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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK
SEPTEMBER 2025

ECONOMIC & FINANCIAL ENVIRONMENT

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BPI

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK

September 2025

The *Monthly Report* is a publication developed jointly by CaixaBank Research and BPI Research (DF-EEF)

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New realities, old risks

The summer has passed with the feeling that the initial impact caused by the Trump administration's economic policy decisions has been lower than initially expected. After compensating for the effects caused by «anticipation» of the tariff hikes at the beginning of the year, the snapshot of economic activity reflects an overall growth cycle that remains in an orderly landing phase and, therefore, far from the scenarios involving a recession. The significant resilience shown by the US, China and India is offsetting the weakness of the euro area, allowing global growth to maintain a cruising speed close to 3%, as reflected by the global PMI which stood at a 15-month high in August. It is true that the average US tariff is going to be much higher than it was at the beginning of the year (17% versus 2.5%) and that the levels imposed on some countries (such as Brazil, Switzerland and India) will have a negative impact on growth. The agreement with China is also yet to be finalised while the US courts reach a decision over the legal avenues used by the executive branch to justify the tariff hikes. However, for the time being the effects on growth are proving to be moderate, and with the new tariff map now laid out, the potential impact of uncertainty on economic agents' decisions has been reduced thanks to the ruling out of a trade war.

On the inflation front, in the absence of retaliation, the impact is being transmitted gradually. Even in the US, the data for Q2 reflect that companies are assuming a significant portion of the tariff hike, without it having a major impact on profits. This combination of growth and inflation will allow the widespread easing of global monetary policy towards neutral territory (–100 bps in the last 12 months) to continue – a trend which the Fed could soon join in a bid to offset the first signs of weakening in the labour market. The situation at the crossroads of the American central bank contrasts with the sense of comfort emerging from the ECB's latest messages regarding the current level of interest rates, now that inflation has stabilised at around 2%.

At this juncture, the monetary policy transmission channels could be affected by new tensions in the bond markets that are affecting the usual suspects (France, the United Kingdom and Japan) as well as the US. This reflects concerns regarding fiscal sustainability and the Fed's independence, as well as certain mismatches between market supply and demand, especially in the long part of the curve. The 30-year American bond, a key benchmark, has returned to the 5% zone and in Europe the realignment of risk premiums has been consolidated, with that of France (80 bps) lying closer to Italy's (87 bps) than Spain's (60 bps) and with the yield on the British 30-year bond at its highest this century (5.6%). Essentially, doubts remain over the fiscal margin that is available in a number of OECD countries in order to tackle the challenges of the new geopolitical scenario, the needs of the energy transition and the medium-term effects of demographics, a sphere in which trends tend to be difficult to reverse in the short term (see the Dossier in this same *Monthly Report)*. This is in addition to the misgivings about how the problem of fiscal sustainability could contaminate monetary policy, which has been treading on thin ice in the last decade, forced to test unconventional tools as a result of assuming responsibilities that were not part of its usual remit. This emphasises even more the importance of the central banks' autonomy.

In this way, the markets' focus of attention will shift until the end of the year from the trade front to the budgetary front, at the expense of consolidating the narrative that the impact of investment in AI (the latest estimates place it at 4-7 trillion dollars by 2030) on productivity – and, therefore, on potential growth – can offset the distortions in global supply that the new geopolitical scenario will entail. In any case, these are the first strikes of the transformation process in which the world economy is currently immersed and which in the near future will test everything from the trade relations between the major economic blocs to the solidity of the institutions that have generated well-being in recent decades, starting with the independence of the central banks and regulatory bodies. Such things tend to be missed when they are already difficult to recover and – like with other important facets of life, and to paraphrase Quevedo – the lessons tend to be learnt late and painfully.

José Ramón Díez
September 2025

Chronology

AUGUST 2025

5 The majority of the reciprocal tariffs imposed by the US on other countries come into force.

JUNE 2025

5 The ECB cuts interest rates by 25 bps and lowers the depo rate to 2.0%.
12 According to the European Commission's Copernicus programme, May 2025 was, globally, the second warmest month of May since records began (the record is held by May 2024).

APRIL 2025

2 «Liberation Day»: Trump announces a universal 10% tariff and higher «reciprocal» tariffs on 57 countries.
17 The ECB cuts interest rates by 25 bps, leaving the depo rate at 2.25%.
28 Spain and Portugal are affected by a massive blackout, causing severe disruptions in both countries.

JULY 2025

27 Agreement between the EU and the US establishing a general tariff of 15%, as well as preferential treatment for a number of strategic products and a European commitment to make purchases from and investments in key US industries.

MAY 2025

3 OPEC increases oil production while internal tensions rise.
28 Legal doubts about the Trump administration's tariffs increase uncertainty over their global effects.

MARCH 2025

4 The European Commission presents its ReArm Europe plan to bolster the EU's defence capabilities.
6 The ECB cuts interest rates by 25 bps, leaving the depo rate at 2.50%.

Agenda

SEPTEMBER 2025

2 Spain: registration with Social Security and registered unemployment (August).
Euro area: CPI flash estimate (August).
9 Portugal: international trade (July).
11 Governing Council of the European Central Bank meeting.
12 Spain: S&P rating.
Portugal: Fitch rating.
16 Spain: quarterly labour cost survey (Q2).
16-17 Federal Open Market Committee meeting.
22 Portugal: house prices (Q2).
23 Spain: loans, deposits and NPL ratio (Q2).
Spain: balance of payments and NIIP (Q2).
Portugal: GDP breakdown by institutional sector (Q2).
25 Portugal: NPL ratio (Q2).
26 Spain: GDP breakdown (Q2).
Spain: Fitch rating.
Spain: Moody's rating.
29 Spain: CPI flash estimate (September).
Euro area: economic sentiment index (September).
30 Spain: household savings rate (Q2).
Portugal: CPI flash estimate (September).
Portugal: tourism activity (August).

OCTOBER 2025

1 Portugal: employment and unemployment (August).
Portugal: public debt (August).
Euro area: CPI flash estimate (September).
2 Spain: registration with Social Security and registered unemployment (September).
8 Spain: financial accounts (Q2).
10 Portugal: international trade (August).
17 China: GDP (Q3).
22 Spain: loans, deposits and NPL ratio (August).
23-24 European Council meeting.
24 Spain: quarterly labour cost survey (Q3).
27 Portugal: loans and deposits (September).
28-29 Federal Open Market Committee meeting.
29 Spain: GDP flash estimate (Q3).
30 Spain: CPI flash estimate (October).
Portugal: GDP flash estimate (Q3).
Euro area: GDP (Q3).
Euro area: economic sentiment indicator (October).
US: GDP (Q3).
Governing Council of the European Central Bank meeting.
31 Portugal: budget execution (September).
Euro area: CPI flash estimate (October).

Solid foundations for growth

Portugal is a small, open economy, and therefore much of its performance depends on the international context. At present, this appears to be weakened. In the US, changes in trade policy have not yet stabilised, leading to uncertainty, and their full effects have not yet been felt. Europe continues to experience weak growth and difficulty in adopting structural measures for rapid joint change. In a more difficult external context, domestic demand has acted as a major support for Portuguese economic growth after several years in which external demand was the main support, a situation that is expected to continue over the 2025-26 horizon. Given what recent economic history has taught us, in order for this situation to be sustainable in the future, it will be necessary to address the main (structural) challenges facing the economy.

The performance of the Portuguese economy has stood out positively in the European space. In the second quarter, GDP increased by 0.6% quarter-on-quarter, the largest expansion recorded among EMU countries after Spain (0.7%); since the beginning of 2024, average year-on-year growth has been 1.9%, higher than the 1.1% seen in the EMU. This positive performance can also be seen in the cumulative growth since 2019, the year before the pandemic. Portugal has recorded cumulative growth of 8.9%, identical to that of Spain, compared to 6% for the eurozone as a whole, 5% for France and stagnation in the case of Germany.

In recent years, this growth has been achieved mainly through the contribution of domestic demand, based on the reduction of interest rates and strong growth in employment, population and wages. Household income increased by more than 5% in 2024, above consumption, further increasing savings levels. On the corporate and government side, the situation is also positive, as balance sheets are more balanced (we concluded this in an analysis in this same publication on the financial situation of companies), allowing value to be generated without imbalances. Proof of this is the behaviour of investment, one of the items that has grown the most since 2019, with a cumulative variation of around 18%. As for public policies, the result of the budgetary stance in recent years is reflected in the progression of public debt, which since 2019 has already fallen by 21 percentage points of GDP to 94.9% in 2024; this year it should grow by around 2 percentage points more. In fact, it is significant that this performance by the Portuguese economy has occurred with fewer structural imbalances at the same time, particularly in terms of domestic and external debt, households, companies and the State.

However, for Portugal to continue to perform well in a sustained manner, allowing for balanced growth and convergence towards the income and wealth levels of its European partners, there are challenges that should be «resolved» or at least planned for resolution in a broadly concerted and consensual manner, especially the most urgent ones.

This is the case with the problem of scarcity and increased cost of access to housing. Portugal is one of the OECD countries with the most houses per inhabitant, but it is also one of the countries with the highest proportion of houses in poor condition and vacant; furthermore, this seemingly available supply often does not match demand in terms of location. In recent years, reduced investment in housing construction (about half compared to 2009, for example) and, on the other hand, various factors driving demand (population growth, demand from non-residents and, above all, from foreign residents with greater purchasing power, as well as tax relief measures aimed at younger people) have caused a significant increase in prices (BPI Research estimates that the average price will increase by around 12% this year after 9% in 2024), which has far exceeded the growth in residents' income. This is one of the most significant challenges Portugal currently faces.

Another significant challenge is related to the external competitiveness of the Portuguese economy. In fact, although we are far from the double-digit current account deficits seen in the first decade of the century, the external balance has worsened in recent months as a result of the significant increase in the trade deficit, i.e. that resulting from foreign trade in goods. BPI Research estimates that this will reach around –8% of GDP at the end of the year, which, if confirmed, would be the highest since 2008, without a rise in fuel prices (as in 2022, for example). We know that this decline is partly related to the impact of volatility and uncertainty caused by the Trump Administration's policies and also to the impact of investment efforts, with a large imported component. However, it also reflects the fragility of external competitiveness, highlighting the importance of supporting the export sector so that it can grow sustainably and diversify its customer base.

Paula Carvalho

Average for the last month in the period, unless otherwise specified

Financial markets

	Average 2000-2007	Average 2008-2019	Average 2020-2022	2023	2024	2025	2026
INTEREST RATES							
Dollar							
Fed funds (lower limit)	3.18	0.54	0.67	5.25	4.25	4.00	3.25
3-month SOFR	3.62	1.01	1.07	5.37	4.37	4.07	3.35
12-month SOFR	3.86	1.48	1.48	4.95	4.19	3.75	3.41
2-year government bonds	3.70	1.04	1.21	4.46	4.24	4.10	3.90
10-year government bonds	4.69	2.57	1.76	4.01	4.40	4.60	4.50
Euro							
ECB depo	2.05	0.20	–0.30	4.00	3.09	1.75	2.00
ECB refi	3.05	0.75	0.20	4.50	3.24	1.90	2.15
€STR	–	–0.54	–0.38	3.90	3.06	1.70	2.06
1-month Euribor	3.18	0.50	–0.32	3.86	2.89	1.74	2.10
3-month Euribor	3.24	0.65	–0.21	3.94	2.83	1.76	2.11
6-month Euribor	3.29	0.78	–0.07	3.93	2.63	1.91	2.14
12-month Euribor	3.40	0.96	0.10	3.68	2.44	2.09	2.18
Germany							
2-year government bonds	3.41	0.35	–0.21	2.55	2.02	1.89	1.97
10-year government bonds	4.30	1.54	0.14	2.11	2.22	2.30	2.40
Spain							
3-year government bonds	3.62	1.69	0.18	2.77	2.26	2.48	2.63
5-year government bonds	3.91	2.19	0.38	2.75	2.48	2.67	2.84
10-year government bonds	4.42	3.17	0.99	3.09	2.90	3.00	3.20
Risk premium	11	164	85	98	68	70	80
Portugal							
3-year government bonds	3.68	3.33	0.07	2.33	2.03	2.01	2.14
5-year government bonds	3.96	3.94	0.35	2.42	2.15	2.31	2.49
10-year government bonds	4.49	4.67	0.96	2.74	2.68	2.85	3.10
Risk premium	19	314	82	63	46	55	70
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.13	1.09	1.05	1.21	1.22
EUR/GBP (pounds per euro)	0.66	0.84	0.87	0.86	0.83	0.81	0.80
EUR/GBP (yen per euro)	129.56	126.41	129.91	156.99	161.18	158.00	154.00
OIL PRICE							
Brent ($/barrel)	42.3	80.1	71.0	77.3	73.1	65.1	65.3
Brent (euros/barrel)	36.4	62.5	63.9	70.9	69.8	53.8	53.5

Forecasts

Change in the average for the year versus the prior year average (%), unless otherwise indicated

International economy

	Average 2000-2007	Average 2008-2019	Average 2020-2022	2023	2024	2025	2026
GDP GROWTH[1]							
Global	4.3	3.3	2.5	3.5	3.3	2.9	2.9
Developed countries	*2.7*	*1.5*	*1.7*	*1.7*	*1.8*	*1.3*	*1.3*
United States	2.7	1.8	2.1	2.9	2.8	1.3	1.3
Euro area	2.3	0.8	1.2	0.7	0.9	1.2	1.1
Germany	1.6	1.3	0.4	–0.7	–0.5	0.4	1.3
France	2.3	1.0	0.7	1.6	1.1	0.4	0.8
Italy	1.5	–0.3	1.6	0.8	0.5	0.6	0.8
Portugal	1.5	0.4	1.5	2.6	1.9	1.6	2.0
Spain	3.6	0.7	0.6	2.7	3.2	2.4	2.0
Japan	1.4	0.4	–0.2	1.5	0.1	1.0	1.0
United Kingdom	2.8	1.2	1.0	0.4	1.1	1.1	1.2
Emerging and developing countries	*6.3*	*4.9*	*3.1*	*4.7*	*4.3*	*3.9*	*3.9*
China	10.6	8.0	4.7	5.4	5.0	4.2	3.9
India	7.2	6.7	3.8	8.9	6.7	6.8	6.6
Brazil	3.6	1.6	1.5	3.2	3.4	2.0	1.8
Mexico	2.3	1.5	0.5	3.4	1.4	1.0	1.4
Russia	–	1.4	0.6	4.1	4.3	1.7	1.3
Türkiye	5.5	4.5	6.3	5.1	3.2	2.1	2.9
Poland	4.2	3.7	3.6	0.1	2.8	3.6	3.3
INFLATION							
Global	4.1	3.7	5.5	6.6	5.7	4.3	3.9
Developed countries	*2.1*	*1.6*	*3.7*	*4.6*	*2.6*	*2.3*	*2.3*
United States	2.8	1.8	4.6	4.1	3.0	2.9	2.6
Euro area	2.2	1.4	3.7	5.4	2.4	2.0	1.9
Germany	1.7	1.4	4.1	6.0	2.5	2.1	2.0
France	1.9	1.3	2.8	5.7	2.3	1.1	1.6
Italy	2.4	1.4	3.5	5.9	1.1	1.6	1.8
Portugal	3.1	1.1	3.0	4.3	2.4	2.1	2.0
Spain	3.2	1.3	3.7	3.5	2.8	2.5	2.0
Japan	–0.3	0.4	0.7	3.3	2.7	1.5	1.5
United Kingdom	1.6	2.3	4.2	7.3	2.5	3.1	2.3
Emerging and developing countries	*6.9*	*5.5*	*6.8*	*8.0*	*7.7*	*5.6*	*4.9*
China	1.7	2.6	1.8	0.2	0.2	0.5	1.0
India	4.6	7.3	6.1	5.7	5.0	4.6	4.4
Brazil	7.3	5.7	6.9	4.6	4.4	4.9	4.2
Mexico	5.2	4.2	5.7	5.5	4.7	4.4	3.7
Russia	14.2	7.9	8.0	5.9	8.5	8.4	6.0
Türkiye	22.6	9.6	34.7	53.9	58.5	36.1	26.1
Poland	3.5	1.9	7.4	10.8	3.7	4.6	3.4

Note: *1. Figures adjusted for seasonality and calendar effects for the euro area, Germany, France, Italy, Portugal, Spain and Poland. Figures adjusted for seasonality for the United States and the United Kingdom.*

Forecasts

Change in the average for the year versus the prior year average (%), unless otherwise indicated

Portuguese economy

	Average 2000-2007	Average 2008-2019	Average 2020-2022	2023	2024	2025	2026
Macroeconomic aggregates							
Household consumption	1.8	0.5	1.2	1.9	3.2	2.0	2.1
Government consumption	2.2	–0.3	2.0	0.6	1.1	1.1	1.1
Gross fixed capital formation	–0.4	–0.7	2.9	3.6	3.0	1.9	4.7
Capital goods	3.4	2.7	5.5	5.6	6.5	–	–
Construction	–1.4	–2.4	2.6	1.2	1.4	–	–
Domestic demand (vs. GDP Δ)	1.3	0.0	1.9	1.7	2.7	1.8	2.2
Exports of goods and services	5.3	4.0	3.6	3.8	3.4	1.7	3.0
Imports of goods and services	3.6	2.7	4.0	1.8	5.0	2.2	3.3
Gross domestic product	**1.5**	**0.4**	**1.5**	**2.6**	**1.9**	**1.6**	**2.0**
Other variables							
Employment	0.4	–0.4	1.1	2.3	1.2	2.1	1.0
Unemployment rate (% of labour force)	6.1	11.4	6.6	6.5	6.4	6.3	6.4
Consumer price index	3.1	1.1	3.0	4.3	2.4	2.1	2.0
Current account balance (% GDP)	–9.2	–2.8	–1.1	0.6	2.2	1.7	1.4
External funding capacity/needs (% GDP)	–7.7	–1.5	0.1	2.0	3.3	1.9	1.6
Fiscal balance (% GDP)	–4.5	–5.1	–3.0	1.2	0.7	–0.1	–1.2

Forecasts

Spanish economy

	Average 2000-2007	Average 2008-2019	Average 2020-2022	2023	2024	2025	2026
Macroeconomic aggregates							
Household consumption	3.7	0.0	0.0	1.7	2.8	3.0	2.3
Government consumption	4.5	0.9	2.6	5.2	4.1	1.5	1.0
Gross fixed capital formation	5.7	–1.2	–1.0	2.1	3.0	4.3	3.1
Capital goods	4.9	0.2	–2.5	1.1	2.8	7.3	2.8
Construction	5.7	–2.6	–1.9	3.0	3.5	3.2	3.3
Domestic demand (vs. GDP Δ)	4.4	–0.2	0.7	1.6	2.7	2.6	2.1
Exports of goods and services	4.7	2.9	2.5	2.8	3.1	2.8	2.0
Imports of goods and services	7.0	0.2	2.5	0.3	2.4	3.9	2.5
Gross domestic product	**3.6**	**0.7**	**0.6**	**2.7**	**3.2**	**2.4**	**2.0**
Other variables							
Employment	3.2	–0.5	1.4	3.2	2.4	2.4	1.8
Unemployment rate (% of labour force)	10.5	19.5	14.5	12.2	11.3	10.6	10.2
Consumer price index	3.2	1.3	3.7	3.5	2.8	2.5	2.0
Unit labour costs	3.1	0.6	3.6	6.1	4.0	3.4	2.7
Current account balance (% GDP)	–5.8	–0.2	0.6	2.7	3.1	2.4	2.6
External funding capacity/needs (% GDP)	–5.2	0.2	1.4	3.7	4.2	3.4	3.6
Fiscal balance (% GDP)[1]	0.3	–6.5	–7.1	–3.5	–3.2	–2.8	–2.6

Note: *1. Excludes losses for assistance provided to financial institutions.*

Forecasts

Calm markets, latent risks

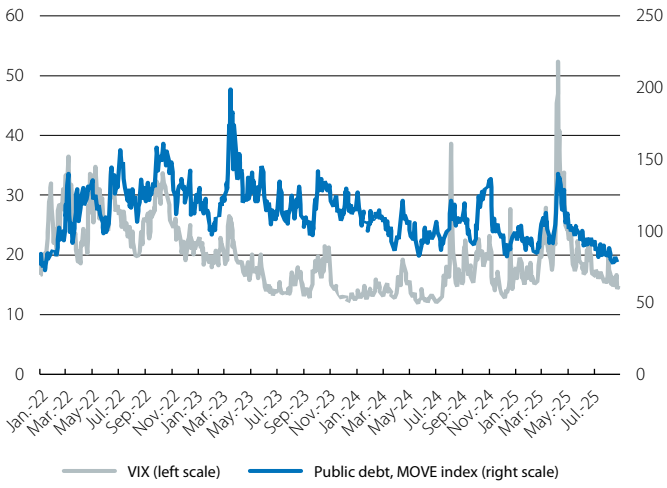
A summer of low volatility. The summer season tends to have lower trading volume and liquidity in the financial markets, so small pockets of instability tend to escalate rapidly, and volatility spikes are frequent. We only have to look back to August 2024 to recall how the depreciation of the yen sparked a massive global equity sell-off which knocked more than 8% off the main indices in just a couple of days. However, the summer of 2025 has been a period of relative calm in the financial markets, with the main measures of volatility remaining contained, despite the underlying instabilities of the macroeconomic environment: uncertainties over tariff agreements, the risk of erosion of the independence of institutions in the US, doubts about the direction of monetary policy, concerns about the fiscal outlook in the developed world and geopolitical risks, with a new source of instability in France.

Summer brings a change of gears between the Fed and the ECB. Whereas the ECB entered the summer cutting rates to neutral territory (depo rate at 2.00% since June) and the Fed did so maintaining a restrictive monetary policy (stable fed funds rate in the 4.25%-4.50% range since December 2024), the last few weeks have brought a certain shift in the outlook for September. According to financial market expectations, in the coming weeks it is likely to be the Fed that will cut rates and the ECB that will keep them unchanged. Specifically, for September the money markets are anticipating a 25-bp cut in the US with around a 90% probability, while they assign an almost 100% probability to a scenario with no change in the ECB's rates and the depo rate remaining stable at 2% through to the end of the year. This shift in market expectations is linked to the messages conveyed by the Fed and the ECB in recent weeks. On the one hand, when the Fed held rates in July, most of its members were more concerned about inflation risks than employment risks and only two members supported a cut. However, the publication of weaker-than-expected labour market data (see the International Economy - Economic Outlook section) led Chair Powell to acknowledge at the annual Jackson Hole symposium that «the shifting balance of risks may warrant adjusting our policy stance». Powell thus opened the door to a rate cut in September, without making any commitments and still awaiting the inflation and employment data for August. Within the ECB, meanwhile, President Lagarde acknowledged that the recent trade agreements have eased global uncertainty (but not eliminated it) and highlighted the resilience of the euro area economy. More emphatically, Isabel Schnabel explained that she sees no need for any changes in monetary policy stance in September. In addition, the latest data reflect an encouraging view of inflation (practically at the target rate since June), which, according to the ECB's messages, reinforces an approach of waiting and seeing how the data and uncertainty evolve.

In the US, sovereign yields are in line with monetary policy expectations but they do not seem to fear institutional risk. The growing expectation that the Fed will resume rate cuts from September and maintain the path of monetary easing through to the end of 2026 drove down treasury yields in the short ends of the sovereign curve (between 6 months and 5 years). This was

Measures of volatility

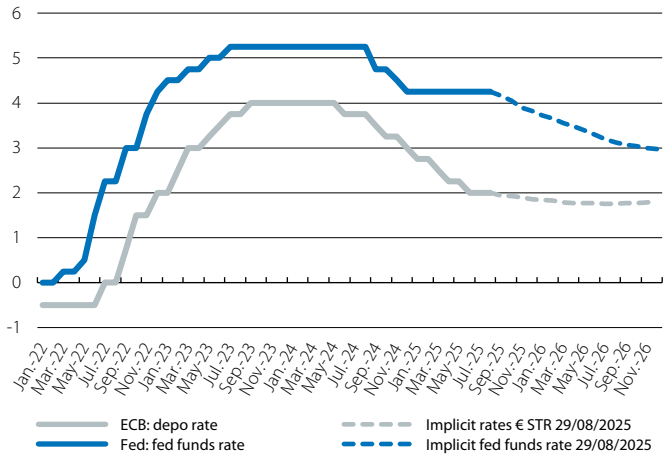
Index *Index*



Source: *BPI Research, based on data from Bloomberg.*

ECB and Fed: interest rates

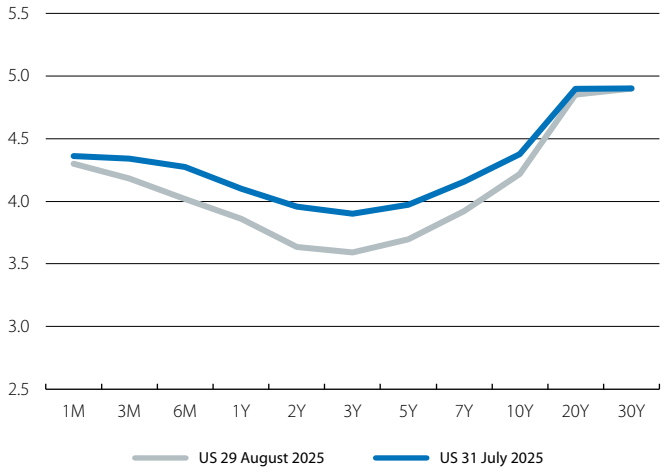
(%)



Note: *The historical data for the fed funds rate correspond to the lower bound.*
Source: *BPI Research, based on data from the ECB, the Federal Reserve and Bloomberg.*

US: sovereign yield curve

Yield (%)



Source: *BPI Research, based on data from Bloomberg.*

particularly the case for the 2-year benchmark, which is especially sensitive to monetary policy and fell more than 30 bps in August. On the other hand, the longer sections showed a more stable pattern of behaviour: the 10-year benchmark fell by around 15 bps, while the 30-year one closed the month practically flat. This differential performance between short and long yields partly reflects the expectation that, even if the Fed lowers rates, underlying fiscal pressures will keep long-term yields high. Also of note is the almost complete lack of reaction in the long-term references to the growing pressures from the White House on the Fed's independence. These pressures intensified with Trump's dismissal of Lisa Cook, a member of the Federal Reserve Board of Governors, accusing her of mortgage fraud; a decision which Cook has already challenged in court, where her future in the role will be determined.

