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

Staff teams from the European Commission (EC), European Central Bank (ECB), and International Monetary Fund (IMF) visited Lisbon during September 16-October 3 for the combined eighth and ninth quarterly reviews of Portugal's economic adjustment program.

There are early signs of a recovery in economic activity. Economic activity is now projected to contract by 1.8 percent in 2013—an upward revision of 0.5 percentage points—before expanding by 0.8 percent in 2014. Unemployment is expected to remain below 18 percent next year and significant external adjustment is ongoing, with Portugal gaining export market share for the third year in a row.

The program's 2013 fiscal deficit target of 5.5 percent of GDP is within reach. Budget execution has been supported by solid revenue performance and improved expenditure control, while underperformance in some parts of the budget is being addressed. Public sector reforms continue to strengthen financial management, fight tax evasion, restructure state enterprises, and reduce costs of public-private partnerships.

The authorities have reaffirmed their commitment to the 4 percent of GDP deficit target for 2014. Reflecting a thorough assessment of the balance between the necessary fiscal adjustment, economic growth, and financing prospects, it was agreed to reaffirm the fiscal deficit target as revised in the 7th review. To reduce the excessive weight of the public sector in the economy, the key consolidation measures to be proposed in the draft Budget for 2014 will rightly aim at rationalizing and modernizing public administration, improving the sustainability of the pension system, and achieving cost savings across ministries. A rigorous implementation of the draft Budget for 2014 will be a decisive step toward respect of the Treaty on Stability, Coordination and Governance (the Fiscal Compact). In the event that some of the measures were determined to be unconstitutional, the government would need to reformulate the draft Budget in order to meet the agreed deficit target. This, however, would imply increasing risks to growth and employment and would reduce the prospects for a sustained return to financial markets.

While banks' buffers are adequate, the operating environment remains challenging.

Banks' solvency has been further strengthened following some additional recapitalisation efforts, while liquidity conditions are gradually improving amid ongoing, and necessary, deleveraging of balance sheets. Nevertheless, profitability remains weak, calling for enhanced and sustained vigilance by the Banco de Portugal and ongoing efforts to improve its supervisory and resolution frameworks. Credit conditions remain challenging, although with recent improvements for the export-oriented sectors. Measures to ensure adequate funding for viable small- and medium-sized companies are being implemented, including initiatives to encourage the diversification of financing sources.

The program's agenda of structural reforms is well advanced, and effective

implementation will be key to sustaining competitiveness gains. Important progress has been made in the areas of labor markets, judicial reforms, reforms of network industries, and regulated professions, with some initial evidence of an impact on the functioning of the economy. A blueprint for a comprehensive reform of corporate income tax has also been prepared, but implementation would need to respect fiscal consolidation targets. Progress is being made, although with some delays, in the reduction of barriers to doing business via easing of administrative burdens and licensing procedures. The authorities are also committed to explore the scope for new initiatives, which will be especially important in view of the need to foster competitiveness and job creation.

The program remains broadly on track, with the authorities determined to achieve its objectives.

Over the summer, sovereign yields reversed earlier gains, amid market concerns about the predictability of policymaking following short-lived political turbulence and Constitutional Court rulings that blocked key policy measures. Public debt remains sustainable; it is now expected to peak at 127.8 percent in 2013 and to decline thereafter. Resolute program implementation and reaffirmed ownership will support the government's return to full market financing. Provided the authorities persevere with steadfast program implementation, euro area member states have declared they stand ready to support Portugal until full market access is regained. Portugal's culture of political and social dialogue remains an important asset to the program.

Portugal's economic adjustment program is supported by loans from the European Union amounting to €52 billion and a €26 billion Extended Fund Facility with the IMF. The conclusion of the 8th and 9th reviews could take place in November, subject to the approval of ECOFIN and EUROGROUP and of the IMF Executive Board. This would allow for the disbursement of €5.6 billion (€3.7 billion by the EU, and about €1.9 billion by the IMF) following the approval of the current reviews. The joint mission for the next program review is expected to take place in November 2013.