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Statement by the EC, ECB, and IMF on the Fourth Review Mission to Portugal

Brussels, 04 June 2012 - Staff teams from the European Commission (EC), European Central Bank (ECB), and International Monetary Fund (IMF) visited Lisbon during May 22-June 4 for the fourth quarterly review of Portugal's economic programme.

The programme remains on track amidst continued challenges. The authorities are implementing the reform policies broadly as planned and external adjustment is proceeding faster than expected. At the same time, rising unemployment has emerged as a pressing concern. The need to combine fiscal consolidation with deleveraging private balance sheets while restoring external cost competitiveness remains a difficult balancing act. But the authorities are determined to stay the course of adjustment and reform. Broad-based political support and social consensus is a key contribution to a successful adjustment.

Growth in 2012 may hold up better than expected. The rebalancing of the economy has continued, with stronger-than-expected exports more than offsetting weaker domestic demand. GDP in 2012 is now expected to decline by 3 percent (against 3¼ percent before). Positive albeit still subdued growth is expected in 2013. However, with domestic demand weak and pressures on firms to reduce high indebtedness, unemployment has increased sharply as part of the adjustment process, and could peak at close to 16 percent in 2013. Continued tensions in the euro area represent a risk clouding the external outlook.

The ambitious 2012 fiscal deficit target remains within reach. Notwithstanding the weaker labour market and a less tax-friendly growth composition, the authorities expect to achieve the deficit target of 4.5 percent of GDP. As during the third review, new fiscal measures were not discussed, but developments warrant close monitoring to detect potential slippages in a timely manner. The strategy to prevent new and to settle existing arrears is being implemented and regional and local governments under financial stress receive additional support, on the condition of enhancing their own consolidation efforts. Reforms of state-owned enterprises and public-private partnerships are on track. Efforts to strengthen public financial management, bolster tax compliance, and streamline public administration are continuing at good pace.

Protecting the banking system and ensuring orderly deleveraging remain among the programme priorities. Liquidity in the banking system continues to benefit from exceptional support from the Eurosystem. The authorities are finalising efforts to ensure that mid-year targets for banks' capital buffers will be met. Further progress has also been made in strengthening the banking supervision and resolution frameworks. Tight credit conditions remain a concern and a range of measures is in train to ensure that sound companies, particularly in the tradable sectors, can fund their activities.

Progress is being made on reforms to raise long-term growth. Although product market reforms could still be stepped up in some areas, the programme's structural reform agenda will create the conditions for sustainable growth in productive jobs over the medium term. Reforms are in progress as regards removing rigidities in the housing market, privatising state companies, making the ports more competitive, and increasing the efficiency of the judicial system. Examples of reforms already legislated include the competition law, the insolvency code, and the urban lease law. Some progress has also been made in reducing the undue burden on consumers and taxpayers by increasing competition and reducing rents in the network and sheltered services sectors, including in the electricity sector. Nevertheless, more determination is needed to push through reforms that touch on sensitive political and vested interests.

The surge in unemployment requires decisive policy action. Temporarily higher unemployment is part of the transition to a more export-oriented economy, but its rise has been exacerbated by Portugal's long-standing labour market rigidities. The recent approval of the revised Labour Code should attenuate job losses. The broader structural reform agenda and rising capacity utilization in the export sector should help employment recover in the medium term. Nevertheless, further action to improve the functioning of the labour market is urgent. This includes institutional reforms that give firms more flexibility in matching labour costs and productivity. The exceptionally high unemployment, particularly among the young, also calls for more immediate measures, including active labour market policies. We also welcome the government's initiative to consider, in the context of the budget 2013, ways to reduce social security contributions targeting specific segments of the labour force.

Overall, this review confirms that the programme is making good progress amid continued strong external support. Provided that the authorities persevere with strict programme implementation, the euro area Member States have declared they stand ready to support Portugal until market access is regained. The efforts of the Portuguese authorities are being complemented by a strengthened EU economic policy framework and new EU initiatives to support growth and employment in Portugal, and in Europe as a whole.

The government's programme is supported by loans from the European Union amounting to €52 billion and a €26 billion Extended Fund Facility with the IMF. Approval of the conclusion of this review will allow the disbursement of €4.1 billion (€2.7 billion by the EU, and €1.4 billion by the IMF). These disbursements could take place in July subject to the approval of the IMF Executive Board and ECOFIN and EUROGROUP. The joint mission for the next programme review is expected to take place in September 2012.

http://ec.europa.eu/economy_finance/articles/financial_operations/2012-06-04-portugal_pt.htm