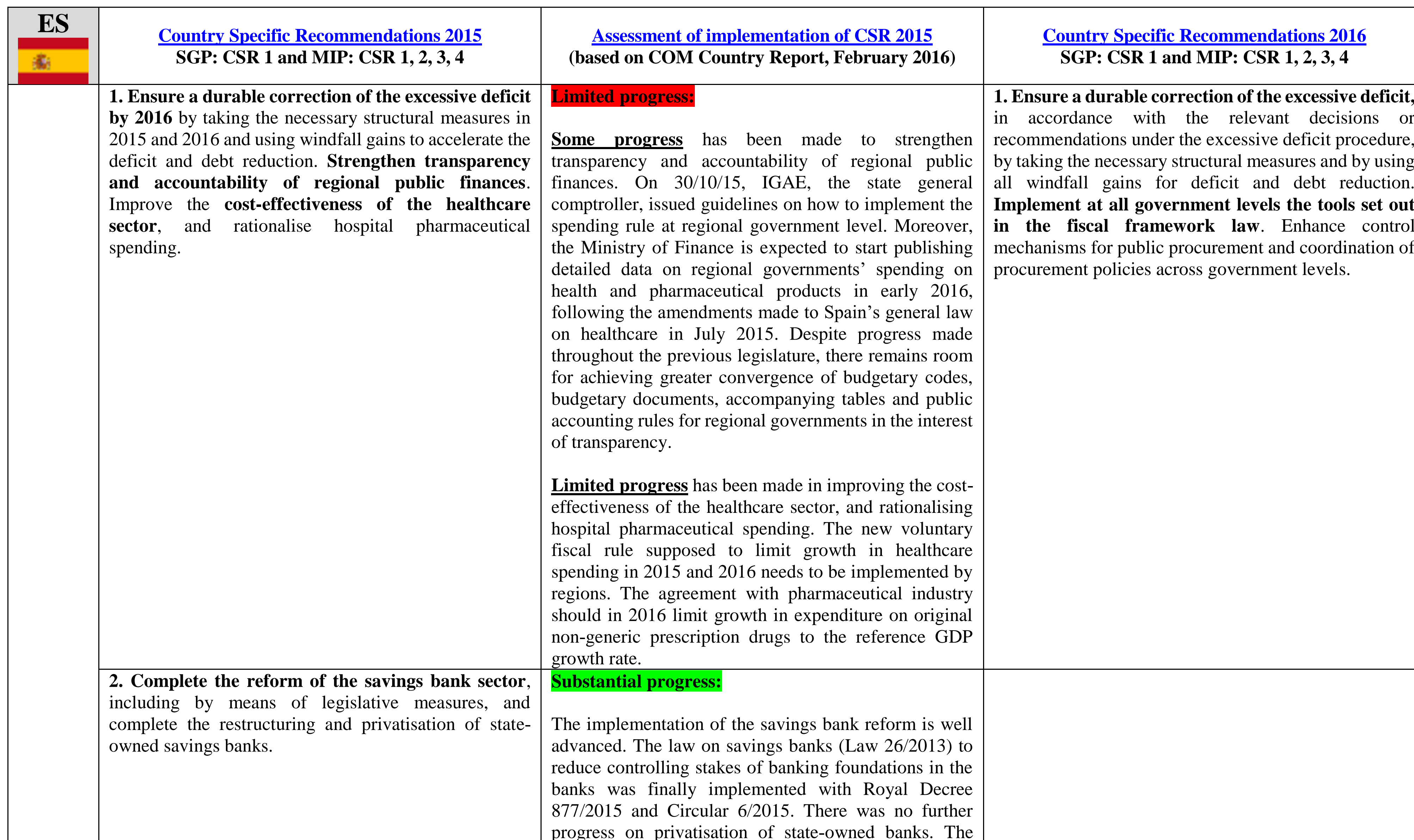
Source: Eurostat (data extracted on 22 September 2016). (1) The Effort Sharing Decision (2009/406/EC) sets country-specific targets for non-ETS emissions only and an EU target for ETS-emissions. For Spain, non-ETS emissions will be reduced by 10% compared to 2005 levels. For the EU, ETS-emissions will be reduced by 21% compared to 2005 level and overall emissions by 20% compared to 1990 levels.
* = Estimate; n.c.s.t. = "no country specific target"; n.a = "not available"; p = provisional and b = break in time series.

