



MINISTÉRIO DAS FINANÇAS

Portugal: restoring credibility and confidence

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Outline

1. On the way to become the difficult Portuguese case
2. The Economic and Financial Assistance Program
3. Fiscal consolidation
4. Financial stability
5. Structural transformation
6. Conclusion: how will it work?

ON THE WAY TO BECOME THE DIFFICULT PORTUGUESE CASE

Portugal's imbalances exposed in the context of the economic and financial crisis

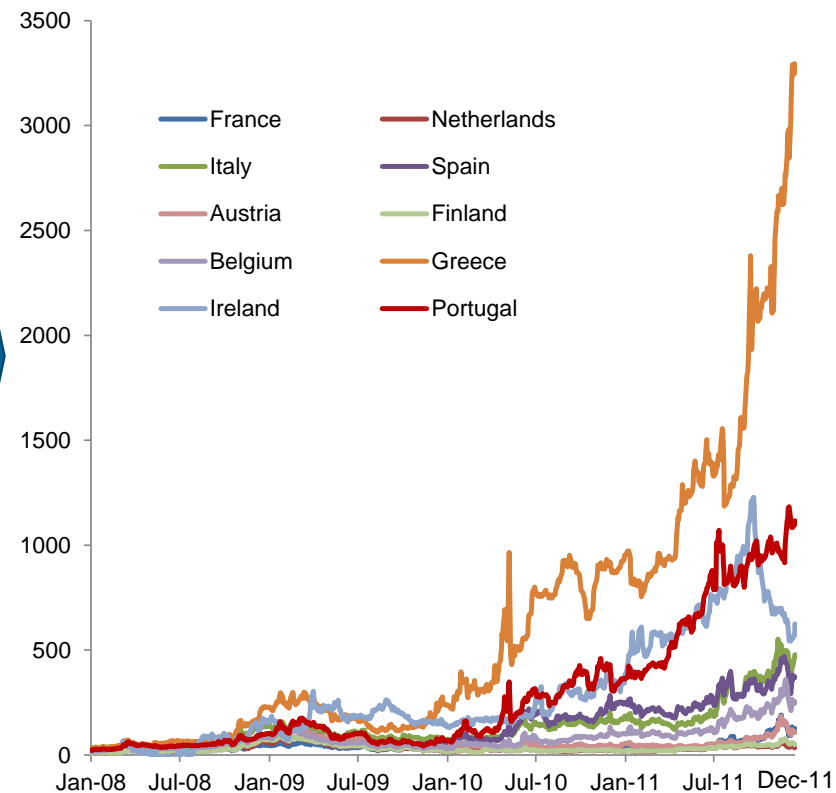
Macro-economic imbalances and structural weaknesses that have been accumulated over more than a decade

