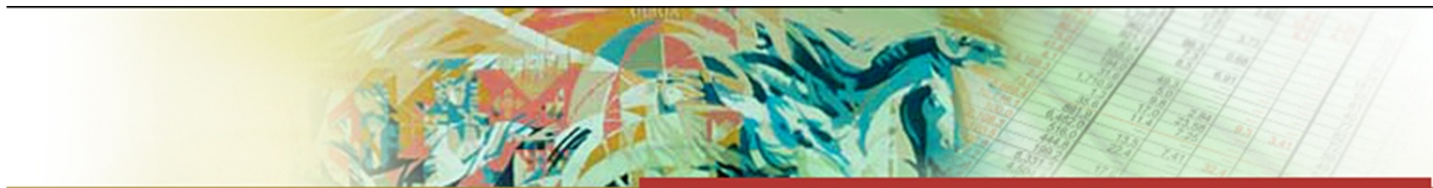




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# The Portuguese economy: recent developments and challenges ahead

Economics and Research Department  
Banco de Portugal  
April 2013

# Overview of presentation

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- The current crisis was driven by an accumulation of macro-economic imbalances in the last decade...
- ... against a background of structural weaknesses
- This exposed the economy to risks
- ... that materialized with the international financial crisis and lead to the necessity of an adjustment programme
- At present, the adjustment is underway



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## Structure of the presentation

- **The economic and financial assistance program**
  - **Main goals**
  - **Reforms under implementation**
    - **Structural reforms**
    - **Fiscal consolidation**
    - **Financial sector**
- **Projections**

# The economic and financial assistance program

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- April 2011, agreed with the EC, IMF and the ECB
- Covers the mid-to-long run financing needs of the General Government for the period 2011 to mid-2013
- The financial package amounts to EUR 78 billion in loans, of which 12 billion for a Bank Solvency Support Facility
- The implementation of the Program is assessed quarterly

# The economic and financial assistance program

## Main goals

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- **The objectives are:**
  - Allow the return of Portugal to a path of sustained GDP growth
  - ... within a framework of financial stability
  - Restore the confidence of international financial markets on the Portuguese economy
- **Focuses its intervention in three main areas:**
  - **Structural reforms** to increase potential growth, create jobs and improve the competitiveness of the economy
  - Strategy for credible **fiscal consolidation**, based on structural measures and budgetary control
  - Orderly process of **deleverage in the financial sector** through market mechanisms and supported by specific funds to recapitalize banks

# The economic and financial assistance program

## Structural reforms' main goals

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- To reach these ambitious goals a detailed reform path was established:

**Labor market:** Increase job creation and reduce segmentation; allow labor cost developments consistent with market conditions at the firm level

**Market for goods and services (including transports and energy):** Promote competition in goods and non-tradable services sectors; reduce the State's involvement in business activities; improve public procurement procedures

**Housing rental market:** Make regulated rents converge to market values and reduce number of vacant houses

**Judicial system:** Improve the efficiency of the courts

# The economic and financial assistance program

## Structural reforms under implementation

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- **Labour market**

- **Changes to the labour code (recent promulgation by the President of the Republic):**

- Increase in working time (elimination of 4 national holidays and 3 vacation days)
- Reduction in compensation for overtime work (50% reduction)
- Increase in the flexibility of working hours (banks of hours defined at the worker level)
- Reduction of severance payments to align with EU average (from 30 days to 12 days per year worked for new open-ended contracts and to 18 days in the first three years for current open-ended contracts and all fixed-term contracts.)
- Unemployment subsidy entitlement period reduced from a maximum of 38 months to 26 months.

# The economic and financial assistance program

## Structural reforms under implementation

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- **Product market**
- Approval of a new competition law (stronger Competition Authority and creation of a dedicated competition Court)
- Sale of State's shares on energy production and distribution firms (EDP: 21,35% and REN: 25%+15%)
- Sale of State owned Airport Operator (ANA) (95% of capital)
- Progressive transposition of the EU services directive (removal of barriers to the establishment of foreign professionals in Portugal)
- Approval of a set of measures aiming at reducing the costs with energy, partly eliminating the excessive profits in this sector.



