crédito y caución
Atradius Group

Country Report

Portugal – December 2012

Overview

General information

Capital:	Lisbon
Government type:	Parliamentary democracy
Currency:	Euro (EUR)
Population:	10.7 million

Most important sectors (% of GDP, 2011)

Services:	75 %
Industry/mining:	23 %
Agriculture:	2 %

Main import sources (2011, % of total)

Spain:	31.1 %
Germany:	12.4 %
France:	6.9 %
Italy:	5.3 %
The Netherlands:	4.8 %

Main export markets (2011, % of total)

Spain:	25.2 %
Germany:	13.8 %
France:	12.2 %
United Kingdom:	5.0 %
Angola:	5.0 %

Key indicators

	2009	2010	2011	2012*	2013*
Real GDP growth (y-on-y, % change)	-2.9	1.4	-1.7	-2.9	-1.9
Consumer price inflation (y-on-y, % change)	-0.8	1.4	3.7	2.9	1.3
Real private consumption (y-on-y, % change)	-2.3	2.1	-4.0	-5.4	-1.2
Retail sales (y-on-y, % change)	-4.8	-1.2	-8.9	-7.4	-2.6
Industrial production (y-on-y, % change)	-8.1	1.5	-1.9	-4.0	-1.6
Unemployment rate (%)	9.5	10.8	12.7	15.5	17.3
Gross fixed capital investments (y-on-y, % change)	-8.6	-4.1	-11.3	-14.1	-6.5
Real net exports (EUR billion)	-14.0	-13.2	-6.1	0.1	1.8
Fiscal balance (% of GDP)	-10.2	-9.8	-4.4	-5.1	-4.7
Government debt (% of GDP)	83.2	93.5	108.1	119.5	127.3

*forecast Source: IHS Global Insight

Political situation: Centre-right administration with an absolute majority

Head of state: President Anibal Cavaco Silva (since March 2006)
Head of government: Prime Minister Pedro Passos Coelho (since June 2011)
Form of government: Coalition of the two centre-right parties PSD and CDS-PP

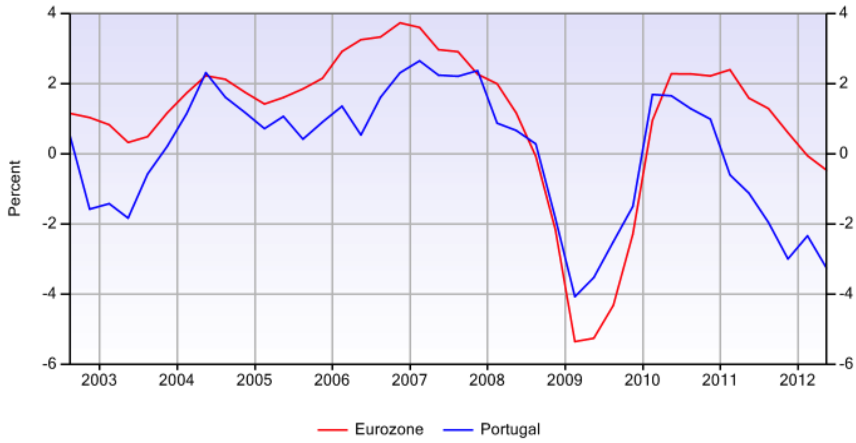
In the June 2011 early parliamentary elections, the centre-right parties PSD (liberals) and CDS-PP (conservatives) achieved an absolute parliamentary majority (132 of the 230 seats). The elections were precipitated as former Prime Minister José Socrates (Socialist party) had resigned in March 2011, after proposed further austerity measures were voted down in parliament. As the coalition holds a solid majority it is expected to remain in power for most of the legislative period until 2015. Violent mass protests against austerity measures, of the kind seen in Greece, are not expected in Portugal and so far any demonstrations have been peaceful. However, social stability may come under pressure as additional austerity measures continue to cut into living standards.