1. Unsustainable public finances

2. Over-indebtedness

3. Anemic economic growth and low productivity

10-year Government bond yields
Spread against Germany in basis points



Source: Bloomberg

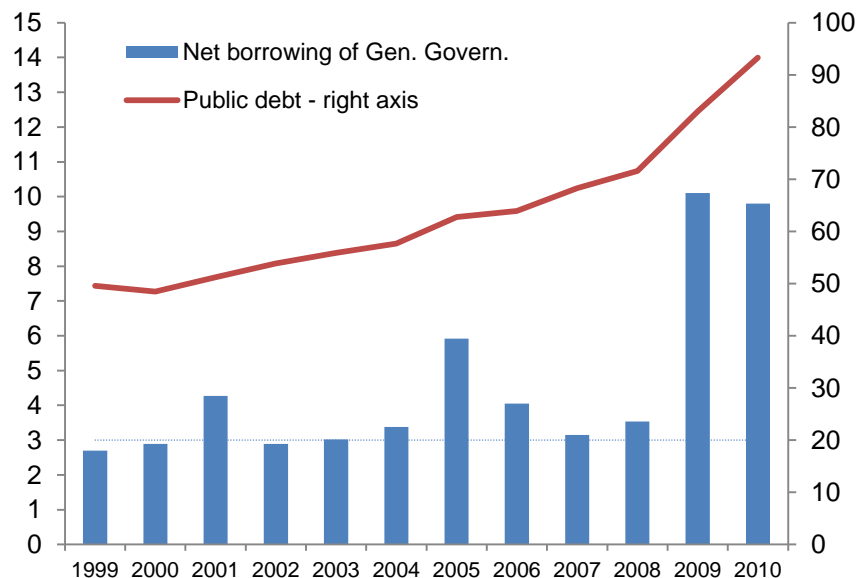
1. UNSUSTAINABLE PUBLIC FINANCES

Persistent imprudence in fiscal policy

Persistent government deficits and increasing public debt

Deficit and public debt

As a percentage of GDP

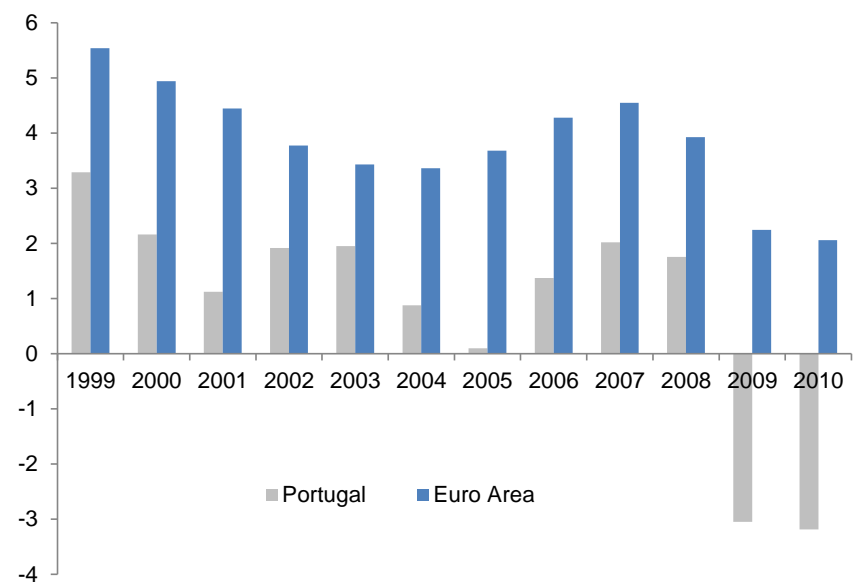


Source: INE, Bank of Portugal and Ministry of Finance

Fragile public finances

Structural Current Primary Balance

As a percentage of GDP



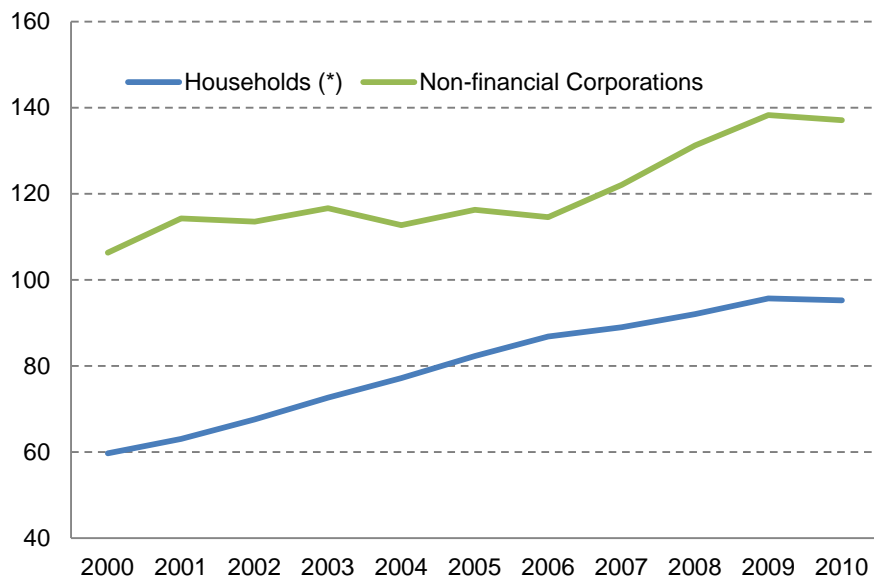
Source: AMECO and Ministry of Finance

2. OVER-INDEBTEDNESS

Debt accumulation by households and firms

Increasing indebtedness of the private sector

Debt of the Households and Non-financial Corporations
As a percentage of GDP

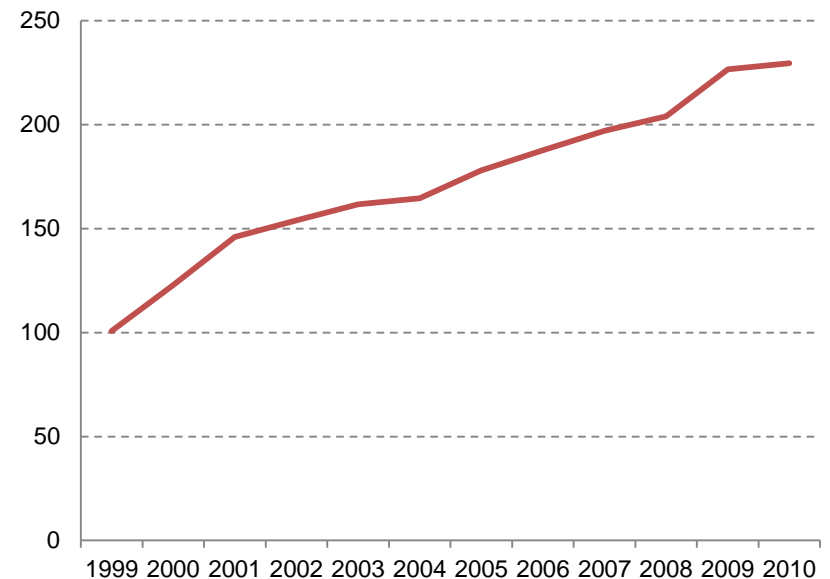


(*) Financial Debt

Source: Bank of Portugal

Increasing external debt

Portuguese gross external debt
As a percentage of GDP



Source: Bank of Portugal

Insufficient conditions to foster economic growth

Obstacles

- Restrictions on the market for corporate control
- Protection of several sectors of the economy
- Weak conditions to entrepreneurial activity
- Poor functioning of the justice system
- Rigidity of the labor market

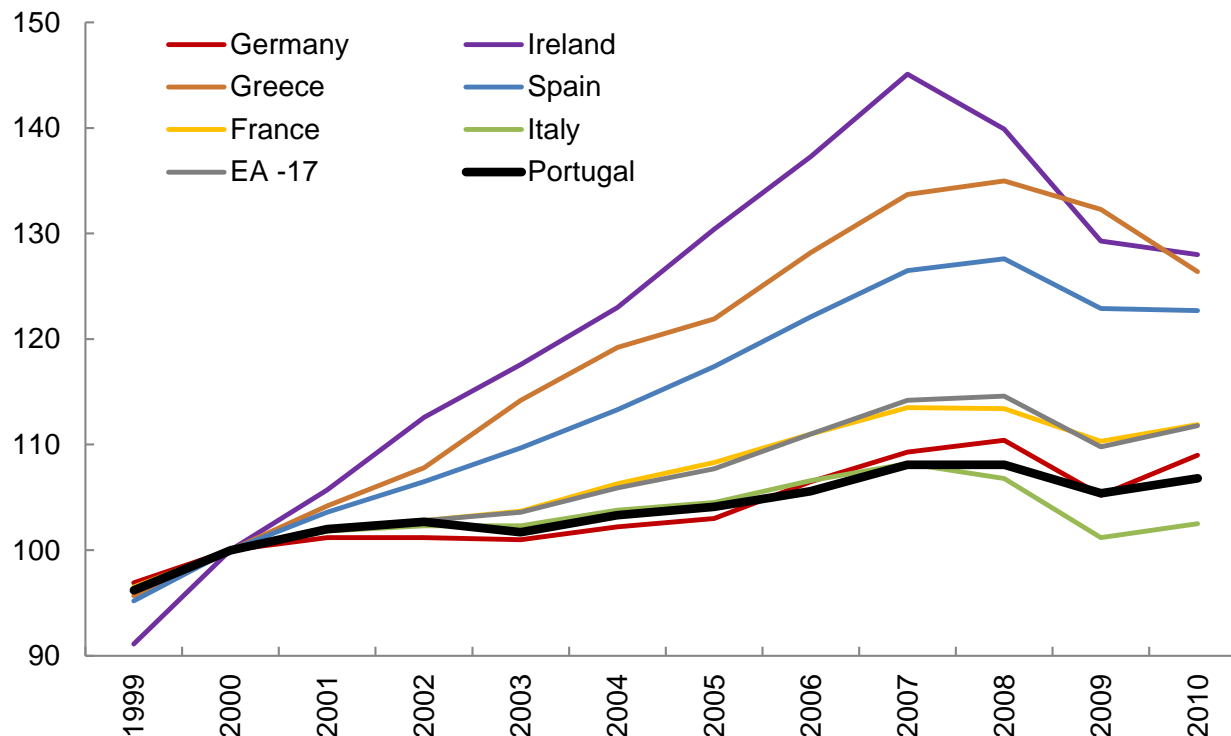
Consequences

- Insufficient attraction of direct foreign investment
- Capital accumulation in non-tradable goods and services sectors
- Lack of competition in several sectors
- Low levels of innovation and productivity growth
- High levels of youth and long-term unemployment

Disappointing performance of the Portuguese economy

GDP – Portugal and some of its European partners

2000 = 100



In the period 1999-2010, the GDP of Portugal grew at an annual average rate of 1%, compared with 1.4% in the euro area

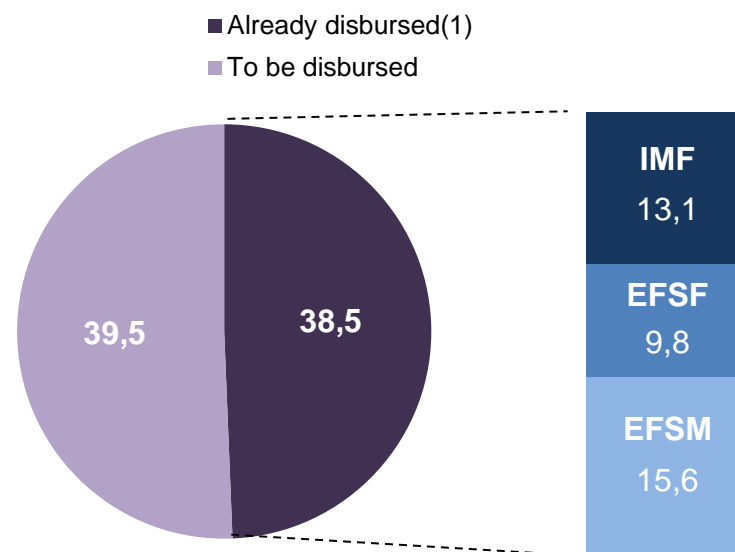
THE ECONOMIC AND FINANCIAL ASSISTANCE PROGRAM

Adjustment Program agreed with the IMF, EC and ECB in April 2011

Key facts

- The Economic and Financial Adjustment Program covers the financing needs of General Government for the **period 2011 to mid-2014**.
- It comprises a financial package amounting to **EUR 78 billion in loans**, including EUR 12 billion for banking sector re-capitalization.
- Each disbursement depends on the technical mission's **quarterly assessment about Portugal's performance** on the implementation of the Adjustment Program.

