

Recent developments and challenges for the Portuguese economy



BANCO DE PORTUGAL
EUROSYSTEM

Carlos da Silva Costa • Governor

National Bank of Poland

19 June 2015



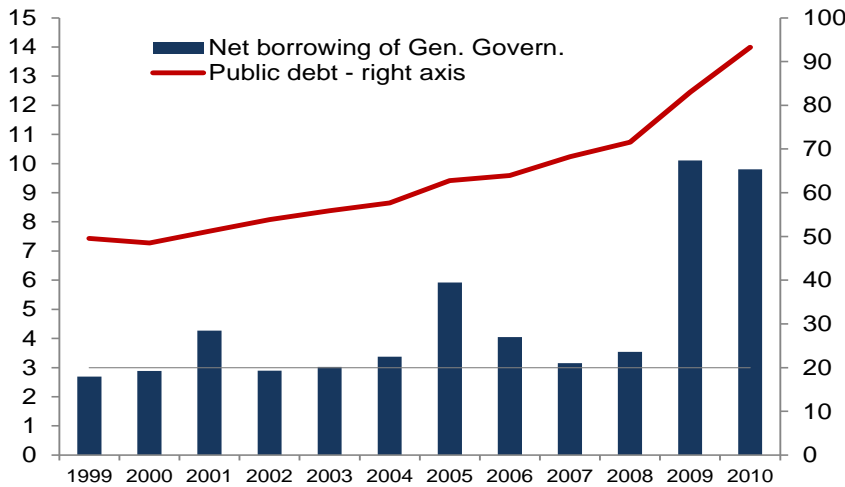
- 1. Growing imbalances and the sudden stop**
- 2. The ongoing adjustment of the Portuguese economy**
- 3. Recent developments and the macroeconomic outlook**
- 4. Challenges ahead: Portugal and the EMU**
- 5. Conclusions**



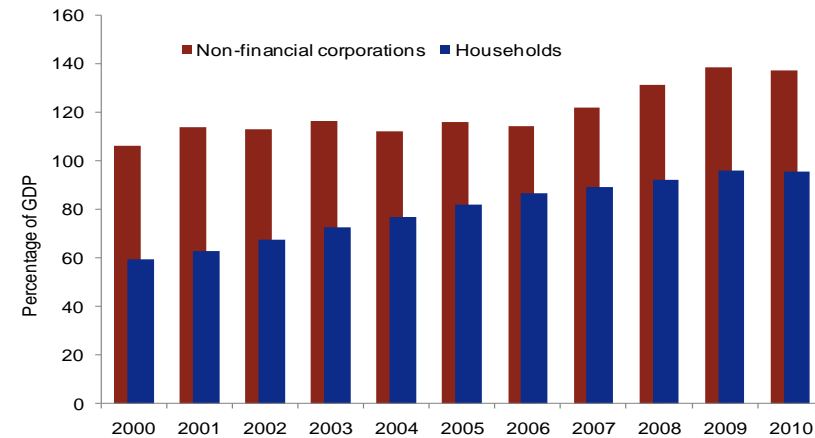
1. Growing imbalances and the sudden stop

Macroeconomic imbalances came to the spotlight in the context of the global crisis

Deficit and public debt (% of GDP)

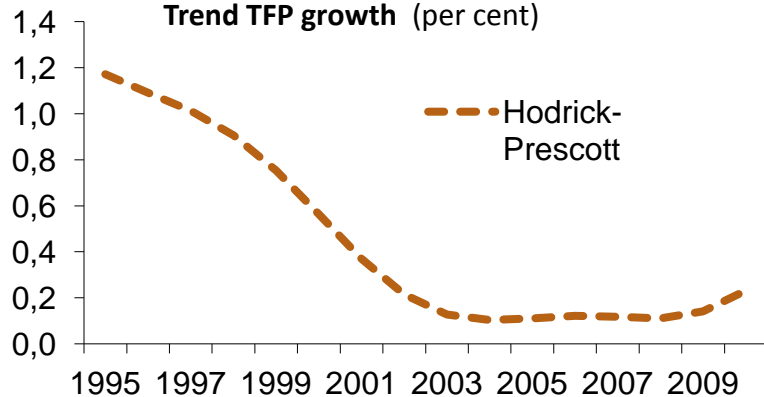


Indebtedness of the non-financial private sector (% of GDP)



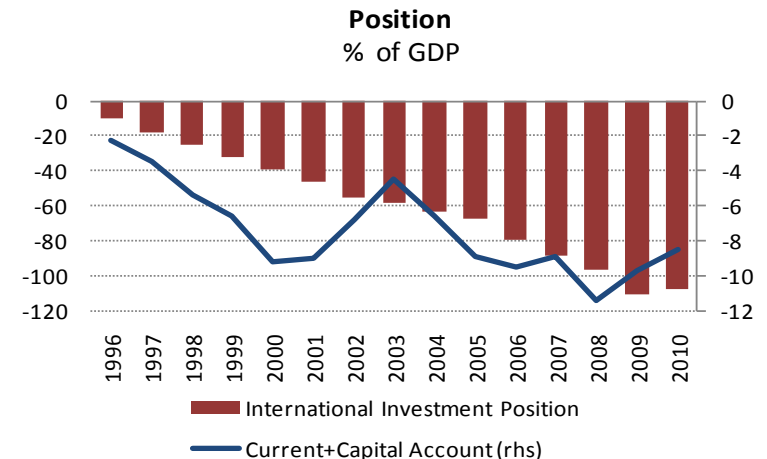
Sources: INE and Banco de Portugal.

