Notes on EU-IMF Program exit and medium-term fiscal strategy

- **EC-ECB-IMF staff has approved the 12th and final Program review mission on May 2nd, assessing that *"the Program has put the Portuguese economy on a path towards sound public finances, financial stability and competitiveness"***
- **On May 4th, the Portuguese Government has announced its decision to exit the Program without requesting a precautionary credit line**
- **On April 30th, the Government had presented its medium-term fiscal strategy document, reinforcing its commitment with fiscal consolidation**
- **The macro scenario is based on a gradual recovery cycle, with GDP growing 1.2% in 2014 and accelerating to 1.5% in 2015 and up to 1.8% in 2018, on the back of strong export performance and a gradual recovery of internal demand**
- **The unemployment rate is expected to decline gradually from 16.3% in 2013 to 13.2% in 2018**
- **The budget deficit is expected to decline from 4% of GDP this year, to 2.5% in 2015 and 0% in 2018**
- **The target for this year is on track: on a cash basis and according to the Program's definition, budget execution in Q1 was €0.9 bn below EU-IMF objective and €0.6 bn below deficit in 2013Q1**
- **For 2015, fiscal consolidation measures are mainly concentrated on the expenditure side**
- **The public debt is expected to peak at around 130% of GDP in 2014 (under ESA 1995), as the Government began a number of debt management operations in SOEs**
- **The IGCP has reintroduced government bond (PGB) auctions in April, with a successful 10y tap 3.5 times oversubscribed**
- **The IGCP plans to deepen its strategy of pre-emptively covering the borrowing needs both through tapping international long-term bond markets and domestic retail sources**

Portugal has decided to exit Program without additional external support

The Portuguese government has decided to exit the 3-year EU-IMF adjustment program without requesting any further assistance mechanisms. The program ends on May 17th and the last disbursement is expected to take place in June.

The decision to opt for a "clean exit" was announced on May 4th, after the evaluation of the economic situation and the conditions of access to financial markets.

Almost simultaneously, the EC-ECB-IMF staff approved the 12th and final review mission on May 2nd, stating that *"the program remains on track to be concluded, following the completion of this final review. The program has put the Portuguese economy on a path towards sound public finances, financial stability and competitiveness. This is the outcome of solid program implementation (…)"*.

Portugal is closing the EU-IMF 3-year Adjustment Program after broadly achieving its 3 main goals:

(i) setting public finances in a sustainable path;

(ii) enhancing competitiveness; and

(iii) guaranteeing the stability of the financial system.

Medium-term fiscal strategy

On April 30th, the Government presented the Fiscal Strategy Document for the next 4 years, where it outlined the country's medium-term fiscal strategy up to 2018 and it also included detailed measures for 2015.

The Document is based on the following macroeconomic scenario:

Macroeconomic scenario (Fiscal Strategy Document for 2014-2018)

	2012	2013	2014 P	2015 P	2016 P	2017 P	2018 P
Real GDP (yoy %)	**-3,2**	**-1,4**	**1,2**	**1,5**	**1,7**	**1,8**	**1,8**
Private consumption	-5,4	-1,7	0,7	0,8	0,8	0,8	0,8
Public consumption	-4,7	-1,8	-1,6	-1,5	-0,8	-0,3	-0,1
GFCF	-14,4	-6,6	3,3	3,8	4,0	4,3	3,8
Exports	3,2	6,1	5,7	5,7	5,3	5,0	5,0
Imports	-6,6	2,8	4,1	4,2	4,3	4,2	4,2
Contributions to GDP growth (pp)							
Domestic demand	-6,9	-2,6	-	-	-	-	-
Net external demand	3,7	1,2	-	-	-	-	-
External sector (% GDP)							
Goods	-4,7	-3,5	-2,7	-2,3	-1,9	-1,6	-1,4
Current account	-2,2	0,4	1,6	2,2	2,4	2,4	2,6
Current and Capital account	-0,1	2,0	2,9	3,4	3,6	3,6	3,8
Unemployment (% labor force)	**15,7**	**16,3**	**15,4**	**14,7**	**14,2**	**13,8**	**13,2**
CPI (%)	**2,8**	**0,3**	**0,4**	**1,1**	**1,5**	**1,5**	**1,5**

Source: Ministry of Finance

Fiscal consolidation strategy is framed in a scenario of gradual but steady recovery of the economic activity

Strong export growth remains the main source of economic dynamism ...

