

The Portuguese Adjustment Program



**Meeting with European Parliament
Delegation**

6 January 2014

Background Information

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The Portuguese Adjustment Program

Outline

1. The Program had to be designed in record time
2. Deterioration of the macroeconomic outlook
3. The financial stability pillar
4. Structural reforms



1. The Program had to be designed in record time

Main dates

Late March/ early April 2011:

- Deterioration in financial market sentiment made **increasingly challenging for Portugal to meet its financing needs**
- The banking sector was **almost shut out of international market funding**

7 April 2011:

- Portuguese authorities **officially requested** financial assistance

20 May 2011:

- The Program was agreed by the **IMF Board**

30 May 2011:

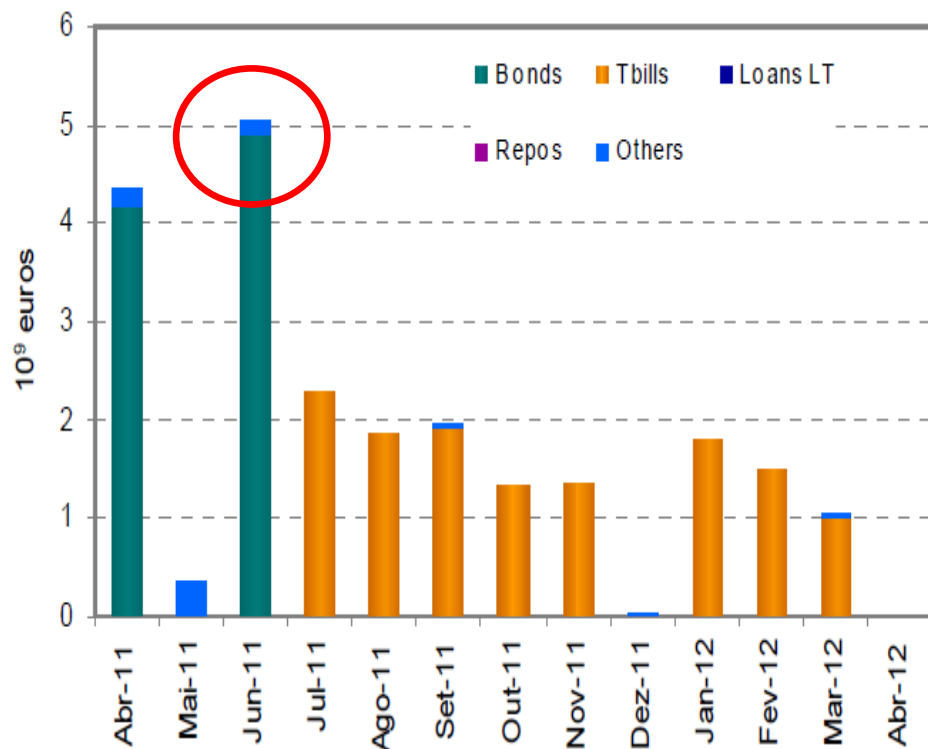
- The Program was agreed by the **European Council**

1. The Program had to be designed in record time

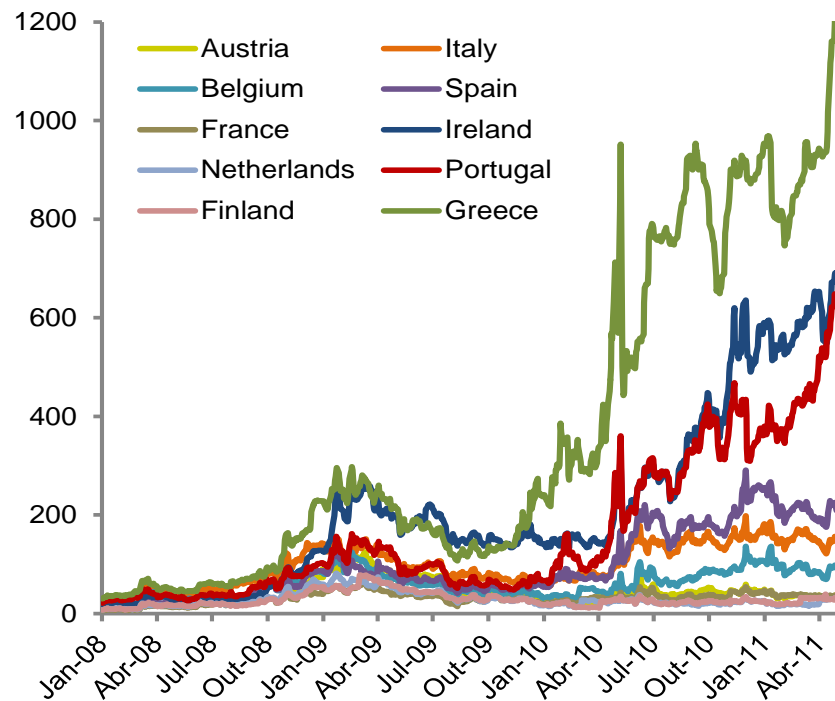
On approval of the program there was a disbursement of €6.1 bn to cover immediate financing needs

Government Debt Repayment Schedule in April 2011 (*)

Total debt - next 12 months



10-year Government bond yields Spread against Germany in basis points

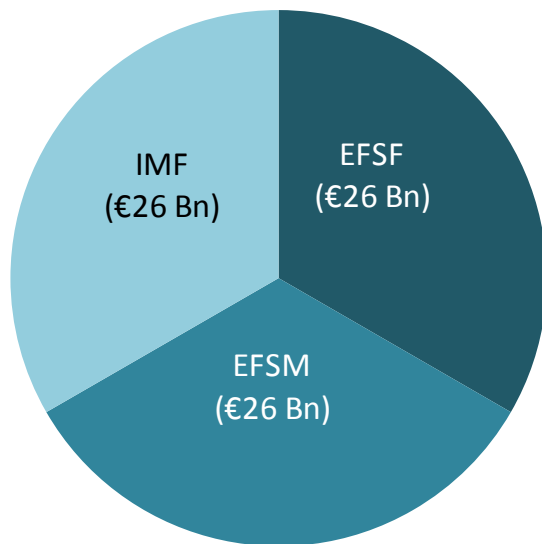


(*) Excluding Saving certificates, Treasury Certificates, CEDIC and CEDIM.
Sources: IGCP, Reuters

