IGCP
Agência de Gestão da Tesouraria
e da Dívida Pública

Notes from the 7th Review

- **Deficit targets revised upwards: 5.5% in 2013, 4.0% in 2014 and 2.5% in 2015**
- **Structural primary balance improved by 6pp of GDP in 2011-12**
- **GDP growth in 2013-14 revised downwards reflecting new euro area projections**
- **Current and capital account turned positive (0.4% of GDP) in 2012**
- **EFSM/EFSF maturities expected to be adjusted to facilitate return to MLT debt market**

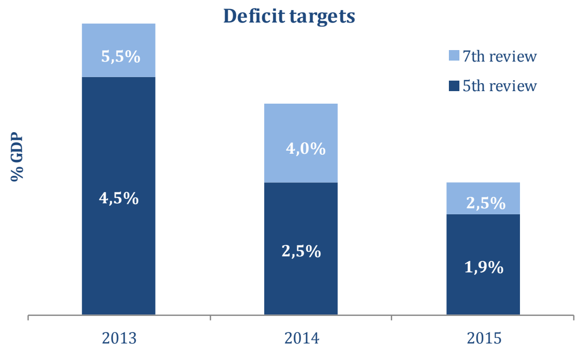
Budget deficit targets revised to allow automatic stabilizers to work

The Government and the EU-IMF mission team have agreed to adjust the budget deficit path, mainly to partially accommodate lower fiscal revenues and higher social transfers, stemming from a deeper recession than initially envisaged. Comparing to the targets set in the 5th review, the limit for 2013 was revised from 4.5 to 5.5% of GDP, while the targets for 2014 and 2015 were raised by 1.5 and 0.6pp of GDP, to 4 and 2.5% of GDP, respectively.

Targets were revised taking into account the balance between:

i) economic and social costs of fiscal consolidation; and

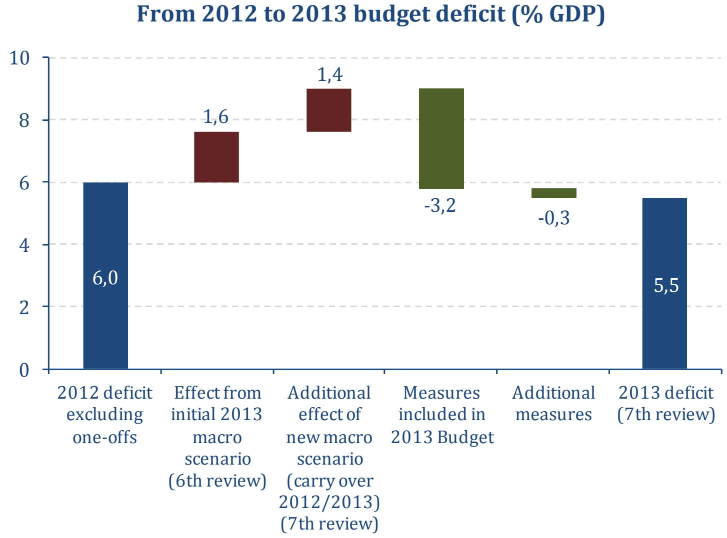
ii) the inevitability of the adjustment given financing restrictions and the impact on public debt sustainability



Source: Ministry of Finance

The revision of the deficit targets will let automatic stabilizers operate to a large extent, while additional consolidation measures on the expenditure side amounting to about EUR 500 million (0.3% of GDP) will be implemented, including several sector-specific savings across different ministries, as well as terminations by mutual agreement in the public sector.

Revision of 2013-15 deficit targets allows for automatic stabilizers to work



Source: Ministry of Finance

The initial plan of expenditure savings amounting to EUR 4 billion in 2013-14, is now rescheduled to occur in 2013-15. More details, in particular for the measures to be taken in 2014, will be specified in the Fiscal Strategy Document (medium-term budget framework) to be presented in April.

