Recent developments in the PT economy and government debt market

- **On a cash basis, the General Government deficit adjusted for the relevant criteria stood at EUR 8.3 billion in 2012, 0.7 billion below the Programme target**
- **On an accrual basis, General Government deficit stood at 5.6% of GDP in the first 3 quarters of 2012, rendering feasible the target of 5% of GDP for the year as a whole**
- **Latest GDP data points to a 3% GDP contraction in 2012, in line with official projections**
- **Exports grew at a healthy pace up to November**
- **Secondary market flows data indicate a return of foreign investors to the MLT government debt market in the past 3 months**
- **The Republic of Portugal successfully returned to the EUR long-term international capital markets with a EUR 2.5 billion syndicated tap of its OT 4.35% Oct 2017**

Budgetary outturn in 2012 within target

Budgetary outturn until the end of 2012 confirms that the Programme *Quantitative Performance Criteria* was met, with the relevant GG deficit on a cash basis standing 0.7 billion below target. Excluding the amount received from the ANA concession (which on a cash basis amounted to 0.8 billion), the deficit would only be marginally above target.

The quantitative target for the GG deficit on a cash basis was met by a wide margin

Targets and implementation of the General Government balance
(EUR mln)

	2012	
	Target (2)	Implementation (3)
General Government Balance (cash basis)	-	**-6.951,5**
Adjustments underlying to the Technical Memorandum of Understanding (1)		
Guarantees, loans and capital injections		-93,4
Supplementary transfer to the National Health Service		1.500,0
Pension funds from banking institutions		-2.783,9
General Government Balance (Programme performance criteria)	**-9.028,0**	**-8.328,8**

(1) The General Government balance includes some operations classified below line, but under the Technical Memorandum of Understanding (EFAP) should affect the balance and be recorded above line.

(2) Revised after the 5th review mission.

(3) Values of implementation adjusted na estimation for with Local Government estimate.

Source: Ministry of Finance

This was achieved against an environment of declining budget revenues, through a tighter execution of public expenditure.

In particular, current primary expenditure in the Central Government and Social Security (CG+SS) stood 1.7% below target, with a major contribution from the purchase of goods and services (almost 8% below target).

Central Government and Social Security Consolidated Account
(EUR mln)

	2012		
	Estimte in 2013 Budget Report	Execution	Execution Degree (%)
Current revenue	**61.287,3**	**60.352,5**	**98,5**
Tax	34.628,2	33.950,6	98,0
Direct taxes	13.914,5	13.646,8	98,1
Indirect taxes	20.713,7	20.303,9	98,0
Social security contributions	16.871,1	16.860,1	99,9
Other current revenue	9.788,1	9.541,8	97,5
Capital revenue	**5.781,9**	**5.836,4**	**100,9**
Effective revenue	**67.069,2**	**66.189,0**	**98,7**
Current expenditure	**70.295,2**	**69.085,6**	**98,3**
Public consumption	25.576,8	24.421,9	95,5
Employees	11.808,1	11.734,3	99,4
Purchase of goods and services and other current expenditures	13.768,6	12.687,6	92,1
Subsidies	1.503,3	2.011,3	133,8
Interests and other charges	8.038,7	7.903,2	98,3
Current transfers	35.176,5	34.749,2	98,8
Capital expenditure	**4.901,9**	**4.489,2**	**91,6**
Effective Expenditure	**75.197,1**	**73.574,9**	**97,8**
Overall balance	**-8.127,9**	**-7.385,9**	
Adjustments related to EFAP			
Guarantees, loans and capital inject	-99,0	-93,4	
Additional transfer to the National Health Service - arrears paym.	1.932,0	1.500,0	
Pension funds	-2.789,8	-2.783,9	
Overall Balance (criteria of the EFAP)	**-9.084,7**	**-8.763,2**	
Memo item:			
Current balance	-9.007,9	-8.733,1	
Primary current expenditure	62.256,5	61.182,4	98,3
Primary current balance	-969,2	-829,8	
Capital balance	880,0	1.347,2	
Primary expenditure	67.158,4	65.671,6	97,8
Primary balance	-89,2	517,3	