Annex 6: Portugal's progress towards EU2020 targets

Indicator	Portugal			EU28	
Employment rate (% of population aged 20-64)	**75**		**Target 2020**	**75**	
	69.1		2015	70.1	
	67.6		2014	69.2	
	65.4		2013	68.4	
	66.3		2012	68.4	
Expenditure on R&D (% of GDP)	**2.7%**		**Target 2020**	**3**	
	n.a.		2015	n.a.	
	1.29		2014	2.03[b]	
	1.33		2013	2.03	
	1.38		2012	2.01	
Greenhouse gas emission[1]	**Total n.c.s.t.** [(1)] (Index 1990 = 100)	**Non-ETS 101**[(1)] (Index 2005 = 100)	**Target 2020**	**Total 80**[(1)] (Index 1990 = 100)	
	n.a.	n.a.	2015	n.a	
	108.82	n.a.	2014	77.05	
	109.11	n.a.	2013	80.24	
	112.36	87.97	2012	81.80	
Share of renewable energy (%)	**31**		**Target 2020**	**20**	
	n.a.		2015	n.a	
	27.0		2014	16.0	
	25.7		2013	15.0	
	25.0		2012	14.3	
Primary energy consumption (million tonnes of oil equivalent-TOE)	**22.5**		**Target 2020**	**1483**	
	n.a.		2015	n.a	
	20.7		2014	1,507.1	
	21.0		2013	1,569.1	
	20.9		2012	1,584.0	
Early school leaving (% of population aged 18-24)	**10**		**Target 2020**	**10**	
	13.7		2015	11.0	
	17.4[b]		2014	11.2[b]	
	18.9		2013	11.9	
	20.5		2012	12.7	
Tertiary educational attainment (% of population aged 30-34)	**40**		**Target 2020**	**40**	
	31.9		2015	38.7	
	31.3[b]		2014	37.9[b]	
	30.0		2013	37.1	
	27.8		2012	36.0	
Population at risk of poverty or social exclusion (thousand - % of total population)	**Reduction by 200 thousand**	**n.c.s.t.**	**Target 2020**	**Reduction by 20 million**	**n.c.s.t.**
	2,765	26.6	2015	n.a.	n.a.
	2,863	27.5	2014	122,258	24.4
	2,879	27.5	2013	122,685	24.6
	2,667	25.3	2012	123,601	24.7

Source: Eurostat (data extracted on 22 September 2016).
(1) The Effort Sharing Decision (2009/406/EC) sets country-specific targets for non-ETS emissions only and an EU target for ETS-emissions. For Spain, non-ETS emissions will be reduced by 10% compared to 2005 levels. For the EU, ETS-emissions will be reduced by 21% compared to 2005 level and overall emissions by 20% compared to 1990 levels.
* = Estimate; n.c.s.t. = "no country specific target"; n.a = "not available"; p = provisional and b = break in time series.