Economic situation: The contraction accelerates

Lack of domestic demand and weaker exports drag down the economy

Real GDP growth

(Annual percentage change in real GDP)



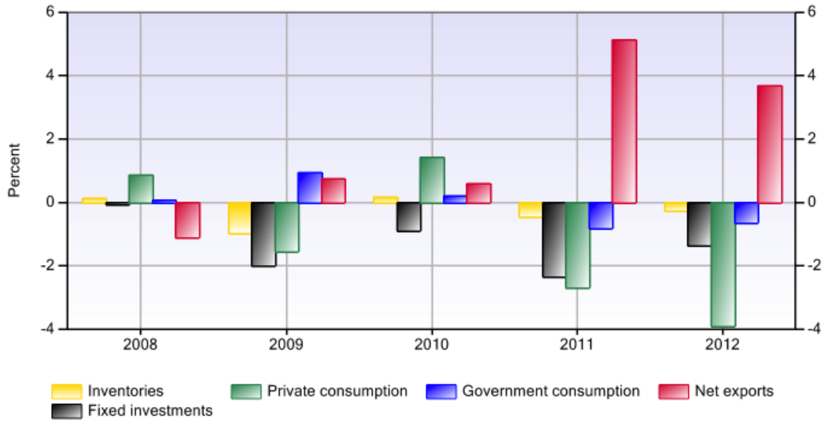
Source: IHS Global insight

In Q2 of 2012 the economic downturn that had been relatively mild so far started to accelerate as domestic demand decreased sharply and global headwinds had a negative effect on export growth: GDP contracted 3.2 % year-on-year after a 2.3 % decrease in Q1. According to Statistics Portugal domestic demand decreased 7.6 % year-on-year in Q2 of 2012 (6.1 % decrease in Q1), with all demand components reflecting this picture. Private consumption declined 5.9 %, with a major negative contribution from spending on cars (down 26.3 % year-on-year). The decline in public consumption accelerated as well in Q2, to -3.9 % (-1.8 % in Q1). Fixed investment has steadily declined since 2011, and decreased 18.7 %, dragged down by the decline in investment in transport and equipment. Only exports contributed positively in Q2 of 2012, growing 4.3 %, but to a significantly lower extent than in Q1 (+7.9 %) as demand from the EU, and particularly Spain, decreased.

In Q3 of 2012 the economy contracted 3.4 % year-on-year and 0.8 % compared with the previous quarter, as the positive contribution of net external demand decreased significantly.

Contribution to GDP Growth: Portugal

(Chain-weighted basis; forecast data edge 2010)

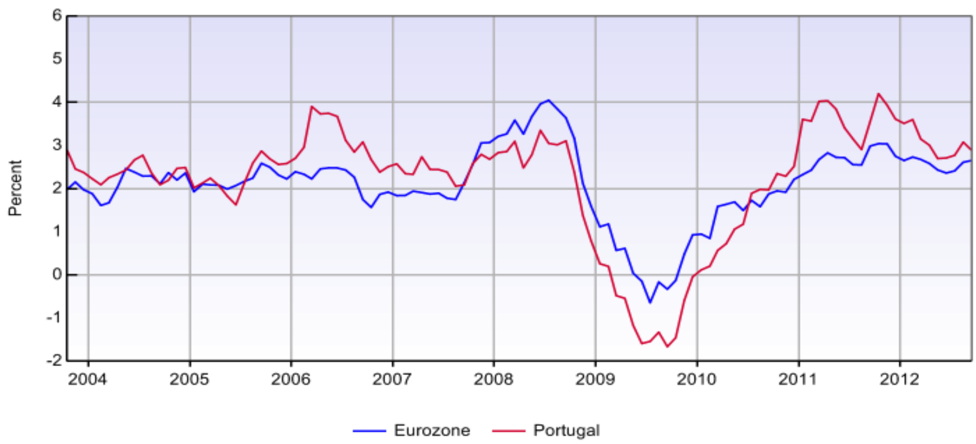


Source: IHS Global insight

According to Statistics Portugal unemployment continued to increase, to 15.8 % in Q3 of 2012 (+3.4 % year-on-year). Inflation in 2011 was 3.7 % and is currently still above the EU average (see chart below), but is expected to decrease to 2.9 % in 2012. The relatively high level is due to higher oil and commodity prices. Inflation is expected to decrease to 1.3 % in 2013 as the weak economic performance curbs pricing power.

