FOR AGENDA

EBS/84/143

CONFIDENTIAL

July 2, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Portugal - Staff Report for the 1984 Article IV Consultation and Review Under the Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Portugal and a review under the stand-by arrangement. Draft decisions appear on pages 14-16.

It is proposed to bring this subject to the agenda for discussion on Monday, July 30, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mrs. Ter-Minassian (ext. (5)8844).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

PORTUGAL

Staff Report for the 1984 Article IV Consultation and Review Under the Stand-By Arrangement

Prepared by the Staff Representatives for the 1984 Article IV Consultation

Approved by Brian Rose and Subimal Mookerjee

July 2, 1984

I. Introduction

A staff team consisting of Mrs. T. Ter-Minassian, Messrs. E. Spitaeller, T. Catsambas (all EUR), E. Kalter (ETR) and, as secretary, Miss C. Strayer (EUR) visited Lisbon from May 28 to June 20, 1984 to conduct Article IV consultation discussions and to complete the scheduled review of the stand-by arrangement which was approved by the Executive Board on October 7, 1983 for the period to February 28, 1985 in the amount of SDR 445 million (118 percent of quota). The staff met with the Prime Minister, the Deputy Prime Minister, the Minister of Finance and Planning, the Governor and the Deputy Governors of the Bank of Portugal and with officials in the Ministries of Finance and Planning, Industry and Energy, Social Equipment and Labor, and in the Bank of Portugal. The previous consultation discussions had taken place from March 8 to 22, 1983, and the staff report was considered by the Executive Board on June 13, 1983.

The stand-by program approved by the Board in October 1983 called for a review to be completed by March 31, 1984 to set performance clauses for 1984. Discussions were held in Lisbon for this purpose in February and March 1984 but agreement was delayed by difficulties encountered in securing reliable estimates of the borrowing requirements of the public enterprises. This information was needed to extend the ceiling on domestic bank credit to the General Government to include the public enterprises, with a view to ensuring a better allocation of financial resources between the public and the private sectors and a more effective control over the public sector finances. The undrawn balance of the program consists of SDR 278.6 million (74 percent of quota). Fund holdings of Portuguese escudos stood at SDR 771.3 million (204.8 percent of quota) on May 31, 1984, including purchases under the Compensatory Financing Facility amounting to SDR 258 million (68.5 percent of quota).

The Portuguese authorities have requested a further purchase under the CFF in the amount of SDR 54.6 million (14.5 percent of quota) on account of a shortfall in foreign exchange earnings during the period April 1, 1983 to March 31, 1984. This request is dealt with in a separate document which is to be circulated shortly.

Portugal continues to avail itself of the transitional arrangements under Article XIV.

II. Report on the Discussions

1. Recent economic developments

Following a successful adjustment effort in 1977-79, supported by a stand-by arrangement with the Fund, the economic performance of Portugal deteriorated markedly in the subsequent years, reflecting rather lax financial policies, in particular increasing deficits in the public sector and in the public enterprises, and losses in competitiveness, as well as adverse external factors such as the worsening of the terms of trade, the recession in the world economy and high interest rates abroad. By 1982 the current account deficit of the balance of payments had reached 13 percent of GDP (compared with virtual equilibrium in 1979) and inflation had accelerated to over 22 percent. In the first few months of 1983, political uncertainties contributed to significant financing difficulties in international capital markets, resulting in sizable losses of international reserves.

The new Government, which took office in June 1983, quickly embarked on a stabilization program supported by a new stand-by arrangement with the Fund. The main objective of the program was the reduction of the current account deficit of the balance of payments to levels which could be financed without substantial further losses of reserves and which would ensure a decline in the debt service ratio over the medium term. Specifically, the current account deficit was targeted to decline from the equivalent of US$3.2 billion (13.2 percent of GDP) in 1982 (Table 1) to at most US$2 billion (9 percent of GDP) in 1983 and to US$1 1/4 billion (6 percent of GDP) in 1984.

