# Towards Stability and Growth in the Portuguese Economy

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## Outline

I. The seeds of the Portuguese crisis (1995-2010)

II. The global crisis and the closure of markets (2007-11)

III. The Economic Adjustment Programme (2011-14)

IV. Looking beyond 2014

# The Portuguese crisis: A tale of…

## *2 Shocks*

- Monetary and financial integration
- EU enlargement and globalization

## *2 Policy mistakes*

- Imprudent fiscal behaviour
- No macroprudential policy

## *2 Ilusions / misperceptions*

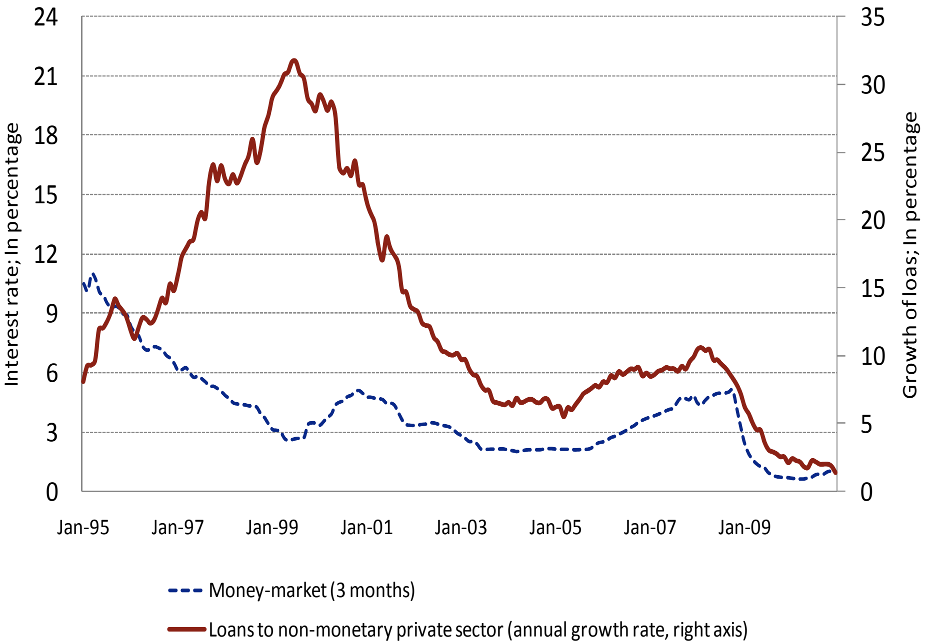
- The CA doesn’t matter
- The EMU governance model

# I. The seeds of the Portuguese crisis (1995-2010)

## Shock 1: Monetary and financial integration

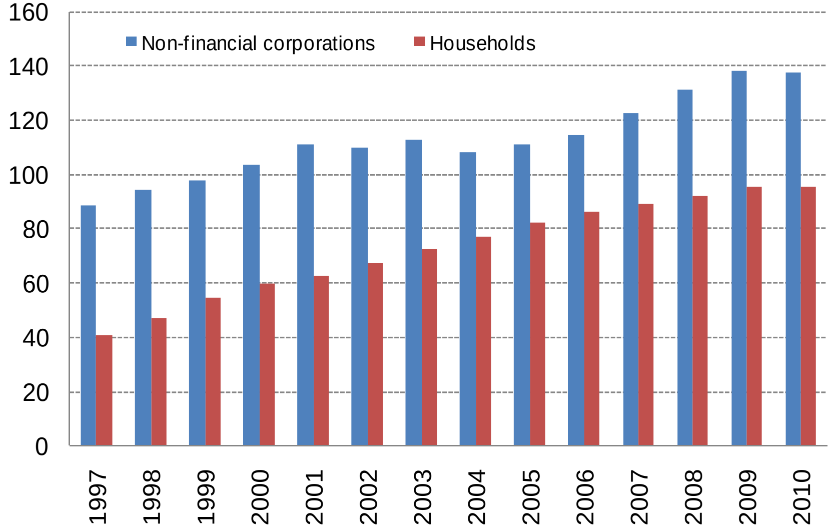
### *EMU enlarged the financing possibilities of domestic agents*

**Interest rate and loans to the private sector**




Sources: ECB and Banco de Portugal.

Indebtness of the non-financial private sector
(% of GDP)




Sources: INE (Statistics Portugal) and Banco de Portugal.

# Shock 1: Monetary and financial integration

## *Higher spending not matched by higher income*

**Portugal - Composition of Expenditure**

(average rate of real growth)

