Portugal: restoring credibility and confidence

Vítor Gaspar

Peterson Institute, Washington
March 19, 2012
Outline

1. On the way to become the difficult Portuguese case

2. The Economic Adjustment Program

3. Fiscal consolidation

4. Deleveraging and 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

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
Unsustainable public finances

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

- Non-financial corporations
- Households (a)

Increasing external debt

Portuguese gross external debt
As a percentage of GDP

Source: Bank of Portugal

(*) Financial Debt

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

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

Key facts

- The Economic 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 recapitalization.

- Each disbursement depends on the technical mission's **quarterly assessment about Portugal's performance** on the implementation of the Adjustment Program.

Financial package

<table>
<thead>
<tr>
<th>EUR Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>IMF</td>
</tr>
<tr>
<td>13.1</td>
</tr>
<tr>
<td>EFSF</td>
</tr>
<tr>
<td>9.8</td>
</tr>
<tr>
<td>EFSEM</td>
</tr>
<tr>
<td>15.6</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>38.5</td>
</tr>
</tbody>
</table>

Already disbursed

4th Disbursement (April 2012)

To be disbursed

(1) Net issuances

Source: IGCP, February 2012

After the **3rd Review** (completed in February 28) the program implementation was **on track**

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

Fiscal consolidation
Putting fiscal policy on a sustainable path

The Economic Adjustment Program

Deleveraging and financial stability
Reduction of debt and financing needs of the economy

Structural transformation
Implementing structural reforms to contribute to potential growth

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 (in May 2011), Portugal faced a very uncertain outlook.

<table>
<thead>
<tr>
<th>Main risks</th>
<th>Major outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Weakening of political support for the Program</td>
<td>• Broad political consensus</td>
</tr>
<tr>
<td></td>
<td>• Social support to the Program</td>
</tr>
<tr>
<td>2. Unfavorable macro-economic developments</td>
<td>• Milder recession than expected in 2011</td>
</tr>
<tr>
<td></td>
<td>• Stronger than expected external adjustment</td>
</tr>
<tr>
<td></td>
<td>• Dynamic exports</td>
</tr>
<tr>
<td>3. Missing the fiscal targets</td>
<td>• Major reduction in overall and structural deficits</td>
</tr>
<tr>
<td></td>
<td>• Progress in institutional reforms</td>
</tr>
<tr>
<td>4. Uncertainty regarding the stability of the financial sector</td>
<td>• Increase in banks’ capital</td>
</tr>
<tr>
<td></td>
<td>• Reduction of credit-to-deposit ratio</td>
</tr>
<tr>
<td></td>
<td>• Increase in transparency: on-site inspections</td>
</tr>
<tr>
<td>5. Insufficient pace of structural reforms</td>
<td>• Success of privatizations process</td>
</tr>
<tr>
<td></td>
<td>• Labor market tripartite agreement</td>
</tr>
<tr>
<td></td>
<td>• Broad range of implemented measures</td>
</tr>
</tbody>
</table>
A turning point in Treasury financing
Portuguese Treasury Bills

Weighted average yield
Percentage

Note: Auction announcement date
Source: IGCP
A turning point in Treasury financing
Portuguese Treasury Bills

Weighted(1) Bid-to-cover ratio

Weighted(1) international allocation
Percentage

(1) Weighted average of 3 and 6 months auctions
Note: Auction announcement date
Source: IGCP
A turning point in Treasury financing
Portuguese Treasury Bonds

Source: 2 years – Bloomberg; 5 and 10 years – Reuters
FISCAL CONSOLIDATION
Portugal’s structural adjustment stands out

Structural adjustment 2010-2011\(^{(1)}\)
Percentage points of potential GDP

- Portugal: 4.0
- Greece: 3.0
- Germany: 2.3
- Ireland: 2.0
- Italy: 1.5
- United Kingdom: 1.5
- Euro area: 1.3
- Spain: 1.2
- France: 0.8

(1) Change in General Government Cyclically Adjusted Balance
Overall deficit below the average for euro area

Overall deficit 2011
As percentage of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Deficit 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ireland</td>
<td>10.3%</td>
</tr>
<tr>
<td>Greece</td>
<td>9.0%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>8.6%</td>
</tr>
<tr>
<td>Spain</td>
<td>8.0%</td>
</tr>
<tr>
<td>France</td>
<td>5.7%</td>
</tr>
<tr>
<td>Euro area</td>
<td>4.3%</td>
</tr>
<tr>
<td>Portugal</td>
<td>4.0%</td>
</tr>
<tr>
<td>Italy</td>
<td>3.9%</td>
</tr>
<tr>
<td>Germany</td>
<td>1.1%</td>
</tr>
</tbody>
</table>