Source: Ministry of Finance

CG+SS effective expenditure was EUR 1.6 bn below target…

… more than compensating the EUR 0.9 bn deviation in fiscal revenue

Primary balance was EUR 0.6 bn better than previously projected

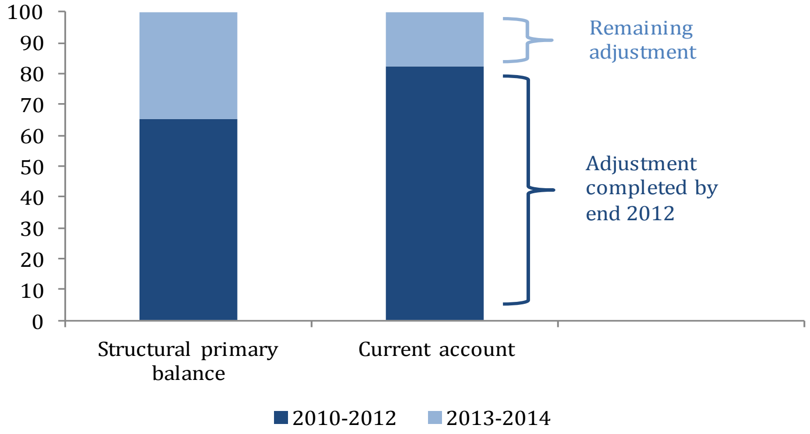
In relation to 2011, primary expenditure declined 3.6% (5.9% excluding transfers to the National Health Service to repay arrears), which is to a large extent explained by a reduction of almost 18% in employees' compensation, mostly on account of the two-month wage cut (2/14 ~ 14%).

Employees' compensation decreased ~ 18% yoy

Macroeconomic imbalances are being addressed

Macroeconomic imbalances are progressively being addressed: roughly 2/3 of the structural primary balance adjustment and 4/5 of the external adjustment that were initially programmed have already been achieved by the end of 2012:

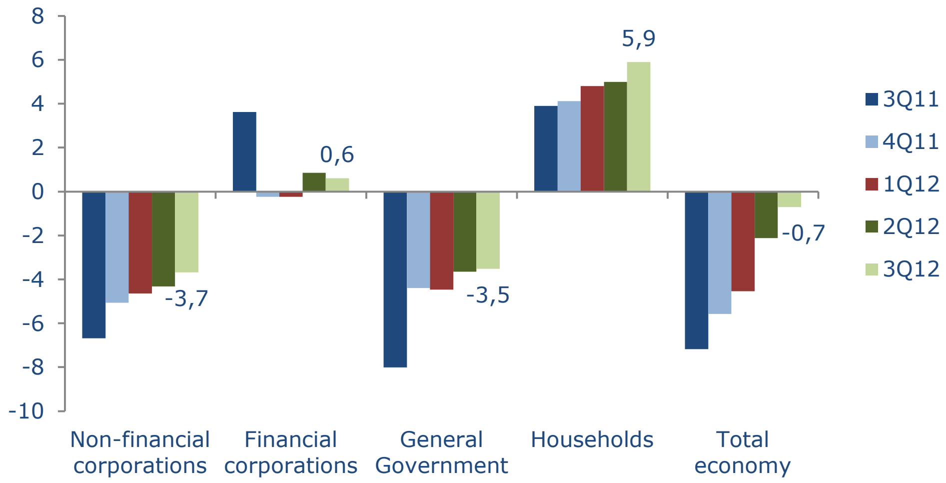
Fiscal and external adjustments
(% of initially projected 2010-2014 adjustment)



Source: IMF

Portuguese economy net borrowing needs amounted to 0.7% GDP in the year ending in 2012Q3, resulting from the narrowing of the external balance of goods and services with total imports decreasing 1.5% while exports increased 0.9%.

Net lending (+)/ Net borrowing (-) by institutional sector
(in % of GDP , accumulated sum of 4 quarters)



Source: Statistics Portugal

In the year ending in Q3 2012 total Portuguese economy net borrowing improved 6.5pp yoy and 1.4pp qoq

General Government net borrowing in the first 3 quarters of 2012 was 5.6% of GDP, comparing with 6.7% in the same period of the previous year. Moreover, it bodes well for meeting the 5% target for 2012 as a whole.

For the remaining 3 institutional sectors there was an increase in net lending capacity in the year ending in 2012Q3, improving 1.3pp from a year earlier.

