

PORTUGAL: MOVING AHEAD

April 2013

Core issues on the Portuguese economy

	Page
1) Macroeconomic Imbalances	3
2) External Adjustment	7
3) Public Finances	17
4) Structural Reforms	23
5) Banking Sector Challenges	28
6) Debt Management	32

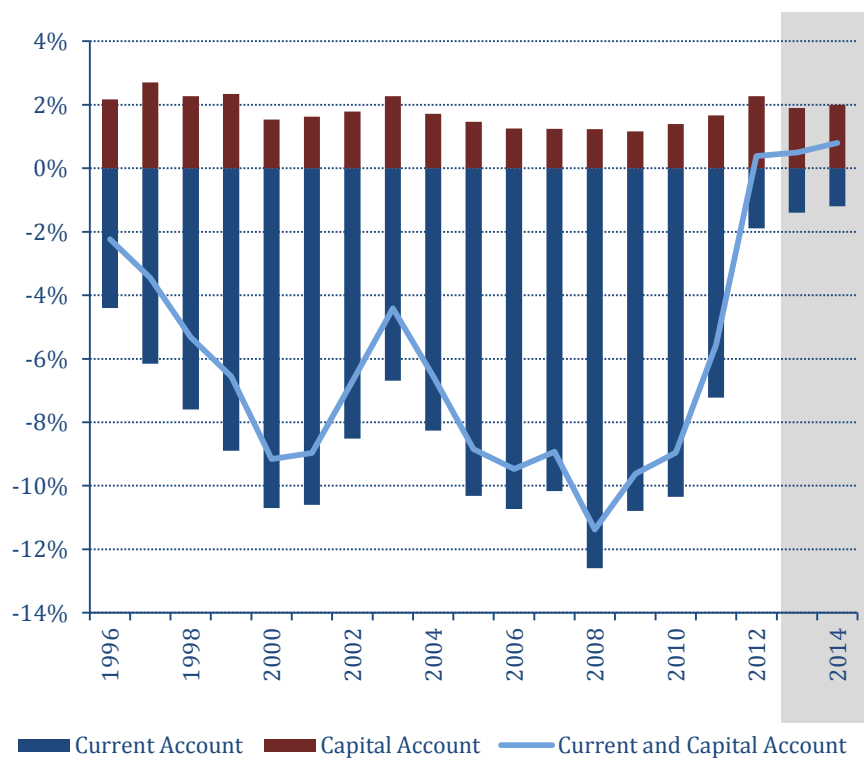
1) MACROECONOMIC IMBALANCES

1) Macroeconomic Imbalances

High external deficit and negative international investment position

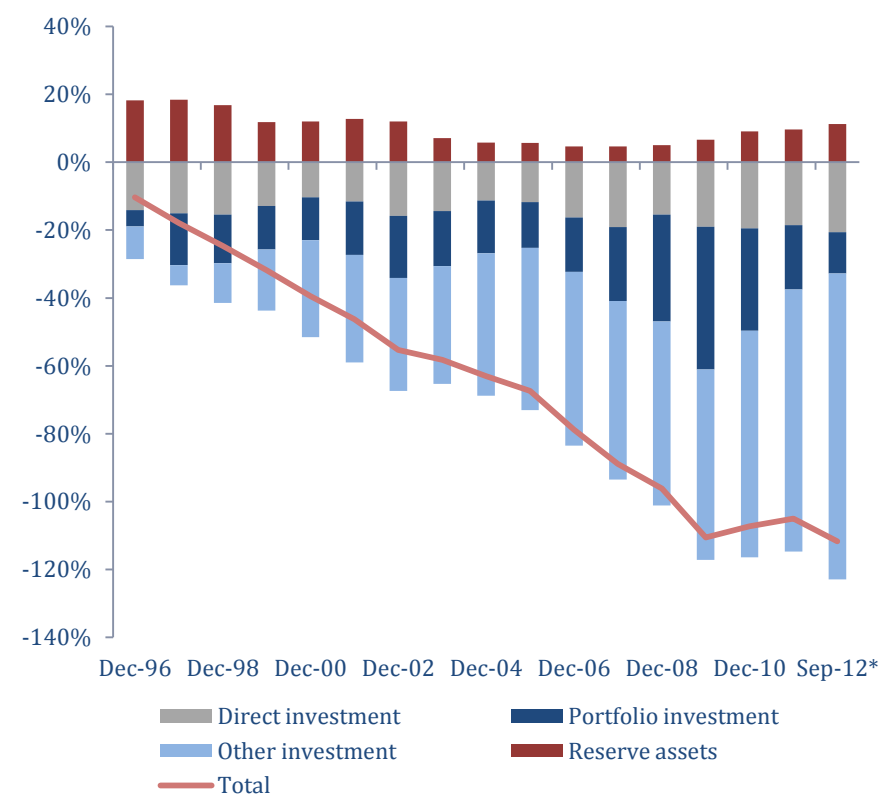
External Deficit

[% GDP]



Net international investment position

[% GDP]



Source: Statistics Portugal, European Commission

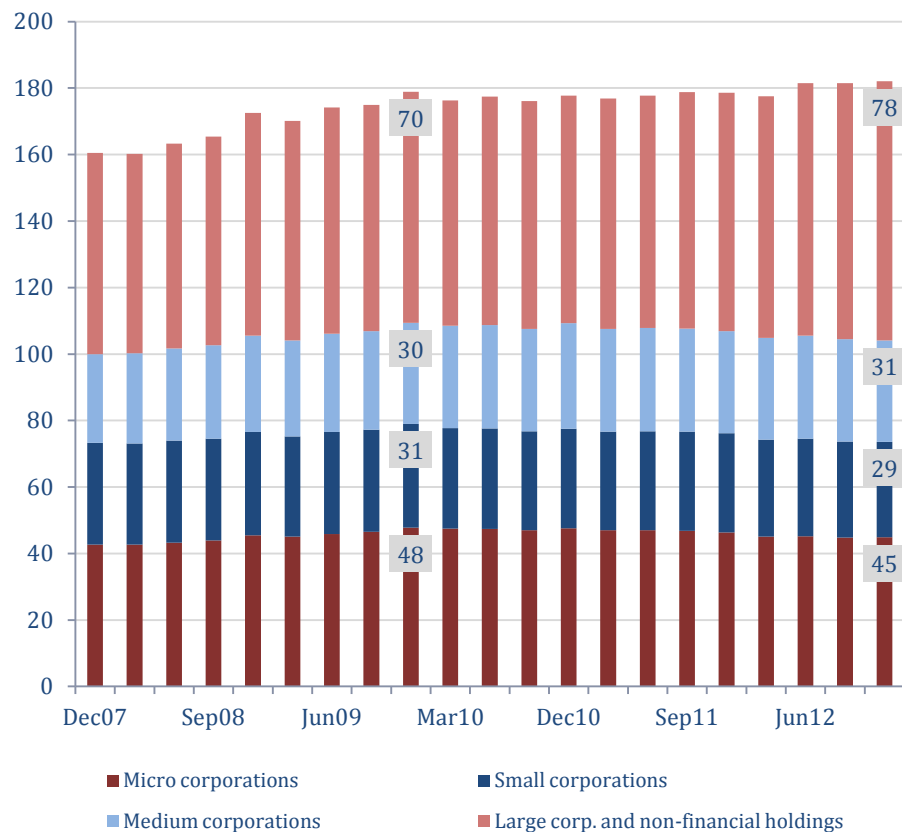
Source: Banco de Portugal

1) Macroeconomic Imbalances

High private sector indebtedness

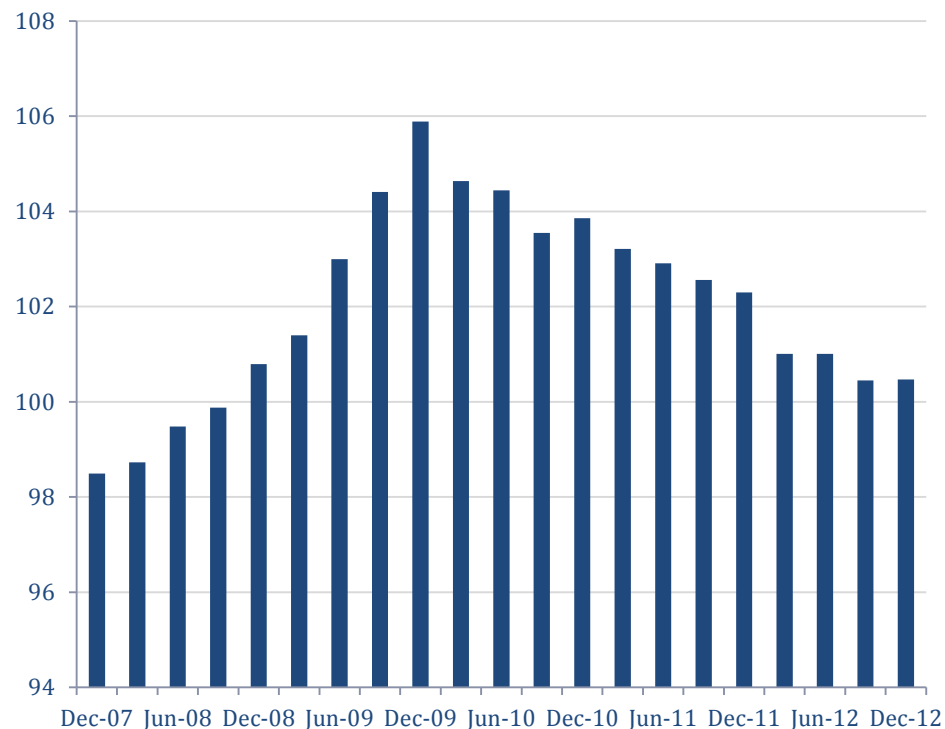
Private corporation indebtedness

[% GDP]



Households indebtedness

[% GDP]



Source: Banco de Portugal

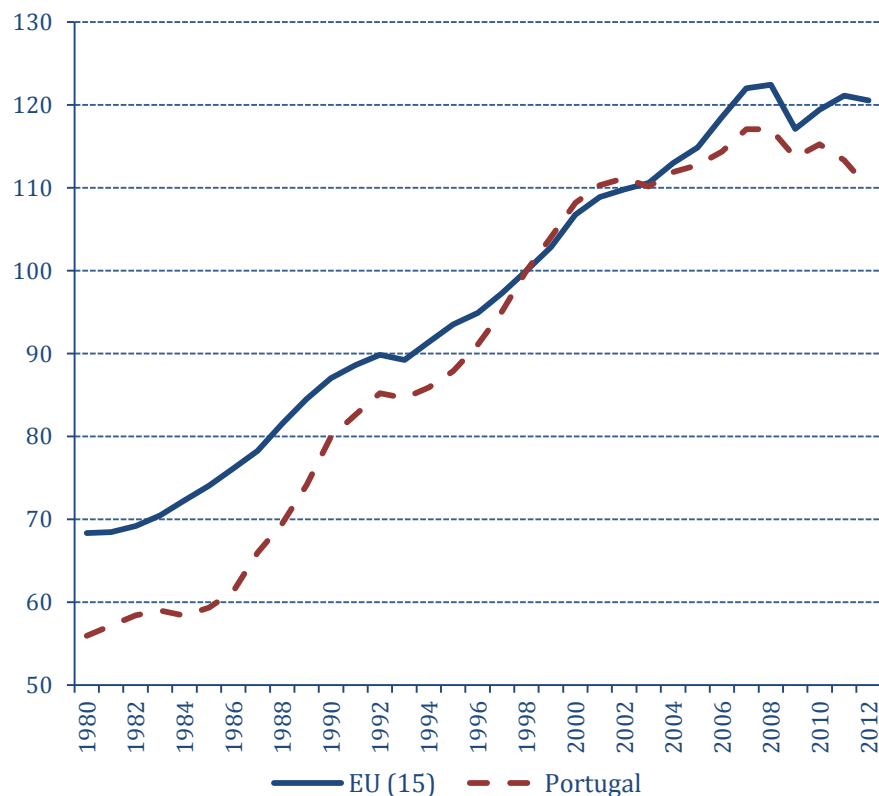
Source: Banco de Portugal

1) Macroeconomic Imbalances

Poor performance of the Portuguese economy since 2000, mainly explained by low Total Factor Productivity (TFP) growth...

Convergence towards euro area average in the 80s and 90s gave place to divergence in the last decade

[Real GDP index, 1998=100]



Source: AMECO

Excessive reliance on consumption

[GDP components and GVA by industry, % total]

	GDP composition					Euro area average (2010)
	1995	2000	2005	2010	2012 Q2	
Aggregate demand composition						
Private consumption	63.1	63.1	64.7	66.9	63.7	57.2
Public consumption	19.7	19.6	21.1	21.9	21.4	21.7
GCF	22.6	27.0	23.5	19.5	14.6	19.2
Exports	22.3	25.4	27.7	31.4	37.4	41.8
Imports	-28.0	-35.1	-37.1	-39.8	-37.1	-40.0
GVA decomposition by sector						
Agric., forestry and fishing	3.9	3.0	2.7	2.5	2.7	1.9
Industry (except construction)	17.9	18.6	18.0	16.9	17.5	19.5
Construction	8.8	9.0	7.5	5.8	4.8	5.6
Wholesale and retail trade, transport, accommodation and food service activities	22.4	23.3	23.2	23.8	24.9	19.3
Information and communication	3.1	3.2	3.8	4.2	4.0	5.1
Financial, insurance	3.4	4.7	6.3	8.2	8.3	5.7
Real estate activities	8.6	8.3	8.0	7.9	8.6	10.7
Public administration, defence, education, human health and social work activities	23.3	21.8	22.1	21.4	19.6	18.9
Other services activities	8.6	8.2	8.4	9.3	9.5	13.3

Source: Banco de Portugal (2009)

2) EXTERNAL ADJUSTMENT

2) External Adjustment

A recovery based on an exports-driven growth

Main indicators for the Portuguese economy

[yoy, %, unless otherwise stated]

	Macroeconomic scenario						
	7th Review						
	2009	2010	2011	2012	2013	2014	2015
Real GDP (yoy %)	-2,9	1,9	-1,6	-3,2	-2,3	0,6	1,5
Private consumption	-2,3	2,5	-3,8	-5,6	-3,5	0,1	0,9
Public consumption	4,7	0,1	-4,3	-4,4	-2,6	-2,0	-1,9
GFCF	-8,6	-3,1	-10,7	-14,5	-7,6	2,5	5,4
Domestic demand	-3,3	1,8	-5,8	-6,7	-4,1	0,1	1,2
Exports	-10,9	10,2	7,2	3,3	0,8	4,4	4,7
Imports	-10,0	8,0	-5,9	-6,9	-3,9	3,1	4,0
External sector (% GDP)							
Goods	-10,0	-10,6	-7,8	-4,6	-3,1	-2,6	-2,3
Goods and Services	-7,4	-7,7	-4,4	-0,5	1,7	2,5	3,1
Current account	-10,8	-10,4	-7,2	-1,9	-0,3	0,4	0,7
Current and Capital account	-9,6	-9,0	-5,6	0,4	1,4	1,9	2,1
Unemployment (% labor force)	9,5	10,8	12,7	15,7	18,2	18,5	18,1
GDP deflator (yoy %)	0,9	0,6	0,5	-0,1	1,7	1,3	1,1

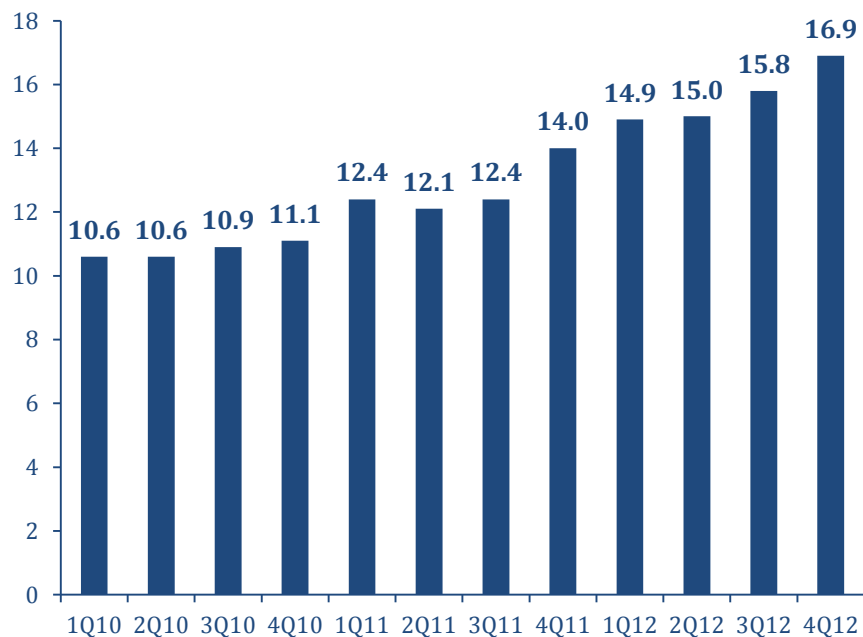
Source: Ministry of Finance and European Commission

2) External Adjustment

Job-losses are more pronounced in the labor-intensive non-tradable sectors...