Financial package EUR Billions



1 Net issuances

Source: IGCP, January 2012

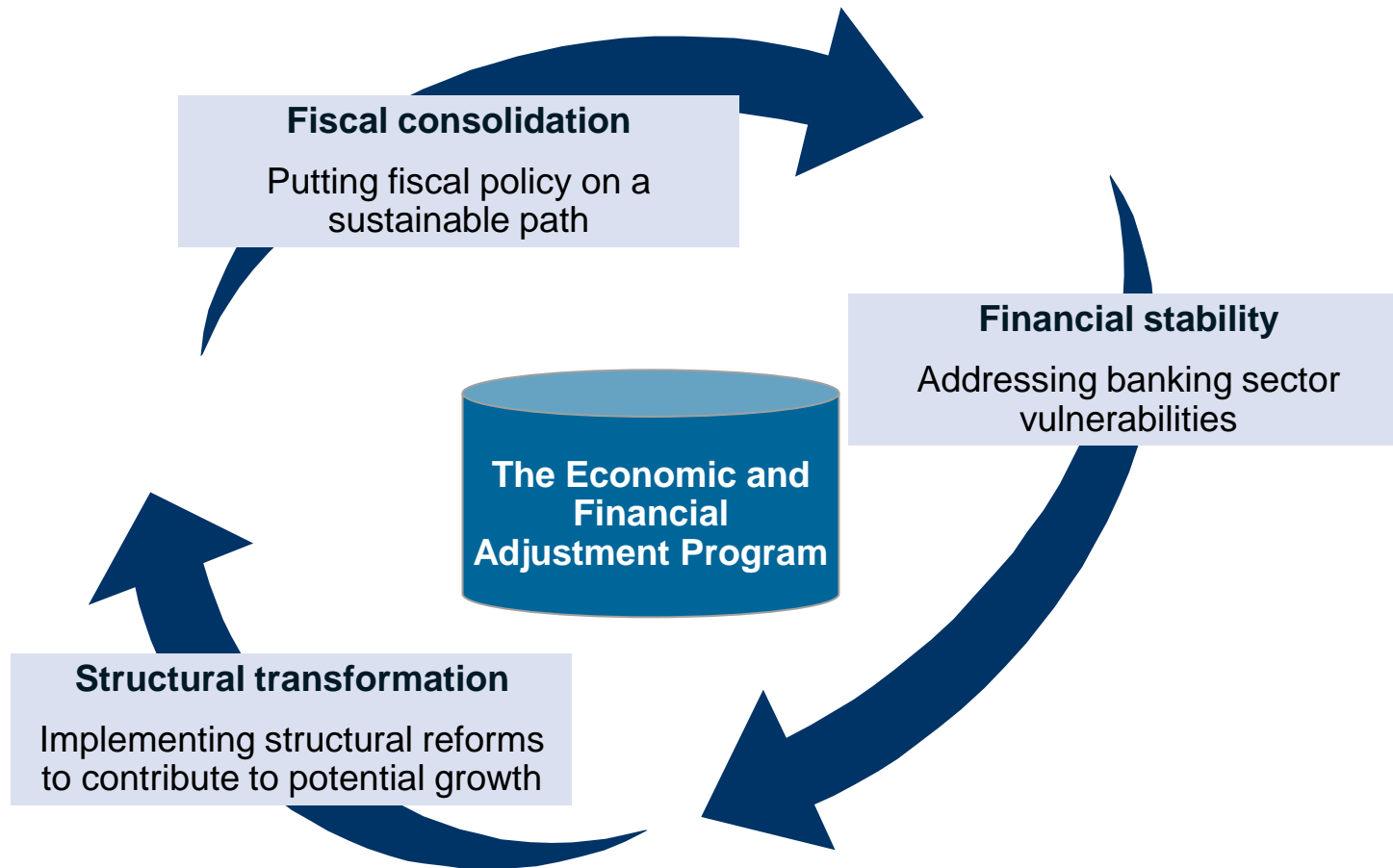
After the 2nd Review, the program implementation was considered **on track**

More information is available at:

IMF: <http://www.imf.org/external/pubs/ft/scr/2011/cr11363.pdf>

European Commission: http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/pdf/ocp89_en.pdf

A balanced Program to cope with the major challenges of the Portuguese economy



The Economic Adjustment Program **protects Government financing** from market pressures, allowing an **orderly adjustment of imbalances** and **time to build up confidence and credibility.**

Reducing uncertainty: Portugal is delivering in all fronts

At the start of the Program, Portugal faced a **very uncertain outlook**

Main risks

Major outcomes

1	Weakening of political support for the Program	<ul style="list-style-type: none"> ▪ Broad political consensus ▪ Social support to the Program
2	Unfavorable macro-economic developments	<ul style="list-style-type: none"> ▪ Milder recession than expected in 2011 ▪ Strong performance of exports
3	Missing the fiscal targets	<ul style="list-style-type: none"> ▪ Major reduction in overall and structural deficits ▪ Progress in institutional reforms
4	Uncertainty regarding the stability of the financial sector	<ul style="list-style-type: none"> ▪ Compliance with the Core Tier 1 ratios ▪ Reduction of loan-to-deposit ratio
5	Insufficient pace of structural reforms	<ul style="list-style-type: none"> ▪ Success of privatizations process ▪ Labor market tripartite agreement ▪ Broad range of implemented measures

Successful debt auction in January, 18

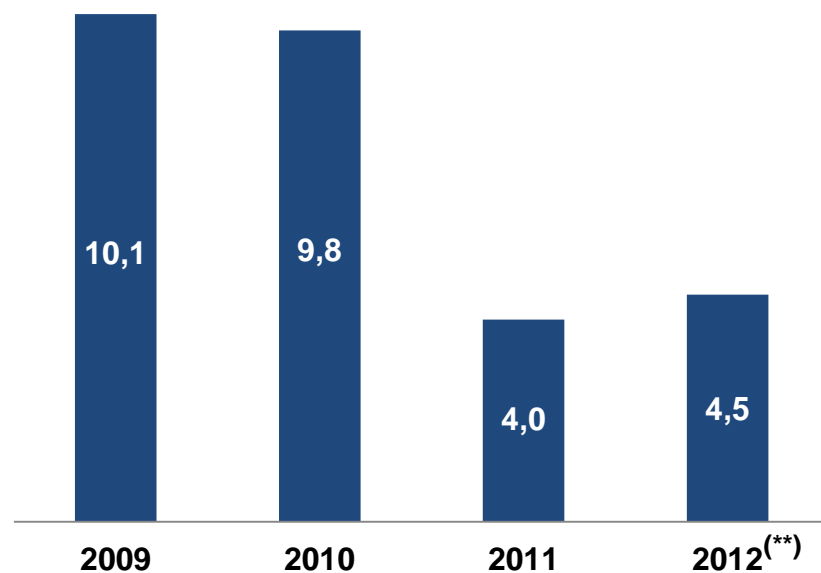
- Bond issuance of 11 months T-bills (last issuance in April 2011)
- High demand in all maturities
- Significant participation from non resident investors

FISCAL CONSOLIDATION

Major reduction of structural deficit in 2011 and 2012

Overall deficit

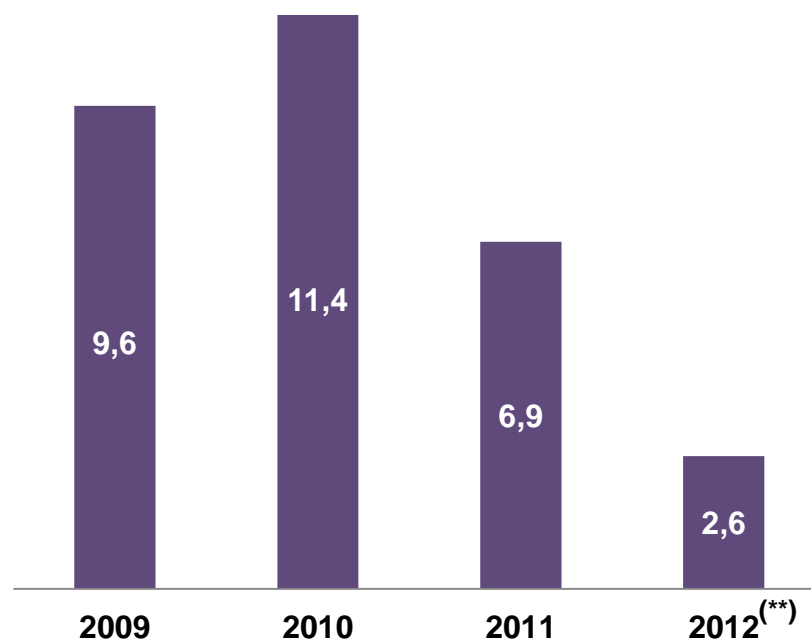
As a percentage of GDP



Limit of 5,9% prescribed in the Program

Structural deficit (*)

As a percentage of GDP



(*) Deficit adjusted for the effect of the cycle; excludes transfer of pensions funds in 2010 and 2011 and concessions in 2011