Trend TFP growth (per cent)



3 • Source: Banco de Portugal

External Accounts and International Investment





1. Growing imbalances and the sudden stop

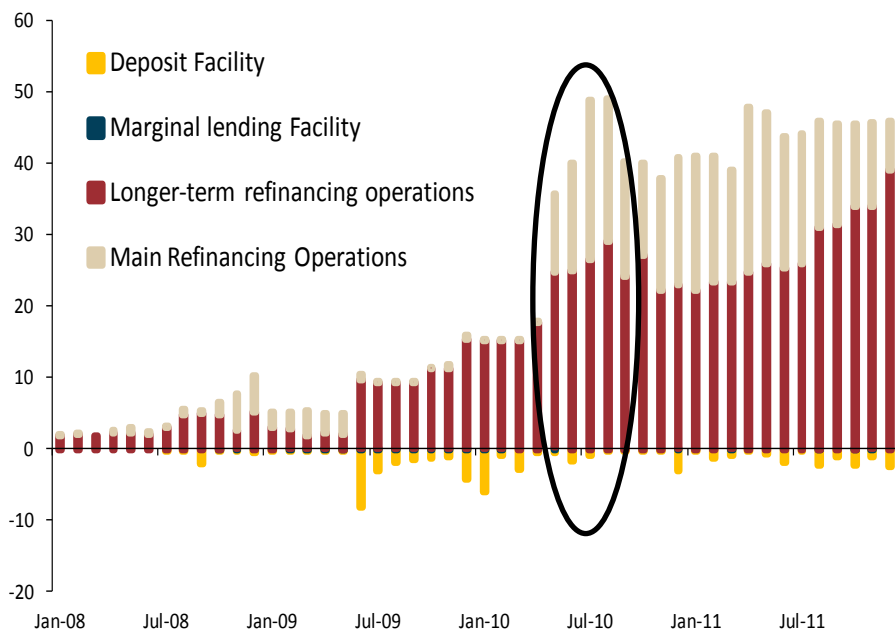
Unsustainable public finances

Over-indebtedness and excessive bank leverage

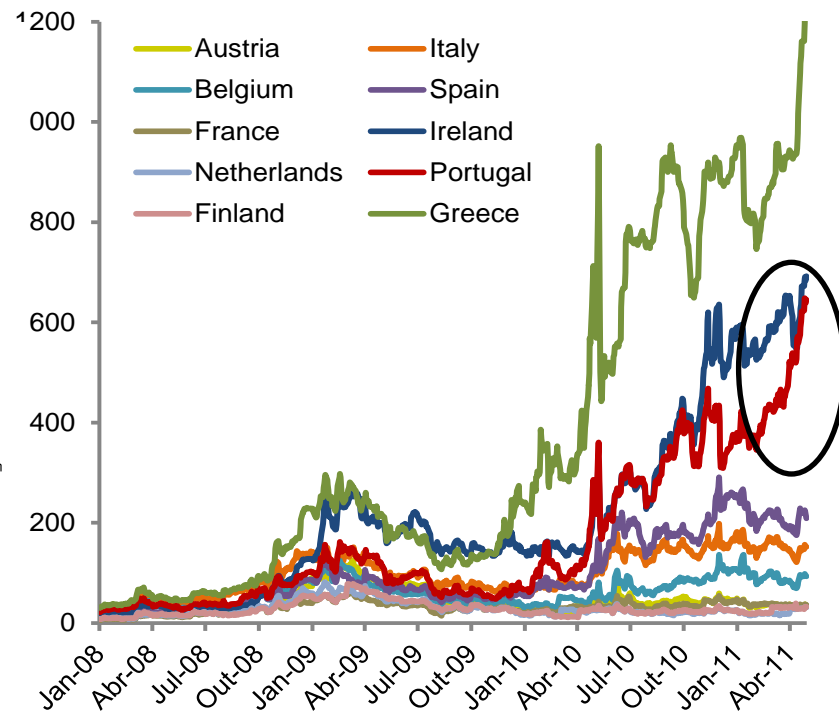
Anemic economic growth and low productivity

Sudden stop in private external finance

Outstanding amounts of monetary policy operation of Portuguese banks
Euro million



