MINISTÉRIO DAS FINANÇAS

Portugal: restoring credibility and confidence

London School of Economics and Political Science

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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

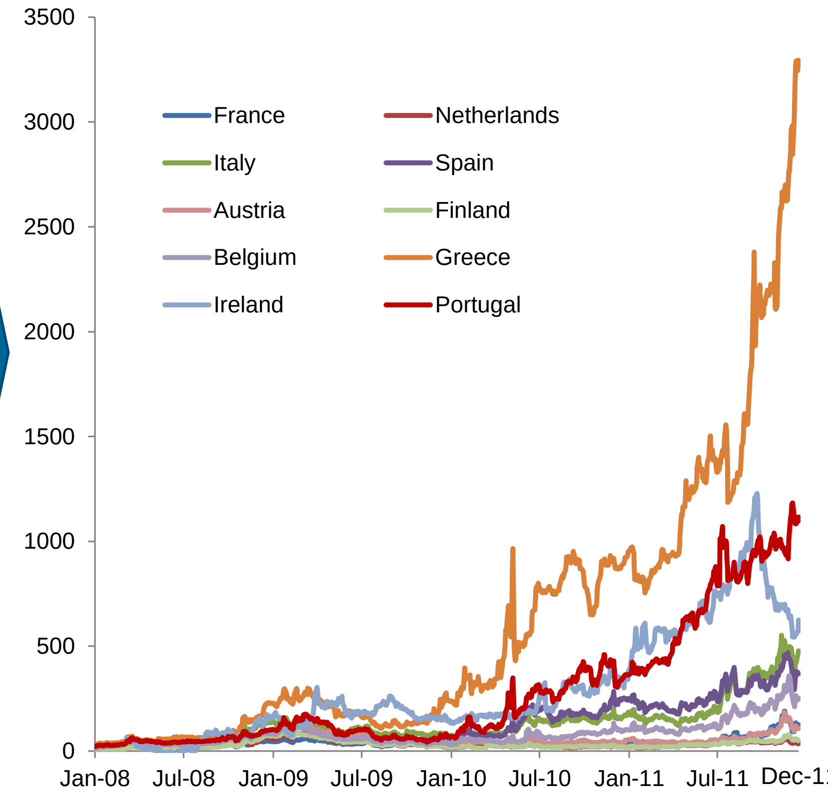
Macro-economic imbalances and structural weaknesses that have been accumulated over more than a decade