... while unemployment begins to gradually decline

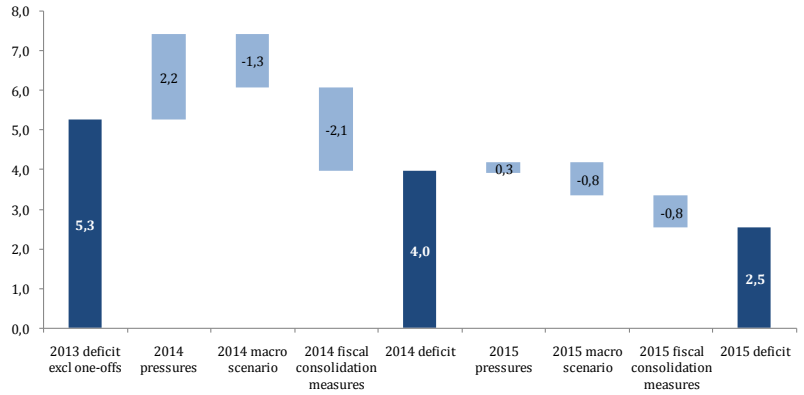
Inflation is projected to gradually increase from its current level and then stabilize at around 1.5%

GDP is projected to grow 1.2% in 2014 (an upward revision of 0.4pp compared to the State Budget for 2014 and in line with the discussions with EU-IMF mission in the 11th review), 1.5% in 2015, 1.7% in 2016 and 1.8% in 2017-2018. Exports are expected to maintain a strong growth momentum, supported by the recovery in external demand. Domestic demand contribution to growth is expected to continue to recover gradually, on the back of a stabilization of private consumption and investment increase.

The labor market is also expected to recover, with the unemployment rate projected to decrease to 15.4% in 2014 (from 16.3% in 2013), declining until 13.2% in 2018, as employment also begins to grow.

The Portuguese government reaffirmed its commitment to continue working towards sound public finances, along the lines of the EU Fiscal Compact framework, and announced measures to attain the agreed objective of a budget deficit of 2.5% of GDP in 2015.

From 2013 deficit to 2015 deficit



Source: Ministry of Finance

Budget deficit is expected to stand below 3% of GDP in 2015 ...

... and to achieve the medium-term objective of a structural deficit of 0.5% of potential GDP in 2017 (when the overall deficit is expected to stand at 0.7% of GDP)

Fiscal consolidation measures in 2014+2015

The fiscal consolidation will be focused on the expenditure side (more than 80%), with public permanent expenditure cuts amounting to €2.8 bn in 2014 and €0.8 bn in 2015.

On the revenue side, the measures will have a less significant impact, focusing on taxes on production and imports and social contributions. The increase in revenue (also considering net effects from expenditure-side measures) amounts to about €0.6 bn in 2014 and €0.5 bn in 2015.

Expenditure reduction measures (EUR millions)	2014	2015	Total
Compensation of employees	**1.207**	**187**	**1.394**
Wage bill	622	-225	397
40-hour week, reduction in the nunmber of public servants through retirements and reduction of the payments for extra hour of work	153	190	343
Mutual agreements (voluntary separation)	60	65	125
Employees requalification scheme	9	58	67
Structural reforms on education and other sectorial measures	363	100	463
Social benefits	**577**	**-289**	**288**
New design of the extraordinary solidarity contribution	67	-660	-593
Sustainability contribution	205	372	577
Other measures targeted to specific sectors	305	0	305
Other expenditures	**994**	**925**	**1.919**
Intermediate consumption	460	537	997
Subsidies	153	99	252
Investment and other current expenditure	359	76	435
Social benefits in kind	21	213	234
Total expenditure reduction	**2.778**	**823**	**3.601**

Revenue increase measures (EUR millions)	2014	2015	Total
Taxes on production and imports	**170**	**150**	**320**
VAT increase of 0.25p.p. to 23.25%	0	150	150
Others	170	0	170
Taxes on income and wealth	**240**	**0**	**240**
Social contributions	**297**	**183**	**480**
Increase of civil servants contribution to health insurance scheme	261	75	336
Increase in the workers social contribution for Social Security of 0.2p.p. to 11.2%	0	100	100
Others	36	8	44
Other revenues	**329**	**165**	**494**
Net impact on fiscal revenues of expenditure measures	**-388**	**16**	**-372**
Total revenue increase	**648**	**514**	**1.162**
Total of permanent measures	**3.426**	**1.337**	**4.763**

Source: Ministry of Finance

Fiscal consolidation measures in 2014 and 2015 mainly concentrated on the expenditure side

Budget outturn in Q1 suggests that the budget execution for 2014 is on track

Budgetary outturn until March confirms that the budget execution in 2014 is on track. In the first quarter of the year, the General Government (GG) balance relevant for Program targets reached -€0.8 bn, around €0.9 bn below the target set for the period.