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

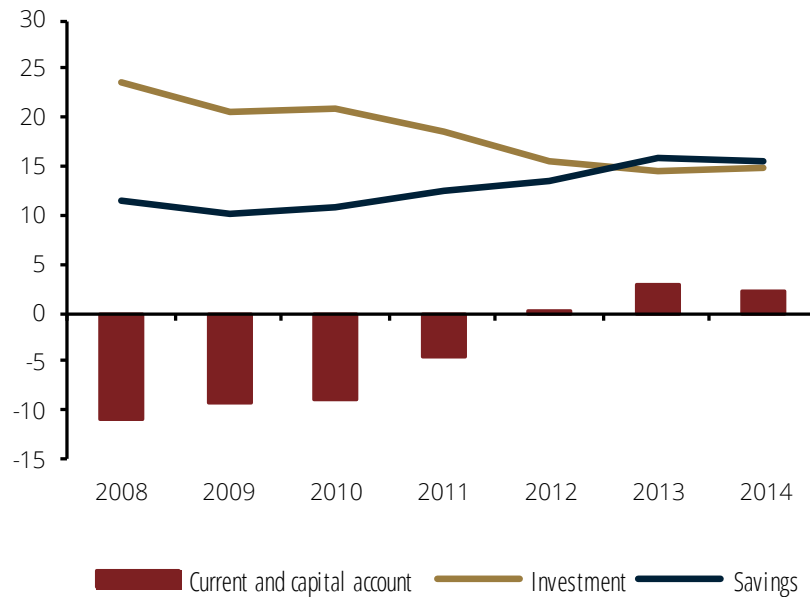




2. The ongoing adjustment of the economy

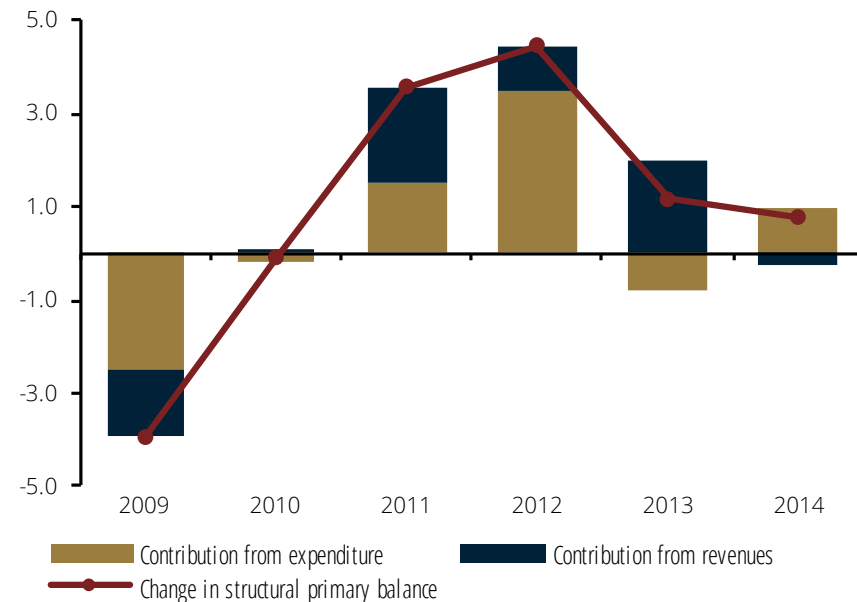
- **Sizeable adjustment of imbalances in a monetary union**
 - i) Net lender position (improvement of around 12 p.p. in the current and capital account between 2010 and 2014)
 - ii) Strong and unprecedented fiscal consolidation effort in 2011-14 (around 10 p.p. improvement in the structural primary deficit)

Current and capital account (% GDP)



Sources: INE and Banco de Portugal

The composition of the fiscal adjustment



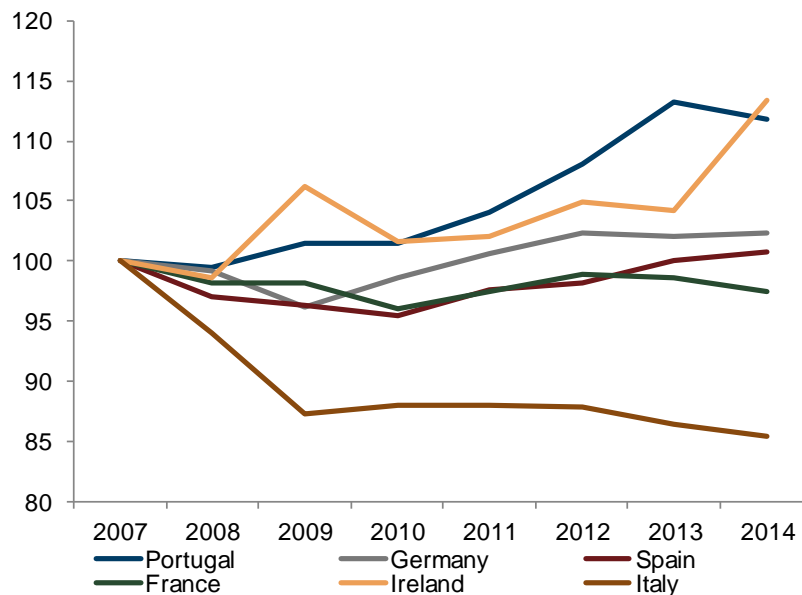
Sources: INE and Banco de Portugal



2. The ongoing adjustment of the economy

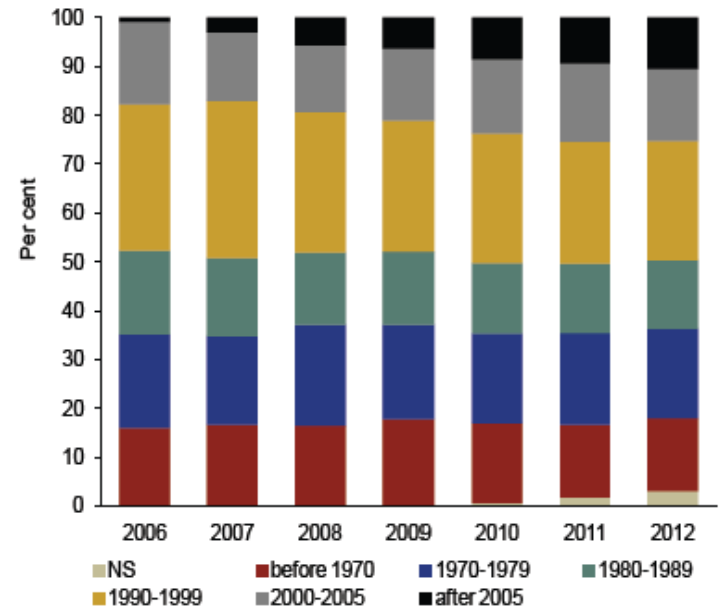
- **Restructuring of the economy and reallocation of resources**
 - i) Weight of exports in GDP increased 10 p.p. between 2010 and 2014
 - ii) Export market share gains of around 10 p.p. in 2010-14
 - iii) Increased geographical diversification of exports; significant share due to young firms

