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Excessive deficit procedure: Council finds that Portugal and Spain have not taken effective action

On 12 July 2016, the Council found that Portugal and Spain had not taken effective action in response to its recommendations on measures to **correct their excessive deficits**.

It confirmed that the two countries **will not reduce** their deficits below 3% of GDP, the EU's reference value for government deficits, by the recommended deadline. And in both cases, it found the fiscal effort to fall **significantly short** of what was recommended.

The Council's decisions **will trigger sanctions** under the excessive deficit procedure. They are based on article 126(8) of the Treaty on the Functioning of the European Union.

The Commission has **20 days to recommend** further Council decisions imposing fines. Those fines should amount to 0.2% of GDP, though Portugal and Spain can submit reasoned requests within 10 days for a reduction of the fines. The Council will have 10 days to approve the fines.

"I am sure that we will have a smart, intelligent result at the end", said Peter Kažimír, minister for finance of Slovakia and president of the Council.

Portugal

In April 2011 however, after several months of market pressure on its sovereign bonds, Portugal requested **assistance from international lenders**. It obtained a €78 billion package of loans from the EU, the euro area and the IMF. In October 2012, the Council extended the deadline for correcting Portugal's deficit by one year to 2014, in the light of the recession that the country faced.

Economic prospects deteriorated further, and Portugal's general government deficit reached 6.4% of GDP in 2012. In June 2013, the Council **extended the deadline** for correcting the deficit by another year, to 2015. It set headline deficit targets of 5.5% of GDP in 2013, 4.0% of GDP in 2014 and 2.5% of GDP in 2015, consistent with 0.6%, 1.4% and 0.5% of GDP improvements in the structural balance respectively.

Portugal exited its economic adjustment programme in June 2014.

However its general government deficit came out at 4.4% of GDP in 2015, and the **deadline was missed** for correcting the deficit. The overshoot was largely due to a financial sector support measure (resolution of Banif), though the deficit net of one-off measures would in any case have been above 3% of GDP. The cumulative improvement in Portugal's structural balance in the 2013-15 period is estimated by the Commission 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.

Overall, since June 2014 the improvement in Portugal's headline deficit has been driven by **economic recovery** and reduced interest expenditure in a low-interest-rate environment. The country's general government gross debt has broadly stabilised. It amounted to 129.2% of GDP at the end of 2013, 130.2% of GDP in 2014 and 129.0% of GDP in 2015, according to the Commission's spring 2016 economic forecast.

The Council concluded that Portugal 's response to its June 2013 recommendation has been **insufficient**. Portugal didn't correct its deficit by 2015 as required, and its fiscal effort falls significantly short of what was recommended by the Council.

Spain

Spain has been subject to an excessive deficit procedure since April 2009, when the Council issued a recommendation calling for its deficit to be corrected by 2012.

In December 2009 however, the Council extended the deadline to 2013. The Commission forecast that Spain's 2009 deficit would reach 11,2 % of GDP, five percentage points more than its previous estimate.

In July 2012, the Council extended the deadline for a further year to 2014 on account of renewed **adverse economic circumstances**. The Commission projected that Spain's general government deficit would reach 6.3% of GDP in 2012, compared to the 5.3% previously expected.

Also in July 2012, the euro area member states agreed to provide up to €100 billion of loans for the **recapitalisation** of Spain's **financial services** industry.

In June 2013, the Council found that Spain fulfilled the conditions for extending the deadline for correcting its deficit by **a further two years**, setting a new deadline of 2016. It set headline deficit targets of 6.5% of GDP for 2013, 5.8% of GDP for 2014, 4.2% of GDP for 2015 and 2.8% of GDP for 2016, consistent with 1.1%, 0.8%, 0.8% and 1.2% of GDP improvements in the structural balance respectively.

Spain exited the financial assistance programme for the recapitalisation of its financial institutions in January 2014. It had used close to €38.9 billion for bank recapitalisation, plus around €2.5 billion for capitalising the country's asset management company.

Spain's general government deficit amounted to 5.9% of GDP in 2014 and 5.1% of GDP in 2015. above the intermediate targets set by the Council. A **relaxation of fiscal policy** in 2015 had a large impact on the fiscal outcome. The cumulative improvement in the structural balance over the 2013-15 period amounted to 0.6% of GDP, **significantly below** the 2.7% recommended by the Council. When adjusted in the light of revised potential output growth and revenue windfalls or shortfalls, it is even lower.

Over the 2013-15 period, low or even negative inflation made achievement of the fiscal targets more difficult, but this was largely offset by higher-than-expected real GDP growth. A low interest rate environment has also helped Spain reduce its deficit. The Commission's 2016 spring economic forecast projects a general government deficit of 3.9% of GDP in 2016 and 3.1% of GDP in 2017. Spain is therefore **not set to correct its deficit** in 2016 as required. The debt-to-GDP ratio declined from 99.3% in 2014 to 99.2% in 2015, thanks to sales of financial assets. According to the Commission's 2016 spring forecast, the debt ratio is expected to rise to 100.3% in 2016 and decline thereafter.

The Council concluded that Spain 's response to its June 2013 recommendation has been **insufficient**. Spain didn't reach the intermediate target set for its headline deficit in 2015 and is not forecast to correct its deficit by 2016 as required. Its fiscal effort falls significantly short of what was recommended by the Council, and it even relaxed its fiscal stance in 2015.

July 2016 decision on no effective action by Portugal to correct its excessive deficit
July 2016 decision on no effective action by Spain to correct its excessive deficit

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