Portugal
Programme Assessment

European Commission, DG ECFIN

15 May, 2014

Root causes of Portugal's initial imbalances and need for assistance

Macro-economic imbalances

- Low GDP and productivity for more than a decade
- High household, corporate and public debts
- Subdued implementation of structural reforms

Trigger for financial assistance request

- Deterioration of confidence and rating downgrades provoked rates incompatible with long-term fiscal sustainability
- Banking sector lost international market funding and started reliance on the Eurosystem for funding

European Commission

EU-IMF Economic Adjustment Programme

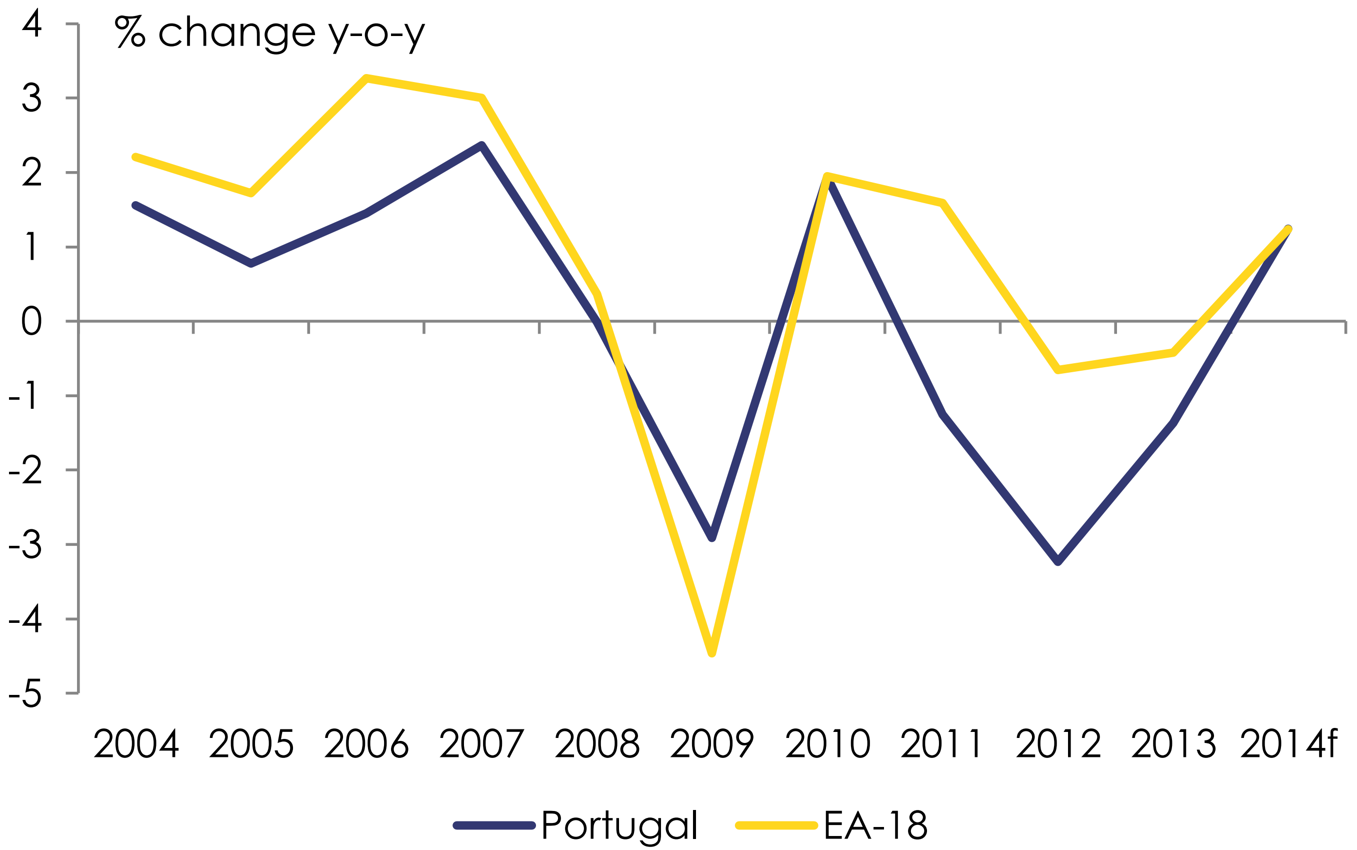
- **Restoring investor confidence via consolidating public finances, enabling sustainable growth and safeguarding financial stability**
  - Executing a credible, balanced fiscal consolidation strategy
  - Rebalancing the economy from non-tradable to tradable sector to improve Portugal's net external position
  - Further supporting the financial sector through more robust supervision and strengthening bank capitalisation
  - Implementing an ambitious structural reform agenda to boost potential growth, improve labour market outlook and regain competitiveness
  - Mitigating negative social impact of the adjustment process