Accumulated export market shares (index: 2007=100)



Sources: ECB and Banco de Portugal

Export decomposition by firms' birth year

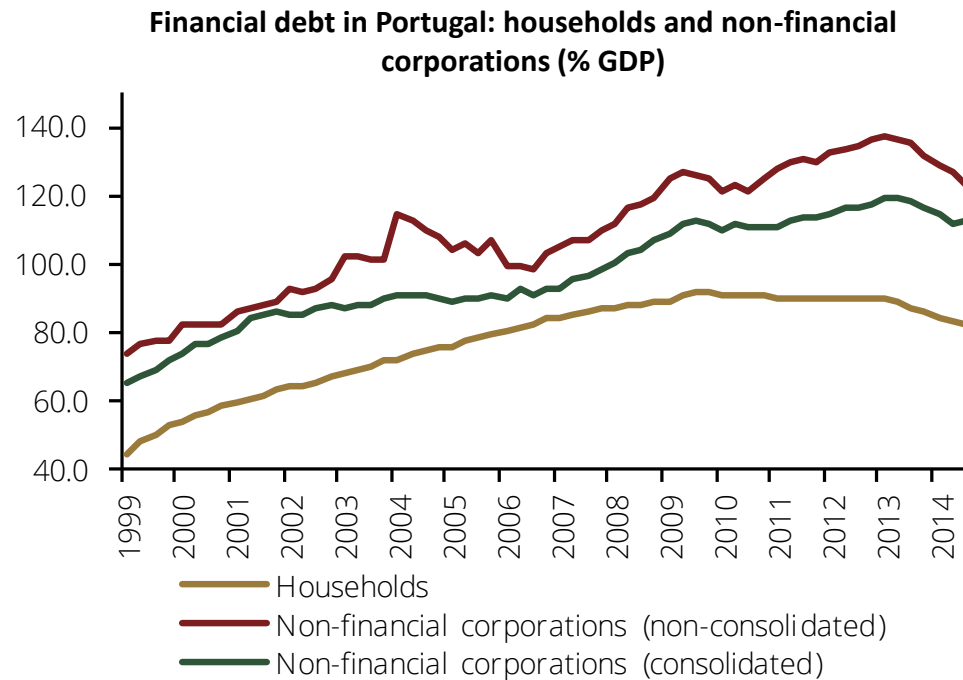


Source: Banco de Portugal calculations based on IES database



2. The ongoing adjustment of the economy

- **The deleveraging process of the private sector is ongoing**
 - i) Indebtedness levels remain above the euro area average
 - ii) They affect consumption and investment decisions of the most indebted agents



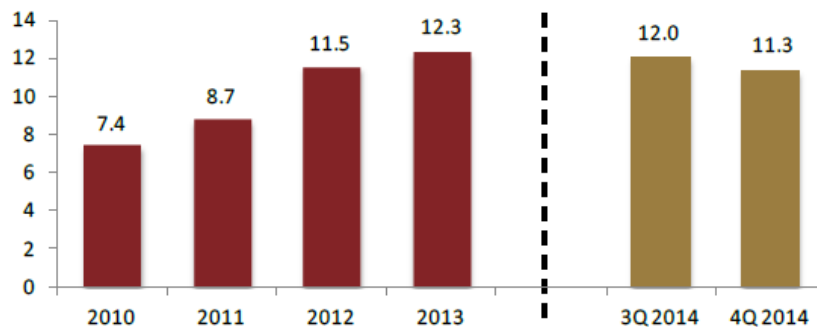


2. The ongoing adjustment of the economy

- **The strengthening of the financial system**

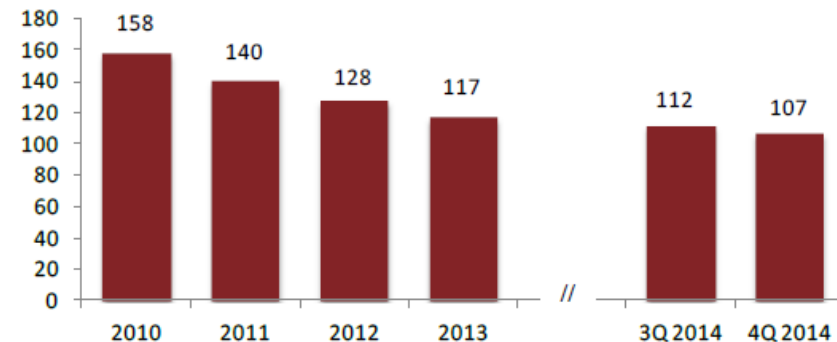
- i) Increased solvency and liquidity position of the banking sector
- ii) Orderly deleveraging process, consistent with the deleveraging of the private sector
- iii) There were no disruptions in financial intermediation stemming from the resolution of BES