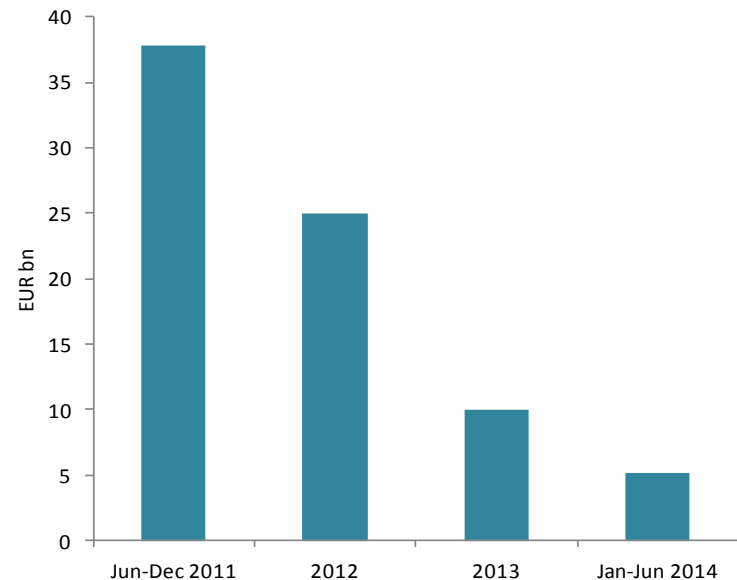
1. The Program had to be designed in record time

- The Program covers the financing needs of the General Government from **2011 to June 2014**.
- The financial package amounted to **EUR 78 billion** in loans, including **EUR 12 billion** for a **Bank Solvency Support Facility**.
- Disbursement schedule significantly front-loaded.

1/3 financed by the IMF and 2/3 financed by the EU

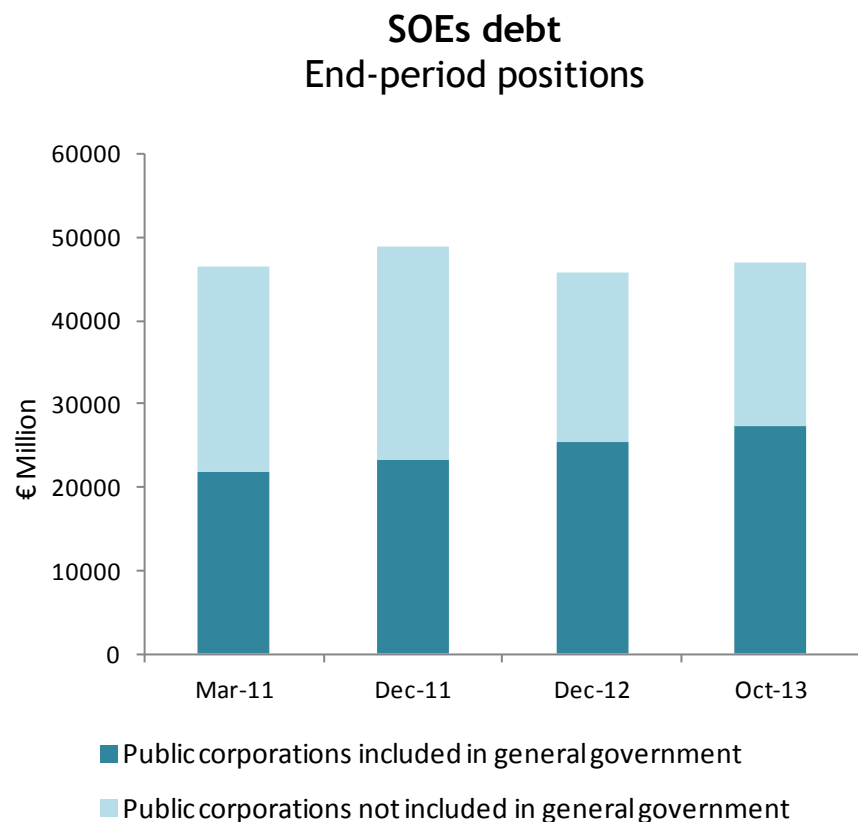


Disbursement schedule (indicative)



1. The Program had to be designed in record time

The program did not cover the financing needs of State-Owned Enterprises (SOE)

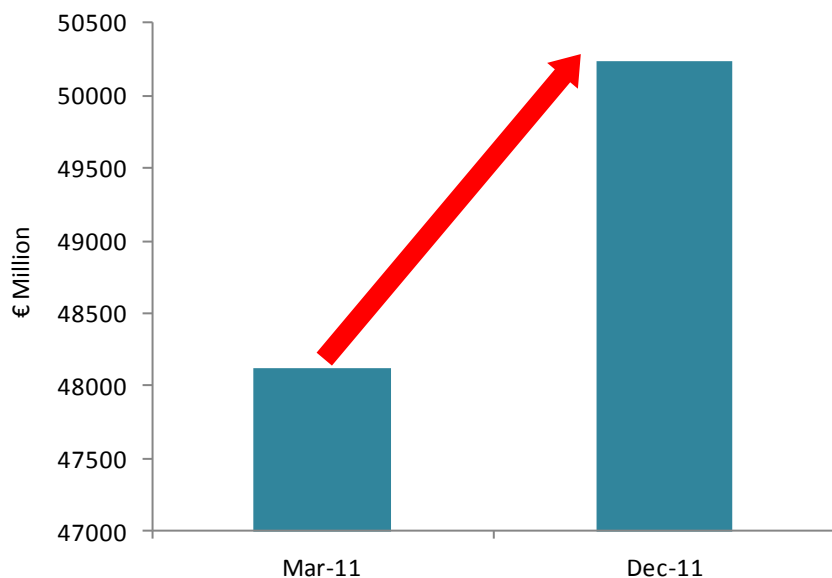


- By March-2011 overall SOE debt amounted to about 27% of GDP.
- With the crisis, many SOE found themselves in severe financial stress.
- In cases of most troubled firms, where domestic banks have been unwilling to roll over the debt, Treasury financing has been provided.