Households gave a positive contribution, as can also be inferred from the increase in the current savings, which rose to 11.2%, very close to the all-time high of 11.5% observed in 2003. This increase was mostly due to the contraction of households' final consumption (-3.4%).

Households' savings rate
(% of disposable income, accumulated sum of 4 quarters)

Source: Statistics Portugal

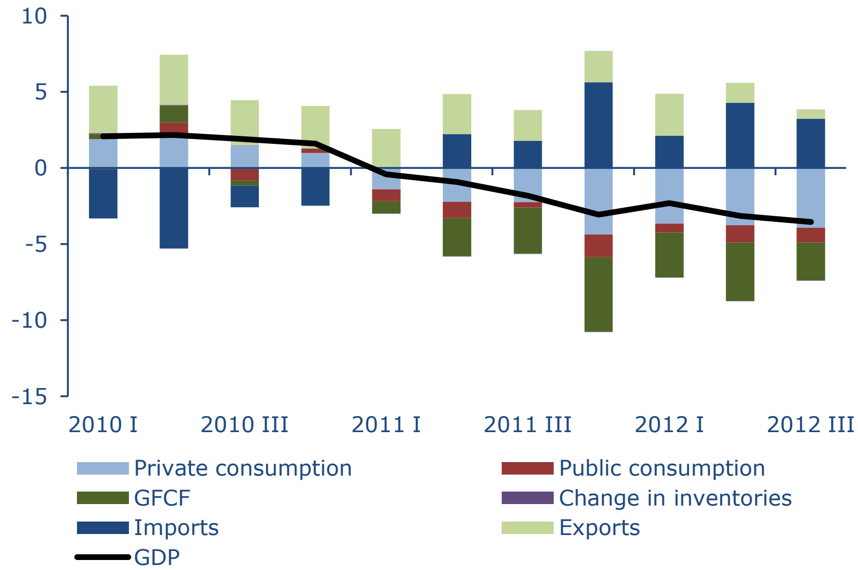
The households' savings rate increased to 11.2% of disposable income

Recent data suggests that the pace of GDP contraction is declining

Portuguese GDP posted a yoy growth rate of -3.5% in 2012Q3 (-3.1% in Q2). The domestic demand recorded a less negative contribution, while the positive contribution of net external demand decelerated to 3.9pp (5.6pp in Q2), determined by a less pronounced reduction of imports and a slowdown of exports growth.

In the first 3 quarters of 2012, GDP contracted 3.0% from a year earlier.

GDP growth rate and contributions of demand components
(% yoy)



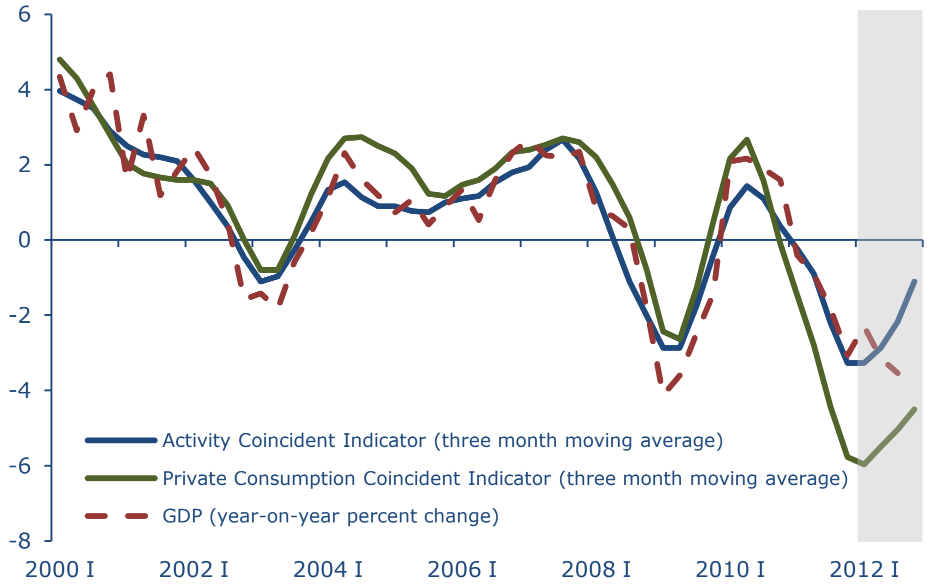
Source: Statistics Portugal

Rebalancing towards the tradable sector continued as domestic demand adjusted

Despite the downbeat GDP outlook, coincident indicators have reversed the negative trend since the beginning of 2012. Hence, the trough of the recessionary period is expected to occur in 2013.