Core Tier 1 ratio (until 2013) and CET 1 ratio (2014) – End of period values



Source: Banco de Portugal

Loan to deposits ratio (%) - End of period values



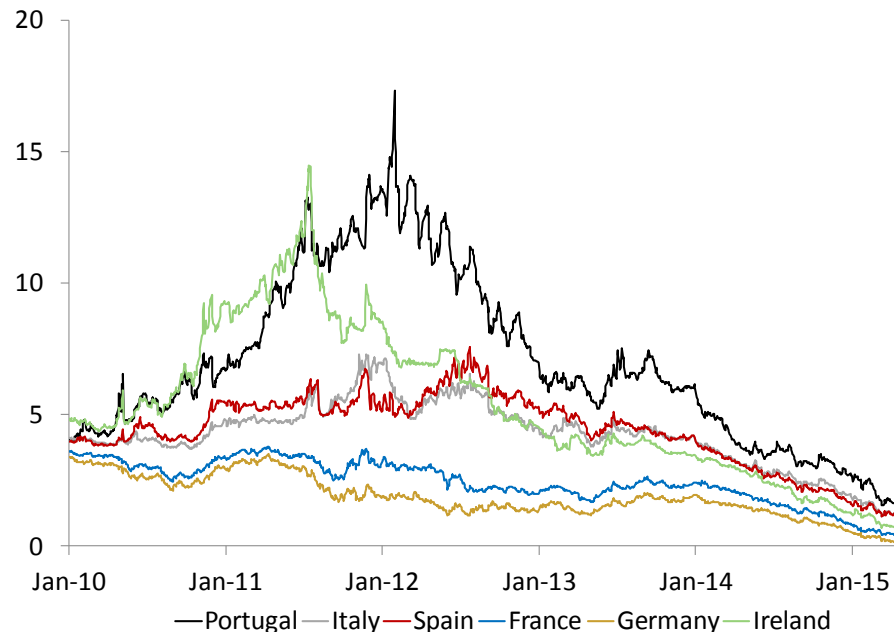
Source: Banco de Portugal



2. The ongoing adjustment of the economy

- **Sustained return of the sovereign to international markets**
 - i) Successful exit from the Programme, anchored on sounder fundamentals & institutional progress on a European level
 - ii) Policy measures at the Eurosystem level are contributing to historically low yields in the euro area

