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SOUTHERN EUROPE: RECOVERY OF THE PUBLIC ACCOUNTS

Guillaume Derrien

Public deficits in Greece, Portugal and, to a lesser extent, Spain, dropped significantly in 2022. According to Eurostat's preliminary results – published on 21 April – the primary deficit nearly halved in Spain (-2.4% of GDP), it was erased in Greece, while Portugal once again posted a surplus (1.6% of GDP).

In Greece and Portugal, the public deficit fell below the 3% GDP limit set by the Growth and Stability Pact, with which they had already realigned between 2016 and 2019. Although down sharply, the deficit in Spain remains significant, at 4.8% of GDP.

Better-than-expected growth in activity and employment and high inflation generated strong tax revenues, which more than offset the rise in spending to cushion the inflationary shock.

After a historic widening of public deficits in 2020-2021 linked to the health crisis, fears that the inflationary shock will lead to further fiscal slippage in 2022 have not materialised.

In its *Debt Sustainability Monitor* published in mid-April, the European Commission improved the long-term debt sustainability outlook for these three countries, highlighting in particular that smaller budget adjustments than most other EU countries will be necessary to counteract demographic ageing.

PRIMARY BALANCES IN THE EUROZONE (2022)

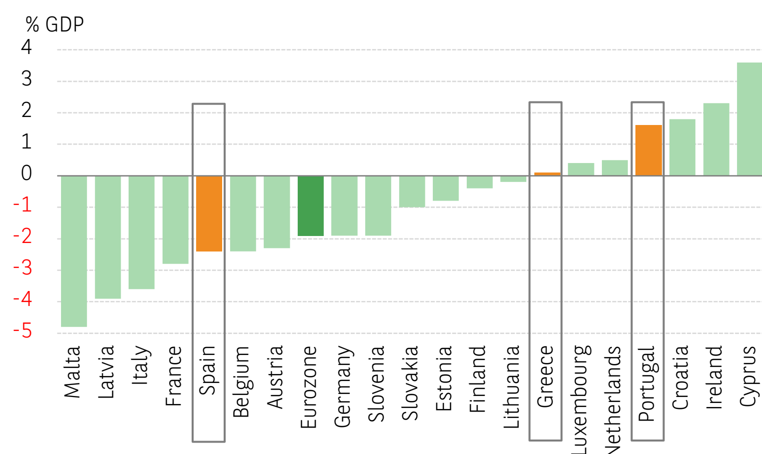

CHART 1

SOURCE: EUROSTAT, BNP PARIBAS

Public finances in Greece, Portugal and Spain improved significantly in 2022. According to Eurostat, Portugal posted a primary surplus of 1.6% of GDP over the past year as a whole, after a deficit of 0.5% in 2021. The recovery in public finances was the most remarkable in Greece: the primary deficit was erased, moving from -4.6% of GDP in 2021 to a slight surplus of 0.1% last year. The situation is still more deteriorated in Spain, but the primary deficit has nevertheless fallen by almost half in the space of a year, decreasing from a GDP ratio of -4.7% in 2021 to -2.4% in 2022. Budget balances, which incorporate debt interest payments, remain in deficit, but they have significantly narrowed too: in 2022, the public deficit stood at -2.3% of GDP in Greece (compared to -7.1% in 2021), -0.4% in Portugal (-2.9% in 2021), and -4.8% in Spain (-6.9% in 2021).

Growth in revenues was the strongest in Greece (+13.7% in 2022), again according to Eurostat. Spain and Portugal also posted a significant increase of 8.1% and 10.1% respectively year-on-year. This was fuelled by higher VAT receipts, social security contributions (employees and employers), and taxes on income and companies. Government spending rose 4.1% in Greece, 4.4% in Portugal and 3.8% in Spain, mainly due to support measures (subsidies, social transfers) designed to cushion the economic shock, but the increase was smaller than income.

Although still elevated, government debt ratios fell again in 2022 (see chart 3). In Greece and Portugal, consolidated debt[1] in relation to GDP fell below 2019 levels, down 23 points of GDP (to 171.3%) and 11.5 points (to 113.9%) respectively last year.

1 Consolidated data excludes public authority debt items held by another public authority from the debt calculation.

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CHANGES IN FISCAL AND PRIMARY BALANCES