Structural primary balance reached equilibrium in 2012

The Programme target for the fiscal deficit was achieved

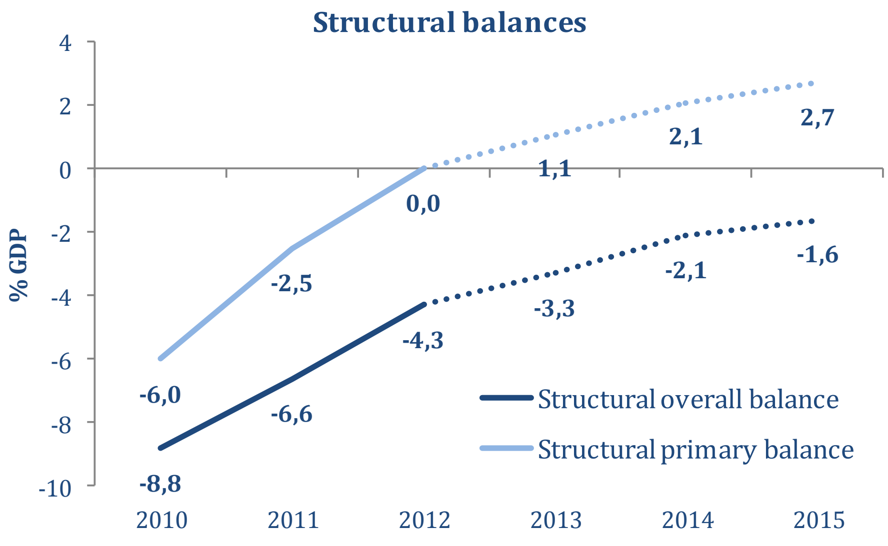
In 2012 the fiscal deficit for the purpose of the Programme stood at 4.9% of GDP, within the target set at 5% of GDP. However, there are 4 one-off operations that Eurostat considers as having an impact on the budget deficit in 2012, which are excluded for Programme purposes:

- concession of airports infrastructure (amounting to EUR 1.2 bn ~0.7pp of GDP) is to be excluded from the revenue;
- capital injection on CGD (EUR 0.75 bn ~0.45pp of GDP) is to be recorded as expenditure;
- capital increase from Parpública to Sagestamo – a Parpública's real estate sub-holding – to replace shareholder's loans is to be imputed to the State expenditure (re-routing case; also amounting to EUR 0.75 bn ~0.45pp of GDP); and
- change in the value of assets of BPN SPVs (EUR 0.1 bn ~0.1pp of GDP).

Taking these operations into account, the relevant deficit for the Excessive Deficit Procedure (to be announced by statistical authorities in the end of March) will probably stand at about 6.6% of GDP. Excluding these and other one-off effects, the fiscal deficit stood at 6.0%.

In structural terms, the fiscal consolidation continued to proceed at a fast pace. The structural primary balance has already improved by 6pp of GDP in 2011-12 (about two thirds of the adjustment required in the initial Programme), with the bulk of the adjustment stemming from the expenditure side.

Structural fiscal balance improved 4.5pp of GDP in 2011-12 (6pp excluding interest payments)



Source: Ministry of Finance

Macroeconomic scenario: lower GDP and higher unemployment rate

The macroeconomic scenario for 2012-14 was revised downwards comparing with previous projections (5th review). The forecast of real GDP growth points to -2.3% and +0.6% in 2013 and 2014, respectively 1.3 and 0.6 percentage points lower than expected earlier.

GDP growth revised downwards in line with other euro area countries

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**

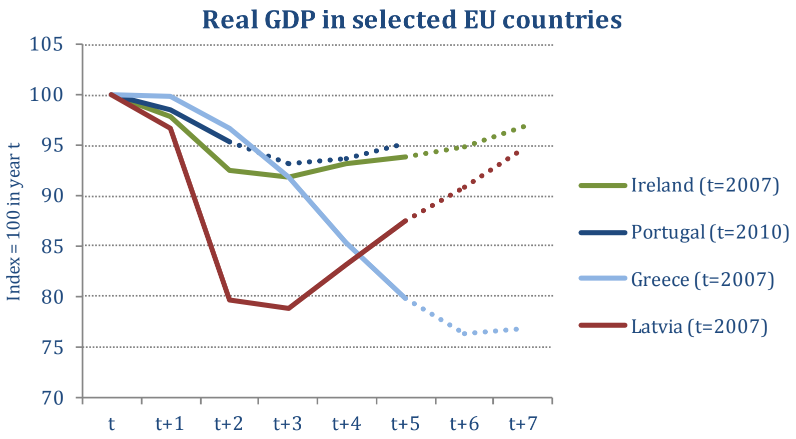
Source: 1996-2012-Statistics Portugal; 2013-2015-Ministry of Finance

This update reflects a worse external environment, namely a weakening economic outlook for the euro area. Over the last 12 months euro area GDP growth projection for 2013 has been revised from 1.0% (European Commission, April2012) to -0.5% (ECB, March 2013).