10-year government bond yields

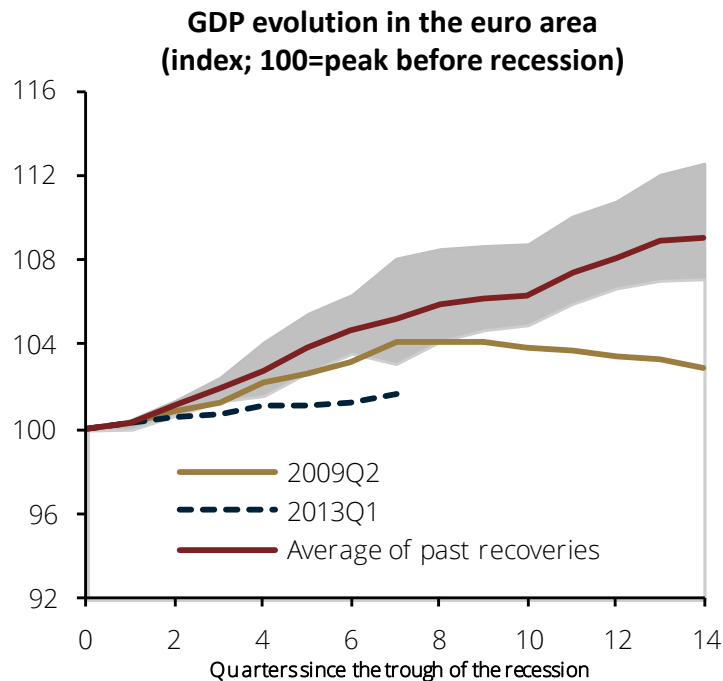




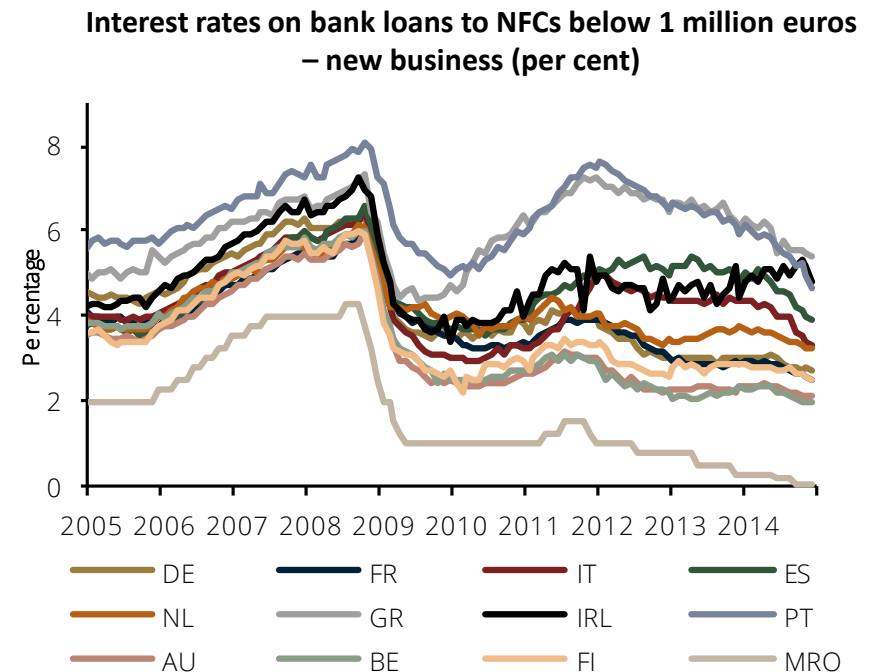
3. Recent developments and outlook

- **The international environment is improving**

- i) The recovery in the euro area has been sluggish but is becoming more broad-based
- ii) Improving monetary transmission mechanism, following years of significant impairment



Sources: EUROSTAT, CEPR and Banco de Portugal calculations



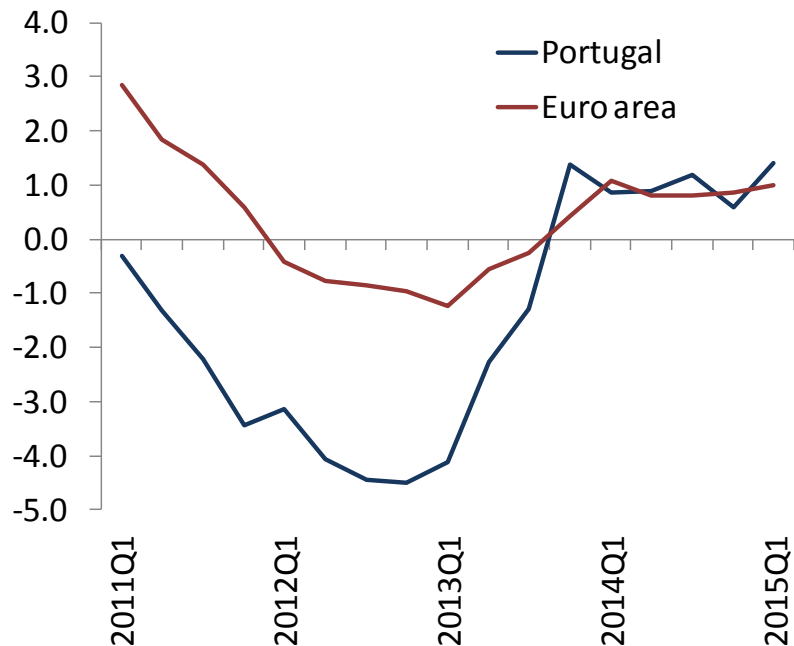
Sources: ECB and Banco de Portugal calculations



3. Recent developments and outlook

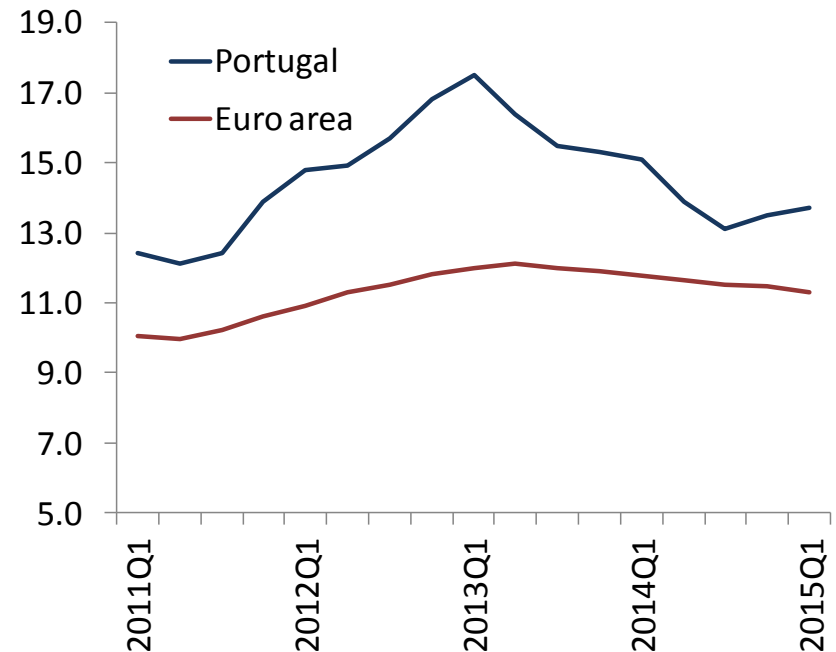
- **A gradual recovery has been observed in Portugal since mid-2013**
 - i) GDP growth close to the euro area in the last quarters
 - ii) Improvement in the labor market, albeit long-term and structural unemployment remain historically high

Year-on-year rate of change of GDP (per cent)



Sources: EUROSTAT and INE

Unemployment rate (per cent)

