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PRESS RELEASE

STATEMENT BY THE EUROPEAN COMMISSION AND THE EUROPEAN CENTRAL BANK FOLLOWING THE FIRST POST-PROGRAMME SURVEILLANCE MISSION TO PORTUGAL

Staff teams from the European Commission and the European Central Bank (ECB) visited Portugal from 28 October until 4 November to conduct a first post-programme surveillance (PPS) mission. This was coordinated with the IMF's first post-programme monitoring (PPM) mission. Staff from the European Stability Mechanism also participated in the mission on aspects related to its Early Warning System.

Economic and financial conditions in Portugal have generally improved since the end of the EU/IMF-supported programme in June. Sovereign yields remain low, in line with developments elsewhere in the euro area and normal market-financing is being gradually restored. Nevertheless, economic recovery is constrained by high levels of debt in the public and private sector and by an increasingly weak external environment which highlights the need for further competitiveness gains. The pace of budgetary consolidation has been adversely affected by a series of one-off factors, despite strong revenue performance. Moreover, efforts to reduce the underlying structural budget deficit have clearly slackened. Progress in structural reforms has lost momentum, with an uneven pace of implementation across policy areas.

The composition of growth in the Portuguese economy has shifted in recent months. Weaker external demand and a number of temporary factors weighed on export performance in the first half of the year and led to a notable decline in the contribution from the external side. At the same time, domestic demand – and more specifically private consumption – has strengthened, supported by a strong labour-market performance. Economic growth in 2014 and 2015 is expected to be slightly below the current projections of the Government. Risks to the near-term economic outlook are to the downside and are, in particular, related to uncertainty in the external environment.

The Government expects a nominal budget deficit of 4.8% of GDP in 2014 (pending the statistical assessment of the Banco Espírito Santo (BES) resolution operation) which includes 1.1% of GDP deficit-increasing one-off factors that do not affect the budgetary position in 2015. On 15 October, the Government presented its draft budget for 2015 which targets a nominal deficit of 2.7%. This target is higher than the 2.5% of GDP required under the Excessive Deficit Procedure (EDP) and committed to under the programme. The mission projects a nominal budget deficit of 3.3% of GDP for 2015 based, among other factors, on less optimistic assumptions on the budgetary impact of macroeconomic developments and of the consolidation measures. Meanwhile, the adjustment in the underlying structural deficit is also likely to fall considerably short of what is required under the EDP, reflecting a fading consolidation effort. The debt-to-GDP ratio, which stood at 128% at the end of 2013, is expected to be lower by the end of this year and to continue on a downward path thereafter, if supported by sufficiently high primary budget surpluses and nominal GDP growth.

The Portuguese banking sector continues to deleverage amid improving liquidity conditions. The results of the ECB's comprehensive assessment have generally confirmed the solvency of the sector, notwithstanding the recent resolution of BES. Yet, looking ahead it is important that the opportunity provided by the comprehensive assessment to strengthen further the resilience of the banking system as a whole is seized. While most banks still project losses in 2014, cost-saving measures are now beginning to yield positive results. However, future profitability remains challenging, not least in light of the domestic macroeconomic environment.

The mission expressed concern that the pace of structural reform appears to have diminished considerably since the end of the programme, in some cases reversing past achievements. Notably, while it remains to be seen whether recent policy measures relating to collective wage bargaining could on balance contribute to a better alignment of wages to productivity developments, the decision to increase the minimum wage could make the transition into employment for the most vulnerable even more difficult. Moreover, efforts to reduce excessive rents in network industries, in particular in energy, need to be stepped up. The mission recalled the importance of increasing the flexibility and competitiveness of the Portuguese economy to underpin the still nascent economic recovery. It therefore urged the Government to maintain an ambitious reform agenda for the future. There is also a need to more systematically monitor and evaluate the impact of reforms.

Borrowing conditions for Portugal have further improved since the end of the programme, amid generalised investor optimism and a continued search for yield. Recent episodes of financial-market volatility are, however, a reminder that managing high levels of sovereign debt remains a challenge for the Government.

The mission would like to thank the Portuguese authorities and the IMF for their constructive and open discussions. The next PPS mission will take place in spring 2015.

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