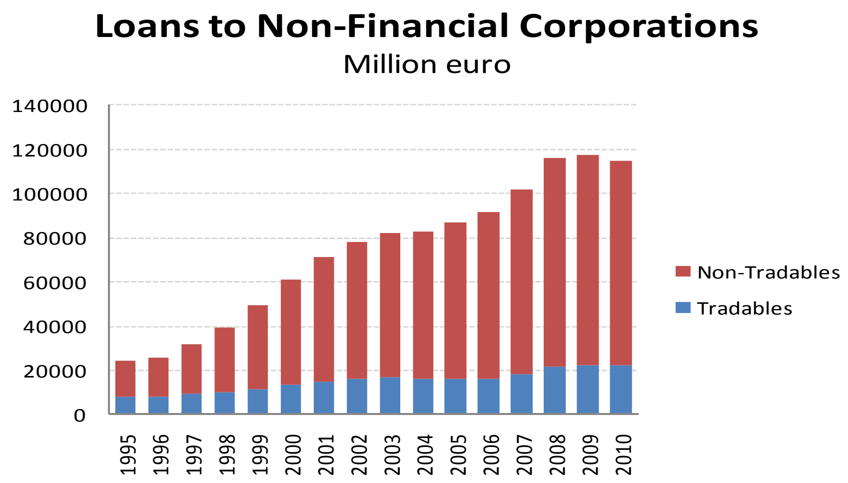
| | GDP | Private consumption | Public consumption | GFCF | Exports | Imports | *p.m. EA12 GDP* |
|---|---|---|---|---|---|---|---|
| **1996-2010** | 1,9 | 2,3 | 2,4 | 1,1 | 4,3 | 4,3 | *1,7* |
| **1999-2010** | 1,2 | 1,9 | 2,1 | -1,3 | 3,5 | 2,8 | *1,5* |
| **1996-2001** | 3,8 | 3,8 | 3,9 | 7,0 | 6,2 | 7,8 | *2,6* |
| **2002-2007** | 1,0 | 1,6 | 1,3 | -1,6 | 5,0 | 3,6 | *1,1* |
| **2008-2010** | -0,4 | 0,8 | 1,7 | -5,5 | -1,0 | -1,1 | *-0,7* |

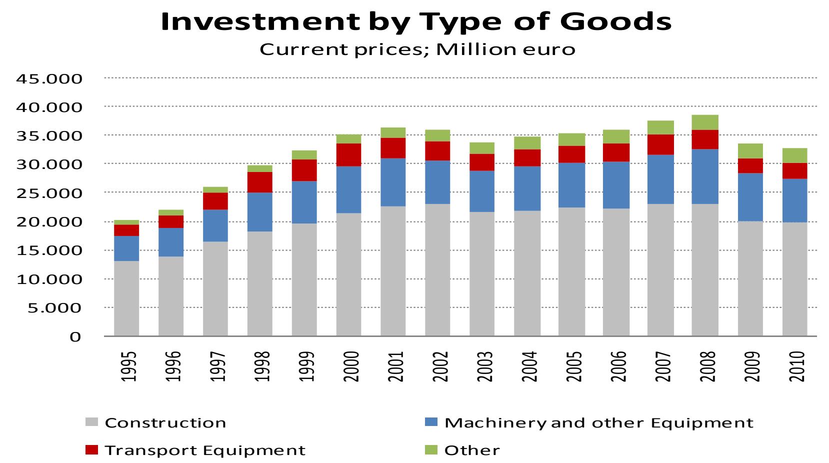
Source: INE and AMECO.

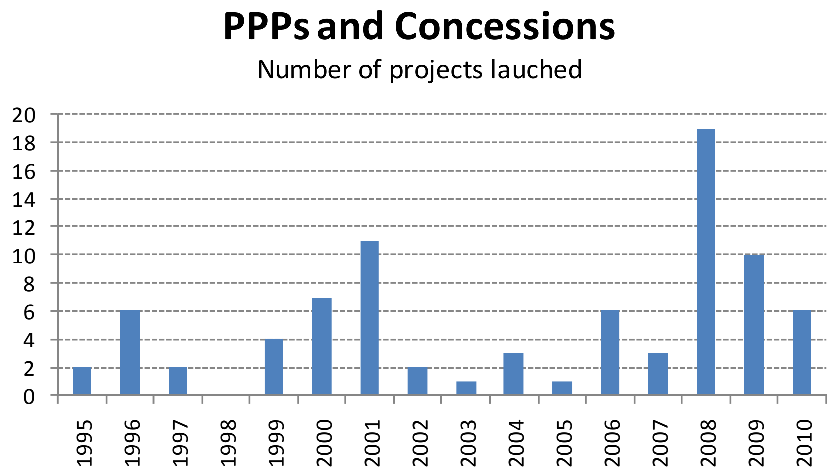
## *Unfavourable expenditure composition*

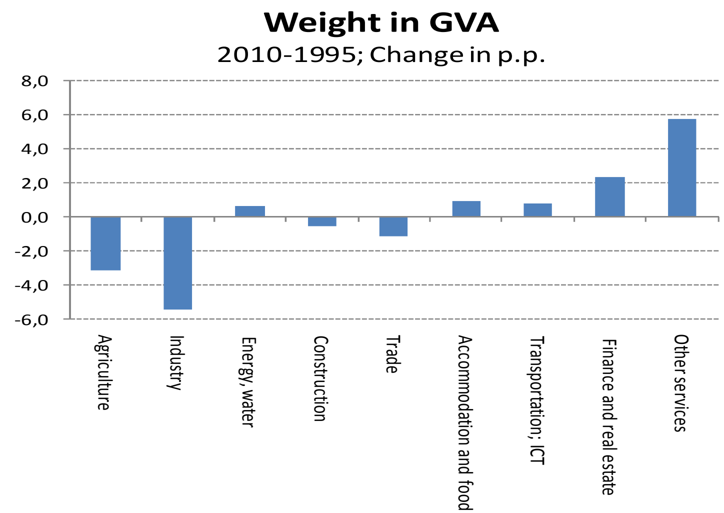
# Shock 1: Monetary and financial integration