Unemployment rate has increased sharply in recent months

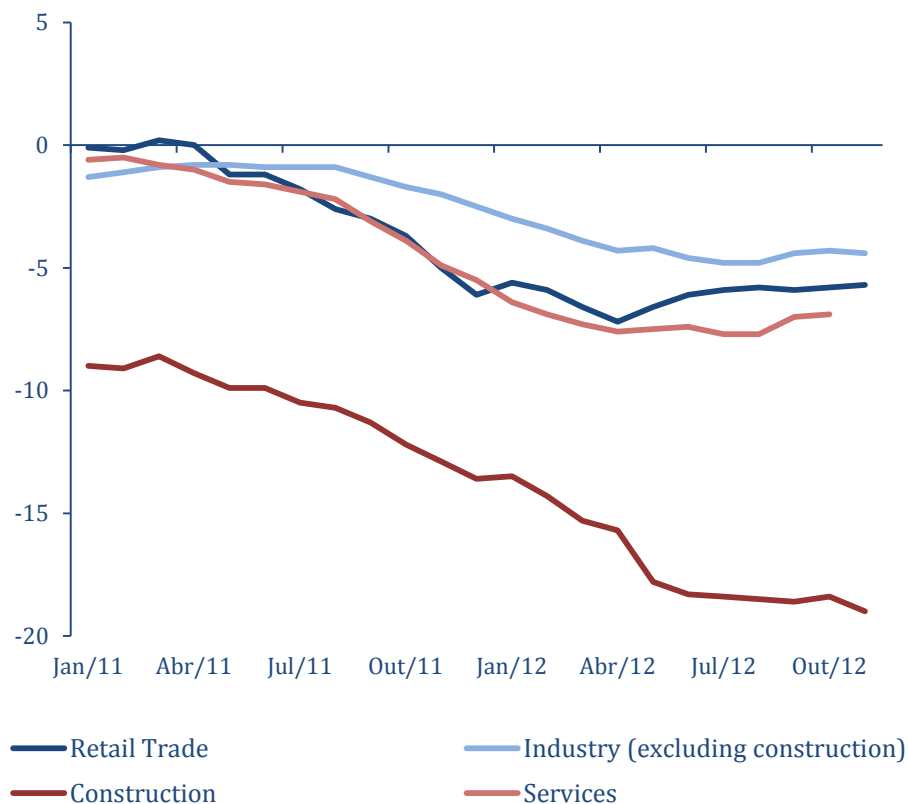
[Unemployment rate, % labor force]



Source: Statistics Portugal

Employment losses highly concentrated on the construction sector

[Employment variation by main sectors, yoy, %]



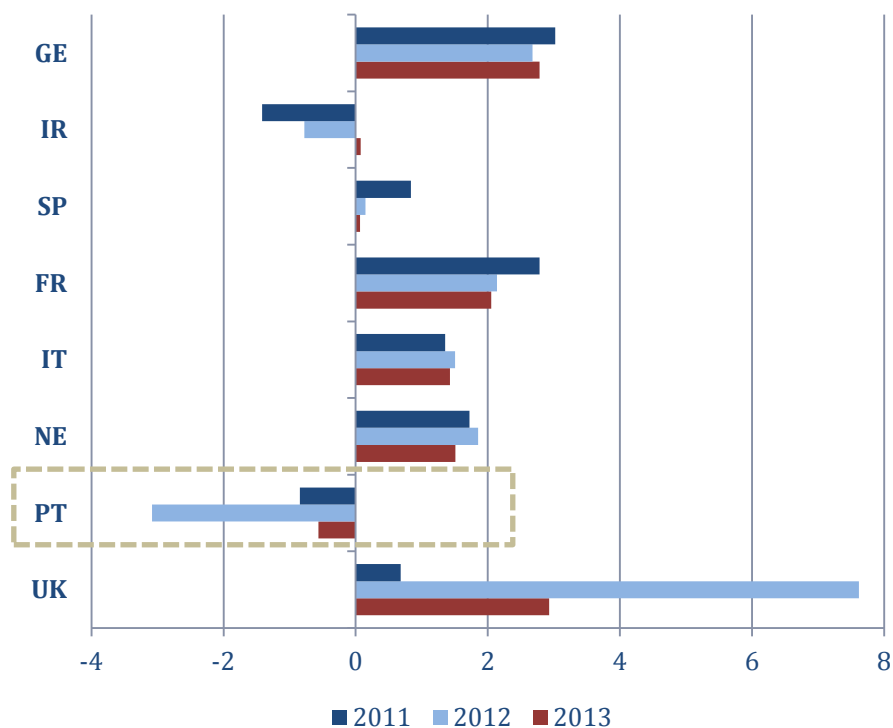
Source: Statistics Portugal

2) External Adjustment

... and wages are adjusting, leading to competitiveness gains

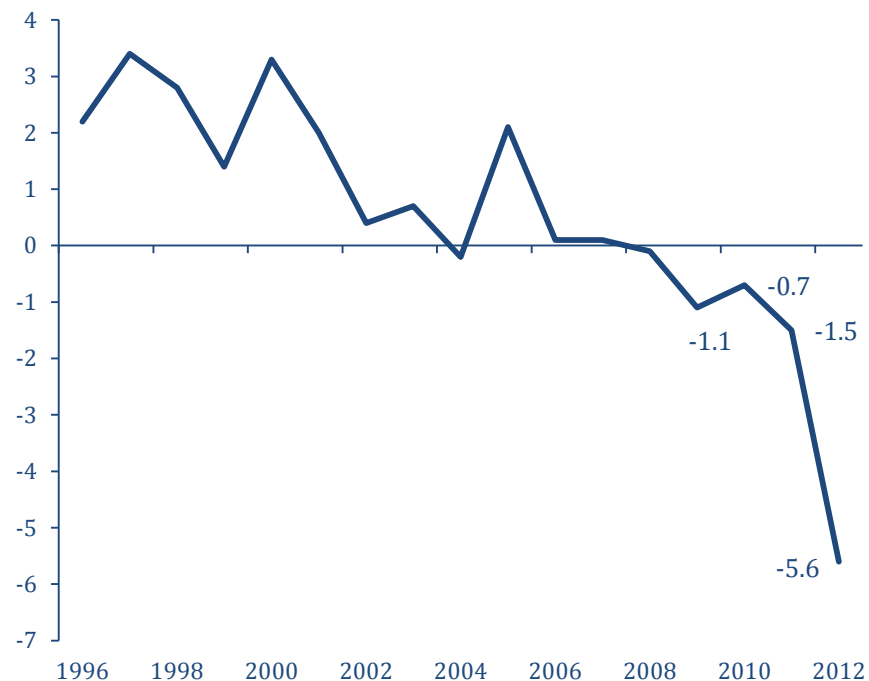
Compensation per employee is decreasing...

[yoy, %]



...and progressively repositioning the economy in euro area competitiveness

[Nominal unit labor costs – differential *vis a vis* euro area, p.p.]



Source: AMECO

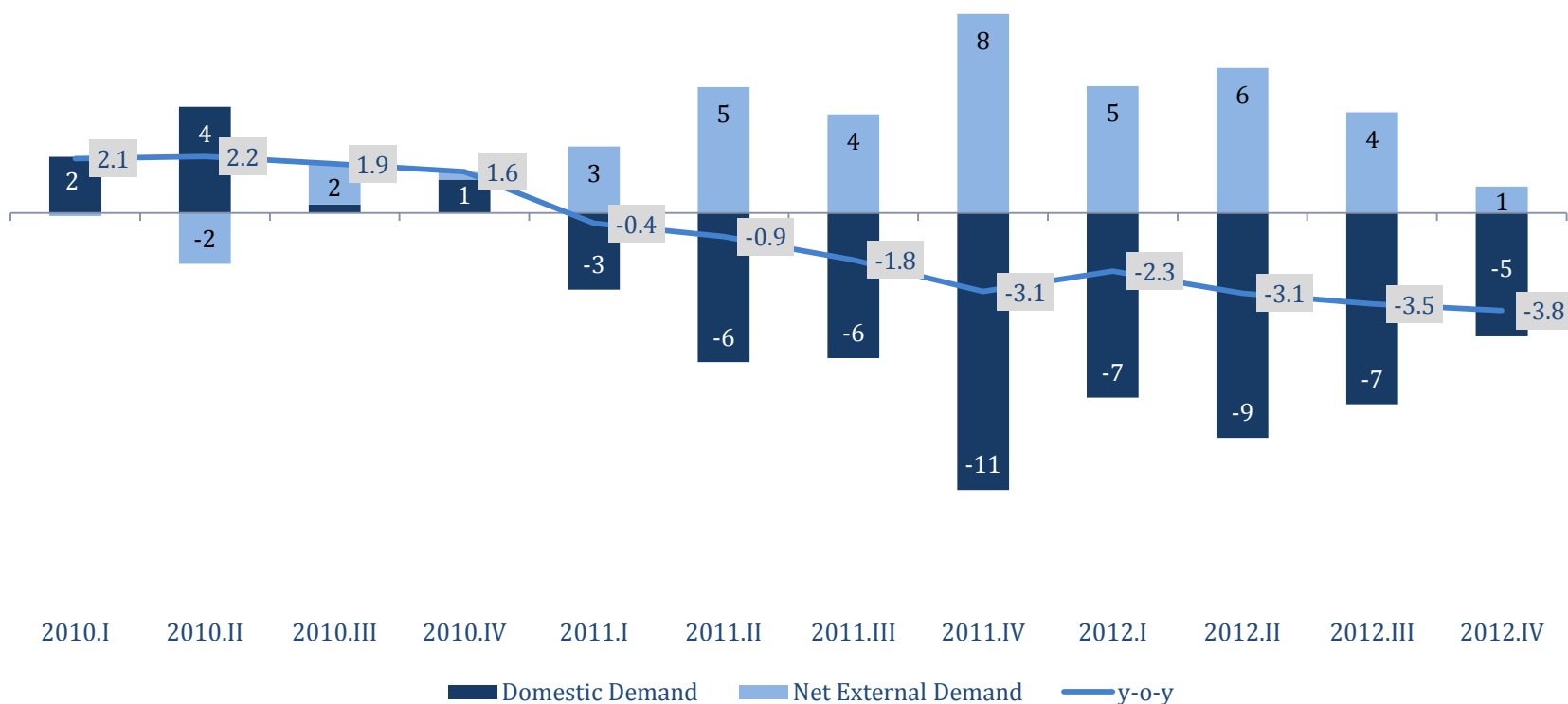
Source: Statistics Portugal, Banco de Portugal

2) External Adjustment

GDP contraction in 2012 in line with the expectations

Net External Demand contribution to GDP growth is robust and steady

[Contributions to yoy real GDP Growth, %]



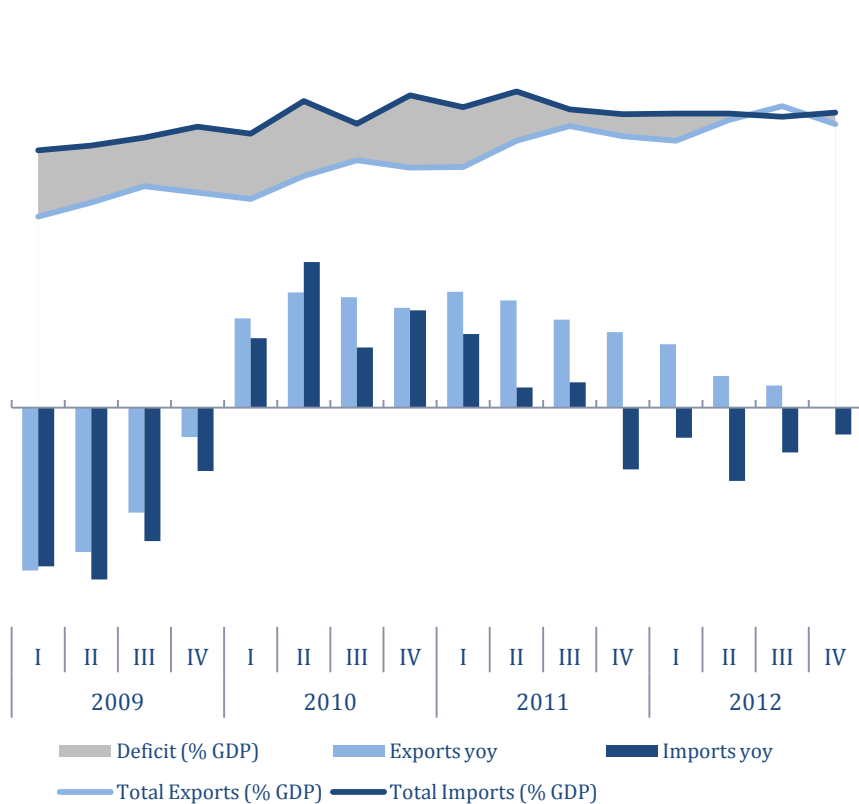
Source: Statistics Portugal

2) External Adjustment

Balance of Goods and Services has reached the turning point on the back of a strong exports performance

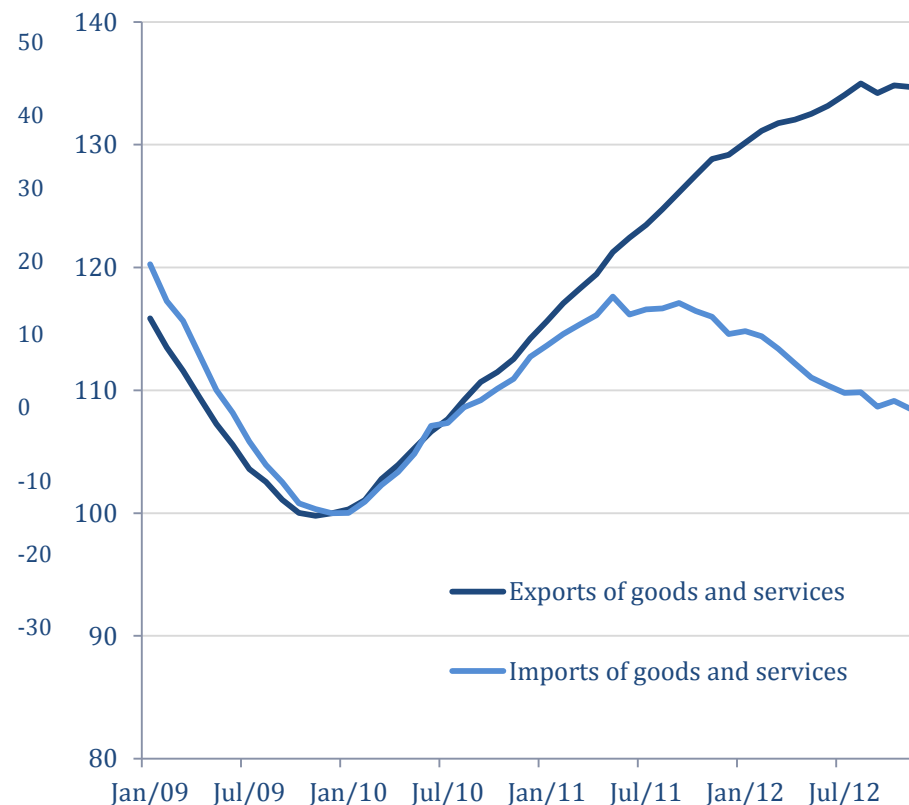
Balance of Goods and Services

[nominal terms, %]



Exports and Imports

[Index: 2009=100, %, 6m.m.a.]