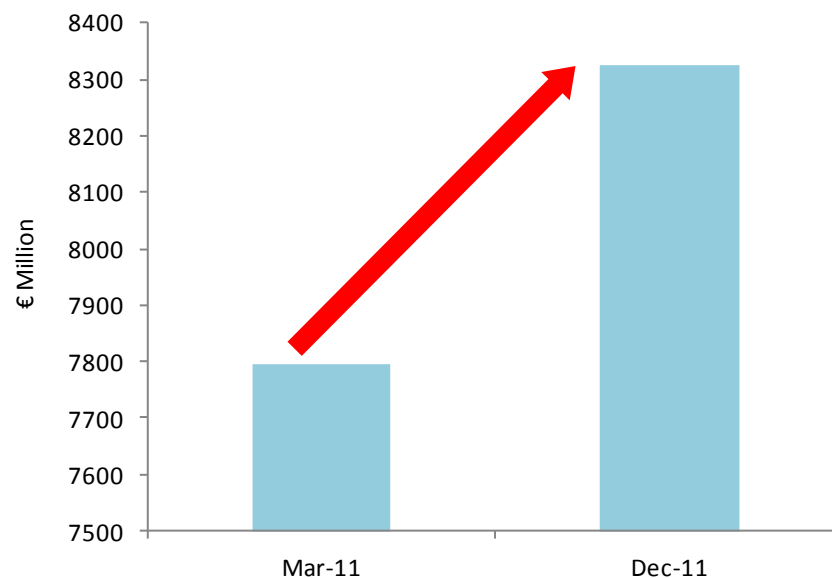
1. The Program had to be designed in record time

The financing gap related with the refinancing of SOEs was closed through Eurosystem financing via the domestic banking system.

**General Government debt (*)
financed through the resident financial sector**
End-period positions



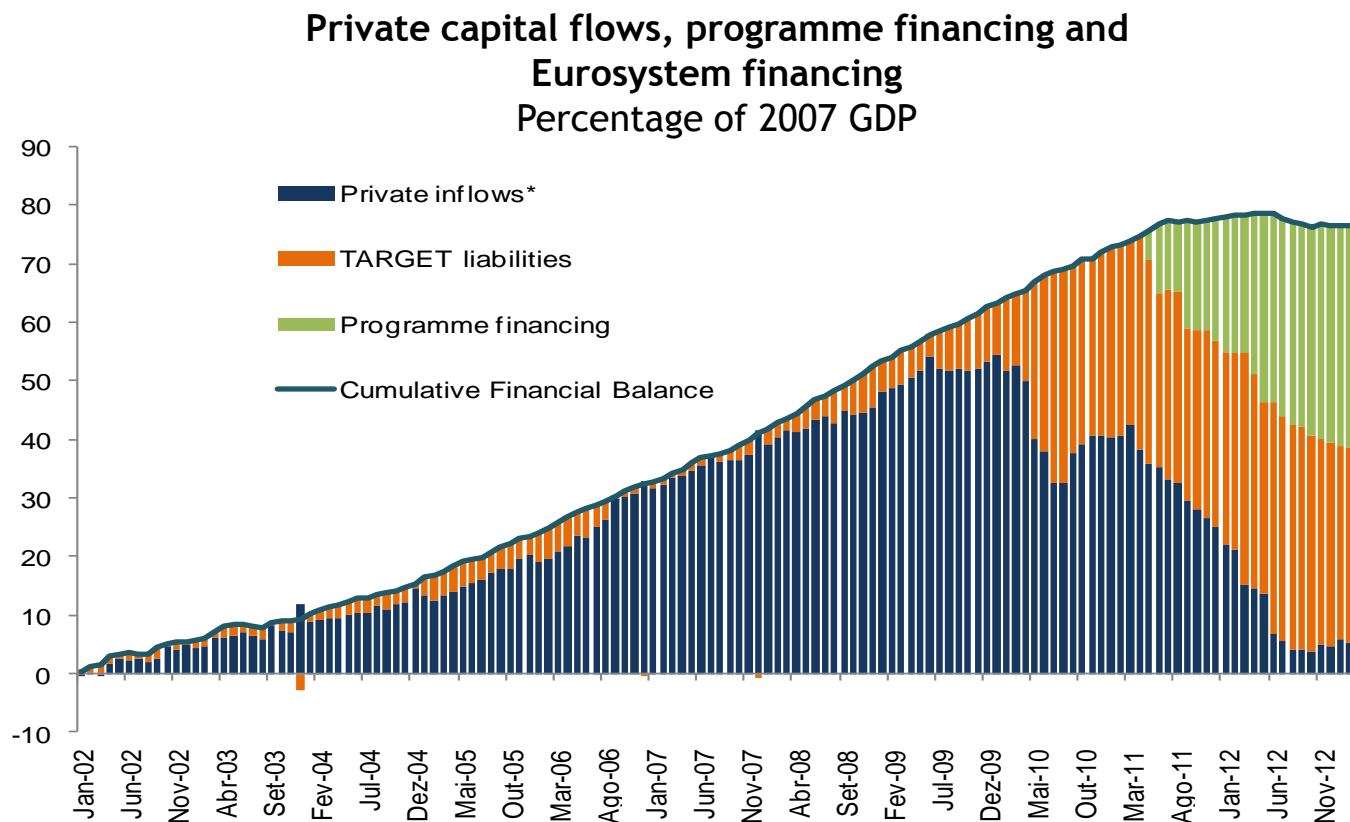
**Debt of SOEs not included in the General
Government financed through
the resident financial sector**
End-period positions