## *A growing weight of the non-tradable sector…*



# Shock 2: EU enlargement and globalisation

## *Lower productivity and wage pressures hurt competitiveness*

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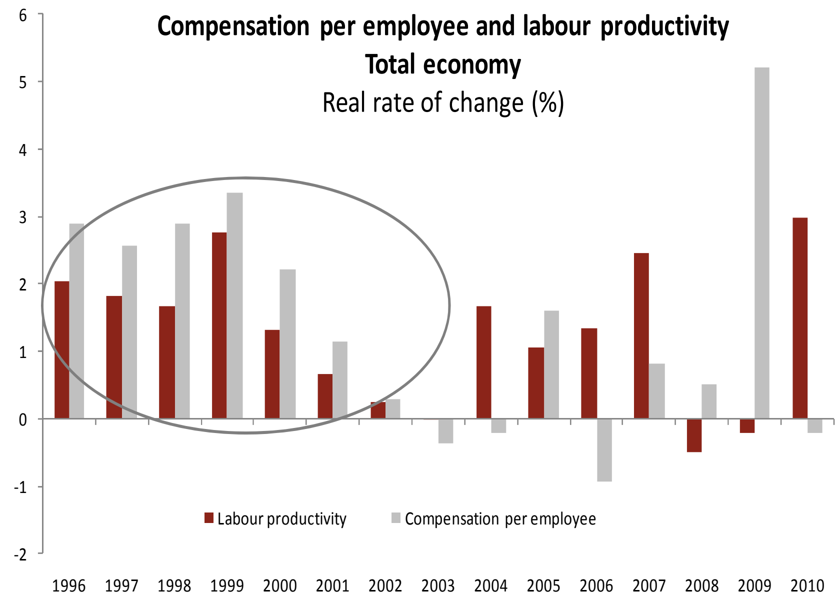
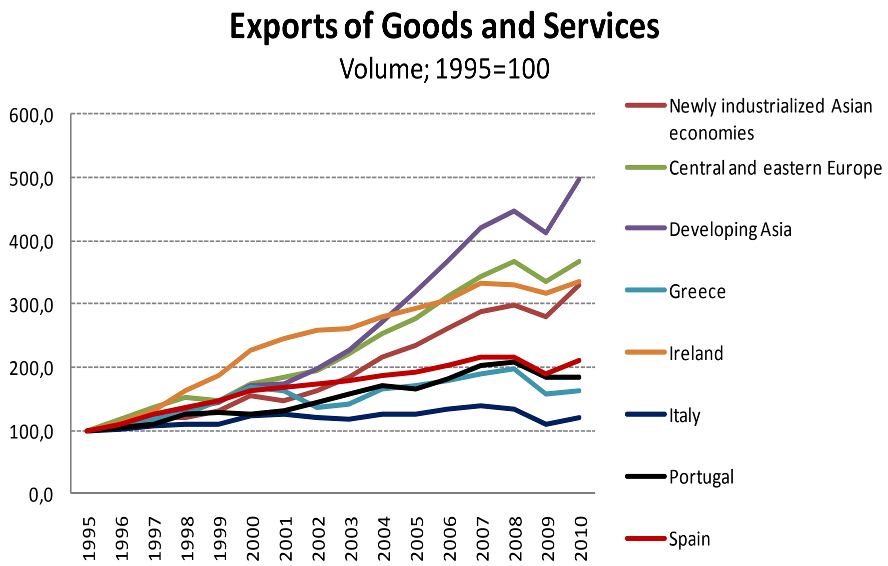
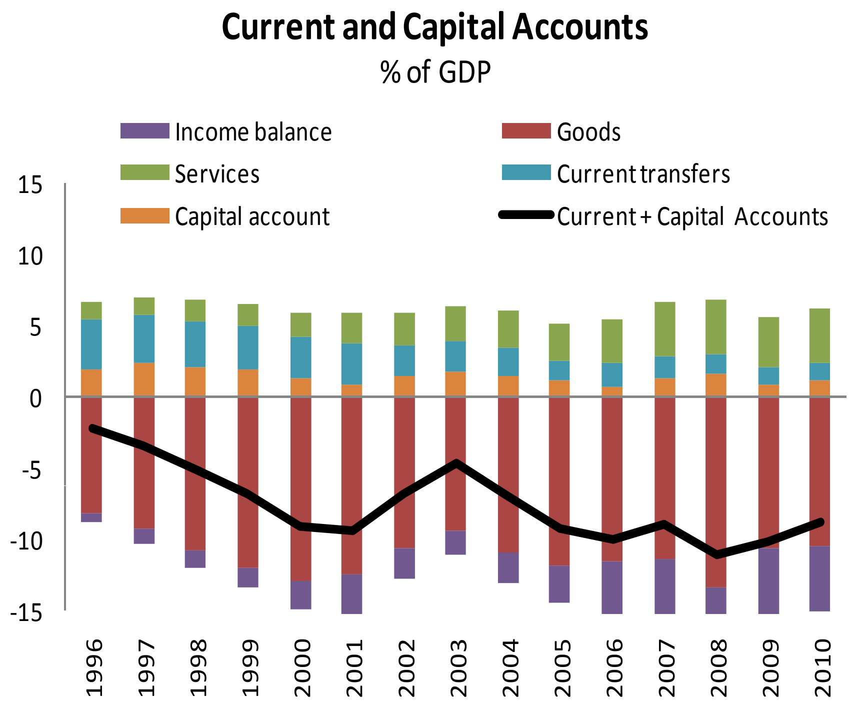