# The economic and financial assistance program

## Structural reforms under implementation

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- **Rental market**
- Improve rental market legislation (law approved setting transition periods for the convergence of rents and negotiation mechanisms between landlords and tenants)
- Revision of the regime applicable to real estate tax (update in the base value of real estate for tax purposes is underway)
- **Judicial system**
  - Main reforms still waiting to be implemented (including a geographical reorganization of courts (already submitted to Parliament) and a proposal for a reform of the Code of Civil Procedure)

# The economic and financial assistance program

## Fiscal policy: fiscal consolidation goals

- **Fiscal consolidation**

- In a context of the deterioration of the macroeconomic scenario, the deficit targets have been relaxed. Currently, a deficit below the 3 per cent of GDP threshold is targeted for 2015.

### General government deficit (national accounts)

As a percentage of GDP

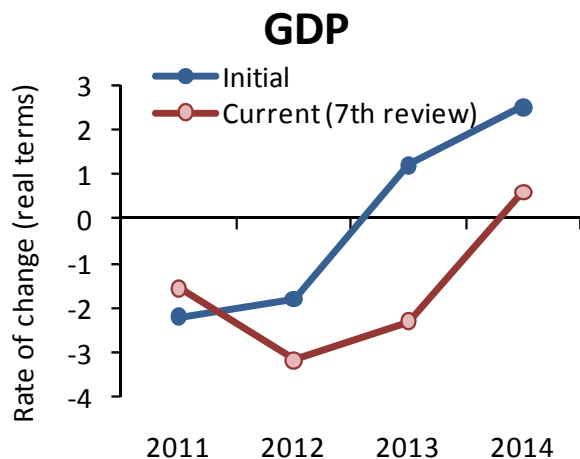
	2011	2012	2013	2014	2015
Initial targets (May 2011)	5.9	4.5	3.0	2.3	1.9
1 <sup>st</sup> revision (5 <sup>th</sup> review, August 2012)		5.0	4.5	2.5	1.9
2 <sup>nd</sup> revision (7 <sup>th</sup> review, February 2013)			<b>5.5</b>	<b>4.0</b>	<b>2.5</b>
Outturn	4.4	6.4			
Outturn excluding temporary measures and special factors	7.2	6.0			

Sources: Ministry of Finance and Statistics Portugal.

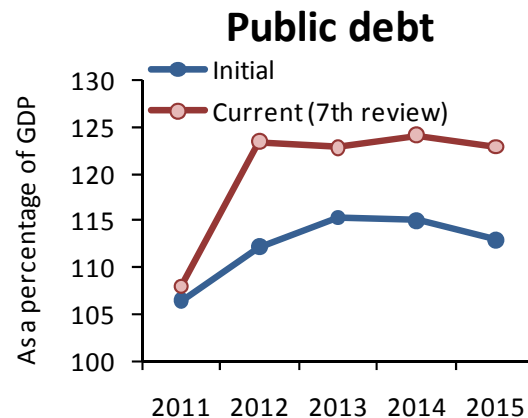
# The economic and financial assistance program

## Fiscal policy: fiscal consolidation goals

- As a result, a worse path for the evolution of the debt ratio than initially expected is now foreseen. Currently, the debt ratio is expected to peak in 2014 at around 125 per cent of GDP.



Sources: Ministry of Finance and Statistics



Sources: Ministry of Finance, Statistics Portugal and Banco de Portugal.

# The economic and financial assistance program

## Fiscal policy: fiscal consolidation goals

A detailed analysis of the calculation of the consolidation effort   as a percentage of GDP						Cumulative 2011-2012	
	2008	2009	2010	2011	2012	p.p. of GDP	m.e.
Overall balance	-3.6	-10.2	-9.8	-4.4	-6.4	<b>3.4</b>	<b>6 386</b>
Temporary measures <sup>a)</sup>	1.1	-	1.7	4.0	0.6	<b>-1.1</b>	<b>-2 112</b>
Special factors <sup>b)</sup>	-	-	2.9	1.2	1.0	<b>-1.8</b>	<b>-3 338</b>
Overall balance excl. temp. measures and special factors	-4.7	-10.2	-8.7	-7.2	-6.0	<b>2.7</b>	<b>5 159</b>
Interest expenditure	3.0	2.8	2.8	4.1	4.4	<b>1.6</b>	<b>2 416</b>
Primary balance excl. temp. measures and special factors	-1.7	-7.3	-5.9	-3.2	-1.6	<b>4.3</b>	<b>7 574</b>
Cyclical component of the balance <sup>c)</sup>	1.2	0.6	1.7	0.8	-1.0	<b>-2.7</b>	<b>-4 627</b>
Primary balance excluding the cyclical component, temporary measures and special factors	-2.9	-7.9	-7.5	-4.0	-0.5		
<i>Change</i>	<i>-1.8</i>	<i>-5.0</i>	<i>0.4</i>	<i>3.5</i>	<i>3.5</i>	<b>7.0</b>	<b>12 201</b> *