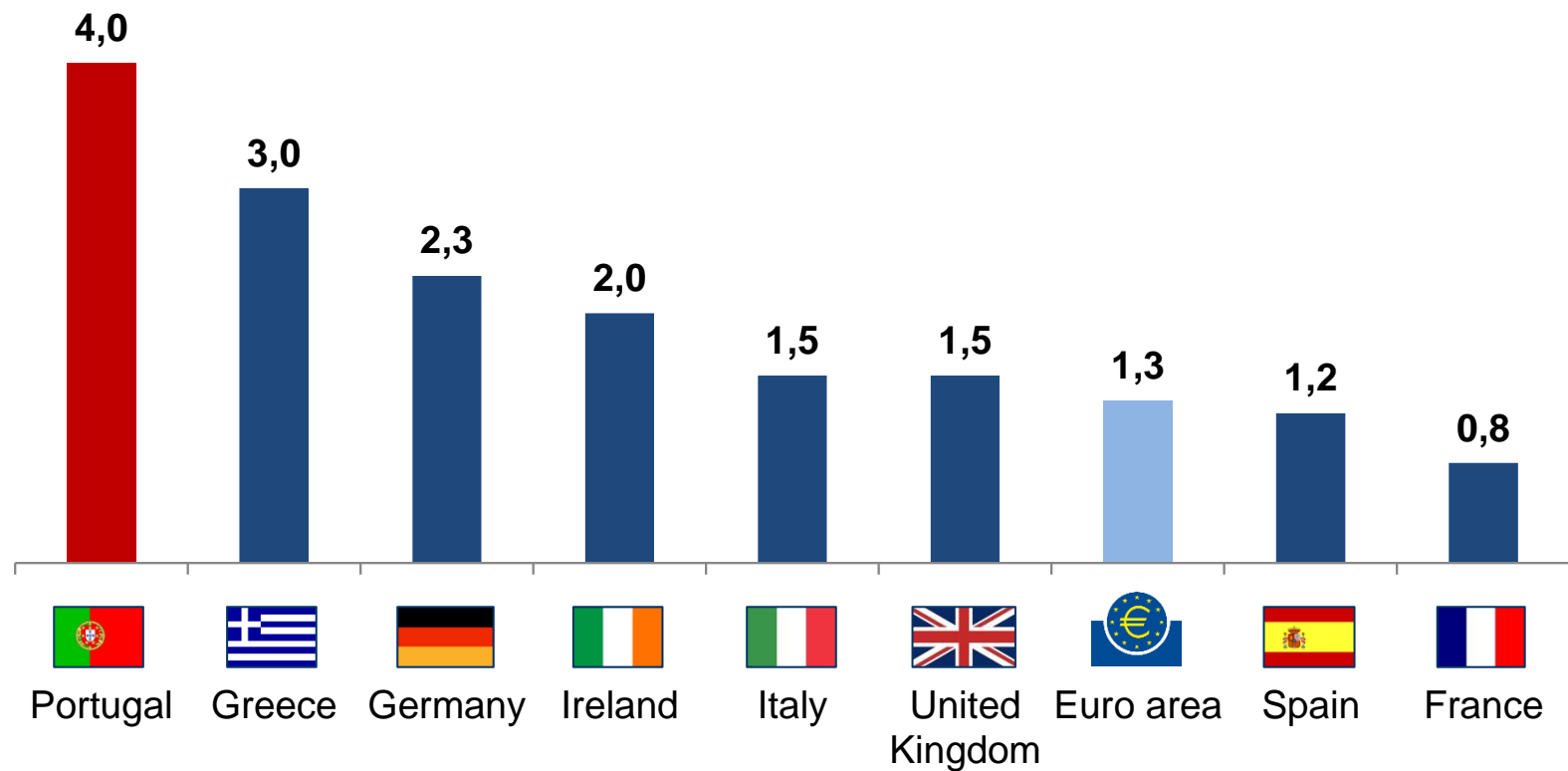
(**) Excludes temporary effects in 2012

Source: Ministry of Finance, January 2012

Portugal's structural adjustment stands out

Structural adjustment 2010-2011⁽¹⁾

Percentage points of potential GDP



(1) Change in General Government Cyclically Adjusted Balance

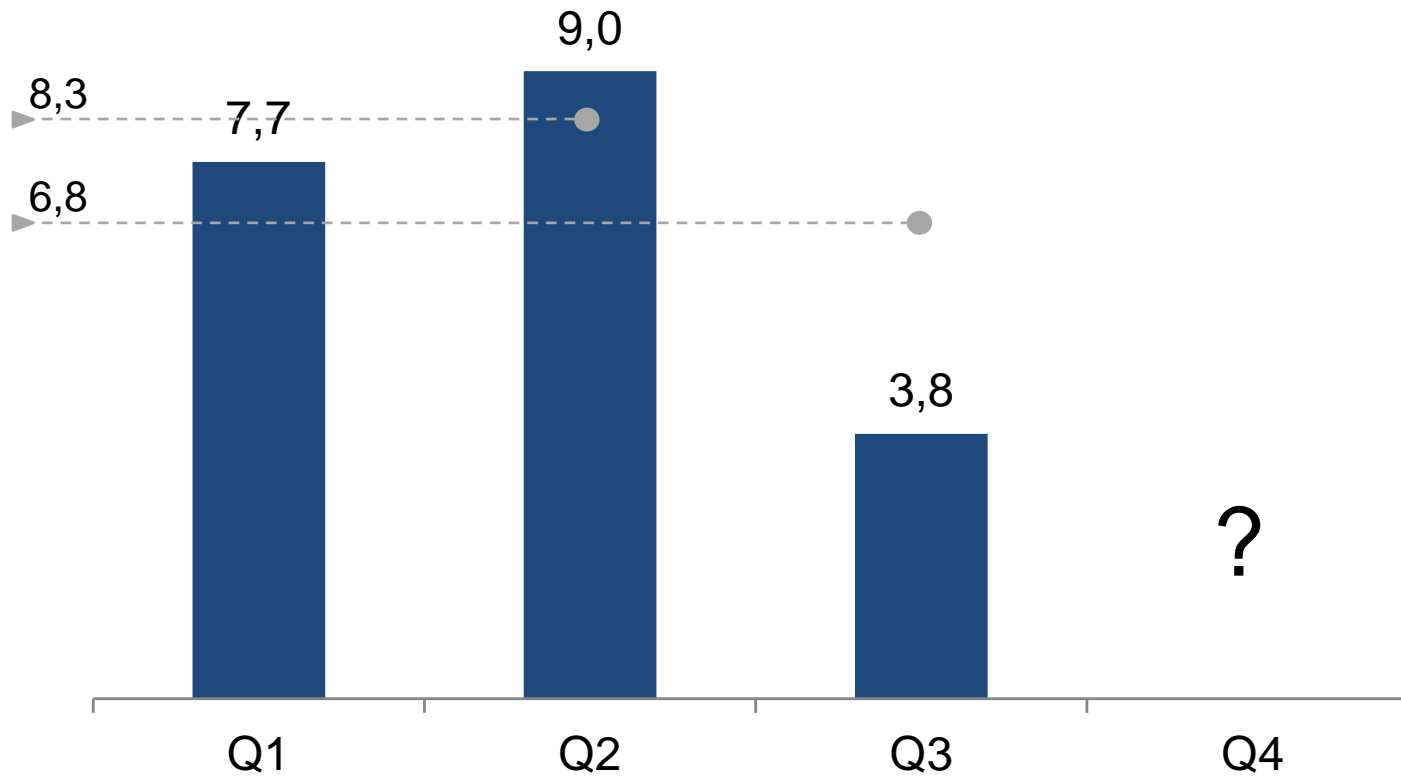
Source: IMF, "Fiscal Monitor Update", January 2012

Q3 budget deficit below 4%

—●— Accumulated deficit

Quarterly general government deficit - national accounts

As a percentage of GDP



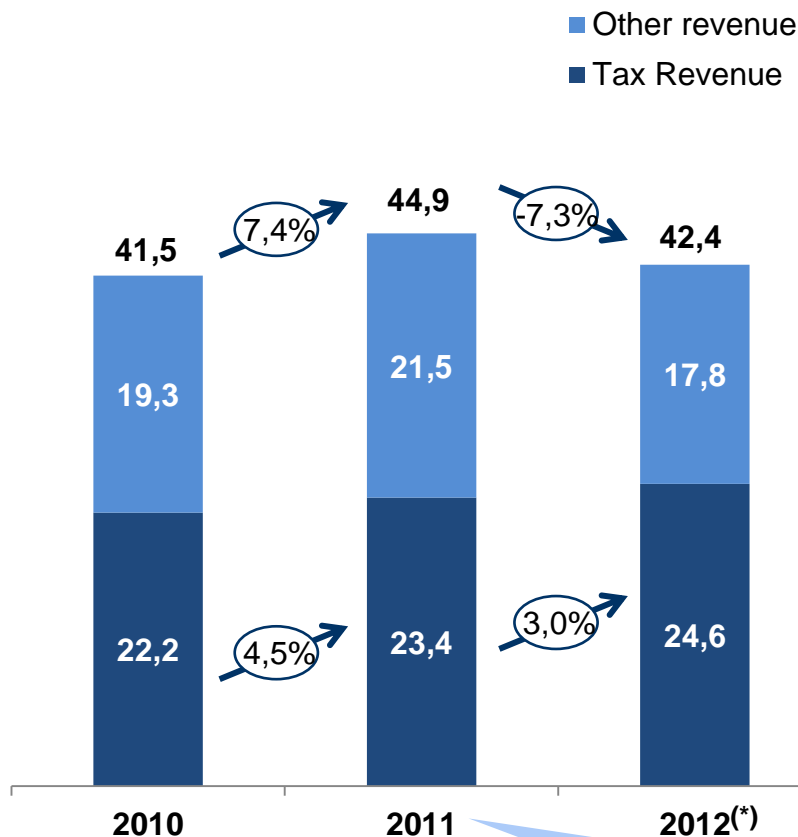
Accumulated deficit fell from **8,3% in the first semester** to **6.8% for the first three quarters.**