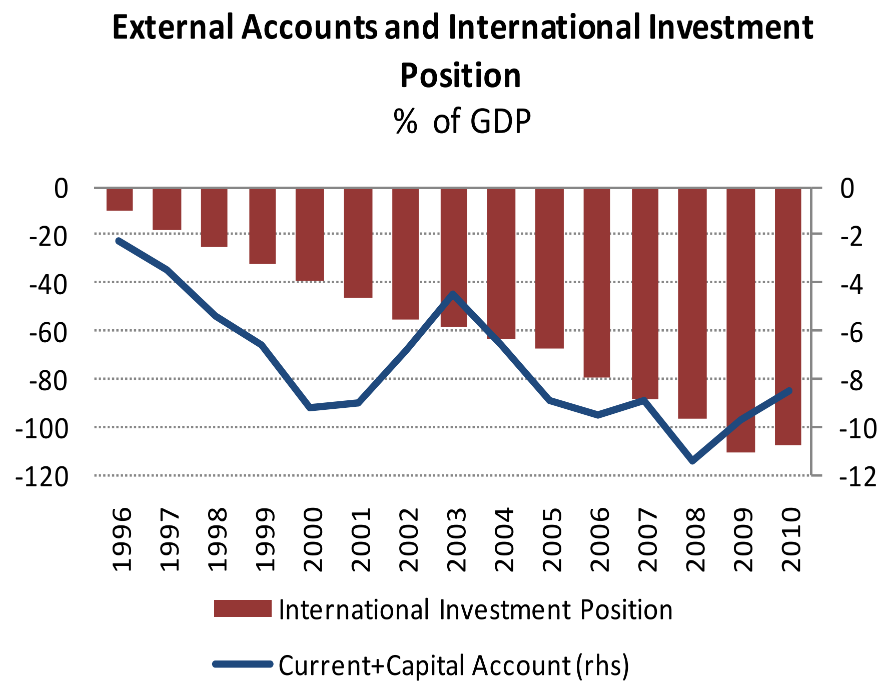

Sources: INE and Banco de Portugal.