(1) IMF, Staff report for the fourth review, 29 November 2011
(2) IMF, Staff report for the fifth review, 30 November 2011
(3) Ministry of Finance, January 2012

Source: IMF, “Fiscal Monitor Update”, January 2012 (except for PT, IR and GR for which data is not available)
Portuguese public debt is sustainable

**Government Debt Sustainability Framework: Baseline**
As percentage of GDP

![Graph showing government debt sustainability framework for Portugal, Greece, Ireland, and Italy.](graph.png)

(1) Staff report: Second Review Under the Extended Arrangement; December, 7 2011
(2) Staff report: Fifth Review Under the Stand-By Arrangement; November, 30 2011
(3) Staff report: Fourth Review Under the Extended Arrangement; November, 29 2011
(4) Staff report for the 2011 Article IV Consultation; June, 20 2001

Source: IMF
Portuguese public debt is sustainable

Government Debt Sustainability Framework: Baseline
As percentage of GDP

(1) Staff report: Second Review Under the Extended Arrangement; December, 7 2011
(2) Staff report: Fourth Review Under the Extended Arrangement; November, 29 2011
(3) Third Review; February 2012
(4) Staff report: Fifth Review Under the Extended Arrangement; February, 13 2012

Source: IMF
## Important progress in the institutional reform front

**Public financial management**
- Approval of the **Spending Commitments’ Control Law**
- Establishment of the **Portuguese Public Finance Council**
- **Adjustment Program** for the Autonomous Region of **Madeira**
- Creation of the new **Tax and Customs Authority**

**Public Administration**
- Reduction of **management positions** (27%) and **administrative units** in central administration (40%)

**SOEs and PPPs**
- Significant **cost reductions in SOE** (e.g.: voluntary redundancy programs)
- Awarded a contract to **review all PPP contracts** to a top-tier accounting firm

**Next challenges**
- Improve **budgetary control** across all levels of Public Administration
- Strategy to clear **stock of arrears**
- Changes to national law in order to include the golden rule and the debt reduction rule from the **Treaty on Stability, Coordination and Governance**

- Extend streamline measures to **regional and local administration**
- **Operational balance for SOEs** as a whole by end-2012
- New fiscally-prudent **PPPs institutional framework**: enhanced role of MoF
DELEVERAGING AND FINANCIAL STABILITY
Stronger than expected external adjustment

Better performance of current account than initial projections

Forecast\(^{(2)}\)

Actual\(^{(1)}\)

External surplus in Q4

Balance of payments

EUR Millions

Better performance of current account than initial projections

Forecast\(^{(2)}\)

Actual\(^{(1)}\)

External surplus in Q4

Balance of payments

EUR Millions

(1) Bank of Portugal, BP Stat, February 2012;
(2) IMF, Staff report: Request for a Three-Year Arrangement Under the Extended Fund Facility, May 2012
Fast correction of external imbalances under adjustment programs

**Current account**
As a percentage of GDP, \( t = \) first year of the Adjustment Programs

![Graph showing current account as a percentage of GDP over time for different programs and years.]

(1) Bank of Portugal, Long series
(2) IMF, Staff report: Request for a Three-Year Arrangement Under the Extended Fund Facility, May 2012
(3) Bank of Portugal, BP Stat, February 2012
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
- Adjustment is **progressing as planned**
- Important contribution of **higher deposits and sizeable asset sales**
- **Stabilization of financing** from the Eurosystem

(1) Excluding intervened institutions

Source: Bank of Portugal, January 2012
Easing of bank liquidity pressures

ECB Measures (8 December)

- Longer-term refinancing operations: 36 months (December 22 and March 1)
- Reduction of the reserve requirements ratio: from 2% to 1%
- Broadening of eligible collateral

Source: Bank of Portugal, March 2012
Depositors’ trust in the Portuguese banking system

**Total deposits** (excluding deposits from financial institutions)

EUR Millions

Source: ECB
STRUCTURAL TRANSFORMATION
Economic growth: importance of the Structural Transformation Agenda

- Openness, competition and competitiveness
  - Network industries: energy, telecommunications, transports
  - Competition
  - Housing Market
- Entrepreneurship, innovation and labor market flexibility
  - Labor market
  - Education and training
- Limited State and economic democracy
  - Privatizations
  - Special rights of the State
  - Public procurement
  - Administrative burden

Confidence, credibility and justice
- Judicial system

Structural transformation
- 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
Portugal needs a broad transformation agenda