(*) Includes debt of SOEs included in the General Government

1. The Program had to be designed in record time

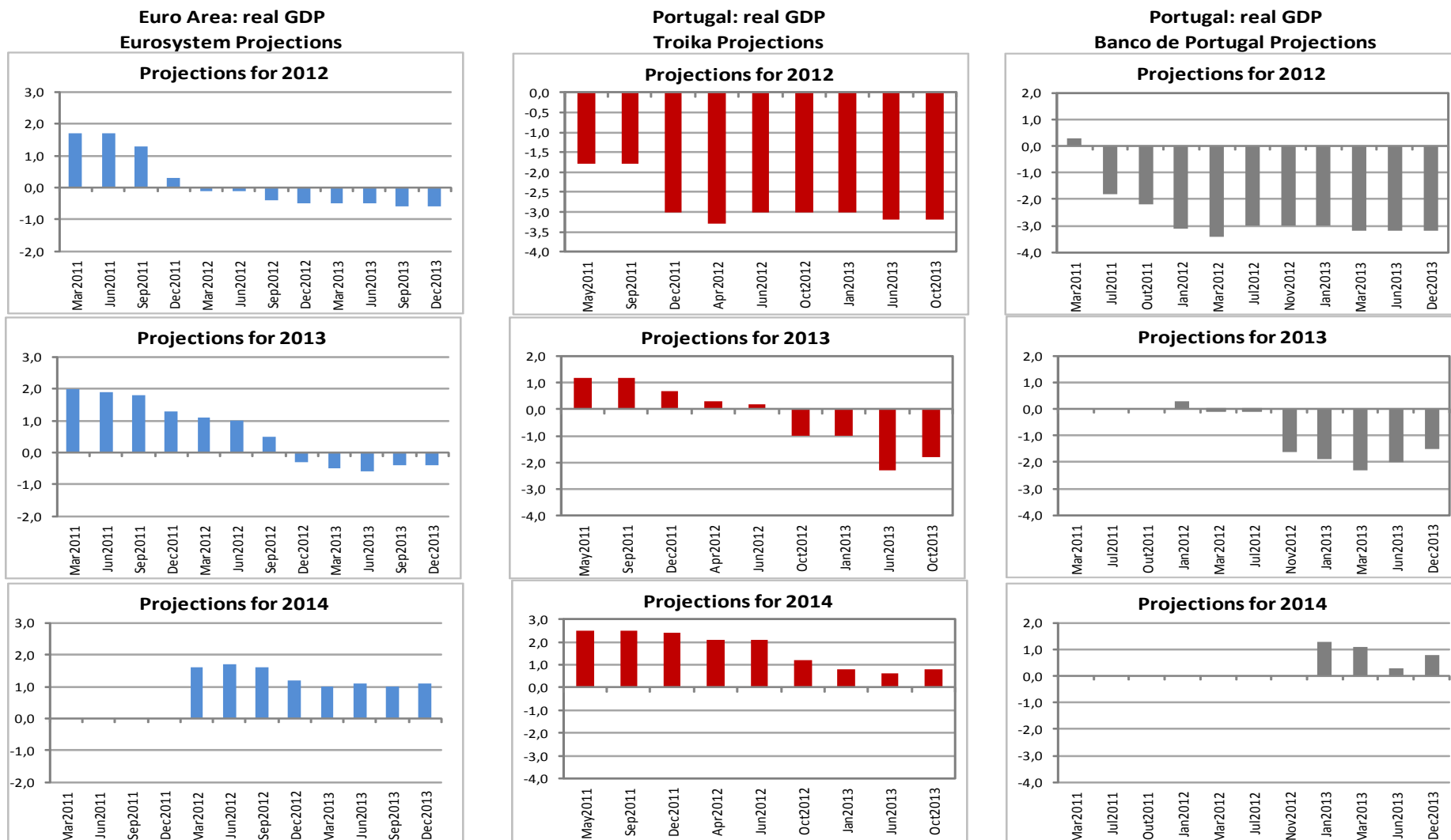
Foreign private financing was gradually substituted by foreign official finance and by Eurosystem financing



* Include other components not considered in the breakdown (mainly information pertaining to securities and other loans not obtained under the programme).

2. Deterioration of the macroeconomic outlook

Sucessive downward revisions of GDP Projections in Portugal and in the Euro Area





2. Deterioration of the macroeconomic outlook

Impact of fiscal policy have been larger than expected

Both in theory and practice there is no “single” fiscal multiplier
The range of estimates for fiscal multipliers is large and depends on:

The size and openness of the economy

Monetary and exchange rate policy

The state of the economy: output gap large or small; banking system situation

The permanent *versus* temporary nature of the fiscal measures

The kind of fiscal measures: taxes *versus* expenditures

Degree of nominal and real rigidities

Public perception regarding future income flows



3. The financial stability pillar

Banco de Portugal main focus was on the financial system pillar

Stabilization of the financial sector:

Addressing banking sector vulnerabilities to restore market confidence, while at the same time ensuring a smooth and gradual deleveraging process that does not undermine growth