## *Impact compounded by EU enlargement and globalisation*



# Shocks 1+2: Persistent CA deficit and increasing external debt



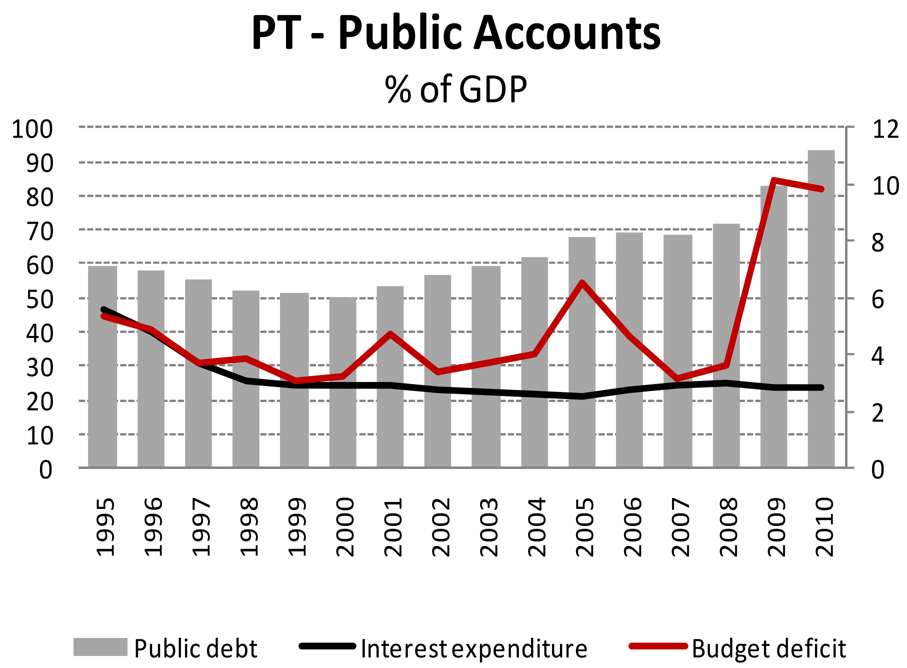
## Two policy mistakes …

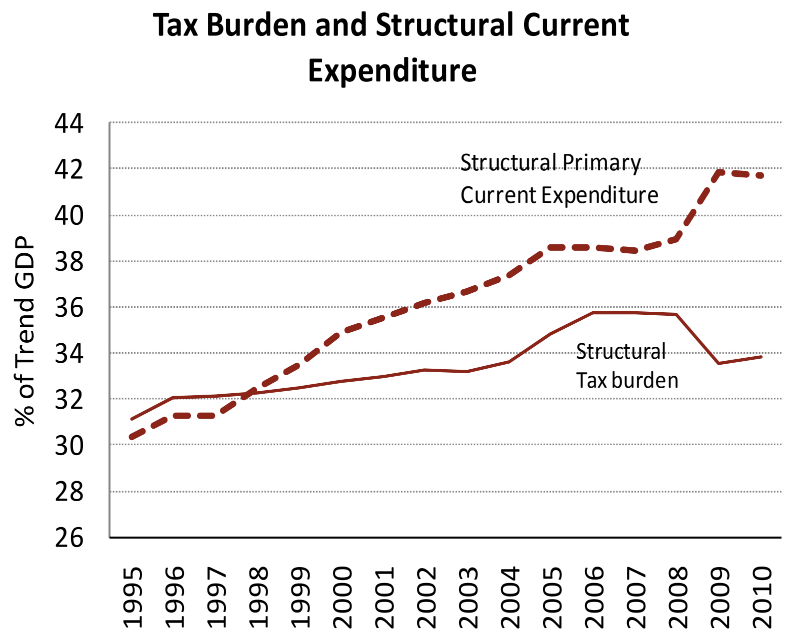
***Imprudent fiscal policy***

***No macroprudential oversight***

## Policy mistake 1

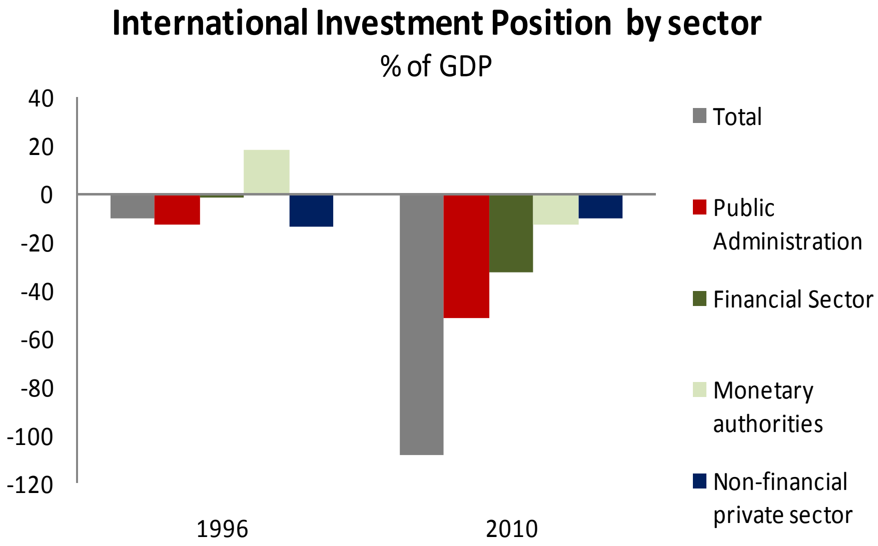
### *Imprudent fiscal policies led to unsustainable public finances*