2013 GDP growth forecasts (%)						
	Portugal			Euro area		
	Autumn 2011	*Autumn 2012*	*Most recent projections*	*Autumn 2011*	*Autumn 2012*	*Most recent projections*
BdP/ECB	0.3	-1.6	-1.9	1.3	-0.3	-0.5
EC	1.1	-1.0	-1.9	1.3	0.1	-0.3
IMF	0.7	-1.0	-1.0	1.5	0.2	-0.2
OECD	0.5	-1.8	-	1.4	-0.1	-

Although recession will be deeper than expected...

The new projections should be put under perspective with the timing of the adjustment process occurring in Portugal when compared with other countries. Thus far, the Portuguese economy has contracted 4.7% since 2010 (or 5.7% since 2007). The new projections point to an overall GDP contraction of just below 7% in the period 2011-13, which is in line with what was observed in Ireland in 2008-10.



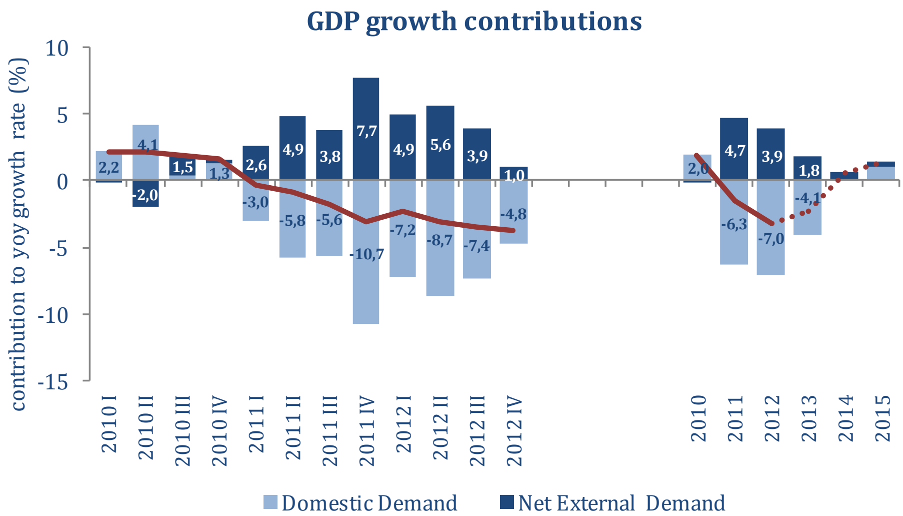
Source: European Commission, Ministry of Finance

... the overall GDP contraction from peak to trough is expected to be in line or smaller than in other countries under adjustment Programme

In 2013, net exports should maintain its positive contribution to GDP growth, although a less robust export performance and also a slowdown of imports reduction are expected. Domestic demand should continue to decline, but at a slower pace than in 2012.

A positive GDP growth rate is projected for the last quarter of 2013 and for 2014 the perspective remains positive. Current forecasts point to an output increase of 0.6%.

Recovery is expected to start in late 2013



Source: Statistics Portugal.

Improvement of financing conditions brings the necessary support to a renewed investment cycle

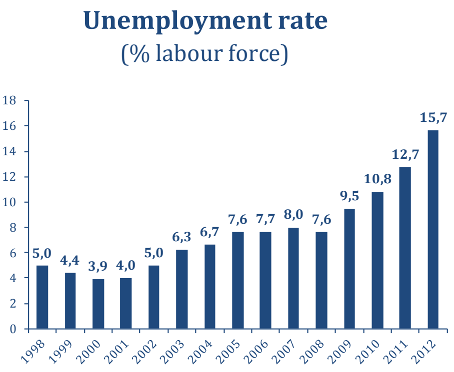
The recovery should be based on a sustained exports performance and on a renewed investment cycle. In order to support investment going forward, it is crucial to guarantee adequate financing conditions.

A comprehensive reform of the corporate income tax is being prepared, with the objective of stimulating investment

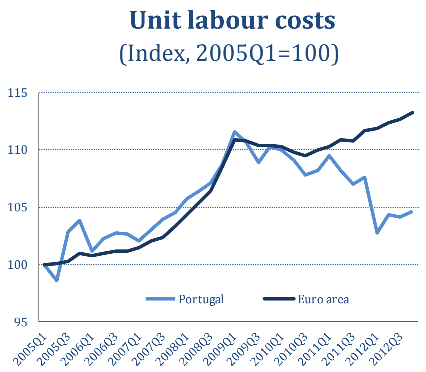
In the current conjuncture, the Government believes it is also the appropriate timing to stimulate investment with other structural measures. Hence, a corporate income tax reform is being designed, which should include a revision of the tax structure, a redefinition of the tax base, and an overall simplification, among other measures. In January, the Government appointed a special Commission for this purpose, which is expected to present a preliminary plan until the end of June, which will be followed by public consultation and discussion.