**A comprehensive strategy
was followed**

Reinforcing
bank solvency

Protecting
banking
system
liquidity

Enhancing
the
effectiveness
of supervision

Improving
the regulatory
framework



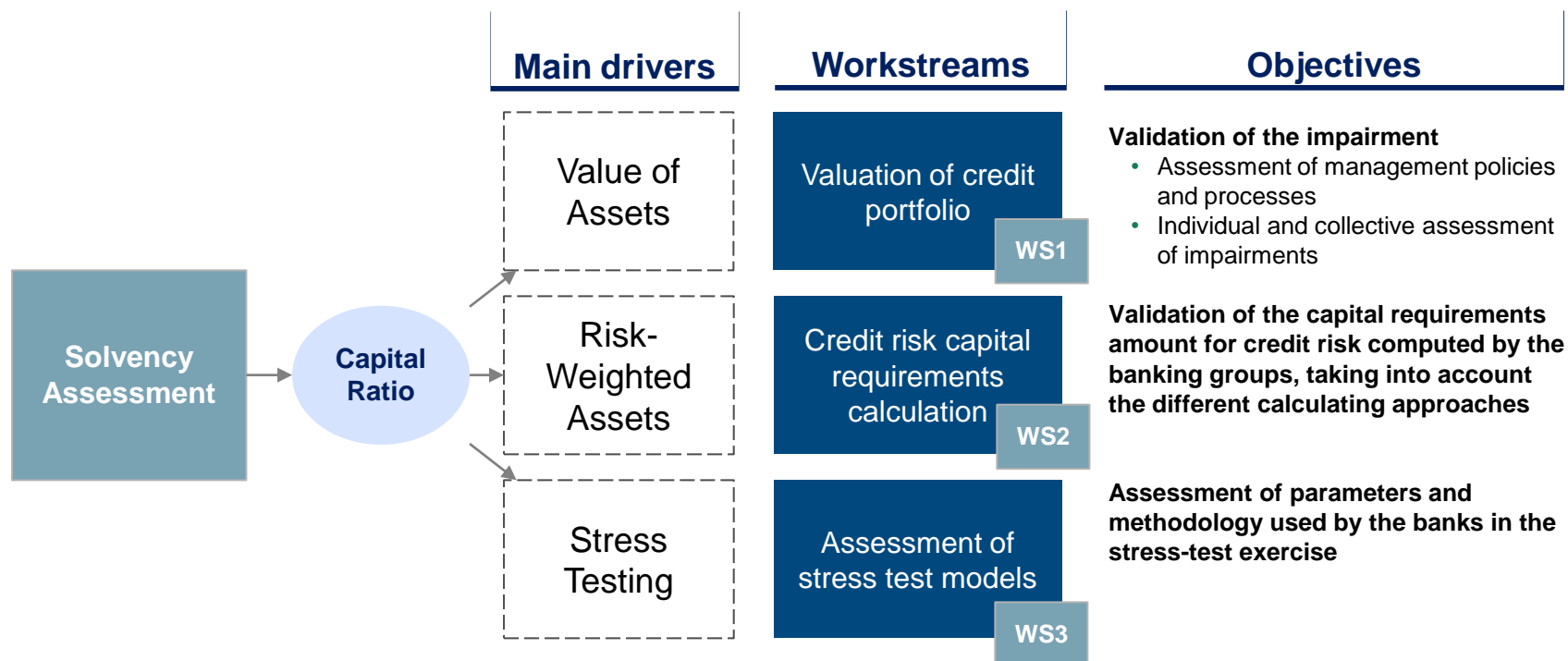
3. The financial stability pillar

- To ensure transparency and enhance confidence in the domestic banking system and in the quality of the balance sheets, **Banco de Portugal favored an approach different from the one followed by Greece and Ireland.** This was closely discussed with the Troika.
- The approach consisted in **combining a point-in-time perspective** to confirm the accuracy of the solvency ratios with a **stressed forward looking perspective** to assess the resilience of banks.
- This approach is very **similar to the one followed by the ECB** in the **comprehensive balance sheet assessment** in the context of the preparatory works for the Single Supervisory Mechanism.