Structural reforms gaps in European economies: a heatmap

<table>
<thead>
<tr>
<th>Medium term</th>
<th>Euro area countries</th>
<th>Selected comparators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor market inefficiency</td>
<td>DE FR NL BE IT ES PT GR AT FI IE</td>
<td>DK SE UK US JP</td>
</tr>
<tr>
<td>Business regulations</td>
<td></td>
<td></td>
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<tr>
<td>Network regulation</td>
<td></td>
<td></td>
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<tr>
<td>Retail sector regulation</td>
<td></td>
<td></td>
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<tr>
<td>Profess. services regulation</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Long term</th>
<th>Euro area countries</th>
<th>Selected comparators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutions and contracts</td>
<td>DE FR NL BE IT ES PT GR AT FI IE</td>
<td>DK SE UK US JP</td>
</tr>
<tr>
<td>Human capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infrastructure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Innovation</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(1) The heatmap is constructed based on a variety of structural indicators from alternative sources in order to flag areas where a country has the greatest need to implement structural reforms. For a discussion of the methodology and detailed components, see IMF, 2010d, "Cross-Cutting Themes in Employment Experiences During the Crisis", IMF Report SM/10/274 Source: OECD; World Economic Forum; Fraser Institute and IMF staff calculations.
Structural reforms: long-run potential impact

2 empirical studies for Portugal

**Approach**

- Bouis and Duval (2011)
  - No model: use empirical results from several studies
  - Broad range of reforms that include reforms in product and labor market and reforms of benefit, tax and retirement systems

- Gomes et al (2011)
  - Multi-country DSGE Model
  - Reforms of labor and services market

**Results**

- Increase in long-term output of 7.8%, after 7 years (8.6% in case of cross-country coordination of reforms in the euro area)

In-depth labor market reform
Agreement on Growth, Competitiveness and Employment

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Implemented measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tackle labor market segmentation</td>
<td>- Reduction of 4 national holidays</td>
</tr>
<tr>
<td></td>
<td>- Elimination of 3 extra days of vacation</td>
</tr>
<tr>
<td></td>
<td>- Decrease in 50% of compensation for overtime work</td>
</tr>
<tr>
<td></td>
<td>- Suspend automatic extension of collective agreements</td>
</tr>
<tr>
<td>Foster job creation</td>
<td>- Implementation of individual and group working time management mechanisms</td>
</tr>
<tr>
<td>Ease transition of workers across firms and sectors</td>
<td>- Reduction of restrictions to individual dismissal</td>
</tr>
<tr>
<td></td>
<td>- Reduction of severance payments to align with EU average</td>
</tr>
<tr>
<td></td>
<td>- Implementation of labor arbitration mechanisms</td>
</tr>
</tbody>
</table>

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

NON-EXHAUSTIVE
**Broad product market reform**

**Objective**

<table>
<thead>
<tr>
<th>Telecommunications</th>
<th>Electricity</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce excessive mark-ups in network industries and non-tradable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Implemented measures**

- Reduce mobile termination rates
- Broaden access of all operators to existing networks
- Revise remuneration scheme of co-generation to accelerate converge to market-based pricing
- Redesign Power Guarantee mechanism
- Revised margins of pharmacies
- Set targets for reduction of pharmaceutical profit margins

**Increasing tradable sector competitiveness by reducing non-tradable sectors excessive costs cascaded through the economy**

**NON-EXHAUSTIVE**
## Improving business environment

<table>
<thead>
<tr>
<th>Objective</th>
<th>Implemented measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foster investment and innovation</td>
<td>Targeted measures to accelerate the resolution of the backlog: 50,000 enforcement cleared since November</td>
</tr>
<tr>
<td>Incentive a more efficient use of resources</td>
<td>Adoption of a law on arbitration to facilitate out-of-court settlement</td>
</tr>
<tr>
<td></td>
<td>Proposal to amend the insolvency code and corporate recovery, focusing on speed, simplification and creation of an extra-judicial phase of corporate recovery</td>
</tr>
<tr>
<td>Judicial system</td>
<td>Approval of a new Competition Law harmonized with the EU legal competition framework</td>
</tr>
<tr>
<td></td>
<td>Strengthen the power of the Competition Authority</td>
</tr>
<tr>
<td></td>
<td>Approval of a specialized court on Competition, Regulation and Supervision</td>
</tr>
<tr>
<td>Competition</td>
<td>Liberalization of regulated professions’ access and exercise</td>
</tr>
<tr>
<td></td>
<td>Reduction of firms’ administrative burden: licensing requirements and other legal formalities</td>
</tr>
<tr>
<td></td>
<td>Revision of the Urban Lease Law</td>
</tr>
<tr>
<td>Other services</td>
<td>Non-exhaustive</td>
</tr>
</tbody>
</table>
Privatization program as a flagship in the agenda