Annex 7: Spain's Country Specific Recommendations for 2015 and 2016



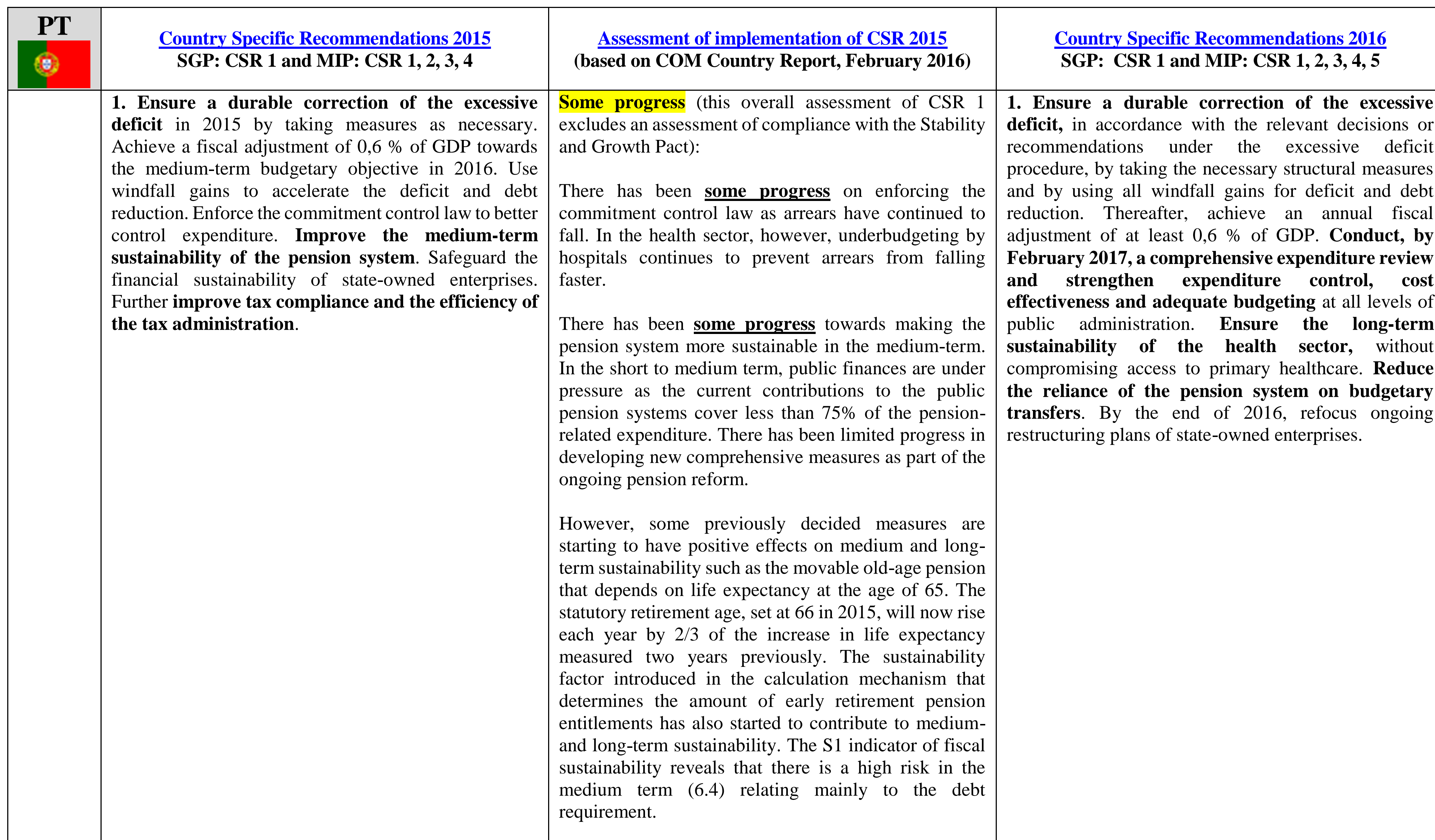
ES	Country Specific Recommendations 2015 **SGP: CSR 1 and MIP: CSR 1, 2, 3, 4**	Assessment of implementation of CSR 2015 **(based on COM Country Report, February 2016)**	Country Specific Recommendations 2016 **SGP: CSR 1 and MIP: CSR 1, 2, 3, 4**
	1. Ensure a durable correction of the excessive deficit by 2016 by taking the necessary structural measures in 2015 and 2016 and using windfall gains to accelerate the deficit and debt reduction. **Strengthen transparency and accountability of regional public finances**. Improve the **cost-effectiveness of the healthcare sector**, and rationalise hospital pharmaceutical spending.	**Limited progress:** **Some progress** has been made to strengthen transparency and accountability of regional public finances. On 30/10/15, IGAE, the state general comptroller, issued guidelines on how to implement the spending rule at regional government level. Moreover, the Ministry of Finance is expected to start publishing detailed data on regional governments' spending on health and pharmaceutical products in early 2016, following the amendments made to Spain's general law on healthcare in July 2015. Despite progress made throughout the previous legislature, there remains room for achieving greater convergence of budgetary codes, budgetary documents, accompanying tables and public accounting rules for regional governments in the interest of transparency. **Limited progress** has been made in improving the cost-effectiveness of the healthcare sector, and rationalising hospital pharmaceutical spending. The new voluntary fiscal rule supposed to limit growth in healthcare spending in 2015 and 2016 needs to be implemented by regions. The agreement with pharmaceutical industry should in 2016 limit growth in expenditure on original non-generic prescription drugs to the reference GDP growth rate.	**1. Ensure a durable correction of the excessive deficit,** in accordance with the relevant decisions or recommendations under the excessive deficit procedure, by taking the necessary structural measures and by using all windfall gains for deficit and debt reduction. **Implement at all government levels the tools set out in the fiscal framework law**. Enhance control mechanisms for public procurement and coordination of procurement policies across government levels.
	2. Complete the reform of the savings bank sector, including by means of legislative measures, and complete the restructuring and privatisation of state-owned savings banks.	**Substantial progress:** The implementation of the savings bank reform is well advanced. The law on savings banks (Law 26/2013) to reduce controlling stakes of banking foundations in the banks was finally implemented with Royal Decree 877/2015 and Circular 6/2015. There was no further progress on privatisation of state-owned banks. The	