Importantly, the more unfavourable macroeconomic scenario led to a significant upward revision of the unemployment rate. The new projections point to 18.2 and 18.5% of the labour force in 2013 and 2014, respectively.

Unemployment continued on the upside and should lag the recovery cycle, peaking at close to 19% in 2014



Source: Statistics Portugal



Source: ECB

Wages are adjusting, leading to significant competitiveness gains

In the meantime, labour costs have decreased substantially, progressively repositioning the economy in euro area competitiveness. In order to further increase the competitiveness of the Portuguese labour market, several measures have already been taken, not least a reduction of severance payments from 30 to 20 days per year of work.

More recently, new limits were agreed with social partners (including the main trade union) for a further reduction. New rules are as follows:

Labour market reforms still underway

- New permanent contracts: 12 days per year of work.
- All the remaining contracts: 18 days per year of work in the first 3 years and 12 days for the remaining period.
- The maximum limit for compensation is maintained at 12 months and this new framework is set to begin until October.

Exports diversification sustains positive performance moving forward

In 2012, the contribution of the net external demand to GDP growth was still positive, though it declined from 4.7pp in 2011 to 3.9pp in 2012.

The positive contribution of net exports gradually decreased over 2012, reflecting a less intense decline of imports, in line with the evolution of domestic demand, and a slight reduction of exports in Q4, on the back of the slowdown of the euro area, as well as other one-off factors, such as prolonged strikes in most relevant ports.

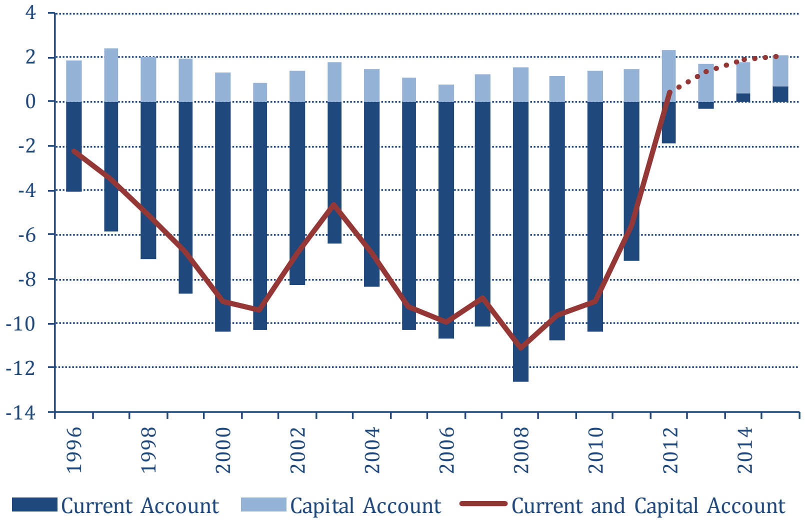
Exports growth decelerated towards the end of 2012, but should still grow around 0.8% in 2013 and 4.4% in 2014

In any case, the external balance of goods and services improved significantly in 2012, moving from -4.4% of GDP in 2011 to -0.5%, and is expected to turn positive in 2013 (+1.7% of GDP).

Moreover, the Portuguese economy presented a positive current and capital account for the first time since the early 1990s (net lending of 0.4% of GDP), which compares with a net borrowing of 5.6% in the previous year and 11.1% when it peaked in 2008.

In 2012 the Portuguese economy presented a net lending of 0.4% of GDP (an adjustment of more than 11pp of GDP since the trough in 2008)

External Accounts (% GDP)



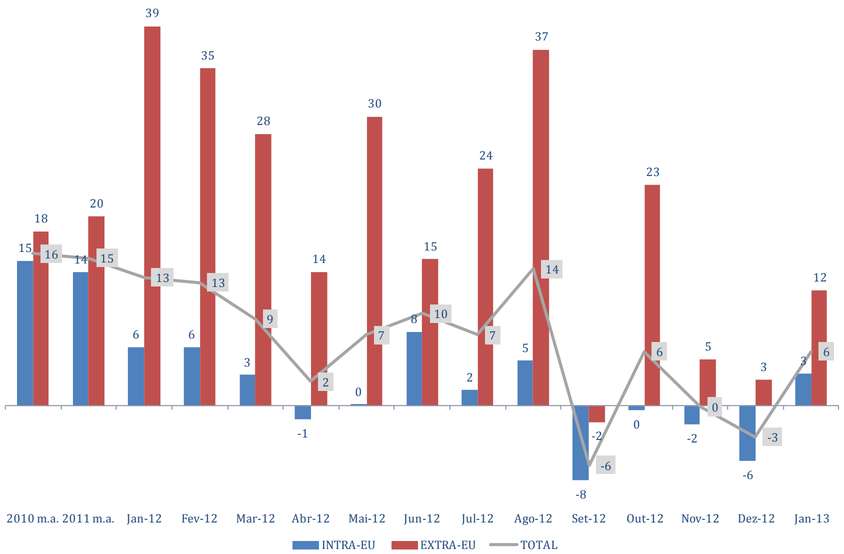
Source: 1996-2012-Statistics Portugal; 2013-2015-Ministry of Finance