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



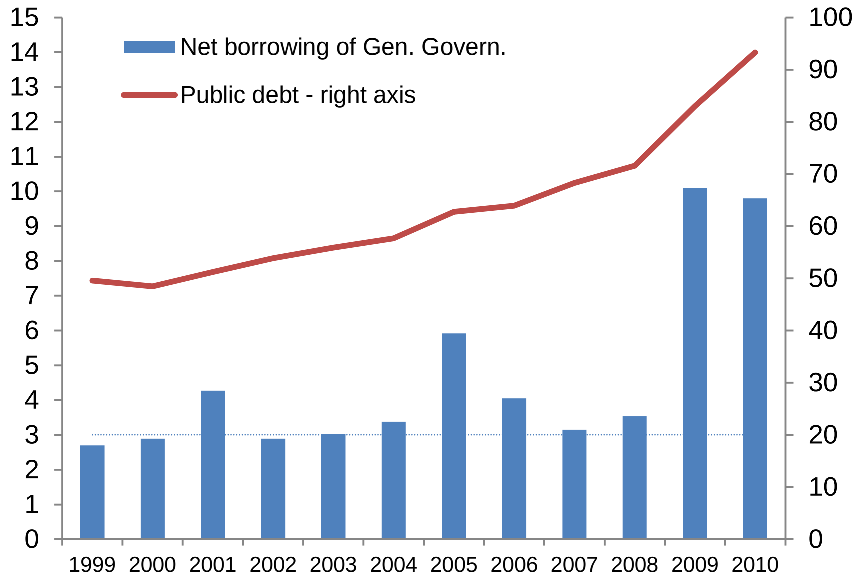
Source: Bloomberg

Persistent imprudence in fiscal policy

Persistent government deficits and increasing public debt

Deficit and public debt

As a percentage of GDP

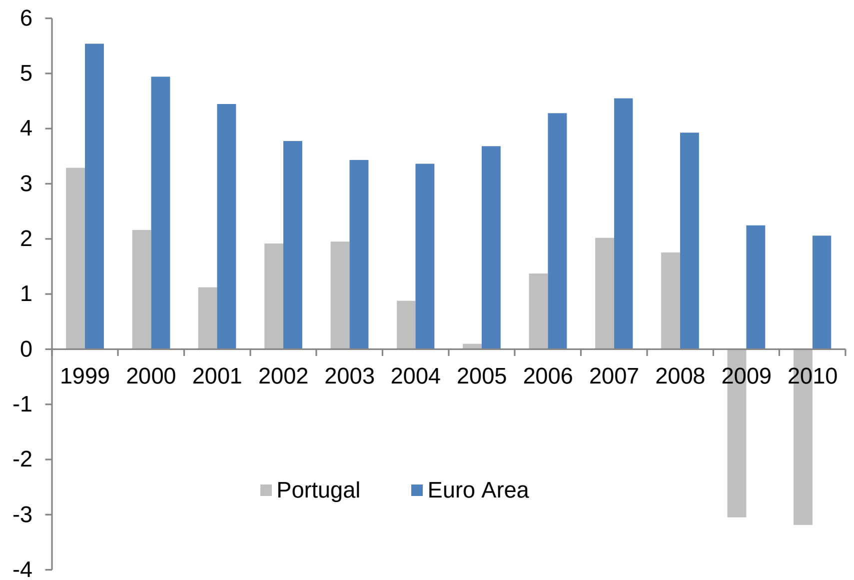


Source: INE, Bank of Portugal and Ministry of Finance

Fragile public finances

Structural Current Primary Balance

As a percentage of GDP



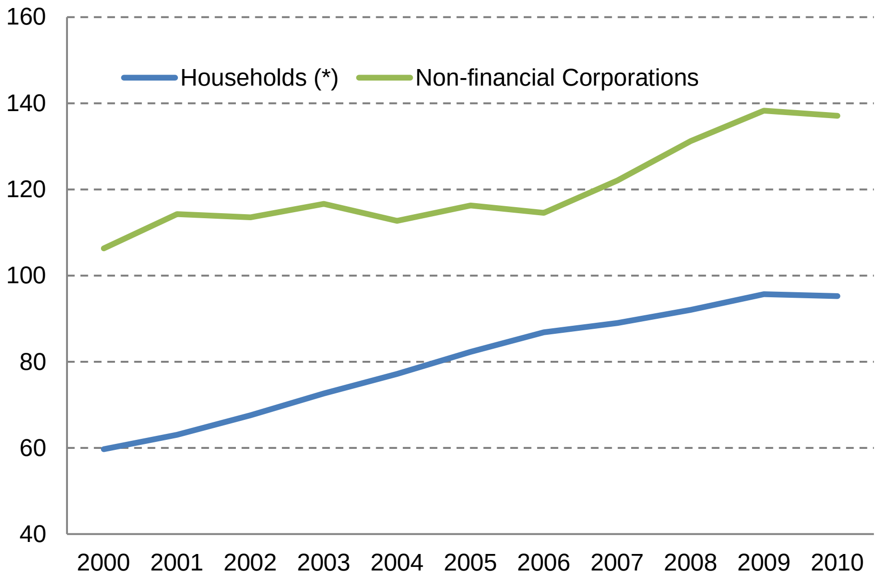
Source: AMECO and Ministry of Finance

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



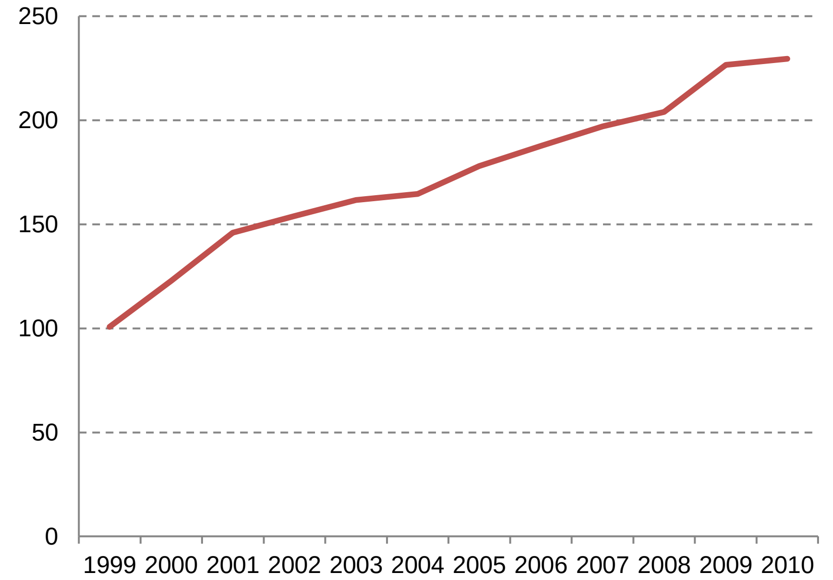
(*) Financial Debt

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

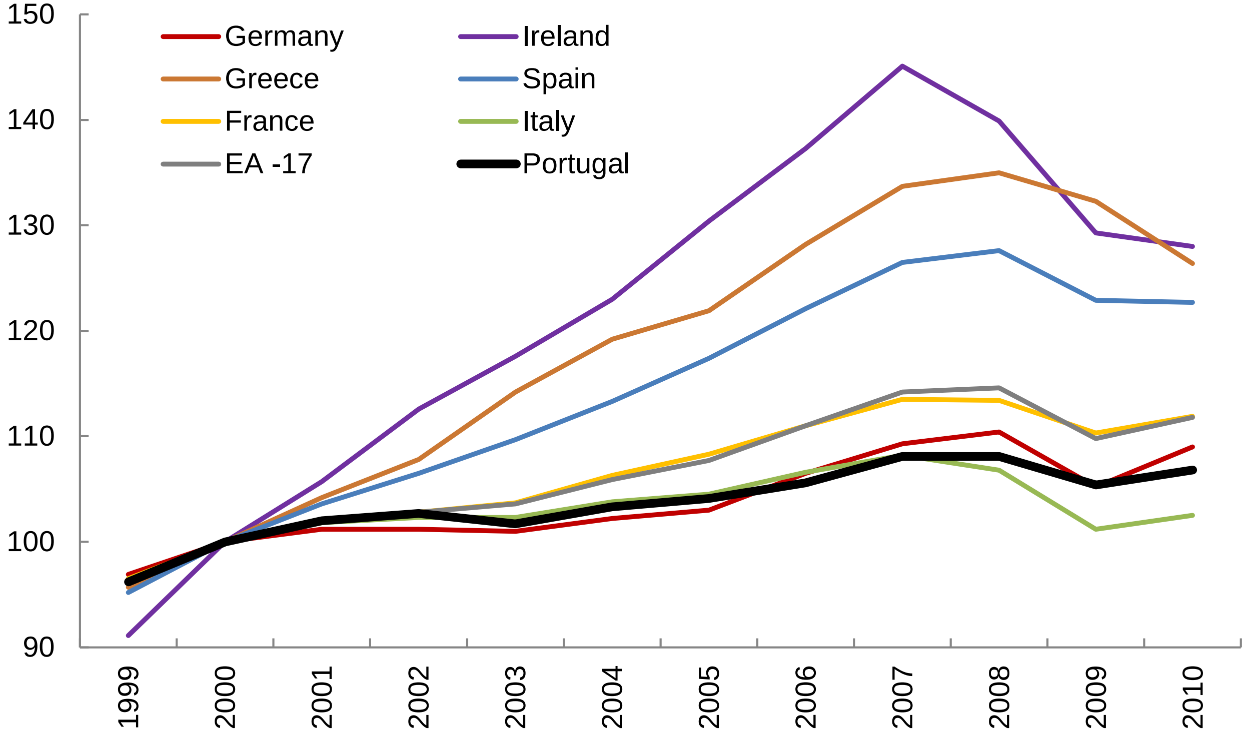
- Restrictions on the market for corporate control
- Protection of several sectors of the economy
- Weak conditions to entrepreneurial activity
- Poor functioning of the justice system
- Rigidity of the labor market