Source: Banco de Portugal

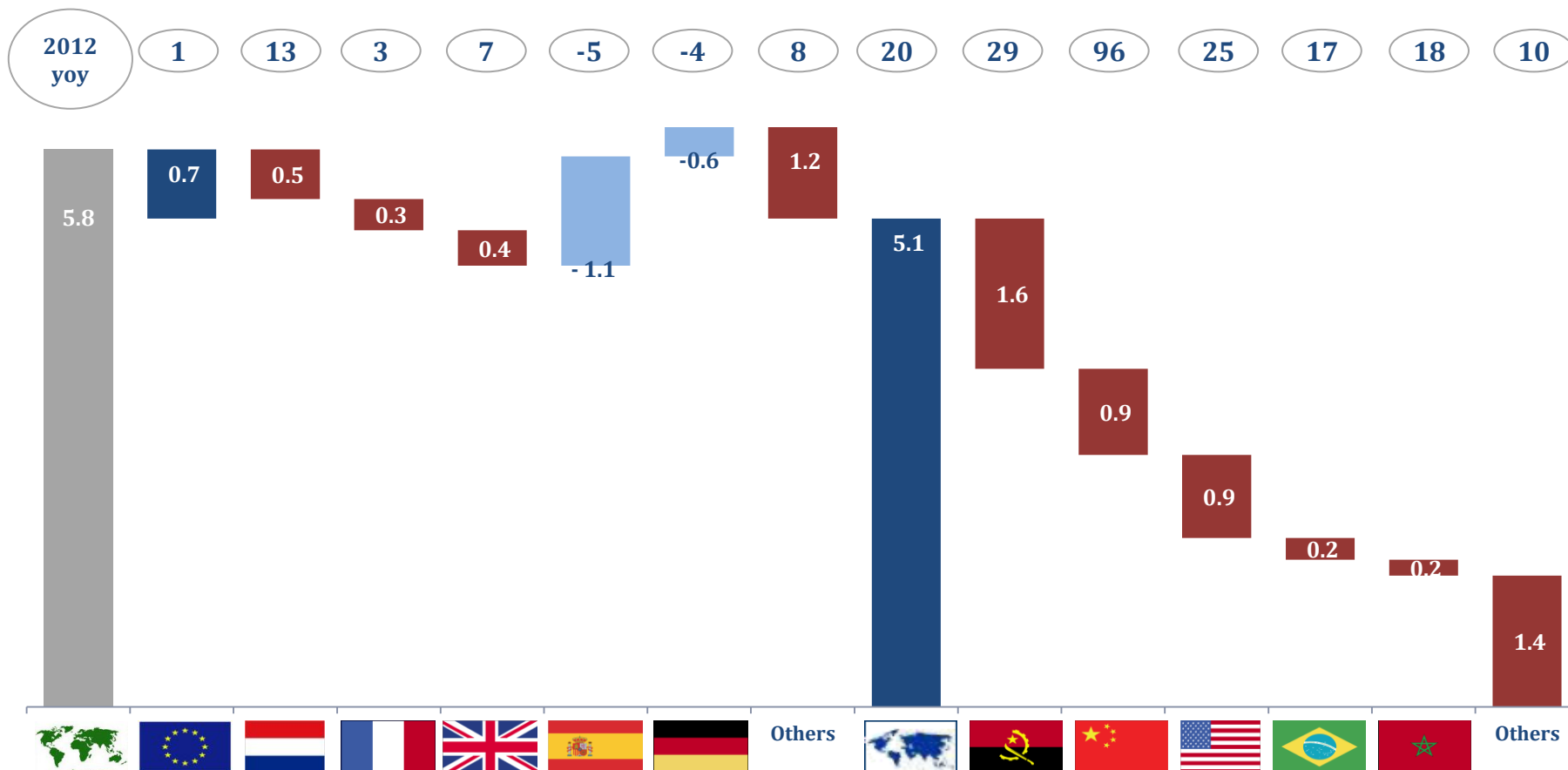
Source: Banco de Portugal

2) External Adjustment

Geographic diversification is boosting Portuguese exports

Major contribution from Intra and Extra-EU exports

[%, 2012]



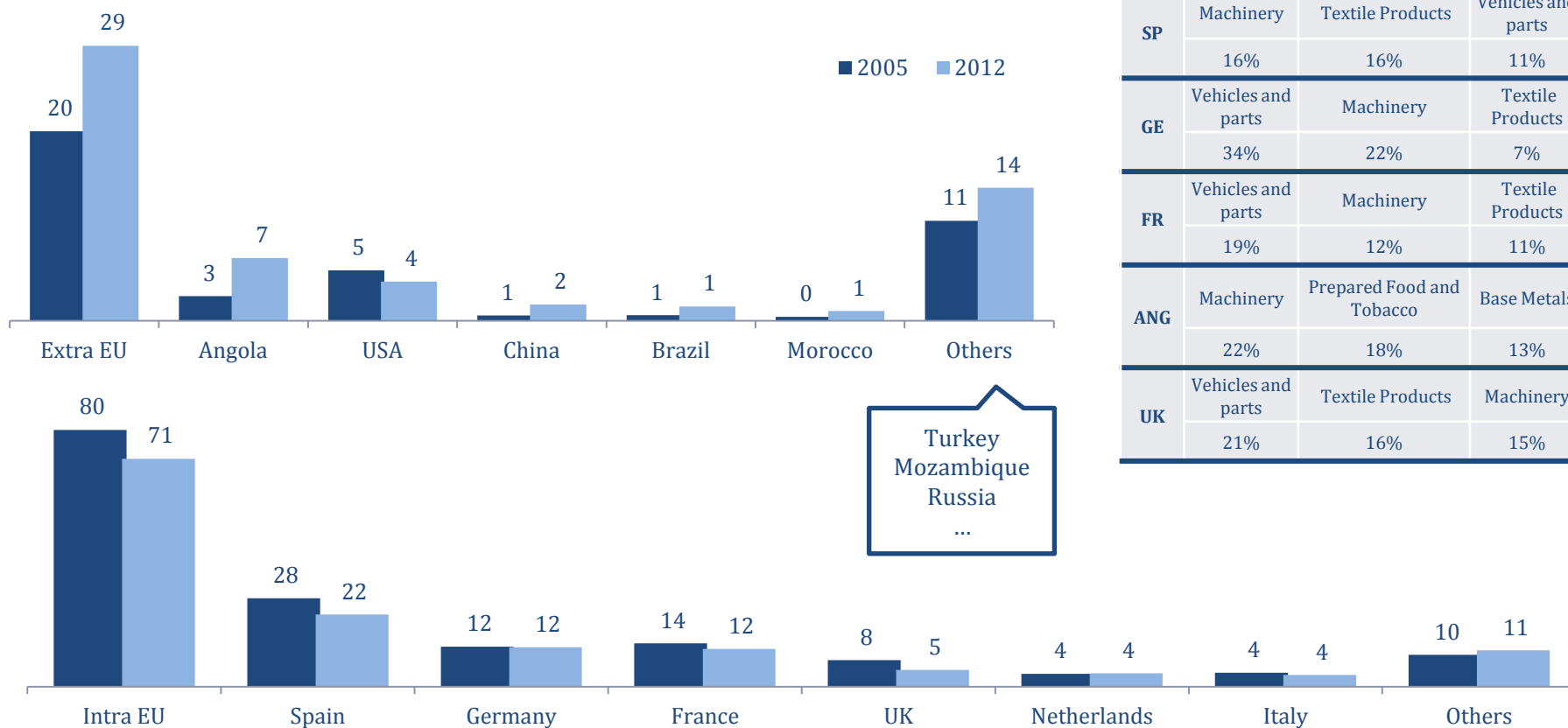
Source: Statistics Portugal

2) External Adjustment

Higher geographic diversification: Extra-EU exports increased to 29% of goods exports

Exports diversification is increasing at a fast pace

[Portuguese goods exports by destination, %]



[Portuguese goods exports by major destination and major product, 2011, % total exports by destination]

SP	Machinery	Textile Products	Vehicles and parts
	16%	16%	11%
GE	Vehicles and parts	Machinery	Textile Products
	34%	22%	7%
FR	Vehicles and parts	Machinery	Textile Products
	19%	12%	11%
ANG	Machinery	Prepared Food and Tobacco	Base Metals
	22%	18%	13%
UK	Vehicles and parts	Textile Products	Machinery
	21%	16%	15%

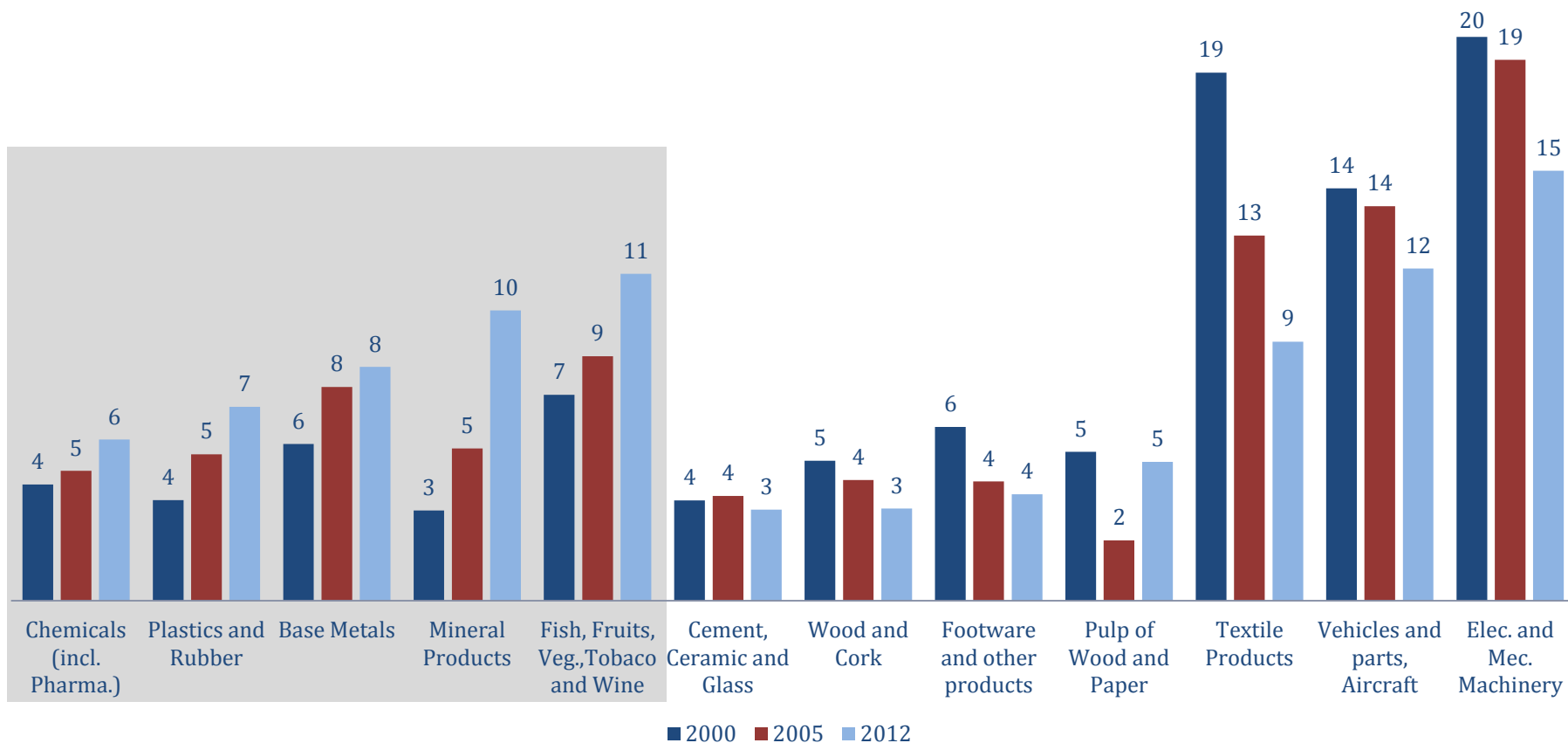
Source: Statistics Portugal

2) External Adjustment

Higher industry diversification on Portuguese goods exports

Sectors' weight on the Portuguese goods exports

[%]



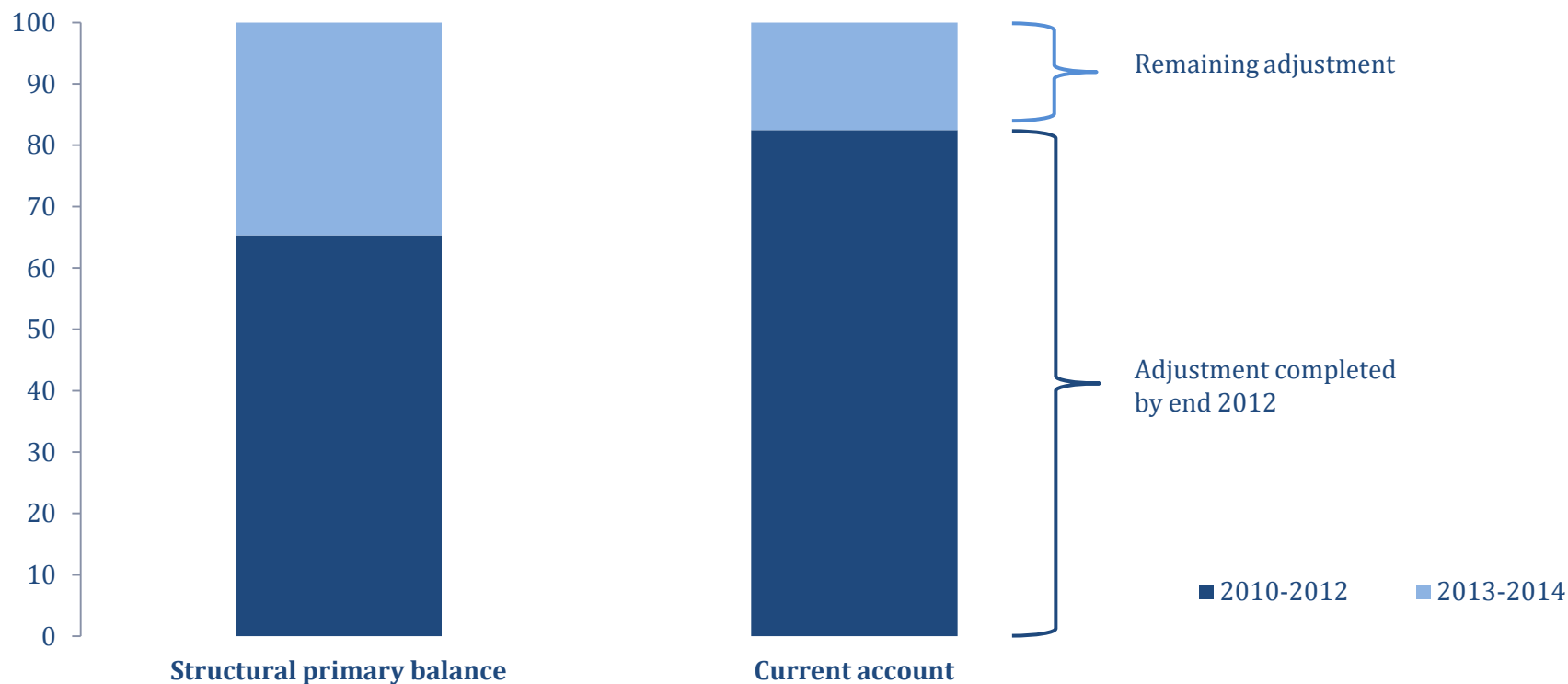
Source: Statistics Portugal

2) External Adjustment

Roughly 2/3 of the structural primary balance adjustment and 4/5 of the external adjustment initially programmed were achieved in the end of 2012

