Executive Summary

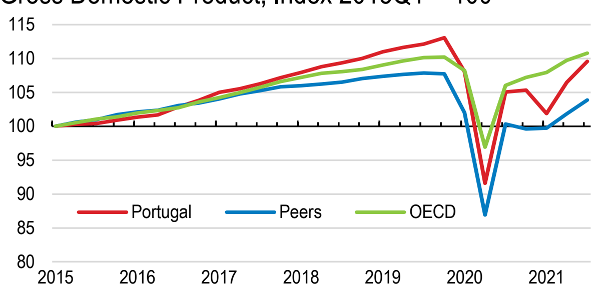
Portugal has been recovering from a deep recession.

As in other OECD countries, the pandemic caused severe human suffering and triggered a deep recession. The economy has been recovering fast, supported by policies, but uncertainty on the outlook remains large.

Economic activity has rebounded sharply, after a major contraction in 2020 (Figure 1). Nevertheless, severely affected sectors, including tourism and hospitality, are still running well below pre-crisis levels.

Figure 1. The pandemic severely hit the economy

Gross Domestic Product, Index 2015Q1 = 100



Note: Peers refer to the weighted average of Greece, Italy and Spain.
Source: OECD Economic Outlook: Statistics and Projections (database) and updates.

StatLink https://stat.link/f7g90v

The direct and indirect policy support helped weather the economic shock. Job retention measures limited job losses. At 6.3% in the third quarter of 2021, the unemployment rate stands below its pre-crisis level (6.5% in 2019). Supportive monetary policy in the euro area, and a broad range of measures, including state loans guarantees, grants, tax deferrals, and the moratorium on credit repayments of firms and households affected by the pandemic prevented a sudden rise in insolvencies and credit defaults.

The economic outlook critically hinges on the evolution of the pandemic, especially the effectiveness of vaccines against virus variants. While the vaccination rate is the highest in the OECD, the recovery is fraught with high uncertainties (Table 1). Persistently weak economic activity due to supply disruptions and restrictions to contain the pandemic may trigger further job losses and bankruptcies of financially vulnerable firms.

Table 1. The recovery is robust

	2019	2020	2021	2022
Gross domestic product	2.7	-8.4	4.8	5.8
Unemployment rate (%)	6.6	7.0	6.9	6.7
Fiscal balance (% of GDP)	0.1	-5.8	-4.3	-2.4
Public debt (Maastricht, % of GDP)	116.6	135.2	133.4	128.3

Source: OECD Economic Outlook No 110

Fiscal and monetary policies need to remain supportive until the recovery is firmly underway. Agile policy responses to fast changing economic developments will be key to limit losses in productive capacity and negative hysteresis effects on the labour market. Further grants and equity injections into distressed but viable firms can support the recovery. An effective and rapid implementation of the Next Generation EU Plan can sustain economic activity while addressing long-lasting vulnerabilities of the economy. Projects that have the strongest positive economic and social impact should be prioritised.

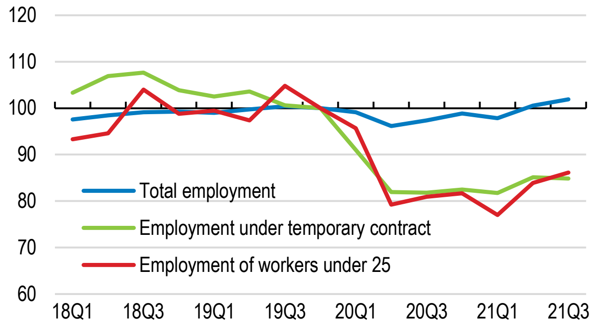
Policies can tackle poverty risks and tensions in health care.

The crisis risks increasing poverty and inequality and puts huge pressure on the healthcare system. Ensuring an inclusive recovery will require strengthening health and labour market policies.

The pandemic has disproportionately hit contact-intensive sectors employing a high share of workers with precarious work contracts, and limited access to social protection (Figure 2)**.** Public employment services need to adapt to new circumstances surrounding the labour market, including higher unemployment among youth. Capacity to reach out those detached from the labour market, especially the youth, needs to strengthen, as the share of jobseekers using employment services is among the lowest in the OECD. Improving the coverage of unemployment benefits by further easing strict eligibility conditions can help. Further efforts to expand training programmes and adapt them to labour market needs will also be key to facilitate labour mobility and improve employability of displaced workers. The inclusion of measures to address youth unemployment and precarious employment conditions in Portugal's Recovery and Resilience Plan is thus welcome.

Figure 2. Job losses were concentrated on young and temporary workers

Index, 2019Q4 = 100



Source: Statistics Portugal.

StatLink https://stat.link/gb71qs

The pandemic has exposed important vulnerabilities in the healthcare sector. During the third wave of the outbreak around the end of 2020, public hospitals almost reached full capacity, delaying access to healthcare. Staff shortages of nurses and long-term care workers are large and workload on healthcare professionals has increased substantially. The pandemic has accentuated mental health problems, calling for a rapid strengthening of policies in this area.