Energy retail and production
- edp

Energy retail and production
- galp energia

Air infrastructure
- Aeroportos de Portugal

Insurance
- Caixa Geral de Depósitos Seguros

Water distribution

2011
- Electricity distribution

2012
- Air transport
- Railway logistics

2013
- Mail distribution
- Television broadcasting

Q1
- (1) Sale of “Caixa Geral de Depósitos” participation of 1%
- (2) Concession
- (3) Expected completion date by “Caixa Geral de Depósitos”
Privatization results above expectations

- **% Equity**
  - 21.35%
  - 40%

- **Bidders**
  - Asia: China Three Gorges
  - Asia: State Grid
  - Europe: E.ON
  - Saudi Arabia: Oman Oil Company
  - Latin America: Eletrobras and Cemig

- **Revenue**
  - EUR 2,693M: premium of 53.6% per share\(^1\)
  - EUR 593M: average premium of 33.6% per share\(^1\)

- **Financing**
  - EUR 2,000M through Chinese banking entities
  - EUR 1,000M through Chinese banking entities

- **Investment**
  - EUR 2,000M until 2015 in wind farms
  - Strategic plan for national economy development (e.g. I&D center construction)

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1 Considering the closing price of the day before the Council of Ministers decision
CONCLUSION:
HOW WILL IT WORK?
Restoring credibility and confidence

The adjustment is inevitable

- Solid starting point for the Program
- Broad popular and social support for adjustment

The Program addresses fundamental imbalances and deficiencies

- Elimination of budget deficit on a durable way – supported by a new fiscal policy framework (at national and European level)
- Elimination of external deficit – current and capital account is projected to be in surplus in 2014
- Deep and frontloaded structural reform agenda that will boost potential output and competitiveness

Robustness of the overall Program

- The Program works disregarding positive impact of structural reforms on potential growth
- Structural reforms are likely to speed up adjustment

Gradual credibility buildup

- The Program shelters government financing from the vagaries of financial markets
- Quantitative objectives and targets steered and monitored over time (total of 9 reviews) before September, 2013.
- Compliance with the Program will push for a gradual change in markets’ expectations and perceptions

(1) Ministry of Finance”, February 2012
Portugal: restoring credibility and confidence

Vítor Gaspar

Frankfurt
March 16, 2012
BACKGROUND SLIDES
Index

- On the way to become the difficult Portuguese case
  - Forecasted and actual budgetary balances
  - Net international investment position
  - Unemployment in Portugal
  - Youth and long-term unemployment in Europe

- Fiscal consolidation
  - Macroeconomic Scenario 2009-2012
  - Overall and Structural deficit in 2011 and 2012
  - Fiscal consolidation process: revenue and expenditure 2010-2012

- Deleveraging and Financial Stability
  - External adjustment: Actual vs Forecast - Current and Capital Account and Balance of Goods and Services
  - Current account in Portugal’s past adjustments
  - EBA Communication, 08 December 2011

- Structural transformation
  - Higher qualifications of younger generations
  - Positive performance in advanced education levels
  - Geographic diversification of Portuguese exports
  - Technology intensity of Portuguese exports
  - Increasing diversity of Portuguese exports
  - Portugal as a competitive location for business in the euro area

- Conclusion: how will it work?
  - Council of the European Union, 30 January 2012
  - Private sector response in 83-84 and 2009
ON THE WAY TO BECOME THE DIFFICULT PORTUGUESE CASE
1. PUBLIC FINANCES ON AN UNSUSTAINABLE PATH

Lack of discipline

Forecasted and actual budgetary balances
As a percentage of GDP

Source: INE and Ministry of Finance
Note: The figures for the forecasts correspond to the values that have been reported in the SGP updates
2. ENORMOUS LEVEL OF EXTERNAL INDEBTEDNESS

Very high levels of the economy borrowing requirements

The worsening of the international investment position...