The policy strategy in support of the external adjustment objective included: (a) a 12 percent devaluation of the escudo in June 1983, which resulted in a marked improvement in competitiveness significantly above the previous peak, followed by the continuation of the "crawling peg" depreciation at the rate of 1 percent a month; (b) increases in August 1983 of 2 percentage points in interest rates on time deposits and of 2 1/2 percentage points in nominal bank lending rates; (c) a reduction in the cash deficit of the General Government from around 12 percent of GDP in 1982 to below 10 percent of GDP in 1983 through a package of tax measures equivalent to about 1 percent of GDP, sharp increases in administered prices of essential goods and of public services, efforts to contain public consumption and cuts in the public investment program; and (d) a marked deceleration in the growth of total financing to the economy through ceilings on domestic and external credit (EBS/83/196, 9/9/83).

Performance under the program in 1983 was generally satisfactory. The performance clauses for year-end were met with comfortable margins (Table 2). The cash deficit of the General Government declined to 9 percent of GDP (Table 3), and the rate of growth of domestic credit to the General Government decelerated to 19 percent in 1983 from 33 percent in 1982 (Table 4). The rate of growth of total financing to the economy declined from 29 percent in 1982 to 18 percent in 1983, against the background of an acceleration in the rate of growth of the CPI (boosted by the devaluation of the escudo and the adjustments in administered prices) from 19 percent to 34 percent between the two years. While the sharp drop in the real rate of growth of financing was in part due to reduced availability of external credit, it also reflected a significant tightening of domestic credit policy and a 6 1/2 percentage point increase in nominal lending rates in the course of the year.

The tightening of credit conditions affected both private and public enterprises. The latter, which in recent years had been financed largely by external credit, were confronted in 1983 with a virtual drying up of new foreign financing. They adjusted by running down stocks, cutting back on investments and running up arrears toward their domestic suppliers. According to still preliminary data, the borrowing requirements of the statutory public enterprises (including the Sines Port Authority and the Vegetable Oils Import Board) declined in 1983 by the equivalent of over 4 percentage points of GDP to around 6 percent of GDP (Table 3). Nevertheless, the substitution of domestic for external financing led to a 40 percent increase in domestic credit to these enterprises, thus accentuating the squeeze on private enterprises, which finance themselves almost exclusively in the domestic credit markets.

The tightening of financial policies was supported by successful efforts to moderate the growth of labor costs. Real wages declined by over 10 percent in the course of 1983, contributing, along with the tax measures and the deceleration in emigrants' remittances, to an estimated 5 percent drop in real disposable income of households. Real consumption, however, declined by only 1 percent as the savings rate fell significantly (Table 5). Total domestic demand fell by over 7 percent in real terms, in reflection of a marked drop in fixed investments and of a rundown of stocks. The effect of this decline on the rate of growth of output was, however, largely offset by a marked improvement in the real trade balance as exports of goods and services rose by over 16 percent in volume, while imports declined by over 8 percent. Thus, real GDP fell by only 0.5 percent (Table 5). Nevertheless, unemployment rose significantly to around 10 1/2 percent of the labor force in the latter part of 1983.

The greater than anticipated improvement in the real trade balance more than offset an unexpected loss in the terms of trade and a shortfall in earnings from invisibles. Remittances were adversely affected by the slower than expected recovery in Europe and by the strength of the U.S. dollar vis-à-vis the currencies of European countries from which the bulk of remittances originates. The current account deficit remained below US$1.7 billion (8 percent of GDP) (or about US$300 million less than the program target) (Table 1). Net capital inflows declined markedly from their record US$3.3 billion level in 1982, in reflection of the financing difficulties referred to above. Total external debt (excluding external liabilities of the Bank of Portugal and shortterm foreign liabilities of the banks) remained well below the program ceiling, and in particular its short-term component recorded a sizable (US$650 million) decline, leading to a significant improvement in the maturity structure of the debt (Table 6). The overall deficit of the balance of payments at below US$900 million was also lower than the program target (US$1,140 million).

Preliminary indications on developments in the first few months of 1984 point to a continued recession in domestic demand, in reflection of the stance of financial policies and of the decline in real incomes. The 12-month rate of inflation decelerated from a peak of 34 percent in December 1983 to around 30 percent by May 1984, despite adverse developments in some agricultural prices. Wage increases negotiated so far have remained generally below 20 percent, lending support to the expectation of a further moderation in inflation in the second half of the year.