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**

Source: Eurostat

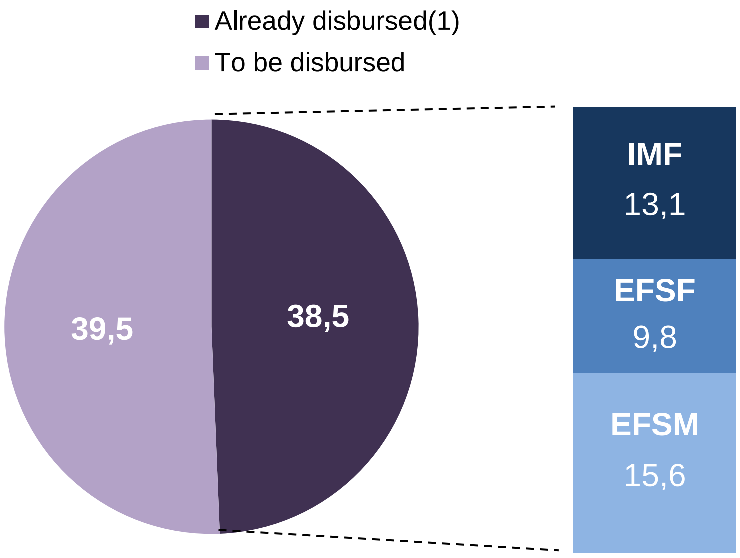
THE ECONOMIC AND FINANCIAL ASSISTANCE PROGRAM

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

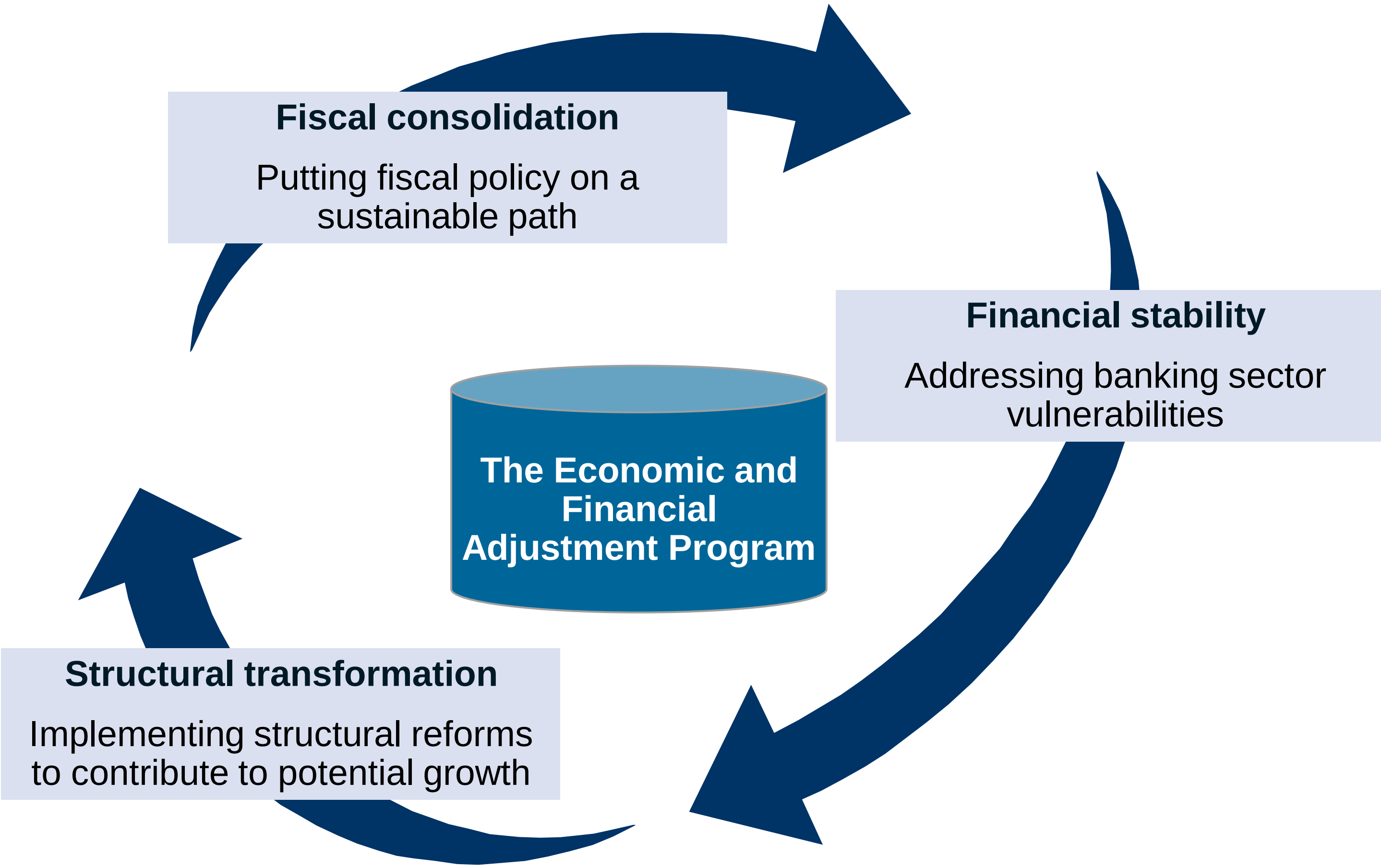
After the 2nd Review, the program implementation was considered ***on track***

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	▪ Broad political consensus ▪ Social support to the Program
2	Unfavorable macro-economic developments	▪ Milder recession than expected in 2011 ▪ Strong performance of exports
3	Missing the fiscal targets	▪ Major reduction in overall and structural deficits ▪ Progress in institutional reforms
4	Uncertainty regarding the stability of the financial sector	▪ Compliance with the Core Tier 1 ratios ▪ Reduction of loan-to-deposit ratio
5	Insufficient pace of structural reforms	▪ Success of privatizations process ▪ Labor market tripartite agreement ▪ Broad range of implemented measures

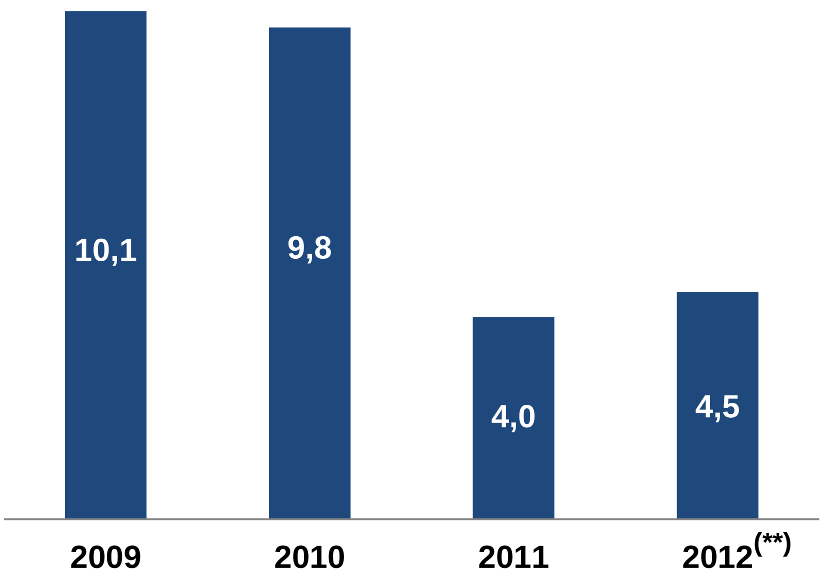
Successful debt auction in January, 18

- 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

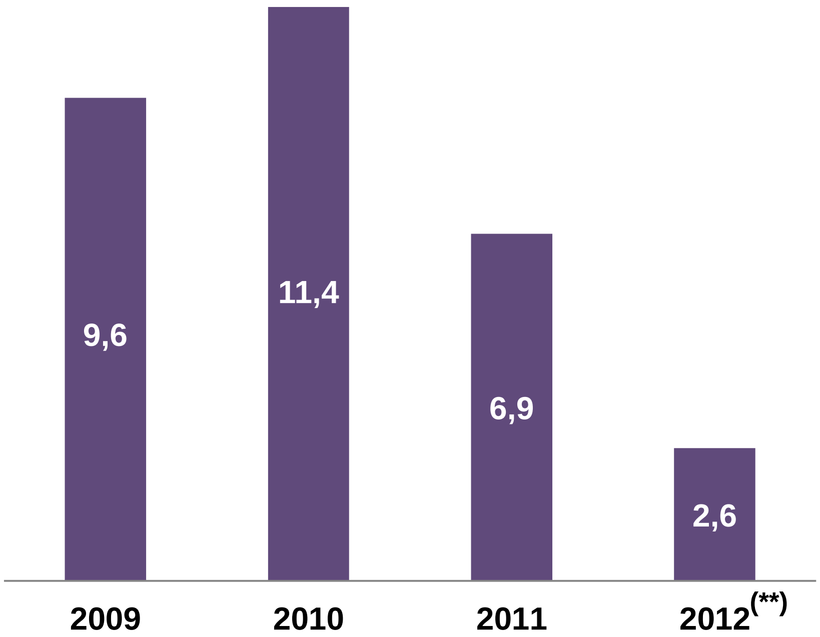
Major reduction of structural deficit in 2011 and 2012

