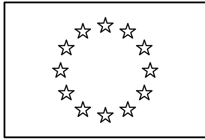

COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION

Portugal

Report prepared in accordance with Article 104(3) of the Treaty

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn has brought about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to prepare a report such as the present one whenever an actual or planned deficit of a Member State exceeds the 3% of GDP reference value. This report, which represents the first step in the "excessive deficit procedure" (EDP), analyses the reasons for the breach of the reference value with due regard to the economic background and all other relevant factors. The amendments to the Stability and Growth Pact in 2005 aimed specifically at ensuring that in particular the economic and budgetary background was fully taken into account in all steps in the EDP. This means for instance that, if an "excessive deficit" is deemed to exist, adequate attention needs to be paid to the economic background and outlook when making recommendations on the pace of the correction. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

2. LEGAL BACKGROUND

This report, which assesses recent and current budgetary developments in Portugal and reviews the short- and medium-term prospects in the light of overall economic conditions and policy action taken by the government, is prepared according to Article 104(3) of the Treaty.

Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[1], which is part of the Stability and Growth Pact. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference

[1] OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005, available at http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

Since the start of stage III of economic and monetary union, two EDP procedures for Portugal have been opened. The last was initiated in June 2005 by the Commission with the adoption of a report under Article 104(3) in view of a planned deficit of 6.2% of GDP in 2005. The EDP procedure concluded that an excessive deficit did exist in Portugal and recommended that "the Portuguese authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner by 2008 at the latest by taking action in a medium-term framework. The general government deficit declined significantly from an actual 6.1% of GDP in 2005 to 3.9% of GDP in 2006 and to 2.6% of GDP in 2007, below the 3% of GDP reference value, mainly with measures of a permanent nature. Therefore, the excessive deficit situation in Portugal had been corrected and the Council, based on a recommendation by the Commission, abrogated its decision on the existence of an excessive deficit in Portugal in July 2008.[2]

According to the April 2009 EDP notification from the Portuguese authorities[3], Portugal's general government deficit is planned to reach 3.9% of GDP in 2009, thus exceeding the 3% of GDP reference value, while general government gross debt would be 70.2% of GDP, above the 60% of GDP reference value and on a rising trend.

Subsequent official budgetary estimates of the Portuguese authorities of May 2009, included in the Medium-Term Steering Report on Fiscal Policy (Relatório de Orientação da Política Orçamental – ROPO), project a budget deficit of 5.9% of GDP in 2009, thus also exceeding the 3% of GDP reference value, while general government gross debt would be 74.6% of GDP, above the 60% of GDP reference value. This compares with a deficit projection of 6.5% of GDP in the Commission services' spring 2009 economic forecasts and a government debt of 75.4%. The difference between the official targets and the Commission forecasts largely results from the sharper recession foreseen by the Commission.

[2] http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/excessive_deficit9109_en.htm

[3] According to Council Regulation (EC) No 479/2009 (previously (EC) No 3605/93), Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Portugal can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables.

Table 1: General government deficit and debt[a]

	2003	2004	2005	2006	2007	2008	2009		2010
							COM	PT	COM
General government balance	-2.9	-3.4	-6.1	-3.9	-2.6	-2.6	-6.5	-3.9	-6.7
General government gross debt	56.9	58.3	63.6	64.7	63.5	66.4	75.4	70.2	81.5

Note:
[a] In percent of GDP.

Source: Eurostat, Commission services' spring 2009 forecast (COM) and Portugal's April 2009 EDP notification

The planned figures for the 2009 deficit provide *prima facie* evidence on the existence of an excessive deficit in Portugal in the sense of the Treaty and the Stability and Growth Pact. The Commission has therefore decided to initiate the excessive deficit procedure for Portugal with the adoption of this report. Section 2 of the report examines the deficit criterion and Section 3 the debt criterion. Section 4 deals with public investment and other relevant factors. This report takes into account the Commission services' spring 2009 forecast, released on 4 May, and the evaluation of subsequent developments.

3. DEFICIT CRITERION

In 2009, the planned government deficit in the April 2009 EDP notification is 3.9% of GDP. Based on more recent information, the government is now projecting a deficit of 5.9% of GDP in 2009, thus also exceeding the 3% of GDP reference value.

Well in excess of 3% of GDP, the planned deficit is not close to the Treaty reference value.