		entry into force of a new accounting framework for SAREB, the Spanish asset management company, is a positive development, as it will allow proper treatment of impairments and asset-price evolution, and help in adapting deleveraging policies of SAREB to credible market assumptions.	
	3. Promote the alignment of wages and productivity, in consultation with the social partners and in accordance with national practices, taking into account differences in skills and local labour market conditions as well as divergences in economic performance across regions, sectors and companies. **Take steps to increase the quality and effectiveness of job search assistance** and counselling, including as part of tackling youth unemployment. **Streamline minimum income and family support schemes and foster regional mobility**.	**Some progress:** **Some progress** has been reached in wage setting, owing in particular to the latest collective bargaining agreement for 2015-2016 signed by social partners in June 2015. The agreement strives to take into account differences in skills and local labour market conditions, as well as divergences in economic performance across regions, sectors and companies. However, the number of workers covered by firm-level agreements is still very low. **Some progress** has been made to increase the quality and effectiveness of job search assistance and counselling, including as part of the tackling youth unemployment. The implementation of the Activation Strategy 2014-2016 is progressing very slowly, as well as the cooperation between the regions and the central government. The national Youth Guarantee was set in motion. However, participation in initiatives to increase labour market participation, entrepreneurship, and the employability of young people is still much lower than expected, and effective outreach mechanisms are lacking. **Limited progress** has been registered in ensuring effective minimum income support schemes that allows smooth transition to the labour market. Income support schemes and social services are scattered across many institutions and levels of government that limit the portability and mobility of the beneficiaries. The delivery of family support schemes (notably affordable early childhood education and care, and long term care) remains poor and regional mobility has not improved.	**2. Take further measures to improve labour market integration**, by focusing on individualised support and strengthening the effectiveness of training measures. Enhance the capacity of regional employment services and reinforce their coordination with social services. **Address gaps and disparities in minimum income schemes and improve family support schemes, including access to quality childcare and long-term care.**