Consumer price inflation

(Annual percentage change)



Source: IHS Global insight

Structural reforms are underway

In early 2011 Portugal received a bailout package worth EUR 78 billion from the so-called 'Troika' (IMF/EU/ECB), guaranteeing the country's financing needs - provided that Portugal abides by the conditions of an attached IMF program, i.e. strict fiscal consolidation and far-reaching structural reforms). Overall, the Portuguese government is demonstrating strong commitment to the program, which ends mid-2014.

According to the IMF many labour market distortions have been addressed (costs of workers' dismissal, degree of protection, reservation wage, unemployment benefits). But there is still the automatic extension of wage ag-reements to entire sectors, which negatively affects the competitive position of many businesses. However, the government promised to tackle this issue in order to generate more export (and thus GDP) growth.

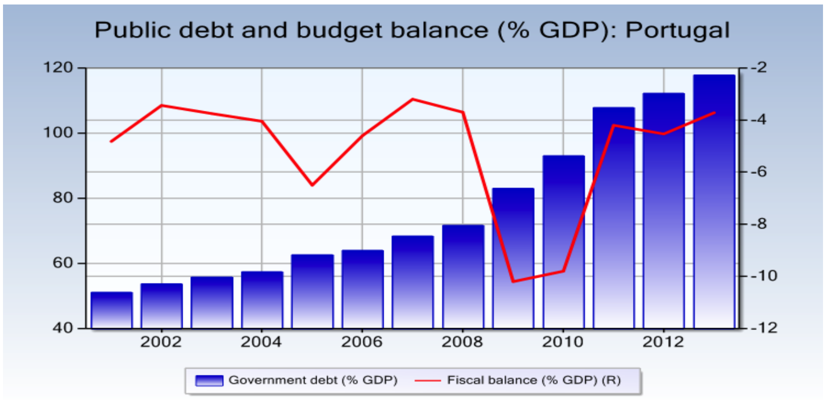
Less progress has been made regarding the competitive framework, as the impact of current measures on network industries such as electricity, telecom and ports are unclear. The IMF has urged the government to address this issue, which hampers dynamism in the economy.

Fiscal policies: progress made, but deficit pressures remain

Real progress has been made with fiscal structural reforms of revenue administration and public finance management, and the IMF qualifies the extent of fiscal adjustment as impressive. On the expenses side the Portuguese government has in general complied with the terms of the bailout program (in some issues even surpassing them). Spending however is firmly under control, especially when taking into account interest costs (up 17.3 %) as well as the heavy burden of increased social security costs (up 23 %).

However, on the revenues side the expected target figures have not been reached, as the impact of the weak economic performance hits tax revenues. January-July 2012 figures show a 2 % year-on-year decline in current receipts, despite a number of tax rate increases (VAT). Especially corporate tax (-15.6 %) and vehicle tax receipts showed considerable decreases, whereas the slide in employment has consequences for social security contributions. As a consequence, the original targeted fiscal deficit of 4.5 % of GDP in 2012 has been relaxed to 5 % of GDP.

End of November 2012 the Portuguese parliament finally passed the 2013 budget, which includes large tax increases (e.g. an increase in the standard income tax from 24.5 % to 28.5 % and an additional 3.5 % surcharge on all incomes in 2013). At the same time further spending cuts of EUR 2.7 billion to pensions and public healthcare will be made. With those measures the government aims to decrease the budget deficit to 4.5 % next year. But the additional tax increases and spending cuts raise the question whether the so far limited effects of the budget deficit reduction on economic performance (a multiplier of 0.5 % according to the IMF) are sustainable. The 2013 budget is critical because the achievement of a positive structural balance will put the debt to GDP ratio, peaking at 127 % in 2013, on a sustainable downward trajectory.