Significant fiscal consolidation in 2011

○ Percent change in total values

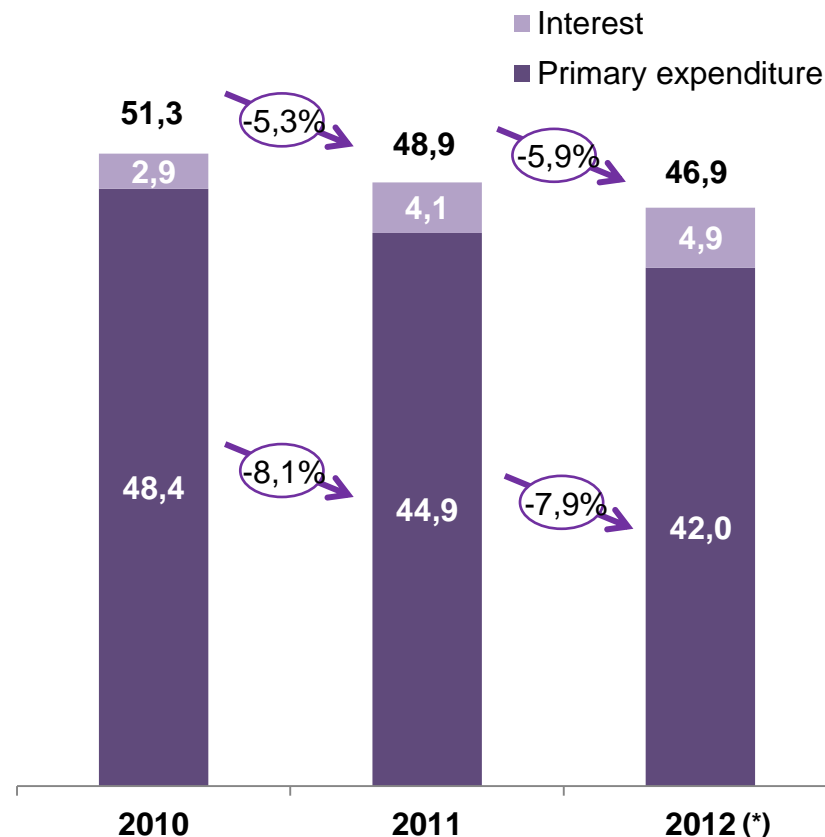
Total revenues

In percentage of GDP



Total expenditure

In percentage of GDP



Coercive tax collection of 1.230M€: **12% above target**

(*) Excludes temporary effects in 2012
Source: Ministry of Finance, January 2012

Important progress in the institutional reform front

NON-EXHAUSTIVE

Major actions

- Effective operation of the **Portuguese Public Finance Council**
- Presentation of the **Commitments' Control Law**
- Creation of the new **Tax and Customs Authority**
- Implementation of the **PREMAC** (Plan for the Reduction and Modernization of the Central Administration of the Government)

Next challenges

- Improve **budgetary control** across all levels of Public Administration
- Control and possibly renegotiate **Public Private Partnerships** agreements
- Restructure **State Owned Enterprises**
- Continue to streamline **Public Administration**

FINANCIAL STABILITY

Reinforcement of banks' capital and deleveraging process are ongoing

Key achievements

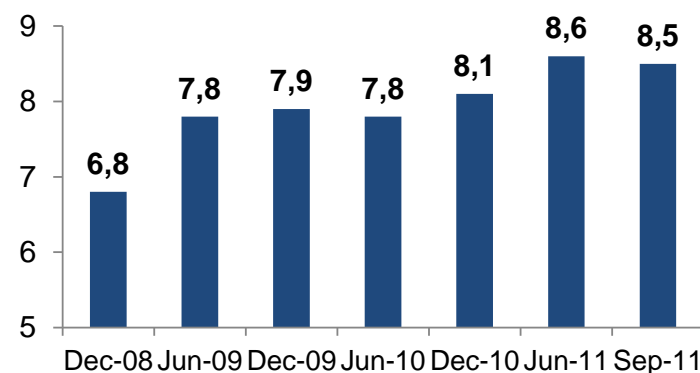
- **Core Tier 1 target of 9%** to be reached by end-June 2012, following a prudent evaluation of sovereign debt exposures
- **Special on-site inspections** confirmed the robustness of capital adequacy
- **Regulatory framework was improved:** legislation on early intervention, resolution and deposit insurance

Reinforce
ment of
banks'
capital

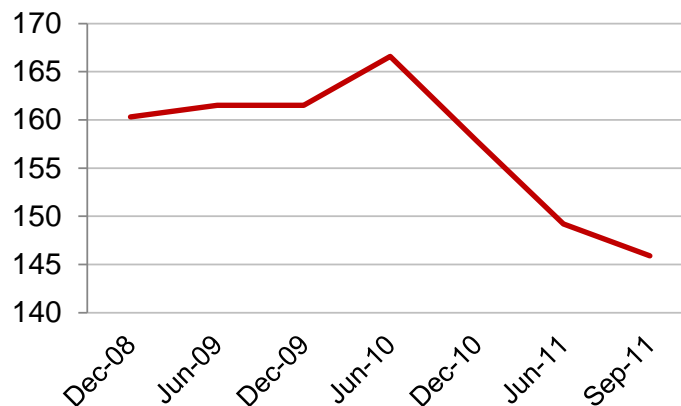
Deleveraging
process

- Adjustment is **progressing as planned**
- Important contribution of **higher deposits and sizeable asset sales**
- **Stabilization of financing** from the Eurosystem