European Commission

Key Programme Achievements

Output Recovery Gaining Momentum

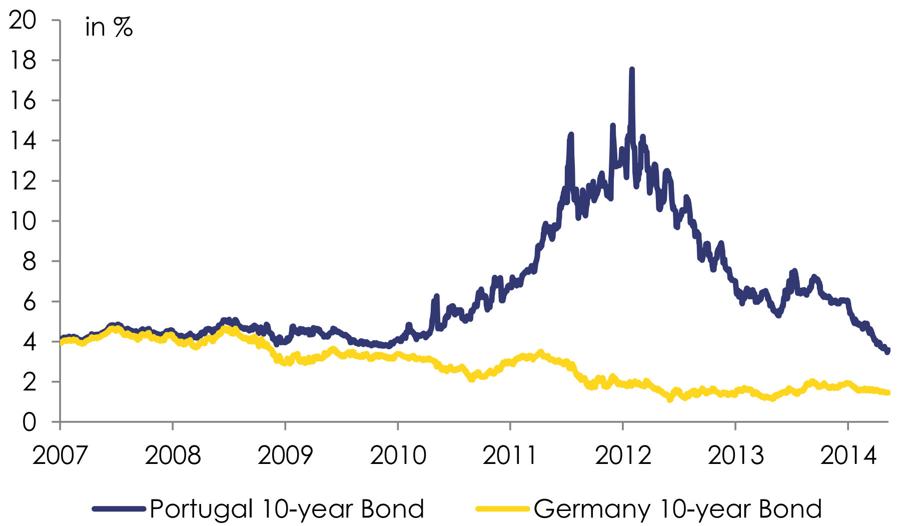
Real GDP growth projection for 2014 in line with EA