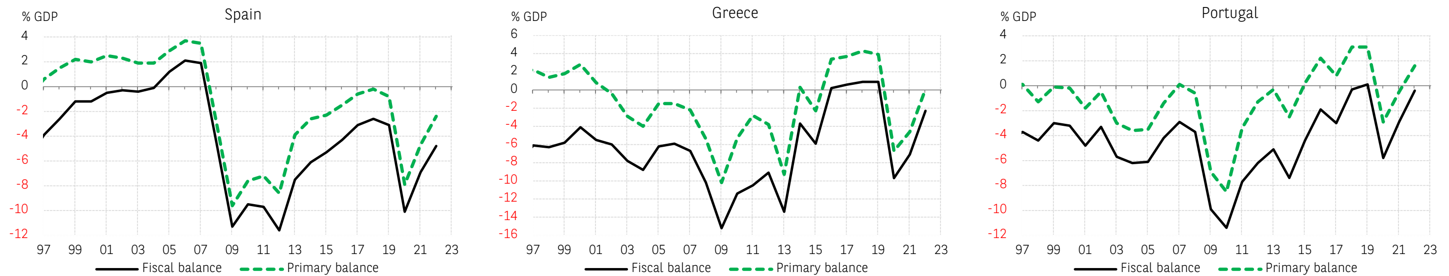

CHART 2

SOURCE: EUROSTAT, BNP PARIBAS

The debt ratio in Portugal is now the same as in Spain, while the country had a gap with its neighbour of 45 points of GDP in 2011. Indeed, public debt dropped less markedly in Spain, which is logical given that public finances are more unbalanced. The public debt ratio in the country fell by 5 points of GDP to 113.2% in 2022, but this is still around 15 points of GDP above the 2019 level.

PAST STRUCTURAL BALANCE ADJUSTMENTS PAY OFF

These positive developments are not only the result of a favourable post-Covid situation. Portugal, Greece and Spain managed to improve their public accounts before the health crisis, at the price of drastic adjustment programmes put in place during the sovereign debt crisis in the eurozone. These austerity measures were very painful for the local population (increases in taxes, prolonged freezing of salaries in the public sector, reduction in pensions and increase in the retirement age). In 2009, these three countries had very large budget deficits, ranging from 7.2% of GDP in Portugal, 10% in Spain and as high as 10.4% in Greece. Ten years later, in 2019, the Spanish deficit had narrowed to just 1.0% of GDP, while Greece and Portugal recorded large budget surpluses, at +3.9% and +2.9% of GDP respectively.

Thanks to these sharp adjustments, structural budget balances[2], whose deficit had reached no less than 13% of GDP in 2009 in Greece (IMF figures[3]), recovered rapidly. The structural balance thus returned to surplus in Greece in 2012 and Portugal in 2014. The structural deficit in Spain was reduced by almost 8 points of GDP during the same 2009–2014 period.

2023 IN THE MOMENTUM OF 2022?

For the time being, the economic situation remains positive, particularly with regards to the dynamics in the labour market in Spain and Portugal: this will further fuel the rise in social security contributions and States' cash flows. The dynamic stalled in Greece in the first quarter of the year, but this followed a sharp increase in employment in 2022 (+5.4%). The jobless rate in Greece has fallen to levels not seen for more than a decade (10.9% in March 2023).

CONSOLIDATED PUBLIC DEBT

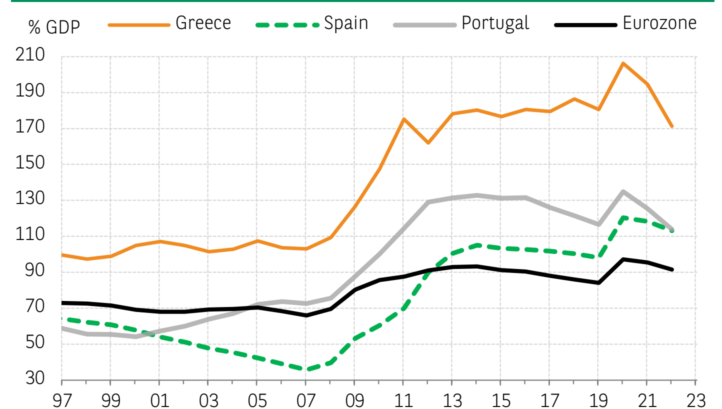

CHART 3

SOURCE: EUROSTAT, BNP PARIBAS

The trend in public accounts over the first few months of 2023 thus shows that the upturn continues, even though the current figures must be taken with caution as the comparison period is limited[4].

THE EUROPEAN COMMISSION TAKES NOTE OF THESE DEVELOPMENTS

With the rise in refinancing rates in Europe, high public debt stock remains one of the Achilles' heels of Southern European countries. The European Commission highlighted this issue in its latest *Debt Sustainability Monitor*, published on 14 April[5]. In its risk profile, established over three timeframes (short [2023], medium and long term), the Commission maintains a "high" medium-term risk on Greece and Portugal due to the level of public debt, as it does for Spain, which is vulnerable to the various adverse scenarios used.