Net international investment position
As a percentage of GDP

... led to the worst position among Euro area countries

Net international investment position in 2010
As a percentage of GDP

Source: Bank of Portugal

Note: The NIIP of Ireland refers to 30 June 2010
Source: AMECO, Bank of Portugal and IMF
Unemployment in Portugal

4Q 2011

By age
Percentage of total unemployed

- 15-24: 29%
- 25-34: 20%
- 35-44: 22%
- 45 and more: 28%

By duration
Percentage of total unemployed

- Until 11 months: 53%
- 12 months and more (long-term): 47%

By education level
Percentage of total unemployed

- Until basic education ("3º ciclo"): 14%
- Secundary and post-secundary: 23%
- Higher education: 63%

Source: INE, “Estatísticas do Emprego”, November 2011
High levels of youth and long-term unemployment

As percentage of labor force, 2010

Youth unemployment (1)

Long-term unemployment (2)

(1) Less than 25 years, annual average
(2) 12 months or more, annual average

Source: Eurostat
FISCAL CONSOLIDATION
## Macroeconomic Scenario 2009-2012

<table>
<thead>
<tr>
<th>GDP and expenditure components</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Consumption</td>
<td>-2.3</td>
<td>2.1</td>
<td>-3.9</td>
<td>-5.8</td>
</tr>
<tr>
<td>Public Consumption</td>
<td>4.7</td>
<td>0.9</td>
<td>-3.9</td>
<td>-3.2</td>
</tr>
<tr>
<td>GFCF</td>
<td>-8.6</td>
<td>-4.1</td>
<td>-11.4</td>
<td>-10.2</td>
</tr>
<tr>
<td>Domestic Demand</td>
<td>-3.3</td>
<td>0.8</td>
<td>-5.7</td>
<td>-6.2</td>
</tr>
<tr>
<td>Exports</td>
<td>-10.9</td>
<td>8.8</td>
<td>7.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Imports</td>
<td>-10.0</td>
<td>5.4</td>
<td>-5.5</td>
<td>-5.9</td>
</tr>
<tr>
<td>GDP</td>
<td>-2.5</td>
<td>1.4</td>
<td>-1.6</td>
<td>-3.3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GDP - contributions to growth (p.p.)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Demand</td>
<td>-3.7</td>
<td>0.8</td>
<td>-6.1</td>
<td>-6.4</td>
</tr>
<tr>
<td>Net Exports</td>
<td>0.7</td>
<td>0.6</td>
<td>4.4</td>
<td>3.1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GDP - Deflators</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
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<tbody>
<tr>
<td>Private Consumption</td>
<td>-2.2</td>
<td>1.7</td>
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<td>-0.6</td>
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<td>-6.4</td>
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<tr>
<td>GFCF</td>
<td>-1.9</td>
<td>2.8</td>
<td>2.1</td>
<td>3.7</td>
</tr>
<tr>
<td>Exports</td>
<td>-5.0</td>
<td>4.2</td>
<td>5.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Imports</td>
<td>-9.2</td>
<td>4.8</td>
<td>8.0</td>
<td>3.9</td>
</tr>
<tr>
<td>GDP</td>
<td>0.9</td>
<td>1.1</td>
<td>0.7</td>
<td>0.9</td>
</tr>
</tbody>
</table>

*Memo item:*

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
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<tbody>
<tr>
<td>CPI</td>
<td>-0.8</td>
<td>1.4</td>
<td>3.6</td>
<td>3.1</td>
</tr>
<tr>
<td>HICP</td>
<td>-0.9</td>
<td>1.4</td>
<td>3.6</td>
<td>3.1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Labour Market</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment Rate (%)</td>
<td>9.5</td>
<td>10.8</td>
<td>12.7</td>
<td>14.5</td>
</tr>
<tr>
<td>Employment growth</td>
<td>-2.6</td>
<td>-1.5</td>
<td>-2.8</td>
<td>-2.5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Productivity and Competitiveness</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour productivity</td>
<td>-0.3</td>
<td>2.9</td>
<td>1.2</td>
<td>-0.8</td>
</tr>
<tr>
<td>Nominal Unit Labour Costs</td>
<td>3.9</td>
<td>-1.9</td>
<td>-1.1</td>
<td>-2.5</td>
</tr>
<tr>
<td>Nominal Unit Labour Costs (relative to UE27)</td>
<td>2.1</td>
<td>-3.1</td>
<td>-2.3</td>
<td>-3.8</td>
</tr>
<tr>
<td>Change in Market Share</td>
<td>2.7</td>
<td>1.7</td>
<td>2.4</td>
<td>0.2</td>
</tr>
<tr>
<td>Terms of Trade</td>
<td>4.3</td>
<td>-0.5</td>
<td>-2.6</td>
<td>-1.2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Disposable Income and Saving</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Households Disposable Income (real)</td>
<td>0.4</td>
<td>1.5</td>
<td>-5.3</td>
<td>-6.2</td>
</tr>
<tr>
<td>Households Disposable Income (nominal)</td>
<td>-0.4</td>
<td>2.9</td>
<td>-1.9</td>
<td>-3.3</td>
</tr>
<tr>
<td>Saving rate (% of Disposable Income)</td>
<td>10.9</td>
<td>10.1</td>
<td>8.7</td>
<td>8.3</td>
</tr>
<tr>
<td>Indebteness of Households</td>
<td>2.3</td>
<td>3.0</td>
<td>0.8</td>
<td>0.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current and Capital Account (% of GDP)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods Account</td>
<td>-10.0</td>
<td>-10.0</td>
<td>-7.2</td>
<td>-5.1</td>
</tr>
<tr>
<td>Current Account</td>
<td>-10.8</td>
<td>-9.7</td>
<td>-6.5</td>
<td>-4.6</td>
</tr>
<tr>
<td>Capital Account</td>
<td>1.2</td>
<td>1.3</td>
<td>1.4</td>
<td>1.5</td>
</tr>
<tr>
<td>Current and Capital Account</td>
<td>-9.6</td>
<td>-8.3</td>
<td>-5.1</td>
<td>-3.1</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance; March 12, 2012
Major reduction of structural deficit in 2011 and 2012