Coincident indicators point to a reversion of the economic cycle over the short-term

GDP and coincident indicators
(yoy %)

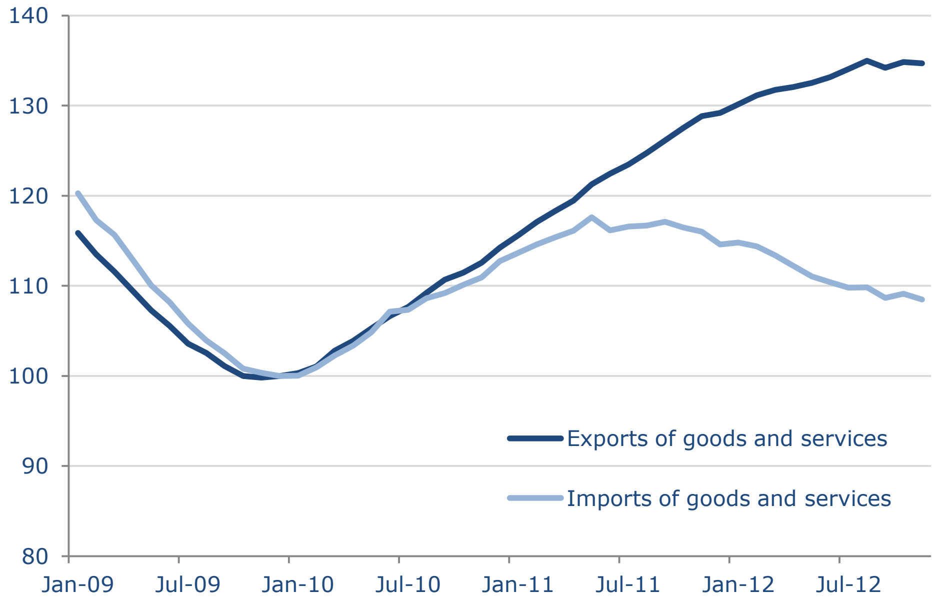


Source: Banco de Portugal, Statistics Portugal

Exports continued to grow at a steady pace in the past few months. Latest data for November show that in the first 11 months of 2012, exports of goods posted an increase of 6.5% comparing with the same period of the previous year. Including services, exports increased 4.6% yoy.

Exports have increased about 35% since 2009

International trade of goods and services
(Index 2009=100, 12mma)



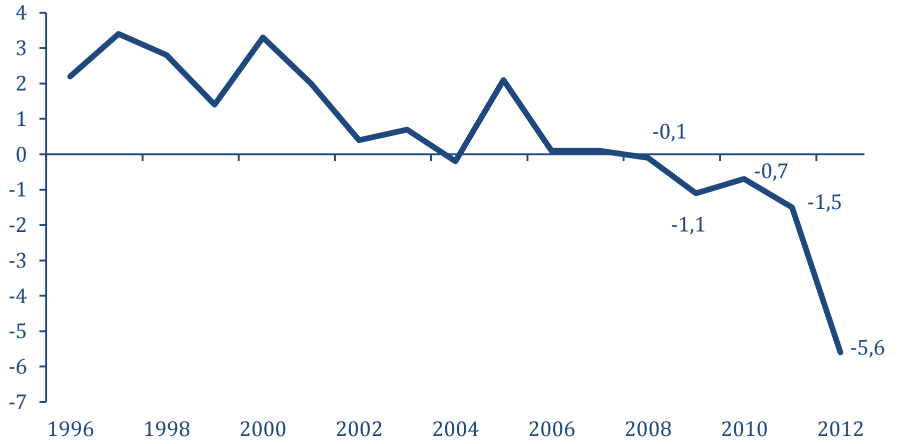
Source: Banco de Portugal

Exports performance relies on heightened competitiveness, for which the labor market developments were crucial.