3. The financial stability pillar

Special on-site Inspections Programs

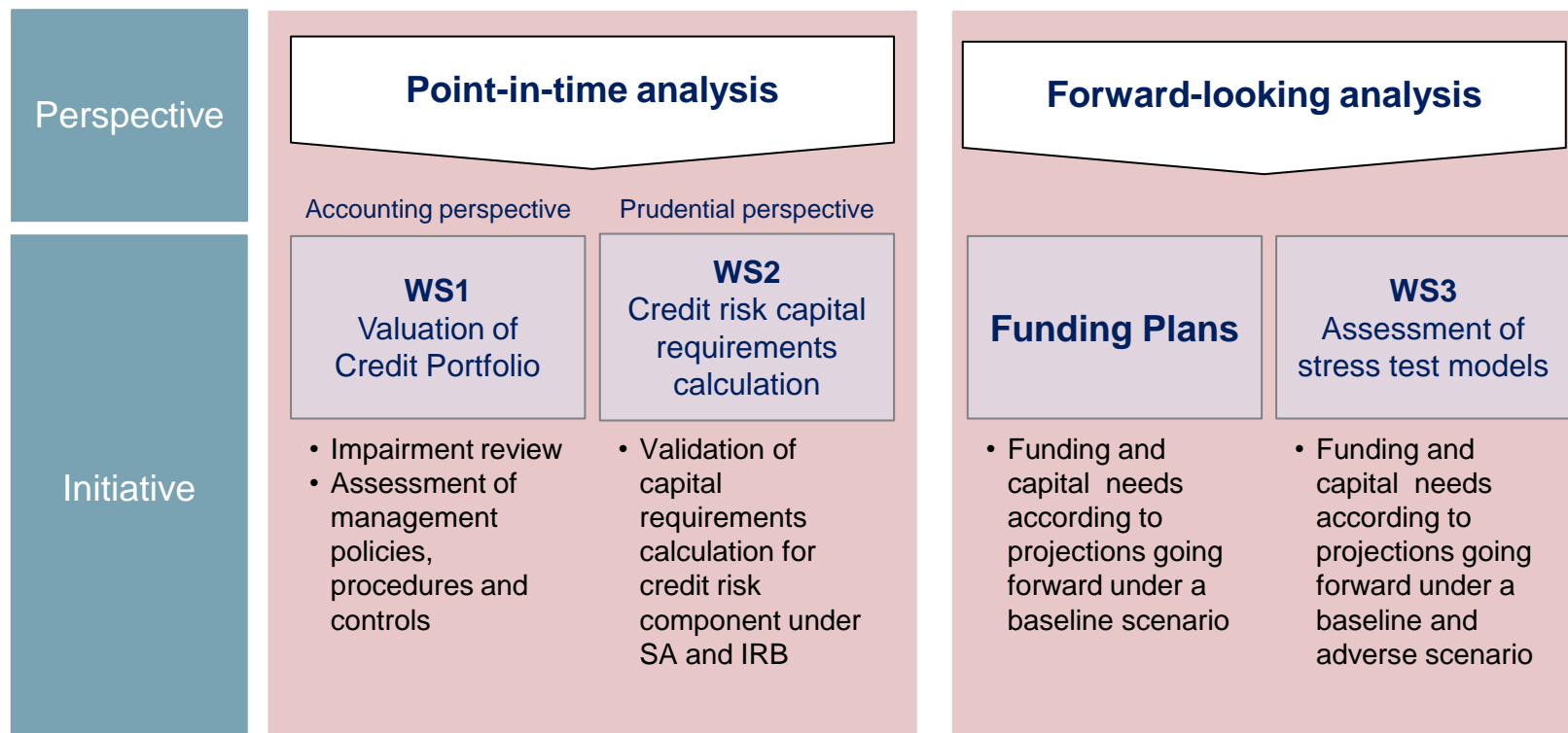
Portuguese experience



3. The financial stability pillar

Special on-site Inspections Programs

Portuguese experience



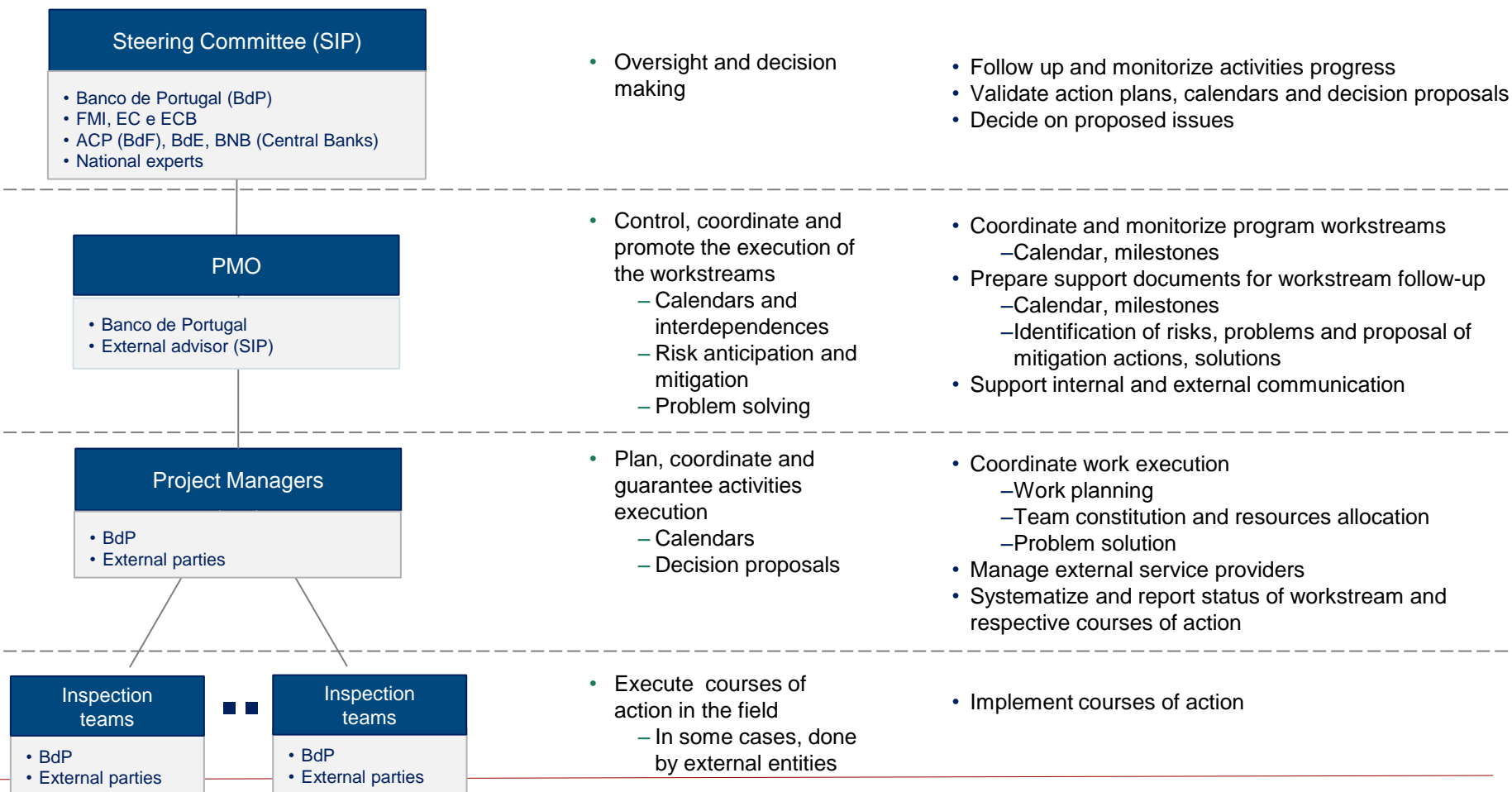
3. The financial stability pillar

A well defined governance structure has been key to the successful execution of the Programme