	4. Remove the barriers preventing businesses from growing, including barriers arising from size-contingent regulations; adopt the planned reform on professional services; **accelerate the implementation of the law on market unity**.	**Some progress:** **Some progress** has been made in removing the barriers preventing businesses from growing. Some measures were adopted since the publication of the 2015 Country Report for Spain with a view to fostering company growth. The April 2015 law on corporate finance aims to improve SME's access to bank credit and non-bank financing. The October 2015 law on the legal framework of public administration sets out the obligation to assess the impact of new legislation on SMEs. **No progress** has been made in adopting the planned reform of professional services. The Spanish government decided in 2015 not to pursue this reform. As a result, no draft law has been sent to Parliament, despite the fact that technical work linked to the reform had been completed. **Some progress** has been made in accelerating the implementation of the law on market unity. At the cut-off date of this report, the central government had completed around 60% of the planned amendments to sector specific legislation. The rate of completed amendments at regional level is around 17%, thus showing little progress since the publication of the 2015 Country Report for Spain. At the time of writing one agreement had been reached at sectoral conference level on gambling. However, some technical groups reporting to the sectoral conferences have made agreements in the areas of industry, tourism, urban and environmental regulations. Cooperation mechanisms among the different administrations set out in the Law, such as the electronic application to share information among central, regional and local authorities, are operational. Lastly, the law also introduces a complaint mechanism offering the possibility for economic agents to seek redress on barriers to market unity within shorter deadlines than ordinary administrative appeals. At the time of writing, 150 complaints had been submitted.	**4. Accelerate the implementation of the law on market unity at regional level.** Ensure implementation by the autonomous regions of the reform measures adopted for the retail sector. Adopt the planned reform on professional services and associations.

			3. Take further measures to improve the labour market relevance of tertiary education, including by incentivising cooperation between universities, firms and research institutions. **Increase performance-based funding** of public research bodies and universities and **foster R&I investment** by the private sector.

Annex 8: Portugal's Country Specific Recommendations for 2015 and 2016



PT	**Country Specific Recommendations 2015** **SGP: CSR 1 and MIP: CSR 1, 2, 3, 4**	**Assessment of implementation of CSR 2015** **(based on COM Country Report, February 2016)**	**Country Specific Recommendations 2016** **SGP: CSR 1 and MIP: CSR 1, 2, 3, 4, 5**
	1. Ensure a durable correction of the excessive deficit in 2015 by taking measures as necessary. Achieve a fiscal adjustment of 0,6 % of GDP towards the medium-term budgetary objective in 2016. Use windfall gains to accelerate the deficit and debt reduction. Enforce the commitment control law to better control expenditure. **Improve the medium-term sustainability of the pension system**. Safeguard the financial sustainability of state-owned enterprises. Further **improve tax compliance and the efficiency of the tax administration**.	**Some progress** (this overall assessment of CSR 1 excludes an assessment of compliance with the Stability and Growth Pact): There has been **some progress** on enforcing the commitment control law as arrears have continued to fall. In the health sector, however, underbudgeting by hospitals continues to prevent arrears from falling faster. There has been **some progress** towards making the pension system more sustainable in the medium-term. In the short to medium term, public finances are under pressure as the current contributions to the public pension systems cover less than 75% of the pension-related expenditure. There has been limited progress in developing new comprehensive measures as part of the ongoing pension reform. However, some previously decided measures are starting to have positive effects on medium and long-term sustainability such as the movable old-age pension that depends on life expectancy at the age of 65. The statutory retirement age, set at 66 in 2015, will now rise each year by 2/3 of the increase in life expectancy measured two years previously. The sustainability factor introduced in the calculation mechanism that determines the amount of early retirement pension entitlements has also started to contribute to medium- and long-term sustainability. The S1 indicator of fiscal sustainability reveals that there is a high risk in the medium term (6.4) relating mainly to the debt requirement.	**1. Ensure a durable correction of the excessive deficit,** in accordance with the relevant decisions or recommendations under the excessive deficit procedure, by taking the necessary structural measures and by using all windfall gains for deficit and debt reduction. Thereafter, achieve an annual fiscal adjustment of at least 0,6 % of GDP. **Conduct, by February 2017, a comprehensive expenditure review and strengthen expenditure control, cost effectiveness and adequate budgeting** at all levels of public administration. **Ensure the long-term sustainability of the health sector,** without compromising access to primary healthcare. **Reduce the reliance of the pension system on budgetary transfers**. By the end of 2016, refocus ongoing restructuring plans of state-owned enterprises.