A sustainable recovery requires addressing macroeconomic vulnerabilities.

Policy action needs to tackle new financial and fiscal risks. Efforts to establish the foundations for a greener economy should be strengthened.

Insolvencies risk surging after the phase out of public support. A large share of Portuguese firms are small, undercapitalised, and vulnerable to economic shocks. The moratorium on credit repayments covered around a third of bank loans to non-financial corporations before being phased out in September 2021. Quasi-equity instruments or provision of non-refundable grants can reduce the risk of a surge in defaults and debt overhang. Past reform of the insolvency regime improved its effectiveness and should facilitate firms' restructuring. The use of out-of-court procedures has remained limited though, and a large backlog of cases poses the risk of court congestion in the future.

Increases in credit defaults can weigh on banks' profitability and curtail credit supply needed to finance investment. The regulator and the supervisor have strengthened incentives for banks to limit the accumulation of non-performing loans in their balance sheets. Measures supporting the development of secondary markets for non-performing loans would also help with the disposal of impaired assets. Policy options include establishing a national asset management company.

Once the recovery is well established, Portugal needs to announce a credible and transparent medium-term fiscal consolidation strategy. Public debt exceeds 130% of GDP and is one of the highest in the OECD. Fast population ageing weighs on public finance and risks to sustainability have accentuated with the rise of contingent liabilities. The pension system needs to adapt to contain future increases in age-related costs.

The modernisation of the budget framework, including the implementation of performance budgeting, is crucial to ensure an efficient use of public funds, including those provided by the EU. Enforcement of the 2015 Budget Framework Law, one of the objectives of the Recovery and Resilience Plan, needs to accelerate and the capacity to monitor and evaluate policies needs to improve to shift spending to productive uses.

The Next Generation EU is a unique opportunity to put growth on an environmentally sustainable path. Reducing water abstraction remains a key priority, calling for further investments in upgrading existing water infrastructure. Reaching the ambitious target of becoming a carbon neutral economy by 2050 requires, as envisaged in the National Energy and Climate Plan 2030, a significant acceleration in emission abatement, including by further increasing electricity supply from renewables and greening the transport sector. Policy action must combine incentives to reduce environmental damages, investment support in less polluting activities and compensation measures for low-income households affected by the measures.

Intensifying the fight against corruption can foster inclusive growth. Preventing economic crimes has been high in the government agenda and the on-going implementation of the new national anti-corruption strategy is welcome. Strengthening the prosecution mechanisms and raising the accountability and integrity of senior public officials are priority.

Unleashing the digital potential can lift productivity growth.

A higher uptake of digital technologies – through better infrastructure and skills development – can boost potential growth. EU support could help speed up this change.

Digital technologies can contribute to speeding up the recovery, by boosting productivity and offering innovative solutions to adapt to behavioural changes triggered by the pandemic. Portugal has achieved impressive progress in the digital transition, but disparities in ICT adoption across firms and people remain large. The 2020 Digital Transition Action Plan that aims at tackling the digital divide is welcome as delays in technology diffusion, especially in small firms, hurt productivity growth and inclusiveness.

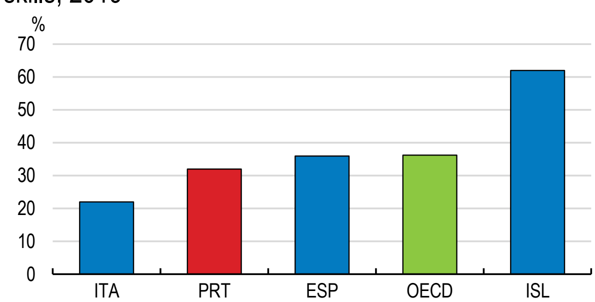
Communication infrastructure is of good quality but fibre deployment and coverage in rural areas should be improved. While fast-broadband subscriptions are among the highest in the OECD, there is room to expand the use of mobile broadband. Broadband prices are high by international standards, including for basic services, reflecting low competition pressures among service providers. Reducing barriers to consumer mobility between suppliers can improve market contestability.

Equipping the population with digital and foundational skills is crucial to embrace the digital transformation. A relatively large share of the population has low education levels and only one third of Portuguese have above basic digital skills (Figure 3). The lack of digital skills is particularly pronounced among older workers and low-educated people. Despite some progress in the past, more women could graduate in ICT fields. The scope of the comprehensive and ambitious initiative to develop digital competences “Incode2030” will expand with the implementation of the 2020 Digital Transition Action Plan.

Reform of the education and training systems needs to accelerate. A large share of schools and teachers are not well equipped to use and teach ICT. Inequality issues in education have accentuated with the pandemic. Efforts to develop teachers’ training and equip schools should continue. Despite ambitious measures to develop adult education, participation has remained relatively low, suggesting the need for increased incentives to uptake training, especially for workers in jobs more affected by the digital transformation. Policy avenues to promote adult education include providing personal training accounts with more generous vouchers for low-skilled workers, together with expanding the training offer by developing online courses and flexible pathways between qualification programmes further.