**Sources:** Statistics Portugal and Banco de Portugal.

**Notes:** **a)** According to the definition adopted in the Eurosystem. **b)** Special factors are transactions that increase the deficit temporarily but, according to the Eurosystem definition, can not be considered temporary measures. **c)** The cyclical component is computed by Banco de Portugal according to the methodology used in the Eurosystem.

\* This figure represents the structural improvement of the fiscal position and encompasses, beyond the impact of consolidation measures, the effect of structural trends and of tax revenue windfalls/shortfalls.

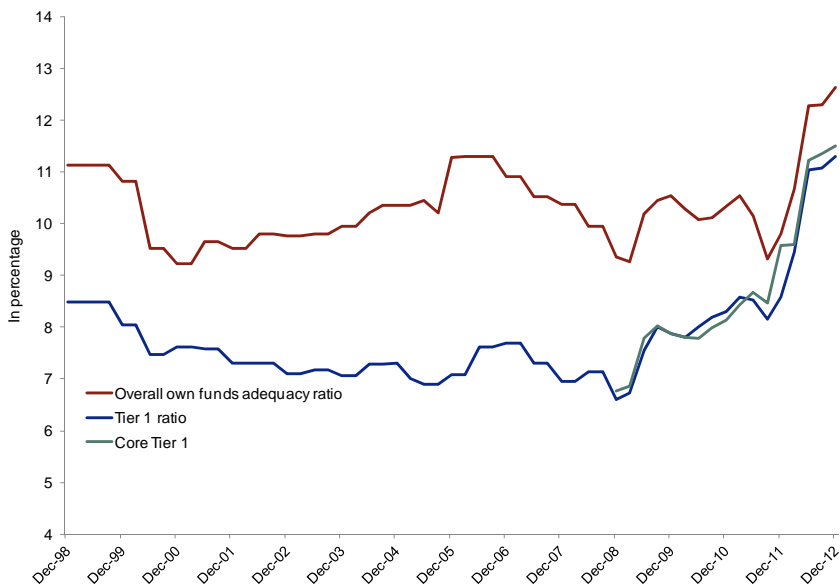
# The economic and financial assistance program

## Financial sector

- **Main goals**

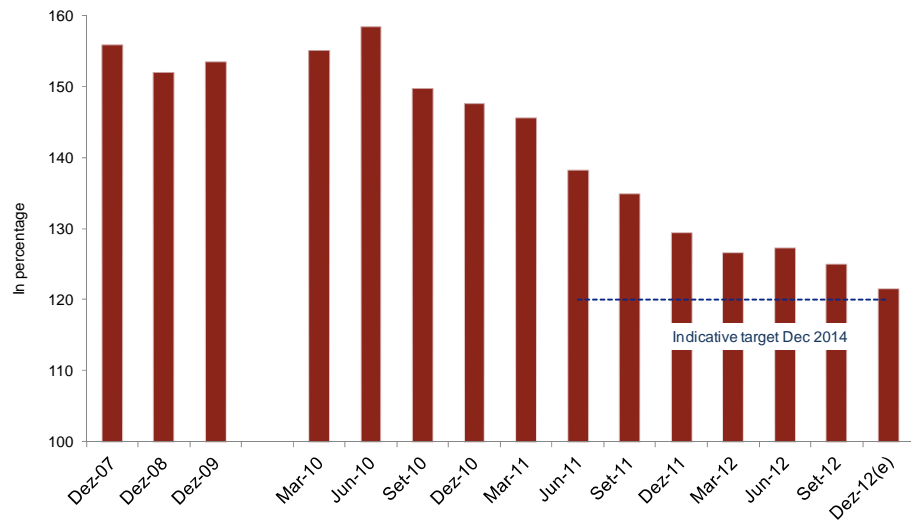
- Reinforcement of capital
- Convergence to a more sustainable funding structure in the medium term

### Capital adequacy ratios (in percentage)



Source: Banco de Portugal.