Core Tier 1 ratio, percentage



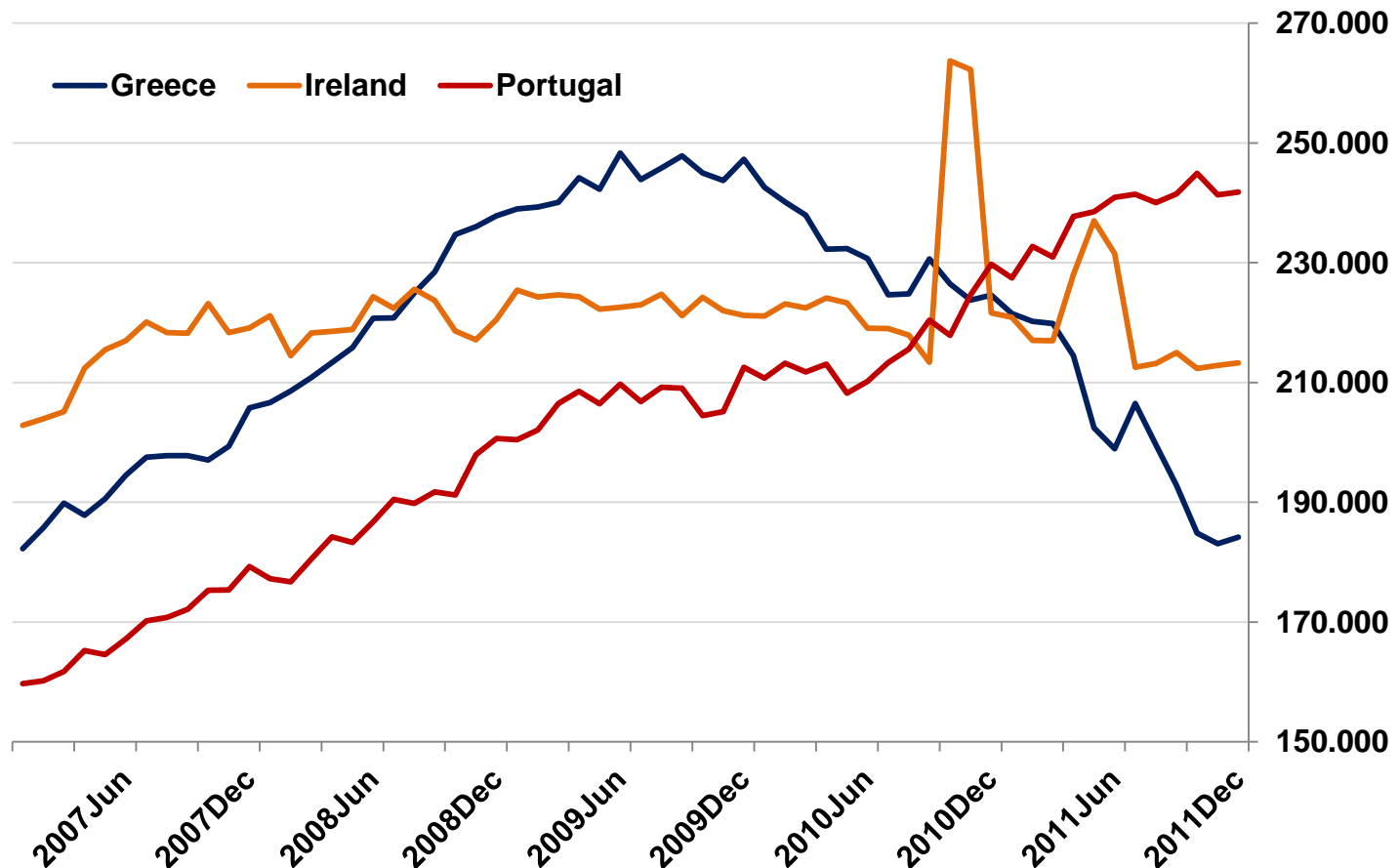
Credit-to-deposits ratio, percentage



Source: Bank of Portugal

Depositors' trust in the Portuguese banking system

Total deposits (excluding deposits from financial institutions)
Million Euros



Source: EBC



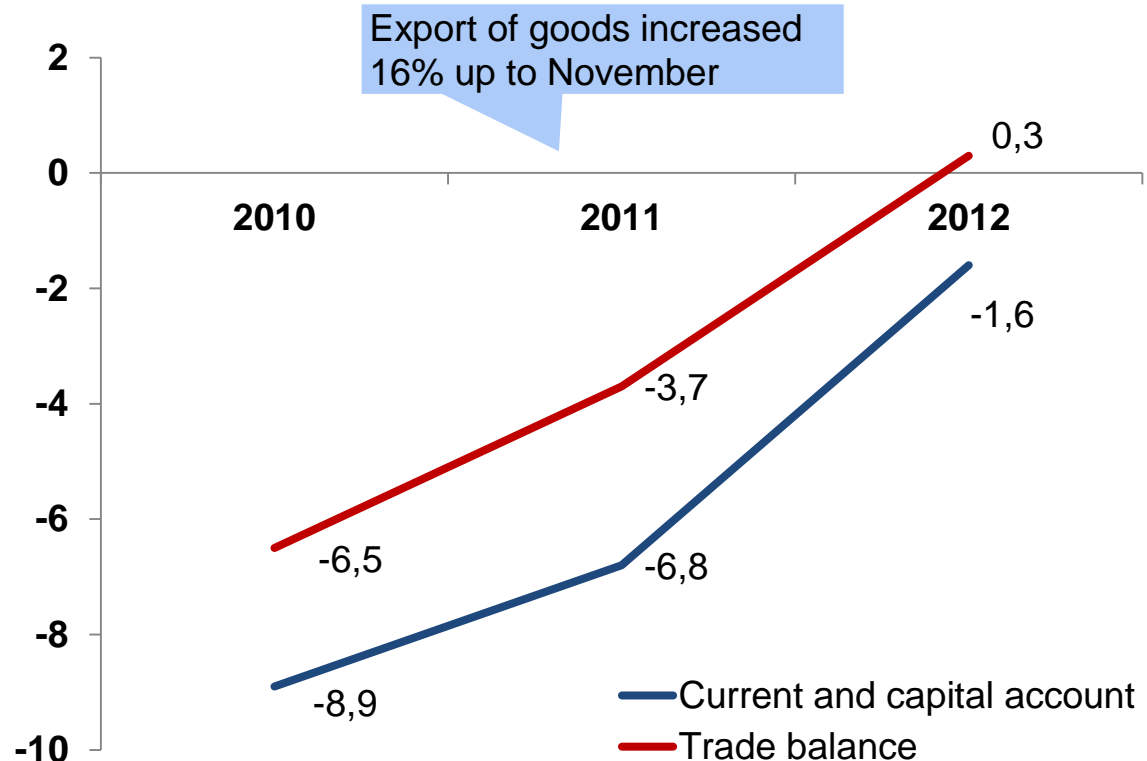
STRUCTURAL TRANSFORMATION

Milder recession than expected in 2011

GDP decline of 1.6% in 2011, against 2.2% initially projected in the Program (May 2011)

Strong performance of Portuguese exports

As a percentage of GDP



Economic growth: importance of the Structural Transformation Agenda

Fiscal consolidation and financial stability are necessary conditions for sustained growth...

...but they are not sufficient.

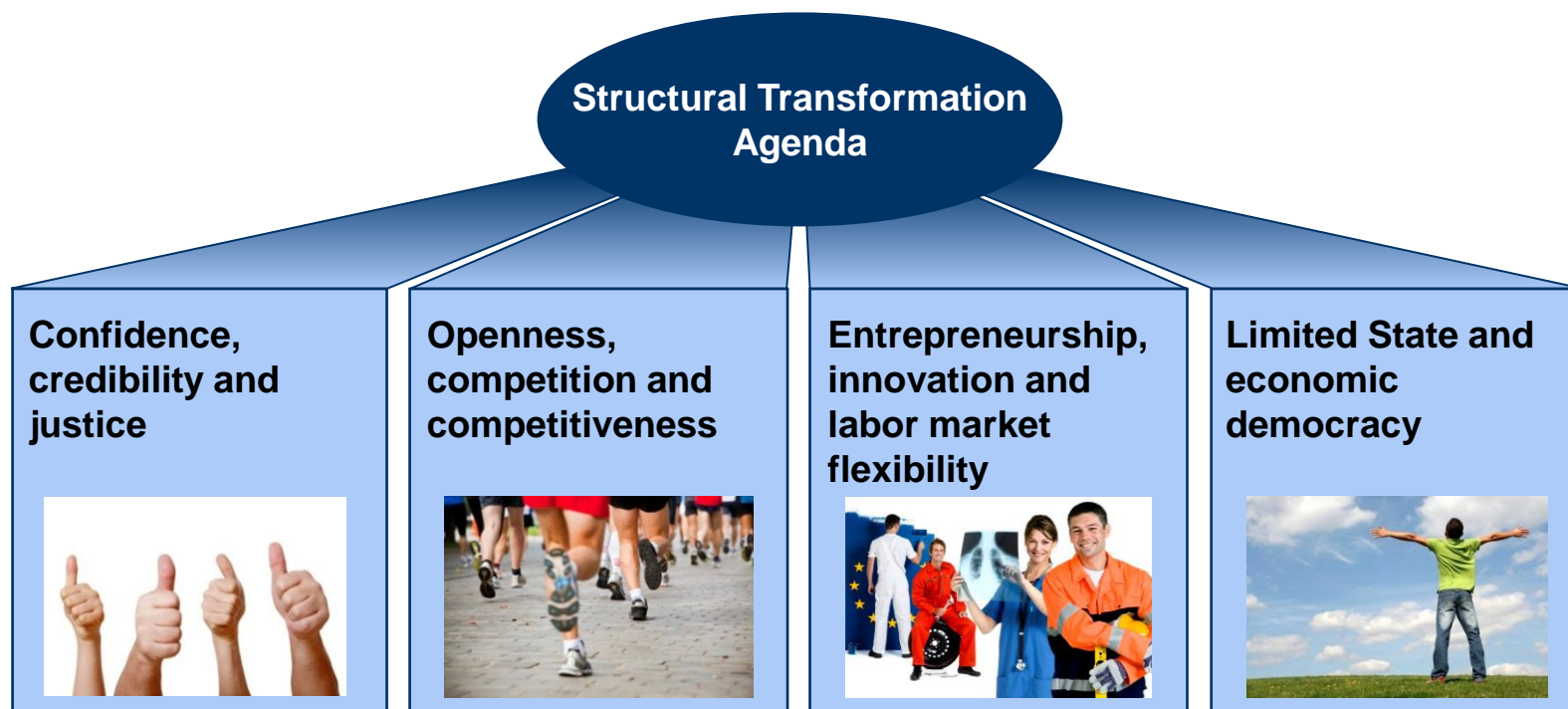
Broad range of structural reforms

- Privatizations
- Liberalization of the Market for Corporate Control
- Competition: e.g. reduction of rents in sectors shielded from foreign competition
- Labor market
- Education and training
- Energy
- Telecommunications and postal services
- Transports
- Other services
- Housing Market
- Judicial system
- Public procurement
- Business environment

Structural transformation of the Portuguese economy

- Opening to foreign investment and to the challenges of international competition
- Competitive location for physical and human capital
- Fully integration in the Single European Market
- Development of a stability culture