Overall deficit
As a percentage of GDP



Limit of **5,9%** prescribed in the Program

Structural deficit (*)
As a percentage of GDP



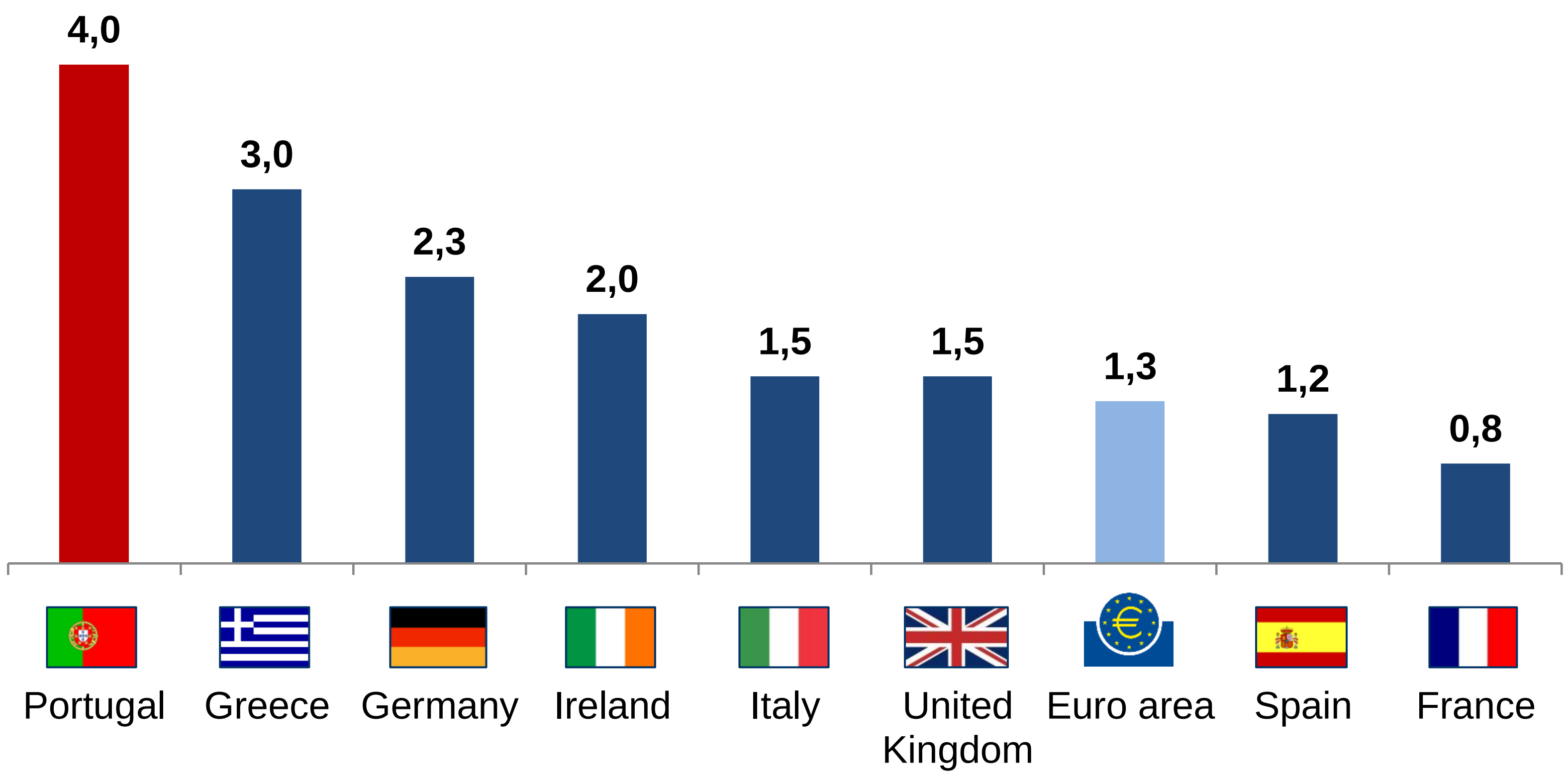
(*) Deficit adjusted for the effect of the cycle; excludes transfer of pensions funds in 2010 and 2011 and concessions in 2011

(**) Excludes temporary effects in 2012

Source: Ministry of Finance, January 2012

Portugal's structural adjustment stands out

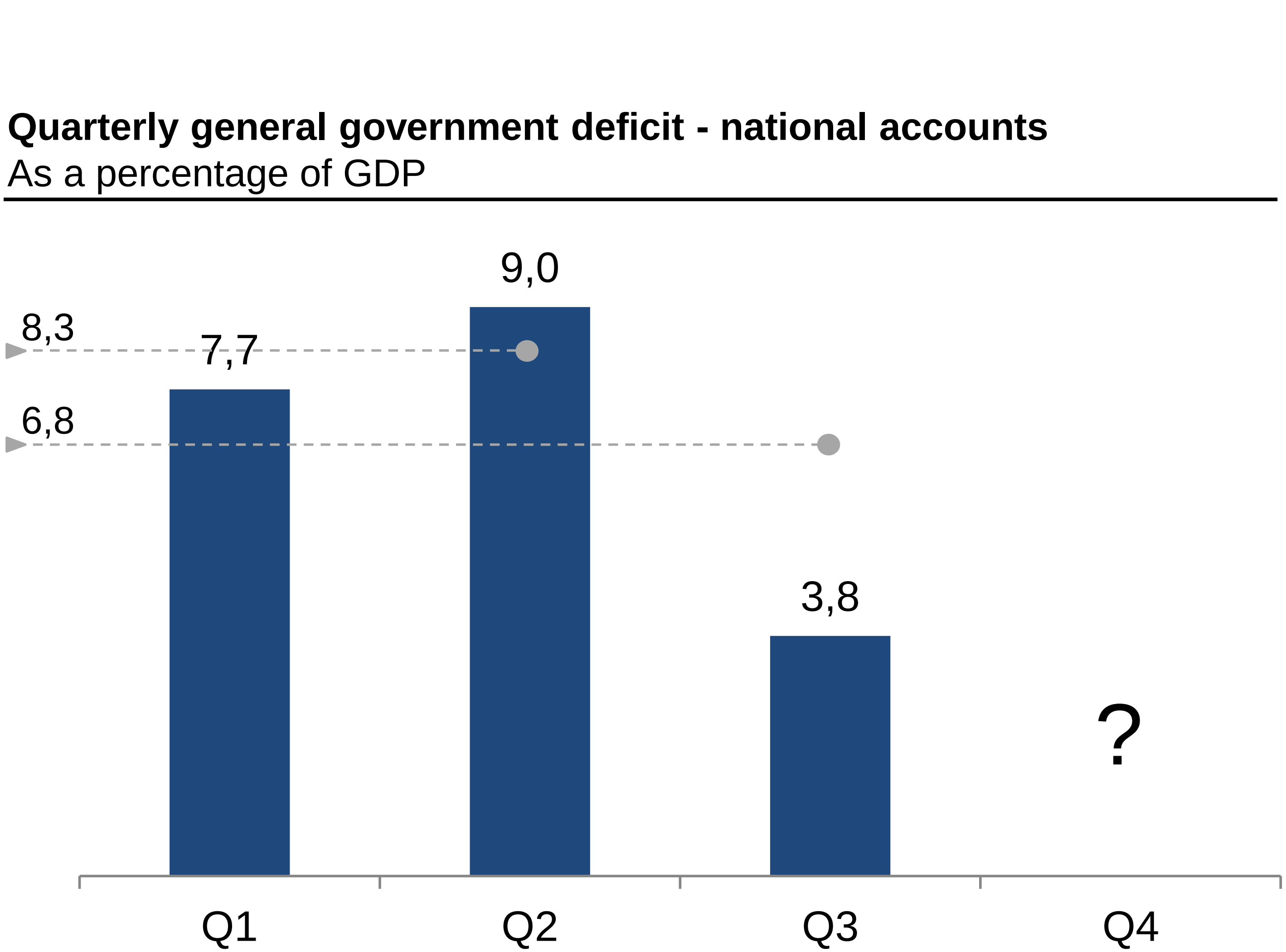
Structural adjustment 2010-2011[1]
Percentage points of potential GDP