Limits and implementation of the General Government balance (€ million)

	2013 Execution	Jan-Mar 2013	Jan-Mar 2014
EFAP limits	**-8.900**	**-1.900,0**	**-1.700**
General Government Balance (cash basis)	**-8.751**	**-1.441**	**-846**
Adjustments underlying to the Technical Memorandum of Understanding			
Garantees, loans and capital injections	-58	-1	-6
Adjustment for the arrears settled - Health arrears clearance strategy	424		
Pension funds	-48	-48	
Adjustment for the arrears settled - Local Administration (€1 billion credit facility)	448	132	14
Adjustment for the arrears settled - RAM Government (€1,1 billion bank loans, with central government guarantees)	854		13
General Government Balance (criteria of the EFAP)	**-7.131**	**-1.358**	**-826**
Gap (General Government Balance (criteria of the EFAP) minus EFAP	**1.769**	**542**	**874**

Source: Ministry of Finance

Gen Gov deficit on cash basis was about €0.6 bn below 2013Q1, setting a good standard for the remaining of the year

Considering the subsector of Central Government and Social Security (CG+SS), the deficit in 2014Q1 was lower than in the same period last year (€0.8 bn in 2014 vs €1.3 bn in 2013), while the primary balance recorded a surplus of €0.3 bn (deficit of €0.4 bn in 2013Q1).

The breakdown of the CG+SS account shows that total expenditure decreased 0.2% yoy and revenue increased 3.2%. On the expenditure side, the global improvement was explained by the decrease in other current expenditures (-1.1pp), and also in the compensation of employees (-0,6pp), reflecting the remuneration reduction measure included in the 2014 State Budget. On the revenue side, the improvement was largely justified by the performance of fiscal revenue (direct and indirect taxes increased 7.8% and 2.8%, respectively) and social security contributions (+3.7%).

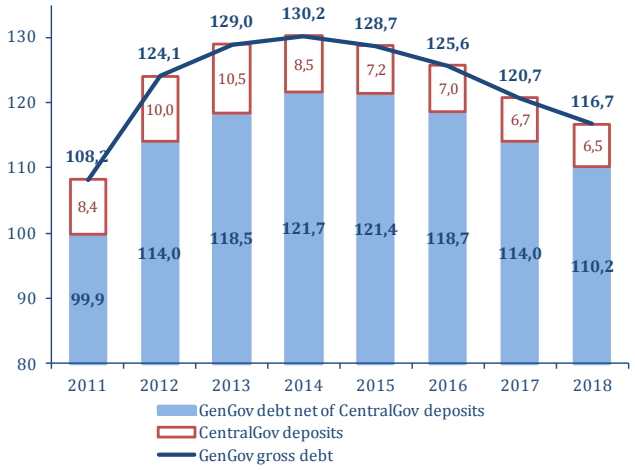
Medium-term public debt projections and borrowing needs

According to most recent debt projections, the General Government debt peaks at about 130% of GDP in 2014, some 3.5pp of GDP higher than foreseen in the 11th review.

This revision stems from the fact that the Treasury started financing some SOEs outside General Government in Q2, which in turn implies the reclassification of all State-guaranteed debt of these companies. This is part of the planned restructuring of the State transportation sector (CP, Carris, and STCP) and also takes into account the borrowing needs of companies that the Ministry of Finance expects will be reclassified within General Government in the context of the new ESA 2010 rules.

The public debt net of Central Government deposits is expected to remain close to 120% of GDP in 2014-15, and then decline towards 110% by 2018.

General Government debt (under ESA 1995 rules)
(% GDP)



Source: Ministry of Finance

Public debt is projected to peak at around 130% of GDP this year ...

... while debt net of Central Government deposits remains close to 120% of GDP

The inclusion of the short-term financing needs of these SOEs is estimated to increase the State net borrowing requirements by about €3.5 bn in 2014. Hence, the State gross financing needs for the year are currently estimated at €27.6 bn (already taking into account buybacks of more than €1.3 bn of PGBs originally maturing in 2015, already conducted until April).