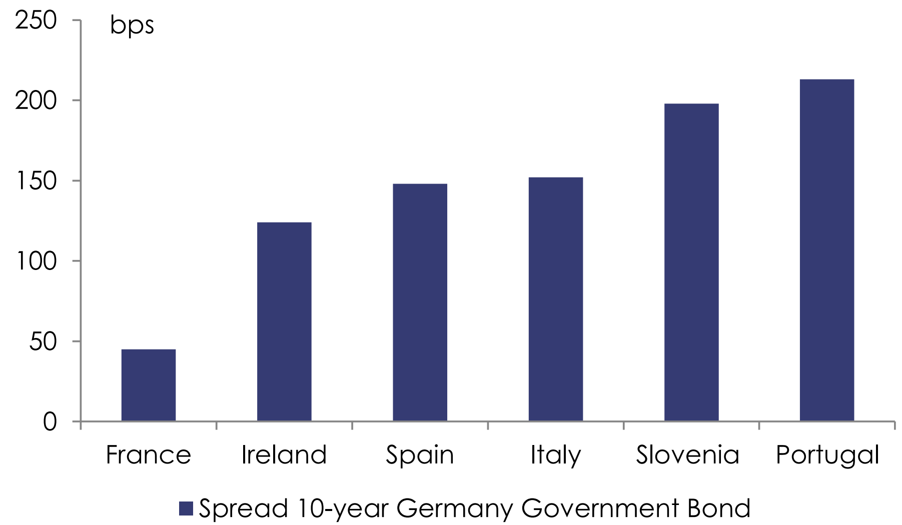


Source: Eurostat, DG ECFIN

Government Bonds at Pre-Crisis Yields

Financing costs have been reduced in recent issuances

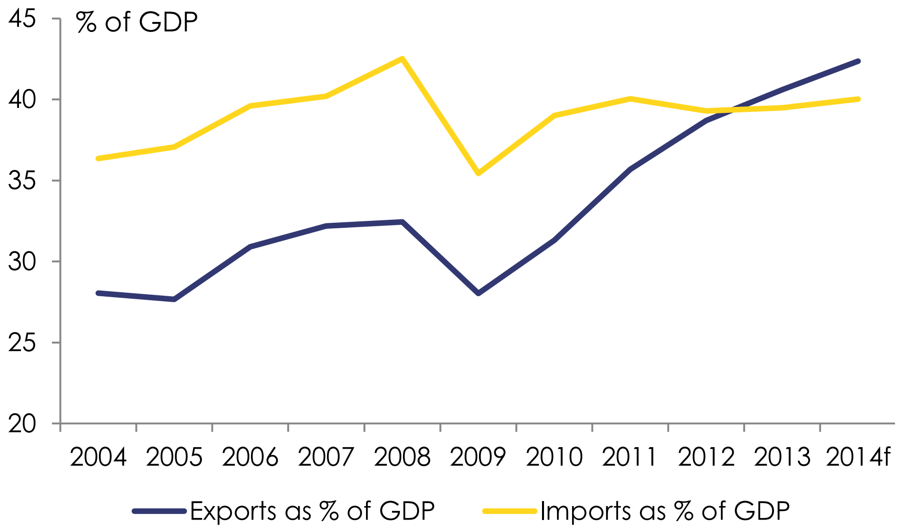


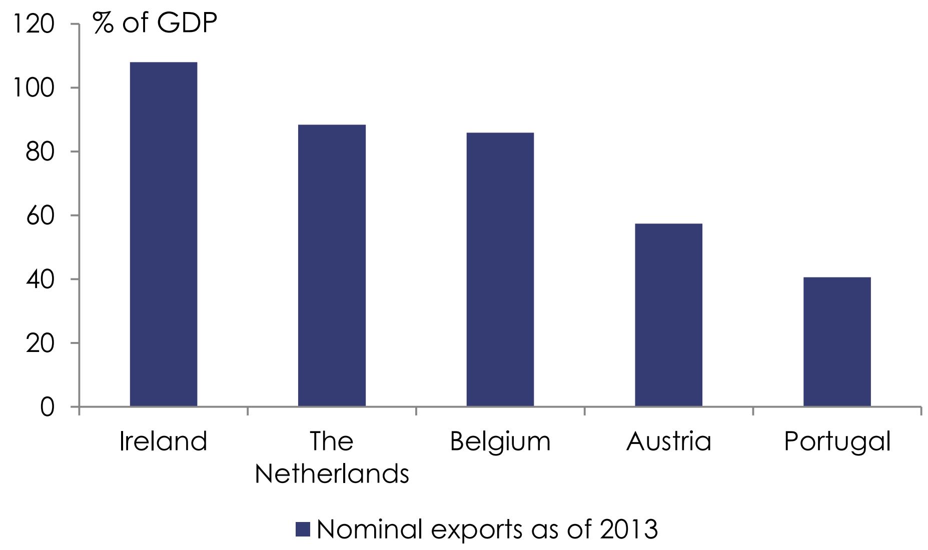


Note: Daily data as of 14 May 2014
Source: Bloomberg

Transition to Export-Oriented Growth Model

Exports as % of GDP have improved but remain below comparable EU MS

