EUROPEAN COMMISSION

MEMO

Brussels, 2 May 2014

Statement by the European Commission, ECB, and IMF on the Twelfth Review Mission to Portugal

Staff teams from the European Commission, European Central Bank (ECB), and International Monetary Fund (IMF) visited Lisbon from 22 April to 2 May for the 12th and final review of Portugal's economic adjustment programme. Discussion with the authorities also focused on the remaining challenges after the end of the programme.

The economic recovery is broadening. Exports continue to drive economic growth, while private investment and consumption have also started to pick up. Unemployment is expected to decline further, in line with the moderate economic recovery expected in 2014 and 2015.

The budget deficit targets of 4 percent in 2014 and 2.5 percent in 2015 have been reaffirmed. The deficit target in 2013 was reached by a comfortable margin and budget performance in the first months of this year was better than expected. However, there are important downside risks to the budget, related to continuing legal challenges which contribute to the pressures for the substitution of higher quality measures with measures of lower certainty and quality. Fiscal accounts may also be impacted by possible changes in the treatment of deferred tax assets which are still under consideration and by the statistical treatment of efforts to more efficiently manage the debt overhang of some state-owned enterprises. The Government has presented its medium-term fiscal strategy until 2018, complying with commitments under the programme.

The stabilisation of the banking sector has continued, but financing conditions in the economy remain difficult.* Bank capitalisation has been significantly strengthened during the programme and dedicated resources remain available to support the banking system, in compliance with EU state-aid rules, should additional capital needs arise. Market liquidity conditions have also continued to improve. The trend in non-performing loans has stabilised, although operating conditions for banks remain challenging. Access to bank credit at reasonable cost is still constrained for viable but highly indebted companies, notably for small and medium-sized enterprises.

Portugal's access to sovereign debt markets has improved markedly amid robust investor demand and sharply declining yields. This reflects domestic economic developments, in the context of a broader market rally across the region. Portugal has used these improved market conditions to conduct a number of successful bond exchanges and issuances, smoothing the profile for future debt payments and building a substantial cash buffer.

The programme remains on track to be concluded, following the completion of this final review. The programme has put the Portuguese economy on a path towards sound public finances, financial stability and competitiveness. This is the outcome of solid programme implementation which at times has implied unavoidable sacrifices by the Portuguese people. During the past three years, the external current account has moved from a substantial deficit into surplus, the budget deficit has been more than halved, and public debt sustainability has been maintained. There have been ambitious reforms across all the main sectors of the economy. The regulatory framework has been reinforced with a view to making product markets and network industries more efficient and ensuring that they translate into better economic performance based on increased competitiveness. Measures have also been taken to improve labour market flexibility.

However, making the economy more dynamic, flexible and resilient is an ongoing challenge. Persisting problems in the structure and functioning of markets reduce the economy's flexibility in responding to adverse shocks. A more dynamic labour market and robust growth are needed to reduce the still very high level of unemployment. Weak competition in some parts of the economy prevents stronger gains in productivity and competitiveness. High levels of indebtedness in the economy, combined with continued high financing costs in a low-inflation environment, underscore the need for decisive measures to reduce corporate debt and associated risk premia.

With the programme ending, it will be essential that Portugal commits to sound economic policies for the medium term. The currently favourable economic and financial conditions should not lead to complacency. Building on the social consensus and resilience demonstrated by the Portuguese people during the programme, it would be appropriate that all actors in the society agree on the broad contours of a strategy to strengthen the economy's prospects for self-sustaining growth and prosperity. This will require a decisive break with the past and a commitment to profound and lasting change.

Portugal's economic adjustment programme 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 12th review could take place in June, subject to the approval of the ECOFIN Council and of the IMF Executive Board. This would allow for the disbursement of €2.6 billion (€1.7 billion by the EU, and about €0.9 billion by the IMF) following the approval of the current review.

*The mission findings on the Portuguese banking sector are independent from and therefore do not prejudge the outcome of the on-going ECB Comprehensive Assessment.

Contacts :

Simon O'Connor (+32 2 296 73 59)

Vandna Kalia (+32 2 299 58 24)

Audrey Augier (+32 2 297 16 07)

For the public: **Europe Direct** by phone **00 800 6 7 8 9 10 11** or by e-mail