Overall deficit
As a percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012(**)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>10,1</td>
<td>9,8</td>
<td>4,0</td>
<td>4,5</td>
</tr>
</tbody>
</table>

Limit of 5,9% prescribed in the Program

Structural deficit (*)
As a percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012(**)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>9,6</td>
<td>11,4</td>
<td>6,9</td>
<td>2,6</td>
</tr>
</tbody>
</table>

(*) 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
Significant fiscal consolidation in 2011

### Total revenues

<table>
<thead>
<tr>
<th>Year</th>
<th>Other revenue</th>
<th>Tax Revenue</th>
<th>Total revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>22.2%</td>
<td>41.5%</td>
<td>41.5%</td>
</tr>
<tr>
<td>2011</td>
<td>23.4%</td>
<td>44.9%</td>
<td>44.9%</td>
</tr>
<tr>
<td>2012</td>
<td>24.6%</td>
<td>42.4%</td>
<td>42.4%</td>
</tr>
</tbody>
</table>

### Total expenditure

<table>
<thead>
<tr>
<th>Year</th>
<th>Interest</th>
<th>Primary expenditure</th>
<th>Total expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>2.9%</td>
<td>19.3%</td>
<td>22.2%</td>
</tr>
<tr>
<td>2011</td>
<td>4.1%</td>
<td>21.5%</td>
<td>25.6%</td>
</tr>
<tr>
<td>2012</td>
<td>4.9%</td>
<td>17.8%</td>
<td>22.7%</td>
</tr>
</tbody>
</table>

Coercive tax collection of 1,230M€: **12% above target**

(*) Excludes temporary effects in 2012

Source: Ministry of Finance, January 2012
DELEVERAGING AND FINANCIAL STABILITY
Faster external adjustment than expected

**Current and capital account**
As a percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>-8,9</td>
<td>-8,8</td>
</tr>
<tr>
<td>2011</td>
<td>-8,1</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>-5,2</td>
<td>-5,8</td>
</tr>
<tr>
<td>2013</td>
<td>-3,2</td>
<td>-3,2</td>
</tr>
<tr>
<td>2014</td>
<td>-2,5</td>
<td>-1,8</td>
</tr>
<tr>
<td>2015</td>
<td>-1,3</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td></td>
<td>-1,8</td>
</tr>
</tbody>
</table>

**Balance of goods and services**
As a percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>-9</td>
<td>-6,5</td>
</tr>
<tr>
<td>2011</td>
<td>-8</td>
<td>-6,6</td>
</tr>
<tr>
<td>2012</td>
<td>-7</td>
<td>-3,6</td>
</tr>
<tr>
<td>2013</td>
<td>-6</td>
<td>-3,2</td>
</tr>
<tr>
<td>2014</td>
<td>-5</td>
<td>-1,6</td>
</tr>
<tr>
<td>2015</td>
<td>-4</td>
<td>-0,3</td>
</tr>
<tr>
<td>2016</td>
<td>-3</td>
<td>0,3</td>
</tr>
</tbody>
</table>

(1) Bank of Portugal, BP Stat, February 2012;
(2) IMF, Staff report: Request for a Three-Year Arrangement Under the Extended Fund Facility, May 2012
Portugal succeeded in past adjustments

Portugal is a paradigmatic example of successful and rapid adjustments in democracy

In the past, the adjustment was mainly due to the private sector

Currently, the public sector will also adjust significantly

Source: Bank of Portugal
Portuguese measures are aligned with the European strategy

- The European Banking Authority (EBA) published a formal Recommendation, and the final figures, related to banks’ recapitalization needs. The aggregated shortfall amounts to 114.7bn Euros.