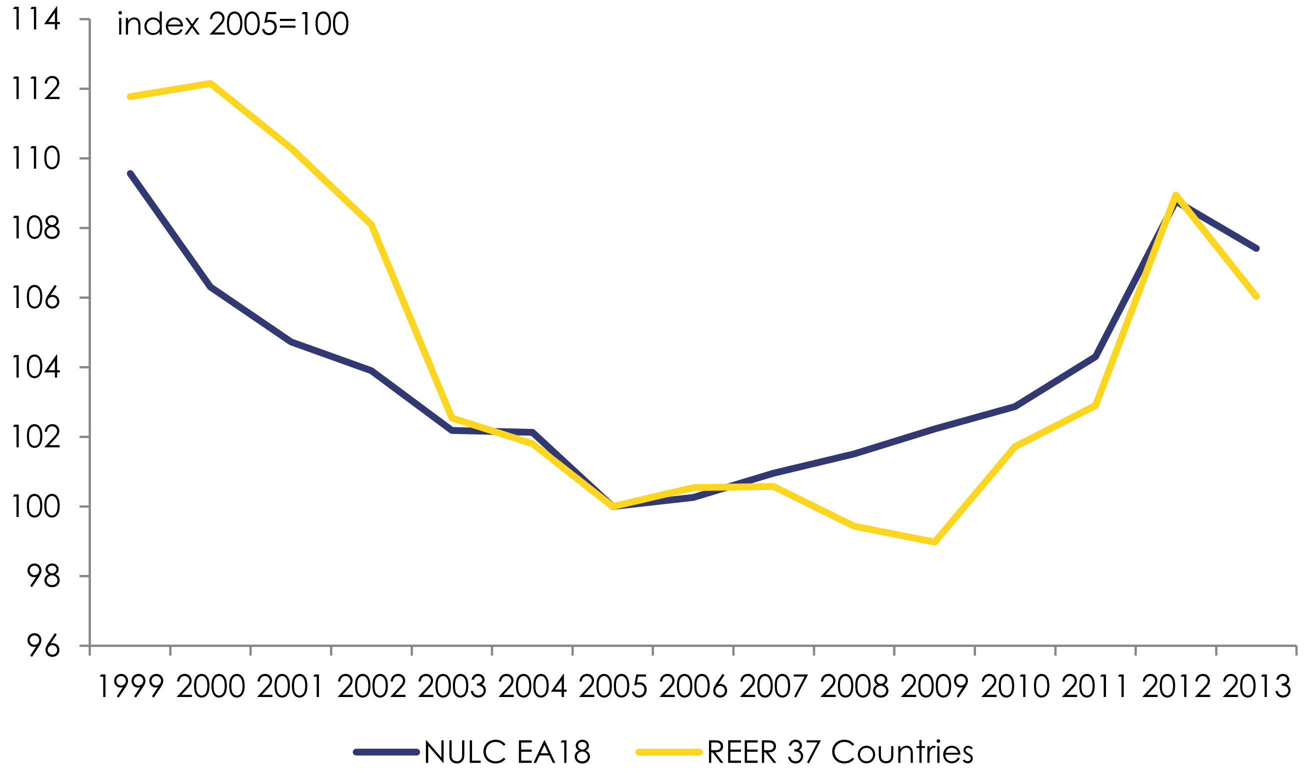




Source: Eurostat; DG ECFIN

Competitiveness Is Recovering

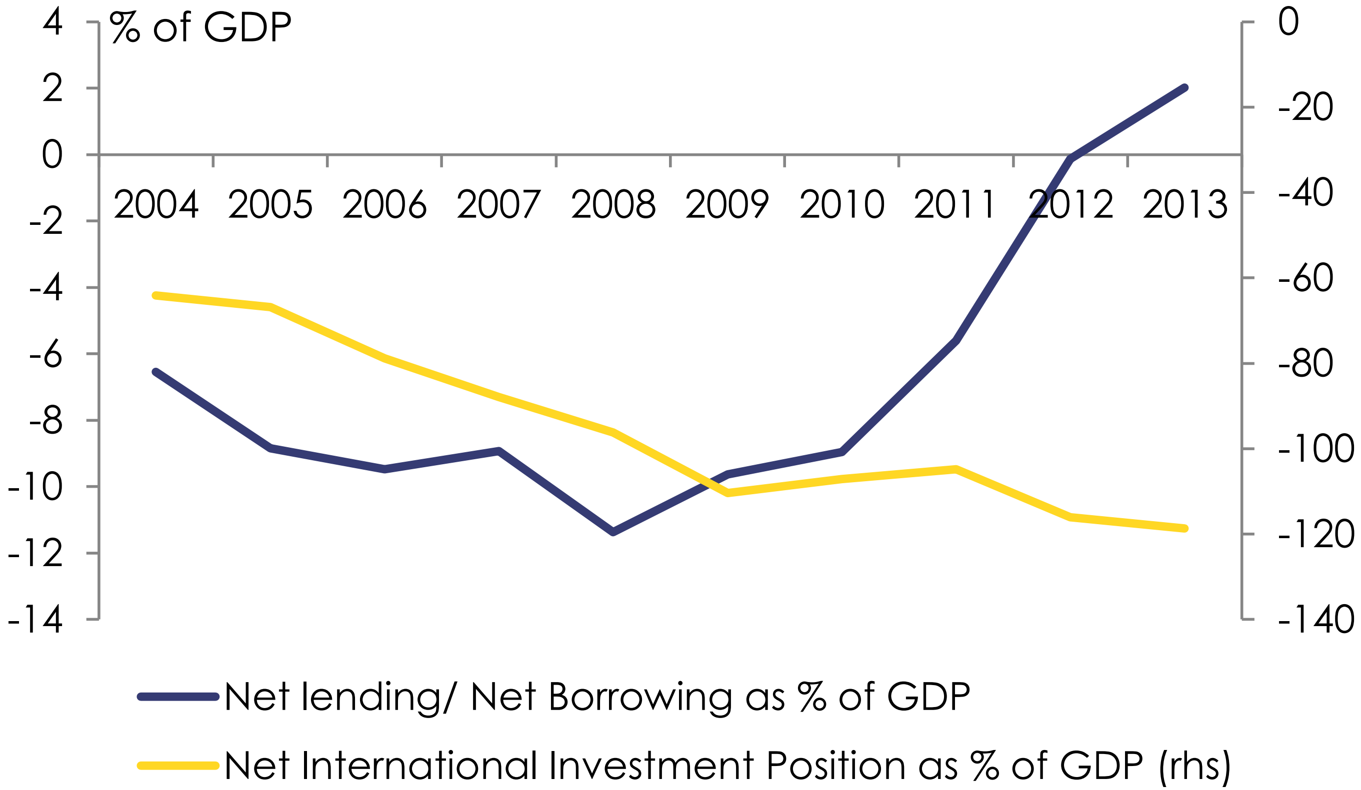
Keeping reforms on track will be crucial to maintain the upward trend



Note: NULC and REER series are inverted
Source: DG ECFIN

External Adjustment Is Ongoing

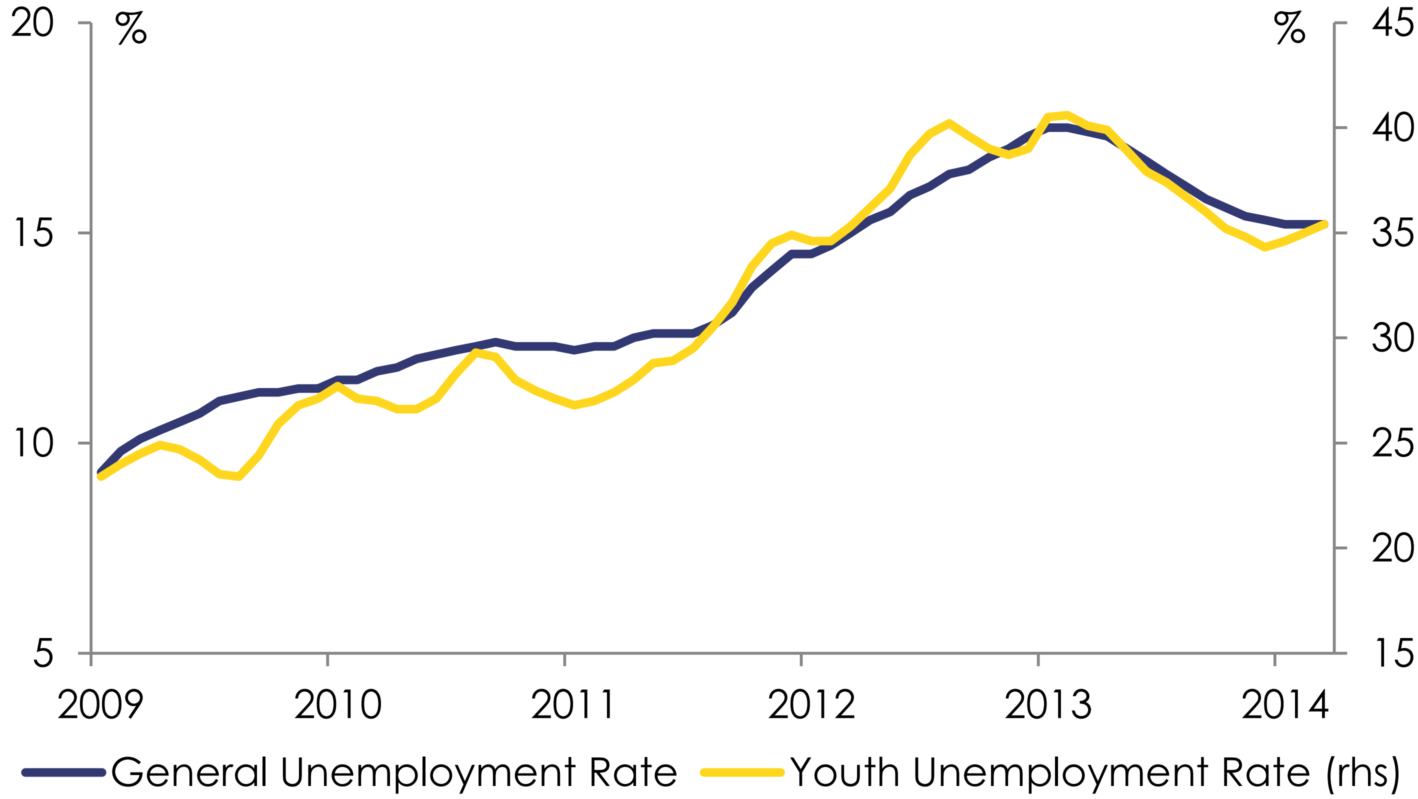
Further improvements in the external balance are necessary to reduce NIIP