Portugal continues its wage adjustment process and is progressively repositioning the economy in euro area competitiveness. Nominal unit labor costs have been consistently declining since 2010, recording a reduction of 2.4% in the year ending in Q3 2012. Concomitantly, nominal unit labor costs variation will be lower than the euro area for the 5th consecutive year, with *Banco de Portugal* projecting a differential of 5.6pp in 2012.

Since 2008 nominal unit labor costs have decreased 9pp *vis-à-vis* the euro area

Nominal unit labor costs – differential *vis-à-vis* euro area
(yoy %)

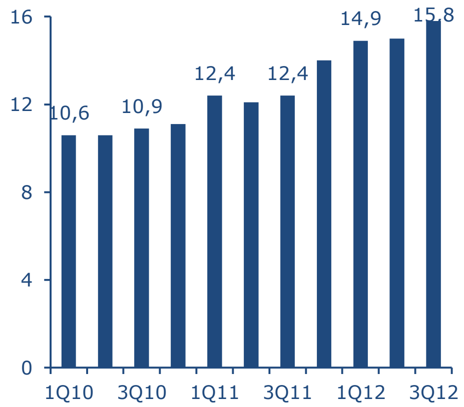


Source: Statistics Portugal, Banco de Portugal

The flipside effect of the economic adjustment is, however, a rising unemployment rate. Still, the pace of the increase of unemployment has been slowing down. Moreover, employment losses are highly concentrated in the construction sector:

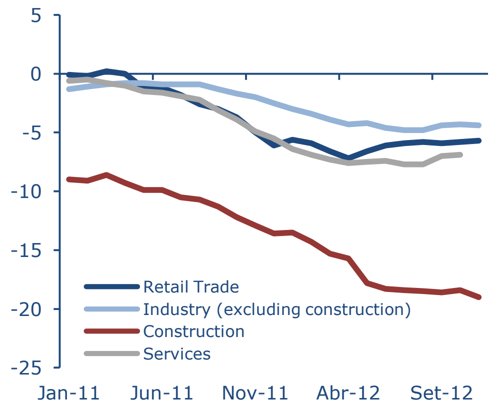
The unemployment rate in the 3 first quarters of 2012 is in line with the Budget forecast for the year as a whole (15.5%)

Unemployment rate
(% labor force)



Source: Statistics Portugal

Employment variation by main sectors
(yoy, %)



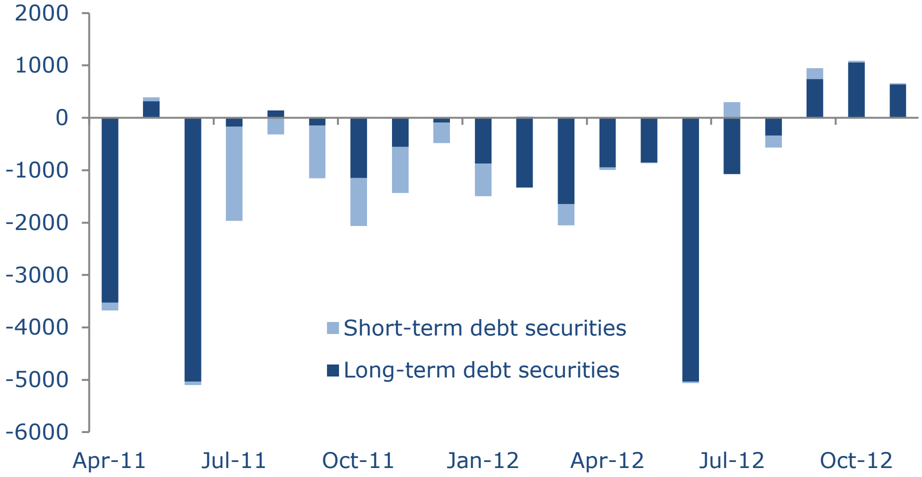
Source: Banco de Portugal

Job-losses more pronounced in the labor-intensive non-tradable sector

Government debt market: sustained signs of higher international demand

The drop in secondary market yields (which are trading at pre-assistance programme levels) has been sustained by a shift in Portuguese bond market flows. According to financial accounts data of *Banco de Portugal*, there was a net inflow of external financing in Portuguese debt securities in the 3 months since September.