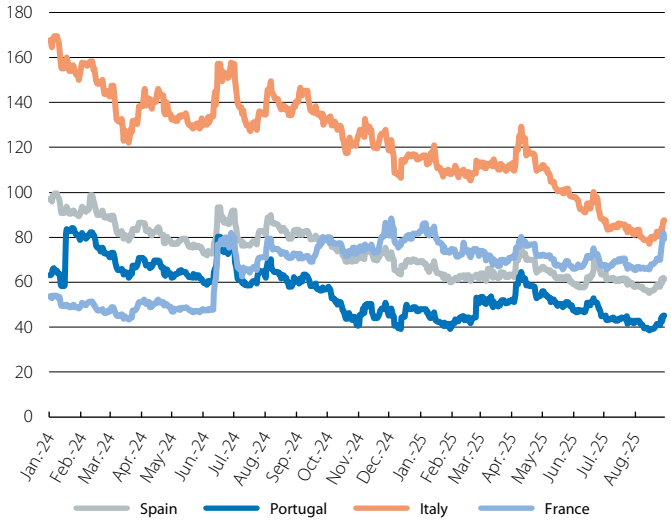
France emerges as a new source of instability. With no surprises from the ECB nor any major changes in monetary policy expectations in the euro area, the region's sovereign yields went through the summer with little change, and the euro-dollar continued to trade in the 1.16-1.17 dollars per euro range. France stood out as an exception within this scenario of relative stability: following the announcement of the vote of confidence, its risk premium surged more than 11 points in just three days, approaching the levels of the Italian premium, and with the 10-year sovereign yield around 3.50% (the highest level since March this year). The contagion effect on the rest of the periphery remained contained, without any shocks in the other risk premiums. Nevertheless, there has been a recent rebound in long-term sovereign yields, as September began with global sovereign bond sales on the back of growing concerns about the fiscal outlook in developed economies.

Another month of gains in the stock markets. The global stock index climbed 2.3% in August and has accumulated gains of 13% so far this year, despite the challenging economic context. In the month, the gains were particularly pronounced in the IBEX 35, driven by the good performance of the banking sector, and in the S&P 500, where the good earnings season and hype around AI once again boosted the performance of the US' stock market. France's CAC 40 lagged behind, as the political instability ended up weighing down share prices and the index slipped 2% in the last three days of the month alone, following the announcement of the confidence motion.

Crude oil stable while gold continues to «shine». The cessation of the air strikes between Iran and Israel, as well as the various tariff negotiations between Trump and other countries, favoured a reduction of the risk premium imposed by investors on the price of oil during much of August. Adding to this situation was the continued expansion of oil production by OPEC countries. However, the price of the Brent barrel stabilised and was trading between 66 and 68 dollars. This trend was maintained during the opening sessions of September, pending the decision from producing countries on potential further production increases and amid the IEA's expectation of excess oil supply over the coming quarters. The price of gold reached a new high (3,500 dollars per ounce) amid heightened uncertainty among investors regarding inflation, debt and fiscal discipline.

Euro area: risk premiums

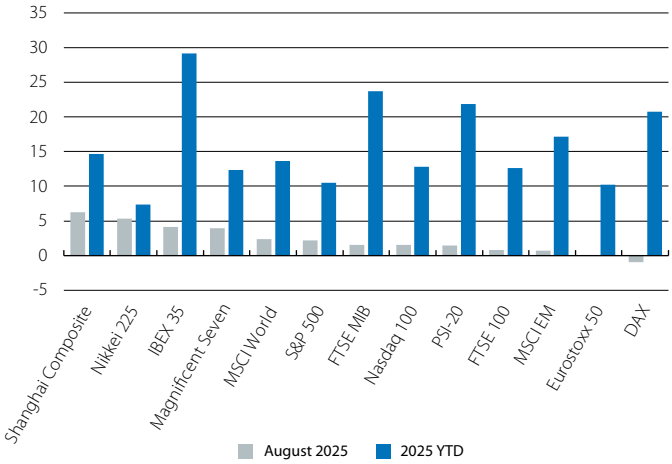
(bps)



Source: *BPI Research, based on data from Bloomberg.*

Stock market indices

Change (%)



Source: *BPI Research, based on data from Bloomberg.*

Commodity prices

Change (%)

	Measure	Price	Change (%)			
			Last month	YTD	2023	2024
Commodities	**Index**	**103.5**	**2.8**	**4.8**	**–12.6**	**0.1**
Energy	**Index**	**27.7**	**–2.6**	**–6.0**	**–25.6**	**–3.9**
Brent	$/barrel	67.8	–2.7	–9.1	–10.3	–3.1
Natural gas (Europe)	€/MWh	31.6	–7.0	–35.4	–57.6	51.1
Precious metals	**Index**	**352.0**	**7.4**	**32.2**	**4.1**	**19.0**
Gold	$/ounce	3,542.5	5.0	35.0	13.1	27.2
Industrial metals	**Index**	**143.2**	**2.7**	**2.1**	**–13.7**	**–1.6**
Aluminium	$/MT	2,619.0	2.1	2.6	0.3	7.0
Copper	$/MT	9,980.5	3.6	13.8	2.2	2.4
Agricultural commodities	**Index**	**55.1**	**3.7**	**–3.3**	**–9.3**	**–8.7**
Wheat	$/bushel	513.0	–0.7	–7.0	–20.7	–12.2

Note: *Data as of 3 September.*
Source: *BPI Research, based on data from Bloomberg.*

What is behind the ECB's interest rates

The ECB has completed a monetary cycle, leaving the negative rates and unconventional measures of the last decade behind and significantly tightening monetary policy since 2022. Since 2024, with inflation gradually being brought under control, the ECB has been easing its interest rates until inflation has virtually reached the target (2%) and monetary policy has entered neutral territory (depo rate at 2.00%).

During this cycle, the ECB has also adjusted the structure it uses to guide and implement monetary policy over the course of the business cycle, and it has done so through two spheres: its strategy and its operational framework.

Monetary strategy: a guide for a volatile economy

The ECB's strategy is the framework that guides its decisions, and it encompasses a vision of the economic environment, monetary policy objectives and a reaction function which sets out how its objective can be achieved given the constraints of the environment. The last time the ECB reviewed its strategy was in 2021: it did so influenced by a decade of low inflation and weak demand and a focus on measures aimed at combating deflation and the threat of the zero lower bound.[1] Today the environment is very different, and this change is evident in the ECB's 2025 strategy update.

The new strategy is based on the view that structural transformations, such as the geopolitical reordering and climate change, result in a more uncertain and volatile economic environment. For the ECB, this means that instances of inflation deviating from the target may become more frequent, persistent and pronounced, and these deviations can be either negative, as in 2010-2019, or positive, as in 2021-2024. Thus, it is not enough to merely reaffirm the key elements of the existing strategic framework; rather, it is necessary to clarify some of the weaknesses identified in recent years.

The continuity of the key pillars provides certainty about the ECB's course of action. There is no change in the inflation target (2%, symmetric, medium-term and referenced to the HICP)[2] or in the official toolbox (interest rates and unconventional measures such as asset purchases, TLTROs and forward guidance). The commitment to climate considerations is also reiterated, as they are relevant to price stability. However, the new strategy incorporates a more balanced reaction function, emphasising that the ECB must

ECB strategy and operational framework review: key points

Strategy review	
Environment	Increased uncertainty and volatility due to structural changes (geopolitics, AI, demography, climate change, etc.).
Inflation target	2%, symmetrical and medium-term.
	Metric: HICP.
Tools	Primary instrument: interest rates.
	Unconventional measures are also included (negative rates, QE, forward guidance, etc.), subject to a proportionality assessment.
Reaction function	Respond to significant and sustained deviations from the target, both positive and negative.
	Disinflationary shocks: zero lower bound risk.
	Inflationary shocks: risk of non-linearity in price-wage relationship.
Other considerations	Implications of climate change for monetary policy.
	Financial stability as a necessary condition for price stability.
Review	Last: 2025.
	Next: 2030.

Operational framework	
Implementation principles	Effectiveness, robustness, flexibility, efficiency and proper functioning of financial markets.
	Without prejudice to the primary objective (inflation) and the foregoing principles, facilitate the secondary objectives (support for general EU economic policies and, in particular, the green transition).
Interest rates	Main benchmark: depo rate.
	Refi – depo rate spread of 15 bps (previously: 50 bps), MLF – refi rate spread remains at 25 bps.
Liquidity	Injected through multiple instruments, but with MROs playing a key role.
	MROs and 3-month LTROs remain fixed-rate tender and full allotment.
	Structural longer-term credit operations and a structural asset portfolio will be introduced to cover liquidity requirements due to autonomous factors and reserve requirements. Without interfering with the monetary policy position.
	Broad collateral framework.
Reserves	Reserve ratio (for determining minimum requirements) of 1% and remuneration of 0% for minimum reserves.
Review	Last: 2024.
	Next: 2026 (review of parameters).

Note: *HICP, harmonised index of consumer prices; LTRO, longer-term refinancing operations; MLF, marginal lending facility; MRO, main refinancing operations; QE, quantitative easing, referring to asset purchases for monetary policy purposes.*
Source: *BPI Research, based on data from the ECB.*

1. The zero lower bound refers to the principle that rates cannot be lowered significantly below 0%. See the Focus «The cost of negative rates: the case of the Riksbank» in the MR03/2020.
2. The ECB also reiterated that it would like the HICP to incorporate more representative measures of housing costs. The HICP, which is calculated by Eurostat, only includes rents that are paid, accounting for less than 6% of the total index.

react to inflation deviations that are persistent and significant (in volatile times, this allows for a degree of tolerance of moderate deviations, avoiding the temptation to fine-tune monetary policy in response to every new data point), including both negative deviations (as emphasised under the previous strategy) and positive ones. In the same spirit, the ECB has introduced agility as a key characteristic of its unconventional measures, which in the future could translate into the inclusion of «escape routes» in the design of these tools so that, in the event of a sudden change in the scenario (as occurred in 2022), the ECB can shift its monetary policy without the need for an overly slow withdrawal of any stimulus measures in place.[3]

Operational framework: the liquidity transition

The review of the operational framework is much more substantial, at least formally, as in practice it formalises operations that had been introduced out of necessity following the 2008 financial crisis (such as establishing the depo rate as the reference interest rate or maintaining fixed-rate, full allotment [FRFA] in refinancing operations).[4] However, the challenge of the operational framework lies in the future: guaranteeing that the ECB's drainage of liquidity[5] does not compromise the implementation of monetary policy. The ECB wants to move from the current environment of abundant liquidity, injected at the time by the central bank itself through unconventional measures, to a world in which the financial system itself determines the liquidity that it wishes to possess: that is, to move from a system governed by the supply of liquidity by the central bank to a system driven by the liquidity demands of financial institutions.

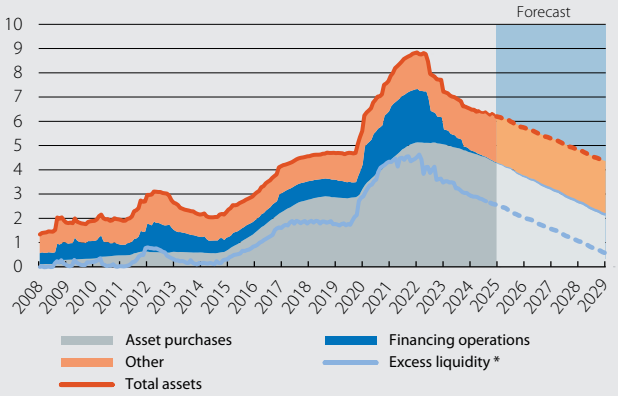
The vision is that a demand-driven system is more efficient (demand is self-satisfying and ensures a proper distribution of liquidity) and robust, as well as reducing the central bank's footprint in financial markets.[6] To implement this, the ECB will make its regular refinancing operations the main source of the central bank's direct liquidity (especially seven-day MROs, but also 3-month LTROs). In addition, in the coming years the ECB will launch two new instruments for supplying reserves: structural longer-term refinancing operations and a structural asset portfolio. The intention is that these two instruments will not interfere with the position (stimulus or restriction) of monetary policy; rather, being long-term, they will provide stability to financial institutions' liquidity needs (and not force them into continuous, large-scale refinancing operations).

The ECB also anticipates that the markets will become a more significant source of financing. This has influenced the decision to narrow the gap between its refi rate (the cost of borrowing from the ECB through MROs) and depo rate (the remuneration provided for depositing liquidity in the ECB). The ECB has reduced this spread from 50 bps to 15 bps, with the dual objective of making MRO loans more attractive (de facto, the refi rate is reduced by 35 bps) and reducing the volatility of interbank interest rates. At the same time, it aims to maintain a sufficiently wide spread between the refi and depo rates so as to preserve the incentives to lend and borrow in the markets.[7] However, the transition will be a gradual one, given that the ECB's drainage of liquidity is progressing slowly[8] (see second chart) and the revival of demand for new liquidity is still only incipient (see third chart).

Taken together, these changes in strategy and operations demonstrate that the ECB has gone through a demanding cycle and has taken note, equipping itself with greater efficiency and flexibility in order to deal with an environment that is at risk from a wide array of shocks (ranging from supply shocks and stagflation scenarios to declines in demand and the risk of the zero lower bound).

ECB balance sheet: total assets

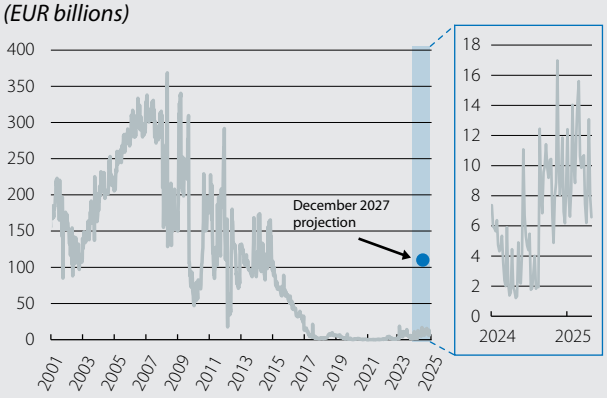
(EUR trillions)



Note: ** Deposits in the deposit facility plus excess reserves less use of the marginal lending facility.*
Source: *BPI Research, based on data from the European Central Bank (ECB) and internal forecasts.*

Use of the ECB's MROs by European banks

(EUR billions)



Note: *The December 2027 projection corresponds to the median expectation per the Survey of Monetary Analysts (MROs + 3-month LTROs).*
Source: *BPI Research, based on data from the ECB.*

3. The mere sending this message is, in itself, an example of an escape route, as it communicates that the ECB wants to be able to quickly abandon unconventional measures if the scenario so requires.
4. Fixed-rate, full allotment: i.e. at the fixed interest rate announced by the ECB, each bank gets as much liquidity as it desires.
5. The ECB is undertaking a withdrawal of liquidity from the financial system through the winding down of its asset purchase programmes and the already completed repayment of its TLTROs (long-term loans).
6. See the Focus «The ECB, in the midst of a review» in the MR12/2023.
7. Institutions that lend can obtain remuneration above the depo rate, and those that borrow pay a cost that is less than the refi rate.
8. It does so passively, by not reinvesting the principal of the assets acquired years ago under the APP and PEPP purchasing programmes, which are now gradually reaching maturity.

Interest rates (%)

	31-August	31-July	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	2.15	2.15	0	–100.0	–210.0
3-month Euribor	2.06	2.01	5	–65.3	–142.9
1-year Euribor	2.12	2.13	–1	–34.1	–96.9
1-year government bonds (Germany)	1.90	1.88	2	–34.2	–92.4
2-year government bonds (Germany)	1.94	1.96	–2	–14.2	–45.1
10-year government bonds (Germany)	2.72	2.70	3	35.7	42.5
10-year government bonds (Spain)	3.33	3.28	6	26.9	19.7
10-year government bonds (Portugal)	3.18	3.12	6	33.2	26.9
US					
Fed funds (lower limit)	4.25	4.25	0	0.0	–100.0
3-month SOFR	4.17	4.30	–13	–13.4	–84.6
1-year government bonds	3.83	4.09	–26	–30.9	–56.9
2-year government bonds	3.62	3.96	–34	–62.5	–30.0
10-year government bonds	4.23	4.37	–15	–34.1	32.5

Spreads corporate bonds (bps)

	31-August	31-July	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	55	54	2	–2.3	2.9
Itraxx Financials Senior	59	56	3	–4.3	–0.9
Itraxx Subordinated Financials	101	96	5	–11.3	–6.5

Exchange rates

	31-August	31-July	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.17	1.14	2.4	12.9	5.8
EUR/JPY (yen per euro)	171.9	172.1	–0.1	5.6	6.4
EUR/GBP (pounds per euro)	0.87	0.86	0.1	4.6	2.9
USD/JPY (yen per dollar)	147.1	150.8	–2.5	–6.5	0.6

Commodities

	31-August	31-July	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	554.89	562.11	–1.3	3.4	3.5
Brent ($/barrel)	68.12	72.53	–6.1	–8.7	–13.6
Gold ($/ounce)	3,447.95	3,289.93	4.8	31.4	37.7

Equity

	31-August	31-July	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	6,460	6,339	1.9	9.8	14.4
Eurostoxx 50 (euro area)	5,352	5,320	0.6	9.3	7.9
Ibex 35 (Spain)	14,936	14,397	3.7	28.8	31.0
PSI 20 (Portugal)	7,760	7,712	0.6	21.7	14.8
Nikkei 225 (Japan)	42,718	41,070	4.0	7.1	10.5
MSCI Emerging	1,258	1,243	1.2	17.0	14.4

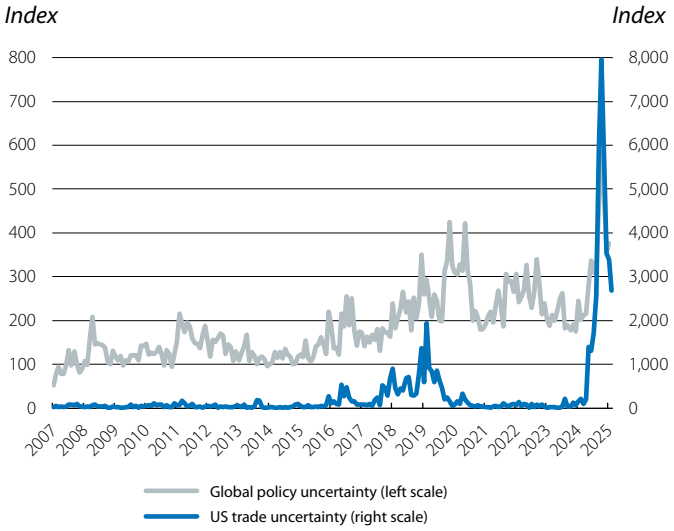
The international economy holds up over the summer

A resilient global economy, with less uncertainty but higher tariffs. The economy returned from the summer break with resilient activity indicators (global composite PMI of 52.9 points in August, a 15-month high) and a reduction in uncertainty surrounding trade relations in the short term. The US and the EU reached an agreement establishing a general 15% tariff on exports of goods from the EU to the US, including cars, semiconductors and pharmaceuticals, as well as preferential treatment for a number of strategic products and a European commitment to make purchases and investments in key US industries. Japan also agreed on a 15% tariff with the US, while the US and China extended their truce and continue to negotiate, with a new deadline set for November. Other economies received more severe US tariffs, especially Brazil and India (50%), as well as Switzerland (39%). In addition, the US eliminated the *de minimis* exemption (products with a value of less than 800 dollars) for all countries and set a 50% tariff on copper. All this leaves an effective average US tariff of close to 17% (the highest level since 1934, and a far cry from the rate of 3% or lower that had prevailed in the last 50 years).

The sources of uncertainty persist. Not only are important trade negotiations still pending, but uncertainty also persists over how long the agreements already reached will last, as well as legal uncertainties (the US Court of Appeals has declared the general bilateral tariffs established under the IEEPA to be illegal), although they remain in force until at least 14 October and the case is likely to be brought before the Supreme Court. There is also uncertainty regarding the macroeconomic impact of the tariffs, ranging from their transmission throughout global and domestic production chains and price formation to possible global reconfigurations of trade flows. On the other hand, politics is harbouring more sources of uncertainty in Europe. In recent weeks, France has suffered a tensioning of its risk premium in the face of a possible fall of François Bayrou's government and a slower correction of its public accounts: in 2024, the budget deficit was 5.8%, the highest in the euro area; public debt, at 113%, is the third highest in the euro area (behind Greece and Italy) and it lies at practically the same level as that of 2020 and 15 pps above that of 2019.

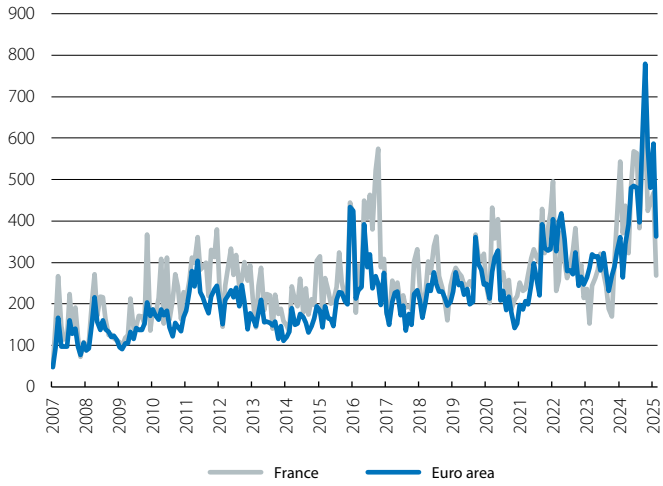
Reversal effects on GDP. The Q2 data show the reversal of the «anticipation effects» due to the entry into force of the US tariffs. After the import boom in Q1 in anticipation of the tariffs caused a drop in US GDP and boosted exports from the other major economies, in Q2 US GDP rebounded 0.8% quarter-on-quarter. This was driven by a significant positive contribution from the foreign sector, albeit one with a mixed composition: a marked fall in imports, a slight decline in exports and slower than usual growth in private consumption and investment. These swings in international trade with the US weighed on Chinese exports in Q2, although the economy compensated for it with higher exports to ASEAN countries and other economies, and China's GDP continued to record solid growth in Q2 (+1.1% quarter-on-quarter, +5.2% year-on-year). In the euro area, GDP slowed to

Economic uncertainty



Source: *BPI Research, based on data from www.policyuncertainty.com.*

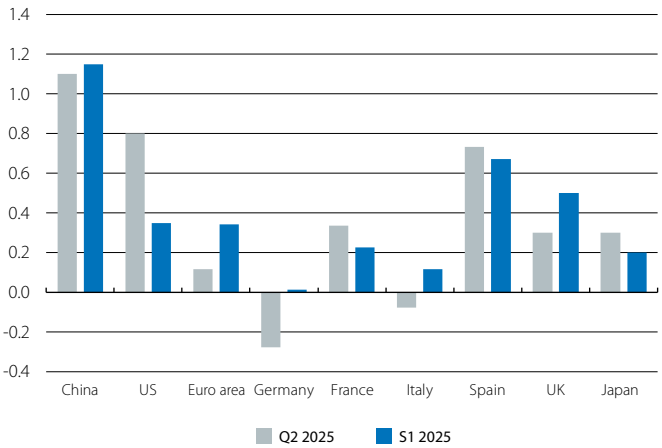
Economic policy uncertainty



Source: *BPI Research, based on data from www.policyuncertainty.com.*

Main economies: GDP

Quarter-on-quarter change (%)



Note: *S1 2025 is the average quarter-on-quarter change of Q1 2025 and Q2 2025.*
Source: *BPI Research, based on data from the Statistics Office of China, the Bureau of Labor Statistics, Eurostat, the ONS and the Statistics Office of Japan.*

0.1% quarter-on-quarter (vs. +0.6% in Q1 or +0.3% excluding Ireland), weighed down by the foreign sector, although the resilience of domestic demand reveals some positive underlying dynamics (in a context in which the unemployment rate fell to a low of 6.2% in July). By country, Germany and Italy contracted (–0.3% and –0.1%, respectively, in Q2 vs. +0.3% in Q1 in both cases) and France accelerated due to the accumulation of inventories (+0.3% in Q2 vs. +0.1% in Q1).

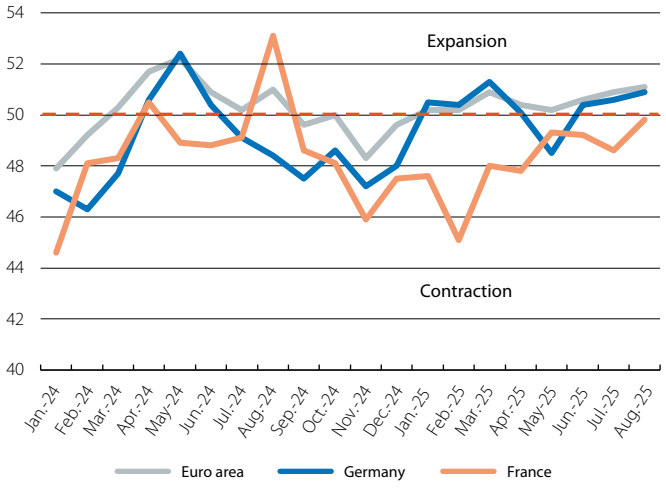
Signs of improvement in Europe's economic activity in Q3. The euro area faces the challenge in the coming months of adapting to new trade conditions with the US which are clearly less favourable than those in place prior to 2025, although the fiscal stimulus due to be deployed in the coming years (ReArmEU plan and the infrastructure plan in Germany) could mitigate some of the impact of the new trade landscape. In this regard, the latest business confidence indicators show some improvement, within a scenario of modest expansion in economic activity. Specifically, the region's composite PMI rose by around 0.5 points between July and August to reach 51.0 – while this indicates only modest growth, it nevertheless represents a peak since mid-2024. In addition, the improvement was widespread among the major economies and both in services and, especially, in manufacturing (in August, the manufacturing PMI [50.7] returned to expansive territory for the first time since June 2022). For July and August as a whole, the economic sentiment indicator also improved, although, like consumer confidence, it remained at somewhat meagre levels.