Source: Eurostat

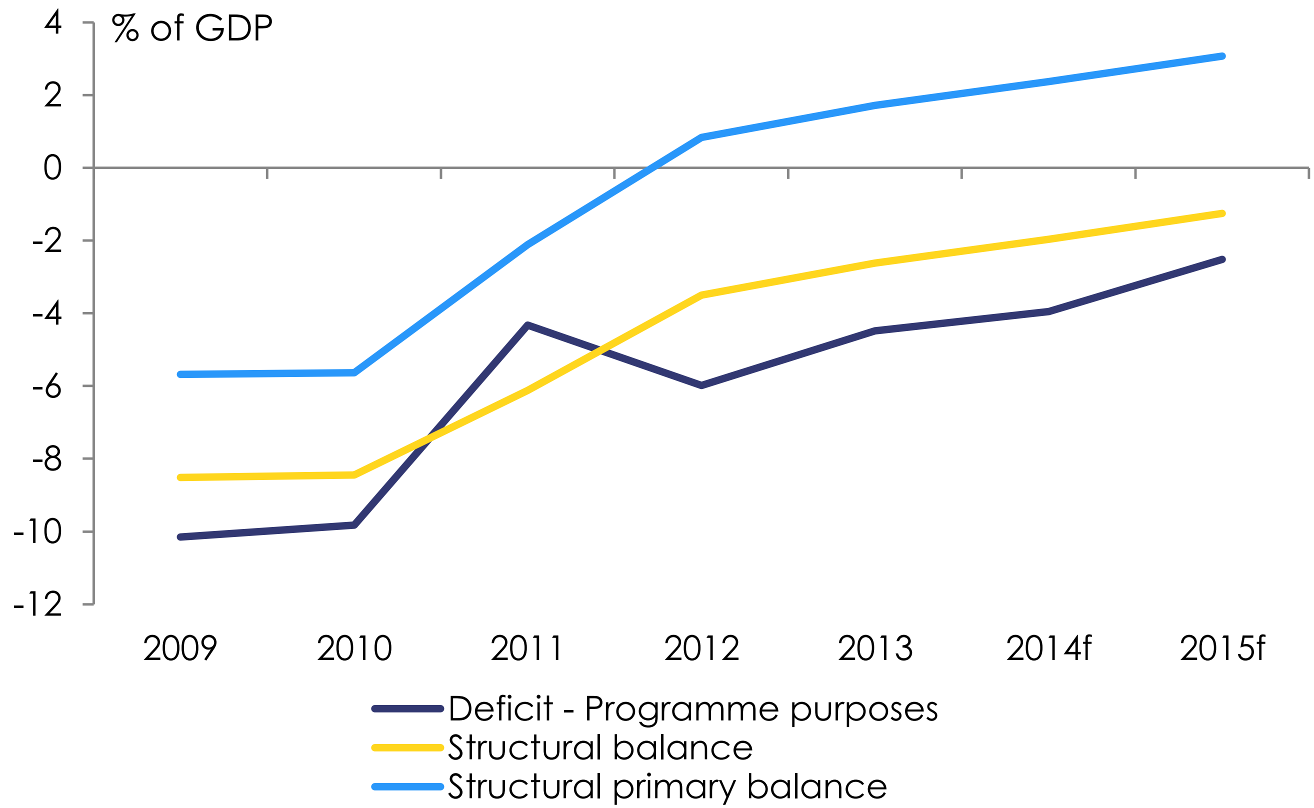
Labour Market Has Bottomed Out

High youth and general unemployment remains concerning



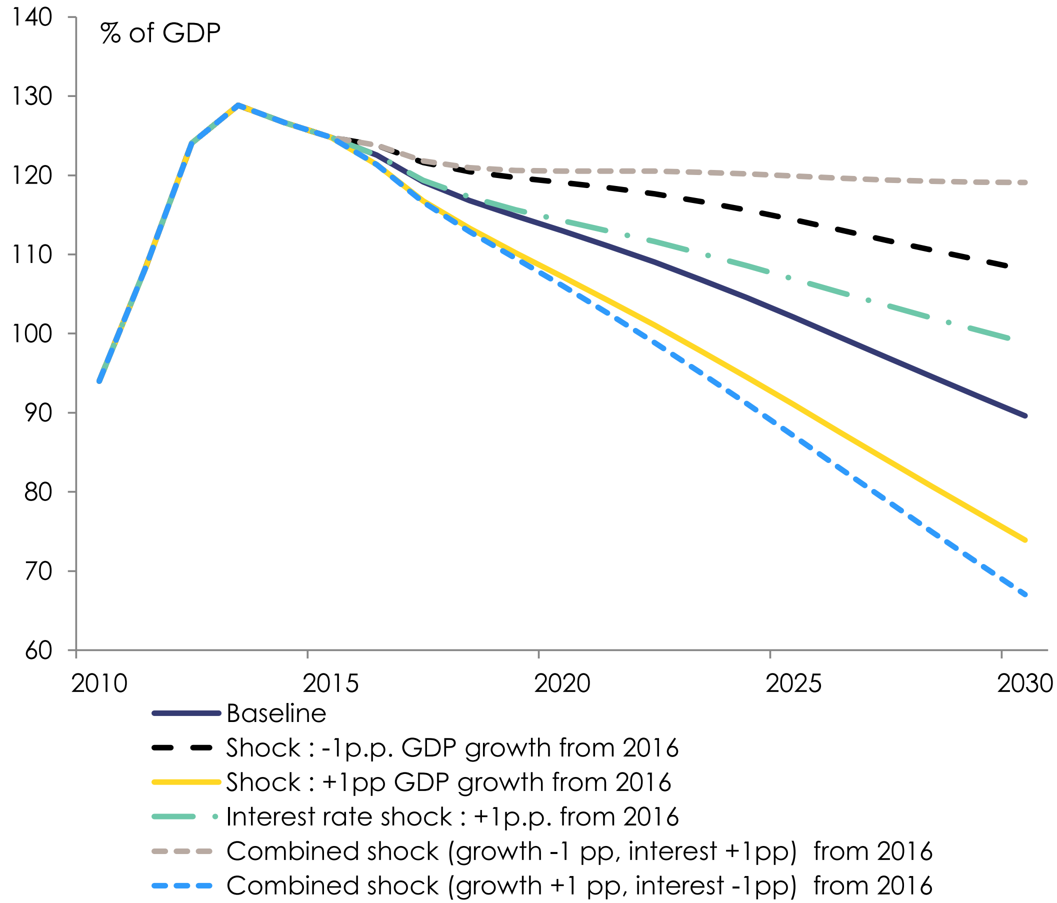
Source: Eurostat

Fiscal Adjustment Has Been Substantial