The planned excess over the 3% of GDP reference value is exceptional. In particular, it results, among other things, from a severe economic downturn in 2009 in the sense of the Treaty and the Stability and Growth Pact. For the years 2009 and 2010, the Commission services' spring 2009 forecast foresees that annual GDP would contract by 3.7% and 0.8% respectively, with the output gap turning markedly negative (close to -3% on average in these years). This will have a significant negative impact on the budgetary position in 2009 and 2010.

Table 2: Macroeconomic and budgetary developments[a]

	2003	2004	2005	2006	2007	2008	2009		2010
							COM	PT	COM
Real GDP (% change)	-0.8	1.5	0.9	1.4	1.9	0.0	-3.7	-3.4	-0.8
Potential GDP (% change)	1.4	1.2	0.7	0.6	0.4	0.5	-0.1	n.a.	0.1
Output gap (% of potential GDP)	-1.4	-1.1	-0.9	-0.2	1.3	0.8	-2.7	n.a.	-3.5
General government balance	-2.9	-3.4	-6.1	-3.9	-2.6	-2.6	-6.5	-5.9	-6.7
Primary balance	-0.2	-0.7	-3.5	-1.2	0.2	0.3	-3.6	-2.8	-3.4
One off and other temporary measures	2.4	2.1	-0.1	0.0	0.1	0.8	0.1	n.a.	0.0
Government gross fixed capital formation	3.1	3.1	2.9	2.4	2.3	2.1	2.5	3.0	2.0
Cyclically-adjusted balance	-2.3	-2.9	-5.7	-3.8	-3.2	-3.0	-5.3	n.a.	-5.1
Cyclically-adjusted primary balance	0.4	-0.2	-3.1	-1.1	-0.4	-0.1	-2.4	n.a.	-1.8
Structural balance[b]	-4.7	-5.0	-5.5	-3.8	-3.3	-3.8	-5.5	n.a.	-5.1
Structural primary balance	-2.0	-2.3	-2.9	-1.1	-0.5	-0.9	-2.5	n.a.	-1.8

Note:
[a] In percent of GDP unless specified otherwise
[b] Cyclically-adjusted balance excluding one-off and other temporary measures

Source: Eurostat, Commission services' spring 2009 forecast (COM) and *Relatório de Orientação da Política Orçamental* (May 2009)

The planned excess over the 3% of GDP reference value is not temporary in the sense of the Treaty and the Stability and Growth Pact. According to the Commission services' spring 2009 forecast, the general government headline deficit will increase to 6.7% of GDP in 2010, based on the customary unchanged policy assumption. Despite the discontinuation of the fiscal package in 2010, no improvement in the fiscal position is expected for that year due to the continued recessionary environment, the working of automatic stabilisers and a marked growth in interest expenditure.

In sum, the planned deficit in 2009 is not close to the 3% of GDP reference value and although the excess over the reference value is exceptional, it is not temporary in the sense of the Treaty and the Stability and Growth Pact. This analysis suggests that the deficit criterion in the Treaty is not fulfilled.

4. DEBT CRITERION

In 2009, the general government gross debt is planned to reach 70.2% of GDP according to the April 2009 EDP notification of the Portuguese authorities, above the 60% of GDP Treaty reference value. The latest official budgetary estimates of the Portuguese authorities[4] project a general government gross debt of 74.6% of GDP in 2009, also above the 60% of GDP reference value. Between 2003 and 2007, the ratio increased by 6½ percentage points of GDP

[4] Medium-Term Steering Report on Fiscal Policy (Relatório de Orientação da Política Orçamental – ROPO).

to 63.5% in 2007, due to high, albeit decreasing, deficits in a context of low GDP growth. According to the Commission services' spring 2009 forecast, the general government debt-to-GDP ratio is projected to significantly increase by 18 percentage points over the forecast period from 63.5% in 2007 to 81.5% in 2010, as the result of high deficits, low nominal GDP growth and a stock-flow adjustment in 2009, mainly reflecting commercial debt repayments and to a lesser extent the acquisition of financial assets in the context of the financial recapitalisation package put in place by the Portuguese authorities, which is explained in more detail in Section 5.4.

Therefore, the debt ratio cannot be considered as "sufficiently diminishing and approaching the reference value at a satisfactory pace" in the sense of the Treaty and the Stability and Growth Pact.

This analysis suggests that the debt criterion in the Treaty is not fulfilled.