Structure

Responsibilities

Functions



3. The financial stability pillar

A structured cascade of regular follow-up meetings was put in place for the overall duration of the Program

	Objective	Participants	Recurrence / Location
Steering committee	<ul style="list-style-type: none"> <input type="checkbox"/> Follow up and monitorize activities progress <input type="checkbox"/> Validate action plans, calendars and decision proposals <input type="checkbox"/> Decide on proposed issues 	<ul style="list-style-type: none"> <input type="checkbox"/> Banco de Portugal (BdP) <input type="checkbox"/> FMI, EC e ECB <input type="checkbox"/> ACP (BdF), BdE, BNB (Central Banks) <input type="checkbox"/> National experts 	<ul style="list-style-type: none"> <input type="checkbox"/> Bimonthly <input type="checkbox"/> BdP
PMO	<ul style="list-style-type: none"> <input type="checkbox"/> Assess overall SIP progress <input type="checkbox"/> Discuss pending subjects and needs for intervention <input type="checkbox"/> Define corrective measures and next steps 	<ul style="list-style-type: none"> <input type="checkbox"/> BdP Project Managers <input type="checkbox"/> BdP, BCG 	<ul style="list-style-type: none"> <input type="checkbox"/> Weekly (Tuesdays 9:00) <input type="checkbox"/> BdP
Project managers committee	<ul style="list-style-type: none"> <input type="checkbox"/> Weekly (past) activities status and report meeting for following week <input type="checkbox"/> Transversal perspective view of SIP <input type="checkbox"/> Problem solving of issues emerging in multiple Participant Banks 	<ul style="list-style-type: none"> <input type="checkbox"/> BdP Project Managers <input type="checkbox"/> Account/consulting firms' representatives <input type="checkbox"/> BdP, BCG 	<ul style="list-style-type: none"> <input type="checkbox"/> Weekly <input type="checkbox"/> BdP
Team leaders committee	<ul style="list-style-type: none"> <input type="checkbox"/> Overall progress status concerning clients common to multiple participant banks <input type="checkbox"/> Sharing of findings and issues related to clients common to multiple participant banks 	<ul style="list-style-type: none"> <input type="checkbox"/> BdP Team Leaders <input type="checkbox"/> BdP Project Managers <input type="checkbox"/> BCG 	<ul style="list-style-type: none"> <input type="checkbox"/> Weekly <input type="checkbox"/> BdP
Technical	<ul style="list-style-type: none"> <input type="checkbox"/> Share thoughts on relevant cases and methodologies applied <input type="checkbox"/> Identify priority cases for analysis <input type="checkbox"/> Share information/knowledge 	<ul style="list-style-type: none"> <input type="checkbox"/> BdP Team Leaders <input type="checkbox"/> Account/consulting firms' representatives 	<ul style="list-style-type: none"> <input type="checkbox"/> Weekly
External Status	<ul style="list-style-type: none"> <input type="checkbox"/> Weekly (past) activities status <input type="checkbox"/> Prepare/schedule meeting for the following week <input type="checkbox"/> Solve/discuss potential issues <input type="checkbox"/> Communication of preliminary results 	<ul style="list-style-type: none"> <input type="checkbox"/> Participant Bank's representatives <input type="checkbox"/> BdP Team Leader <input type="checkbox"/> Account/consulting firms' representatives 	<ul style="list-style-type: none"> <input type="checkbox"/> Weekly <input type="checkbox"/> Participant Bank premises

3. The financial stability pillar

3 Major inspection programs made in the last 3 years

	SIP (2011)	OIP (2012)	ETRICC (2013)
Scope	All credit portfolio	Construction and real estate portfolio	All credit portfolio (excluding retail mortgage, consumer credit and sovereign exposures)
Reference date	June 2011	June 2012	April 2013
Population in scope	€281 Billion	€69 Billion	€93 Billion
% of total asset	65%	16%	23%
Sample for individual assessment	51%	56%	48%
# sampled entities	5 651	2 856	2 206
# BdP resources	69	31	27
# External resources	226	98	191
Public disclosure	16-dec-2011	3-dec-2012	2-Aug-2013



3. The financial stability pillar

Selection of external entities followed rigorous criteria of independence and work quality

	Role	Expertise
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BCG

Has provided ongoing support to the coordination of workstreams to ensure a successful and interconnected execution within the predetermined time frames

- Vast experience in setting-up and helping PMO's of similar nature
 - Direct participation as PMO manager for the Central Bank of Ireland program
- Deep knowledge of Portuguese banking system

PWC

PWC worked alongside Ernst & Young on the valuation of credit portfolio workstream in 4 participant banks of the Portuguese banking system

- Independence: PWC does not audit any of the Participant banks in Portugal
- Direct participation of foreign partners in the UK program of Asset Protection Scheme

Ernst & Young

Ernst & Young worked alongside PWC on the valuation of credit portfolio workstream in 4 participant banks of the Portuguese banking system

- Independence: Ernst & Young does not audit 7 of the participant banks
- Direct participation of foreign partners with experience in similar programs (UK, Ireland)

Oliver Wyman

Provide expertise and independent validation of stress-test models and underlying assumptions

- Significant experience in similar projects



3. The financial stability pillar

Quality and consistency assured by BdP

BdP team's main objectives

Define the Terms of Reference (ToR) of the Program

Ensure that the methodology and assumptions defined in the Terms of Reference are applied in a consistent manner

Anticipate potential problems/issues that might compromise the established schedule and contribute to minimize those issues

Anticipate potential problems and difficulties that may compromise the work plan determined and contribute to avoid or minimize potential negative impacts



3. The financial stability pillar

BdP approach to prudential supervision

- 1 Permanent on-site presence
- 2 Frequent horizontal solvency reviews (QRA and RWA)
- 3 Forward looking approach (baseline and adverse scenarios)
- 4 Micro and macro integration
- 5 External and internal auditors challenging