State Treasury borrowing needs and sources (€ billion)

	2013 E	2014 P	2015 P	2016 P	2017 P	2018 P
State borrowing requirements	**24,5**	**27,6**	**15,5**	**15,7**	**15,4**	**16,6**
Net financing needs	**11,3**	**15,3**	**6,1**	**3,3**	**0,6**	**1,5**
Overall deficit *	7,7	7,4	4,3	2,8	1,4	0,1
Private sector banks' recapitalizations	1,1					
Other net acquisitions of financial assets **	3,9	8,0	1,7	0,5	-0,8	1,4
Privatizations (-)	-1,5	-0,1	0,0	0,0	0,0	0,0
MLT Redemptions	**13,2**	**12,4**	**9,4**	**12,4**	**14,8**	**15,2**
Tbonds (PGB incl exchange offer + MTN)	13,2	12,4	8,9	9,9	11,3	11,0
IMF			0,5	2,6	3,5	4,2
State financing sources	**24,5**	**27,6**	**15,5**	**15,7**	**15,4**	**16,6**
Use of deposits	**-0,4**	**5,3**	**3,6**	**0,0**	**0,0**	**0,0**
Financing in the year	**24,9**	**22,3**	**11,8**	**15,7**	**15,4**	**16,6**
Executed						
EU-IMF	10,0	4,8				
Tbonds	12,0	7,3				
Tbills (net)	1,3					
Retail debt (net)	1,1	1,1				
Other flows (net)	0,6					
To be executed						
EU-IMF		3,0				
Tbonds		4,7				
Tbills (net)		0,0				
Retail debt (net)		1,4				
Additional financing needs	-	-	11,8	15,7	15,4	16,6
Total additional financing needs 2015-18						**59,5**
State Treasury cash position at year-end	**15,3**	**10,0**	**6,4**	**6,4**	**6,4**	**6,4**
of which: deposits for bank recap	6,4	6,4	6,4	6,4	6,4	6,4

** State sub-sector cash deficit in 2012-14. Projection for GG deficit in 2015-18 (Fiscal Strategy Document, Apr 2014).*
*** Includes refinancing of other public entities (namely SOEs and regions), as well as ESM participation, capitalization of the resolution fund, and redemption of CoCos.*

Source: IGCP

With the final EU-IMF disbursements and the positive contribution of domestic retail, the borrowing needs for the year are broadly covered ...

... additional market financing will be used to pre-fund 2015

Taking into account the additional EU-IMF loans to be disbursed in June and the continuous positive contribution of domestic financing sources (such as domestic retail), the borrowing needs for the year are broadly covered. In addition, the use of the €6.4 bn currently earmarked for bank recap will be reconsidered after the conclusion of the ECB's Comprehensive Assessment later this year.

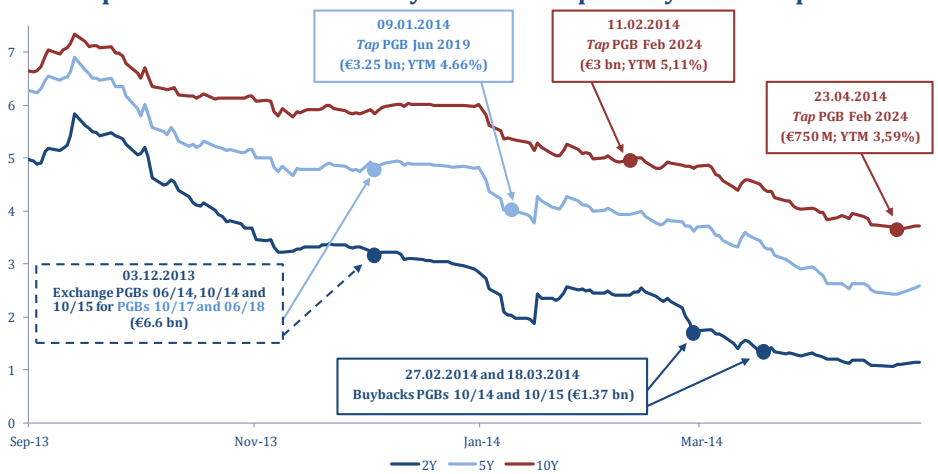
Financing strategy based on both market and retail funding sources

The financing strategy for 2014 has proceeded at a good pace. Portugal has been working to accumulate a significant cash buffer and has been actively buying back bonds in the markets.