Fiscal and external adjustments

[% of initially projected 2010-2014 adjustment]



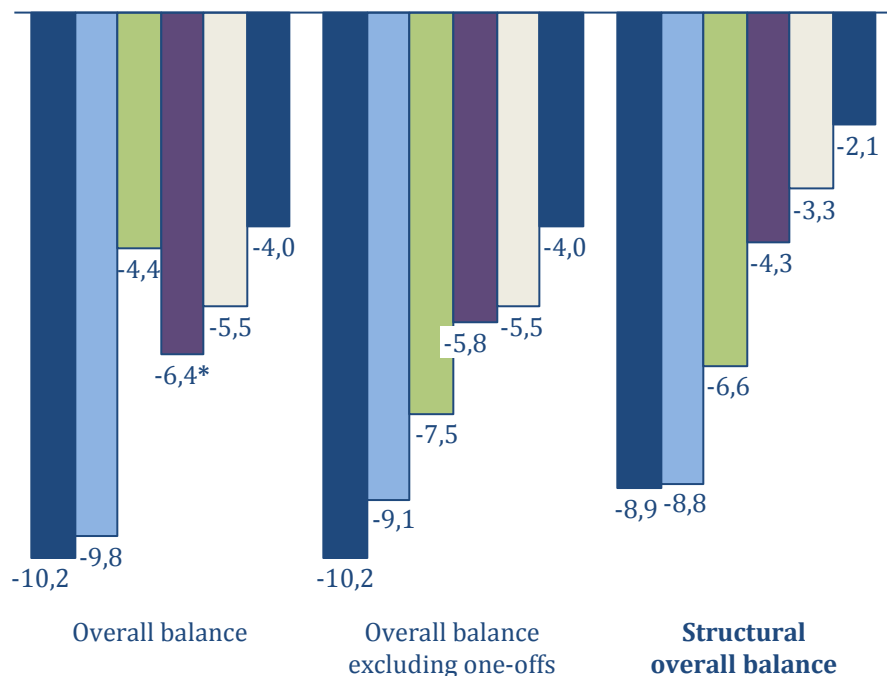
Source: IMF

3) PUBLIC FINANCES

A sizable structural fiscal adjustment is at work

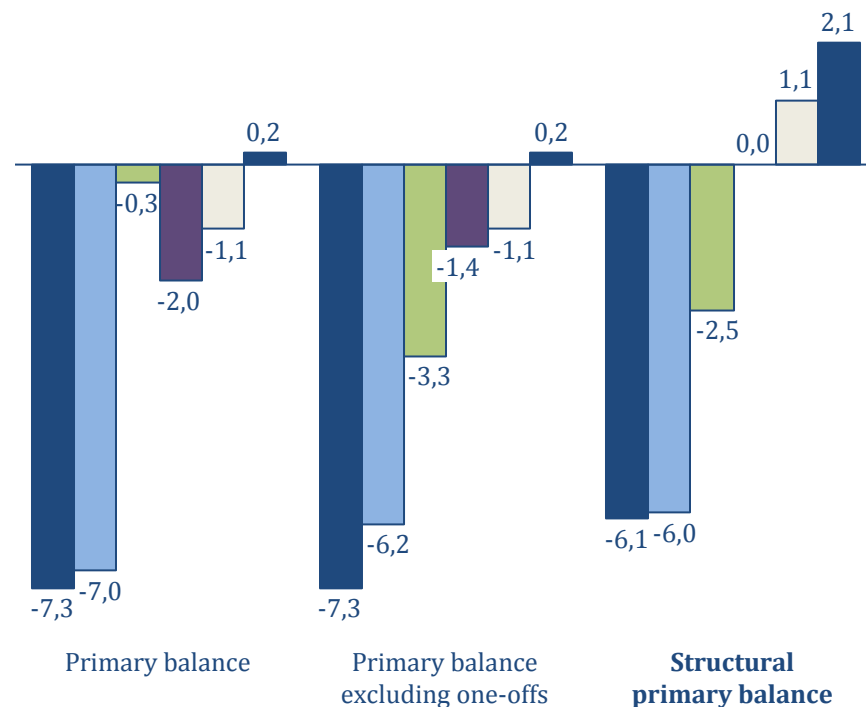
Overall balance

[% GDP]



Primary balance

[% GDP]



2009 2010 2011 2012 2013 2014

* In 2012, the overall deficit compatible with Programme rules, i.e. excluding a number of reclassifications decided by the statistical authorities, stood at 4.7% (within the target of 5%)

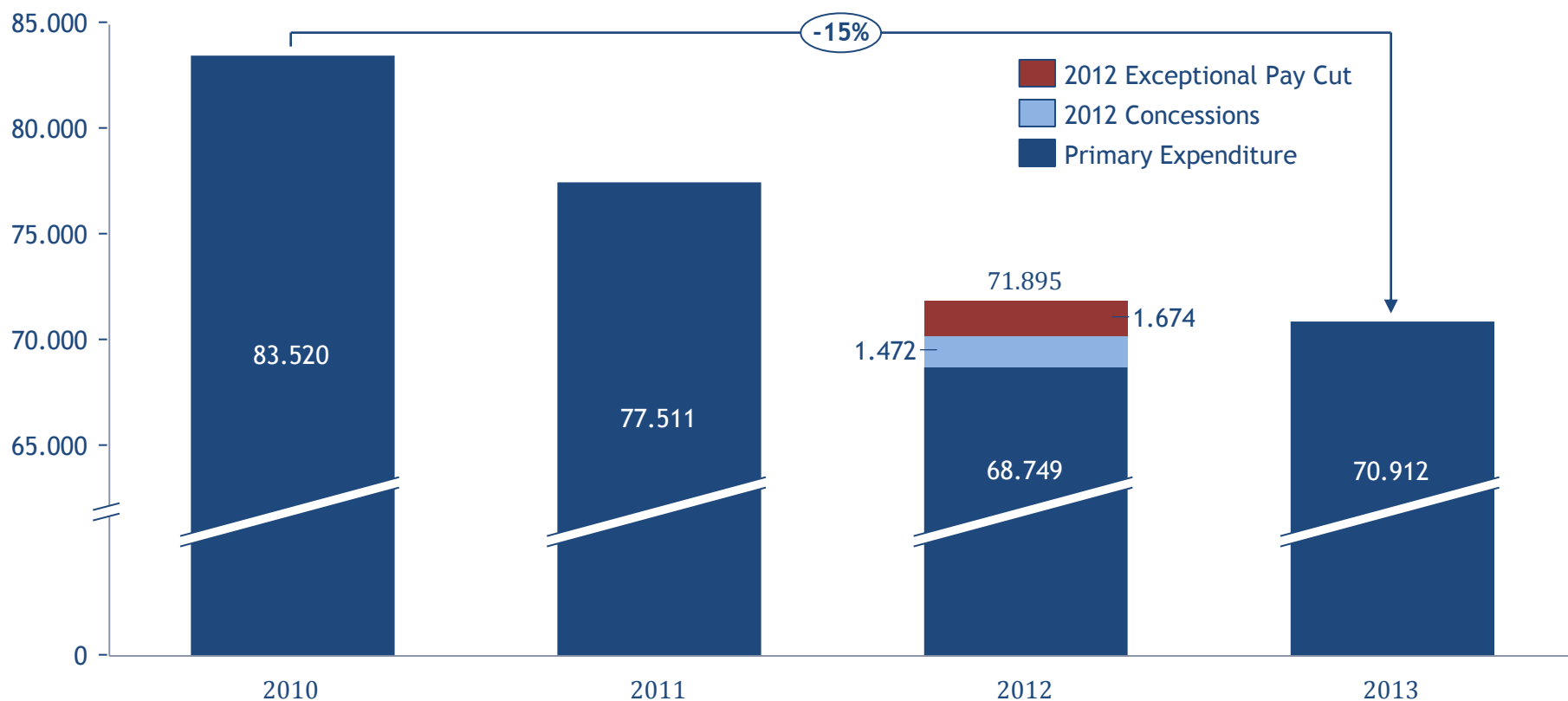
Source: Ministry of Finance

Source: Ministry of Finance

Strong fiscal adjustment from 2010 to 2013

Primary Expenditure

[EUR mln]



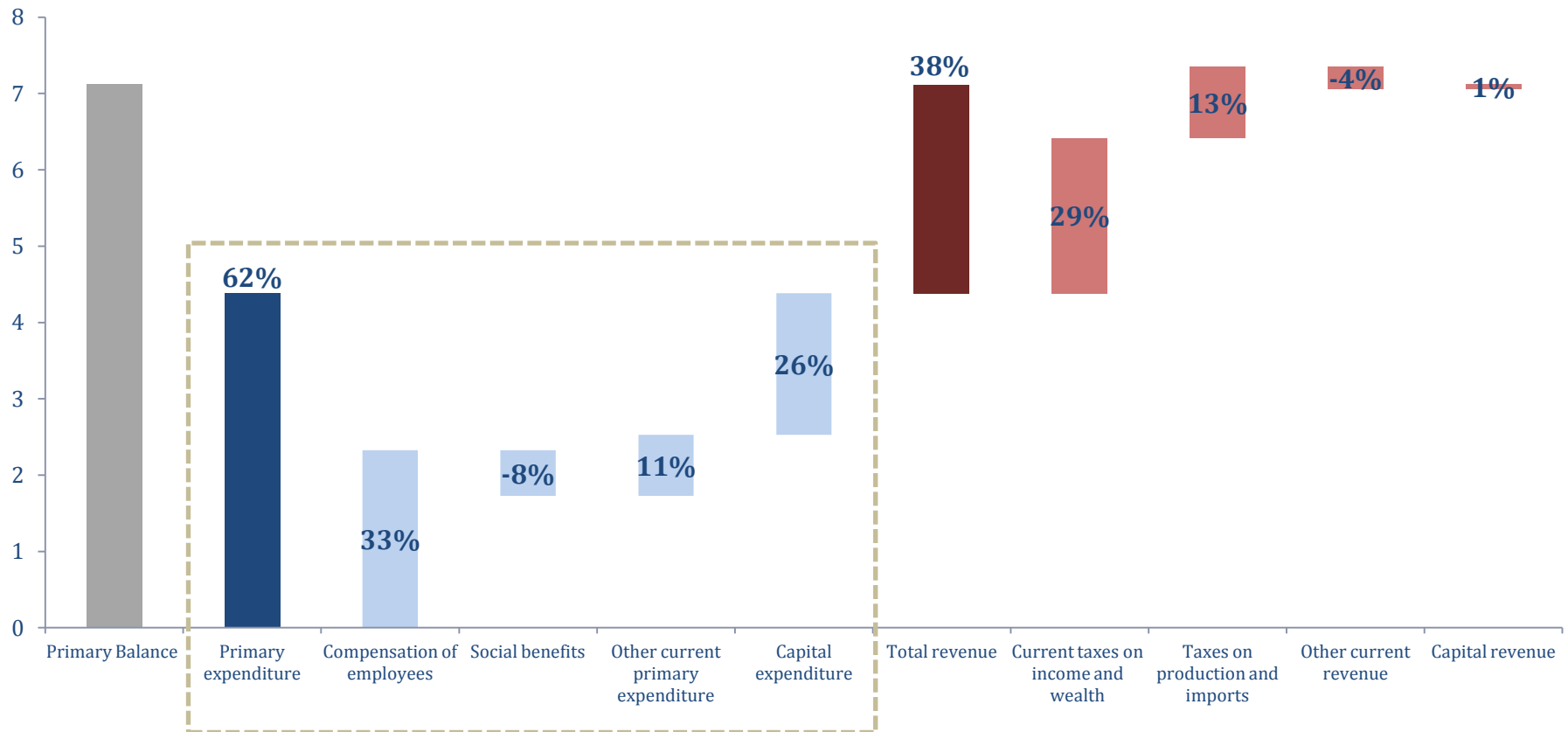
Source: Ministry of Finance

3) Public Finances

By 2013, the primary balance will have improved by 7.1pp of GDP from the 2009 peak: more than 60% from the expenditure side

Primary balance adjustment 2013 vs 2009

[p.p. GDP]



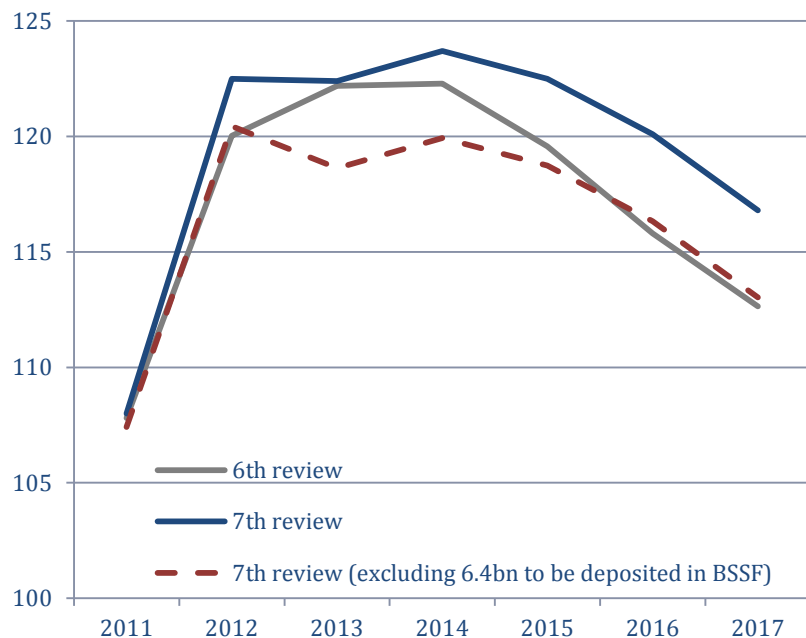
Source: Statistics Portugal, Ministry of Finance, and IGCP calculations

Public debt remains on a sustainable path

Public debt peaks at around 124% of GDP in 2014

Assumptions on most relevant variables for public debt dynamics

[% GDP]