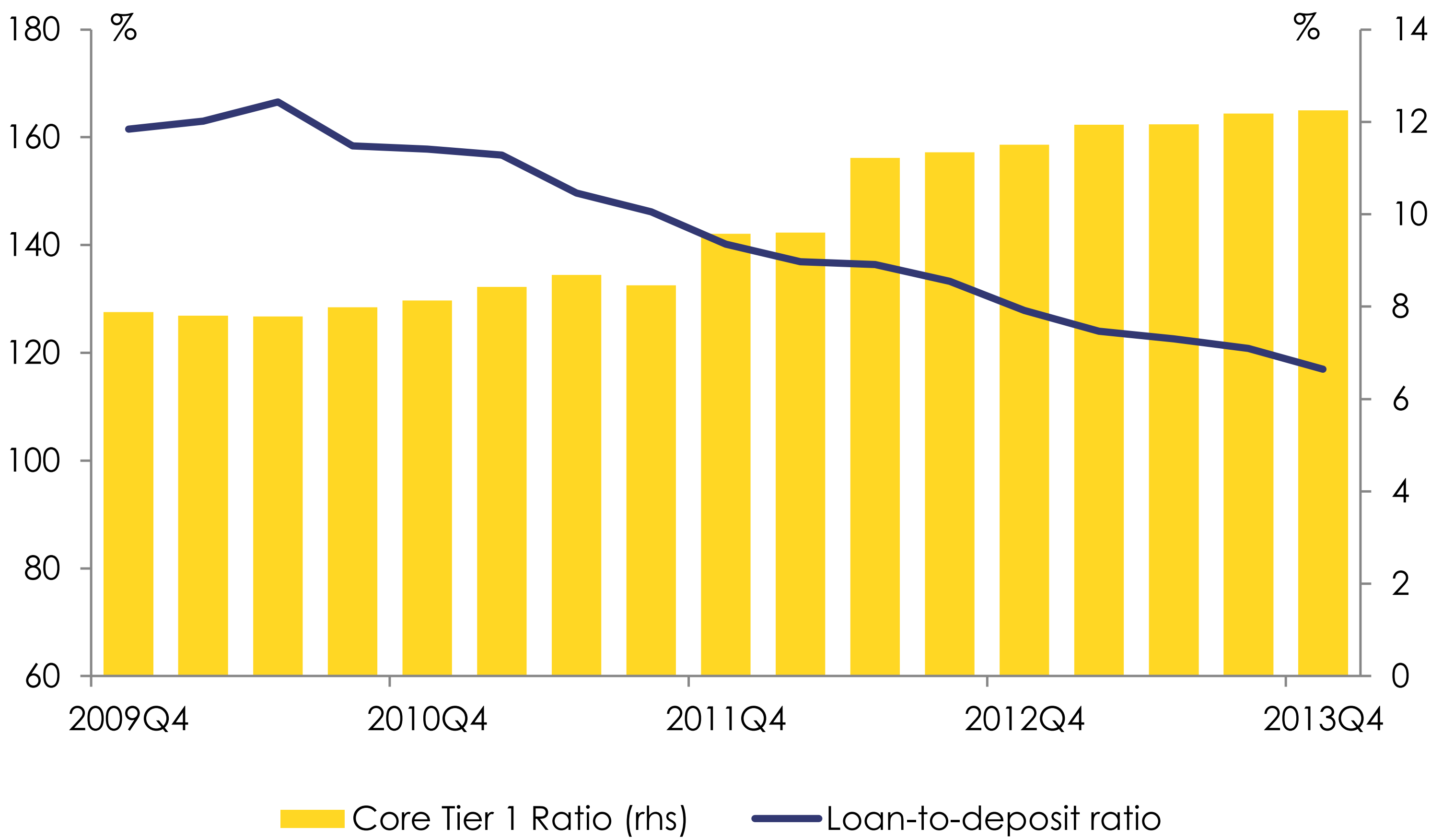
Note: For the purposes of the Programme, the budget deficit in 2012 excludes the impact of CGD recapitalisation (about 0.5% of GDP), and in 2013 BANIF recapitalisation (about 0.4% of GDP).
Source: Eurostat; DG ECFIN