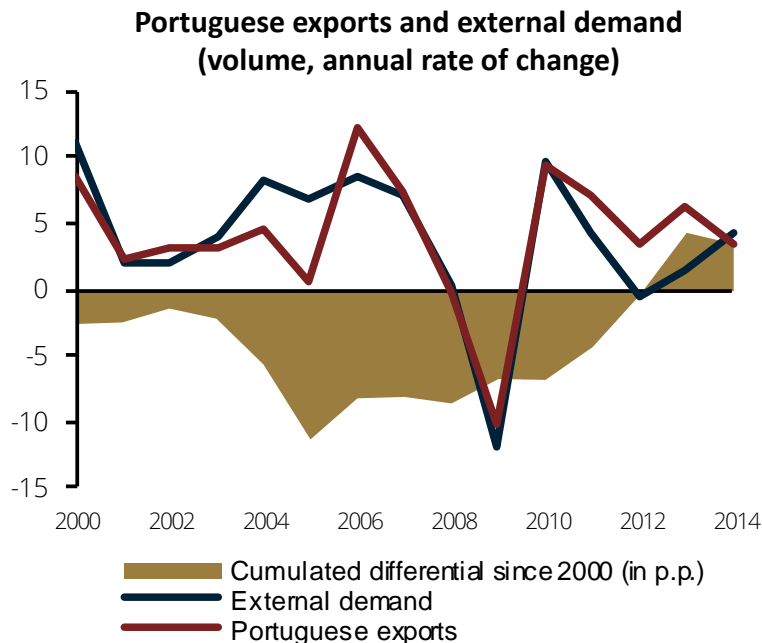


Sources: EUROSTAT and INE

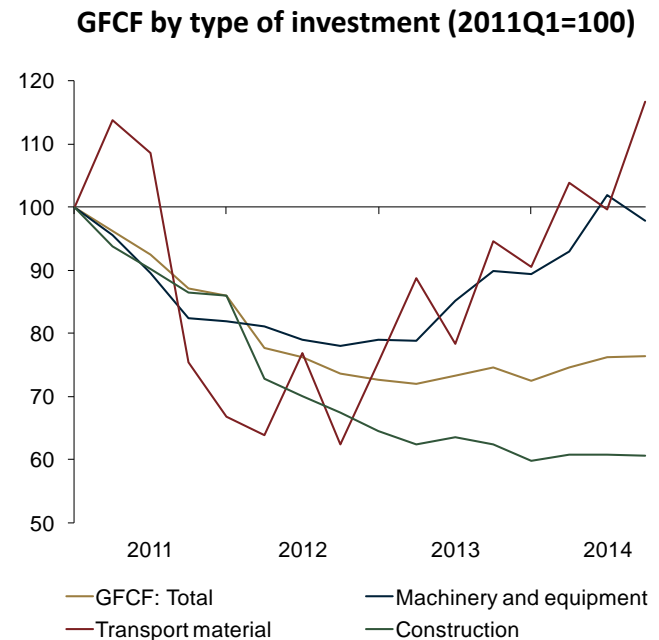


3. Recent developments and outlook

- **The gradual recovery is rooted in resilient exports coupled with improving domestic demand**
 - i) The deceleration in the exports of goods in 2014 was due to temporary factors, notably related to exports of fuels
 - ii) Investment dynamics is still lagging, but growth is already strong in machinery, equipment and transport material