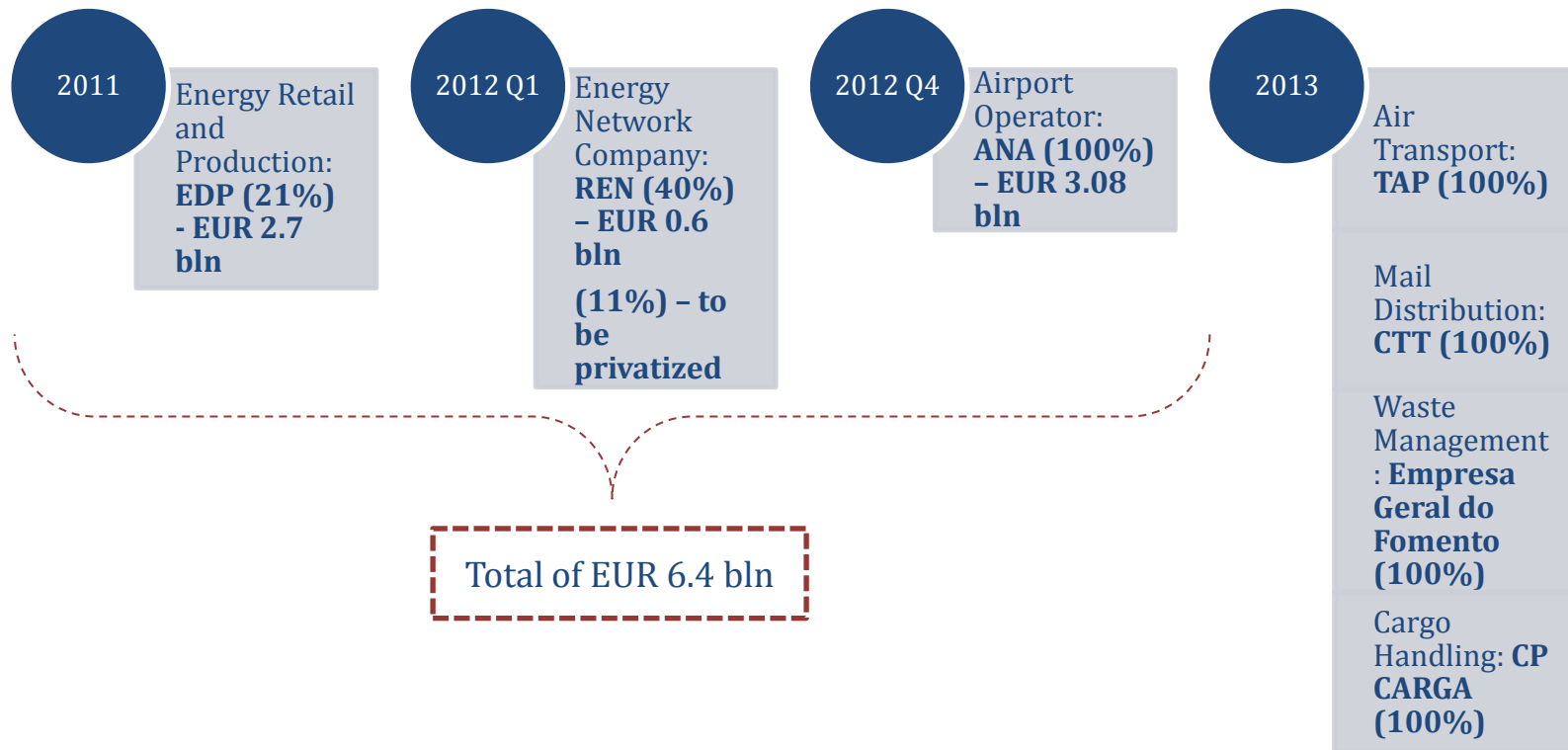


YEAR	2012	2013	2014	2015	2016
Real growth rate (yoy %)	-3,2	-2,3	0,6	1,5	1,8
GDP deflator (yoy %)	-0,1	1,7	1,3	1,1	1,4
Primary balance (% GDP)	-0,5	-1,1	0,1	1,8	3,1
Interest costs (% GDP)	4,4	4,4	4,2	4,3	4,4
Implicit interest rate (%)	3.9	3.6	3.7	3.8	3.9

Source: Ministry of Finance

Source: Ministry of Finance

Privatization programme revenues exceeds initial estimates



- i. Initial estimate of Privatization Revenues: EUR 5bln
- ii. EDP/REN sold at a 54%/34% premium over market prices

Note: Percentage of General Government's shareholding in brackets.

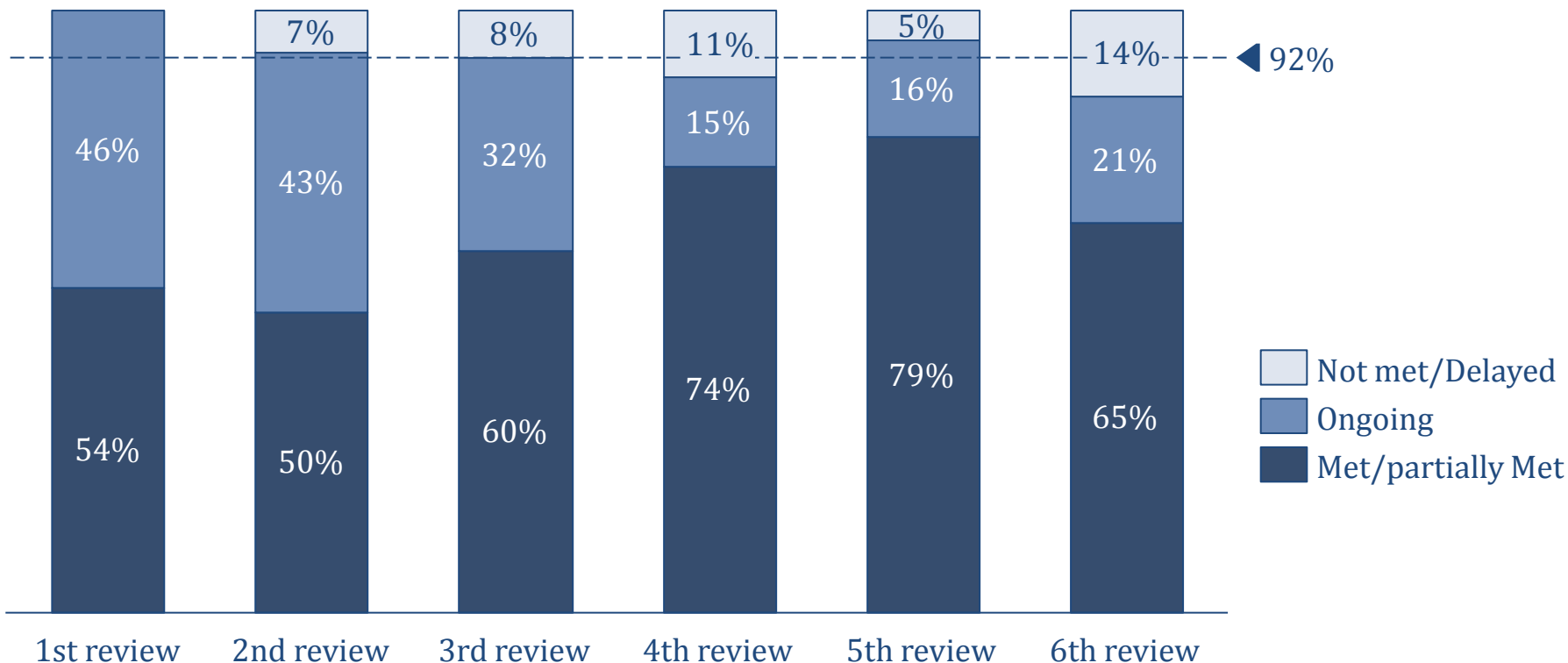
Source: Ministry of Finance

4) STRUCTURAL REFORMS

4) Structural Reforms

Strong willingness to put in place the measures envisaged in the Economic Adjustment Programme

Implementation of the Economic Adjustment Programme' measures



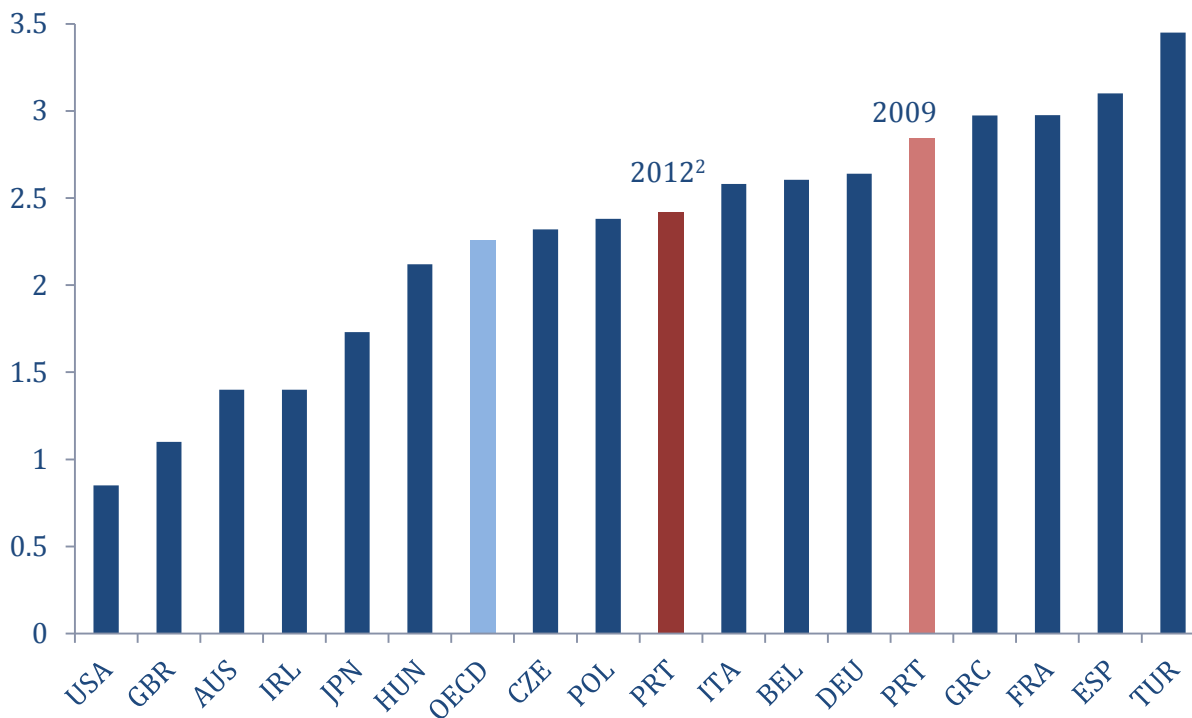
Source: European Commission

4) Structural Reforms

Labour Market Reforms: boost flexibility and improve productivity

Decreasing rigidity in the labour market

[Strictness of employment protection legislation, Scale from 0 (least stringent) to 6 (most restrictive)¹, 2009]



¹ Weighted average of three sub-indices: protection of permanent workers against (individual) dismissal, regulation on temporary forms of employment and specific requirements for collective dismissal.

² Assuming that changes to the Labour Code recently approved in parliament come into force.

Agreements with Social Partners:

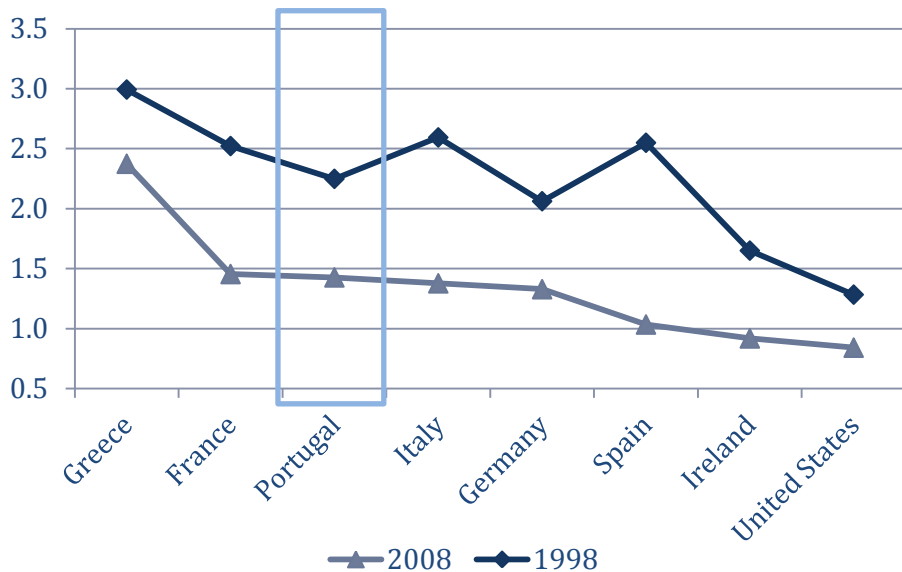
- Increase incentives to work:** cut unemployment insurance benefits
- Ease employment protection legislation:** reduce requirements for individual dismissals and continue to diminish severance payments
- Reform working time arrangements:** introduce individual “bank of hours”
- Boost flexibility on wage setting:** decision at working councils in corporations

Source: OECD

Foster competitiveness and remove hurdles to investment

High rigidity in the product market

[Integrated Product Market Regulation]



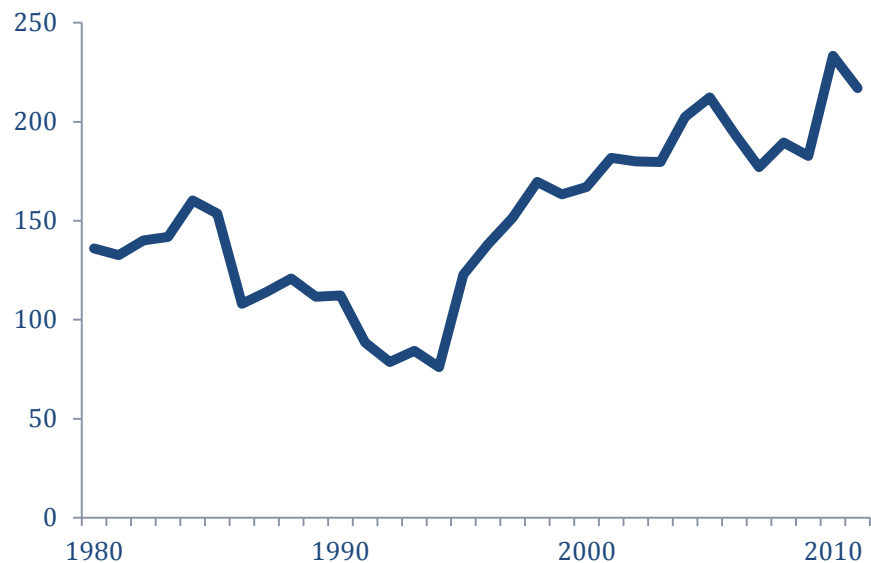
Source: OECD

Promote a competitive environment:

- New Competition Law;
- Specialized court for Competition;
- Strengthen the power of the Competition Authority.

High level of backlog cases

[Backlog/Ruled cases, %]



Source: PORDATA

Improve the functioning of the judicial system:

- Strengthen alternative dispute resolutions to remove workload from courts;
- Implementation of a new judicial map;
- New Insolvency and Corporate Recovery Code;
- New Code of Civil Procedure.