Signs of a not-so-robust US labour market. The bulk of activity indicators in the US point to a dynamic GDP in Q3 (the New York and Atlanta Feds' trackers indicate growth of 0.6%-0.7% quarter-on-quarter), but the most relevant figure over the summer was job creation. Specifically, the labour market created 51,000 new jobs per month on average in July and August (vs. 127,000 on average over the previous 12 months). Moreover, the statistical revision of the series revealed that just 6,000 jobs were created in May and June in total (vs. 291,000 initially estimated). The contrast between the loss of dynamism in job creation and an unemployment rate that is relatively stable at 4% suggests that the labour market may be cooling on both the demand and the supply side. Indeed, this was the reflection made by Fed Chair Jerome Powell at the annual Jackson Hole symposium, after which he opened the door to a rate cut in September (see the Financial Markets Economic Outlook section).

Inflation diverges between the two sides of the Atlantic. In the euro area, headline inflation was 2.1% year-on-year in August, virtually at the ECB's 2% target. Although core inflation, which excludes energy and food, remained at 2.3% year-on-year, behind this stability lies a low inflation figure for non-energy industrial goods (0.8%) and a services inflation that is slowly but steadily moderating (3.1% in August, its lowest level since April 2022). In contrast, inflationary pressures in the US remain at close to 3%, with the headline CPI standing at 2.7% year-on-year in July and core inflation accelerating to 3.0% (the highest record since February). However, these figures suggest that the impact of the tariffs on final consumer prices has so far been modest, with limited pressures on the items that should be most affected (electronic equipment, textiles, etc.).

Euro area: composite PMI

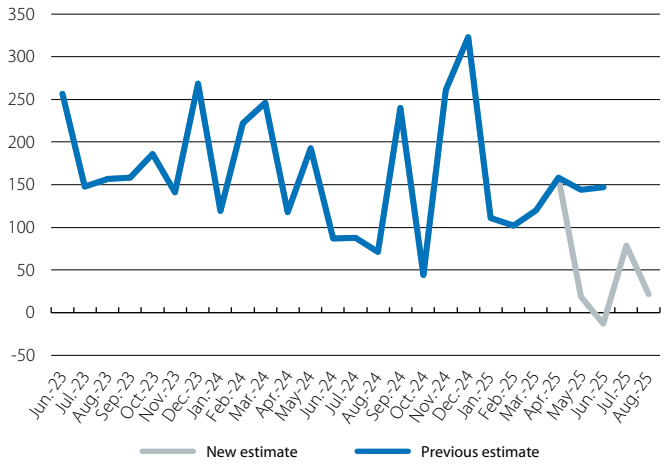
Index



Source: *BPI Research, based on data from S&P Global PMI.*

US: employment

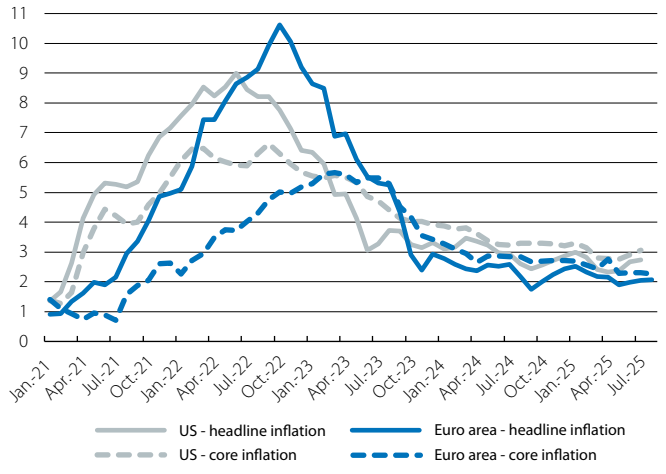
Monthly change (thousands)



Note: *Excludes the agricultural sector.*
Source: *BPI Research, based on data from the Bureau of Labor Statistics.*

Advanced economies: CPI

Year-on-year change (%)



Note: *Core inflation excludes energy and all food.*
Source: *BPI Research, based on data from the Bureau of Labor Statistics and Eurostat.*

5% of GDP on defence: Why? What for? Is it feasible?

The NATO summit held in The Hague on 24 and 25 June concluded with the commitment by its members to increase defence spending to 5% of GDP by 2035. The defence market is a natural monopsony in which demand is dominated by governments, so these types of commitments have an immediate implication for public finances, especially in a global context of fiscal constraints like the current one.[1] In Europe, it also coincides with the desire to give its economy a competitive boost on the basis of the Draghi report,[2] so there is significant competition for resources for other strategic areas, such as the green and digital transition. Here, we seek to understand the reasons behind NATO's commitment, explain what objectives are being pursued and assess to what extent it is reasonable to expect the EU to boost its defence spending in the coming years.

Why?

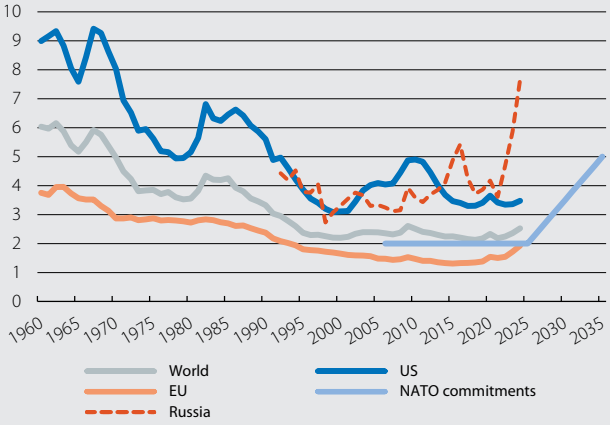
The establishment of defence spending commitments is nothing new to NATO. Indeed, since the Riga summit in 2006, a benchmark of 2% of GDP has been set, and this goal was reinforced at the Wales summit in 2014 following Russia's invasion of Crimea. The US' criticisms of the systematic failure of its European partners to meet these targets has not been exclusive to the Trump administrations; they also resonated with Obama and Biden in the White House, and the data show that they are justified in their criticism (see first chart). Another structural element is the mention of the threat posed by Russia to Euro-Atlantic security, materialised since 2022 with the invasion of Ukraine, and which has led to an unprecedented leap in the country's military spending and its transformation into a «war economy». However, under the current conditions – without any direct involvement of NATO members in a war – none of these factors alone would make it necessary to raise the commitment to 5% of GDP, a figure which the US last met in the final years of the Cold War and throughout the 1960s. Thus, the most reasonable justification should be sought in the desire to have a greater deterrent power in a more polarised geopolitical scenario, in which NATO members have gradually seen their role in the world economy wane, together with their share of absolute defence spending at the global level (from 75% 30 years ago to 55% today). In contrast, the sum of China, India and Russia has steadily increased and today exceeds 20% of the total (see second chart).

What for?

NATO's new commitment for 2035 is split between 3.5% of GDP to cover essential defence needs and capabilities – mainly equipment and personnel – including for its mobilisation, and 1.5% to protect critical infrastructure,

Global defence spending and NATO commitments

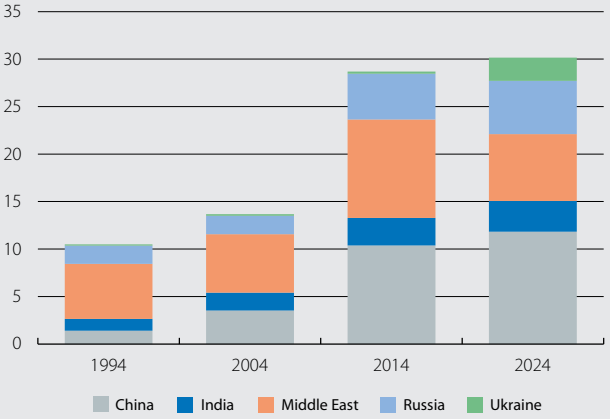
(% of GDP)



Source: *BPI Research, based on data from the World Bank and SIPRI.*

Non-NATO defence spending: selected countries

(% of global total)



Source: *BPI Research, based on data from SIPRI.*

increase civil and digital resilience, to foster innovation and to strengthen the industrial base. Thus, the first component is one that seeks to ensure a faster response in the short term to conventional threats and aggressions, while the second one would provide member countries with a more robust and broad-spectrum autonomous layer of security. Meeting these targets is undoubtedly a driving force behind more resources being employed, but qualitative considerations are just as relevant, if not more so.[3] In this regard, NATO has stressed the importance of a cooperative and coordinated systemic approach, with common standards and joint public procurement processes that facilitate the interoperability and interchangeability of equipment and weapons, as well as a more secure supply chain for the provision of critical materials to the defence industry.[4] This same diagnosis has

1. See the Focus «Debt limits» in the MR01/2025.
2. See the Focuses «Draghi proposes a European industrial policy as a driving force to address the challenges of the coming decades» in the MR10/2024 and «A shift in the EU's political priorities» in the MR04/2025.
3. Carnegie Endowment (2025). «Taking the pulse: does meeting the 5 percent of GDP target enable Europe to confront the Russian threat?».
4. NATO (2024). «NATO industrial capacity expansion pledge», and NATO (2024) «Defence-critical supply chain security roadmap».

been carried out by European institutions in recent years,[5] presenting, as highlighted in the Draghi report, three particularly marked weaknesses of the defence sector vis-à-vis the US: the fragmentation of its internal market – which affects both its industry and governance – the high external dependence and the low percentage of spending on research, development and innovation.

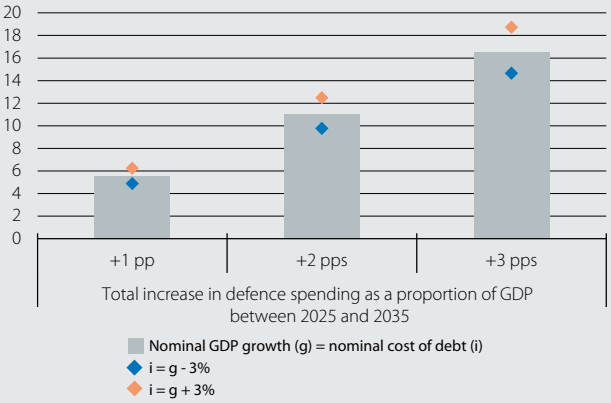
Is it feasible?

In the EU, the various initiatives proposed by the European Commission to finance the expansion of defence spending leave the bulk of the fiscal effort in the hands of Member States. On the one hand, the first measures presented in March and already endorsed by the Council – which include a new 150-billion-euro loan instrument (SAFE) to promote joint purchases, and the possibility of deviating from the spending rule over the next four years by up to 1.5% of GDP – has generated little enthusiasm among Member States with limited fiscal margin. These measures fail to cushion the significant impact that the new defence commitments will have both on public debt (see some scenarios in the third chart),[6] with risks of pushing up the cost of sovereign financing, and on additional adjustments to those already required by the medium-term fiscal plans (see fourth chart).[7] This latter impact could have potential implications for income growth and distribution, depending on the value of the various fiscal multipliers and on which taxes and/or expenditure items the compensatory measures are concentrated in.[8] In fact, in this context, Spain, France and Italy have not requested the activation of the escape clause, significantly reducing the scope of this measure to around 200-300 billion euros compared to the 600 billion initially estimated. On the other hand, the appetite of the so-called «frugal countries» to push for a new NGEU-style joint debt-issuance spending programme seems to have been diluted in recent months, as priority has instead been given to pursuing national proposals, as in the case of Germany. Moreover, the increase proposed by the European Commission for the next budget cycle[9] is dwarfed by the magnitude of the commitments reached within NATO.

5. EEAS (2022). «A strategic compass for security and defence», European Commission (2022), «Defence Investment Gaps Analysis and Way Forward» and European Commission (2025), «White Paper for European defence - Readiness 2030».
6. The scenarios in the third chart show the increase in public debt derived exclusively from different increases in defence spending (1 point, 2 points or 3 points of GDP between 2025 and 2035, distributed proportionally over each of the next 10 years), and in each case the sensitivity to a negative, neutral or positive gap between nominal GDP growth and the nominal cost of public debt. We assume that the increase in defence spending is not compensated for by higher taxes or reduced spending elsewhere.
7. See the Focus «The new EU economic governance framework» in the MR01/2025.
8. Regarding fiscal multipliers, see V. Sheremirov and S. Spirovska (2022) «Fiscal multipliers in advanced and developing countries: Evidence from military spending», Journal of Public Economics.
9. See the Focus «The 2028-2034 EU budget: An impossible mission?» in this same *Monthly Report*.

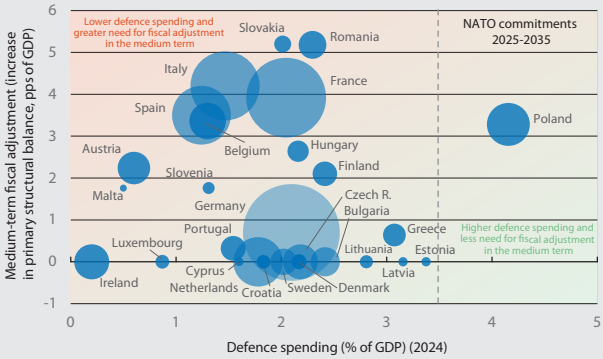
Increase in defence spending: impact on the public debt to GDP ratio

(pps)



Note: *We assume a gradual annual increase in defence spending between 2025 and 2035.*
Source: *BPI Research.*

Current defence spending and projected fiscal adjustment in the medium term in EU countries



Notes: *Total fiscal adjustment during the period covered by the medium-term fiscal-structural plans (4 years or 7 years with an extension). The area of the circles is proportional to the nominal GDP of 2024 in euros. Eurostat 2023 data for non-NATO countries (Austria, Cyprus, Ireland and Malta).*
Source: *BPI Research, based on data from NATO, Eurostat and the European Commission.*

At this juncture, in the current geopolitical scenario, the motivations for wanting to boost defence spending above current levels are understandable. There are also aspects that need to be strengthened in public procurement processes and in Europe's defence industry in order to meet the emerging challenges with guarantees. Nevertheless, the aspiration of reaching 5% of GDP is undoubtedly highly ambitious. Taking a reference level of 3%-3.5%, in 10 years this figure would compensate for the deficit in defence spending accumulated by European governments in recent decades – a considerable effort. The fiscal bill could be lowered through a precise identification of critical priorities, better coordination to reduce costs and avoid duplication, and encouraging synergies with the private sector in the field of innovation; this would also allow progress to be made in other strategic areas in order to raise the potential growth of the European economy.

The 2028-2034 EU budget: An impossible mission?

On 16 July, the European Commission presented its proposal for the 2028-2034 EU budget, kick-starting a negotiation process with the Council and the European Parliament that could continue through to the end of 2027. In order to give the EU genuine strategic autonomy, the next budget should pursue two key objectives: to revitalise European competitiveness – following the guidelines laid out in the Draghi report – and to address the challenges of global geopolitics, including increased trade protectionism and the commitments assumed within NATO. Achieving these objectives will require vast resources to be mobilised. However, the capacity of the private sector to do so is yet to be seen, while on the public side, it seems that it will fall on national budgets, which today have limited degrees of freedom. In short, this will be quite some balancing exercise.

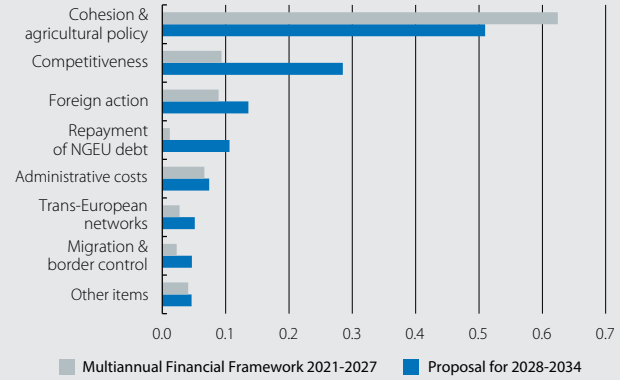
A cycle with new priorities

The Commission's proposal for the next budget (Multiannual Financial Framework as termed in Brussels) puts the total volume of resources at close to 2 trillion nominal euros, which represents an annual average equivalent to 1.3% of the EU's expected GDP between 2028 and 2034.[1] This figure represents a quantitative leap compared to the previous budget, which amounted to just over 1.2 trillion euros (1% of the average nominal GDP for 2021-2027), although this was then reinforced by 800 billion euros of NGEU funds, of which the repayment of the joint debt issued to finance it would now absorb 168 billion. In addition, for the sake of simplicity and flexibility, the proposal entails a reduction in the number of thematic areas and EU programmes, as well as changes in their implementation, facilitating the reallocation of funds according to needs and including a transformation of structural funds (social and territorial cohesion, and agricultural policy) in the direction marked by the NGEU funds.

The focus of the funds has also been substantially changed in response to the strategic priorities review (see first chart). Some of the main innovations include the creation of a Competitiveness Fund allocated with a budget of 409 billion euros, which becomes the EU budget's main vehicle for pursuing the investment agenda proposed by the Draghi report.[2] The main recipients include the boost to innovation through the Horizon programme (175 billion) and the defence and space industries (131 billion), both with a significant increase over the 2021-2027 cycle, while the rest will be allocated to the clean transition, digital leadership and various bioeconomy sectors. These funds are complemented by a bigger budget for the Connecting Europe facility for trans-European transport networks (including military mobility) and energy networks (81 billion in total).

Main elements of the EU budget

(% of annual GDP)



Notes: *In nominal terms relative to the average GDP of each period. Initial commitments approved by the Council for the period 2021-2027 (excluding NGEU) and proposal by the European Commission for 2028-2034.*
Source: *BPI Research, based on data from the European Commission.*

As for other strategic areas, of particular note is the significant increase in resources allocated to international cooperation and support for EU candidate countries. Thus, the Global Europe instrument is bolstered up to 200 billion, while two funding lines outside the budget are proposed to cover needs linked to the war in Ukraine and the country's future reconstruction (for a total of 131 billion). At the same time, funds for the management of migration, asylum and border control are increased (up to 74 billion). Finally, with emergency management such as COVID-19 in the forefront, the Commission's proposal includes a new transitional lending mechanism which is allocated 395 billion – also outside the budget – for potential future crises, which would be in addition to other EU funds aimed at building resilience in the spheres of health and civil protection.

The eternal funding dilemma

The new Competitiveness Fund marks a step forward for leveraging a structural change in the European economy, but its impact is expected to be limited without a full Savings and Investment Union to mobilise the necessary private capital. This will be particularly important for financing innovative projects that can drive the digital transformation and lead to productivity gains, as well as for supporting the green transition with the formation of a European clean technology industry. On the other hand, the EU effort proposed in some areas, especially in defence, appears to fall short of the current investment deficits and the commitments assumed, suggesting that the public contribution will have to come largely from national budgets that are already under significant stress in most Member States (see «5% of GDP on defence: why? What for? Is it feasible?» in this same *Monthly Report*).

1. European Commission (2025). «The 2028-2034 EU budget for a stronger Europe».
2. See the Focus «A shift in the EU's political priorities» in the MR04/2025.

As in previous budget cycles, the debate over funding will remain intense up until its adoption. In contrast to the positions that demand the extension of the model used for the NGEU funds, with joint debt and non-reimbursable transfers, another group of countries is showing their usual reluctance, now reinforced given that the bill for those issues will absorb 8% of the total EU budget (24 billion each year). In short, although the combined fiscal space is wider than the individual one, with the consequent gains in terms of financing costs, Europe's public finances are starting from a position with relatively high debt levels (87% of GDP in 2024).[3] In this context, the Commission's proposal provides for the possibility of using joint issues (up to 690 billion, somewhat less than NGEU), but only for the purposes of addressing certain contingencies (such as the new crisis mechanism) or for granting loans (either to Member States or to candidate countries, such as Ukraine).

Another noteworthy element is the proposal to increase own resources by around 350 billion for the whole period 2028-2034, which would represent around 20% of total expected revenues (see second chart). These would come from different sources, including the Emissions Trading System (ETS) and the Carbon Border Adjustment Mechanism (CBAM), as well as new taxes on waste from unrecycled electrical and electronic equipment, tobacco and a fixed business contribution according to the level of turnover. Some of these new resources were already proposed in 2020 for the current budget cycle and were not adopted.

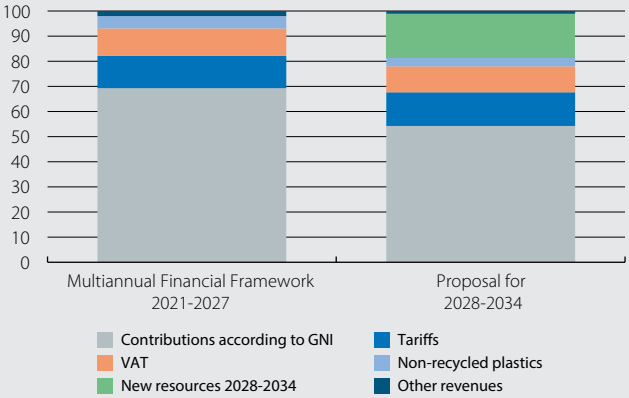
Cohesion and the green transition, key to the political negotiation

With regard to cohesion funds and agricultural policy (broadly including the environment and the climate transition), some voices point out that it is in these categories that the fiscal constraints and the EU's new strategic priorities have been most clearly reflected. Thus, the nominal resources allocated for these policies are set to remain stable relative to the commitments for 2021-2027 (around 800 billion), but they would decline both as a percentage of the total budget (from 64% to 40%) and relative to GDP (from 0.6% to 0.5% per year, as shown in the first chart). This reduction contrasts with the stagnation of the last 15 years in the convergence between European regions, given the significant gap that persists between the most developed regions in the north-west and those with the lowest income per capita in the east, which still have large rural areas and an important role played by their agricultural sector.[4] Moreover, a possible enlargement of the EU led by Ukraine would reinforce this diagnosis.

3. Includes 82% of GDP of national debt of Member States and 5% of GDP of pooled debt.
4. European Commission (2024). «Ninth report on economic, social and territorial cohesion».

Sources of funding for the EU budget

(% of total revenues)



Notes: *Gross national income (GNI) is equivalent to the sum of GDP and the foreign income balance from labour and capital. Own resources from tariffs also include agricultural taxes.*
Source: *BPI Research, based on data from the European Commission and the Council.*

In addition to this quantitative change in the structural funds is the proposal for a significant adjustment in how they are governed. Following the design of the NGEU funds, the Commission envisages the development of National and Regional Partnership Plans (NRPPs) which will encompass the reform and investment programmes of each Member State and would provide access to the resources allocated in the EU budget. Criticisms of the role that local and regional governments will have in this new scheme indicate that this will also be a central element of the emerging political debate. Another component that is due to be inherited from NGEU is the availability of loans for implementing the measures set out in the NRPPs. The Commission proposes a total of 150 billion, which could potentially raise the total resources for cohesion and agricultural policy to levels equivalent to the current ones, albeit with the difference that these loans would increase the level of national public debt, whereas the EU budget essentially includes non-refundable transfers between Member States.

Last but not least, the search for support in the European Parliament and for consensus in the Council will also pivot on the new Commission's apparent shift on the environmental and climate agenda. Criticisms point out that, despite the fact that the proposal maintains a target of 35% for EU expenditure in these areas, the follow-up of the commitments set out in the European Green Deal is lost, and the content of the measures seems increasingly subordinate to the competitive drive, with greater emphasis placed on supporting industrial decarbonisation and less on sustainable agriculture and biodiversity.

Undoubtedly, the negotiation of the next budget will once again test the health of the European project, on which our strategic autonomy needed to address the geopolitical challenges that will continue to come from abroad will depend.

Do tariffs work as a fiscal revenue tool in the US?

The use of tariffs has become a centrepiece of the Trump administration's economic policy. With this strategy, the White House has declared that it is pursuing three main goals: protecting domestic industries and repatriating manufacturing to US soil (including bolstering economic independence in strategic sectors), correcting the trade deficit, and boosting revenues to fund part of the growing fiscal deficit. However, these objectives are difficult to reconcile with one another. It is difficult to curb imports in order to defend local production while relying on them as a source of tax revenues. In fact, the more successful trade policy is in restricting imports, the lower the revenues that can be expected. This underlying tension raises doubts about the power of tariffs as a revenue source, and it is precisely on this point that we focus the analysis of this article.

Effective tariff: from 2% to 15%... to what level?

As of August 2025, we estimate that the average effective tariff applied by the US stands at around 17%. This represents an increase of 2 pps compared to our June estimate[1] and one of 15 points since the beginning of the year. This level reflects the accumulation of measures introduced between February and June: the universal tariff of 10%, 50% on steel and aluminium, 25% on cars, as well as 35% on Canada, 25% on Mexico[2] and 45% on China. It also incorporates adjustments resulting from bilateral agreements reached in the summer with partners such as the United Kingdom (10%), the EU (15%) and Japan (15%), where cars are taxed according to the country-specific tariffs in place. It also includes the new, higher tariffs affecting countries such as Switzerland (39%), India (50%) and Brazil (50%). It should be noted that some negotiations remain ongoing: China (deadline on 10 November), Mexico (deadline at the end of October), the EU (pending, inter alia, the list of strategic products subject to 0%) and possible sector-specific tariffs on electronic and pharmaceutical products, so the final level is yet to be known.

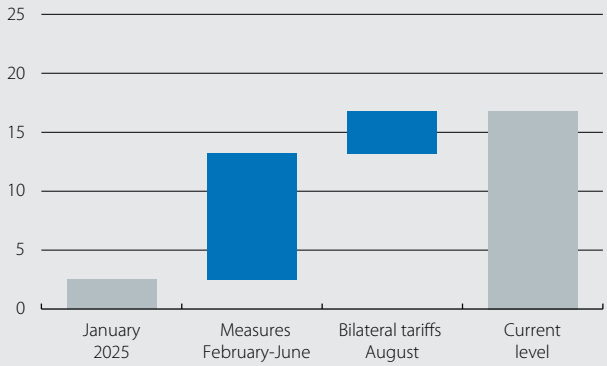
Revenues from tariffs: from 0.3% of GDP... to 1%?

Historically, US Treasury revenues from tariffs have been marginal, since up until recently they had not been intended as an important fiscal policy instrument or tax collection mechanism. The main sources of income have traditionally been corporate and personal income taxes, which together have accounted for some 60% of total revenues, equivalent to around 10% of GDP. By comparison, tariffs have contributed just 2% of total tax collections and 0.3% of GDP.[3]

1. See the Focus: US tariffs: where do we stand and what comes next? in the MR06/2025.
2. The tariff imposed on Mexico and Canada only applies to goods that do not meet the conditions of the USMCA.
3. If we exclude revenues from Social Security contributions, income from corporate and personal income taxes represent 89% of the total and tariffs, 3%.