In current prices, exports of goods increased 5.8% in 2012, with extra-EU exports accounting for 5.1pp of the change. The intra-annual performance was unequal over the year, with exports actually decreasing in Q4, on the back of a reduction of intra-EU exports of goods (-2.5% yoy), while extra-EU exports grew 10% yoy, reflecting increases in almost all groups of products.

Most recent data shows that exports turned positive again in January (+5.6% yoy), on the back of a positive development in both intra-EU and extra-EU trade. This behaviour suggests that the trend from previous years may be sustainable and that the soft patch observed in the 2012 Q4 might be temporary and explained by the European economic recession and other one-off factors.

Exports diversification is increasing at a fast pace, with extra-EU exports of goods justifying more than 80% of the positive performance in 2012.

Portuguese goods exports' growth (yoy,%)

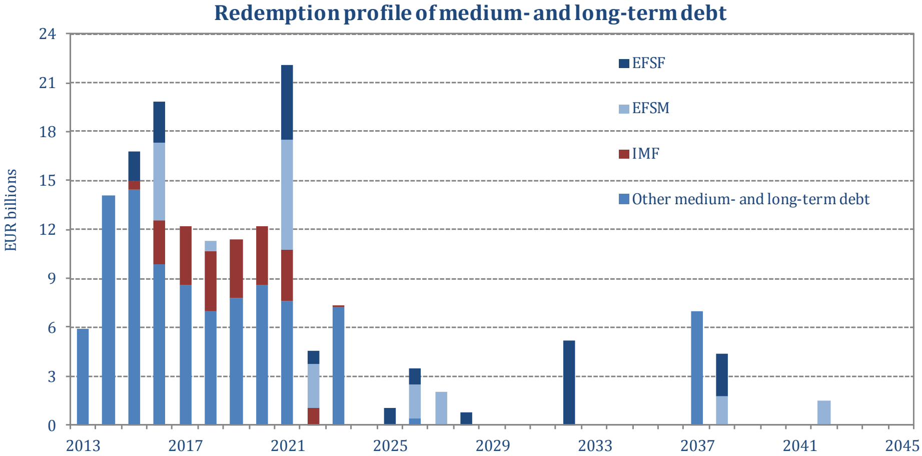


Source: Statistics Portugal

EFSF/EFSM maturities adjustment facilitates return to MLT debt market

In January, Portugal and Ireland requested a reprofiling of the EFSM/EFSF loans, in order to smooth the redemption profile of the public debt and facilitate the return to the medium- and long-term debt market.

Redemption profile of medium- and long-term debt



Source: IGCP

Maturity of EFSM/EFSF loans will probably be extended to remove 2016/21 redemption peaks

On March 16th, the Eurogroup agreed to an adjustment of the maturities of the EFSF loans. The technical details are pending on the proposal to be presented by the Troika and EFSF. The ECOFIN has also endorsed the Troika to come forward with a specific proposal for the EFSM loans.

In any case, it should be highlighted that the maturity extension will not entail a change of the NPV of the loans, as these will be extended at available market rates.

Moreover, the rescheduling of the deficit targets decided in the 7th review does not require additional EU-IMF financial support, given the current cash position and the available set of financing sources.

New deficit targets do not require additional official funding

Official statements on the 7th review mission to Portugal:

- **Ministry of Finance** http://www.portugal.gov.pt/pt/os-ministerios/ministerio-das-financas/mantenha-se-atualizado/20130315-mef-paef.aspx
- **EU-IMF Mission** http://www.imf.org/external/np/sec/pr/2013/pr1378.htm

Official statements on the request for a maturity extension of EFSM/EFSF loans:

- **ECOFIN (Mar 5)** http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/135815.pdf
- **Eurogroup (Mar 16)** http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/136194.pdf

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

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

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