MEMO/12/142

Brussels, 28 February 2012

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

Brussels, 28 February 2012 - Staff teams from the European Commission (EC), European Central Bank (ECB), and International Monetary Fund (IMF) visited Lisbon during February 15-27 for the third quarterly review of Portugal's economic programme.

The programme is on track, but challenges remain. Policies are generally being implemented as planned, and economic adjustment is underway. In particular, the large fiscal correction in 2011 and the strong 2012 budget have bolstered the credibility of Portugal's front-loaded fiscal consolidation strategy. Financial sector reforms and deleveraging efforts are advancing, while steps are taken to ensure that credit needs of companies with sound growth prospects are met. Reforms to increase competitiveness, growth, and jobs have also progressed, although many reforms still await full implementation. The broad political and social consensus that is underpinning the programme is a key asset.

Looking ahead, the Portuguese economy will continue to face headwinds. In 2012, trading partner import growth is expected to weaken further, while domestic demand adjusts, and unemployment and bankruptcies are rising. As a result, GDP in 2012 is expected to decline by 3¼ percent, following a fall of 1½ percent in 2011. In 2013, a slow recovery should take hold, mainly supported by private investment and exports. External adjustment is proceeding.

The fiscal deficit target for 2012 remains within reach. The deficit target of 4.5 percent of GDP is expected to be met with current policies, provided that downside risks to the economic outlook do not materialise. To contain fiscal risks, the government needs to strengthen measures to prevent arrears accumulation and implement a strategy to settle existing arrears. The government has also agreed an adjustment programme with the autonomous region of Madeira and will continue to reform state-owned enterprises, further strengthen tax administration, and streamline public administration.

Further progress on protecting the banking system and ensuring orderly deleveraging has been made. The rules for providing public capital to banks have been clarified, and plans to ensure that capital buffers of individual banks meet end-June 2012 targets are being finalised. Given the recent monetary policy decisions by the ECB, banks' liquidity constraints are expected to ease further. Furthermore, the authorities are considering a range of measures to mitigate funding strains for sound companies, including appropriate measures to discourage ever-greening of doubtful loans. Any such steps should avoid risks on public finances. Developments will be kept under close review to ensure that the inevitable deleveraging does not deprive dynamic enterprises of credit.

A number of promising growth-enhancing structural reforms are falling in place. The recent tri-partite agreement on labour market reforms underscores Portugal's ability to take bold reform steps in the context of social dialogue. Reforms are also progressing well as regards unclogging the court system, promoting competition, privatizing viable companies, and fostering an efficient housing rental market.

Nevertheless, more efforts are needed to clear Portugal's structural reform backlog in the network and sheltered services sectors. Long-standing entry barriers and a web of excessive rents are stifling economic dynamism. The resulting high non-tradable prices not only curb external competitiveness, but also put socially unfair burdens on consumers and taxpayers. First reform successes include measures to level the playing field in the telecommunication sector, and meaningful steps to reduce rents in energy markets, particularly electricity, are underway. Both the pace and scope of these reform efforts should be stepped up.

In sum, Portugal is making good progress toward adjusting its economic imbalances. Determined implementation of reforms remains key to ensure economic recovery and fiscal sustainability. These efforts will be backed up by a strengthened EU economic policy framework. Moreover, provided 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 government's programme is supported by loans from the European Union amounting to €52 billion and a €26 billion arrangement under the IMF's Extended Fund Facility. Approval of the conclusion of this review will allow the disbursement of €14.9 billion (€9.7 billion by the EU, and €5.2 billion by the IMF). These disbursements could take place in April 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 May 2012.