US: effective tariff

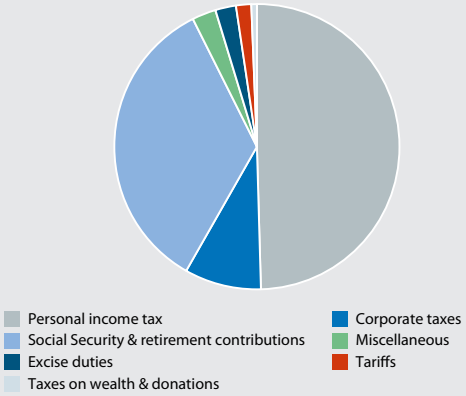
(%)



Note: *Updated rates based on trade agreements and written communications.*
Source: *BPI Research, based on data from UN COMTRADE.*

US: sources of tax revenues

(%)



Note: *Average proportions during the period 2015-2024.*
Source: *BPI Research, based on data from the US Treasury.*

However, this year the pattern has begun to change, especially since April, following the entry into force of the universal tariff of 10%, along with other sector-specific ones. Between January and July alone, the Treasury has raised 114.9 billion dollars in tariffs, equivalent to nearly 0.4% of GDP. In other words, so far this year, more revenue has been collected through this means (as a proportion of GDP) than in all of 2023 and 2024 combined (see second chart). Beyond the first half of the year, the final result will henceforth depend on both the final level at which the tariffs settle and the behaviour of imports.

In this regard, data for the first half of the year reveal that, after having surged by almost 20% quarter-on-quarter in Q1 in anticipation of the tariffs, imports of goods fell 20% month-on-month in April before stabilising between May and June at around 270 billion dollars, just below the prior year average (274 billion dollars). In a scenario in which we assume that monthly imports will stabilise at around these levels, and we apply an effective tariff of 17% (the level in place right now), the total revenues for the year from this source would amount to 1.1% of GDP.

Is 1% a realistic and sustainable long-term scenario?

For the White House, it is crucial to keep revenues from tariffs at high levels in order to cover part of the projected increase in the public deficit over the next 10 years as a result of the new budget act. Collecting revenues equivalent to 1% of GDP, as we projected earlier, would prevent a significant deterioration in the fiscal accounts. Is this level actually achievable?

The success of this strategy depends not only on the level of the tariffs, but also on whether imports remain stable. For that to happen, at least two conditions are needed: that the elasticity of imports to prices be low and/or that aggregate demand remain strong.

Let's start with the first condition. The behaviour of imports will depend, first of all, on how tariffs are passed on to prices, that is, how the cost is shared between exporters, importers and final consumers. Several studies on the tariffs imposed on China in 2018 found that they resulted in an almost one-for-one increase in the price of imported goods, suggesting that it was US importers and consumers who absorbed the cost.[4]

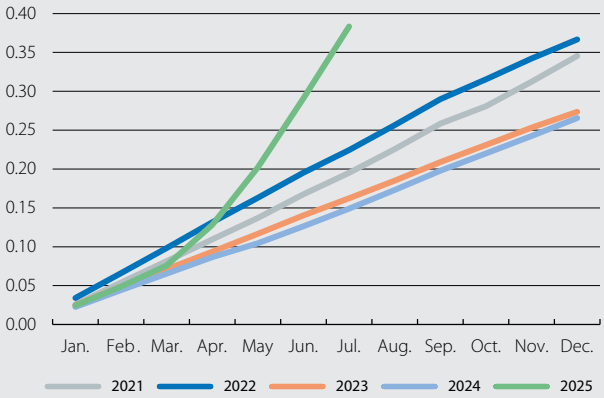
Surveys conducted by various regional Fed banks show that many firms plan to pass the tariffs on to consumers either fully or in part. For instance, a survey by the Atlanta Fed[5] reveals that at least 55% of firms plan to do so, and of that group, half plan to pass on «all» or «most» of the cost. Although it is still early to assess the final impact on consumer prices, CPI data from June and July showed that prices of certain imported goods have already begun to rise.[6] If part of the tariffs is passed on to the final consumer, then the behaviour of imports going forward will depend on the sensitivity of demand to prices. The price elasticity of imports has been estimated by several studies to lie somewhere between –1 and –5.[7] Taking the most conservative value (–1),[8] we can assume that a 1% increase in the price of an imported good reduces its demand by 1%.

One channel that could partially cushion this effect is the exchange rate. A strong dollar would help counteract an increase in the price of imported goods. However, so far this year, the dollar has depreciated by 10% against its main peers, possibly weakened by growing expectations of an economic slowdown in the US.

4. See M. Amiti, S.J. Redding and D.E. Weinstein (2019). «The impact of the 2018 tariffs on prices and welfare». Journal of Economic Perspectives, 33(4), 187-210. And A. Cavallo, G. Gopinath, B. Neiman and J. Tang (2021). «Tariff Pass Through at the Border and at the Store: Evidence from US Trade Policy». American Economic Review: Insights, 3(1), 19-34.
5. Federal Reserve Bank of Dallas (2025). «Texas Business Outlook Survey: Special Questions». April.
6. See the CaixaBank Research Brief Note on US inflation published in June (content available in Spanish).
7. See R.C. Feenstra, P. Luck, M. Obstfeld and K.N. Russ (2018). «In Search of the Armington elasticity». The Review of Economics and Statistics, 100(1), 135-150.
8. O. Jeanne and J. Son (2020). «To What Extent Are Tariffs Offset by Exchange Rates?» Working Paper nº 27654, National Bureau of Economic Research.

US: cumulative revenues from tariffs

(% of GDP)



Source: *BPI Research, based on data from the US Treasury and the Bureau of Economic Analysis.*

This last point leads us to the second condition needed for tariff policy to work as a sustained revenue mechanism: that aggregate demand is not weakened. Our forecasts point to a moderation in GDP growth, from 2.8% in 2024 to 1.3% in 2025 and 2026 (the analyst consensus places it around 1.5%). This anticipated cooling is explained both by the direct effects of the tariffs – through the mechanisms described – and by the increased uncertainty, which will adversely affect consumption and investment decisions. In addition, a foreseeable cooling in the global economy will weigh down foreign demand for US exports, and in a less dynamic environment, imports will inevitably be affected.

So far, a sharp fall in imports has not materialised, but that is because an anticipation effect still persists. In addition, we should recall that some goods, such as pharmaceuticals and semiconductors, have remained exempt from tariffs up until now, and this maintains the incentive to accumulate stocks. For example, according to US Census Bureau data, imports of pharmaceutical products have increased so far this year by 15%, while imports of furniture and clothing have fallen by 15% and 10%, respectively.

In short, the increase in tariff revenues has been significant and reaching 1% of GDP would be a material figure, but it seems difficult to do so in a sustained manner over time.

Year-on-year (%) change, unless otherwise specified

UNITED STATES

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Activity									
Real GDP	2.9	2.8	2.7	2.5	2.0	2.1	–	–	–
Retail sales (excluding cars and petrol)	5.2	3.4	3.6	4.1	4.8	4.8	4.6	4.4	...
Consumer confidence *(value)*	105.4	104.5	102.2	110.6	99.8	93.1	95.2	98.7	97.4
Industrial production	0.2	–0.3	–0.4	–0.3	1.2	1.0	0.8	1.4	...
Manufacturing activity index (ISM) *(value)*	47.1	48.2	47.3	48.2	50.1	48.7	49.0	48.0	48.7
Housing starts *(thousands)*	1,421	1,371	1,338	1,387	1,401	1,346	1,358	1,428	...
Case-Shiller home price index *(value)*	312	330	332	336	340	338	337	...	...
Unemployment rate *(% lab. force)*	3.6	4.0	4.2	4.1	4.1	4.2	4.1	4.2	...
Employment-population ratio *(% pop. > 16 years)*	60.3	60.1	60.0	59.9	60.0	59.8	59.7	59.6	...
Trade balance [1] *(% GDP)*	–3.0	–2.8	–2.9	–3.0	–3.5	–3.6	–3.6	...	...
Prices									
Headline inflation	4.1	3.0	2.6	2.7	2.7	2.4	2.7	2.7	...
Core inflation	4.8	3.4	3.2	3.3	3.1	2.8	2.9	3.1	...

JAPAN

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Activity									
Real GDP	1.2	0.1	0.8	1.2	1.8	1.2	–	–	–
Consumer confidence *(value)*	35.1	37.2	36.9	36.1	34.7	32.8	34.5	33.7	34.9
Industrial production	–1.4	–3.0	–1.8	–2.5	2.5	0.8	2.6	–0.9	...
Business activity index (Tankan) *(value)*	7.0	12.8	13.0	14.0	12.0	13.0	–	–	–
Unemployment rate *(% lab. force)*	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.3	...
Trade balance [1] *(% GDP)*	–3.0	–1.1	–1.1	–1.0	–0.9	–0.7	–0.6	–0.6	...
Prices									
Headline inflation	3.3	2.7	2.8	2.9	3.8	3.4	3.2	3.0	...
Core inflation	3.9	2.4	2.0	2.3	2.7	3.2	3.5	3.4	...

CHINA

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Activity									
Real GDP	5.4	5.0	4.6	5.4	5.4	5.2	–	–	–
Retail sales	7.8	3.3	2.7	3.8	3.6	4.4	4.8	3.7	...
Industrial production	4.6	5.6	5.0	5.6	6.8	6.2	6.8	5.7	...
PMI manufacturing *(value)*	49.9	49.8	49.4	50.2	49.9	49.4	49.7	49.3	49.4
Foreign sector									
Trade balance [1,2]	865	997	898	997	1,086	1,146	1,146	1,159	...
Exports	–5.1	4.6	5.4	10.0	5.7	6.0	5.6	7.1	...
Imports	–5.5	1.0	2.1	–1.8	–6.9	–0.9	1.1	4.1	...
Prices									
Headline inflation	0.2	0.2	0.5	0.2	–0.1	0.0	0.1	0.0	...
Official interest rate [3]	3.5	3.1	3.4	3.1	3.1	3.0	3.0	3.0	3.0
Renminbi per dollar	7.1	7.2	7.2	7.2	7.3	7.2	7.2	7.2	7.2

Notes: *1. Cumulative figure over last 12 months. 2. Billion dollars. 3. End of period.*
Source: *BPI Research, based on data from the Department of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Standard & Poor's, ISM, National Bureau of Statistics of Japan, Bank of Japan, National Bureau of Statistics of China and Refinitiv.*

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Retail sales *(year-on-year change)*	–1.9	1.2	2.1	2.2	2.0	2.7	3.5	2.2	...
Industrial production *(year-on-year change)*	–1.6	–3.0	–1.7	–1.5	1.4	1.2	0.2	...	...
Consumer confidence	–17.4	–14.0	–13.0	–13.4	–14.1	–15.7	–15.3	–14.7	–15.5
Economic sentiment	96.2	95.7	96.0	95.1	95.5	94.3	94.1	95.7	95.2
Manufacturing PMI	45.0	45.9	45.5	45.4	47.6	49.3	49.5	49.8	50.7
Services PMI	51.2	51.5	52.1	50.9	51.0	50.1	50.5	51.0	50.5
Labour market									
Employment (people) *(year-on-year change)*	1.4	1.2	1.0	0.7	0.7	0.7	–	–	–
Unemployment rate *(% labour force)*	6.6	6.4	6.3	6.3	6.3	6.3	6.3	6.2	...
Germany *(% labour force)*	3.1	3.4	3.4	3.4	3.6	3.7	3.7	3.7	...
France *(% labour force)*	7.3	7.4	7.4	7.3	7.5	7.6	7.6	7.6	...
Italy *(% labour force)*	7.7	6.6	6.3	6.2	6.3	6.3	6.2	6.0	...
Real GDP *(year-on-year change)*	0.7	0.9	1.0	1.3	1.5	1.4	–	–	–
Germany *(year-on-year change)*	–0.7	–0.5	–0.6	–0.2	0.2	0.2	–	–	–
France *(year-on-year change)*	1.6	1.1	1.1	0.6	0.6	0.8	–	–	–
Italy *(year-on-year change)*	0.8	0.5	0.5	0.6	0.7	0.4	–	–	–

Prices

Year-on-year change (%), unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
General	5.5	2.4	2.2	2.2	2.3	2.0	2.0	2.0	2.1
Core	5.0	2.8	2.8	2.7	2.6	2.4	2.3	2.3	2.3

Foreign sector

Cumulative balance over the last 12 months as % of GDP of the last 4 quarters, unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Current balance	2.0	3.3	3.4	3.3	3.0	3.6	3.6	...	...
Germany	5.5	5.6	6.3	5.6	5.4	6.7	6.7	...	...
France	–1.0	0.1	0.3	0.1	0.0	–0.8	–0.8	...	...
Italy	0.1	1.1	0.9	1.1	1.1	1.6	1.6	...	...
Nominal effective exchange rate[1] *(value)*	94.7	95.0	95.5	94.2	93.5	96.8	97.3	98.4	98.4

Credit and deposits of non-financial sectors

Year-on-year change (%), unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Private sector financing									
Credit to non-financial firms[2]	2.7	0.8	1.0	1.4	2.2	2.6	2.7	2.8	...
Credit to households[2,3]	1.7	0.5	0.5	0.9	1.5	2.1	2.2	2.4	...
Interest rate on loans to non-financial firms[4] *(%)*	4.6	4.9	4.9	4.4	3.9	3.4	3.3	3.3	...
Interest rate on loans to households for house purchases[5] *(%)*	4.4	4.6	4.7	4.3	4.0	3.7	3.6	3.6	...
Deposits									
On demand deposits	–8.5	–3.9	–2.5	1.2	3.6	5.3	5.1	5.6	...
Other short-term deposits	21.1	12.3	10.5	6.0	2.3	–0.1	–1.0	–0.8	...
Marketable instruments	20.3	20.3	22.1	18.6	15.7	11.0	10.4	6.4	...
Interest rate on deposits up to 1 year from households *(%)*	2.7	3.0	3.0	2.6	2.2	1.9	1.8	1.7	...

Notes: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*

Source: *BPI Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

Employment supports resilient economy

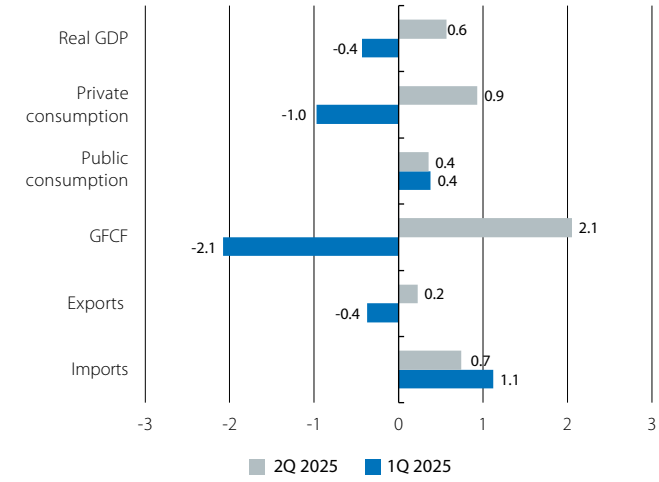
In Q2 2025, GDP grew 0.6% quarter-on-quarter, in line with the average quarterly growth observed since 2019.This recovery more than offset the 0.4% decline in Q1 and reflects a return to the average quarterly growth rates recorded in recent years. Domestic demand contributed 0.8 percentage points (pp) for quarterly growth, highlighting the 2.1% qoq increase in GFCF. In turn, external demand subtracted 0.2 pp from quarterly growth, with imports growing by 0.7% while exports continue to record more moderate growth compared to recent historical performance. Until the end of the year, quarterly growth is expected to fluctuate, with a strong third quarter driven by consumption, as households have benefited from increased income due to reductions in income tax rates and retroactive payments since the beginning of the year, as well as extraordinary payments to pensioners. However, in Q4 there may be a correction (not excluding a slight contraction), as household income normalises (similar to the effect in Q4 2024-Q1 2025). It should be noted that, overall, these measures represent an extraordinary increase in household income of €900 billion, equivalent to 0.3% of nominal GDP. Investment is expected to strengthen in the second half of the year, driven by the acceleration of the PRR and lower financing costs. In this scenario, we maintain the outlook that the economy will grow 1.6% in 2025.

Inflation rises again in August.The INE's flash estimate points to a rate 0.2 percentage points higher than the previous month, rising to 2.8%. Underlying CPI remained stable at 2.5%. Once again, unprocessed food products are driving the new rise in the index, with a year-on-year inflation rate of 7.0% (6.1% in July). The high and rising prices of some food *commodities* on international markets (e.g. coffee and beef, where the degree of national self-sufficiency is low) help to explain this behaviour, as do the significant wage increases in the agriculture and fisheries sector, which are above the overall economy. In turn, the rigidity of service inflation, which has been above 4% for several months, contributes to the stickiness of the underlying CPI.

Employment continues to surprise in 2025. In fact, the second quarter data revealed not only a new historic high (since 2011), but also a growth rate not seen since the post-pandemic recovery period. The increase of 148,400 individuals compared to the same quarter last year (i.e., 2.9%) is the highest recorded in a second quarter since 2017, excluding the pandemic period (see chart). This behaviour is widespread across the secondary and tertiary sectors, but it is manufacturing, consulting, scientific & technical activities, and accommodation & catering that stood out, accounting for more than 65% of the year-on-year increase in employment in Q2. The positive signs are also reflected in other indicators: job creation was widespread across all age groups, at the highest qualification levels (secondary and higher education) and in more stable employment contracts (as opposed to more precarious contracts). In this context, the unemployment rate fell by 0.2 percentage points compared to the same quarter last year, reaching 5.9%, the lowest rate in this

Demand elements

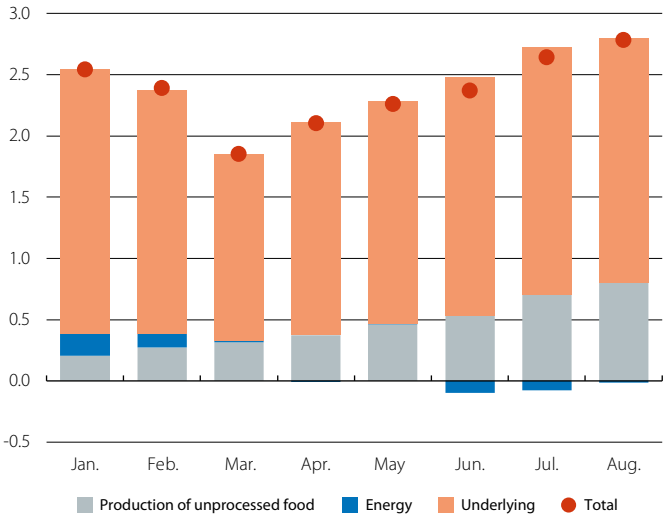
Quarter-on-quarter change (%)



Source: *BPI Research based on data from the National Institute of Statistics.*

Contributions to the CPI

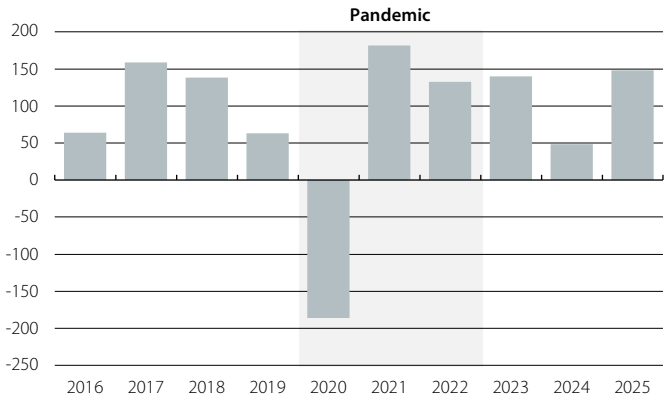
Year-on-year change (%)



Source: *BPI Research, based on data from the National Institute of Statistics.*

Year-on-year change in employment in the second quarter of each year

(Thousand individuals)



Note: *Non-seasonally adjusted data.*
Source: *BPI Research based on data from the National Institute of Statistics.*

statistical series (excluding the pandemic period). Given this robustness, salaries continue to increase: the average gross monthly remuneration per worker increased by 3.7% year-on-year in Q2, to €1,388. The labour market signals are positive (in July, employment rose by 4.0% year-on-year) and point to surprising job creation in 2025.

Housing continues to appreciate. In the run-up to the release of data on the Housing Price Index for Q2 2025 (to be released by INE on the 22nd), interim information points to an upward trend. The Confidencial Imobiliário Residential Price Index closed the first half of the year with an average year-on-year increase of 14.9%, although monthly variations in the second quarter were not as exuberant as those recorded at the beginning of the year. Transactions will also have remained at high levels (around 40 thousand homes/quarter). In turn, the bank valuation of housing in July was €1,945/m² (national median), up 18.7% year-on-year, with the number of valuations up 3.7% compared to the same month in 2024. Expectations for prices and sales in the near future point to a stabilisation of the latter and a more restrained evolution of prices.

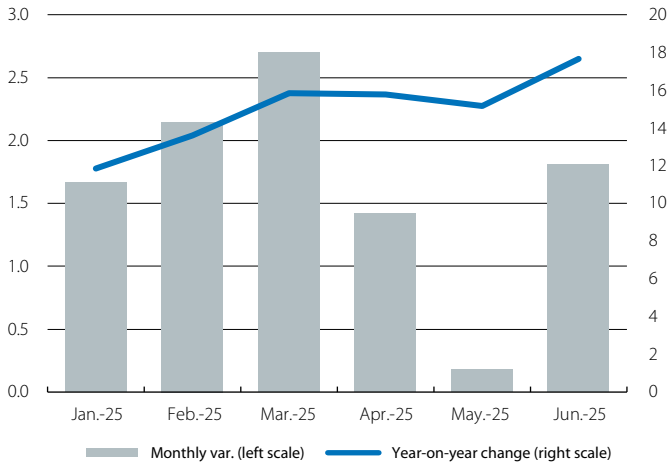
In June, in cumulative terms, Portugal's current account recorded a surplus of €577 million. This figure reflects an 80% deterioration in the balance in the first six months of 2024 (–2.283 billion euros), mainly due to the worsening of the goods balance deficit, which deteriorated by 2.748 billion euros compared to the same period last year (resulting from the worsening of the deficit in food and chemical products and a reduction in the surplus in refined petroleum products), driven by an increase in imports (+€2.490 billion) and a decrease in exports (–€258 million). On the other hand, the services balance surplus increased by €754 million (+5.3%) compared to June 2024, mainly due to the increase in exports of travel and tourism services (+€489 million). The main products exported by Portugal were motor vehicles, trailers and semi-trailers (12% of total exports up to June 2025), followed by food products and computer, electronic and optical products (with a preponderance of 8% and 7%, respectively).[1]

The credit portfolio for the non-financial private sector is accelerating and growing at its fastest pace since early 2009. In fact, stock increased by 5.3% year-on-year in July, a trend largely explained by the mortgage loan portfolio (+7.3% year-on-year), followed by consumer credit and other purposes (6.5%) and non-financial companies (2.2%). More specifically, the increase in the mortgage loan portfolio accounts for around 67% of the increase in credit to the private sector, while 18% is explained by consumption and other purposes and the remaining 15% by NFCs. Part of the dynamism in mortgage lending can be explained by the reduction in financing costs (the implicit interest rate in mortgage contracts fell by 0.09 pp to 3.385% in July, the lowest level since April 2023), and also by the granting of credit to younger people (who accounted for more than 50% of new operations granted in the first half of the year).

1. For further details on the trade balance, see the BPI Research publication «Dynamics of Portuguese Foreign Trade: analysis of the balance of goods and exposure to major trading partners».

Residential Property Price Index

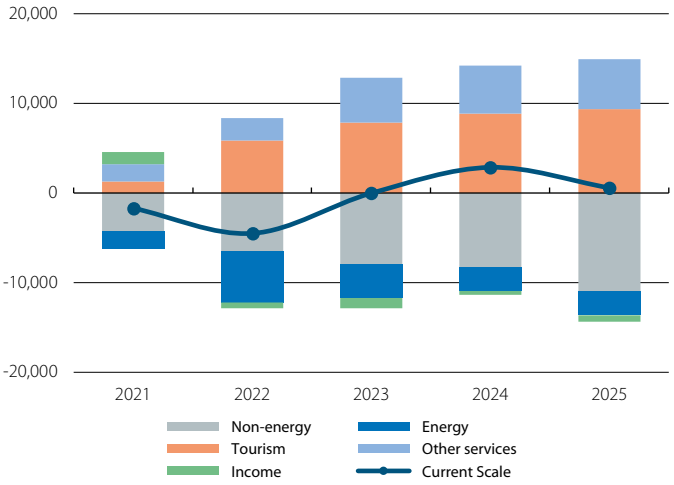
Monthly and year-on-year change (%)



Source: *BPI Research, based on data from Confidencial Imobiliário.*

Component current balance

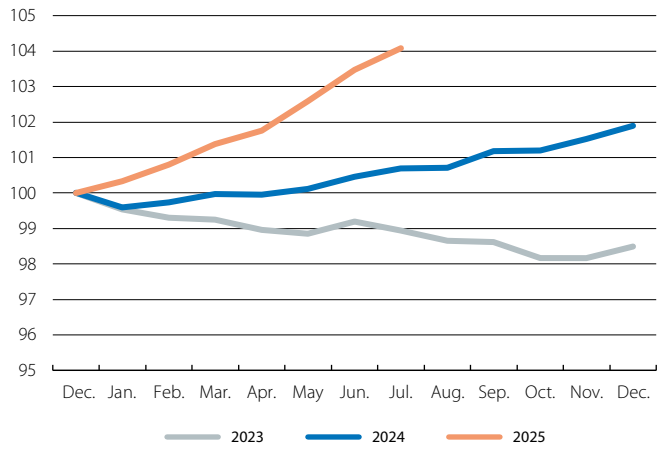
(Accumulated figures up to June, in millions of euros)



Source: *BPI Research, based on data from Datastream.*

Evolution of the credit portfolio to the non-financial private sector

(Base 100 = December of the previous year)



Source: *BPI Research, based on data from Banco de Portugal.*

The limits to the productivity and competitiveness of Portuguese companies

The Portuguese corporate fabric is substantially asymmetrical in terms of scale. According to data from the Bank of Portugal (BdP), in 2023, 99.7% of existing companies were micro, small and medium-sized enterprises (SMEs, the majority of which were micro and small, representing around 89.3% and 8.9%, respectively). Although there has been a greater variation in the number of companies since 2017 (see first chart), the focus remains on smaller companies, reflecting the difficulties the private sector has had in becoming more competitive, increasing efficiency in resource allocation and internationalising, leaving national companies at a disadvantage compared to their European and, particularly, North American counterparts. Larger size facilitates productivity gains and investment in more efficient processes, which is evident in the fact that, although large companies represent less than 0.5% of the total number (BdP, 2023), they are the ones that generate the most wealth, accounting for 36.4% of gross value added.