4. Structural reforms

Several structural reforms were implemented

Examples

Labor Market

- Increase in **working days**: up to 7 additional (3 vacation + 4 holidays)
- Reduction of restrictions to **individual dismissal**: based on performance
- Restrictions on **automatic extension of collective agreements**
- Reduction of **severance payments to align with EU average** (from 30 days to 12 days per year worked for new permanent contracts; for remaining contracts 18 days per year of service in the first 3 years of the contract and 12 days for subsequent years)
- **Unemployment subsidy** entitlement period reduced from a maximum of 38 months to 26 months

Product Market

- Approval of measures aiming at **reducing the costs with energy** (partly eliminating the excessive profits in this sector)
- Improve **rental market legislation** (set transition periods for the convergence of rents and negotiation mechanisms between landlords and tenants)
- Liberalization of the **energy and gas market**

Judicial system

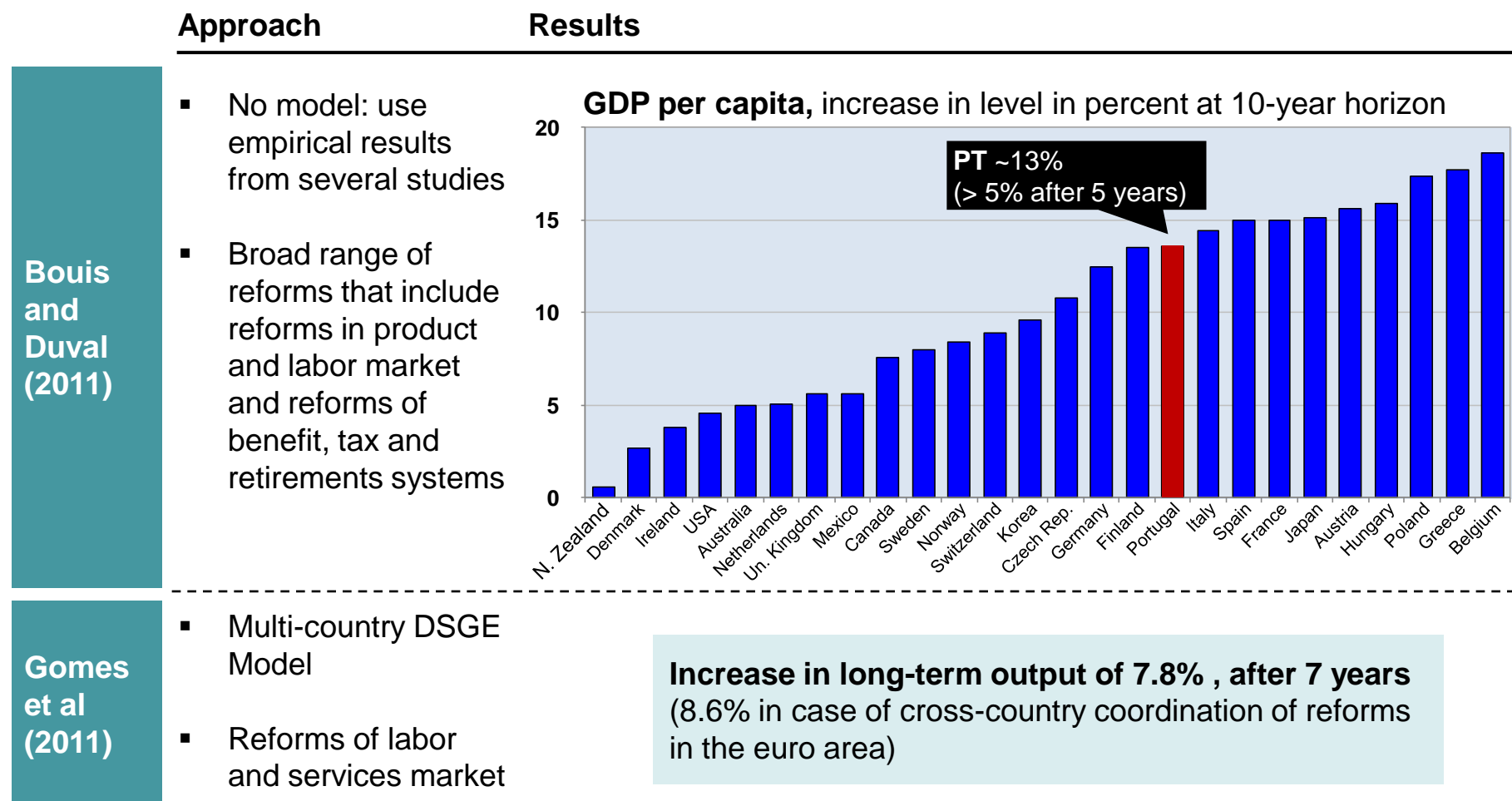
- Adoption of a **law on arbitration** to facilitate out-of-court settlement
- Approval of **new Code of Civil Procedure**, submitted to Parliament
- Adoption of a new **Judiciary Map**, submitted to Parliament
- Reduction of the **backlogged cases**

Business environment

- New **insolvency code and corporate recovery**
- New **Competition Law** harmonized with the EU legal competition framework
- Liberalization of **regulated professions' access and exercise**
- Reduction of firms' administrative burden: **licensing requirements and other legal formalities**
- Adoption of the new **Urban Lease, Renovation works and Urban Rehabilitation Laws**

4. Structural reforms

Long-run potential impact of structural reforms in Portugal





4. Structural reforms

In a complex society the implementation of structural reforms takes time



This is further complicated by the fact that the positive impact on output and employment of structural reforms is not immediately visible



The ownership of the reforms by the society is crucial to break vested interests



The Portuguese Adjustment Program