Table 3: Debt dynamics[a]

	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**		**2010**
							COM	PT	
Government gross debt ratio	56.9	58.3	63.6	64.7	63.5	66.4	75.4	74.6	81.5
Change in debt ratio[b]	1.3	1.4	5.3	1.1	-1.1	2.9	8.9	8.2	6.1
Contributions:									
Primary balance	0.2	0.7	3.5	1.2	-0.2	-0.3	3.6	2.8	3.4
Snow ball effect	1.4	0.5	0.7	0.2	-0.3	1.7	4.0	4.4	2.7
of which									
Interest expenditure	2.7	2.6	2.6	2.7	2.8	2.9	3.0	n.a.	3.3
Real GDP growth	0.5	-0.9	-0.6	-0.9	-1.2	0.0	2.8	n.a.	0.6
Inflation (GDP deflator)	-1.8	-1.4	-1.6	-1.8	-1.9	-1.2	-1.7	n.a.	-1.3
Stock flow adjustment	-0.3	0.3	1.1	-0.2	-0.6	1.4	1.4	1.0	0.1

Notes:
[a] In percent of GDP.
[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; *D, PD, Y* and *SF* are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.
Source: Eurostat, Commission services' spring 2009 forecast (COM) and *Relatório de Orientação da Política Orçamental* (May 2009)

5. RELEVANT FACTORS

Article 104(3) of the Treaty provides that the Commission report "shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors including the medium-term economic and budgetary position of the Member State". These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms

the excess over the reference value and which the Member State has put forward to the Commission and to the Council" need to be given due consideration.

In view of the above provisions, the following four subsections consider in turn (1) the medium-term economic position; (2) the medium-term budgetary position (including public investment); (3) other factors put forward by the Member State; and (4) other factors considered relevant by the Commission.

5.1. Medium-term economic position

Cyclical conditions and potential growth. The Portuguese economy has generally recorded below-potential GDP growth rates and below euro-area rates in the current decade, with GDP growing at an annual average rate of 1%. In 2008 GDP stagnated, primarily influenced by sluggish external demand, reflecting the financial crisis and cooling activity in the main trading partners. Domestic demand growth also fell, driven by shrinking gross fixed capital formation. Despite weak GDP growth, Portugal recorded a high and rising external imbalance. This is indicative of low potential growth, which is hampered by a number of deeply rooted factors. In particular, overall productivity is low and the specialisation pattern is still significantly based on low-skill intensive industries, being thus especially vulnerable to the competition of emerging countries that have been quickly integrating into world trade.

Portugal's GDP is expected to fall by 3¾% in 2009 and further, by ¾%, in 2010, according to the Commission services' spring 2009 forecast. The recovery is expected to be slow because of the uncertainties on the external setting and also a number of structural features such as low productivity growth and the large savings-investment gap. The output gap is estimated to have turned slightly positive in 2007/2008, but it should turn again negative in 2009 and 2010. Specifically, the output gap has changed from ¾% of GDP in 2008 to -2¾% and -3½% in 2009 and 2010 respectively.

Recent structural reforms. The Portuguese economy faces challenges of a structural nature, namely relatively low productivity and potential GDP growth. The main recent structural reforms include old-age pension reforms, changes in central government administration, notably a reorganisation of services, the health sector and containment of compensation of government employees. The authorities have also embarked on a strengthening of the budgetary process and institutions and revised fiscal rules for regional and local governments. These structural reforms are in general expected to help reining in public spending growth over the medium term and work towards containment of fiscal imbalances. In line with the priorities put forward in the Portuguese National Reform Programme (including the latest 2008 implementation report) in the context of the Lisbon strategy for growth and jobs, the government has dovetailed efforts to areas considered key to foster productivity and thereby potential GDP, such as R&D and innovation. The Government's initiative "*A Commitment to Science for the Future of Portugal*" defines explicit goals in terms of R&D spending to be reached by 2010: an overall goal of 1.8% of GDP. Regarding energy policy, the government has been actively promoting a substantial switch to renewable energy sources, an important contribution to sustainable economic growth and to the reduction of the external deficit. Concerning employment issues, the adoption of the Labour Code is now passing another legislative step. The government has also directed efforts towards a simplification of the administrative burden. The main pillars of the public administration reform are: first, the reform of the State's central administration (*PRACE – Programa de Reforma da Administração Central do Estado*) intended to result in an overhaul of central government

structures; second, changes on public employment, namely new career and pay scales, as well as employment standards for government employees; and third, performance evaluation for services, workers and managers.