With the end of the EU-IMF disbursements (the last one expected to take place in June), IGCP will continue to fund both in the domestic and in the international market.

In April, IGCP held an auction on PGBs maturing in February 2024, with an issuance amount of €750 mln (maximum of the indicative global range and bid-to-cover of 3.5). This was the first regular PGB auction since April 2011, before Portugal asked for external support. IGCP plans to continue raising funds in international markets, according to investor demand, through a combination of syndicated deals and regular auctions.

PGB performance in secondary market and primary market operations

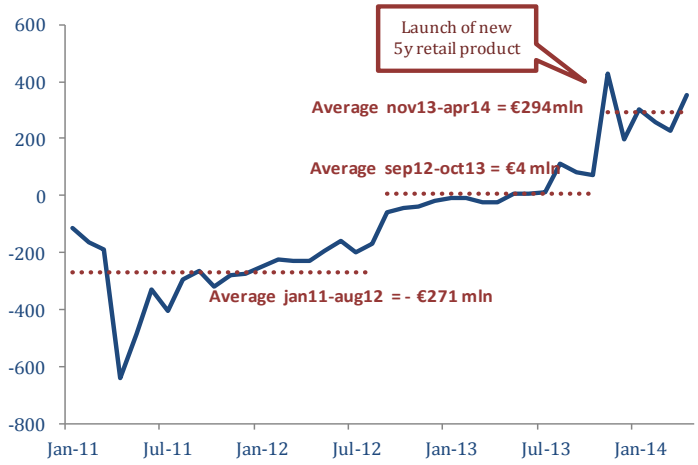


Gradual return to medium- and long-term financing has reinforced outperformance of PGBs in secondary market

Source: IGCP

In the domestic front, retail products continue to contribute positively. Up to the end of April, the net financing from Savings and Treasury certificates amounted to over €1.1 bn, compared to a target of €2.5 bn for the whole year considered in the 2014 Budget. Since the launch of Savings Plus certificates, 6 months ago, more than €1.3 bn were issued through this instrument.

Net issuance of retail debt (€ million)



Strong contribution of domestic retail funding is benefitting from the steady improvement of the domestic savings rate

Source: IGCP

Annex 1: General Government Account 2009-2018 (accrual basis)

General Government Account (accrual basis)						
(% GDP)	2009	2010	2011	2012	2013	2013 vs 2009
Total revenue	**39,6%**	**41,6%**	**45,0%**	**40,9%**	**43,7%**	**4,1pp**
Current revenue	38,9%	38,8%	40,5%	39,4%	42,8%	3,9pp
Current taxes on income and wealth	9,0%	8,8%	9,9%	9,3%	11,8%	2,8pp
Taxes on production and imports	12,7%	13,3%	13,7%	13,7%	13,6%	0,9pp
Social contributions	12,5%	12,3%	12,3%	11,6%	12,2%	-0,3pp
Other current revenue	4,6%	4,4%	4,6%	4,9%	5,2%	0,6pp
Capital revenue	0,7%	2,8%	4,6%	1,5%	0,9%	0,2pp
Total expenditure	**49,7%**	**51,5%**	**49,3%**	**47,4%**	**48,6%**	**-1,1pp**
Current expenditure	45,8%	45,7%	45,4%	44,4%	46,2%	0,4pp
Social benefits	22,0%	22,0%	22,1%	22,5%	23,4%	1,5pp
Compensation of employees	12,7%	12,2%	11,3%	10,0%	10,7%	-2,0pp
Interest (EDP)	2,8%	2,8%	4,0%	4,3%	4,3%	1,4pp
Intermediate consumption	5,0%	5,2%	4,6%	4,5%	4,4%	-0,6pp
Subsidies	0,7%	0,7%	0,7%	0,6%	0,7%	-0,1pp
Other current expenditure	2,5%	2,8%	2,6%	2,6%	2,7%	0,1pp
Capital expenditure	4,0%	5,7%	4,0%	2,9%	2,4%	-1,5pp
Gross fixed capital formation	3,1%	3,8%	2,6%	1,5%	1,5%	-1,6pp
Other capital expenditure	0,9%	1,9%	1,4%	1,4%	0,9%	0,1pp
Overall balance	**-10,2%**	**-9,8%**	**-4,3%**	**-6,4%**	**-4,9%**	**5,3pp**
Memo items						
Primary expenditure	**46,9%**	**48,7%**	**45,3%**	**43,1%**	**44,3%**	**-2,6pp**
Primary balance	**-7,3%**	**-7,0%**	**-0,3%**	**-2,1%**	**-0,6%**	**6,7pp**

