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Statement by the European Commission, ECB and IMF on the first review mission to Portugal

Staff teams from the European Commission, European Central Bank (ECB), and International Monetary Fund (IMF) visited Lisbon from 1 to 12 August for the first regular quarterly review of the Portuguese government's economic programme. The objectives of the programme are to restore competitiveness and to put Portugal's economy on a path of sustainable growth, sound public finances and job creation.

In our assessment the programme is on track. We welcome the new government's commitment to the ambitious and comprehensive programme agreed in May 2011 and take note of its determination to accelerate implementation in key areas. In this regard, prospects for success have been enhanced by the decisions of European leaders at the summit on 21 July to lower interest rates to near the European Financial Stability Fund's funding rate, significantly extend maturities, and – most importantly – stand ready to provide financing until market access has normalised, provided Portugal perseveres with the adjustment effort. A successful completion of the programme now more than ever hinges on the effort and resolve of the Portuguese government and people.

Economic growth and inflation for the year as a whole are expected to remain in line with the programme framework. Exports have been relatively strong; consumer confidence indicators are steady; and employment has remained broadly stable. While GDP is expected to contract by 2.2% this year we still project a recovery to begin taking hold in early 2013.

We appreciate the authorities' strong commitment to the programme's fiscal **consolidation path,** including the measures to redress recent slippages in expenditure controls during the first semester. On account of these revenue-increasing measures, we expect that the fiscal deficit will be limited to 5.9% of GDP in 2011, as programmed. We will also continue to work closely with the authorities to strengthen public financial management and ensure that fiscal performance remains on track in 2011 and beyond. In the near future, adoption of a 2012 budget consistent with reducing the deficit to 4.5%of GDP, and development of a four-year fiscal strategy will be the key challenges.

As to the **financial sector**, banks are strengthening their capital levels to meet the new capital requirements established under the programme and existing legislation is being amended to strengthen the augmented solvency support facility. A balanced and orderly deleveraging of the banking sector remains critical to eliminating funding imbalances on a permanent basis, while safeguarding adequate credit for dynamic sectors to spur growth. Progress has also been made to strengthen the supervisory and regulatory framework.

The success of the programme hinges above all on the opening of the economy to **competition.** Reducing government involvement in private sector activity and establishing a level playing field for firms is critical in this regard, and the government has got off to a good start with the abolition of the special rights of the state in private companies ahead of schedule. Labour market reforms to align the protection and rights under fixed and open-ended contracts are advancing, and the authorities are working on a proposal to create an employer-financed fund for paying out workers' severance entitlements. Progress has been made in preparing for a so-called fiscal devaluation and we take note of the authorities' assurances that they still plan to take a major first step in this regard with the 2012 budget. This reform should be focussed on improving competitiveness, and should be kept simple and broad-based. While the reforms have generally got off to a promising early start, most of the difficult changes still lie ahead and the authorities' resolve in this regard will undoubtedly be fiercely tested by opposition from vested interests.

The government's programme is supported by loans from the European Union amounting to €52 billion and a €26 billion Extended Fund Facility with the IMF. Approval of the conclusion of this review will allow the disbursement of €11.5 billion (€7.6 billion by the EU, and €3.9 billion by the IMF). This disbursement can take place in September 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 November 2011.