### Credit to deposits ratio for the 8 largest resident banks - FCP



Source: Banco de Portugal.



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# Structure of the presentation

- The economic and financial assistance program
  - Main goals
  - Reforms under implementation
    - Structural reforms
    - Fiscal consolidation
    - Financial sector
- **Projections**

# Projections

- These projections were based on information up to mid-March 2013 and therefore already include the information pertaining to the State Budget for 2013.

## Projections of Banco de Portugal: 2013-2014

Annual rate of change, per cent

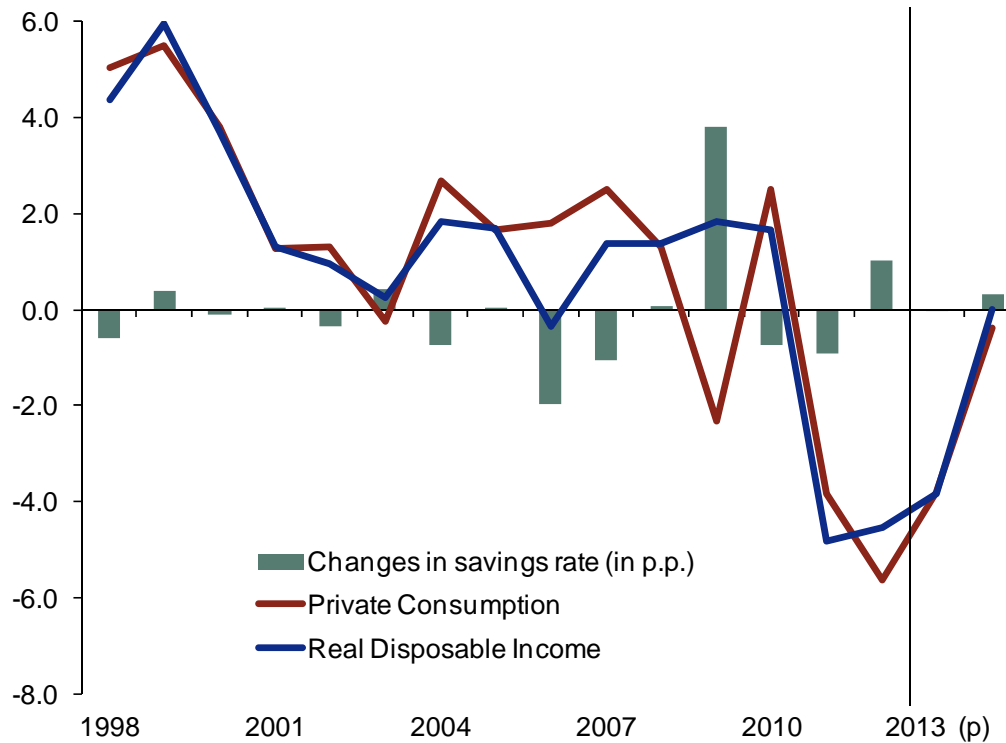
	Weights 2011	EB Spring 2013			EB Winter 2012		
		2012	2013 <sup>(p)</sup>	2014 <sup>(p)</sup>	2012 <sup>(p)</sup>	2013 <sup>(p)</sup>	2014 <sup>(p)</sup>
Gross Domestic Product	100.0	-3.2	-2.3	1.1	-3.0	-1.9	1.3
Private consumption	66.5	-5.6	-3.8	-0.4	-5.5	-3.6	0.1
Public consumption	20.0	-4.4	-2.4	1.5	-4.5	-2.4	1.5
Gross fixed capital formation	17.9	-14.5	-7.1	1.9	-14.4	-8.5	2.8
Domestic demand	104.4	-6.8	-4.2	0.4	-6.9	-4.0	0.8
Exports	35.8	3.3	2.2	4.3	4.1	2.0	4.8
Imports	40.1	-6.9	-2.9	2.7	-6.9	-3.4	3.5
Contribution to GDP growth (in p.p.)							
Net exports		3.9	1.9	0.7	4.2	2.1	0.6
Domestic demand		-7.0	-4.2	0.4	-7.2	-4.0	0.8
of which: change in inventories		0.2	-0.1	0.1	0.0	0.2	0.0
Current plus capital account (% of GDP)		0.8	3.6	4.8	-0.1	3.1	4.4
Trade Balance (% of GDP)		0.1	2.8	3.8	0.3	3.1	4.1
Harmonised Index of Consumer Prices		2.8	0.7	1.0	2.8	0.9	1.0

Sources: INE and Banco de Portugal.