The authorities have maintained a cautious stance of financial policies, in line with the indicative ceilings for 1984 of the initial stand-by program. The rate of growth of total domestic credit remained around 20.5 percent in the first three months of the year, while that of broad money accelerated slightly to around 21.5 percent, reflecting some recovery in time deposits. Domestic bank credit to the enlarged public sector (defined to include the General Government and the statutory public enterprises) rose by 26 percent in the 12 months to March 1984, compared with 25.4 percent in 1983. This slight acceleration was, however, more than offset by a reduction in the growth of external financing, particularly to the public enterprises, so that the growth of total financing to the public sector declined to below 17 percent by March 1984 compared with nearly 22 percent in 1983.

The current account of the balance of payments recorded a further significant improvement in the first quarter of 1984, when the deficit (at US$350 million) was less than half the level in the corresponding period of 1983. Exports continued to rise at a sustained rate, while imports in U.S. dollars remained over 11 percent below the level a year earlier. A recovery was also recorded in receipts from tourism and workers' remittances. Capital inflows, especially of a medium- and long-term nature, were limited in the first quarter of the year, as the authorities did not seek syndicated loans, following a US$350 million credit to the Republic in December 1983. As a result, the overall balance of payments recorded a deficit of US$263 million, and foreign exchange reserves of the Bank of Portugal declined to below the equivalent of two weeks of imports. Capital inflows increased significantly in the second quarter of the year, following the arrangement of various private placements and the issue of floating rate notes. As a result, foreign exchange reserves have been rebuilt somewhat, and currently stand at around US$400 million. Gold reserves amount to over 20 million ounces, equivalent to US$7.5 billion (one year of imports) at current market prices.

2. Economic policies

a. The overall strategy

The Portuguese authorities recognize that the progress toward external adjustment made in 1983 must be continued in 1984, if a sustainable balance of payments position is to be secured. For this purpose, a further reduction in the current account deficit in 1984 to at most US$1 1/4 billion remains a priority objective of economic policy. In the light of the current prospects for a continued strong growth of merchandise exports, for some recovery in other foreign exchange earnings, and for only a slight deterioration in the terms of trade, the achievement of the balance of payments objective should be consistent with no more than a moderate decline in import volumes on average for the year (Table 1). Given the drop recorded so far, this would imply some increase in imports and in aggregate demand in the second half of 1984. The authorities also attach great importance to securing a further sustained decline in the rate of inflation to around 23 percent by year-end (Table 5). The average rate of inflation in 1984 will remain, however, above the 1983 level, mainly in reflection of the recent and prospective adjustments in administered prices of petroleum products, subsidized commodities and public services, needed to secure a further improvement in the public sector finances in 1984.

To promote the achievement of their economic objectives for 1984, the authorities intend to maintain a cautious stance of monetary and credit policies and to secure a further reduction in the borrowing requirements of the public sector in relation to GDP. For this purpose a number of measures have already been taken, aimed at strengthening the finances of the General Government and of the public enterprises. To ensure the desired allocation of financial resources between the public and the private sectors, the authorities have agreed to the extension of the program ceilings on domestic bank credit to the General Government to include the public enterprises. The authorities are also committed to the maintenance of a strong competitive position through continued moderation of wage costs and through a gradual depreciation of the escudo vis-à-vis a basket of partner countries' currencies at the rate of 1 percent a month. Short-term policies are to be complemented by a determined attempt to begin tackling some of the structural weaknesses of the economy, particularly in the area of the public sector finances.

b. Monetary policy

Monetary policy will continue to be conducted in the near future within the framework of quantitative controls on domestic bank credit which has characterized it in the last several years. Although the authorities are aware of the costs, particularly in terms of the efficiency of the banking system, of a protracted resort to credit ceilings, they recognize that the current narrowness of the interbank money market would prevent an effective control of the monetary base and of the broader monetary aggregates. It is the authorities' intention to promote over the medium term the broadening of the monetary and the financial markets through a more flexible interest rate policy and through the creation of a wider range of financial instruments. In this way they hope both to reduce the impact of the public sector deficit on the monetary base and to channel savings into productive investments.

The monetary program agreed with the authorities, which will form the basis for the setting by the Bank of Portugal of monthly ceilings on credit by the banking system, is geared to promoting the targeted deceleration of inflation to 23 percent by year-end and a slight pickup of output in the second half of the year. Specifically, the program targets *a rate of growth of total domestic credit around 21 percent, consistent* with a recovery in the real demand for money and no loss in net foreign assets of the banking system for the year as a whole (Table 4). The expectation of a small decline in velocity is supported by the authorities' committment to a more flexible management of interest rates and by the prospect of a significant increase in real interest rates during the year as inflation decelerates.