Figure 3. Adult digital skills are below average

Share of individuals with above-basic overall digital skills, 2019



Source: Eurostat.

StatLink https://stat.link/wy7tpr

There is large room to increase investment in digital technologies and in complementary intangible assets in small firms. A range of measures is in place to foster the adoption of ICTs and to promote partnerships between firms and research institutes to stimulate innovation. Their scope should expand with the implementation of the Recovery and Resilience Plan. The multiplication of initiatives poses some risk of dispersion and efficiency losses, calling for a thorough evaluation.

MAIN FINDINGS	KEY RECOMMENDATIONS
Policies for a stronger and resilient recovery	
The economic recovery can be slow due to containment measures needed to limit the spread of the virus.	Maintain fiscal policy support until the recovery is firmly underway, while making it more targeted.
Public debt exceeds 130% of GDP and increased contingent liabilities can complicate fiscal consolidation. Details on the strategy to contain public spending in the coming years are missing.	Once the recovery is firmly established, gradually phase out support measures and announce a clear and credible medium-term fiscal consolidation strategy.
Available EU funds, including under Next Generation EU plan, will reach record levels. Absorption might be slow due to hurdles in designing, approving and implementing programmes.	Ensure the transparent and effective implementation of programmes financed with EU funds Prioritise projects that have the strongest economic and social impact by relying on cost-benefit analysis.
Population ageing puts pressure on the financial sustainability of the pension system.	Duly implement the link between increases in the retirement age and life expectancy gains to continue to ensure the long-term financial sustainability of the pension system. Extend that link to the minimum age of early retirement.
Corporate sector vulnerabilities have increased. Insolvencies are likely to surge after the end of the moratorium on credit instalments, in spite of a new relief measure. The government has started to reinforce support to the capitalisation of firms.	Strengthen direct aid to companies in a timely, targeted and temporary way, by using quasi-equity injections, state-contingent loans or non-refundable grants.
A surge in insolvencies could translate into a marked increase in credit defaults.	Strengthen incentives for banks to reduce their non-performing loans should they prove insufficient. Consider establishing a national asset management company.
Courts have a large backlog in insolvency cases that risks increasing significantly.	Encourage the use of out-of-court insolvency procedures.
Rules on conflict of interest for statespersons are not strict. There are no specific rules for Members of Parliament on how to engage with the private sector and lobbyists.	Introduce codes of conduct on how to engage with lobbyists including a lobbying register.
Addressing social and environmental challenges in crisis time	
Like in several other OECD countries, the pandemic hit Portugal hard, putting huge pressure on the healthcare sector, which was compounded by shortages of healthcare professionals. The number of nurses and long-term care workers per inhabitant has been low compared to the OECD average.	Improve the working conditions of healthcare professionals, notably to facilitate recruitment.
The COVID-19 crisis has triggered major changes in the labour market. Employment prospects have deteriorated for the youth and the low-skilled.	Increase resources allocated to public employment services to provide individualised support and to reach out jobseekers, especially the younger ones.
Meeting the new ambitious climate objectives and reducing air pollution in large cities will require reducing greenhouse gas emissions in the transport sector.	Accelerate investment in electric mobility and public transportation as envisaged in the Recovery and Resilience Plan. Once the recovery is firmly established, progressively increase the coverage of the carbon tax, while financially supporting the population in adjusting to greener usages.
While there are plans to increase resources for upgrading water infrastructure, they will be too low to ensure high quality services and avoid leakages. Municipalities lack expertise to design and implement water infrastructure projects.	Increase investment in water infrastructure further, and strengthen technical support to municipalities on how to design and implement infrastructure projects, using EU funds.
Reaping the benefits of the digital transition	
The prices of broadband are relatively high. High market concentration in the telecommunication sector and low consumer mobility suggest competition pressures to reduce them are low.	Remove constraints to consumer mobility across telecommunication providers, for example by restricting the use of loyalty clauses in contracts and providing clearer information on the quality of services.
Schools and teachers are not well equipped to use and teach ICT. The government has initiated a range of measures to address this issue under the Recovery and Resilience Plan.	Accelerate and expand the provision of adequate digital resources to schools and teachers, including regular in-service training on ICT use.
The number of STEM and ICT professionals has to increase to address skill shortages. More women could engage in STEM and ICT studies. Improving gender equality one of the targets of the Recovery and Resilience Plan.	Further promote the enrolment of women in STEM fields, by reinforcing communication campaigns and early exposure to ICT projects, as planned.
Participation in adult learning is low, especially among low-skilled workers, more at risk of being affected by the digital transition. Ambitious programmes are in place to address that issue, but those not covered by these programmes have few incentives to train.	Consider introducing a personal training account for adults, with more generous vouchers for low-skilled workers.
Lack of awareness and expertise in digital technologies undermines the adoption of digital tools in small firms. Implementation of cybersecurity measures and data protection legislation is difficult for SMEs. The Recovery and Resilience Plan includes a range of programmes to support the digital transition in SMEs.	Expand the coverage of programmes for small companies to acquire digital training, advisory services and information on security and privacy after a thorough evaluation of their impact.

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