Notes: (p) – projected. For each aggregate, this table shows the projection corresponding to the most likely value, conditional on the set of assumptions considered.

# Projections: Domestic Demand

## Consumption, Disposable Income and Savings Rate (annual rate of change)



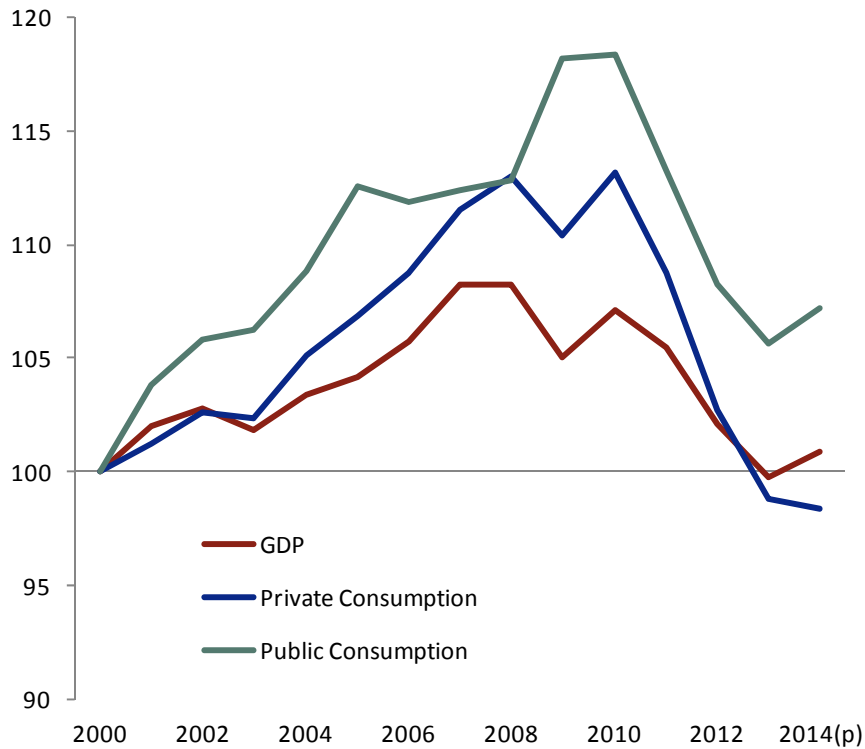
Sources: INE and Banco de Portugal.

Notes: (p) - projected. The savings rate is represented as a percentage of disposable income.



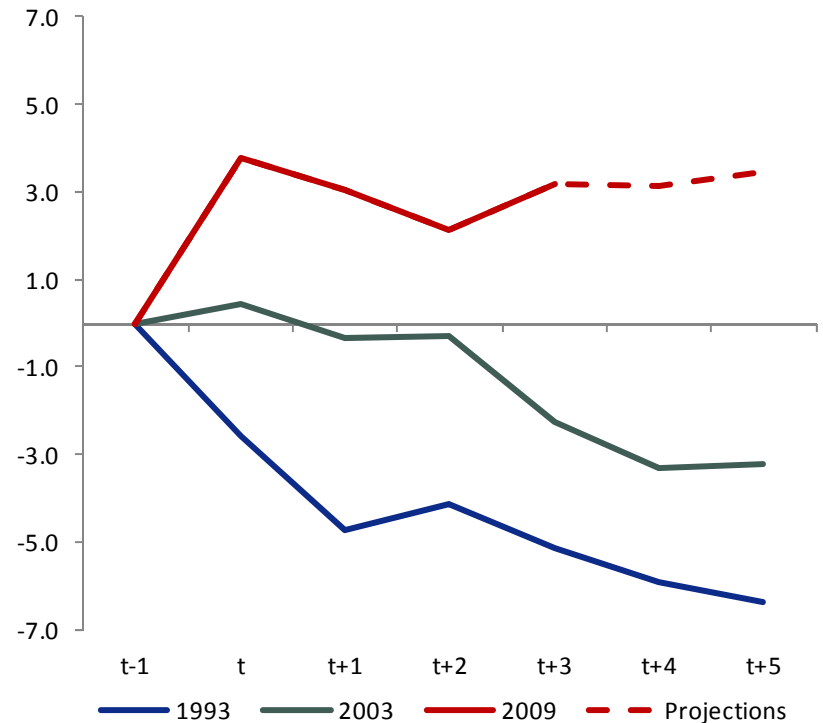
# Projections: Domestic Demand

**GDP, Private Consumption and Public Consumption**  
(Index 2000=100)



Source: INE and Banco de Portugal.