Clear strategy and strong implementation effort

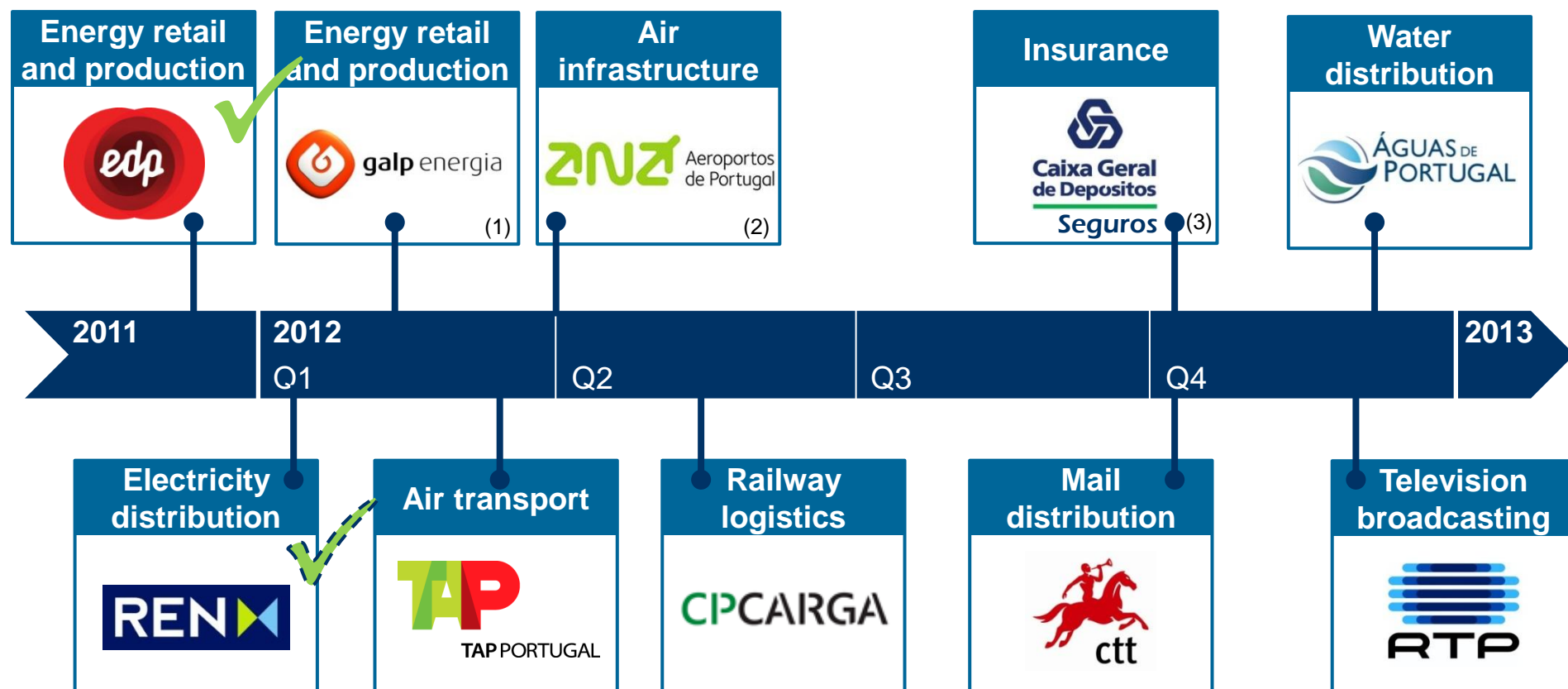


Structural MoU measures implementation – Second Review

Observed / Ongoing	22
Partially observed	4
Not observed	0

Source: European Commission, "The Economic Adjustment Programme for Portugal – Second Review", December 2011

Privatization program as a flagship in the agenda



- (1) Sale of "Caixa Geral de Depósitos" participation of 1%
- (2) Concession
- (3) Expected completion date by "Caixa Geral de Depósitos"

Success of EDP privatization: a global operation

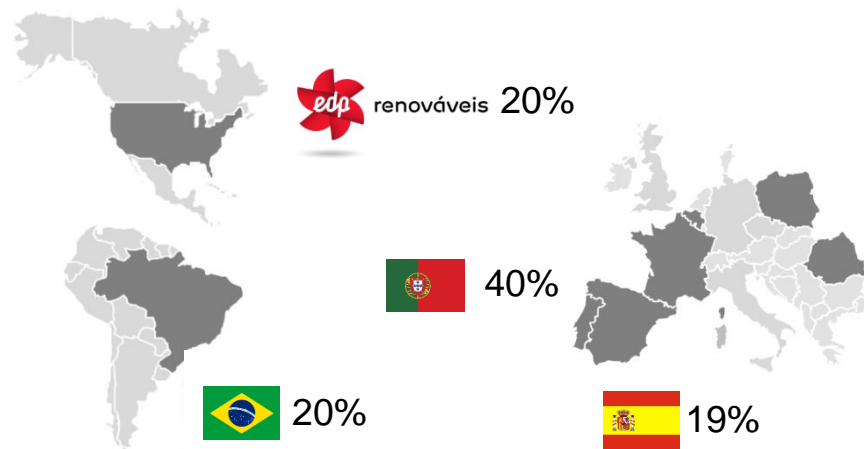
Opportunities identified

Internationalization vehicle

Access to specialized know-how

Key facts

EBITDA, 9M2011



#1 hydro developer in Europe

#3 wind player worldwide

Ranked as *Best Electric Utility Worldwide* in 2010 and 2011

Privatization process

4 international bidders

- 1 Europe
- 2 Latin America
- 1 Asia

Sale of 21.35% of equity to China Three Gorges

- Total revenue of EUR 2,693M with a premium of 53.6% per share¹
- Investment of 2,000M€ until 2015 in wind farms
- Guaranteed funding of EUR 2,000M through Chinese banking entities

¹ Considering the closing price of the day before the Council of Ministers decision

Source: EDP – Investor Presentation, November 2011; Ministry of Finance

Labor market reform

Agreement on Growth, Competitiveness and Employment

NON-EXHAUSTIVE

Objectives

Increase in competitiveness through

- Labor market flexibilization
- Labor cost reduction

Working time

Key measures

- Implementation of individual and group “bank of hours” (working time accumulation)
- Decrease in 50% of compensation for overtime work

Holidays/vacations

- Reduction of 4 national holidays
- Elimination of 3 extra days of vacation

Dismissal and compensation

- Reduction of restrictions to individual dismissal
- Reduction of severance payments to align with EU average
- Implementation of labor arbitration mechanisms

The agreement between the **Government, Unions and Enterprises Associations**: an important step to implement reforms in an environment of **social dialogue**



Improving business environment

NON-EXHAUSTIVE

Objective

Portugal
as a
competitive
location for
physical
and human
capital

Judicial system

Key measures

- Conclusion of an audit with targeted measures to accelerate the **resolution of the backlog**
- Adoption of a **law on arbitration** to facilitate out-of-court settlement
- Proposal to amend the **insolvency code and corporate recovery**, focusing on speed, simplification and creation of an extra-judicial phase of corporate recovery

Competition

- Approval of a new **Competition Law** harmonized with the EU legal competition framework
- Strengthen the power of the **Competition Authority**
- Operationalization of specialized **court on Competition, Regulation and Supervision**

Other services

- Liberalization of **regulated professions'** access and exercise
- Reduction of **companies' administrative burden**

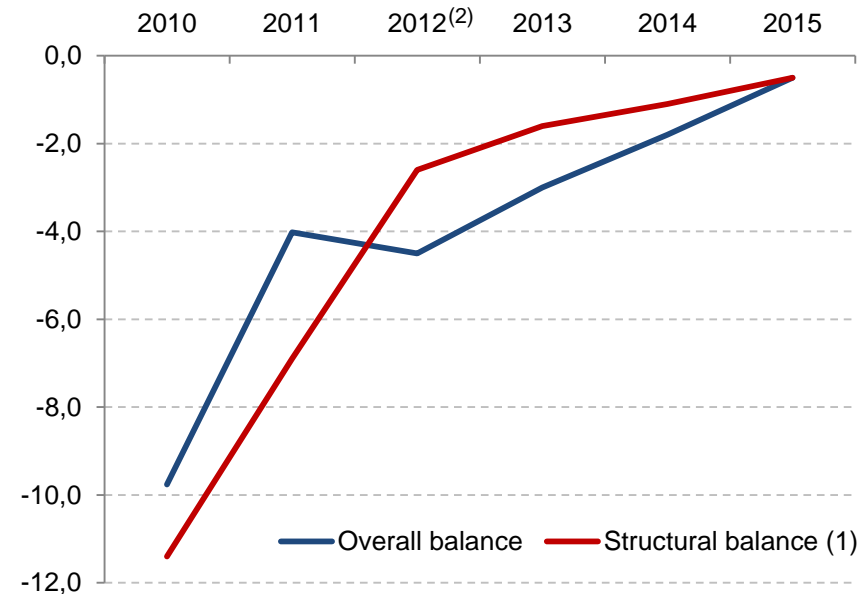
CONCLUSION: HOW WILL IT WORK?