Source: IHS Global insight

Banking system has been bolstered

Portuguese banks have drawn EUR 60 billion under the European Central Bank's (ECB) supplementary longer-term refinancing operation (LTRO), a three year bank funding at low rates, which has enabled them to finance a large part of their 2012 requirements. Funds have partly been used to purchase government bonds, but exposure to sovereign debt remains limited compared to other EU-peers in financial trouble.

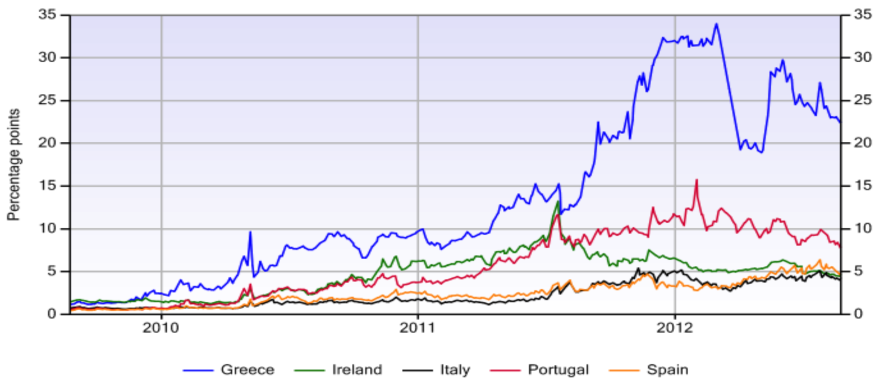
Meanwhile capital support from the government (as part of the 'Troika' rescue package) has enabled large banks to bolster their capital ratios. Non-performing loans stood at 8% by the end of September 2012, but the overall asset quality is relatively good compared to banks in other peripheral EU countries. Nevertheless, credit constraints are increasing and hamper the economic activity, with smaller firms operating in the domestic market being mainly affected by the very tight credit conditions.

Cautious financial market access

According to the IMF program Portugal is due to return to the financial markets mid-2013. There are two positive developments in this respect: Firstly, Portugal has seen a significant reduction in the yield divergence of its 10-year benchmark bond, from a peak of 15 % early this year to approximately 7% recently (see chart below). There are similar declines in yields for other maturities. Secondly, Portugal has made a cautious comeback to the markets with a successful EUR 3.76 billion debt swap, extending the maturities and lowering the yield. Whether Portugal will be ready for a full-fledged return to the financial markets after the expiry of the IMF program is still an open question. However, there is confidence that the 'Troika' will extend its support beyond the expiry of the program if needed.

Long bond yield divergence within the Eurozone

(10-year government bond yield spreads over the German Bund)



Source: Atradius Economic Research

Prospects: still a long and rocky road ahead

No recovery in 2013

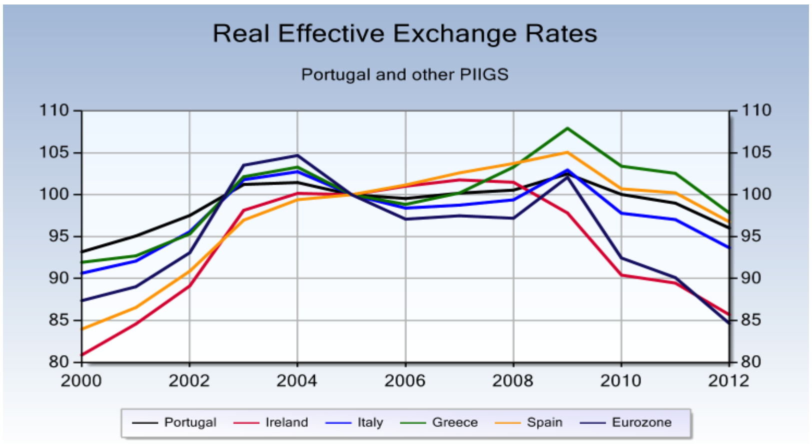
As said above, the relative success in the implementation of IMF program hasn't stopped the Portuguese economy from sinking deeper into recession in the short-term. GDP is expected to contract 2.9 % this year, followed by another 1.9 % decrease in 2013. The worrying growth of unemployment to more than 17 % and the prospect of more austerity measures to be implemented in 2013 in order to tackle the budget deficit put a lot of pressure on domestic demand, risking the prospects of an early return to growth. Private consumption and industrial production will continue to contract in 2013.