Public Debt High but Sustainable



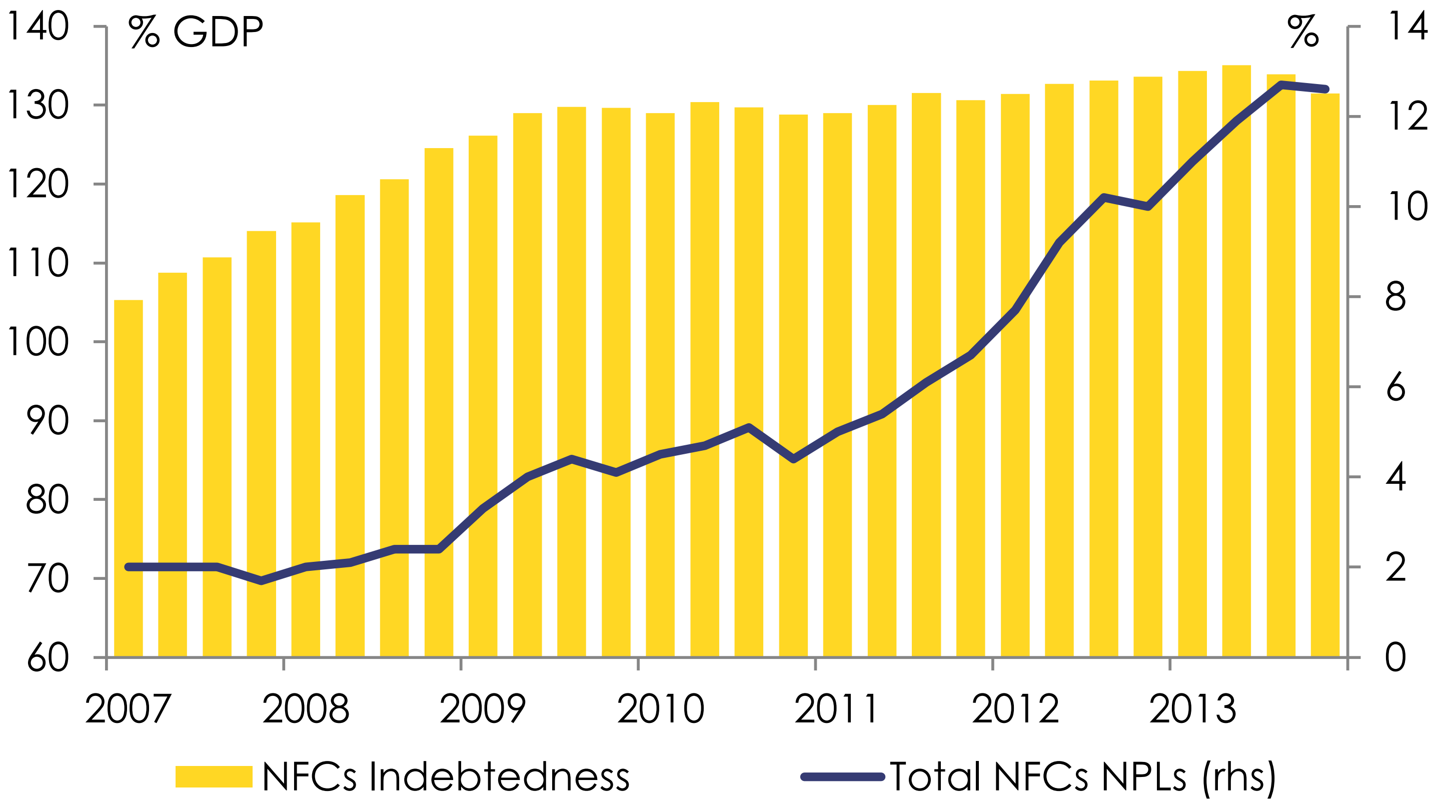
Source: Eurostat; DG ECFIN

Banks Have Adjusted Significantly



Note: Core Tier 1 ratio according to Programme definition and excluding the banks in resolution
Source: Banco de Portugal