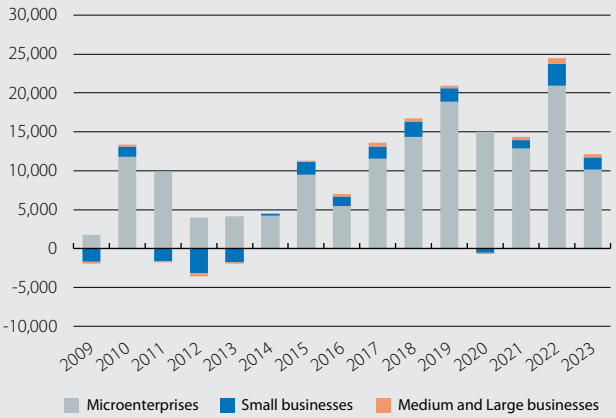
According to data from Eurostat and the Fed, nominal GDP per capita in 2024 was around 26.7 thousand euros in Portugal, approximately 16.3 thousand euros below the Eurozone (ZE) average and 59.1 thousand euros below that seen in the USA. This difference in income is structurally justified by a gap in the productivity of labour and capital (see second chart), which widened throughout the 20TH century and has persisted to the present day. While most European and, above all, North American companies are able to boost their operations and grow in terms of assets and market value, Portuguese companies face limitations in obtaining increasing returns on a large scale. There are several reasons for this obstacle, with the consequent weak dynamism of the Portuguese private sector, which translates into the prevalence of the same dominant companies and a reduction in the number of securities traded on the stock market (152 companies listed on Portuguese stock exchanges in 1990 vs. 47 in 2025).[1]

Although the main companies have, on average, been following a positive trend in valuation since 2020 (taking into account the valuation of the PSI, despite its small representation in the business universe), as well as having recorded improvements in terms of profitability and financial autonomy compared to the period between 2008 and 2015, many face deficiencies in access to sources of capital. Due to their small size, financing costs are generally higher because of credit risk, there are fewer solutions available, and companies have less capacity to issue equity, basing their balance sheet on debt. In turn, liquidity is lower and investment in fixed assets is restricted so that companies can pay their liabilities, with the current ratio (current assets over current liabilities) being lower in the PSI than in the EUROSTOXX50 and S&P500 indices, and gross fixed capital formation (GFCF) as a percentage of GDP has been lower in Portugal than in the eurozone and the US since 2011, restricting growth. The lack of private productive investment is further aggravated by the lack of public investment. Net capital stock has increased by only 2.3% in Portugal since 2008 (well below the 18.2% and 31.2% recorded in the EU and US averages, respectively, according to 2023 data from AMECO), which is insufficient to offset the progressive obsolescence of existing assets.

1. According to data from a report by Macedo Vitorino.

Companies by size

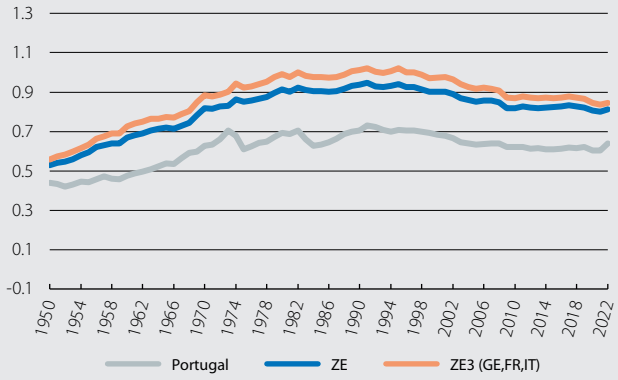
(Annual variation in total number)



Source: *BPI Research, based on data from BdP.*

Total factor productivity

(Solow Residual, ratio to the US)*



Notes: *ZE3 corresponds to the three largest economies in the EZ by GDP, that is, Germany, France and Italy. * Residual of a Cobb-Douglas production function assuming constant returns to scale ($Y = AL^{\alpha}K^{1-\alpha}$), with the capital stock (K) and hours worked (L) as inputs, allowing the estimation of total factor productivity (A).*

Source: *BPI Research, based on data from the Long-term Productivity Database.*

Related to investment, the reduced focus on innovation also explains the delay in Portuguese companies. Technical progress and the search for more innovative and efficient methods are essential to the long-term competitiveness of any economy, and the lag in technological capacity in Portugal (and Europe) compared to the US is now being exacerbated by the spread of artificial intelligence, compromising internationalisation and strategic positioning (see third chart). Between 2013 and 2023, private companies (governments) spent an average of 0.8% (0.1%) of GDP on research and development in Portugal, while in the EU and the US these proportions were 1.4% (0.3%) and 2.3% (0.3%), respectively. On the positive side, Portugal leads the way in investment in innovation in higher education.

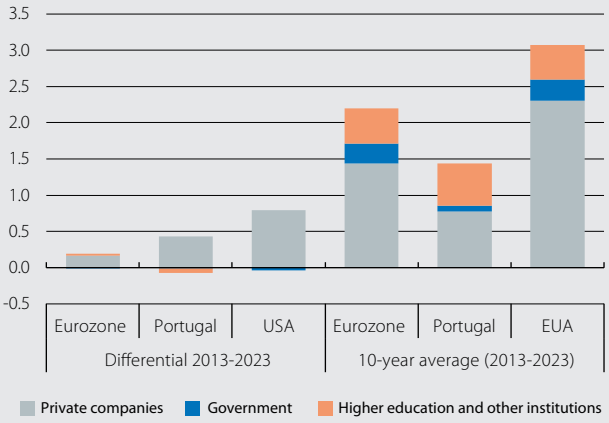
The scarcity of productive and innovative investment highlights another problem: the phenomenon known as «brain drain». Portugal has a reasonable proportion of *STEM* (science, technology, engineering and mathematics) graduates, comparable to the EU average, but faces challenges in retaining its skilled workforce, particularly young people who qualify in high value-added areas such as technology and manufacturing and do not find sufficient employment opportunities (in terms of salary, progression and application of knowledge), with many choosing to emigrate to countries where career prospects in these same areas are more valued. In fact, Portugal is the 5th EU Member State where nominal compensation for workers[2] has risen less in the last two decades (+13% between 2004 and 2024, compared to +18.4% in the EU). As a result, the business sector ends up specialising in low value-added segments.

Finally, taxes are another crucial aspect, as they affect both businesses and individuals. According to Eurostat data, the tax burden on labour rose by 0.8% in Portugal between 2015 and 2024, bucking the trend of tax relief seen in the main European economies and the US, even though it remains below the EU average (see forth chart). A higher tax burden reduces households' disposable income, which is already uncompetitive compared to most European economies (where wages have increased considerably more since the beginning of the century, as mentioned above). Furthermore, although measures have been put in place to slow down the «brain drain«, such as the youth income tax scheme, the benefits tend to be limited or temporary.

2. Average remuneration earned annually by each worker, including wages and Social Security contributions, according to AMECO.

R&D expenses

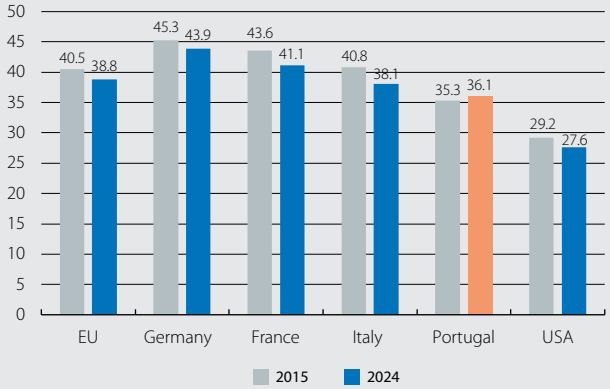
(% of GDP)



Source: *BPI Research, based on data from Eurostat.*

Tax burden on labour

Tax on gross salary income plus social security contributions as a percentage of labour costs



Source: *BPI Research, based on data from Eurostat.*

In short, Portugal suffers from a chronic competitiveness challenge intrinsically linked to its business fabric, which is based on small scale, lack of investment and innovation, and specialisation in low-value sectors, despite having good levels of human capital. To reverse the problem, i t is necessary to reduce the gap productivity promoting an increase in productive investment and research, creating conditions to enhance specialised labor in disruptive sectors and reforming the tax system.

Tiago Miguel Pereira

Setor empresarial com situação financeira mais sólida

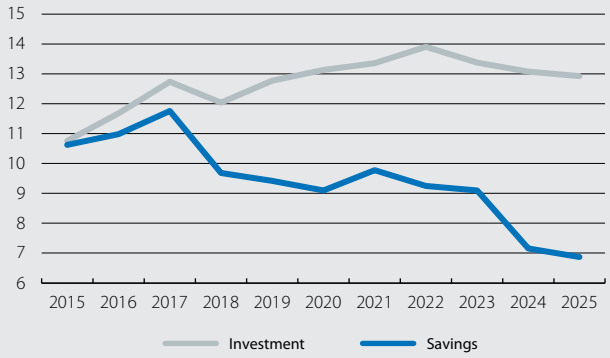
The financing needs of non-financial companies have been increasing over the last decade. In 2024, it was €14.7 billion, which contrasts with a financing capacity of €0.7 billion in 2015. This evolution reflects a much lower increase in revenue generated by the sector compared to its expenses, which since 2015 have increased by 65% and 81%, respectively. In 2024, the resources generated in the sector reached 164 billion, up 4.7% year-on-year, benefiting from the increase in gross value added generated during the year. However, costs incurred rose at a faster pace – 7.2% year-on-year – reflecting significant increases in remuneration paid (9.5% year-on-year) and interest and taxes paid, +13% and +14.7%, respectively, compared to 2023. These developments were reflected in weak growth in the operating surplus to €48 billion in 2024, 2.3% more than in 2023; in a small increase in investment – 37 billion in 2024, +3.1% year-on-year; and the reduction of savings in the sector to 20 billion euros, 17% less than in the same period last year. At the beginning of 2025, the trend remains unchanged, with expenditure growing by 1.1% compared to the end of 2024 and revenue by just 0.5%.

But despite this increase in financing needs, non-financial companies have seen significant improvements in their financial situation.[1] in the last decade. In this period, assets increased by 96 million euros, liabilities[2] around 20 billion and equity 146 billion. In 2024, the net asset position of Portuguese companies improved, with net assets standing at €13,728 million, a significant increase compared to 2023 and a reversal of a structurally negative trend. On the asset side – 92% of GDP – the contribution was €13.5 billion, with increases in deposits and relationships with other companies, both through equity holdings and loans granted. Deposits stood at €74 billion, €5.6 billion more than in 2023 and almost double pre-pandemic levels (the average between 2015 and 2019 was €39.5 billion). The increase in net liabilities from shares and holdings – 87% of GDP – was much more moderate, at only €3.2 billion, due to the increase in debts related to payment terms to suppliers or contracted services and the increase in long-term debt securities, which at the end of 2024 stood at €33.6 billion, €4.2 billion more than in 2023. On the other hand, long-term borrowing decreased by €6.4 million in 2024, to €120 billion. The increase in equity capital, represented in the financial accounts as liabilities in shares and other holdings, also contributed to the improvement in the financial position of the Portuguese business sector. In 2024, the figure stood at €248 billion, or 124% of GDP. All these variations resulted in a reduction in the leverage ratio,

1. Net worth assessed on the basis of national financial accounts, reflecting changes in the financial assets and liabilities of a given sector vis-à-vis other institutional sectors or the rest of the world.
2. In this article, the liabilities of non-financial companies in shares and other equity are considered as the equivalent of the companies' equity. Therefore, the reference to liabilities is net of this item which in the national financial accounts is classified as a liability.

Portugal: savings and investment of non-financial companies

(% of GDP)



Source: *BPI Research, based on data from the National Institute of Statistics.*

Non-Financial Corporations - National Financial Accounts

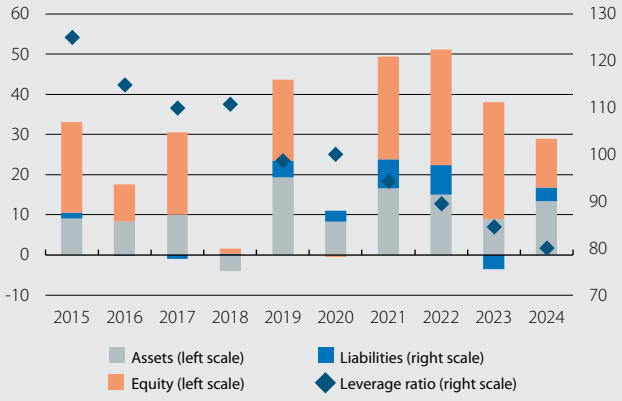
(Million euros)

	2005	2023	2024	1Q 25
1. Total Assets	**140,452**	**248,724**	**262,240**	**265,729**
Loans	15,920	28,877	31,894	31,884
Titles	1,578	3,335	3.009	3.195
Deposits	32,646	68,493	74,127	74,843
Cash	1,494	2,053	1,969	1,657
Commercial credits	14,696	21,990	22,776	23,624
Other credits	28,085	49,912	49,400	51,880
Shares and other holdings	43,432	70,682	75,666	75,228
Others	2,601	3,381	3,400	3,419
Net assets (1-2-3)	**–50,732**	**3,437**	**13,728**	**16,654**
2. Total liabilities	**335,164**	**587.010**	**602,462**	**607.620**
Loans	139,942	181,144	176,447	176,448
Titles	20,274	39,287	43,784	46,073
Commercial credits	10,358	19,388	19,942	19,650
Others	8,340	8,340	8,340	8,340
3. Shares and other holdings (share capital)	**143,981**	**341,724**	**353,950**	**358,544**

Source: *BPI Research, based on data from Banco de Portugal.*

Portugal: changes in assets, liabilities and equity and leverage ratio

(Billions of euros, %)



Source: *BPI Research, based on data from the BdP.*

measured as the ratio between debt and assets, to 80.2%, a decrease of around 45 percentage points between 2015 and 2024.

The increase in nominal debt in the non-financial corporate sector has been relatively contained over the last decade – only €30 billion – as a result of the near stabilisation of public sector debt, which fell by €0.7 billion during the period, offsetting the increase of around €31 billion in the private sector. This, combined with strong nominal GDP growth, was reflected in a 61 percentage point reduction in the debt ratio.[3] to 106% of GDP.

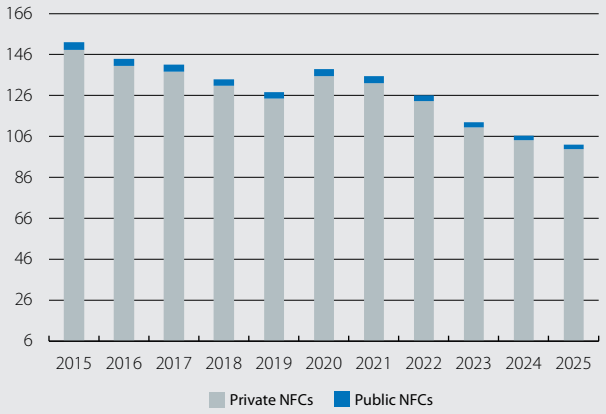
In 2024, the nominal value of the debt was 303 billion euros, mostly concentrated in the private sector (98% of total debt).

In the private sector, debt continues to consist mostly of loans – 57.5% in 2024 – but there has been an increase in debt issuance, mainly taken out by non-residents. In 2024, this represented 13.4% of the debt of the NFEs, with the debt taken on by non-residents amounting to 19 billion (6.5% of the total vs. 3.3% in 2015). It essentially reflects the increase in long-term issues, which rose by €16.5 billion over the decade, mainly taken up by non-residents. In 2015, long-term debt held by non-residents was 7.3 billion and in 2024 it was 18.4 billion, exceeding the amounts held by the resident financial sector.

This aspect – greater interest from non-residents – combined with the increased residual maturity of issues, suggests greater credibility and an improvement in the risk profile of the national business sector among foreign investors. According to the Bank of Portugal[4] between 2020 and 2024, the residual maturity of the issues increased from 9.7 years to 13.8 years. And it is not surprising that the largest companies, with the greatest exposure abroad, are the main issuers of debt securities, despite the fact that the

Portugal: debt of non-financial companies

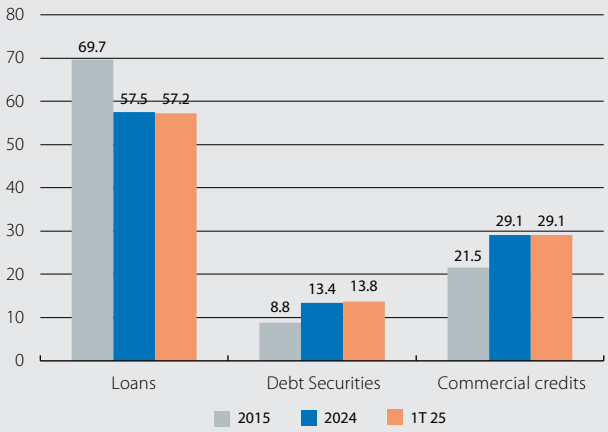
(% of GDP)



Note: *2025 is just the 1st quarter.*
Source: *BPI Research, based on data from Banco de Portugal.*

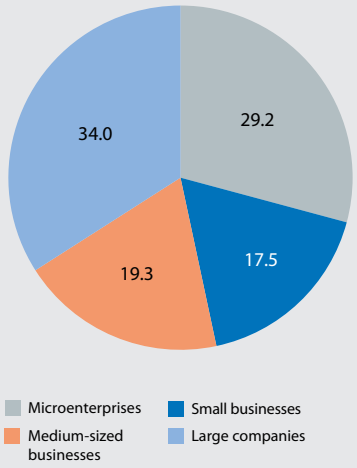
Portugal: debt distribution by instrument

(% of total debt)

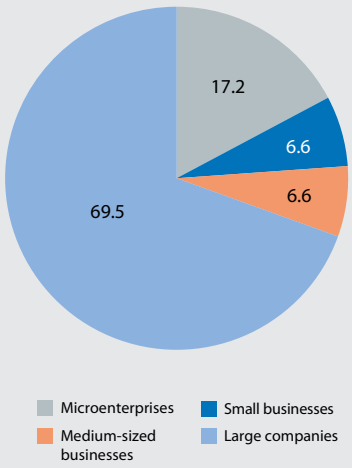


Source: *BPI Research, based on data from Banco de Portugal.*

Indebtedness by size of NFE



Debt issuance by size of NFE



Source: *BPI Research, based on data from BdP.*

3. This article uses the Banco de Portugal series which, unlike Eurostat, include commercial credits, thus reflecting a higher level than that obtained through Eurostat statistics. At the end of 2024, trade credits represented 29.5% of GDP (30.8% in 2015).
4. https://bpstat.bportugal.pt/conteudos/noticias/2379/?utm_source=bportugal.pt

distribution of debt is relatively balanced when analysed by company size.

Finally, a reference to the main long-term debt issuing sectors: *utilities* and consulting, scientific and technical activities, which according to Banco de Portugal account for 70% of long-term debt securities, also noting that, in the case of the electricity sector, the largest increase in long-term debt is associated with ESG issues (67% of the amount issued by the sector).

In short, in an environment of greater uncertainty where risks are mostly negative, the business sector finds itself in a more solid financial position, which has been recognised by investors who are showing a greater appetite for taking on debt from these same companies. This solidity, combined with more benign inflation, lower financing costs and abundant European funds (NGEU), opens the door to a revival of investment, which in Portugal's case is urgently needed to restore and increase capital stock, which is still on an unfavourable trajectory.

Teresa Gil Pinheiro

What do consumer credit data tell us?

Household debt underwent a significant correction after the sovereign debt crisis: after peaking at 94.4% of GDP at the end of 2009, household debt declined in relative terms, mainly between 2013 and the end of 2018, with household debt for home purchases playing a major role in this correction. Conversely, debt relating to loans for consumption and other purposes began to recover earlier, with the first positive signs in mid-2017. However, the most recent data point to a stabilisation or even reversal of this trend (to be confirmed), with an increase in household debt in Q2 2025 (from 56.2% in Q1 to 56.8% of GDP), explained by debt for house purchases. On the other hand, debt for consumption and other purposes appears to have stabilised at around 19.4% of GDP. It is the latter that we will focus on in this article, unraveling what has supported this section.

Consumer credit and other purposes encompass different types of credit, ranging from car loans, credit cards, or personal loans (to finance education or the purchase of furniture, for example). According to the Bank of Portugal, these 3 types represent the majority of consumer and other credit, and the remainder concerns credit granted to Non-Profit Institutions serving families (NPIs) and Individual Entrepreneurs (ENIs). At the same time, consumer credit can be granted by banks or other specialised institutions. In order to analyse the dynamism of this credit segment, we will divide the article into two parts: in the first part, we will address consumer credit and other purposes granted by the banking sector, while in the second part we will look at consumer credit on a broader basis of institutions, focusing on new credit operations, which is the information available in this area.

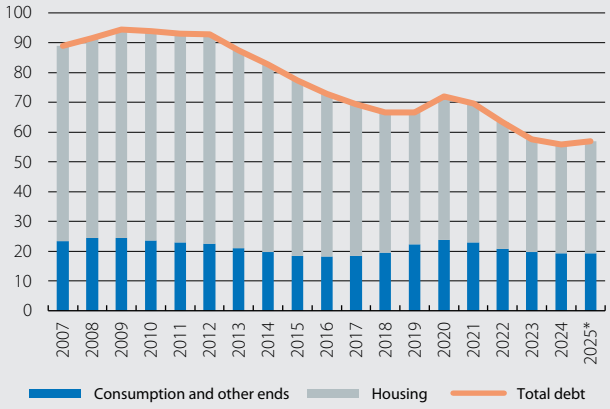
The evolution of consumer credit in the banking sector

Looking specifically at consumer credit and other loans granted by the banking sector, at the end of the second quarter Portugal had the fifth highest ratio in relation to GDP among the other euro area countries (11.3% compared to 9.4% for the euro area as a whole).[1]

Compared to mortgage loans, consumer and other credit is typically more expensive: the interest rate underlying the portfolio was 7.37% in June, far from the peak of 9.31% recorded at the end of 2008, but still high compared to the 3.39% rate for the mortgage loan portfolio. Compared to the other members of the Eurozone, Portugal had the 5th highest rate at the end of Q2.

Given the higher costs, it is not surprising that default rates are higher compared to, for example, mortgage loans: the non-performing loan ratio stood at 2.5% in June (0.2% in the case of housing loans), very close to minimum levels (2.4% at the beginning of 2025). At the same time, 8.4% of debtors in the consumer credit and other purposes segment had overdue loans (compared to 1.6% in the case of mortgage loans), a percentage that, after reaching a low of 7.6% in July 2023, began to increase in line with the rise in market interest rates, but still in a contained manner. Finally, the vast majority of loans in the portfolio were granted with an extended maturity, with approximately 77% of the portfolio having a maturity of more than 5 years.[2]

Individual debt, by type
(% GDP)



Note: * Data for Q2.
Source: BPI Research, based on data from BdP.

By type, personal loans stood out, accounting for around 40% of consumer credit and other purposes in June, followed by car loans and credit cards. Compared to the weight at the end of 2019, there was an increase in the case of personal credit (by 5 pp) and car credit (by 3 pp). In fact, growth in consumer credit and other purposes has been sustained by these two items (accounting for around 74% of the increase in consumer credit and other purposes in June).

Although not a cause for concern, the increase in the amount of overdue loans in the consumer credit and other purposes segment (with year-on-year variations between 1% and 6% in recent months) is mainly explained by the car loan and personal loan segments. The June data points to a more pronounced increase than in previous months, but nevertheless a contained one. If we analyse in terms of ratios, the ratio of overdue loans in the car loan segment is practically in line with the

1. If we consider consumer credit excluding other purposes, Portugal ranks second (7.2% of GDP), behind Luxembourg (8.2%) and above the Eurozone average (5.0%).

2. Consumer credit is included in the Macroprudential Recommendation, implemented in 2018, limiting maturity and the *debt service-to-income ratio*. In the case of maturity, it is limited to 7 years in the case of personal credit and 10 years in the case of car credit and personal credit for education, health and energy transition.

historical minimum[3] (2.2% in June compared to a minimum of 2.1%), while the ratio for the credit card and personal credit segment is slightly above, but close to, the respective minimums (4.4% compared to a minimum of 3.9%, and 2.6% compared to a minimum of 2.4%, respectively).

The various segments have a very different weight in total overdue loans than was the case at the end of 2019: at that time, ENIs and ISFLs accounted for more than half of overdue consumer and other loans, followed by personal loans, car loans and credit cards. Over the years, the correction observed in ENIs and ISFLs has been significant, shifting to a more residual weight in 2025 (around 17%). With the exception of personal loans (which accounted for 41% in June), the remaining loans accounted for around 20%.

The total pie of consumer credit

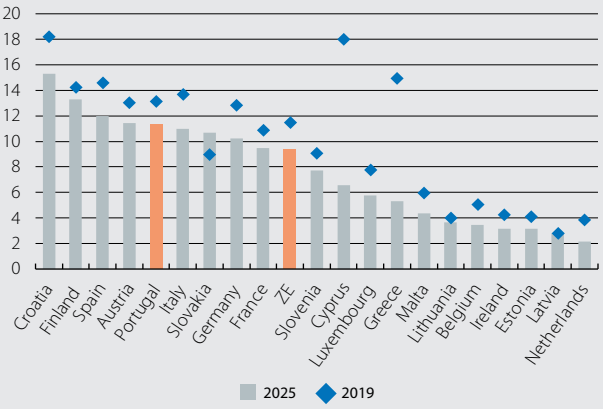
Total consumer credit encompasses not only banks but also other entities with specialised activities, and the statistical information is broken down into various types, with the following standing out due to their weight: other personal loans (accounting for 43% of the total granted in the first half of 2025, including, for example, loans for home improvements), loans for the purchase of used cars and other vehicles (29%) and revolving credit[4] (16%). This distribution changed slightly compared to pre-pandemic levels, with an increase in the weight of used car and revolving credit, to the detriment of other personal loans.