4) Structural Reforms

Labour and product market reforms combined can have a positive impact on GDP per capita of 6% in the medium term

Impact of labour and product market reforms

Potential yields of reforms			
Reforms	Shock variables	In 5 years	In 10 years
Labour-Product market combined	GDP per capita, level	+6%	+14%
Labour market	Unemployment rate	-0.8p.p.	-1.7p.p.
Labour market	Labor productivity, level	-0.7p.p.	+1.7p.p.
Product market	Total factor productivity, level	+4%	+8%

Source: Bouis and Duval (2011), IMF

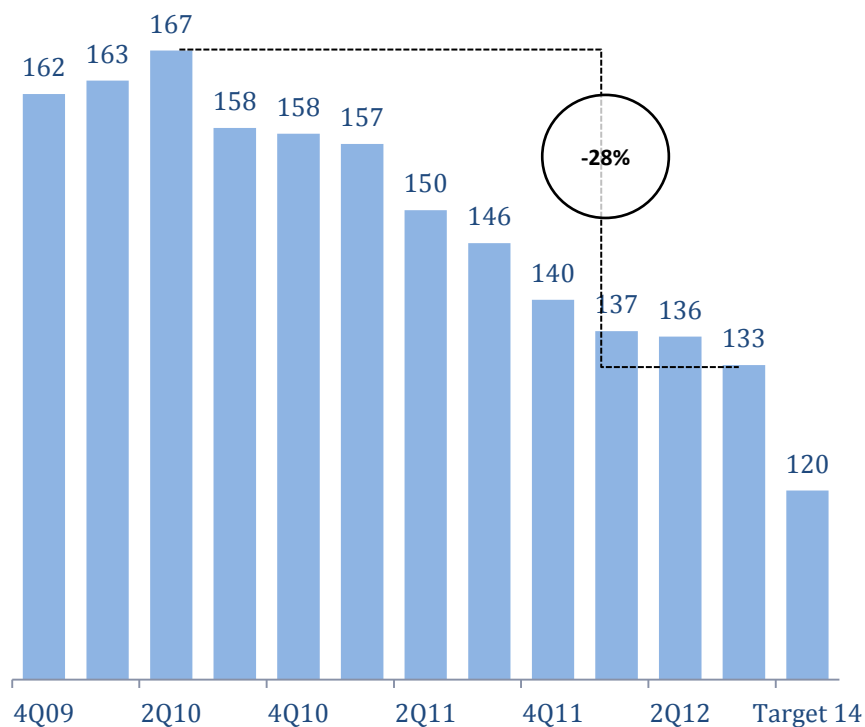
5) BANKING SECTOR CHALLENGES

5) Banking Sector Challenges

Deleveraging the financial system while reinforcing banks' capital

Reduction on loan-to-deposit to 120% by end-2014

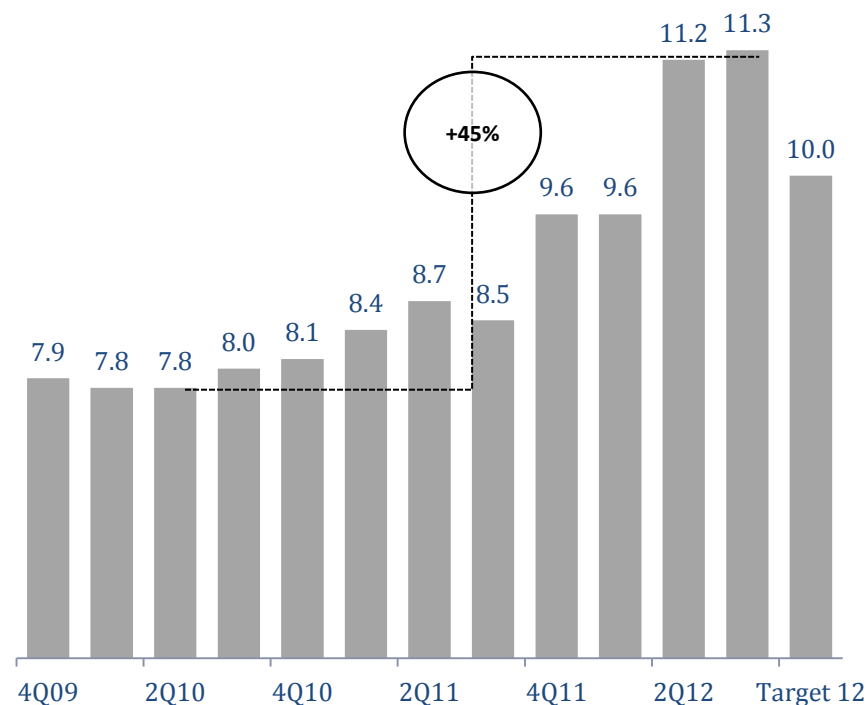
[Loan to deposit rate, %]



Source: EC

Capital requirements: Core Tier 1 of 10% by end-2012

[Core Tier 1, %]

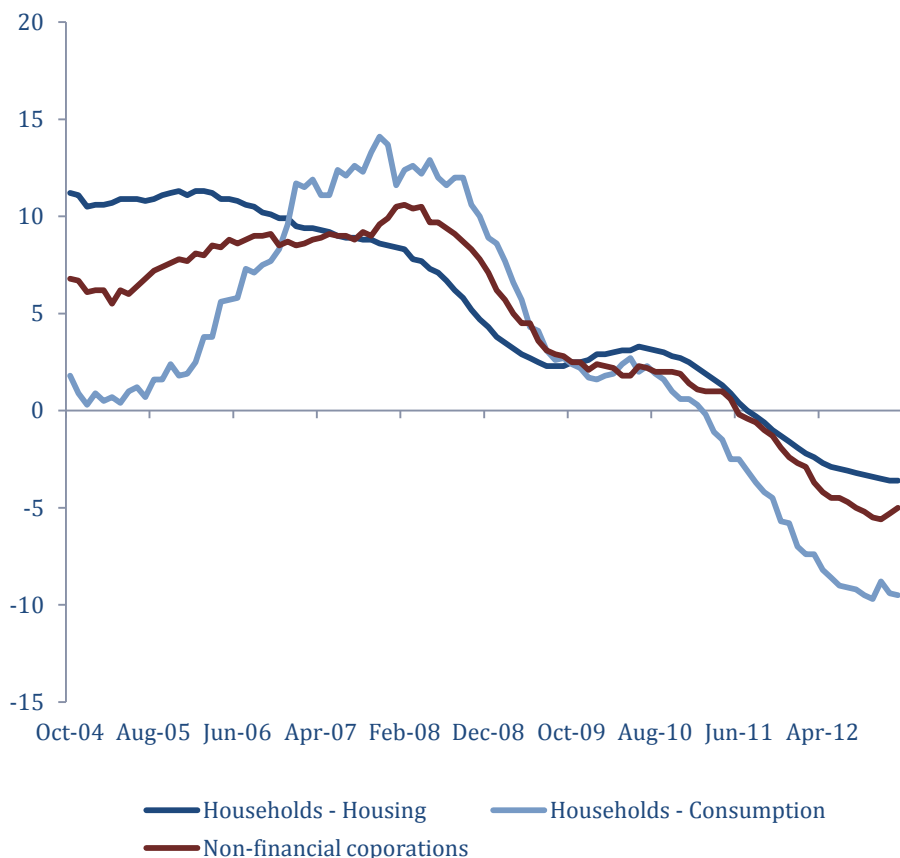


Source: EC

Balanced deleveraging of the financial system

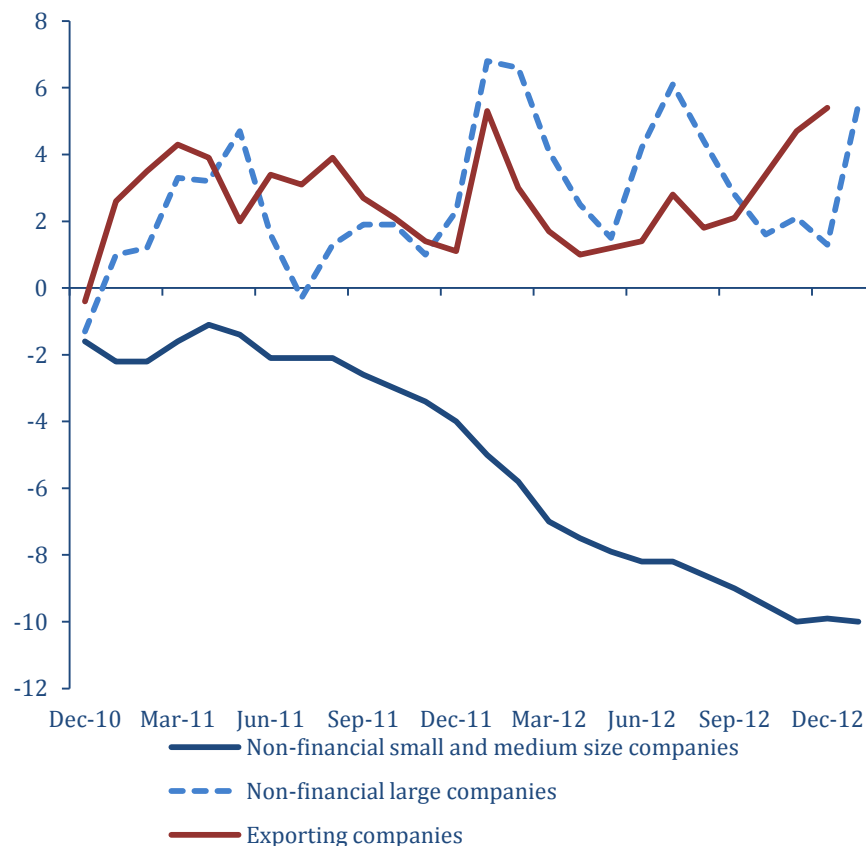
Credit to the corporate sector is decreasing...

[Loans outstanding, yoy, %]



...however, it has been maintained to large companies and to the export sector

[Granted loans, yoy, %]



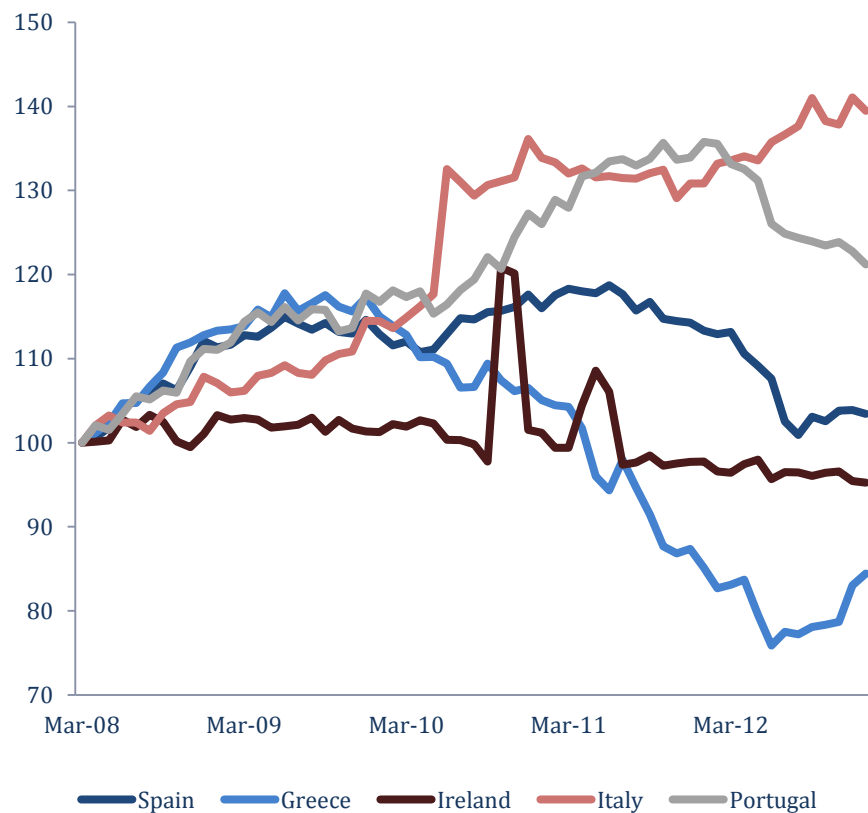
Source: Banco de Portugal

Source: Banco de Portugal

Strong confidence on the Portuguese financial system

Despite a recent reduction, deposits are above several European peers

[Index: 2008=100, %]



Source: European Central Bank

Households deposits are resilient

[Index: 2008=100, %]



Source: Banco de Portugal

6) DEBT MANAGEMENT

Financing needs fully covered in 2013

Borrowing needs and sources 2012-2014

[EUR bln]

	2012	2013	2014
State borrowing requirements	45,7	32,7	39,5
Net financing needs	18,2	13,4	6,7
Overall balance *	8,9	8,6	6,7
Bank recapitalizations	4,2	0,8	-1,5
Other acquisitions of financial assets **	7,3	5,5	1,5
Privatizations (-)	-2,2	-1,5	0,0
Redemptions	27,4	19,2	32,8
Tbills	11,0	13,4	18,6
Long-term bonds	16,5	5,8	14,2
EU-IMF	0,0	0,0	0,0
State financing sources	55,2	40,2	45,9
Financing from previous budget	7,6	9,5	7,5
Financing in the year	47,6	30,7	38,3
Tbills	16,3	15,7	18,6
Exchange offer	3,6		
Syndicated tap		2,4	
Rollover MTN	1,3		
EU-IMF	27,5	10,1	8,0
Retail debt (net)	-1,6	0,1	0,0
Other (net)	0,5	2,4	0,0
Additional financing needs	-	-	11,8
State Treasury excess financing	9,5	7,5	6,4
of which: deposits for bank recap	3,5	6,4	6,4

* State sub-sector cash deficit in 2012-13. Projection for GG deficit in 2014 (7th review).

** Includes refinancing of other public entities within General Government (namely SOE and regions), which do not translate into higher GG debt. It also includes CGD recap, BPN resolution, ESM participation, and loans to capitalize Resolution Fund.

Source: IGCP and Ministry of Finance

Funding Strategy: the use of multiple funding channels and extending the debt maturity allows a progressive recovery of market access

Increase Communication with Investors

Funding Channels

Redemption Profile

Retail Funding

- Improve pricing offered in existing retail products
- Launch New products

PGB

- Return gradually to a regular PGB issuance
- Reshape the PGB yield curve

MTN issuance

- Use of superior flexibility to access an enlarged investor base
- Access strategic investors

Treasury Bills

- Increase the international investors' base participation

Exchange Offers

- Explore opportunities to extend debt stock maturity

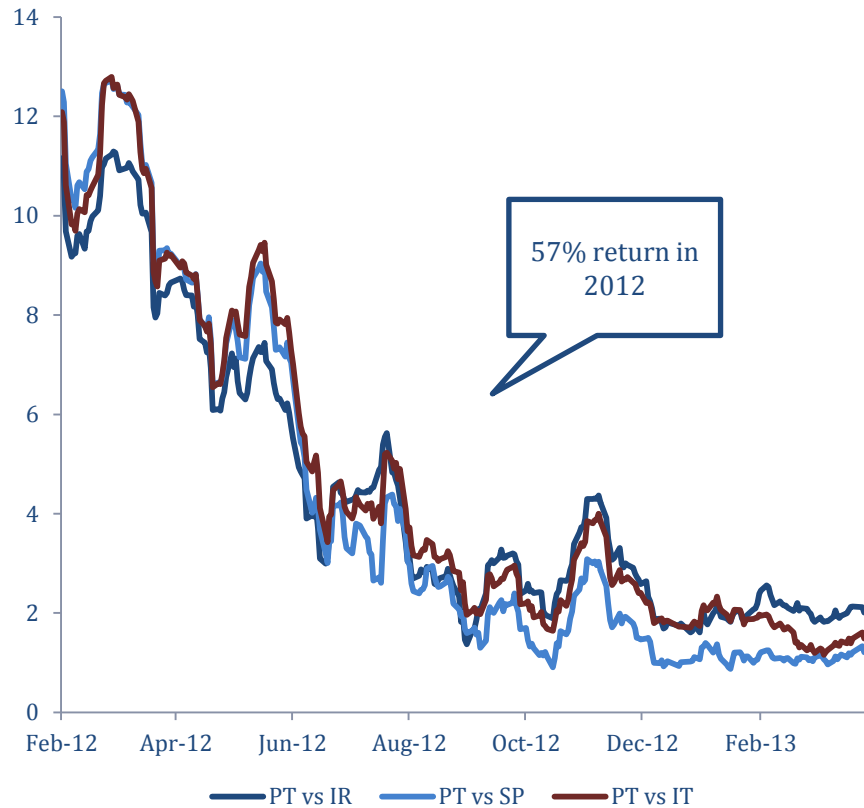
Official Sector

- Extension of assistance programmes debt maturities

Portuguese Government bonds presented the best returns in 2012

Strong performance vs EU peers on bonds...