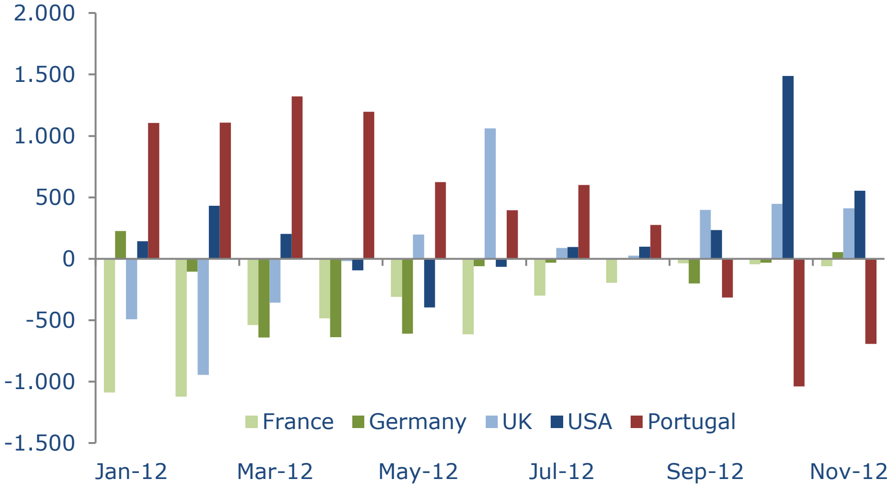
General Government Debt Securities in International Portfolio Investment
(EUR mln)



Source: Banco de Portugal

Until August, the most prominent buyers were local investors. Since September the tide has changed and a number of non-resident investors have entered the PGB market. More importantly, the buying and selling activity has intensified, improving liquidity in the market.

Buying/selling flows by country
(EUR mln)



Non-domestic investors, especially US, presented net buying flows from September onwards

Source: IGCP

Return to MLT debt primary market

Following the developments in secondary market, Portugal successfully tapped international capital markets with a EUR 2.5 billion syndicated issuance on the OT 4.35% October 2017.

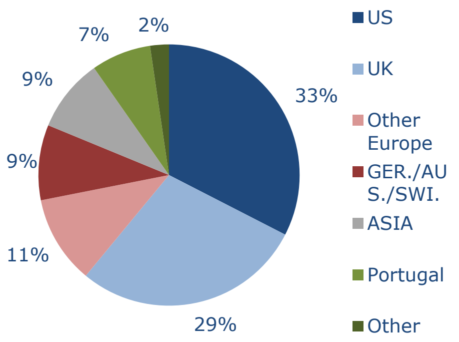
This is Portugal's first OT syndication since February 2011 and marks the sovereign's return to the international long-term bond markets following its request for official assistance in April 2011.

The final order book exceeded EUR 12 billion via approximately 300 accounts, underlining the breadth of support for this transaction. The deal enjoyed strong take-up from a diversified set of investors, both geographically and by sector:

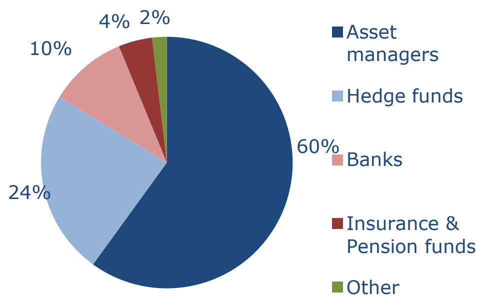
Large fraction allotted to real money investors ...

... with strong demand from US and UK (though allocation to continental Europe + Asia also accounted for 30%)

Geographical distribution



Distribution by type of investor



Source: IGCP

The quality and size of the order book enabled Portugal to fix the spread of the tap at mid swaps +395bp (or 436bp over the corresponding OBL), 15bp inside of Initial Pricing Thoughts, for a corresponding yield of 4.891%. This represents approximately a 5bp new issue concession versus the corresponding secondary market at the time of announcement.

Further information on the Portuguese economy can be obtained from:

- **Ministry of Finance** www.portugal.gov.pt/en/the-ministries/ministry-of-finance
- **Banco de Portugal** www.bportugal.pt
- **Statistics Portugal** www.ine.pt
- **Portugal Economy Probe** www.peprobe.com

Disclaimer:

Tel: +351 217923300
Fax: +351 217993795
E-mail: info@igcp.pt

Web site: www.igcp.pt
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