- Banks will be required to strengthen their capital positions by building up an exceptional and temporary capital buffer against sovereign debt exposures to reflect market prices as at the end of September.

- In addition, banks will be required to establish an exceptional and temporary buffer such that the Core Tier 1 capital ratio reaches a level of 9% by the end of June 2012.

- Sales of sovereign bonds will not alleviate the buffer requirement to be achieved by June 2012.

- Pursuant to the Recommendation, the national authorities will require banks to submit, by 20th January, their plans detailing the actions they intend to take to reach the set targets.

Source: EBA Communication, 08 December 2011
STRUCTURAL TRANSFORMATION
The increase in education level of younger generations…

… has approached the human capital qualification to its European pears

Population with higher education by age group

- Percentage

Source: OCDE - "Education at a Glance 2011"
The completion rate of PhDs is the highest in Europe

Students completing a PhD in 2009

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portugal</td>
<td>3.0</td>
</tr>
<tr>
<td>Finland</td>
<td>2.5</td>
</tr>
<tr>
<td>Germany</td>
<td>2.0</td>
</tr>
<tr>
<td>Slovakia</td>
<td>1.5</td>
</tr>
<tr>
<td>Austria</td>
<td>1.5</td>
</tr>
<tr>
<td>EU 21</td>
<td>1.4</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>1.3</td>
</tr>
<tr>
<td>France</td>
<td>1.3</td>
</tr>
<tr>
<td>Slovenia</td>
<td>1.3</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.2</td>
</tr>
<tr>
<td>Belgium</td>
<td>1.2</td>
</tr>
<tr>
<td>Spain</td>
<td>1.0</td>
</tr>
<tr>
<td>Estonia</td>
<td>0.8</td>
</tr>
</tbody>
</table>

Some Portuguese schools are among best-in-class

Financial Times – Business Education Rankings
Position in 2011

- #33 European Business School
- #65 Master in Management
- #45 Executive education – Customized
- #54 Executive education – Open
- #39 European Business School
- #2 e #61 Master in Management (1)
- #64 Executive education – Open

(1) The Master #2 (CEMS) is offered by a network of schools of which Nova SBE is part of

Source: OCDE - "Education at a Glance 2011"
Source: Financial Times – Business Education Rankings
Structural transformation is ongoing…

Geographic diversification of Portuguese exports

**Total weight**

**Percentage**

- Intra - EU15
- PALOP
- USA
- OPEP
- Brazil
- EFTA
- Canada
- Japan
- Others

**EFTA:** Iceland, Norway, Liechtenstein, Switzerland

**PALOP:** Angola, Cape-Verde, Guinea-Bissau, Mozambique and São Tomé and Príncipe

**UE-15:** Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxemburg, The Netherlands, Portugal, Spain, Sweden e United Kingdom

Source: INE

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intra - EU15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PALOP</td>
<td></td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>OPEP</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EFTA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Graph Note:**

- **2000** and **2010** indicate the percentage weight of each category in the years 2000 and 2010, respectively.

**Source:** INE
Structural transformation is ongoing…
Technology intensity of Portuguese exports

Exports of manufacturing goods by technology intensity
Percentage

<table>
<thead>
<tr>
<th>Year</th>
<th>High</th>
<th>Medium-high</th>
<th>Medium-low</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>10.3</td>
<td>31.2</td>
<td>14.3</td>
<td>44.2</td>
</tr>
<tr>
<td>2001</td>
<td>11.4</td>
<td>30.3</td>
<td>13.7</td>
<td>44.7</td>
</tr>
<tr>
<td>2002</td>
<td>10.3</td>
<td>31.4</td>
<td>14.5</td>
<td>43.8</td>
</tr>
<tr>
<td>2003</td>
<td>11.7</td>
<td>30.8</td>
<td>15.6</td>
<td>41.9</td>
</tr>
<tr>
<td>2004</td>
<td>12.4</td>
<td>30.7</td>
<td>17.4</td>
<td>39.4</td>
</tr>
<tr>
<td>2005</td>
<td>12.1</td>
<td>30.7</td>
<td>19.6</td>
<td>37.6</td>
</tr>
<tr>
<td>2006</td>
<td>11.5</td>
<td>31.1</td>
<td>21.7</td>
<td>35.7</td>
</tr>
<tr>
<td>2007</td>
<td>11.2</td>
<td>30.9</td>
<td>22.0</td>
<td>35.9</td>
</tr>
<tr>
<td>2008</td>
<td>10.5</td>
<td>30.8</td>
<td>23.1</td>
<td>35.7</td>
</tr>
<tr>
<td>2009</td>
<td>8.1</td>
<td>29.4</td>
<td>23.4</td>
<td>39.1</td>
</tr>
<tr>
<td>2010</td>
<td>7.8</td>
<td>30.6</td>
<td>24.2</td>
<td>37.4</td>
</tr>
</tbody>
</table>