General Government Account (accrual basis)						
(% GDP)	2014 P	2015 P	2016 P	2017 P	2018 P	2018 vs 2013
Total revenue	**43,2%**	**43,3%**	**43,3%**	**43,1%**	**43,0%**	**-0,7pp**
Current revenue	42,1%	42,3%	42,3%	42,1%	42,0%	-0,8pp
Current taxes on income and wealth	11,3%	11,4%	11,4%	11,4%	11,4%	-0,4pp
Taxes on production and imports	13,7%	13,9%	13,9%	14,0%	14,0%	0,4pp
Social contributions	11,8%	11,7%	11,5%	11,4%	11,2%	-1,0pp
Other current revenue	5,3%	5,4%	5,4%	5,3%	5,4%	0,2pp
Capital revenue	1,1%	1,0%	1,0%	1,0%	1,0%	0,1pp
Total expenditure	**47,1%**	**45,8%**	**44,8%**	**43,8%**	**43,1%**	**-5,5pp**
Current expenditure	45,1%	43,6%	42,7%	41,8%	41,2%	-5,0pp
Social benefits	22,9%	22,4%	22,0%	21,6%	21,2%	-2,2pp
Compensation of employees	9,7%	9,1%	8,8%	8,6%	8,5%	-2,2pp
Interest (EDP)	4,3%	4,3%	4,2%	4,1%	4,2%	-0,1pp
Intermediate consumption	4,6%	4,3%	4,3%	4,1%	4,0%	-0,4pp
Subsidies	0,7%	0,7%	0,7%	0,7%	0,7%	0,0pp
Other current expenditure	2,8%	2,8%	2,6%	2,7%	2,7%	0,0pp
Capital expenditure	2,1%	2,2%	2,0%	2,0%	1,9%	-0,5pp
Gross fixed capital formation	1,8%	1,7%	1,7%	1,6%	1,6%	0,1pp
Other capital expenditure	0,3%	0,4%	0,3%	0,3%	0,3%	-0,6pp
Overall balance	**-4,0%**	**-2,5%**	**-1,5%**	**-0,7%**	**0,0%**	**4,9pp**
Memo items						
Primary expenditure	**42,8%**	**41,5%**	**40,5%**	**39,7%**	**38,9%**	**-5,4pp**
Primary balance	**0,4%**	**1,8%**	**2,8%**	**3,4%**	**4,2%**	**4,8pp**

Source: Ministry of Finance

Annex 2: Calendar of upcoming events

Upcoming events	
Date	**Event**
May 15, 2014	GDP 2014Q1 (flash estimate)
May 25, 2014	Elections for European Parliament
Sep 30, 2014	EDP notification + entry into force of ESA 2010
Oct 15, 2014	Deadline for presentation of 2015 Budget
No deadline	Pending Constitutional Court decisions on 2014 Budget *

* As the 2014 Budget entered into force, a number of members of Parliament have requested the successive control of the Constitution in a number of fiscal consolidation measures, namely on (i) the additional wage cut on public sector workers, (ii) the new design of the extraordinary solidarity contribution on pensioners, (iii) the increase of civil servants contribution to health insurance scheme, and (iv) the introduction of means-testing on survival pensions.
There is no specific deadline for the Constitutional Court decision on these requests.

Official statements on the Program exit:

- **P. Minister (May 4)** http://www.portugal.gov.pt/en/keep-updated/20140504-pm-fim-paef.aspx
- **Eu. Comm. (May 5)** http://europa.eu/rapid/press-release_STATEMENT-14-145_en.htm

Official statements on the 12th review mission to Portugal (May 2):

- **Ministry of Finance** http://www.portugal.gov.pt/pt/os-ministerios/ministerio-das-financas/mantenha-se-atualizado/20140502-mef-paef.aspx
- **EU-IMF Mission** http://www.imf.org/external/np/sec/pr/2014/pr14193.htm

Presentation of Fiscal Strategy Document (Apr 30, in Portuguese only):

- **Ministry of Finance** http://www.portugal.gov.pt/pt/mantenha-se-atualizado/20140430-mef-msess-deo.aspx
- **Link to document** http://www.portugal.gov.pt/pt/os-ministerios/ministerio-das-financas/documentos-oficiais/20140430-mf-deo.aspx

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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