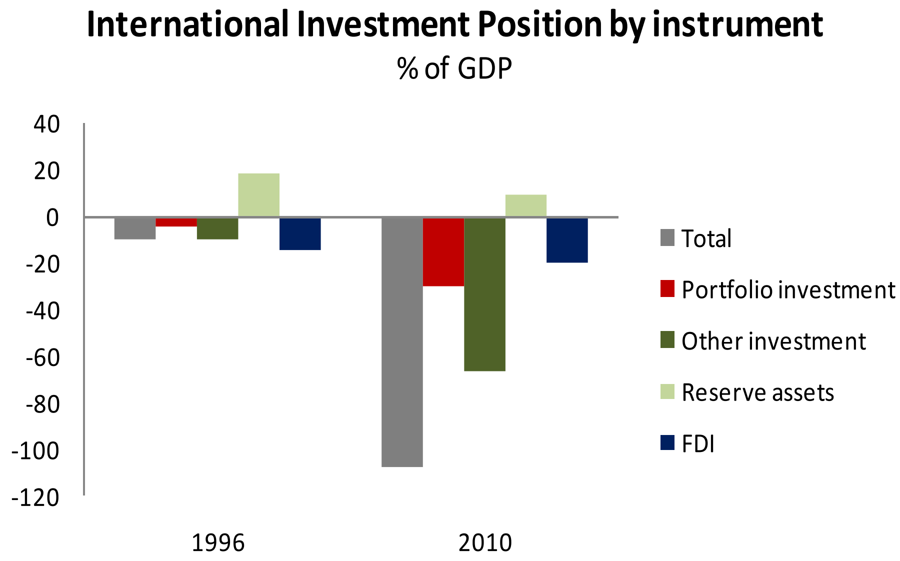


# Policy mistake 2

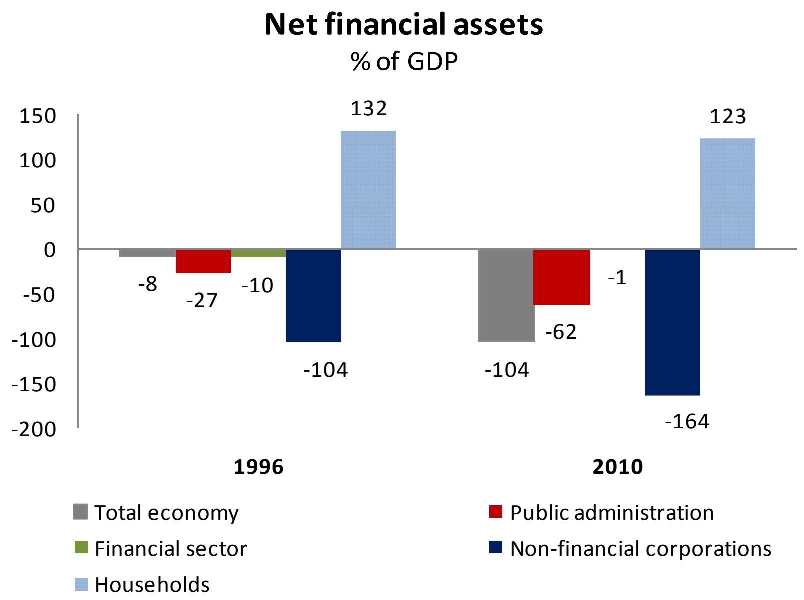
## *No macroprudential policy*

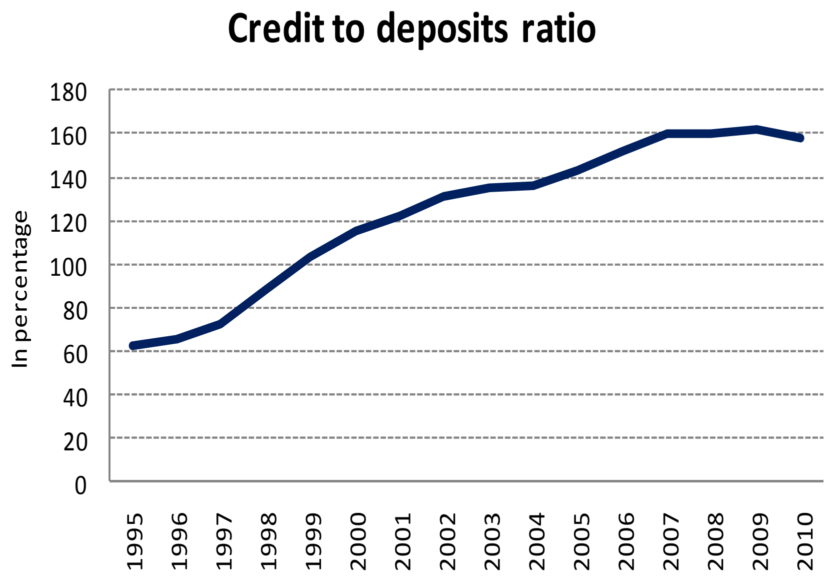


# Policy mistake 2

## *No macroprudential policy*



# I. The seeds of the Portuguese Crisis (1995-2010)

## Two ilusions / misperceptions …

### *Current account deficits don't matter*

*"The fact that both Portugal and Greece are members of both the European Union and the euro area … and the fact that they are the two poorest members of both areas, suggest a* ***natural explanation for today's current account deficits****. …"*

Blanchard, O. and F. Giavazzi (2002), "*Current account deficits in the euro area: The end of the Feldstein-Horioka Puzzle?*"

## Two ilusions / misperceptions …

### *The EMU governance model*

- Fiscal sovereignty
- No default
- No bail-out
- No exit

# The outcome

## *Unsustainable financial position and allocation of resources*

### Financial imbalances

- High public and private indebtdeness
- Excess banking sector leverage
- Growing external deficits and debt

### Real imbalances

- Growing demand-supply gap
- Lower productivity / trend GDP growth
- Excessive weight of non-tradables in terms of GVA and employment

## Policy mistake 1 – take 2:

### *Huge fiscal expansion in 2007-2010*

**Fiscal indicators 2007-2010**

% of GDP

| | 2007 | 2008 | 2009 | 2010 | Change 2010-2007 |
|---|---|---|---|---|---|
| **Total balance** | -3,1 | -3,6 | -10,2 | -9,8 | -6,7 |
| **Structural balance** | -4,3 | -6,2 | -11 | -13,2 | -8,9 |
| **Structural primary balance** | -1,4 | -3,2 | -8,2 | -10,3 | -8,9 |
| **Public debt** | 68,3 | 71,6 | 83,1 | 93,3 | 25 |

Source: INE and Banco de Portugal.