(1) Change in General Government Cyclically Adjusted Balance
Source: IMF, "Fiscal Monitor Update", January 2012

Q3 budget deficit below 4%

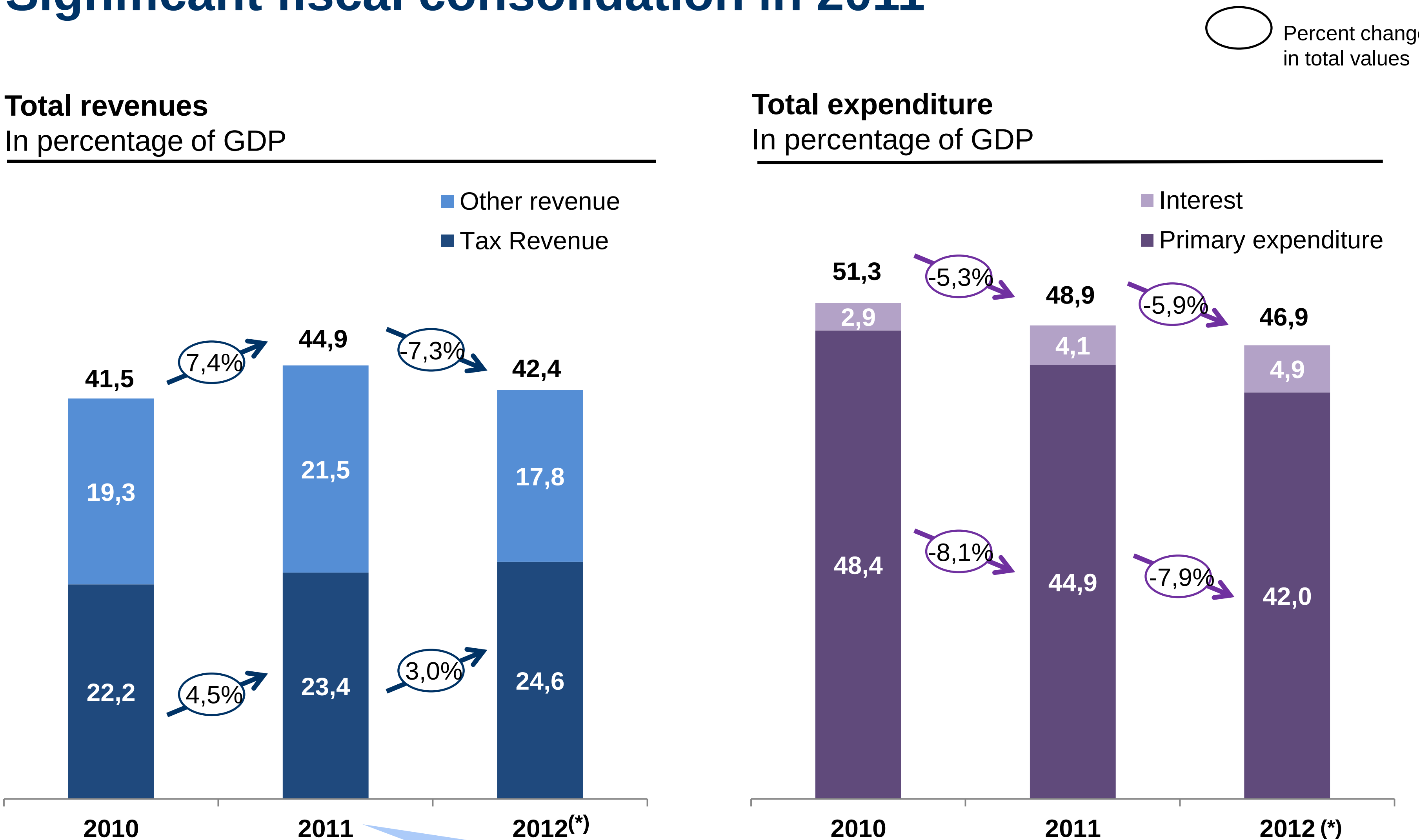
Quarterly general government deficit - national accounts
As a percentage of GDP



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

Source: INE, December 2011

Significant fiscal consolidation in 2011



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

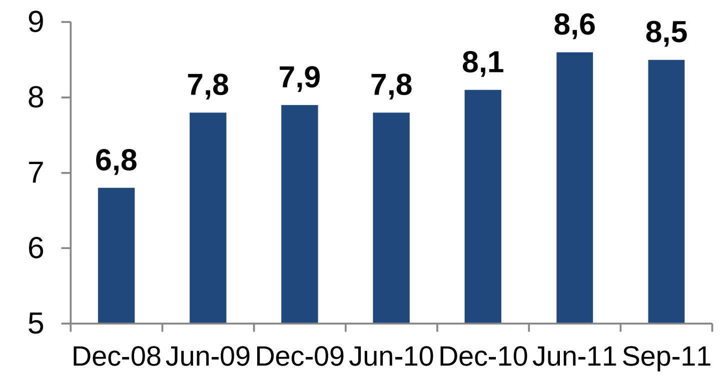
Reinforcement of banks' capital and deleveraging process are ongoing