Corporate Sector: Slow Deleveraging and High NPLs



Note: Indebtedness refers to lending and securities other than shares in the domestic banking sector
Source: Banco de Portugal; DG ECFIN

Key Structural Reforms Were Undertaken

Labour market

- Key labour code changes to improve flexibility, reduce segmentation and increase incentives to work
- Implementation of strategic plan to fight youth unemployment

Education

- Comprehensive reform of pre-university education system to increase school autonomy and accountability
- Vocational training reforms to enhance labour market matching

Housing market

- New urban lease law to increase access to rental housing and improve labour mobility
- New incentives for renovations

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Key Structural Reforms Were Undertaken

Energy markets

- Liberalisation of electricity and gas markets
- Several wide-ranging reform packages aimed at reducing excessive rents and cutting the electricity tariff debt

Transport sector

- Modernization of regulatory framework, including creation of AMT
- Reform package in ports sector to reduce end user costs, including new port labour law and elimination of port use fees
- Various cost-saving and liberalisation measures in railways sector

Telecoms & postal sector

- Liberalisation and opening up to competition of telecoms and postal sectors, including privatization of postal services company
- Strengthening of regulatory framework for telecoms sector

Key Structural Reforms Were Undertaken

Business environ-ment

- Simplification of licensing procedures for businesses, moving to a zero authorisation approach
- Establishment of Single Point of Contact for entrepreneurs
- Introduction of "one-in/one-out" rule for burdensome new regulations
- Compilation of inventory and cost analysis of regulations

Services & regulated professions

- Sector-specific amendments to liberalise a wide range of legal regimes governing the services sector
- Framework law and new by-laws (in progress) to remove unjustified barriers to entry in key regulated professions

Key Structural Reforms Were Undertaken

Judicial system

- New Code of Civil Procedure to expedite court process
- Court system reform to improve efficiency and accountability
- Various measures aimed at speeding up debt enforcement cases

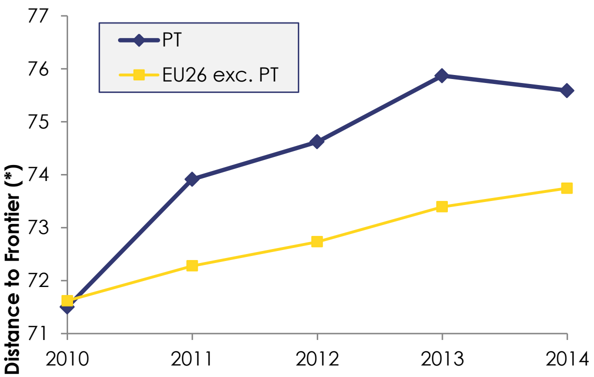
Regulatory framework

- Adoption of new legal framework to strengthen role of key sectorial regulators and Competition Authority and to ensure their independence

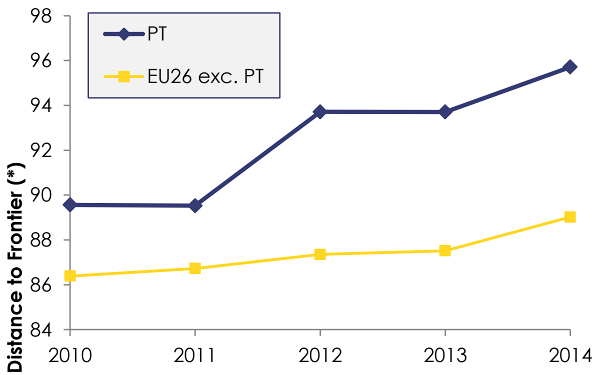
Ease of Doing Business Improving

"Distance to Frontier*" evolution for selected "Doing Business" indicators
(Portugal versus average for other EU countries)

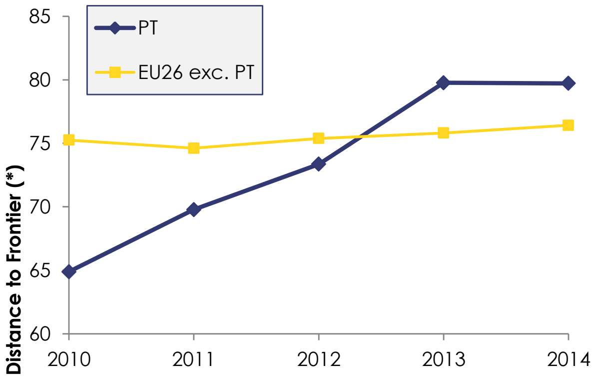
Overall ease of doing business



Starting a business



Dealing with construction permits



*Note: "Distance to Frontier" measures performance relative to the best performance ever observed for any country. Index values ranges from 0-100, with 100 being the best.

Source: World Bank "Doing Business" reports, 2010-2014

Much Achieved But Challenges Remain

- GDP growth still not robust and unemployment is unacceptably high
- High debt levels suggest Portugal could be affected by a turn in bond market sentiment
- Corporate sector indebtedness and high NPLs continue to weigh on bank profitability and growth
- Concern that reform momentum has slowed in key areas

A continued strong commitment to structural reforms and fiscal consolidation is essential