- *Success in stabilising the economy was short-lived*
- *Not timely-targeted-temporary*
- *Risk of refinancing grossly underestimated*

### *Macroeconomic imbalances came to the spotlight in the context of the global economic and financial crisis*

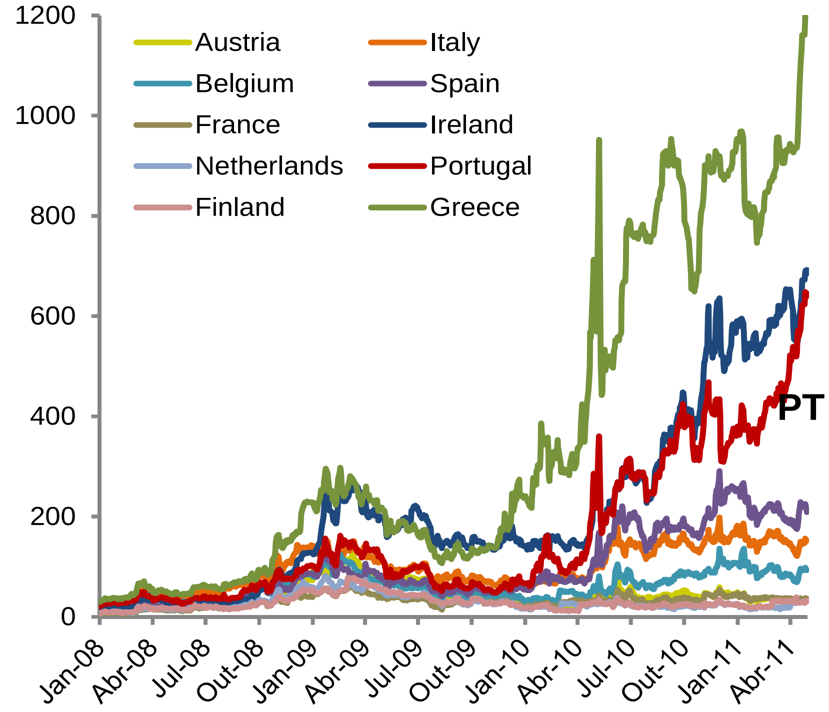
**Unsustainable public finances**

**Over-indebtedness and excessive bank leverage**

**Anemic economic growth and low productivity**

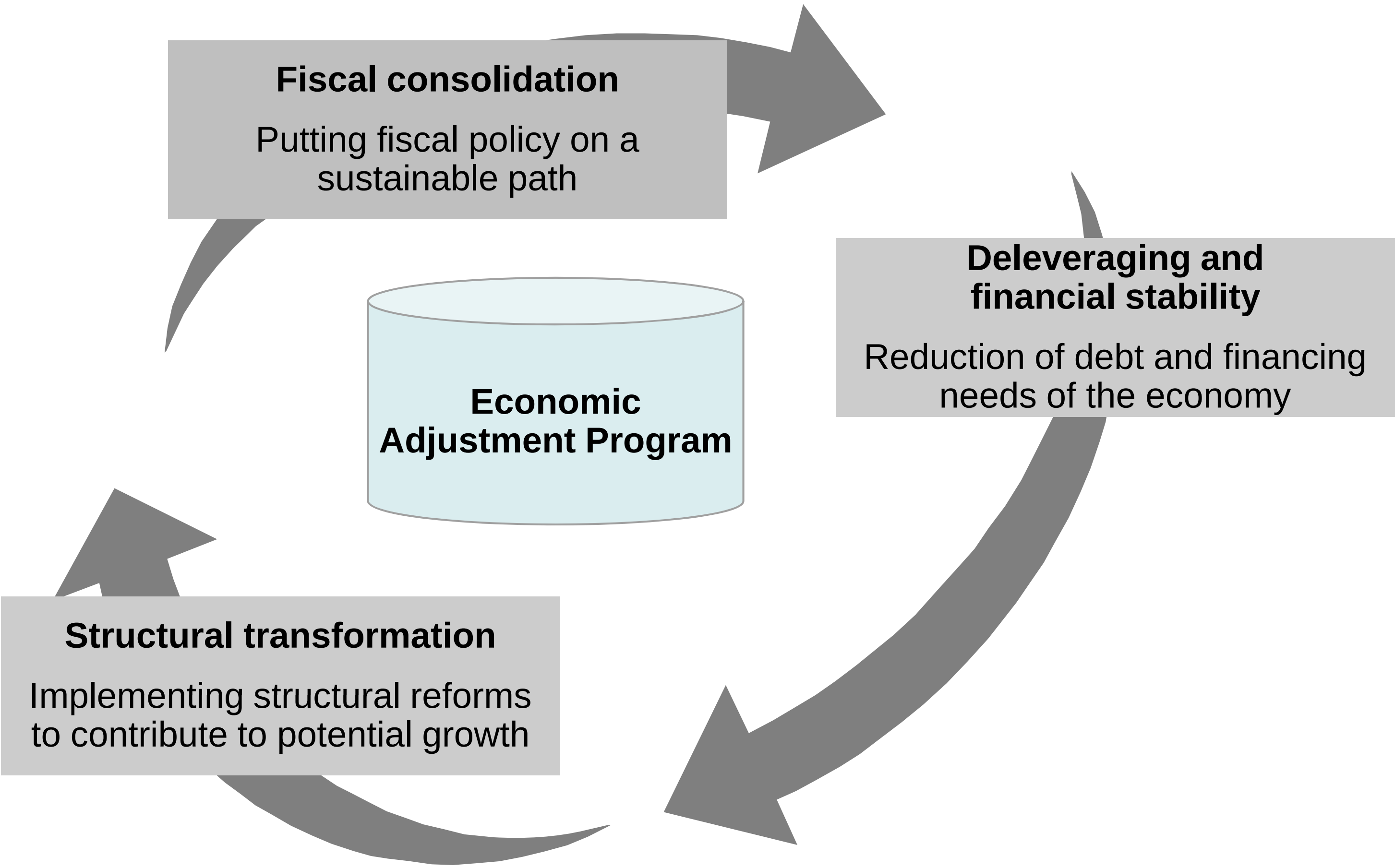
Markets question the ability of Portugal to repay its debts