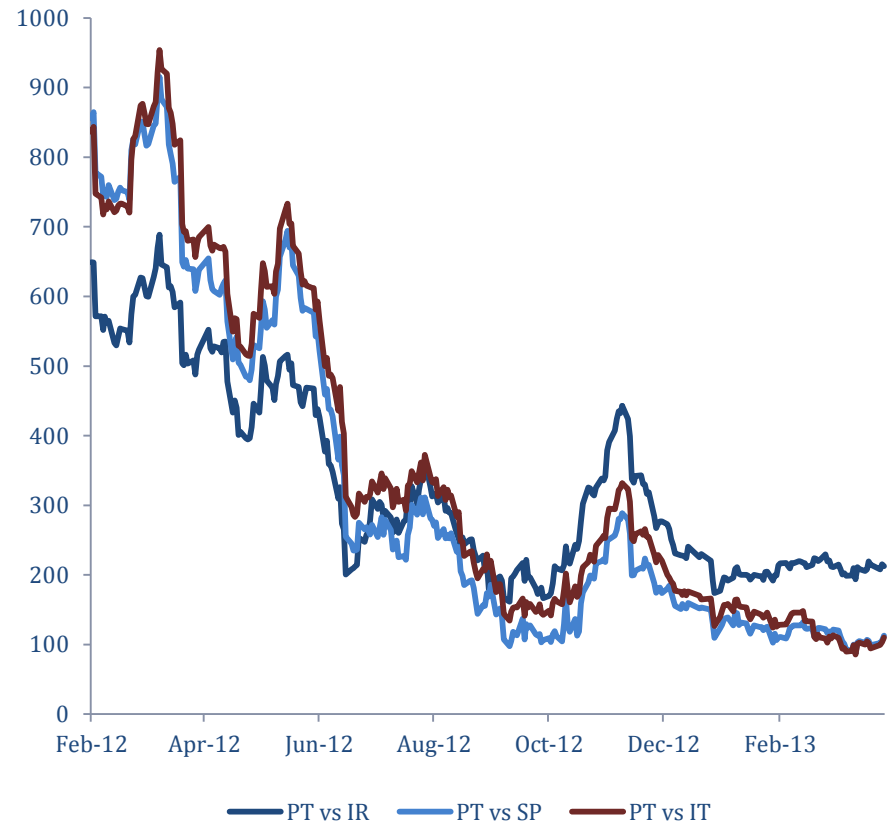
[Portuguese 5yr yield spread vs peers, %]



Source: Bloomberg

... and on CDS market since the start of the year

[Portuguese 5yr CDS spread vs peers, b.p.]

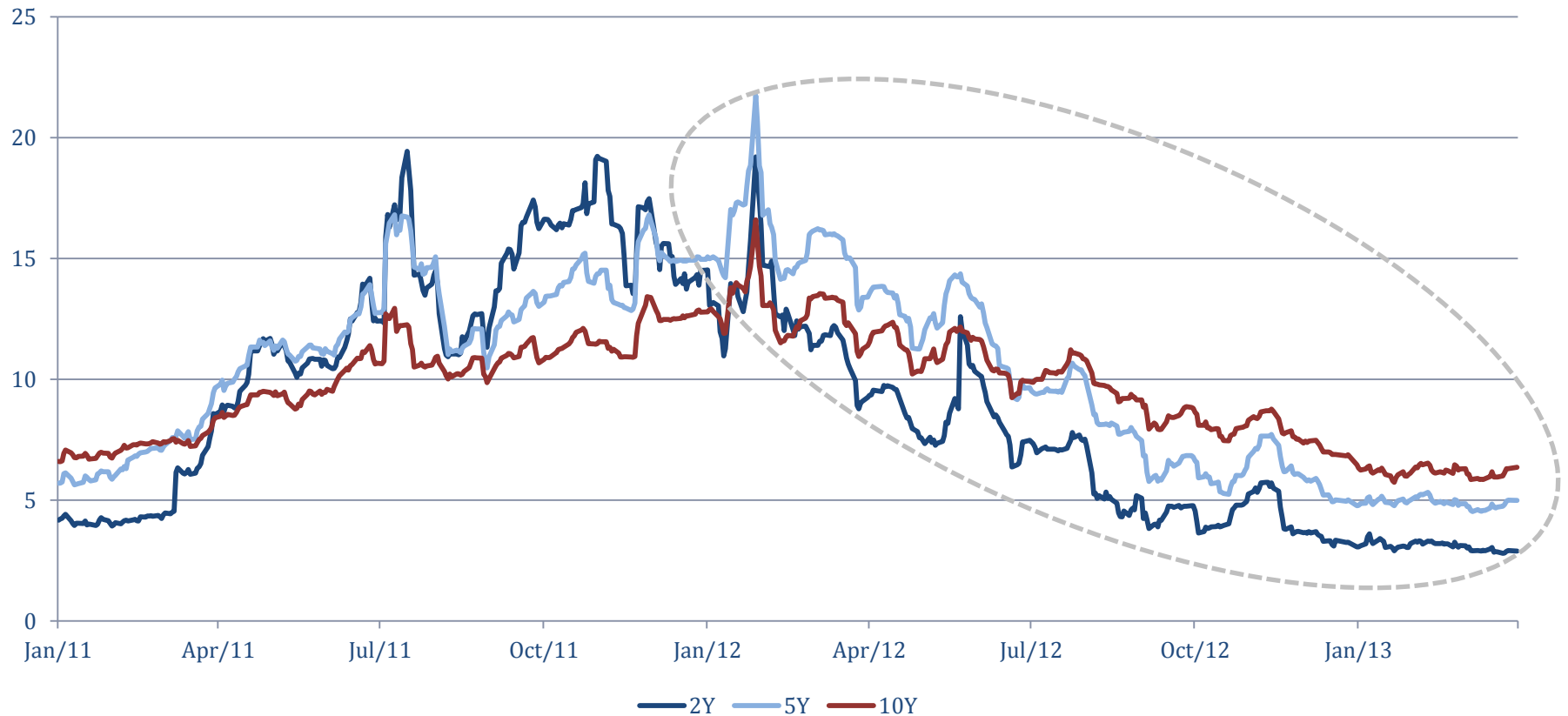


Source: Bloomberg

Portuguese Government bonds' yields have tightened considerably in the last year

PGB's secondary market yields

[%]

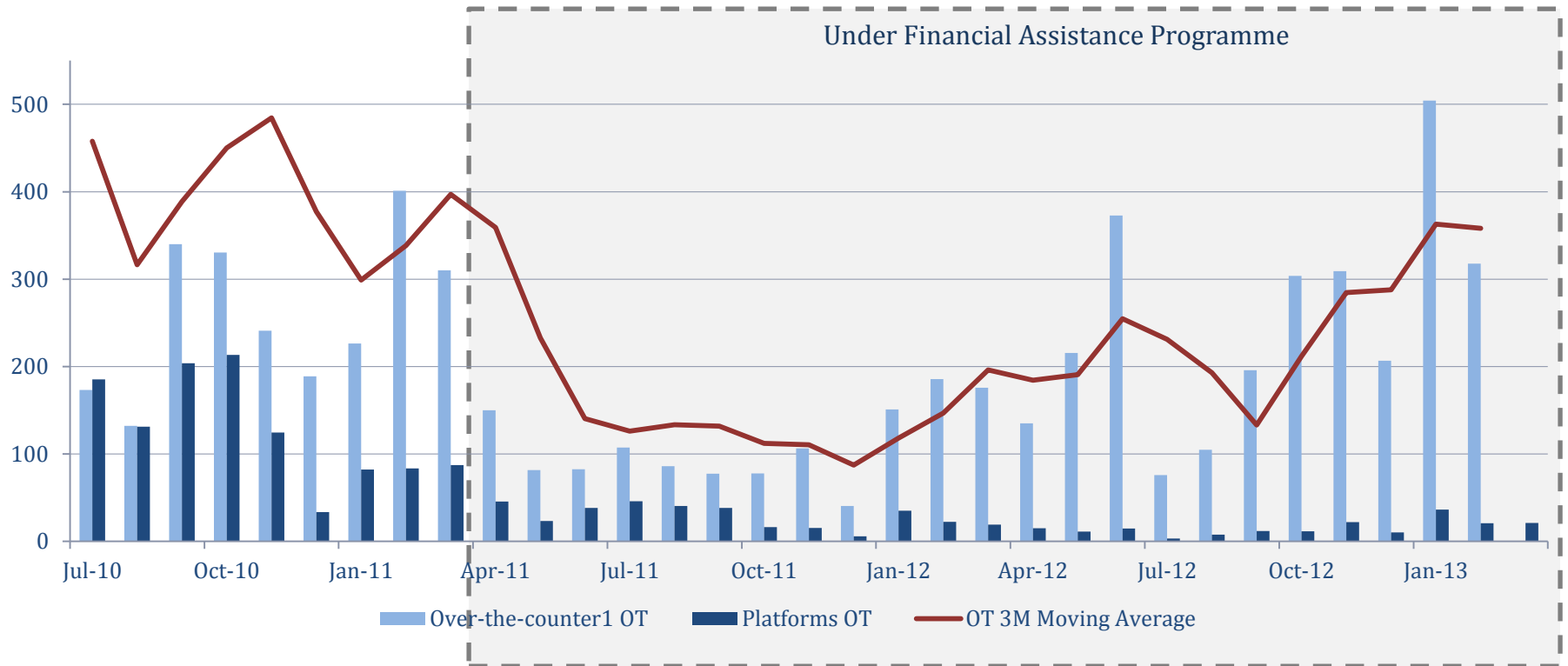


Source: Bloomberg

Portuguese Government bonds' daily average turnover is gradually returning to pre financial assistance programme levels

PGB Daily Average Turnover

[EUR mln]

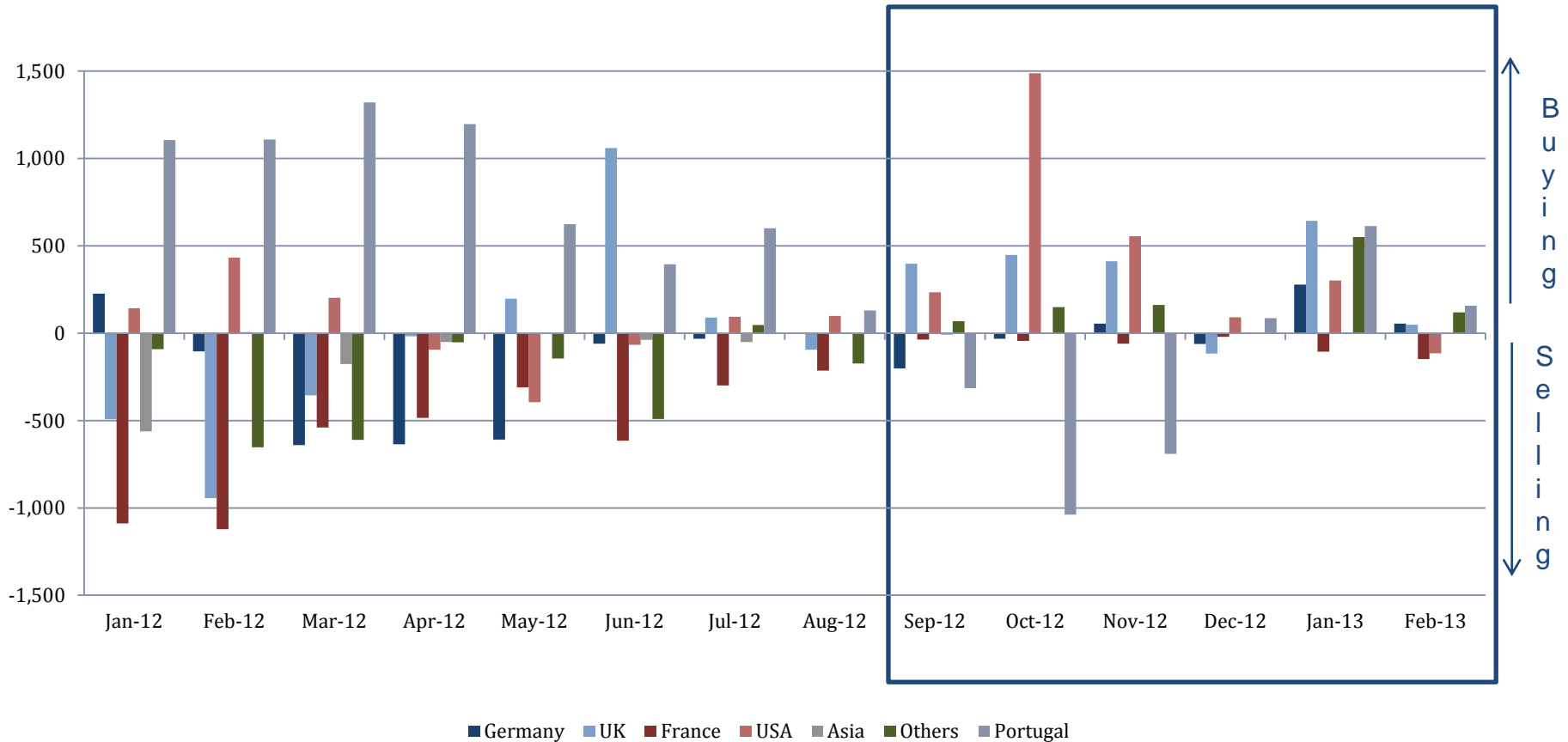


Source: BTEC, eSpeed, MTS and : IGCP, HRF reports by Primary Dealers

Non-domestic investors presented significant net buying flows

Selling/buying net flows by geography

[EUR mln]



Source: IGCP, HRF reports by Primary Dealers

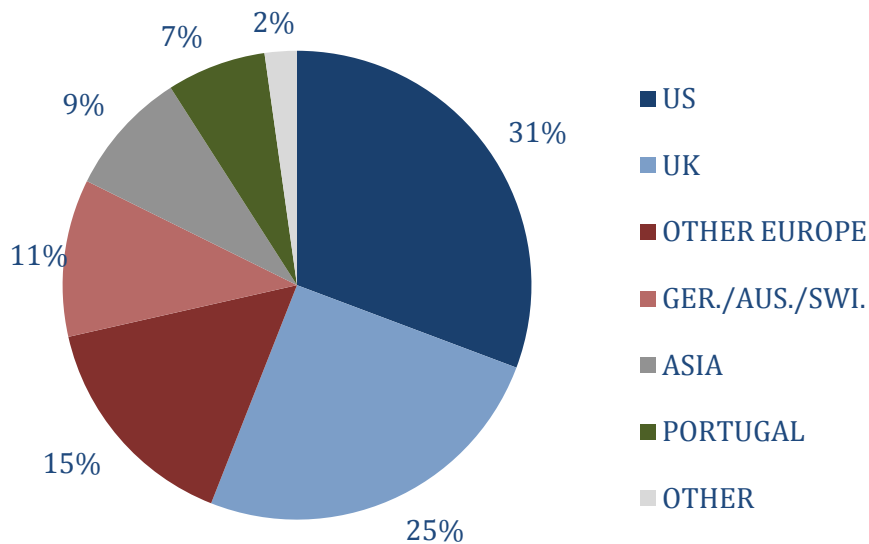
6) Debt Management

First OT syndication since February 2011, marking the sovereign's return to the international long-term bond markets