Consumer credit granted in 2024 increased at a similar rate to that seen in 2021 and 2022 (10%), accelerating compared to the 0.8% recorded in 2023. This increase is justified by the credit granted for the purchase of used and new cars and other vehicles, and for other personal loans. The monthly average recorded in 2024 (€702 million) is the highest since the beginning of the historical series (2012), a robust growth that is supported by a favourable economic and financial context (namely the strength of the labour market and the fall in interest rates). The number of new contracts also increased by 5% in 2024, reaching the highest figure in the historical series (1,674,700 contracts). The Bank of Portugal's Credit Market Monitoring Report also shows that 55% of consumer credit granted in 2024 was provided by specialised entities, slightly below the previous year's figure (–0.6 pp).

The first half of 2025 continues to point to significant growth, with an increase of almost 9% year-on-year in the amount granted, with other personal loans and used car purchases continuing to contribute (accounting for around 75% of the growth in consumer credit granted during this period). In turn, the number of contracts

3. The BPStat historical series only begins in December 2018.
4. Includes credit cards, credit lines, current accounts, and overdraft facilities.

Consumer credit portfolio and other purposes
(% GDP)



Note: *2025 data is relative to the end of Q2; those from 2019 are from the end of the year.*
Source: *BPI Research, based on ECB data.*

increased by 1.6% year-on-year, which indicates that consumers are borrowing more money per contract signed than in the same period in 2024. In this sense, the monthly average exceeds 744 million euros.

Therefore, the two main consumer credit segments are personal credit (44% of the total) and car credit (39%), with very dynamic growth in 2024 (6.6% and 15%, respectively). In the case of personal loans, there was a 6.6% increase in the amount, accompanied by a smaller increase in the number of new contracts (2%), i.e. the average amount per contract increased in 2024, with almost 50% of contracts having an average amount of more than €5,000 (around 47% in 2023). Even so, personal credit represented 1.3% of GDP, lower than that recorded before the pandemic (1.6% in 2019, the highest level in the series that began in 2013). The average contract term was 4.8 years, a slight increase compared to the 4.7 years in 2023, with contracts signed for between 5 and 7 years representing more than 40% of the total. Almost all personal loans are made at a fixed rate (around 98%).

In turn, in car loans, not only did the average monthly amount increase in 2024 (15%), but the number of new contracts also rose by 13%. The total granted in 2024 reached 1.2% of GDP, below the 1.4% recorded in 2019 or the 1.5% recorded in 2018 (maximum level). The average amount per contract increased slightly compared to 2023 (from €15,100 to €15,300), with an average term of 7.5 years (unchanged from 2023). In the case of new credit agreements for used vehicles, the vast majority are for more than seven years, contrary to what happens in the case of credit agreements for the purchase of new vehicles, where the distribution is more homogeneous and only around 36% of agreements are for a period of more than seven years. Fixed-rate loans also predominate in this segment.

Monitoring household credit and debt data remains relevant even in a context

where the robustness of the labour market and the good economic environment are key. Thus, although in aggregate terms the reading is relatively calm, we do not have information on the dispersion of indebtedness by income or wealth brackets; this reading would provide more information as to whether or not there are possible indications of stress. In any case, any loss of control over debt could undoubtedly put families' financial situation in a debilitating position again, which is why this aggregate deserves monitoring.

Vânia Duarte

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Coincident economic activity index	3.5	1.8	1.5	1.7	1.7	1.7	1.7	1.7	...
Industry									
Industrial production index	–3.1	0.8	–0.2	–0.4	–2.3	1.3	2.9	...	...
Confidence indicator in industry *(value)*	–7.4	–6.2	–6.1	–4.2	–5.1	–4.8	–4.4	–3.8	–3.3
Construction									
Building permits - new housing (number of homes)	7.5	6.5	13.4	23.6	37.5	16.3	12.4	...	...
House sales	–18.7	14.5	19.4	32.5	25.0	...	–	–	–
House prices *(euro / m² - valuation)*	9.1	8.5	8.5	13.2	15.8	17.4	18.1	18.7	...
Services									
Foreign tourists *(cumulative over 12 months)*	19.0	6.3	7.8	6.3	4.6	4.0	4.0	3.9	...
Confidence indicator in services *(value)*	7.7	5.6	2.4	10.9	12.5	6.6	9.4	12.8	13.5
Consumption									
Retail sales	1.1	3.2	3.7	5.0	4.5	4.7	5.8	6.2	...
Coincident indicator for private consumption	2.9	2.7	2.7	3.4	3.6	3.3	3.2	3.1	...
Consumer confidence index *(value)*	–28.6	–18.0	–14.3	–14.3	–15.5	–17.9	–17.6	–15.7	–16.2
Labour market									
Employment	2.3	1.2	1.2	1.3	2.4	2.9	3.8	4.0	...
Unemployment rate (*% labour force*)	6.5	6.4	6.1	6.7	6.6	5.9	6.1	5.8	...
GDP	**2.6**	**1.9**	**2.0**	**2.8**	**1.7**	**1.9**	–	–	–

Prices

Year-on-year change (%), unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
General	4.4	2.4	2.2	2.6	2.3	2.2	2.4	2.6	2.8
Core	5.1	2.5	2.5	2.7	2.3	2.3	2.4	2.5	2.5

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–1.4	2.0	0.5	2.0	5.3	4.4	4.4	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–4.0	2.0	–1.1	2.0	5.4	6.9	6.9	...	...
Current balance	**1.5**	**6.0**	**5.1**	**6.0**	**4.2**	**3.7**	**3.7**	**...**	**...**
Goods and services	4.1	6.5	6.4	6.5	5.2	4.5	4.5	...	...
Primary and secondary income	–2.6	–0.6	–1.3	–0.6	–0.9	–0.9	–0.9	...	...
Net lending (+) / borrowing (–) capacity	**5.5**	**9.1**	**8.6**	**9.1**	**7.5**	**7.1**	**7.1**	**...**	**...**

Credit and deposits in non-financial sectors

Year-on-year change (%), unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Deposits [1]									
Household and company deposits	–2.3	7.5	6.0	7.5	6.5	5.4	5.4	6.2	...
Sight and savings	–18.5	–0.3	–8.1	–0.3	5.0	5.1	5.1	6.5	...
Term and notice	22.2	15.3	22.6	15.3	7.8	5.8	5.8	5.9	...
General government deposits	–12.4	26.7	29.1	26.7	29.3	39.6	39.6	15.5	...
TOTAL	**–2.6**	**7.9**	**6.7**	**7.9**	**7.1**	**6.4**	**6.4**	**6.5**	**...**
Outstanding balance of credit [1]									
Private sector	–1.5	1.9	1.0	1.9	3.3	5.0	5.0	5.3	...
Non-financial firms	–2.1	–1.0	–0.6	–1.0	0.1	2.3	2.3	2.2	...
Households - housing	–1.5	3.0	1.3	3.0	4.9	6.4	6.4	7.3	...
Households - other purposes	0.2	5.4	4.6	5.4	5.7	6.6	6.6	6.5	...
General government	–5.5	0.6	–4.1	0.6	–8.0	3.8	3.8	1.4	...
TOTAL	**–1.7**	**1.8**	**0.9**	**1.8**	**2.9**	**4.9**	**4.9**	**5.2**	**...**
NPL ratio *(%)* [2]	**2.7**	**2.4**	**2.6**	**2.4**	**2.3**	**...**	–	–	–

Notes: *1. Residents in Portugal. The credit variables exclude securitisations. 2. Period-end figure.*
Source: *BPI Research, based on data from the National Statistics Institute of Portugal, Bank of Portugal and Refinitiv.*

The good times continue for the Spanish economy

Q2 2025 began with all bets placed on a slowdown in the growth of the Spanish economy. In early April, and after months of threats, the Trump administration announced bilateral tariffs and catapulted the main uncertainty indicators to all-time highs. Weeks later, a blackout left the Iberian Peninsula without electricity for a day. Moreover, all this happened in an environment in which the euro area economy was once again showing signs of cooling.

The Spanish economy exceeds expectations once again in Q2 2025. Despite this unfavourable context, the Spanish economy not only maintained its buoyancy, but accelerated relative to the previous quarter. In Q2, GDP grew by 0.7% quarter-on-quarter, 0.1 pp more than in Q1. The breakdown of this figure also stands out due to the strength of domestic demand, which contributed 0.9 pps to quarter-on-quarter GDP growth. Private consumption was one of the main drivers of domestic demand, growing 0.8% quarter-on-quarter and accelerating compared to the 0.5% recorded in Q1. Investment, meanwhile, grew 1.6% quarter-on-quarter, thus outpacing GDP growth for the third consecutive quarter. Exports also advanced at a steady pace of 1.1% quarter-on-quarter, despite the uncertainty surrounding trade and the weakness of our main trading partners. However, the growth of domestic demand, especially investment, boosted imports, which grew by 1.7% quarter-on-quarter, resulting in a negative contribution from foreign demand.

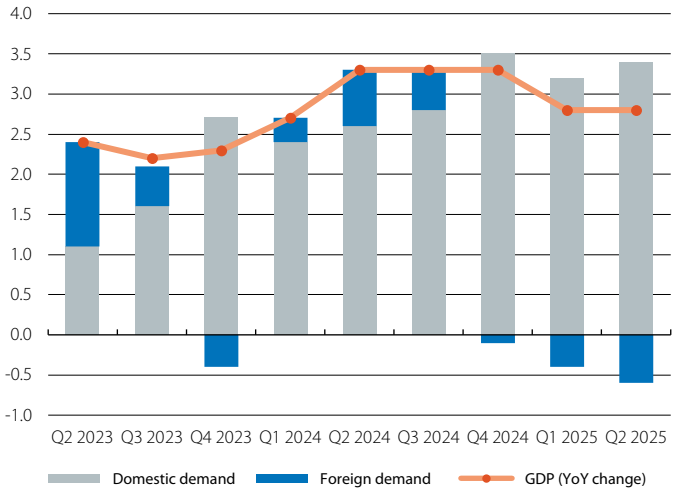
Positive signals in the main economic activity indicators for Q3. The first indicators for Q3 show mixed signals between supply and demand. On the one hand, business confidence indicators point to a solid growth rate for Q3. In August, the manufacturing sector's PMI rebounded to 54.3 points, the best figure since October last year and well clear of the contractionary zone below the 50-point threshold in which it stood between February and April. Also, the PMI for the services sector remained in the expansionary zone with 53.2 points, a slightly lower figure than in July.

On the other hand, the CaixaBank consumption tracker points to a moderation in consumption, following the good performance in Q2. So far in Q3, domestic consumption has grown by 2.8% year-on-year, 1.5 pps less than in Q2. However, correcting for seasonal and calendar effects, the tracker points to a growth rate in private consumption similar to that of Q2.

The labour market holds up despite the adverse seasonality of the end of summer. Following a record Q2, Spain's labour market continues to show signs of strength, consolidating itself as one of the pillars of economic growth in recent years. In August, the number of Social Security affiliates fell by 0.9% month-on-month, as is commonplace in a month marked by the end of summer contracts and the temporary halt of some economic activities. This fall is similar to the one recorded in

Spain: contribution to GDP growth

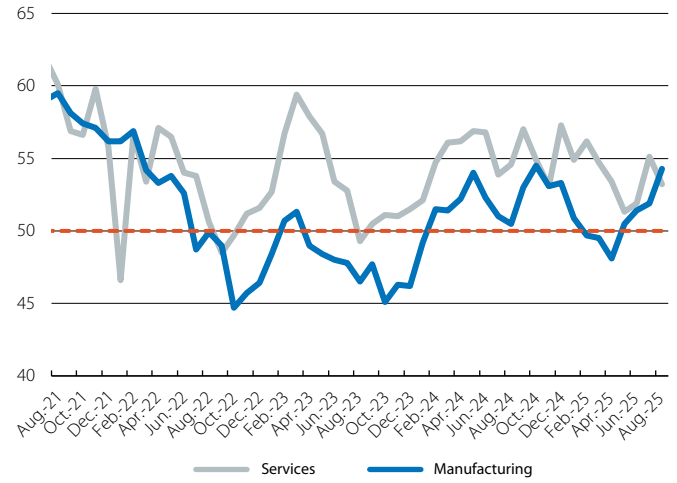
Pps and year-on-year change (%)



Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

Spain: PMI

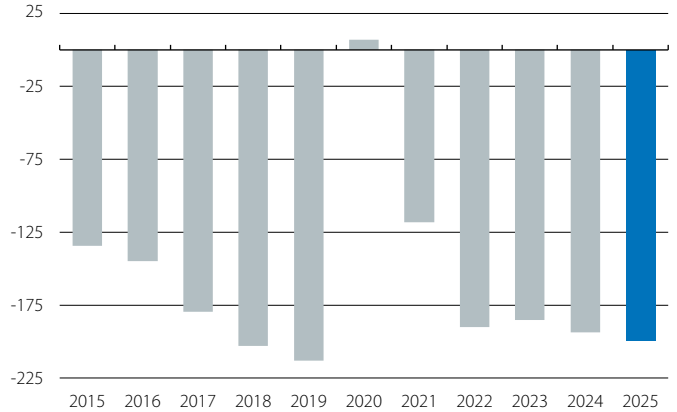
Level



Source: *BPI Research, based on data from S&P Global PMI.*

Spain: monthly change in registered workers in August

(Thousands)



Note: *Data not seasonally adjusted.*
Source: *BPI Research, based on data from the Ministry of Labour and Social Economy.*

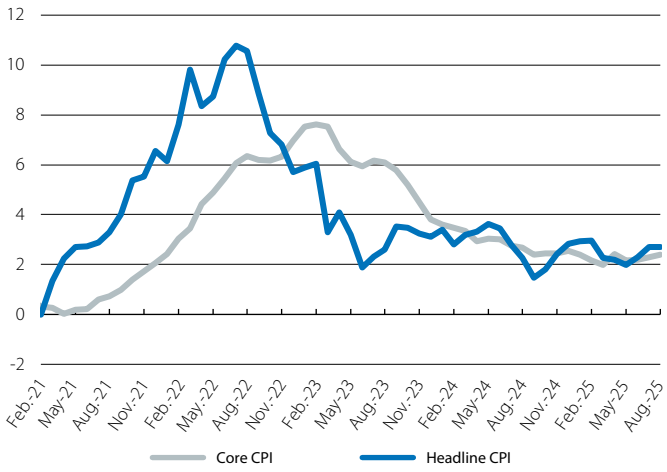
August last year and also to the average of the months of August between 2014 and 2019. In year-on-year terms, the number of registered workers has grown at a rate of 2.3%. By sector, job growth has been particularly strong in construction, with a year-on-year rate that accelerated by 0.4 pps to 3.5%, while in industry and services the rate has stabilised.

Electricity and food prices give inflation a respite. In August, headline inflation remained at 2.7%, according to the CPI flash indicator published by the National Statistics Institute (INE). This stabilisation is in response to two opposing effects: the upward pressure exerted by fuels, which is offset by the downward contribution from electricity and food. Meanwhile, core inflation (excluding energy and unprocessed food) increased by 0.1 pp to 2.4%. Thus, after two months on the rise, headline inflation lies 0.7 pps above the figure of May, when the current price rebound began. This rebound has been driven by rising prices of fresh food and, to a lesser extent, electricity. Currently, the futures markets suggest that energy prices will remain stable during the remainder of the year. Also, the decline in food prices this month advanced by the INE could indicate a pause in their upward trend. If the current dynamics are maintained, we could see inflation peak in September.

The housing market closed its best first semester since 2007. In a context marked by the recovery of purchasing power and lower interest rates, housing demand continues to show significant strength. In June, sales grew by 17.9% year-on-year, maintaining the buoyancy observed in previous months. The cumulative balance for the year to date reinforces this trend: between January and June, some 358,000 sales transactions were recorded, representing a 19.7% increase over the same period last year and marking the best first half of the year since 2007. The combination of dynamic demand and a supply which, although reactivated, is growing at a more moderate rate, is causing the price tensions to persist. In Q2 2025, the Association of Registrars' repeat home sales price index rose by 14.8%, up from the previous 14.2% and marking the highest rate since 2006.

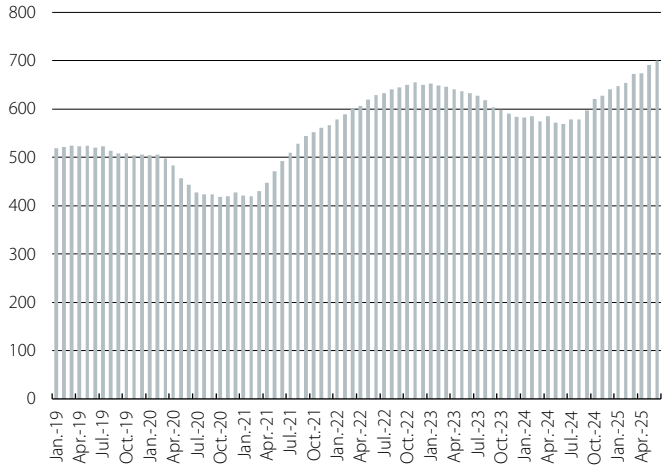
The trade deficit rises sharply in the first half of the year. Unlike the real estate sector, the current context does not favour the foreign sector. The strength of domestic demand is driving up import growth. Added to this is the uncertainty over trade, as well as the weakness of the euro area, which are adversely affecting exports. In the first half of the year, exports of goods grew by 1.0% year-on-year, but the 5.4% increase in imports has led to a deficit of 25.1 billion euros in Q1 2025, a figure that far exceeds that of the same period last year (–15.8 billion). By component, the deterioration stands out not only due to the increase in the energy deficit, which is commonplace in Spain's balance of trade, but also due to the sharp deterioration in the balance of non-energy goods, which shows a deficit of 8.78 billion, versus just 138 million in 2024. The widening of the non-energy deficit is explained by the greater dynamism of imports, which are up 7.4% year-on-year, far outpacing the 2.6% growth in exports.

Spain: inflation
Year-on-year change (%)



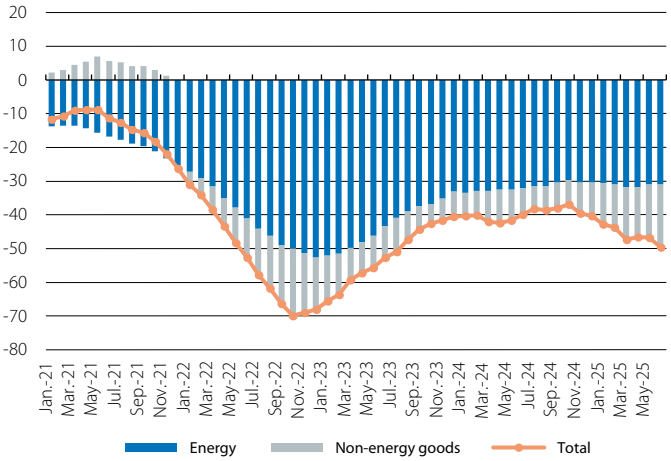
Note: *The figure for August 2025 is provisional.*
Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

Spain: home sales
*(Thousands)**



Note: ** 12-month cumulative total.*
Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

Spain: balance in the trade of goods
*(EUR billions)**



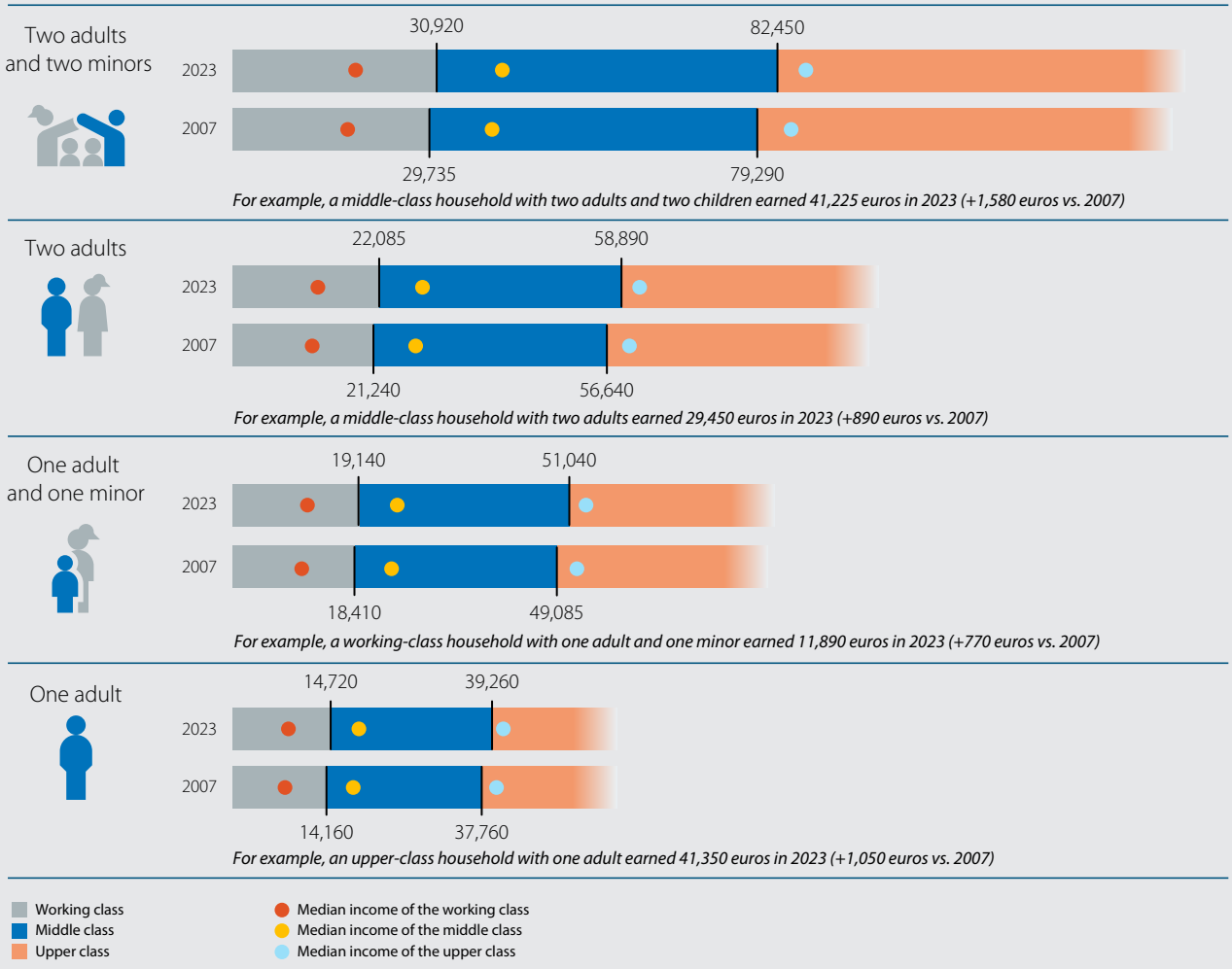
Note: ** 12-month cumulative total.*
Source: *BPI Research, based on data from the Bank of Spain.*

Spain's middle class in numbers: rising incomes, waning sense of progress

The middle class continues to expand as a share of Spain's total population, according to the latest data from the National Statistics Institute's Living Conditions Survey (LCS). In 2023, 61.5% of households belonged tothe middle class (+0.4 pps vs. 2022), 8.1% to the upper class (−0.7 pps) and 30.4% to the working class (+0.3 pps). In the same year, incomes increased for all economic classes, and for the middle and working classes in particular: the income of a middle-class household increased by 3.7% in real terms, that of a working-class household by 3.3% and that of an upper-class household by 1.3%. These findings challenge the common perception that the middle class is in retreat, so this article aims to offer a practical guide to interpreting the results: what do we mean by middle class? How many euros do households belonging to it earn? What differences do we observe according to the family structure?

To analyse the middle class in Spain, we use the data from the LCS, which gathers economic and social information from households and their members, and we adopt the OECD definition, which considers middle-class households to be those with an income between 75% and 200% of the median income of the population.[1] In order to compare households of different sizes and compositions, we adjust household incomes using the OECD equivalence scale, which allows us to calculate income per unit of consumption.

Income of Spanish households by class and household composition
(Annual euros)



Note: *Net household income in real terms. Working class is defined as households with incomes below 75% of the median, middle class as households with incomes between 75% and 200% of the median, and upper class as the rest.*
Source: *BPI Research, based on data from the Living Conditions Survey (LCS, National Statistics Institute).*

1. See the article «How has the middle class evolved in Spain?» in the MR12/2024 for further details.

This scale assigns a value of 1 to the first adult (over 14 years of age), 0.5 to additional adults and 0.3 to those under the age of 14. For example, a household with two adults and two minors is equivalent to 2.1 consumption units, while a household with one adult and one minor is equivalent to 1.3 units. Using the adjusted incomes per unit of consumption, the thresholds for each class are established (households with incomes below 75% of the median are considered to be working class, and those above 200% to be upper class) and households with different compositions can be compared.

The accompanying infographic allows us to identify which economic class each type of household belongs to according to its income and composition.[2] For instance, according to the established thresholds, a household consisting of two adults and two minors would be classified as middle class if its income lies between 30,920 euros and 82,450 euros in 2023. On average, households in this class earned 41,225 euros, which is 1,480 euros more than in 2022 and 1,700 more than in 2019, but only 1,579 euros more than in 2007. This result shows how improvements in incomes in real terms are concentrated in these latter years, since between 2014 and 2019 households only managed to recover the sharp fall in incomes that was triggered by the financial crisis between 2008 and 2013.[3] Thus, the cumulative progress over a period of more than 15 years is limited, having been affected by multiple crises (the financial crisis, the pandemic, inflation), which helps explain why the general sentiment does not reflect a perceived improvement in income levels. For example, the average annual improvement in real terms between 2007 and 2023 for a household of two adults and two children is less than 100 euros per year, which represents a very small improvement in living standards. On the upside, all households saw an improvement in their situation in 2023, which shows that the middle class is recovering economic capacity after years marked by multiple crises. If this pattern is consolidated, as the data for 2024 suggest, then we may be entering a period of more sustained progress – one that Spanish households might finally begin to feel.

2. Net household income in real terms (2018 euros).

3. The income of a household with two adults and two minors decreased by 5,557.1 euros between 2007 and 2013, and recovered by 5,284.7 euros between 2013 and 2019.