Structural transformation is ongoing…
Increasing diversity of Portuguese exports

Exports of manufacturing goods by type of goods

<table>
<thead>
<tr>
<th>Year</th>
<th>Textiles and textile articles</th>
<th>Machinery and mechanical appliances; electrical equipment</th>
<th>Footwear, headgear and other accessories</th>
<th>Vehicles, aircraft, vessels and associated transport equipment</th>
<th>Wood and articles of wood; cork; manufactures of straw</th>
<th>Pulp of wood or of other fibrous cellulosic material; paper</th>
<th>Mineral products</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>26</td>
<td>23</td>
<td>8</td>
<td>10</td>
<td>5</td>
<td>6</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>28</td>
<td>19</td>
<td>6</td>
<td>14</td>
<td>5</td>
<td>5</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>38</td>
<td>13</td>
<td>4</td>
<td>14</td>
<td>4</td>
<td>2</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>43</td>
<td>10</td>
<td>4</td>
<td>15</td>
<td>4</td>
<td>3</td>
<td>9</td>
<td></td>
</tr>
</tbody>
</table>

Source: INE
Structural transformation is ongoing…
Portugal as a competitive location for business in the euro area

Ease of Doing Business Rank (June 2011)
Country position in OECD ranking

Note: The rankings for all economies are benchmarked to June 2011
Source: World Bank and IFC; Doing Business 2012; October 2011
CONCLUSION: HOW WILL IT WORK?
Council of the European Union, 30 January 2012
Communication by euro area Member States

Today, we have taken major steps in the implementation of our overall strategy to fight the crisis:

1. The Treaty on stability, coordination and governance in the Economic and Monetary Union has been finalized. It will be signed in March. At the same time an arrangement will be decided about the procedure to be followed to bring to the Court of Justice a case of noncompliance with the Treaty.

   This represents a major step forward towards closer and irrevocable fiscal and economic integration and stronger governance in the euro area. It will significantly bolster the outlook for fiscal sustainability and euro area sovereign debt and enhance growth.

2. The Treaty establishing the European Stability Mechanism is ready for signature, and the objective is that it enters into force in July 2012. This permanent crisis mechanism will contribute to raising confidence, solidarity and financial stability in the euro area. It will have a wide range of tools available and a strong financial basis.

   As agreed in December, we will reassess in March the adequacy of resources under the EFSF and ESM.

3. Concerning Greece, we note progress made in the negotiations with the private sector to reach an agreement in line with the parameters agreed upon in October. We urge the Greek authorities and all parties involved to finalize negotiations on the new program in the coming days. Restoration of credibility requires that all political parties irrevocably commit to the new program. We urge our Finance Ministers to take all necessary steps for the implementation of the PSI agreement and the adoption of the new programme, including prior actions, well in time for the launching of the PSI operation by mid-February. We recall that PSI in Greece is an exceptional and unique case.

4. We welcome the latest positive reviews of the Irish and Portuguese programmes which concluded that quantitative performance criteria and structural benchmarks have been met. We will continue to provide support to countries under a programme until they have regained market access, provided they successfully implement their programmes.

5. We welcome the measures decided and already enacted by Italy and Spain to reduce the public deficit and boost growth and competitiveness and call on them to pursue their important efforts for fiscal consolidation and structural reforms. These reforms as well as their swift implementation will reinforce financial stability in Italy and Spain as well as the euro area as a whole.

Source: Council of the European Union
Dynamism of the private sector: a key issue to ensure the success of the program

In the last adjustment program (83-84), the private sector had a rapid response

Real growth rate
Percentage


Private consumption (residents) Public consumption GDP

In 2009, the private sector started the adjustment process (but …)

Borrowing Requirements by Institutional Sector
As a percentage of GDP

2004 2005 2006 2007 2008 2009 2010

Total economy Non-financial private sector Financial sector General Government

Source: Bank of Portugal