Key achievements

Reinforcement of banks' capital

- **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

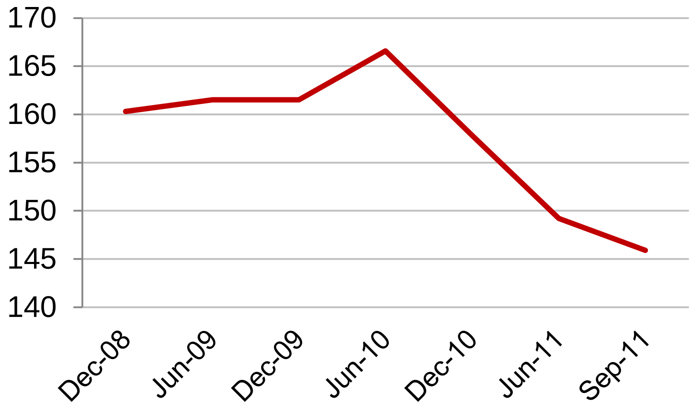
Core Tier 1 ratio, percentage



Deleveraging process

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

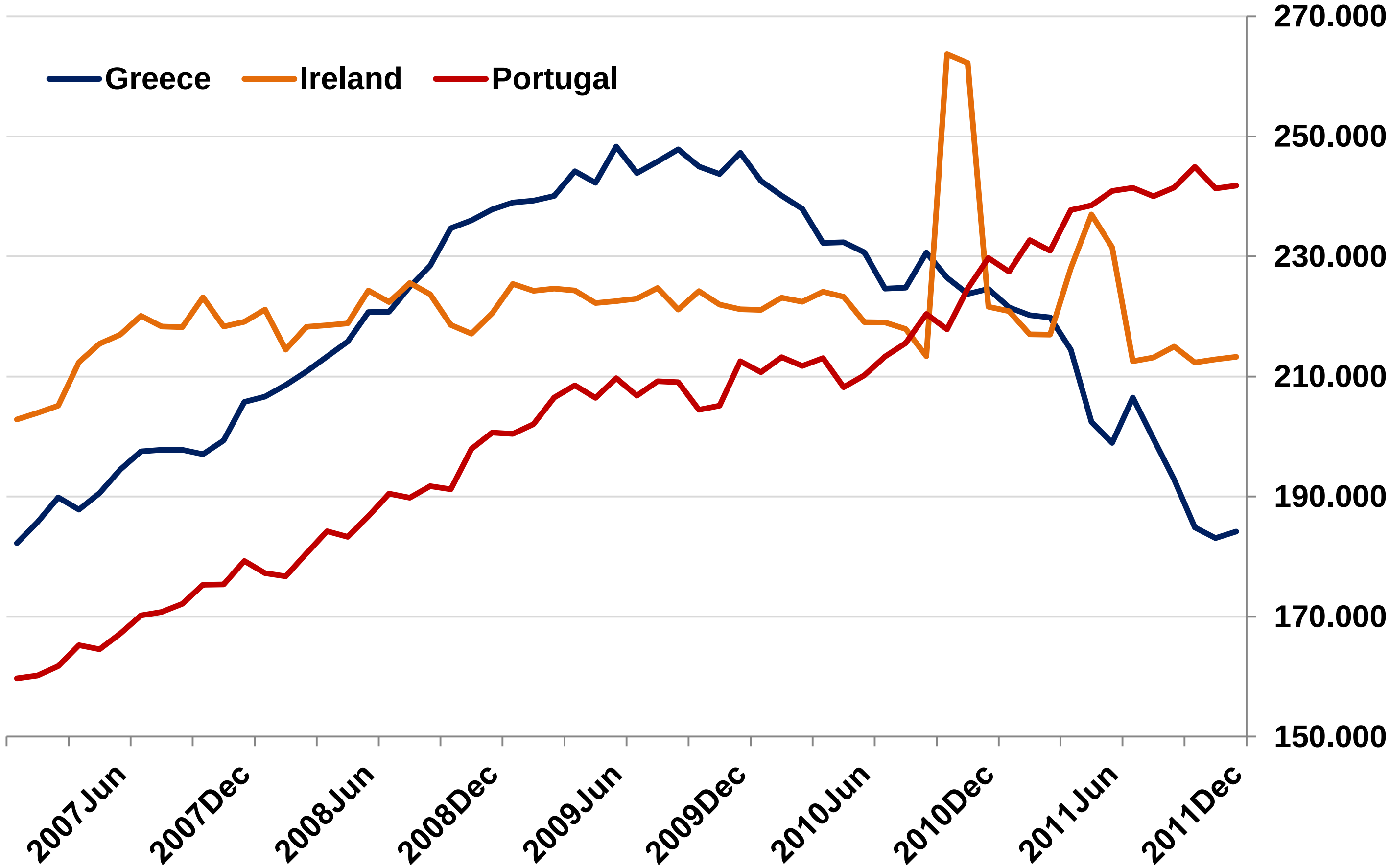
Credit-to-deposits ratio, percentage



Source: Bank of Portugal

Depositors’ trust in the Portuguese banking system

Total deposits (excluding deposits from financial institutions)
Million Euros



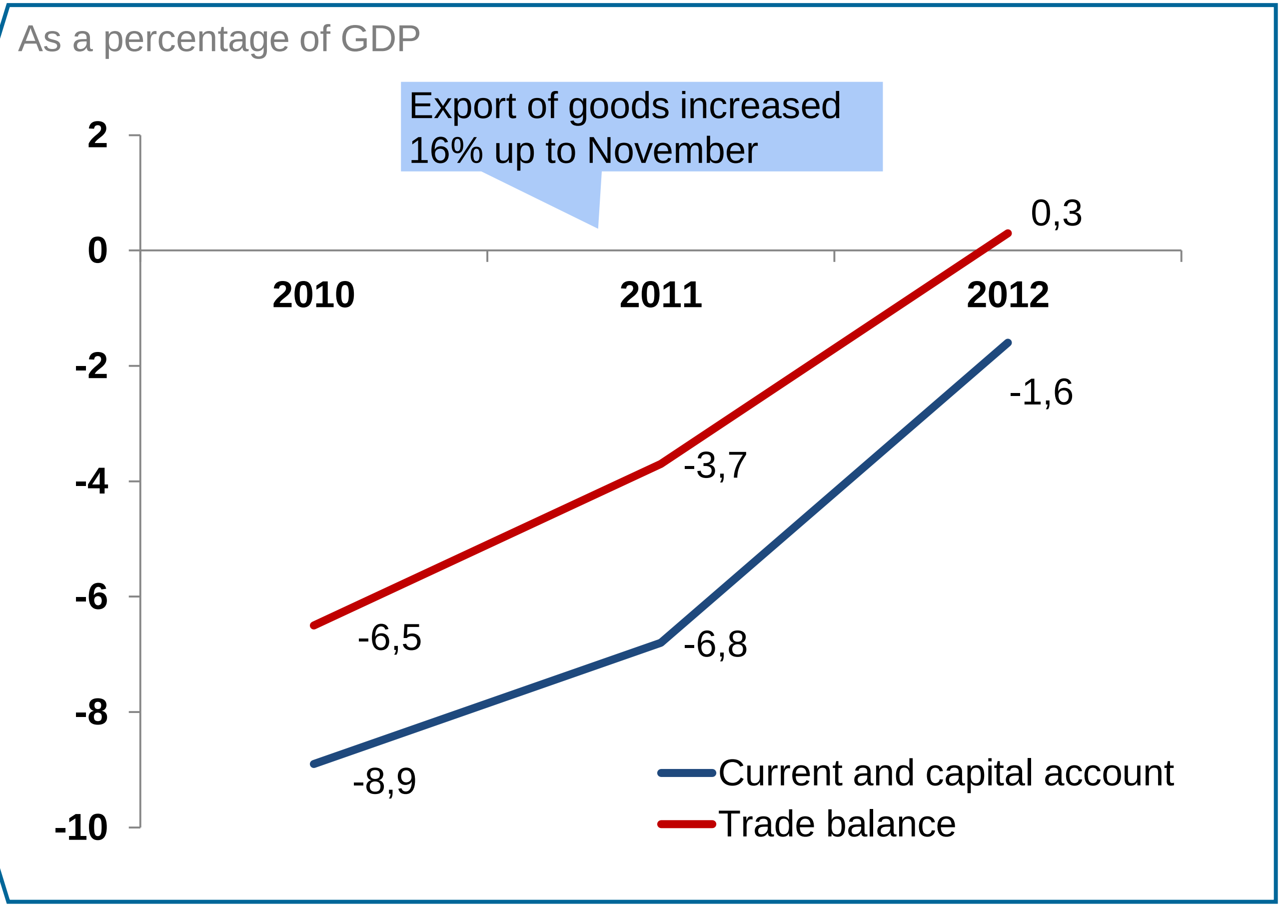
Source: EBC

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



Source: Bank of Portugal, “Boletim Económico – Inverno 2011”, January 2012

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 Transformation Agenda