**Cumulative Change in Households Savings Rate in economic downturns**  
(Percentage Points of Disposable Income (t-1=0))

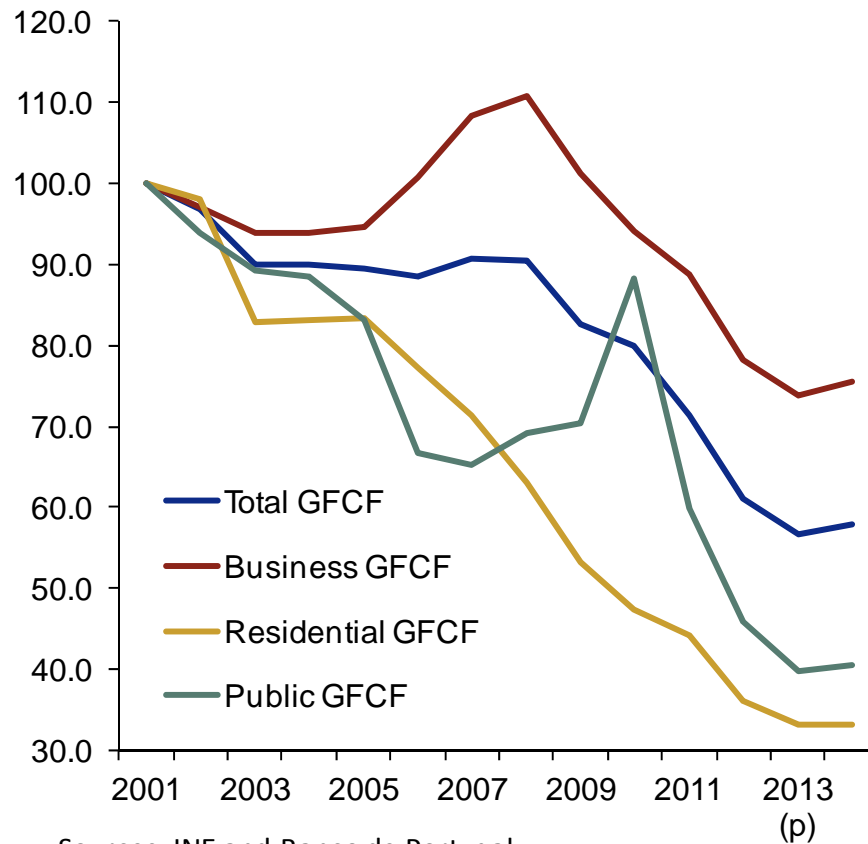


Sources: INE and Banco de Portugal.

Note: t corresponds to the year in which GDP registered a negative growth for the first time in a sequence of years.

