Conclusion of EFSF financial assistance programme for Portugal: an overview

18 May 2014
Portugal’s clean exit results from adequate crisis response

- Three years of sound policies and international support have laid the foundation for a correction of external and fiscal imbalances that is supporting a more sustainable economic recovery.
- The fiscal deficit has been significantly reduced.
- Wide-ranging structural reforms have improved Portugal’s competitiveness, boosting exports and correcting the chronic external deficit.
- Portugal’s renewed credibility is confirmed by market participants through low financing costs.

Yield on 10-year Portuguese government bond

Unit: %
Source: Datastream
The origins of Portugal’s crisis

- **Low GDP and productivity growth** for over a decade before the crisis started
- **Weak competitiveness** due to decreasing productivity and structural inefficiencies
- **High external indebtedness**, leading to growing household and corporate debt
- **Public debt had been steadily increasing** with high structural budget deficits
- The **banking sector** was increasingly cut off from **international market funding**
- Concerns over **fiscal sustainability** pushed up sovereign spreads with access to markets gradually becoming restricted
Financial assistance

- Portuguese authorities requested assistance from the EU and IMF in April 2011
- Reform package agreed in May 2011 by Eurogroup/ECOFIN
- Total financial assistance programme of €78 billion

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<th>EFSF</th>
<th>European Commission (EFSM)</th>
<th>IMF</th>
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<td>€ billion</td>
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Financial assistance provided by the EFSF

- The EFSF disbursed a total of **€26 billion** from June 2011 to April 2014
- **Repayment** of loan principal by Portugal starts in 2025, ends in 2040
- **Average maturity of** loan tranches was initially nearly 14 years
- In April 2013 the Eurogroup decided to **extend** the average maturity by up to 7 years

Source: EFSF
Key objectives of macroeconomic adjustment programme

- A fiscal consolidation strategy consisting of revenue-raising and expenditure reducing measures
- Stabilisation of the financial sector: strengthening banks’ liquidity and capital, deleveraging, reinforcement of the supervisory and regulatory framework
- In-depth structural reforms to address external and internal imbalances and to raise potential growth (measures include labour market reforms, liberalisation of services, scaling down of direct involvement of government in the economy)
Programme conclusion: ‘clean’ exit

- **12 successful reviews** by European Commission, ECB and IMF
- Troika findings during 12th review (April/May 2014) confirm **achievements**
  - Economic recovery is broadening; GDP growth of 1.2% in 2014 and 1.5% in 2015 is predicted
  - Budget deficit targets of 4% in 2014 and 2.5% in 2015 have been reaffirmed
  - Current account surplus of 0.4% in 2013 was Portugal’s first in 20 years
  - Capitalisation of banks has been significantly strengthened
  - Long-term sovereign bonds yields have fallen to 3.6%
  - Portugal was able to build a comfortable cash buffer

- Decision of ‘**clean’ exit** supported by the Eurogroup and troika institutions
Fiscal adjustment helped to improve credibility

- **Budget deficit declined from 10% of GDP in 2010 to 4.9% of GDP in 2013.** According to the most recent forecasts, Portugal should reach a primary surplus in 2014.

- **Government debt is expected to decline** after increasing at a slower pace due to smaller budget deficits.

- **Fiscal adjustment should continue** in line with the commitments affirmed by the Portuguese authorities.

**Budget balance (% of GDP)**

**Government debt (% of GDP)**

*Source: European Commission*

*Source: Ministry of Finance*
A remarkable external adjustment

- Portugal’s chronic current account deficit **turned into a surplus**, for the first time in 20 years …
- … on the back of a **strong performance of exports**, due to an **improvement in competitiveness** that resulted from the implementation of sound structural reforms

*Source: Bundesbank, Banco de Espana, Banca d’Italia and central statistical offices*
Back to growth

- **GDP expanded in three of the last four quarters** on the back of an improvement in domestic demand in tandem with a continuing increase in exports. Still, GDP contracted in Q1 2014 mostly due to a decline in exports.

- **GDP growth is expected to be positive on annual terms**: it should expand by 1.2% in 2014 and 1.5% in 2015. The unemployment rate started to decline but remains high.

- The effects of **structural reforms** should continue to improve potential GDP growth.

![GDP growth (% QoQ & % YoY)](source: INE)

![GDP growth (% y/y)](source: European Commission, IMF)
Banking sector developments

- **During the program 4 banks were recapitalised**: CT1 capital ratios are currently well above the Banco de Portugal’s (BdP) requirement of 10%. Regulatory Tier 1 Capital ratio for the sector as a whole at 12% (2013Q3). The Bank Solvency Support Facility still has € 6.4 billion at its disposal in case of need.

- **Strong deleveraging took place**: for the 4 major banks: -8.2% in total assets (2009-2013)

*Graph showing Regulatory Tier 1 Capital (%) in whole banking sector from 2008 to 2013 Q3.*
Next steps: Post-programme surveillance

- Euro area Member States exiting financial assistance fall under post-programme surveillance (based on EU’s Two-Pack Regulation).
- These countries will remain subject to enhanced surveillance until they have paid back a minimum of 75% of the assistance received.
- Post-programme missions will be carried out twice a year by the European Commission with the ECB, IMF and the ESM.
- The ESM/EFSF will conduct its Early Warning System (EWS) until the end of the repayment of the loans, joining the European Commission in its missions.
Summary: The program was concluded but challenges remain

- Portugal’s fiscal consolidation efforts and structural reforms have assured a successful return to funding in financial markets.

- The example of Portugal confirms the experience of other euro area countries: financial assistance combined with the implementation of necessary policy reforms is effective and allows countries to restart economic growth and resume market financing.

- Challenges remain beyond the end of the program: high private and public debt/GDP ratio mean that deleveraging will continue.

- Reform efforts must continue - both fiscal and structural – to allow for a continuing reduction of the fiscal deficit and improve potential GDP growth.
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