5.2. Medium-term budgetary position

Structural deficit and fiscal consolidation in good times. According to the Commission services' calculations, obtained according to the commonly agreed methodology on the basis of the data of the Commission services spring 2009 forecast, the structural deficit improved from 5½% of GDP in 2005 to 3¼% in 2007. Thus, fiscal consolidation took place in 2006 and 2007, when the economy was moving from bad towards more neutral times. The structural deficit is projected to deteriorate from 3¾% of GDP in 2008 to 5½% of GDP in 2009 and to improve slightly to around 5% in 2010, against a backdrop of a clearly widening negative output gap. According to the Commission assessment, the 2008 budgetary execution benefited from unforeseen one-off government sales of concessions for the construction and exploitation of electric dams and motorways worth some ¾% of GDP (compared with similar operations in 2007 worth 0.1% of GDP). In 2009, such one-off operations would only represent 0.1% of GDP. If the Commission assessment of one-offs and other temporary measures is used, the structural primary deficits would be close to 1% of GDP in 2008, 2½% in 2009 and 1¾% of GDP in 2010 respectively.

The overall fiscal stance is expansionary in 2009 and restrictive in 2010. The stimulus package is foreseen to be at the core of the expansionary fiscal stance in 2009, so its withdrawal in 2010 is expected to make it acquire a restrictive tone in that year.

Public investment. Government investment has declined somewhat in terms of GDP from close to 3% between 2003 and 2005 to an average of around 2¼% since then. According to the Commission services' spring 2009 forecast, the public investment ratio is expected to increase by ½ percentage point of GDP in 2009 reflecting the discretionary fiscal stimulus packages in response to the EERP[5]. In 2010, a return to a figure in line with recent years is foreseen. In both 2009 and 2010, the government investment-to-GDP ratio would fall well short of the general government deficit ratio by over 4 percentage points of GDP.

Quality of public finances. Portugal has made progress towards fiscal consolidation in the current decade. Continued expenditure containment and enhanced tax collection brought the budgetary deficit below the 3% of GDP reference value in 2007, before returning above this threshold in 2009 in the context of the current economic and financial crisis. Since mid-2005, Portugal embarked into a process of fiscal consolidation, which brought the budget deficit down from 6.1% of GDP in 2005 to 2.6% of GDP in 2007 on the back of both falling expenditure and rising revenue ratios, mainly through the reduction of current primary expenditure.

Concerning the institutional aspects of public finances, important steps have been taken, or are due to enter into force, in particular in the area of public administration reform. These

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[5] The authorities adopted measures to renew school premises and technologically upgrade them in 2009 with an impulse of 0.3% of GDP. This investment effort was already being planned for 2009 and the coming years but was frontloaded as a response to the crisis. In addition, improvements in some public buildings (e.g., hospitals, universities, courts, offices of public services) notably aiming at improving energy efficiency, will represent an investment effort of less than 0.1% of GDP. Overall, these measures will support construction activity and demand in some areas of equipment.

include, most notably, the restructuring of central government services, the introduction of new career and pay scales, employment standards for government employees and performance evaluation for services, workers and managers. In addition, a consolidation of public services networks in several sectors, including the reform of the health services have been underway, leading to the closure of various local services. Whilst the impact of these measures on the efficiency and effectiveness of public expenditure has not yet fully materialised, they may have the potential to yield a more efficient use of public resources in several areas of the public sector. The overall efficiency and effectiveness of public spending could also benefit from improvements in the governance of public finances. In this domain, the Portuguese authorities have put forward plans to develop performance based budgeting, with a multi-annual budgetary framework and numerical budgetary rules, but implementation has not yet materialised.

Long-term sustainability of public finances. In its opinion of 10 March 2009 on the January 2009 update of the Stability Programme of Portugal, the Council assessed the long-term sustainability of Portugal's public finances as follows. While the long-term budgetary impact of ageing is somewhat higher than on average in the EU, recently enacted pension reforms have helped to contain the projected increase in pension expenditure over the coming decades. The budgetary position in 2008, as estimated in the programme, is almost sufficient to stabilize the debt ratio over the long term before the budgetary impact of population ageing is taken into account. Moreover, the current level of gross debt is above the Treaty reference value. Achieving higher primary surpluses over the medium term, as already foreseen in the programme, would contribute to reducing the medium risks to the long-term sustainability of public finances.[6] In addition to what is noted by the Council, the risks from financial sector stabilisation schemes (explained in more detail in Section 5.4) put in place by Portugal could have a potential negative impact on the long-term sustainability of public finances, although some of the cost of the government support could be recouped in the future.