Sources: INE and Banco de Portugal calculations



Sources: INE and Banco de Portugal calculations



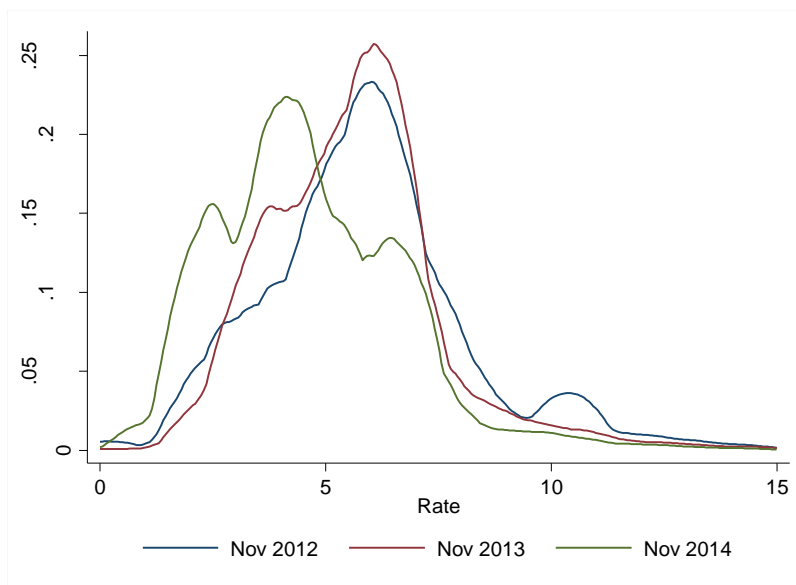
3. Recent developments and outlook

- **Credit developments have been consistent with the adjustment**

- i) Improvement in credit market conditions since 2013

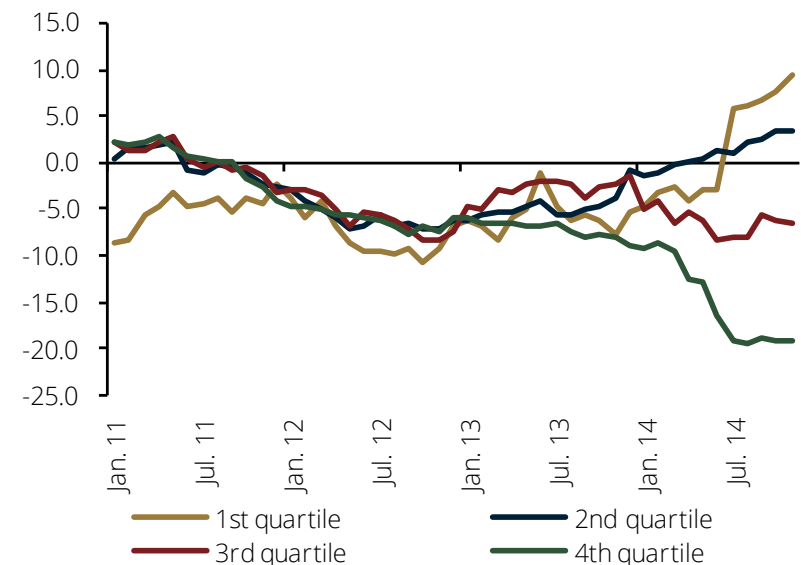
- ii) Credit flows have been channeled to the most dynamic and productive firms, notably exporting firms in the private sector

Distribution of interest rate to non-financial corporations (new business), in percentage



Source: Banco de Portugal

Credit to private firms by risk profile



Note: Low (high) risk corresponds to the low (high) z-score deciles

Source: Banco de Portugal



3. Recent developments and outlook

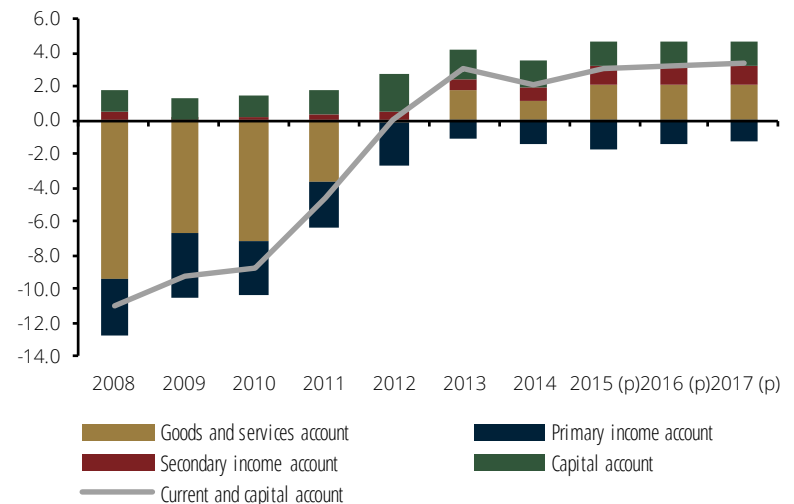
- **The latest macroeconomic projections by Banco de Portugal**
 - i) GDP growth close to the euro area throughout the horizon
 - ii) Gradual recovery of domestic demand and strong export dynamics
 - iii) Significant recovery in business GFCF
 - iv) Sustained correction of macroeconomic imbalances

Projection June 2015 (annual rate of change, per cent)

	2014	2015 ^(p)	2016 ^(p)	2017 ^(p)
Gross Domestic Product	0.9	1.7	1.9	2.0
Private Consumption	2.1	2.2	1.7	1.7
Public Consumption	-0.3	-0.5	0.2	0.0
GFCF	2.5	6.2	4.4	6.0
Exports	3.4	4.8	6.0	6.4
Imports	6.4	5.7	5.5	6.5
Current & Capital Account (% GDP)	2.1	3.0	3.2	3.4
Trade Balance (% GDP)	1.1	2.1	2.1	2.1
HICP	-0.2	0.5	1.2	1.3

Source: Banco de Portugal.

Current and capital account (% of GDP)



Sources: INE and Banco de Portugal.

Note: (p) - projected.



4. Challenges ahead: PT and the EMU

- **Adjustment of accumulated imbalances will continue in PT**
 - i) Even under conservative macroeconomic assumptions, fulfilling the Fiscal Compact ensures debt sustainability
 - ii) Need to increase financial autonomy of non-financial corporations
 - iii) Need to restore banking sector profitability



4. Challenges ahead: PT and the EMU

EMU - MUTUAL TRUST

Responsibility



Solidarity

It is not possible to reinforce the area as a whole without the acceptance by the parties of the rules resulting from the whole

It is not possible to guarantee the stability of the whole without policy instruments to absorb shocks that Member State are subject

Sound Economic Policies

- Comply with fiscal compact and MIP
- Create a European Fiscal Council
- Enforcement should rest with Eurogroup

Cross-country risk sharing

- Create a European Monetary Fund
- Complete banking union (Single Resolution Fund and Common Deposit Guarantee Scheme)
- Create a Capital Markets Union



4. Challenges ahead: PT and the EMU

- **Improving long-run growth is of the essence (PT and EMU)**
 - i) Need to sustain the reform momentum
 - ii) Investments in physical and human capital are key
 - iii) Deepen Single Market
 - iv) Capital Markets Union



- Sounder fundamentals, coupled with institutional progress on a European level, have solidly anchored the exit from the Assistance Programme
- The projections point to a sustained but gradual recovery, which can only be enhanced via an acceleration of investment
- The ongoing macroeconomic adjustment requires long-term commitments which anchor agents' incentives; maintaining ownership and social cohesion throughout the process is key
- The current process of institutional deepening on a European level is essential to foster macroeconomic stability and enhance potential growth



Thank you!