Confidence, credibility and justice

Openness, competition and competitiveness

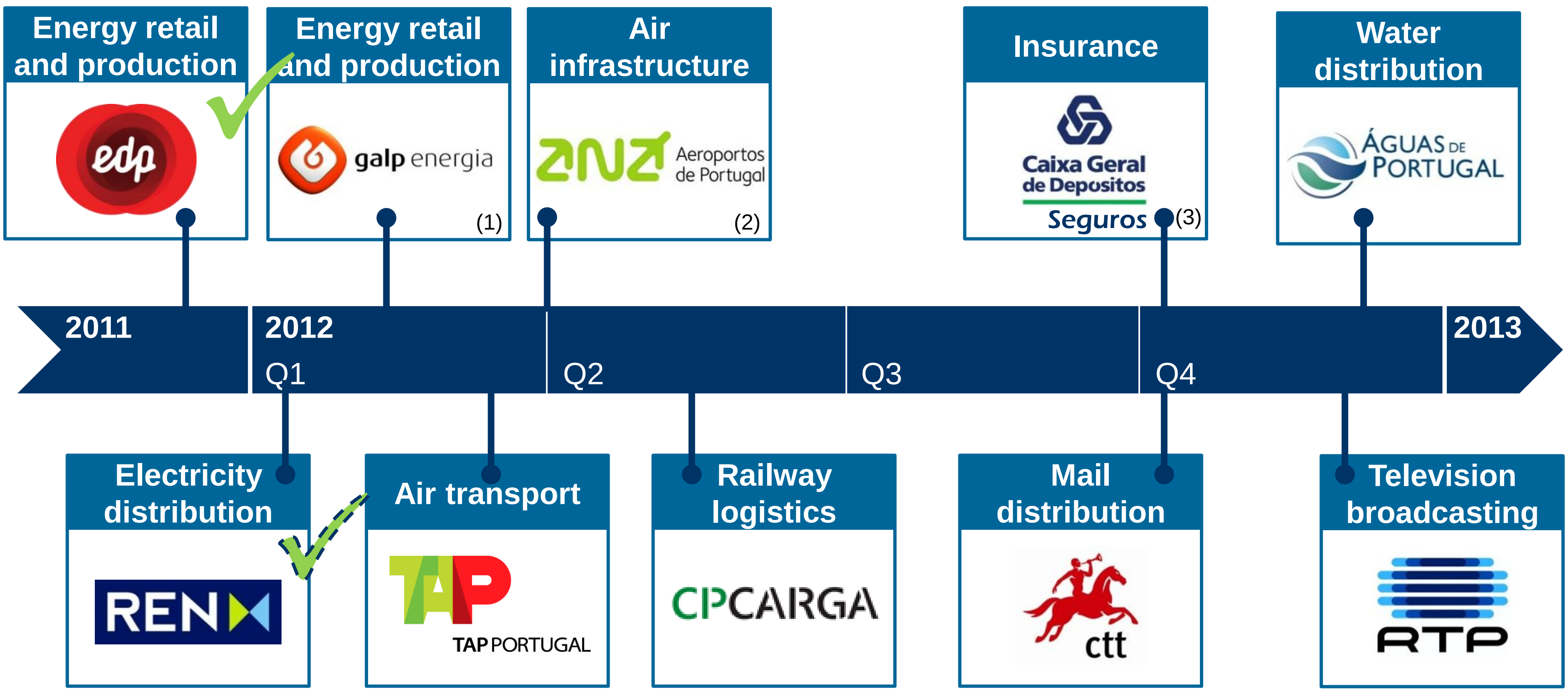
Entrepreneurship, innovation and labor market flexibility

Limited State and economic democracy

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

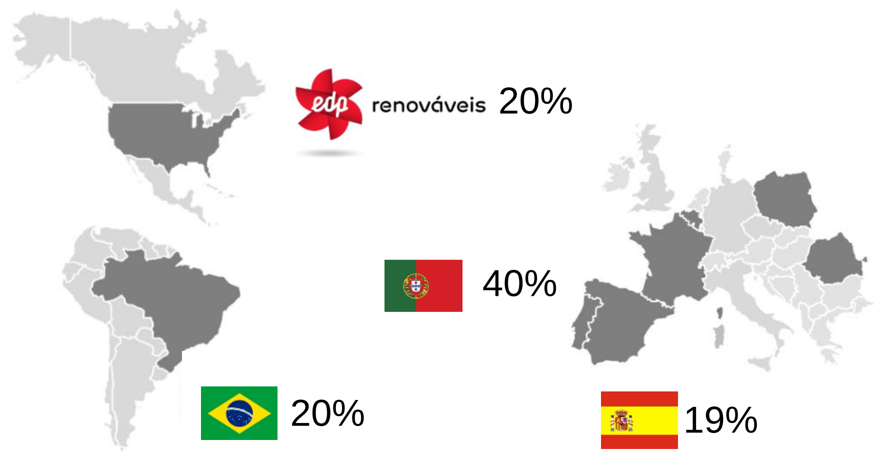
Opportunities identified

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 share[1]
- **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**

Key measures

Working time

- 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		Key measures
Portugal as a competitive location for physical and human capital	**Judicial system**	▪ 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**

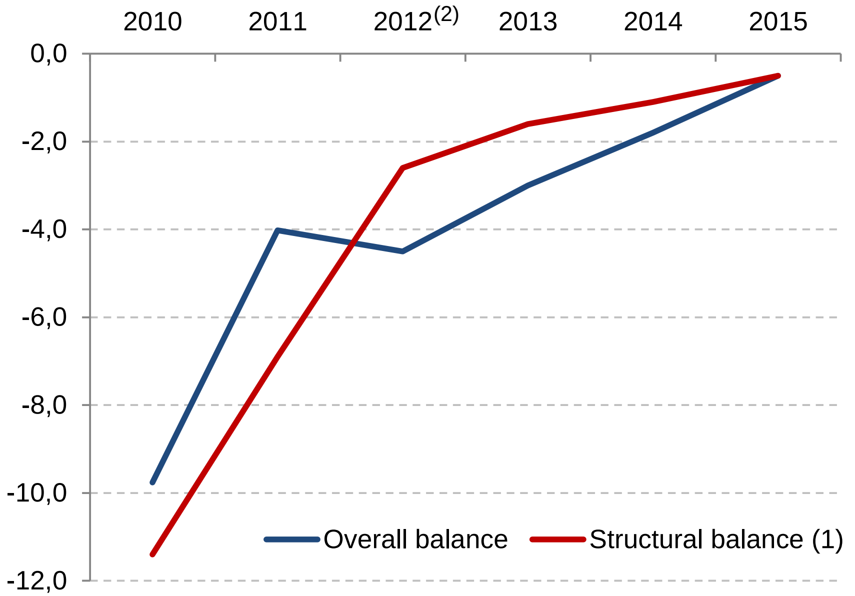
CONCLUSION:
HOW WILL IT WORK?