5.3. Other factors put forward by the Member State

In a letter of 24 August 2009, the authorities of Portugal listed some relevant factors in accordance with Article 2(3) of Council Regulation (EC) No 1467/97. The analysis presented above already covers almost the items put forward by the authorities, including the budgetary impact of the fiscal stimuli to soften the slowdown in 2009. The accompanying report attached to the letter stresses the deterioration of the economic scenario and the budgetary impact of the stimulus measures taken by the government to face up to the current economic crisis. The letter also refers to the latest official budgetary estimates of the Portuguese authorities, already included in the Medium-Term Steering Report on Fiscal Policy (Relatório de Orientação da Política Orçamental – ROPO), which expects a budget deficit of 5.9% of GDP in 2009, thus exceeding the 3% of GDP reference value, while general government gross debt would be 74.6% of GDP, above the 60% of GDP reference value. These figures reinforce the conclusions reached in this report regarding the excessive deficit.

[6] Since the submission of the stability/convergence programme, risks to the long-term sustainability may have changed in view of the worsened economic and budgetary situation. The new assessment will be published in the upcoming report on the long-term sustainability of public finances in the European Union.

5.4. Other factors considered relevant by the Commission

Recent public finance developments in Portugal were also influenced by the following factors in the area of budgetary institutions and procedures.

The breach of the 3% of GDP reference value in 2009 largely reflects the strength of the downturn and the discretionary fiscal measures taken in response to it. Measures with an impact in 2009 have been adopted, including a fiscal stimulus package presented in December 2008 as a direct response to the EERP. This package represents a fiscal impulse of 1¼% of GDP in 2009 (of which 0.8% of GDP is to be financed out of the national budget and the rest through EU funds). Overall, the package is in line with the EERP: its measures are timely and targeted at the areas most affected by the crisis. In addition, most of the measures are temporary and limited to 2009. Furthermore, the worsening of the budget balance also reflects the working of automatic stabilisers by means of lower revenue and a higher expenditure-to-GDP ratio and the fading impact of the one-off operations recorded in 2008.

As regards financial markets, the Portuguese authorities have adopted a number of measures to help stabilising the financial sector. These measures include: strengthening information disclosure obligations by financial institutions; increased bank deposit guarantees (from 25000 to 100000 euro per account holder and bank); granting of guarantees to new borrowing by Portuguese banks with maturity between three months and three years; the possibility of reinforcing the equity capital of banks through government investment, with up to a combined total of €16 bn. (11¾% of GDP) being earmarked for these two measures until end 2009 (the latter not exceeding €4 bn. or 2½% of GDP). So far, the efforts by the authorities to support the financial markets do not seem to have had a detrimental impact on public finances, but possible rescue operations may put upward pressure on government finances.

In its opinion on the most recent update of the Stability Programme, the Council considered that in the context of the given favourable economic growth assumptions, the projected government revenue could turn out to be on the high side. The Council considered that in the current international economic and financial conditions, a major source of uncertainty is related to the macroeconomic scenario, which appears to be based on favourable growth assumptions. Hence, a scenario where lower-than-expected GDP growth would dampen revenue growth and jeopardise the fall in the expenditure-to-GDP ratio envisaged in the programme is a distinctive possibility.

6. CONCLUSIONS

In 2009, the planned government deficit in the April 2009 EDP notification is 3.9% of GDP, above and not close to the 3% of GDP reference value. Based on more recent information, the government is now projecting a deficit of 5.9% of GDP in 2009, thus also exceeding the 3% of GDP reference value. These deficit developments reflect the economic downturn and the impact of the Portugal's economic policy response to the crisis.

The excess over the reference value can be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. However, it cannot be considered temporary. This suggests that the deficit criterion in the Treaty is not fulfilled.

General government gross debt has been above the 60% of GDP reference value since 2005 and is planned to stand at 70.2% of GDP in 2009. Based on more recent information, the

government is now expecting debt at 74.6% of GDP in 2009. The debt ratio cannot be considered as diminishing sufficiently and approaching the reference value at a satisfactory pace within the meaning of the Treaty and the Stability and Growth Pact. This suggests that the debt criterion in the Treaty is not fulfilled.

In line with the Treaty, this report has also examined “relevant factors”, which, according to the Stability and Growth Pact, can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the double condition – that the deficit remains close to the reference value and that its excess over the reference value is temporary – is fully met. Considered on their own merit, the relevant factors in the current case on balance seem to be relatively favourable.

The existence of a severe economic downturn, with public finance implications, increases the need to undertake enhanced surveillance under the EDP.