# Projections: Domestic Demand

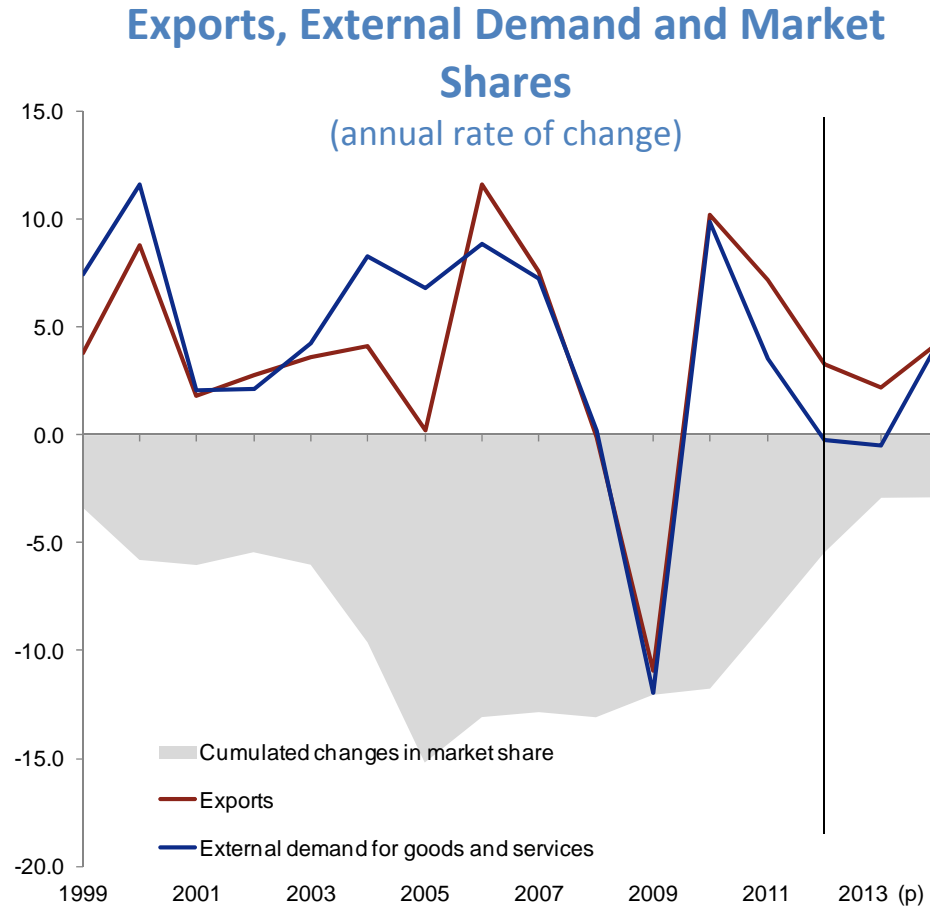
**GFCF by Institutional Sectors**  
(Index: 2001=100)



Sources: INE and Banco de Portugal.

Note: (p) - projected.

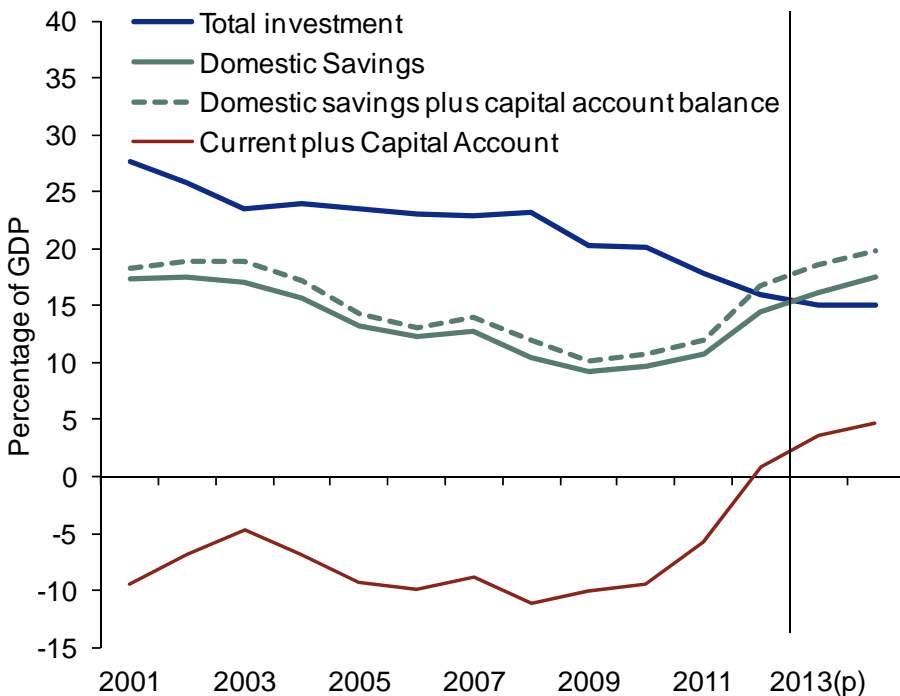
# Projections: Exports



Sources: ECB, INE (Statistics Portugal) and Banco de Portugal.  
Note: (p) - projected.