2 The structural balance corresponds to the budgetary balance adjusted for the impact of the economic cycle (economy component) as well as temporary measures taken by governments (e.g. those linked to Covid-19) and one-off capital transfers (e.g. financial assistance to the banking sector).
3 The IMF and the Commission produce estimates of structural balances in Europe, sometimes with different estimates. However, the trajectories remain substantially the same.
4 The consolidated deficit in Spain stood at EUR 8.6 billion in January-February 2023, compared to EUR 12.4 billion in January-February 2022 (source: CIGAE). In Greece, the consolidated budget balance posted a surplus of EUR 0.9 billion cumulatively over January–March 2023, compared to a deficit of EUR 2.3 billion over the same period in 2022 (source: Greek Ministry of Finance). Portugal posted a consolidated budget surplus of EUR 4.9 billion in cumulative terms over January–March 2023 compared to EUR 0.9 billion in January–March 2022 (source: DGO Portugal).
5 https://economy-finance.ec.europa.eu/system/files/2023-04/ip199_en_1.pdf

However, the short-term risk remains "low" for these three countries, as for all eurozone economies. Apart from Spain, gross financing needs in Greece and Portugal will be among the lowest in Europe (see chart 4), which is partly the result of the improvement in fiscal balances. The Commission also highlights several other factors which are common to most eurozone countries and which will help to cushion the shock linked to the rise in interest rates: extension of the average maturity of government bonds, increase in the share of public debt held by the Eurosystem and new budgetary solidarity mechanisms, in particular via the Next Generation EU programme.

In the long term, Greece and Portugal's risk profile has been revised downwards this year, from "medium" to "low". These countries now have a better long-term rating than The Netherlands, France or Germany, which, according to the European Commission estimates, will have to make larger budgetary adjustments both to stabilise the level of their long-term public debt and to lower their debt-to-GDP ratio to 60% by 2070[6]. Spain's long-term risk profile has also been reduced from "high" to "medium". Greece and Portugal are therefore, from the point of view of their budgetary equilibrium, in a better position than Spain, although for Greece, the starting point – the debt ratio – is much less favourable.

This long-term debt trajectory, which is more reassuring for the financial markets, probably offers an explanation for the limited rise in bond rate spreads in these countries compared to the German *Bund* in the current context of a rise in interest rates in Europe (see chart 5).

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6 These are the H1 and H2 indicators measured by the European Commission to establish the long-term risk. See analysis on pages 59–70 of the *Debt Sustainability Monitor* 2022.

GOVERNMENT GROSS FINANCING NEEDS

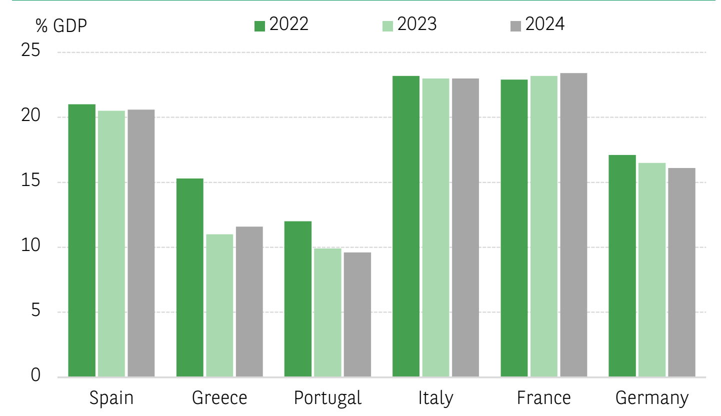

CHART 4 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

GOVERNMENT BOND YIELDS, SPREAD WITH GERMANY

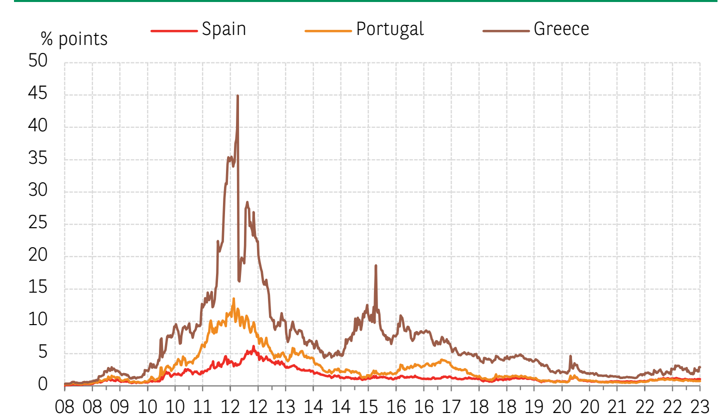

CHART 5 SOURCE: REFINITIV

GOVERNMENT GROSS FINANCING NEEDS

Gross financing needs are the payment flows that the government must guarantee to cover its cash deficits over a given period, usually on a year-wide basis. These needs are the sum of four factors:

Primary deficit + debt burden + debt rollover[1] + stock flow adjustment[2]

A given debt stock may therefore be associated with very different financing needs from one year to the next, depending on the depreciation schedule, loan structure, etc.

1 Debt rollover consists of repaying maturing loans with new loans.

2 The adjustment of stock flows brings together items that affect the debt stock but have no impact on the budgetary balance. This includes, for example, the acquisition of financial assets by public authorities (loans granted, injection of liquidity into companies) or accounting effects linked, for example, to the appreciation or depreciation of debt held in foreign currencies. For a more precise definition of the adjustment of stock flows and its impact on the evolution of debt in eurozone countries, see in particular Stock-flow adjustment for the Member States, the euro area (EA-19) and the EU-27, for the period 2016–2019, Eurostat, April 2020.

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