**10-year Government bond yields**
Spread against Germany in basis points




Source: Bloomberg

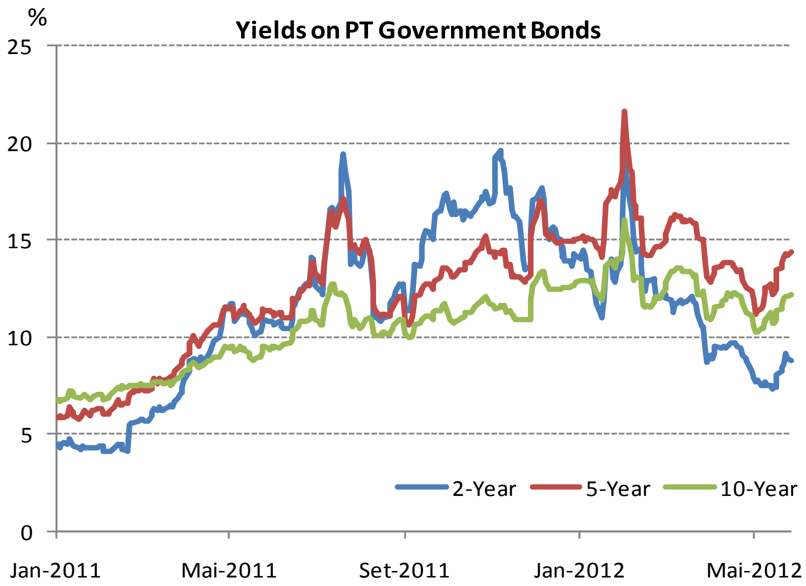
## *Addressing the challenges of the Portuguese economy: A strategy for sustainable growth in the euro area*

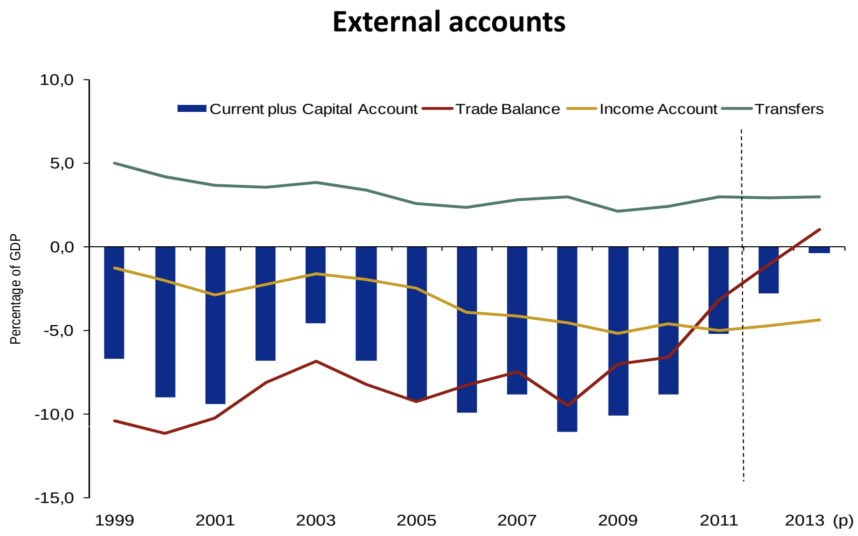



The Economic Adjustment Program **protects the financing of the economy** from market pressure, allowing an **orderly adjustment of imbalances** and **time to restore credibility.**

## *Portugal is delivering on all fronts…*

- Banks more capitalized and less leveraged
- Significant structural adjustment of public accounts
- Structural reforms under way:
  - ✓ Fiscal framework
  - ✓ Privatization
  - ✓ Labour market
  - ✓ Utilities
  - ✓ Justice
  - ✓ Housing market




Sources: INE (Statistics Portugal) and Banco de Portugal.

# The near term challenges…

- ***Keep momentum on program implementation***
  - Reform design and enforcement are key
- ***Key concerns***
  - Labour market developments
  - Financing of the economy
- ***Return to markets in Sep 2013***
  - Depends also on EU institutional developments
  - Precautionary / contingent mechanism needed

# The longer-term challenge

***How to turn the PT economy na attractive location to invest and work?***

- Debt levels will remain high
- Consolidating a new economic model
- Re-balancing resource allocation
- An investment-friendly institutional framework
  - The State as a referee not a player
  - Highly qualified public administration
  - Stable tax system
  - Efficient labour market: flexibility and “safety nets”

## Any comments / questions welcome!