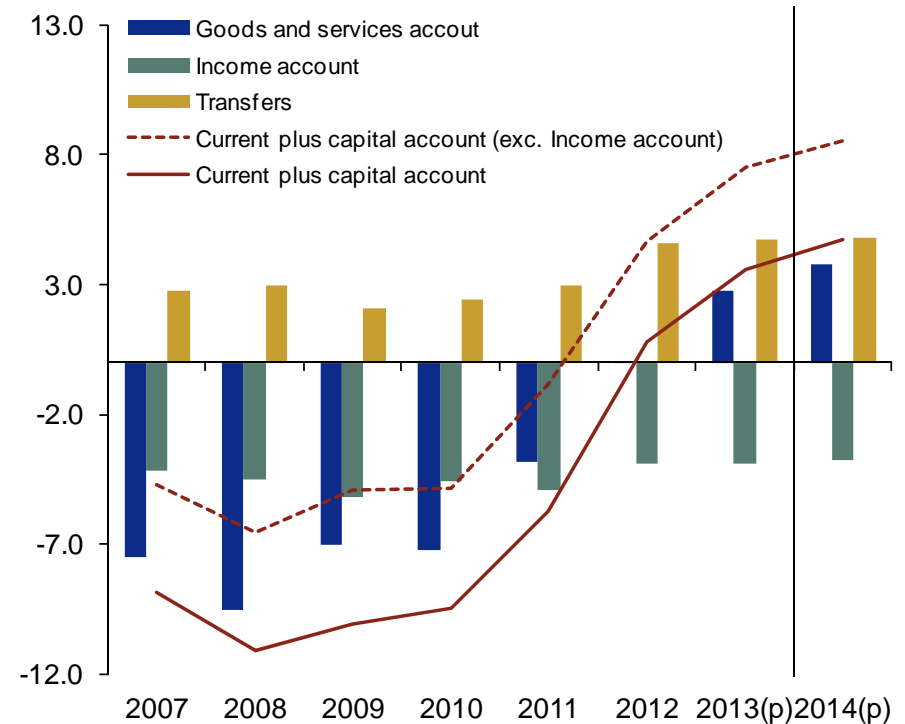
# Projections: Balance of Payments

## External Financing Requirements (as a percentage of GDP)



Sources: INE (Statistics Portugal) and Banco de Portugal.  
Note: (p) - projected.

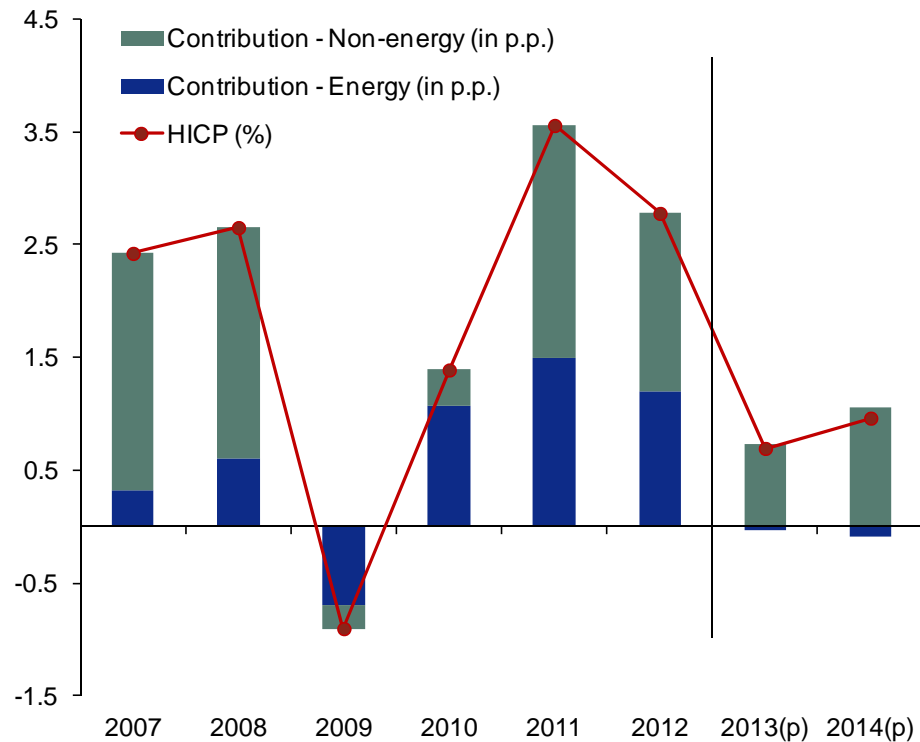
## Current plus Capital Account (as a percentage of GDP)



Sources: INE and Banco de Portugal .  
Note: (p) - projected.

# Projections: Inflation

## Inflation: contribution to the annual rate of change (in percentage points)



Sources: Eurostat and Banco de Portugal.

Note: (p) - projected.



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