Public finances on a sustainable path

General government balance approaching equilibrium

General Government balance

As a percentage of GDP



(1) Deficit adjusted for the effect of the cycle; excludes transfer of pensions funds in 2010 and 2011 and concessions in 2011

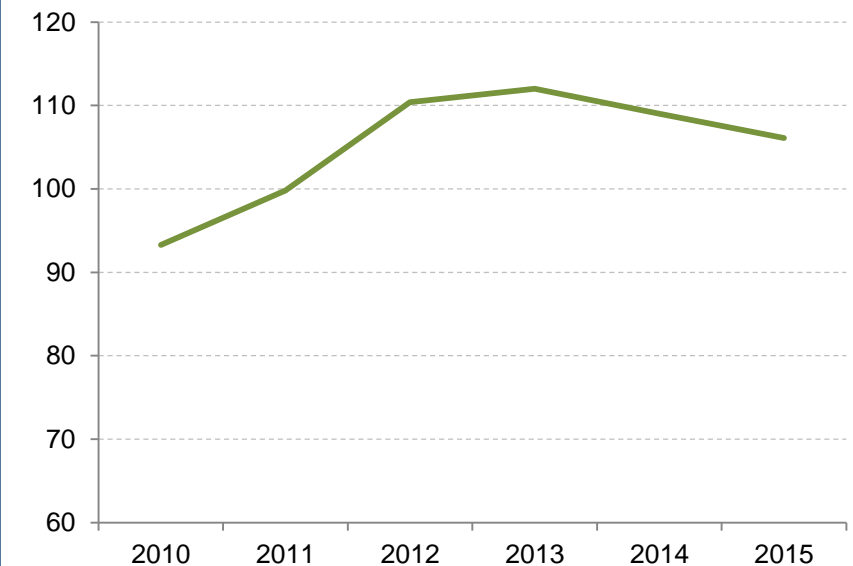
(2) Excludes temporary effects in 2012

Source: Ministry of Finance, 2010-2012 : Jan. 2012, 2013-2015: Nov. 2011

Decreasing of public debt

General government gross debt

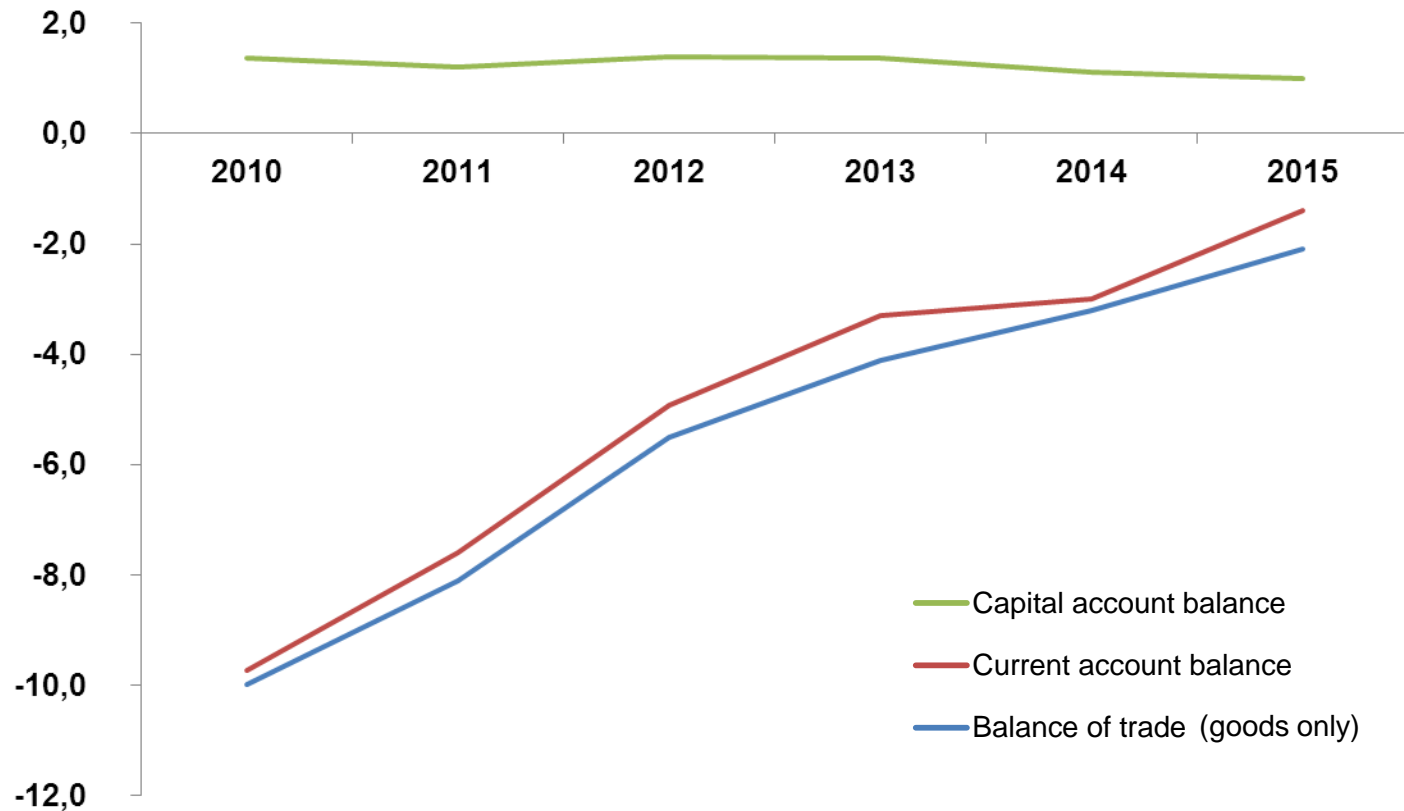
As a percentage of GDP



Source: Ministry of Finance, November 2011

Elimination of the trade deficit

As percentage of GDP



Return to growth

Sustained economic growth

GDP Growth

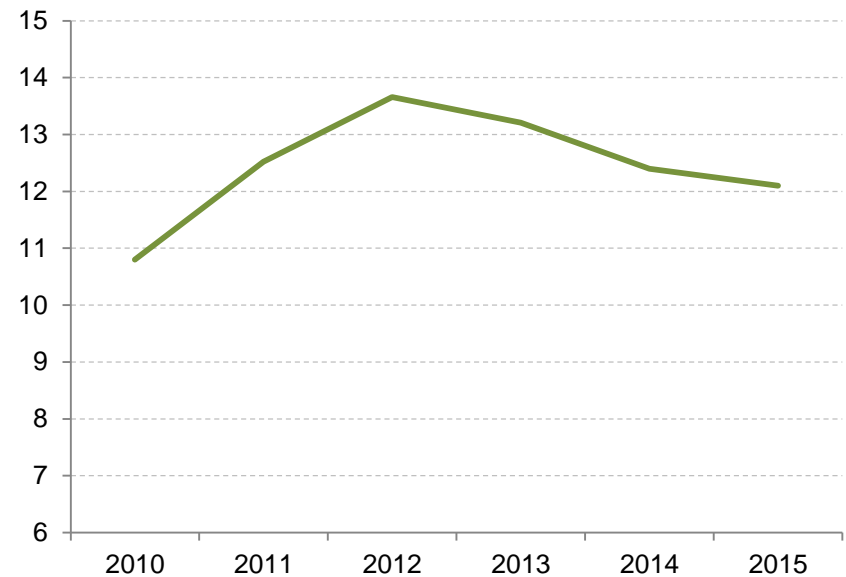
Year-on-year percent change



Job creation

Unemployment rate

Percentage



Source: Ministry of Finance, November 2011

Source: Ministry of Finance, November 2011

Portugal has entered a transformation process...

Crisis as an opportunity for positive change that fosters further progress

- Portugal was a **success case** in the second half of the 20th century
- History proves that we attain **great achievements** when facing national challenges

Building up credibility and confidence at home and abroad

- Broad **internal consensus**, both political and social, about the need of adjustment
- Support from our **international partners** providing financing up to 2014



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