After the steep decrease in investments in 2011, tighter constraints on investment credit remain one of the major concerns of the Portuguese government and the troika, since the bailout program's success will be determined largely by the economy's capacity to achieve sustainable growth and competitiveness. But persistent uncertainty about the economic outlook, reflected in deteriorating business confidence, will continue to affect investment decisions in 2013. Therefore, real fixed investments will decrease further, by 6.5 % year-on-year.

Exports are expected to keep growing, however decelerating growth and the negative economic outlook of many of Portugal's main trade partners is bound to take its toll on Portuguese exports, leading to an expected lower growth rate in this GDP component in 2013.

The competitive position has hardly improved

Despite the notable decline in Real Effective Exchange Rates, Portugal's competitive position has hardly improved compared to other EU countries in troubles, and in comparison to the Eurozone there is even deterioration (see chart below). This underscores the need for further structural reforms in order to be able to increase foreign market share.



The decreasing current account deficit is positive news

Meanwhile the current account deficit has narrowed, to 3.3 % of GDP in 2012 from 6.4 % of GDP in 2011. But this is mainly attributable to weak domestic demand cutting imports, as well as the fact that external funding is much harder to obtain. However, it is anticipated that expected improvements in the country's competitive position, continued weak demand and foreign financing constraints will further narrow the current account to 2.7 % of GPP in 2013, and may even produce a surplus by 2015-2016.

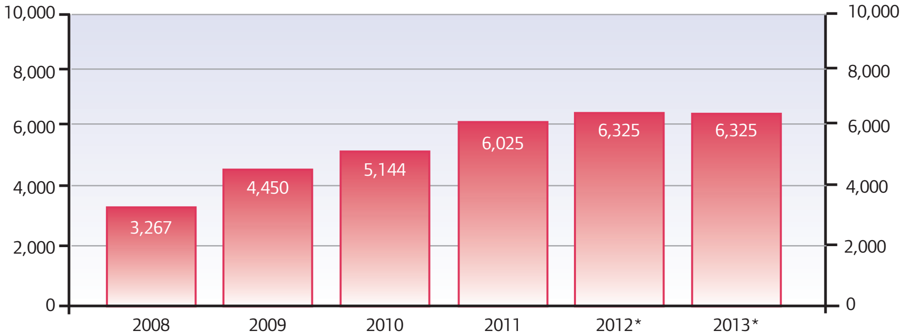
Insolvencies to increase further in 2012

As a result of the continuing decrease in consumption, investment, and employment business conditions for many companies will remain very difficult and access to bank loans will remain problematic. Those sectors particularly exposed to the downturn are construction, timber and furniture, fixtures and fittings, iron and steel, retail and electronics, and domestic appliances.

After a 17.1 % year-on-year increase in 2011, we expect business insolvencies to rise again this year: by 5 %, to about 6,300 cases (see chart below).

Portuguese business insolvencies

(year-on-year change)



% change 53.9 % 36.2 % 15.6 % 17.1 % 5.0 % 0 %

*forecast

Sources: Statistics Portugal; Atradius Economic Research.

Note: Forecasts are based on the outcome of statistical models and expert opinion. The history of growth rates in the table represent estimates based on official insolvency statistics and model-based calculations. As such they should be treated as indicative. All views expressed here are those of Atradius Economic Research (date of final forecast: 10 October 2012)

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