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Industry									
Industrial production index	–1.6	0.4	–0.3	1.3	–0.7	1.6	2.3	...	...
Indicator of confidence in industry *(value)*	–6.5	–4.9	–3.0	–5.9	–5.4	–5.2	–6.2	–4.5	–5.8
Manufacturing PMI *(value)*	48.0	52.2	51.5	53.6	50.0	50.0	51.4	51.9	54.3
Construction									
Building permits *(cumulative over 12 months)*	0.5	16.7	10.2	16.7	20.1	...	...	...	...
House sales *(cumulative over 12 months)*	–10.2	9.9	–1.2	9.9	17.1	23.1	23.1	11.2	2.5
House prices	4.0	8.4	8.2	11.3	12.2	...	...	...	...
Services									
Foreign tourists *(cumulative over 12 months)*	18.9	10.1	12.3	10.1	8.1	6.3	6.3	5.6	...
Services PMI *(value)*	53.6	55.3	55.2	55.1	55.3	52.2	51.9	55.1	53.2
Consumption									
Retail sales[1]	2.5	1.8	2.6	2.9	3.4	5.1	6.2	4.7	...
Car registrations	16.7	7.2	1.7	14.4	14.0	13.7	15.2	17.1	17.2
Economic sentiment indicator *(value)*	100.5	103.0	105.5	101.5	103.3	103.1	102.1	104.3	101.7
Labour market									
Employment[2]	3.1	2.2	1.8	2.2	2.4	2.7	...	...	...
Unemployment rate (% labour force)	12.2	11.3	11.2	10.6	11.4	10.3	...	...	...
Registered as employed with Social Security[3]	2.7	2.4	2.3	2.4	2.3	2.2	2.2	2.3	2.3
GDP	**2.7**	**3.2**	**3.3**	**3.3**	**2.8**	**2.8**	...	...	...

Prices

Year-on-year change (%), unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
General	3.5	2.8	2.2	2.4	2.7	2.2	2.3	2.7	2.7
Core	6.0	2.9	2.6	2.5	2.2	2.3	2.2	2.3	2.4

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–1.4	0.2	–1.8	0.2	3.3	2.0	2.0	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–7.2	0.1	–3.1	0.1	4.2	4.1	4.1	...	...
Current balance	**39.8**	**48.7**	**48.3**	**48.7**	**44.3**	**44.3**	**44.3**	**...**	**...**
Goods and services	58.8	68.8	68.3	68.8	64.4	64.4	64.4	...	...
Primary and secondary income	–19.1	–20.0	–20.0	–20.0	–20.1	–20.2	–20.2	...	...
Net lending (+) / borrowing (–) capacity	**56.0**	**67.1**	**65.7**	**67.1**	**63.5**	**63.3**	**63.3**	**...**	**...**

Credit and deposits in non-financial sectors[4]

Year-on-year change (%), unless otherwise specified

	2023	2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	06/25	07/25	08/25
Deposits									
Household and company deposits	0.3	5.1	4.3	5.1	4.6	3.9	3.9	4.8	...
Demand and notice deposits	–7.4	2.0	–1.6	2.0	3.1	5.0	5.0	6.5	...
Time and repo deposits	100.5	23.5	47.5	23.5	12.6	–1.5	–1.5	–3.6	...
General government deposits[5]	0.5	23.1	14.8	23.1	24.4	25.5	25.5	15.7	...
TOTAL	**0.3**	**6.3**	**5.1**	**6.3**	**5.9**	**5.4**	**5.4**	**5.7**	**...**
Outstanding balance of credit									
Private sector	–3.4	0.7	–0.3	0.7	1.7	2.6	2.6	2.6	...
Non-financial firms	–4.7	0.4	–0.6	0.4	1.6	2.5	2.5	2.2	...
Households - housing	–3.2	0.3	–0.7	0.3	1.4	2.3	2.3	2.4	...
Households - other purposes	–0.5	2.3	1.2	2.3	3.1	3.5	3.5	3.9	...
General government	–3.5	–2.6	–5.4	–2.6	–0.3	5.3	5.3	12.7	...
TOTAL	**–3.4**	**0.5**	**–0.7**	**0.5**	**1.6**	**2.7**	**2.7**	**3.2**	**...**
NPL ratio (%)[6]	**3.5**	**3.3**	**3.4**	**3.3**	**3.2**	**3.0**	**3.0**	**...**	**...**

Notes: *1. Deflated, excluding service stations. 2. LFS. 3. Average monthly figures. 4. Aggregate figures for the Spanish banking sector and residents in Spain. 5. Public-sector deposits, excluding repos. 6. Data at the period end.*

Sources: *BPI Research, based on data from the Ministry of Economy, the Ministry of Transport, Mobility and Urban Agenda (MITMA), the Ministry of Inclusion, Social Security and Migration (MISSM), the National Statistics Institute (INE), S&P Global PMI, the European Commission, the Department of Customs and Excise Duties and the Bank of Spain.*

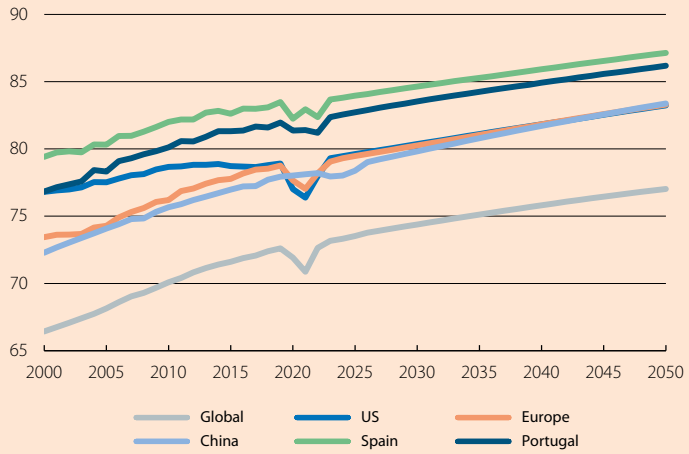
Demography and destiny: the world that awaits us in 2050 with fewer births and longer lifespans

We are living increasingly longer lives and – even more importantly – with better health. This is undoubtedly excellent news for all of us. However, this longevity, combined with a persistently low birth rate, is reconfiguring the demographic structure of our societies. This demographic shift calls for a profound transformation in how we organise ourselves that goes far beyond the necessary – but insufficient – use of population levers such as immigration or birth rates. In this article, we address the demographic dimension of this challenge before going on to analyse, in the following four articles of this Dossier, how this transition will impact three key areas: macroeconomics,[1] public finances[2] and savings and interest rates.[3]

In order to understand the magnitude of the demographic change that is coming, it is important to observe in more detail the trends that are shaping this new reality. Fertility rates are declining throughout the world and in the US, China and most European countries they are already below replacement level. This threshold, estimated at 2.1 children per woman, is the level at which the population would remain constant without migratory flows. In the case of Spain, the fertility rate has already been well below this threshold for over 40 years: it reached a low of 1.1 children per woman in the 1990s and is expected to remain very low over the next 25 years (1.3 children per woman). At the same time, life expectancy at birth increased by approximately seven years globally between 2000 and 2025, to 74 years, and by five years in the case of Spain, to 84 years (see first chart). Only the COVID-19 pandemic caused a temporary setback, with a fall of up to two years in some countries, from which it has already recovered. This improvement is expected to continue, with an additional three-year increase between 2025 and 2050, both globally and in Spain. Thus, by 2050, the world's population will be longer-living and older, but will also enjoy better health, since it is estimated that most of the increase in life expectancy will be in good health.[4] In fact, between 2000 and 2021, 70% of the improvements in life expectancy at 60 years of age already corresponded to improvements in healthy life expectancy, defined by the WHO as years without major diseases or injuries.[5] However, population ageing will also mean an increase in the prevalence of chronic diseases and dependency, and this will translate into an increase in the total burden of disease (Disability-Adjusted Life Years, or DALY) globally.

Life expectancy at birth

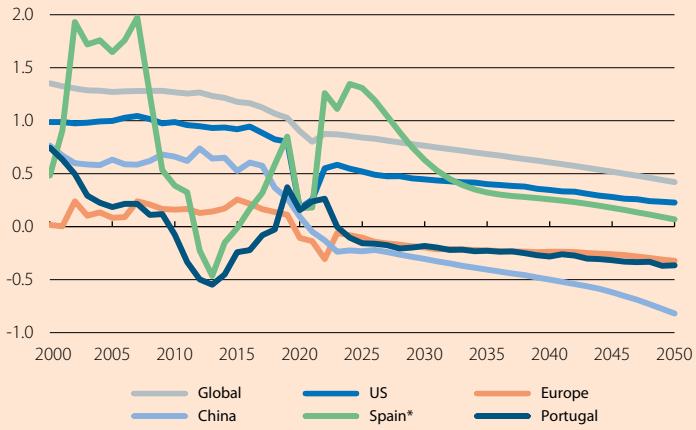
(Years)



Source: *BPI Research, based on data from* UN World Population Prospects *2024.*

Population growth

Annual change (%)



Note: ** Continuous Population Statistics (2000-2023) and Population Projections (2024-2050).*
Source: *BPI Research, based on data from the National Statistics Institute (for Spain) and* UN World Population Prospects *2024 (for the rest).*

This demographic change translates into a gradual decline in the annual growth rate of the global population (see second chart). This phenomenon is especially evident in European countries and in China, where population growth has stagnated and has even begun to retreat. In Spain,

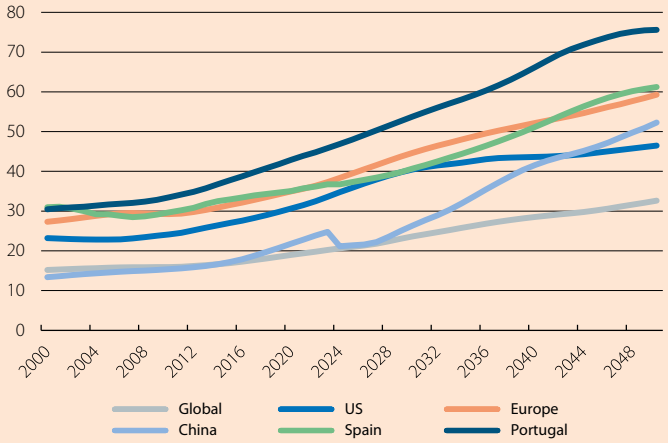
1. See the article «The effects of ageing on growth and policy tools to mitigate them» in this same Dossier.
2. See the articles «The impact of ageing on public finances: a major challenge for Spain and Europe» and «Levers to mitigate the impact of demographics on public finances: the case of pensions» in this same Dossier.
3. See the article «Will an ageing society pay lower interest rates?» in this same Dossier.
4. S.E. Vollset, H.S. Ababneh, Y.H. Abate, C. Abbafati, R. Abbasgholizadeh, M. Abbasian, H. Ariffin (2024). «Burden of disease scenarios for 204 countries and territories, 2022–2050: a forecasting analysis for the Global Burden of Disease Study 2021», The Lancet, 403(10440), 2204-2256.
5. OECD (2025). «OECD Employment Outlook 2025: Can We Get Through the Demographic Crunch?», OECD Publishing, Paris.

recent waves of migration have temporarily alleviated this situation, but they will not be able to reverse on their own the trend of a lower secular population growth observed in all European countries.

As a result, the global demographic structure is undergoing a profound transformation and it is becoming less and less like the classic pyramid with a wide base formed by young people and a narrower peak of elderly people. Instead, the population structure is assuming a more obelisk-like form, with a narrow base due to low birth rates and an increasingly wide upper section as a result of longer life expectancies.

Dependency ratio

Population over 65 years of age over the population aged 25 to 64 (%)



Source: *BPI Research, based on data from the National Statistics Institute (for Spain) and* UN World Population Prospects *2024 (for the rest).*

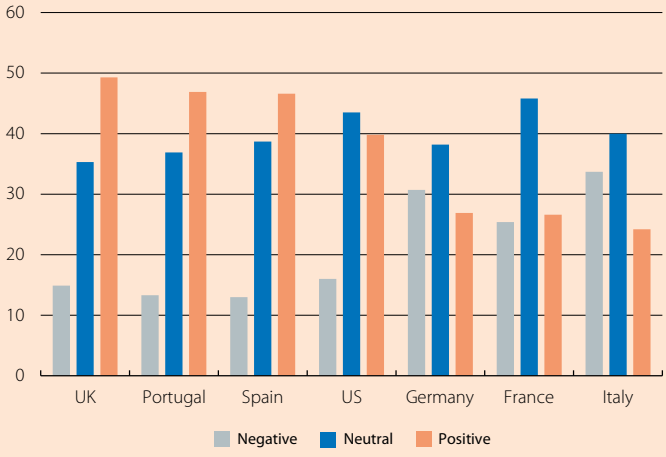
This change in the silhouette reflects a transformation that will require profound changes in a social system based essentially on working generations supporting retirees. In Spain, the 67-year-old cohort entering retirement has been more numerous since 2020 than the 25-year-old cohort entering the labour market. This «demographic trap» in which generations are not being replaced will be accentuated in the coming years. In fact, the proportion of the population over 65 years of age compared to the population aged 25 to 64, known as the dependency ratio, is currently 36% in Spain, which means that for every person over 65 there are 2.6 people of working age. This dependency ratio will increase sharply to 61% in 2050, which means that for every retiree there will be only 1.6 people of working age (see third chart).

In this context of population ageing and stagnation, birth rates would be a first demographic lever to counteract population ageing. The reality of the last few decades and the forecasts for the next few do not invite optimism in this regard. Public policies that reduce the cost of having children can help promote child birth, but they generally have a very limited impact and, as the OECD states in its latest Employment Outlook,[6] even the best known policies would not bring the fertility rate up to replacement level. Also, an increase in birth rates would only begin to have an impact beyond 2050, since it will not change the demographic reality of the working-age population for the next 25 years.

Thus, immigration emerges as the unavoidable demographic lever to curb population decline, albeit only partially. Between 2022 and 2024, in a context of the post-COVID rebound in migratory flows, almost 1.2 million immigrants entered Spain. The National Statistics Institute's migration forecasts for the coming years are equally significant, with net inflows of approximately 375,000 per year between now and 2053, although demographic forecasts of migratory flows are the ones most subject to uncertainty. And yet, the migratory flows needed to maintain the current dependency ratio would be around one million immigrants a year in a sustained manner for three decades.[7] It would be very difficult to receive influxes almost three times greater than those expected and, at the same time, offer the resulting population adequate public services to avoid the saturation of healthcare, infrastructure, etc. Moreover, immigration is a sensitive issue, as it affects social, economic and cultural aspects, and sometimes public perception can be distorted. For example, 7 out of every 10 European citizens overestimate the proportion of the foreign-born population in their country. In 2024, 13.9% of the EU population had been born abroad, a figure that in Spain reached 18.2%. Despite some prejudices, in most European countries citizens have a positive view of the

Impact of immigration on the country's development

(%)



Source: *BPI Research, based on data from the* World Values Survey Wave *7: 2017-2022.*

6. OECD (2025). «OECD Employment Outlook 2025: Can We Get Through the Demographic Crunch?», OECD Publishing, Paris.
7. Bank of Spain (2024). Annual Report 2023. Bank of Spain, Madrid.

economic impact of immigration.[8] In Spain and Portugal, 47% of the population has a positive view of immigration, 40% a neutral view and only 13% a negative one. However, in some countries such as Italy, opinions tend to be more negative (24% in favour vs. 34% against, with 40% neutral).

Since neither immigration nor a rise in birth rates seem capable, on their own, of reversing this demographic transformation, it is essential to explore how the economy, the welfare system and private savings can adapt to this new population reality.

Josep Mestres Domènech and Vânia Duarte

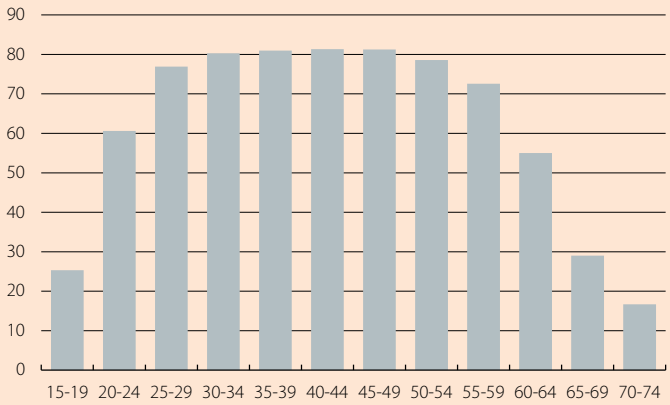
8. According to data from the World Values Survey Wave 7: 2017-2022.

The effects of ageing on growth and policy tools to mitigate them

The current phase of the global demographic transition, characterised by slowing population growth and an ageing population (for further details, see the article «Demography and destiny: the world that awaits us in 2050 with fewer births and longer lifespans» in this same Dossier), involves a series of transformations and broad-spectrum challenges for the economy, which seem to have cast a shadow over the prospects for global growth over the coming decades. However, the future is not written in stone and it can be shaped with the right policies. Proof of this is the fact that the «demographic dividend» that Africa has enjoyed for decades has not been reflected in significant economic development in the region, in contrast to the dynamism of Southeast Asia, which has become an engine of global growth in the last 25 years. Indeed, this dynamism has been led by China, which has managed to transform its economy into a global competitor, including in high-tech products, despite a relatively ageing population.

Employment rate by age group in OECD countries (2023)

(%)



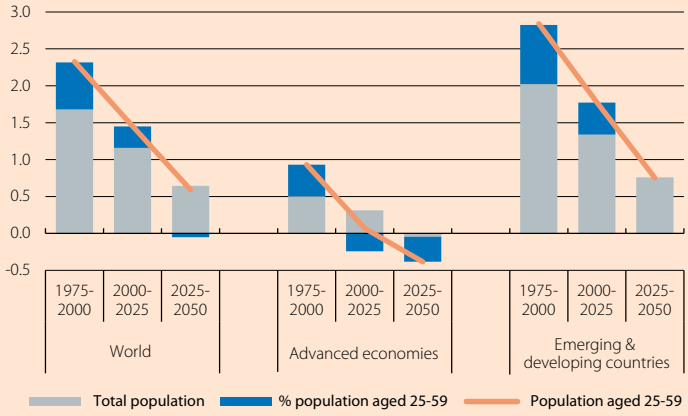
Note: *Population in employment over the total population in each age group.*
Source: *BPI Research, based on data from the OECD.*

The diminishing role of demographics in growth

Taking into account that a country's economic activity depends on the volume of its resources and the way in which they are used and combined, the current demographic transition poses two simultaneous challenges. On the one hand, lower population growth slows down the increase in available resources, in this case, the labour factor. On the other hand, population ageing causes the most utilised labour resources – usually the population between 25 and 59 years of age (see first chart) – to decrease as a share of the total. If we look at projections by the United Nations,[1] the combination of these two factors seems to lead, *ceteris paribus*, to a significant slowdown in economic growth in the coming decades. This is the case both for advanced countries, where the total population has already stagnated at best, and especially for emerging and developing countries, where for the first time the share of people of working age will decline relative to the population as a whole (see second chart).[2]

Average annual change in the population aged between 25 and 59

(% and contributions in pps)



Note: *Forecasts from 2024 onwards.*
Source: *BPI Research, based on data from the United Nations.*

Scope for closing the gender gap and prolonging working life

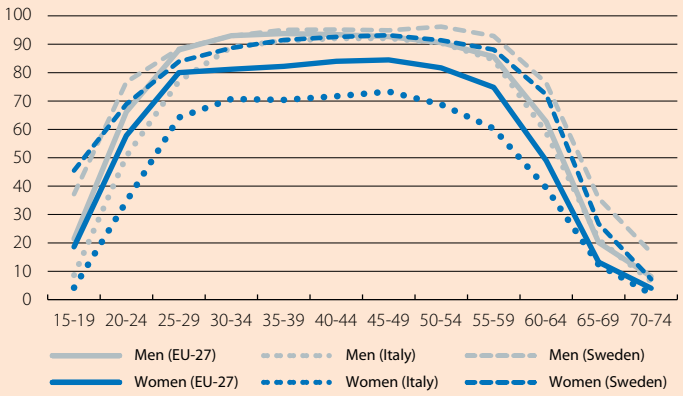
Among the elements that could help mitigate the effects of the current demographic transition on economic growth, one of the main areas of action is policies aimed at increasing the supply of labour. In this regard, despite the convergence observed in recent decades due to social and educational factors,[3] even today stark differences persist in the labour force participation rate between countries, as well as between population groups within these countries, with the lowest rates found among women and with a sharp decline in workers from 60 years of age (see the third chart for the EU as a whole and the contrast between two of its member countries, Italy and Sweden). Some of the levers that can

1. World Population Projections 2024: https://population.un.org/wpp/.
2. The IMF estimated in its World Economic Outlook report this spring that, with current policies, the global growth of the economy between 2025 and 2050 will be 1.1 pp lower than in 2016-2018.
3. C. Fernández Vidaurreta and D. Martínez Turégano (2018), «Labour market participation rate in the euro area: performance and outlook, a long-term view», Bank of Spain Economic Bulletin.

help boost participation among women include, above all, policies that facilitate a balance between work and family life, such as flexible part-time work arrangements, non-deterrent tax treatment for secondary earners and adequate provision of early childhood education services.[4] On the other hand, in order to extend people's working lives, incentives can be implemented to align the effective retirement age with the statutory one, to promote the compatibility of retirement and certain forms of employment, to bolster active policies with lifelong learning and to improve the health conditions in old age.[5] Also, given the differences between world regions in the stage and intensity of these demographic changes and the persistence of wide gaps in economic development, managing migratory flows will continue to play an important role.[6] Only an ambitious implementation of this set of policies can significantly cushion the effects of the demographic transition (see example for different EU countries in the fourth chart, based on UN projections).[7]

Participation rate by sex and age group in the EU 2023

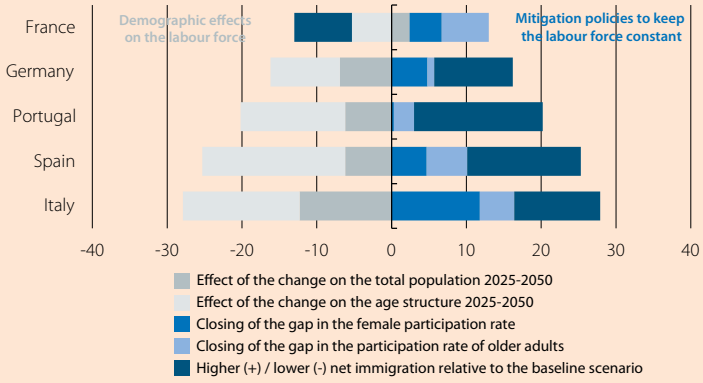
(%)



Note: *Labour force over total population in each age group.*
Source: *BPI Research, based on data from Eurostat.*

Labour force change in EU countries: 2025-2050

Demographic effects and mitigation policies (%)



Note: *Closing of the gender gap assumes that the female participation rate increases in all age groups to match the level for males; closing of the gap among older adults assumes that the participation rate in the 60 to 74 age group increases for both sexes to match the value in Sweden; higher/lower net immigration takes place in the 25 to 59 age group to match the labour force of 2050 with that of 2025.*
Source: *BPI Research, based on data from the United Nations and Eurostat.*

Productivity to the rescue (driven by AI)?

In addition to greater use of the labour factor, its more efficient use combined with capital resources is also a key source for overcoming the determinism of the current demographic transition. Over the past few decades, labour productivity has continued to increase at a steady pace globally, driven by structural change and macroeconomic stabilisation in emerging countries, which have facilitated efficiency gains, improvements in education level and the accumulation of productive capital (see fifth chart). However, the effect of these processes tends to be progressively exhausted as the degree of economic development advances and sectoral tertiarisation becomes more pronounced. Moreover, we observe a practical stagnation in the translation of technological advances to total factor productivity (TFP).[8] In this regard, recent developments in the field of artificial intelligence (AI) have opened the door for this general-purpose technology to boost TFP across a broad spectrum of sectors, particularly those involving more cognitive tasks, as well as accelerating innovation processes. However, there is still significant uncertainty over the degree of complementarity/substitutability of AI with the labour factor,[9] leaving ample scope for future scenarios. Some baseline estimates place the increase in labour productivity in the US in the range of 1%-1.5% per year,[10] which would offset the demographic brake on GDP growth discussed above. In the rest of the world, the expected

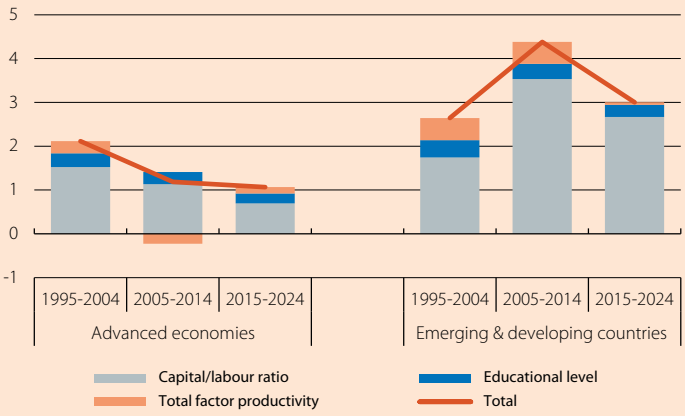
4. J. Fluchtmann, M. Keese and W. Adema (2024), «Gender equality and economic growth: Past progress and future potential», OECD.
5. IMF (2025). «The rise of the silver economy: global implications of population aging», World Economic Outlook.
6. See, for example, the case of the euro area after the pandemic: O. Arce, A. Consolo, A. Días and M. Weissler (2025), «Foreign workers: a lever for economic growth», ECB.
7. In the case of Spain, the projections produced by the National Statistics Institute (INE) differ significantly from those of the United Nations, mainly with regard to immigration flows. Specifically, while the latter anticipate an average of 60,000-70,000 net entries between 2025 and 2050, the INE's projections place this figure between 350,000 and 400,000 people. Using the latter as a reference, we estimate that the labour force in Spain would remain relatively stable during this period.
8. Changes in total factor productivity measure the variation in production in an economy that is not explained by increases in the productive factors (capital and labour); for example, through these factors being used more efficiently.
9. D. Acemoglu (2024), «The simple macroeconomics of AI», NBER.
10. M. Baily, E. Brynjolfsson and A. Korinek (2023). «Machines of mind: The case for an AI-powered productivity boom», Brookings; Goldman Sachs (2023), «Generative AI: hype, or truly transformative?».

gains would likely be more moderate given the reduced exposure to and preparedness for the adoption of AI, including institutional aspects, the rollout of digital infrastructure and vocational training (see sixth chart).[11]

A comprehensive strategy to address the demographic challenges

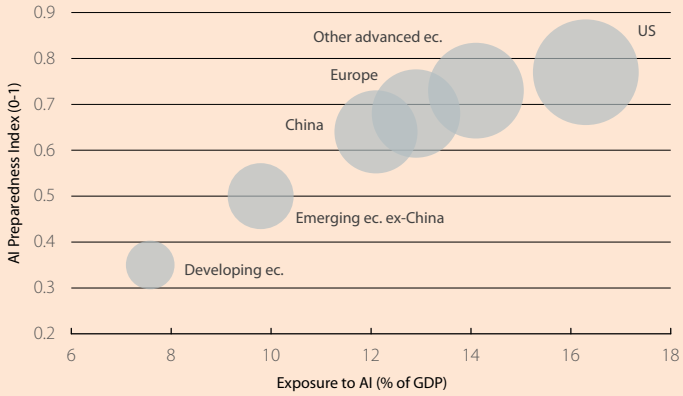
Policies aimed at increasing the labour supply and boosting productivity have a high potential to offset the effects of the demographic transition. However, their effectiveness will depend decisively on three factors. Firstly, it will depend on the existence of favourable conditions for business activity and job creation. In the EU, this need has been echoed in the Competitiveness Compass,[12] which seeks to revitalise the growth capacity of the European economy through improvements in the regulatory framework of the internal market and the mobilisation of capital towards strategic investments. Secondly, the range of professional skills needs to be adapted to technological changes, the green transition and new patterns of demand in an ageing society. To this end, active labour market policies must minimise the costs of adjusting to this new reality and firms must adapt their job positions, paying particular attention to jobs at risk due to task automation, increasingly shaped by advances in AI. Thirdly, the set of public policies must be adapted to promote further improvements in citizens' welfare at the same time as maintaining fiscal discipline,[13] while private actors will have to adjust their consumption and investment decisions to the new income and wealth conditions across the life cycle.[14] In both cases, the distributional effects of the ongoing changes will also be relevant for determining the magnitude of the challenges.