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

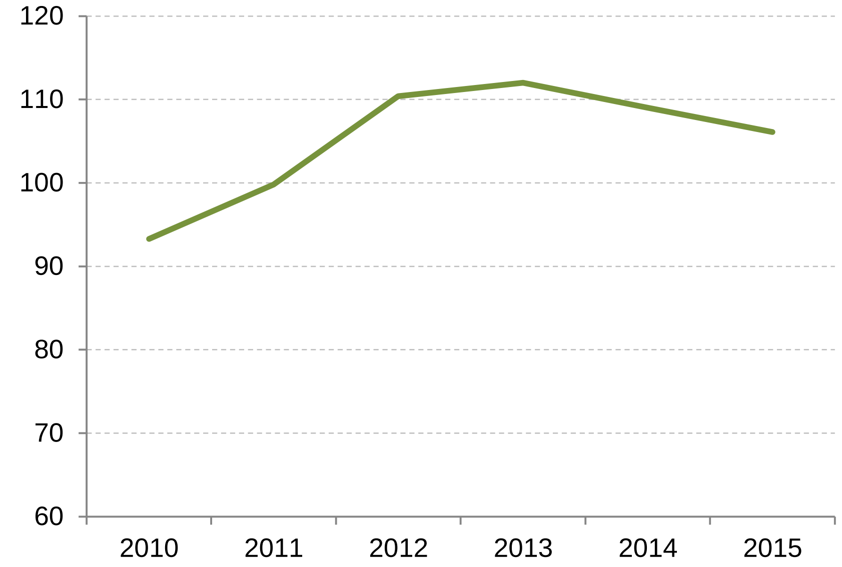
(2) Excludes temporary effects in 2012

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

Decreasing of public debt

General government gross debt

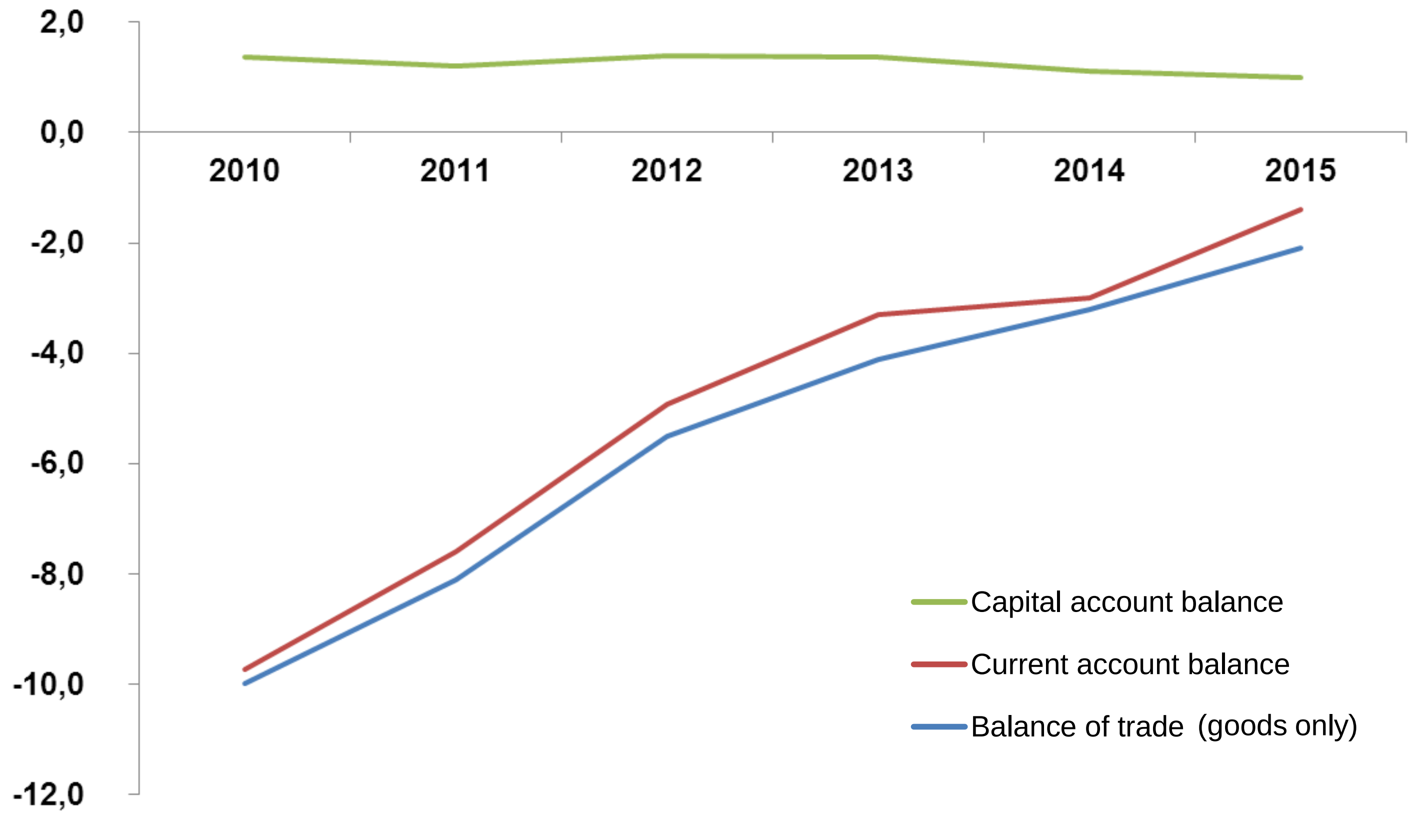
As a percentage of GDP



Source: Ministry of Finance, November 2011

Elimination of the trade deficit

As percentage of GDP



Source: Ministry of Finance, November 2011

Return to growth

Sustained economic growth

GDP Growth

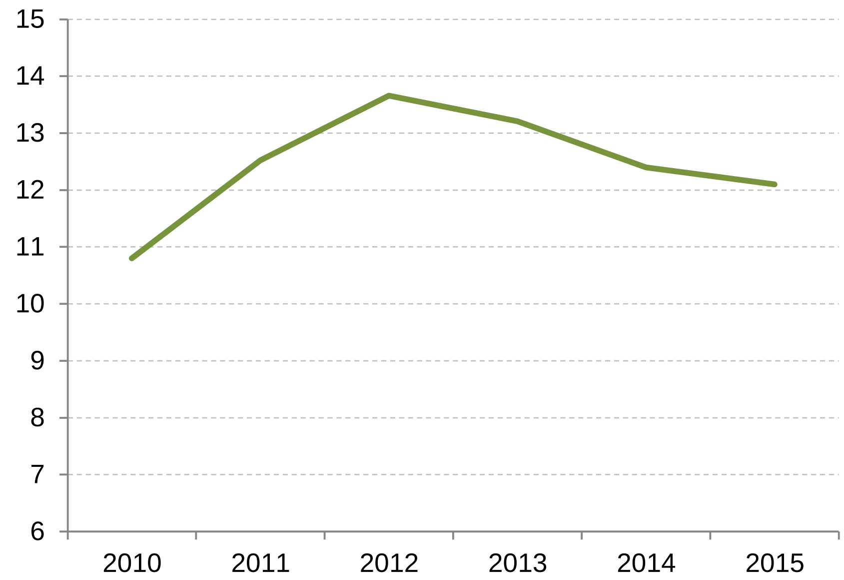
Year-on-year percent change

Source: Ministry of Finance, November 2011

Job creation

Unemployment rate

Percentage



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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