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

		wage structure with the risk of affecting employment and competitiveness perspectives.	
	3. Improve the efficiency of public employment services, in particular by increasing outreach to non-registered young people. **Ensure effective activation of benefit recipients and adequate coverage of social assistance**, in particular the minimum income scheme.	**Some progress:** **Some progress** has been made in increasing outreach to non-registered young people but challenges in its implementation still persist. A broad network of partners engaged in the implementation of the Young Guartantee has been set to reach out to young people aged under 30 and not in employment, education or training (NEET). Another positive step has been the creation of a Youth Guarantee online platform where NEETs can register. **Some progress** has been made in improving the efficiency of the public employment services through a reinforced performance management and an ongoing shift towards digital services. While partnerships with municipalities, training organisations and social economy actors are well developed, there has been limited progress in binding partnerships with private employment services. The two pilot projects of partnership with private employment services in Lisbon and Porto have been delayed and a tender procedure has yet to be launched. There has been **some progress** in ensuring adequate coverage of social assistance, in particular through the minimum income scheme. There have been changes to the eligibility criteria of the minimum income scheme which may extend its coverage. Further measures in this area include an increase in child benefits, including for single parents households. No new specific measures have been taken on activation for minimum income scheme recipients.	**3. Ensure the effective activation of the long-term unemployed and improve the coordination between employment and social services.** Strengthen incentives for firms to hire through permanent contracts.
	4. Take further measures to reduce the corporate debt overhang, to address the corporate non-performing loans ratio in banks and to reduce the debt bias for corporates under tax provisions. **Improve the**	**Some progress:** **Some progress** has been made on reducing the corporate debt overhang and allowing the private sector	**4.** Take measures, by October 2016, to **facilitate the cleaning up of the balance sheets of credit institutions and address the high level of non-performing loans.** Reduce the debt bias in corporate

	efficiency of debt restructuring tools for viable companies by introducing incentives for banks and debtors to engage in restructuring processes at an early stage.	to deleverage This includes the well advanced implementation of the corporate deleveraging strategy, which includes the revamping of the PER and SIREVE insolvency tools and changes in the tax treatment of debt financing. However, at close to 190% of GDP Portugal's private sector is one of the most highly indebted in the EU. Moreover, access to credit remains costly and difficult for businesses, in particular SMEs. Therefore, there is still the need to continue to pay attention to the problem of high indebtedness and to encourage the banking sector to raise capital in order to be able to clean its balance sheet from the high burden of corporate non-performing credit.	taxation and improve the access to finance for start-ups and small and medium-sized enterprises via the capital market.
	5. Accelerate measures and increase transparency as regards concessions, including in the transport sector, and private-public partnerships at local and regional level.	**Limited progress:** **Limited progress** has been made on transparency. A revised framework for public-private partnerships (PPPs) entered into force on 1 June 2012. The government has renegotiated several road PPPs. In most cases, the Court of Auditors has already expressed its view that no prior approval is required for the changes to be effective. As regards water concessions at local level and railway PPPs, the Court of Auditors expressed a negative opinion of the way the state had managed the contracts. Existing legislation does not empower UTAP, the Ministry of Finance's taskforce for PPPs, to cover concessions, regional and local PPPs or even central government PPPs/concessions in the water/sewerage/waste businesses (or any concession given to SOEs by law in an in-house relationship). The authorities are aware of these loopholes and agree there is a need to find a solution. However, no concrete suggestions or timeline has yet been proposed.	**5. Increase transparency and efficiency in public procurement** as regards public-private partnerships and concessions. By the end of 2016, **improve and accelerate administrative and licensing procedures, accelerate tax litigations and reduce regulatory barriers,** especially in business services. Incentivise cooperation between universities and the business sector.