Average annual change in real labour productivity
(pps)



Source: *BPI Research, based on data from The Conference Board.*

AI exposure and preparedness by world region



Note: *The size of the bubble is proportional to the product of the two variables, which approximates the sensitivity to an AI-driven productivity shock.*
Source: *BPI Research, based on data from Cerutti* et. al. *(2025).*

11. E.M. Cerutti *et al.* (2025). «The Global Impact of AI – Mind the Gap», IMF.
12. See the Focus «A shift in the EU's political priorities» in the MR04/2025.
13. See the articles «The impact of ageing on public finances: a major challenge for Spain and Europe» and «Levers to mitigate the impact of demographics on public finances: the case of pensions» in this same Dossier.
14. See the article «Will an ageing society pay lower interest rates?» in this same Dossier.

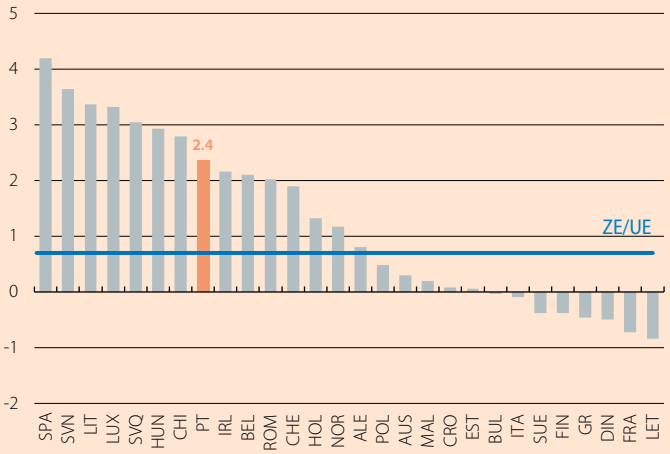
The impact of ageing on public finances: the great challenge for Portugal and Europe

It is undeniable that population ageing will have a significant impact on the public accounts of developed economies. In the case of Portugal, the projections reflect the warning sign: the European Commission (EC) estimates that the Portuguese population over 65 years of age is expected to increase by 800,000 individuals by 2050, of which 500,000 will be people over 80 years of age; on the other hand, people aged between 20 and 64 (i.e., working age) are expected to decrease by 1,300,000.[1] Given this scenario, the elderly dependency ratio will increase significantly (from 40.7% in 2022 to 68.6% in 2050), with a reduction in tax revenues (with the reduction of social contributions) and an increase in public expenditure. More specifically, if current economic policies are maintained, the EC estimates that public spending on ageing will increase by 3.7 pp over the next 25 years in Portugal (reaching 23% of GDP in 2050), the vast majority of which will be related to pension spending.

The EC analyses the direct impact of ageing on public spending in three areas: pensions, health care and long-term care. Public spending on pensions represents the largest share (around 65% of spending on ageing in Portugal, compared to 57% in the case of the EU) and the EC estimates that, if there are no changes in economic policies, this spending will increase from 12.2% of GDP in 2022 to 14.6% in 2050 (that is, more than 6.8 billion euros considering the GDP of 2024). The expected increase for Portugal (of 2.4 pp) exceeds that expected for the EU as a whole (of 0.7 pp, to 12.1% of GDP in 2050) and it is the 8th country that could face the largest increase in these charges in the EU as a whole (the highlight goes to Spain, whose charges are expected to increase by more than 4 pp). Thus, in 2050, Portugal is expected to be the 4th EU country with the highest public pension expenditure, behind Spain (17.3%), Italy (15.5%) and Belgium (14.8%).

Public spending on pensions

Variation 2022 vs.2050 (pp of GDP)



Source: *BPI Research, based on data from the European Commission* (Ageing Report *2024).*

The weight of pensions in GDP will increase over the next 20 years, with the peak being reached in 2046 (15.2%). The main determinant for this increase is the proportion of people over 65 in the working-age population (20-64 years), the so-called «dependency ratio»; more specifically, Portugal currently has the equivalent of 2.5 people of working age for every person over 65, but by 2050, this proportion will decrease to 1.5. The increase in the proportion of older people in the working-age population will increase pension burdens by 7.5 pp of GDP, an impact that was especially relevant between 2030 and 2040 (3.2 pp). This effect is partially mitigated by the expected fall in the replacement rate (the ratio between the average pension and the average salary), by dynamics in the labour market (namely the increase in the employment rate) and by a lower coverage rate (retirees among the population of retirement age).

At the same time, health spending is expected to increase across the EU, with the increases expected for Portugal exceeding what is expected for the EU (0.9 pp and 0.3 pp, respectively). By 2050, health spending is expected to slightly exceed 7% of GDP in both cases. Long-term care costs will also increase during this period: in the case of Portugal, the increase could reach 0.4 pp, to 0.9% of GDP, a lower burden than expected for the EU as a whole (2.3% of GDP in 2050, an increase of 0.6 pp).

Thus, overall, direct public spending on ageing in Portugal is expected to increase from almost 19% of GDP in 2022 to almost 23% in 2050. This represents an increase of 3.7 pp, much higher than the expected increase for the EU as a whole, of 1.5 pp (to 21.6%).

In conclusion, demographics are expected to exert upward pressure on public spending in the medium term, in Portugal and the rest of the European Union. However, it is also important to note that the level of uncertainty associated with the baseline projections in this article is very high, linked to the underlying macroeconomic and demographic assumptions and their evolution

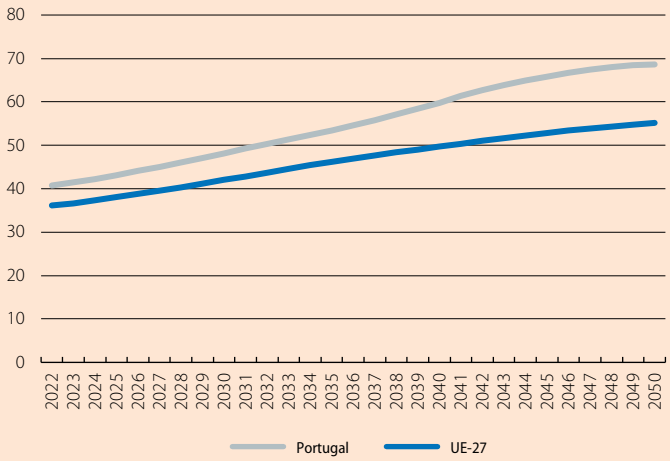
1. European Commission (2024). «2024 Ageing Report: Economic & Budgetary Projections for the EU Member States (2022-2070)».

over a very long time horizon. Furthermore, action is still possible, and the EU and Portugal can still use the levers they have available to begin reversing this situation as soon as possible. The next article sheds some light on these potential levers.

Vânia Duarte

Elderly dependency ratio

(%)



Source: *BPI Research, based on data from the European Commission (*Ageing Report *2024).*

Levers to mitigate the impact of demographics on public pensions in Portugal

The data revealed in the previous article corroborate the upward pressure of demographics on public expenditure in the coming years and, in the absence of additional measures, this will result in a deterioration of public accounts in the medium term, a scenario that is common to other developed economies.[1]

In this article, we focus on some levers to mitigate the impact of population ageing on public finances and, in particular, on pension spending: extending careers (either voluntarily or more coercively) and attracting immigrants.[2] Other policies could be added to these, particularly to promote the use of private savings instruments (such as pension funds), or measures to encourage birth rates and/or talent retention.

The levers that can change the course of pension spending

The EC estimates that the 2.4 percentage point increase in public spending on pensions in Portugal over the next 25 years is solely explained by demographic dynamics, more specifically, by the growing weight of the older population in the working-age population.

One way to ease the pressure on pensions is to encourage career extension by increasing the employment rate of older people. Nevertheless, the EC draws attention to the distinct dynamics that this situation implies; while, on the one hand, increased employment generates more economic growth and fewer pensioners, i.e. lower pension expenditure in absolute terms and in relative terms compared to GDP, on the other hand, longer working lives mean more rights when these workers retire, i.e. higher pensions and, consequently, increased costs. Still, the conclusion is that an increase in the employment rate of older people contributes to reducing pension costs; more specifically, the EC[3] estimates that a 10 pp increase in the employment rate of individuals aged between 55 and 74 compared to the scenario *baseline* (i.e., to 70% in 2050) would allow pension spending to be reduced by 0.5 pp of GDP in Portugal, i.e., around 22% of the increase expected in the baseline scenario (2.4 pp). Currently, the employment rate in this age group is around 58%, which means it would need to increase by 12 pp by 2050. Over the last 10 years, the increase in the employment rate in this age group was higher (around 25 pp), but the context was different: the starting point was lower (around 32% in 2012) and the financial assistance program brought some impositions in this field, which will have caused an extension of the professional life of older individuals (for example, the change in the formula for calculating the sustainability factor).[4] Thus, the 12 pp seems ambitious in a context where the employment rate is already at quite significant levels, but it does not seem impossible considering the current conditions for accessing retirement without penalties.

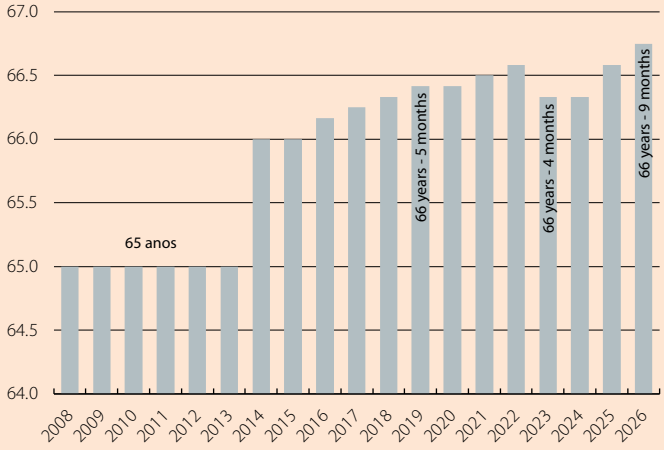
Policies that encourage career extension may include, for example, combining salary with pension, promoting participation in the labour market in more flexible working arrangements (e.g. opting for part-time work, teleworking) or reorganising within companies, adjusting roles to the abilities and skills of older people (e.g. reducing more physically demanding work) and promoting cooperation between employees of different age groups. Another relevant aspect concerns the promotion of professional development, encouraging lifelong learning and the development of skills.[5]

Another more coercive way of increasing career length is by postponing the legal retirement age (i.e., without penalties), for example, in line with the increase in life expectancy, a practice already followed in Portugal. In the *Ageing Report 2024*, the EC analyses the impact of postponing the retirement age, linking it to increased longevity: it assumes that the statutory retirement age increases in line with 3/4 of the increase in life expectancy at age 65 between 2022 and 2050. This would mean that the legal retirement age in Portugal would increase from 66 years and 7 months in 2022 to practically 69 years in 2050, since life expectancy is expected to increase by about 3 years in this period. This effect alone would represent a reduction in pension costs of 0.2 pp of

1. For more information, see the details explained in the article «The impact of aging on public finances: the great challenge for Portugal and Europe», in this publication.
2. The levers to mitigate the macroeconomic impact of ageing are discussed in detail in the article «Ageing and economic growth: effects and levers for their mitigation», in this publication.
3. Conclusions drawn from the sensitivity analysis carried out within the scope of *Ageing Report 2024*.
4. The sustainability factor adjusts the pension value to the average life expectancy at age 65 and applies to early retirements. In 2014, this calculation was changed and the normal retirement age was now indexed to changes in life expectancy, rather than being a fixed number (at the time, 65 years). That year, early retirements began to face steeper penalties, reflecting the increase in the sustainability factor and the normal retirement age. In 2025, the application of the sustainability factor implies a 16.93% pension cut, and the normal retirement age is 66 years and 9 months in the general Social Security regime.
5. For more information, see Cedefop (2013). «Older workers – new opportunities».

GDP in 2050 compared to the scenario *baseline*. Since Portugal already has the normal retirement age indexed (by 2/3) to the average life expectancy at 65 years, it justifies that the gains with a measure of this level are not as expressive as is the case, for example, with Hungary, Austria or Poland (with savings of around 1 pp of GDP); in fact, Portugal is the fourth country that would save the least on pensions with an increase in the retirement age under these conditions compared to the current scenario.

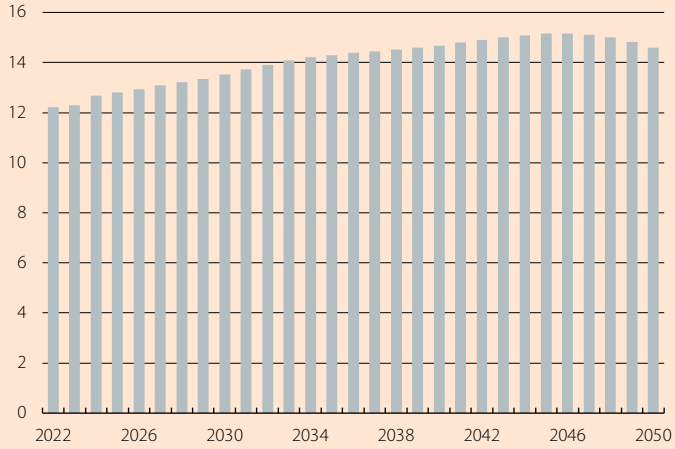
Evolution of the Normal Retirement Age in Portugal
(Years)



Source: *BPI Research, based on data from GEP and Ordinances.*

Finally, immigration is also a relevant lever for reducing pension costs in Portugal. In this case, the phenomenon is explained by the expected increase in the employed population and, therefore, economic growth, which implies that pension costs would decrease in relative terms. In the case of Portugal, the EC estimates that a 33% increase in annual net migration flows compared to the *baseline* scenario (i.e. from an average of 24,600 people between 2022 and 2050 to 32,700) would result in savings in pension costs as a percentage of GDP of 0.4 pp. A net migration balance of 32,700 individuals is slightly higher than the historical average for the last 20 years (31,240), but lower than the average of 149,670 between 2023 and 2024, or the average recorded in the three years prior to the pandemic (35,270). However, in order to assess the impact of immigration on public finances more comprehensively, it would be necessary to analyse the evolution of immigrants' contributions to public revenues in comparison with the benefits they will receive throughout their lives (for example, the impact will be more positive in the case of young immigrants with higher levels of education).

Gross public expenditure on pensions
(% PIB)



Source: *BPI Research, based on data from the European Commission.*

In conclusion, if current policies are maintained, public spending on pensions is projected to increase by 2.4 pp over the next 25 years (from 12.2% of GDP in 2025 to 14.6% in 2050). The need to act quickly is pressing: pension spending is expected to increase steadily over the next 20 years, reaching a peak of 15.2% of GDP in 2046. Extending the working life of older people by creating conditions in companies or appropriate public policies, and attracting young immigrants and/or retaining national talent could offset this increase in pension costs or, at least, mitigate this increase according to the sensitivity analyses explored in this article. Nevertheless, it is worth mentioning the inherent difficulty of making macroeconomic and demographic projections for such a long time horizon. Furthermore, these EC projections do not reflect recent data on migration flows, which are higher than those underlying this projection exercise.

Vânia Duarte and Javier García Arenas

Will an ageing society pay lower interest rates?

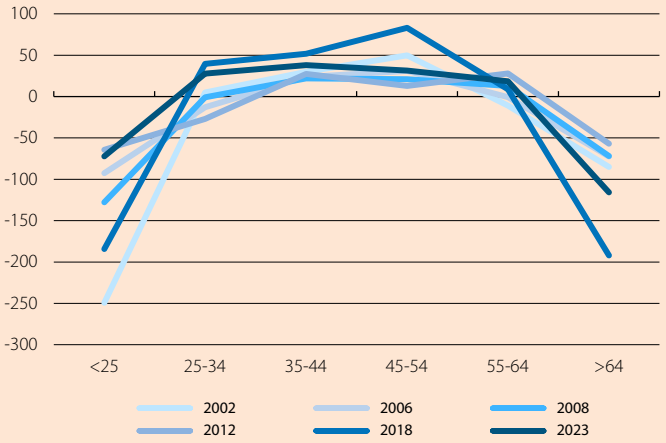
In the other pages of this Dossier, we have analysed in depth how ageing will affect the capacity for economic growth and the public finances. All these changes will have consequences on the supply and demand for savings and, therefore, on the interest rates of economies.

From ageing to savings: transmission channels

We can divide the transmission mechanisms of population ageing on interest rates between those that affect the demand for savings and those that affect the supply. On the demand side, it should be borne in mind that population ageing goes hand in hand with a reduction in fertility and lower population growth. This results in less dynamic GDP[1] and, consequently, investment: that is, lower demand for savings, leading to lower interest rates. In other words, as the capital of an economy slowly depreciates, the lower growth of the economy causes the capital stock-to-GDP ratio to rise and generates a relative abundance of capital, which pressures interest rates downwards.[2]

US: savings rate by age

Deviation from the national average (%)

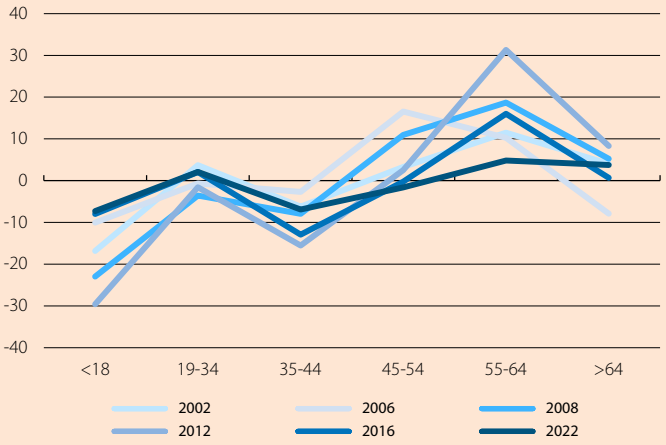


Source: *BPI Research, based on data from the Consumer Expenditure Survey (Bureau of Labor Statistics).*

On the supply side there are different mechanisms, and all of them are derived from the so-called life cycle theory.[3] According to this theory, the savings rate varies over the course of our lives following an inverted U-shape: young people and the elderly save less, while the middle-aged save more. The first chart shows how this relationship plays out in the US (not so clearly in Italy).[4] The reason is the desire to enjoy a relatively stable quality of life over time. Thus, the life cycle theory suggests that people should save more at those ages at which they earn higher incomes, and use these extra savings to improve their quality of life in stages with a lower income flow (typically youth and old age).

Italy: savings rate by age

Deviation from the national average (%)



Source: *BPI Research, based on data from the* Indagine sui bilanci delle famiglie italiane (Banca d'Italia).

Taking into account these fluctuations in savings throughout the life cycle, population ageing generates two major forces on the supply side. The first presumes a change in the behaviour of savers. Ageing is associated with an increase in life expectancy and in the number of years of labour inactivity after retirement. If people want to maintain a stable quality of life over a longer retirement, as the life cycle theory postulates, then higher life expectancy should spurt an increase in savings in the years of labour activity. That is, the increase in life expectancy ought to increase the supply of savings.

The second force is based on changes in the composition of savers. On the one hand, the increase in the elderly population means that a greater proportion of the population would be comprised of a segment which, according to the life cycle theory, should have lower savings rates. This dynamic depresses the total supply of savings. However, the third chart

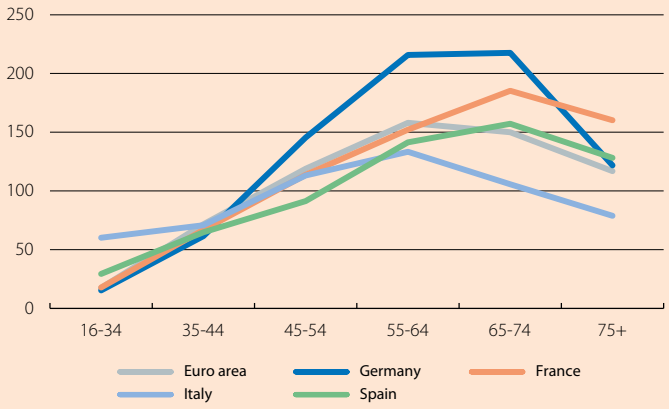
1. See the article «The effects of ageing on growth and policy tools to mitigate them» in this same Dossier.
2. See C. Jones (2023). «Aging, secular stagnation, and the business cycle», Review of Economics and Statistics, 105(6), 1580-1595.
3. A. Ando and F. Modigliani (1963), «The 'life-cycle' hypothesis of saving: aggregate implications and tests», American Economic Review, 53(1), 55-84.
4. In Spain, according to internal CaixaBank Research data, there is also a clear inverted-U relationship between the savings rate and age.

illustrates how the elderly population is, at the same time, a group that tends to have a larger stock of savings accumulated throughout their lives (whether in the form of real estate or financial assets) and, therefore, if the elderly population increases in relative terms, so too should the total supply of savings. Overall, changes in the composition of the population have an uncertain effect because they present two opposing forces: a flow effect (lower savings rate) and a stock effect (greater accumulated stock of savings).[5]

Finally, there is another mechanism that goes beyond the supply and demand for savings. Nominal interest rates also depend on inflation, since we usually talk about interest rates in terms of a currency, such as the euro or the dollar, and not in «real units». If population ageing makes the labour factor more scarce (for example, due to a reduction in the percentage of workers), then there could be more dynamic growth in wages and, therefore, in inflation, which would end up driving up interest rates in nominal terms.[6] However, in the demographic transition there could also be disinflation if the loss of economic growth occurs more quickly than the reconfiguration of the productive structure (demand would lose steam faster than supply).

Average net wealth by age group

(% of the national average)



Note: *Net wealth is the difference between assets (including real estate and financial assets) and total liabilities.*
Source: *BPI Research, based on data from the* Household Finance and Consumption Survey *(Eurosystem).*

The net effect on interest rates

The mixture of mechanisms with different impacts on the supply and demand for savings and on inflation expectations prevents us from drawing unambiguous conclusions. While lower economic growth, higher life expectancy and the «stock of savings» effect tend to push rates downwards, the «flow of savings» effect and the traction between wage growth and inflation push them upwards.

One way of settling the net effect on interest rates is to build an economic model that contains all of the forces discussed as ingredients. This is what studies like those conducted by Auclert *et al.* (2021),[7] the IMF (2023)[8] and Lisack *et al.* (2017) do.[9] According to all of these models, population ageing results, on balance, in lower interest rates. However, each model has its nuance. On the one hand, the IMF believes that, as the demographic transition is already at an advanced stage, its impact on interest rates in the future will be moderate. On the other hand, Lisack *et al.* (2017) emphasise the life expectancy channel (which will continue to progress) and still anticipate a significant downward pressure on interest rates in the 2040 horizon. In the same vein, Auclert *et al.* (2021) highlight the «stock of savings» effect and project persistent downward pressure through to 2050. A monograph by the ECB itself[10] also estimates a persistent negative impact.

However, these results are not free of uncertainty.[11] Beyond the particularities of each model, there is the question of how people's actual behaviour will change. For example, a longer working life would ease downward pressures on interest rates. Also, the inverted-U relationship between the savings rate and age is still a theoretical postulate, and actual data show significant variation across countries and time periods, with some meaningful deviations from the theoretical postulates (compare the most canonical case of the US, in the first chart, with the deviations presented by Italy, in the second). In short, like in the rest of the articles of this Dossier, in the case of interest rates the key once again lies in which levers will be activated in order to manage demographic forces.

5. N. Lisack, R. Sajedi and G. Thwaites (2017). «Demographic trends and the real interest rate», Bank of England Staff Working Paper.
6. C.A.E. Goodhart and Manoj Pradhan (2020). «The great demographic reversal», Economic Affairs, 40 (3).
7. A. Auclert *et al.* (2021). «Demographics, wealth, and global imbalances in the twenty-first century», National Bureau of Economic Research Working Paper.
8. IMF (2023). «The natural rate of interest: drivers and implications for policy», chapter 2 of the World Economic Outlook of April 2023.
9. See the reference in footnote 5.
10. C. Brand, M. Bielecki and A. Penalver (2018). «The natural rate of interest: estimates, drivers, and challenges to monetary policy», ECB Occasional Paper.
11. See the discussion in a previous article, «The demographic cycle of savings and interest rates», in the Dossier of the MR11/2018.

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