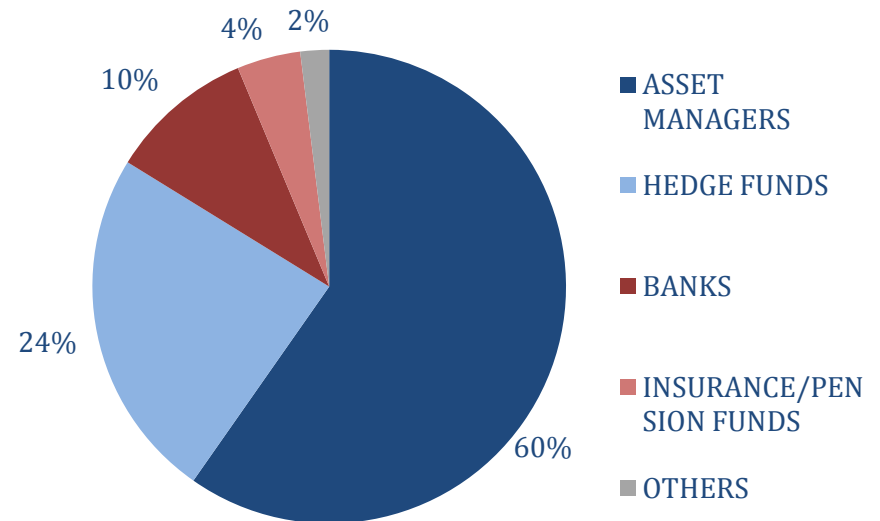
The final order book exceeded €12 billion via approximately 300 accounts

EUR 2.5 bln OT Syndicated Tap due 16 October 2017

Distribution by Geography



Distribution by Investor Type

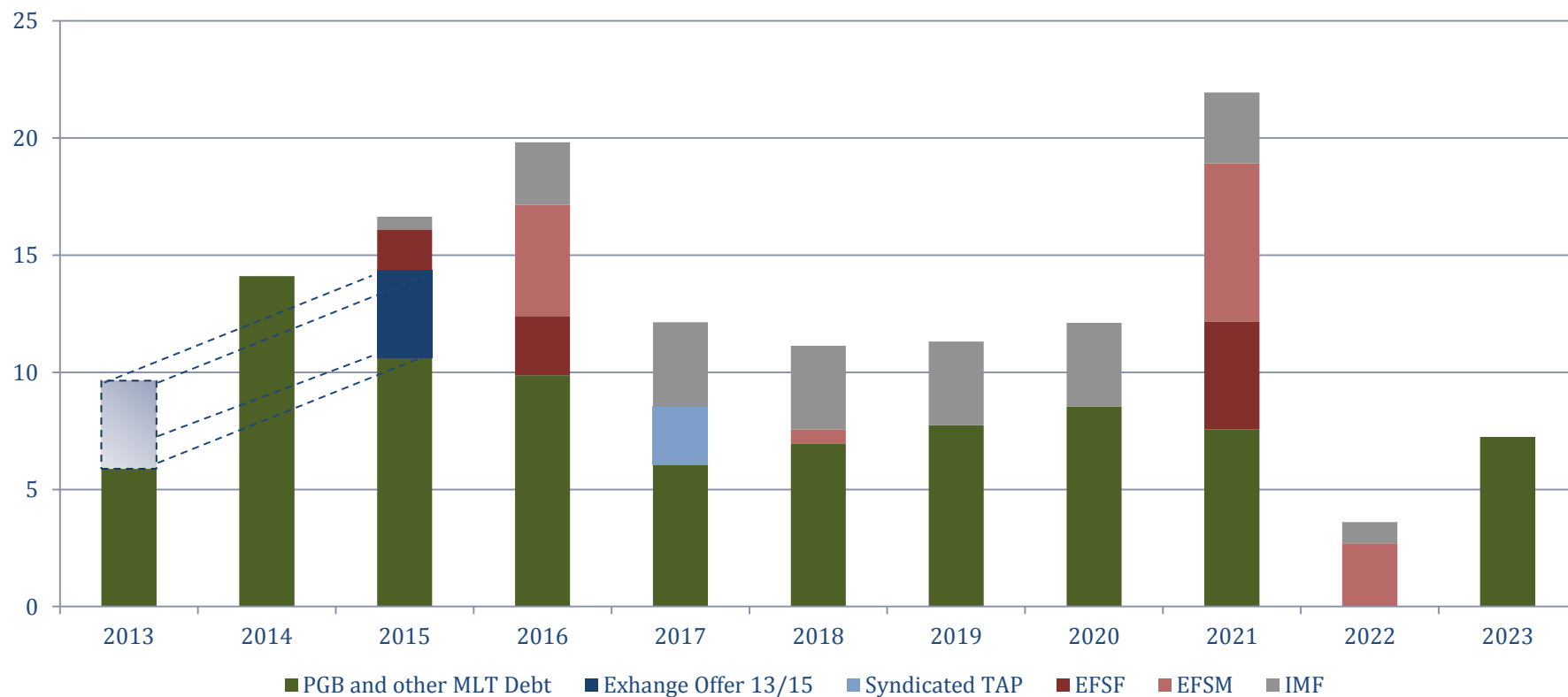


Source: IGCP

... and the smoothing of the redemption profile

Refinancing Profile – Medium and Long Term

[EUR bln]

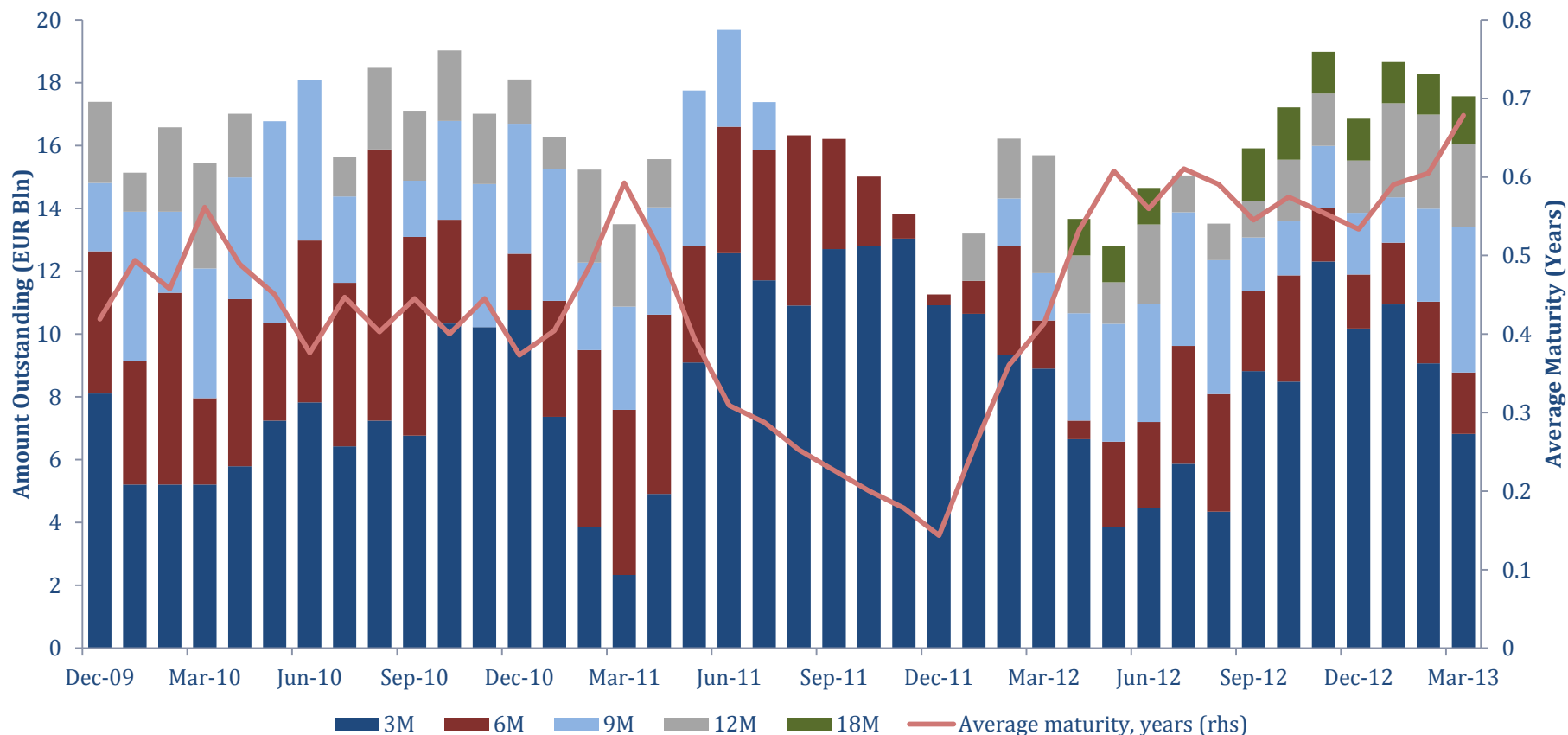


Source: IGCP

Stable market demand for bills: increasing outstanding and the maturity programme

Higher average maturity and opening of 12 and 18 months maturities

[Portuguese bill programme]

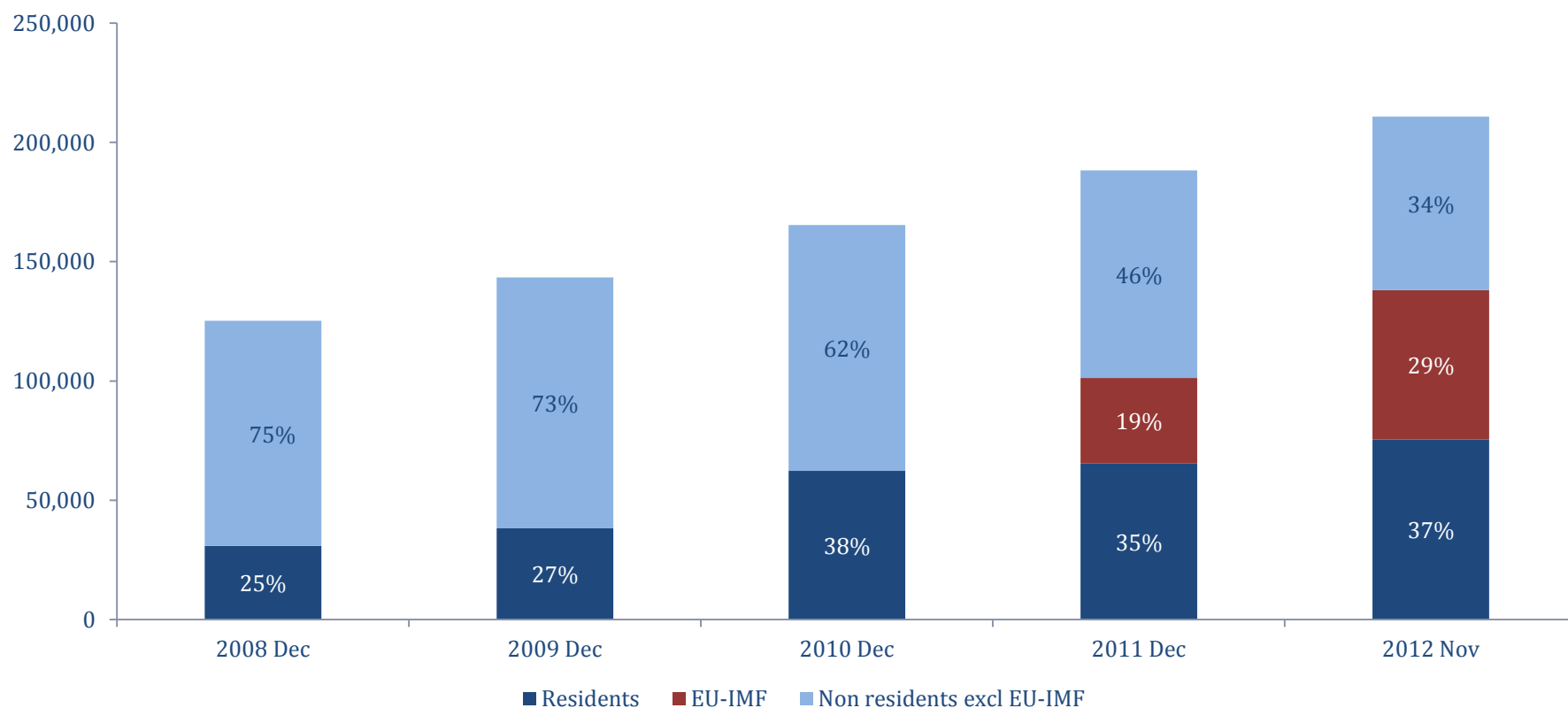


Source: IGCP

The Financial Assistance Programme led to a change in public debt holders' profile ...

Public debt holders by geography

[EUR mln, % of total State debt]



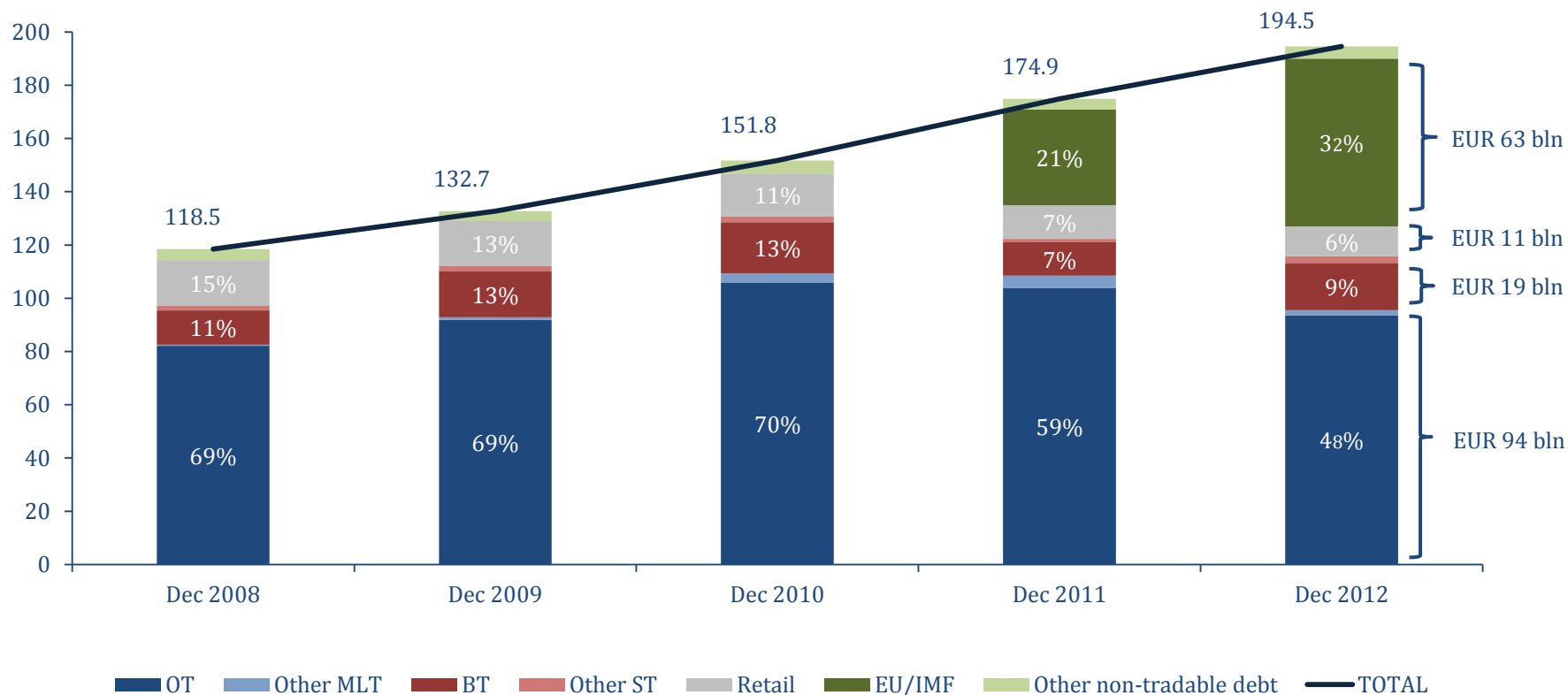
Source: Banco de Portugal

6) Debt Management

... and the weight of EU/IMF loans (32% by Oct-2012) offset the reduction of bonds, bills and retail debt

Public debt composition

[EUR bln and % of total State debt]



Source: IGCP

**Web site: www.igcp.pt
Bloomberg pages: IGCP
Reuters pages: IGCP01**