As a step in this direction, on June 21, 1984, the Bank of Portugal announced a liberalization of the structure of the rates on bank deposits. Henceforth the Bank will only set the level of a "pivot" rate, namely that on deposits with maturities of six months to one year, leaving the banks free to choose the levels of the rates on deposits of other maturities. The authorities intend to keep the appropriateness of the level of the "pivot" rate (currently set at 28 percent) under review and to make adjustments in the light of changing circumstances, particularly developments in the rate of inflation and in interest rates abroad. Steps will also be taken to promote financial savings, especially of small savers, for example by expanding the scope of passbook savings accounts. As regards lending rates, those on short-term loans, which account for over 80 percent of total bank credit, are currently very high in effective terms due to the practice of paying the interest "up front". A small reduction in these rates--1 percentage point in nominal terms, equivalent to about 1.7 percentage points in the effective cost of credit--was announced on June 21, 1984. The adverse effect of this reduction--with the "pivot" rate on deposits remaining unchanged--on the profitability of the banks will be offset by a reduction in the reserve requirements coefficients which will free bank liquidity for investment in the interbank bond market, where rates currently average about 24 percent.

c. Fiscal policy

The Portuguese authorities recognize that, even after the substantial improvement recorded in 1983, the public sector finances remain an area of serious weakness, which will require a sustained corrective effort in the short as well as in the medium term. For 1984 they intend to secure a further reduction in the consolidated borrowing requirements of the enlarged public sector in relation to GDP equivalent to about 1 percentage point, to no more than 14.4 percent of GDP (Table 3). The program ceilings on domestic bank credit to the enlarged public sector and on the external debt (Tables 2 and 4) are consistent with this targeted reduction. The scope for achieving a more substantial decline in the public sector borrowing requirements is constrained in 1984 by the absence or the likely reversal of some temporary factors which contributed to their decline in 1983 (such as the extraordinary tax measures introduced in September 1983 and the rundown of stocks of some public enterprises) and by the adverse impact of the domestic recession on revenues of the General Government and of some public enterprises. The Government is, however, committed to taking in 1984 a number of actions which will lead to further significant improvements in the public sector finances in 1985 and beyond.

The initial budget for 1984 targeted a reduction of the overall deficit of the General Government to below 7 percent of GDP, to be achieved primarily through the containment of expenditures, which, excluding interest payments on the public debt, were projected to show a sizable decline in real terms. Available information on the implementation of the budget to date points to the likelihood of some shortfalls in tax revenues and in social security contributions as a result of the sharper than anticipated downturn in domestic demand. Also, additional outlays are likely to be needed for interest payments, for selected public investment in the depressed construction sector and for increases in the equity capital of some public enterprises, such as the chemical company and the railways, in connection with restructuring programs for these companies. In order to offset in part the adverse impact of these developments, the authorities will take steps to reduce the use of most budgetary appropriations from the average 90 percent which has prevailed in recent years, to around 85 percent. Nevertheless, the decline in the general government deficit relative to GDP in 1984 is likely to be small.

A comprehensive effort will be required in 1985 and beyond to secure further reductions in the deficit. For this purpose the authorities are accelerating progress toward the reform of the tax system, to make it more equitable and responsive to developments in the tax base, so as to ensure a gradual rise in the tax ratio without significant adverse side effects. A value-added tax will be introduced in 1985, to replace various existing indirect taxes. A commission has been recently appointed to prepare the reform of the system of direct taxation, with a view to implementing such a reform within the next couple of years. Significant success has been recorded in recent months in recovering arrears in the payment of selected taxes and of social security contributions, as well as in improving administration and enforcement, but there is clearly scope for substantial further progress in this area. In the preparation of the 1985 budget the authorities will also undertake a thorough review of the existing fiscal incentives and exemptions, which in recent years have substantially eroded the tax base, with the aim of reducing their scope and cost to the budget.

On the expenditure side, the authorities have already taken steps, through a hiring freeze, to moderate the growth of public employment which has been very rapid in recent years. Over the medium term, it is necessary to promote mobility within the civil service, the autonomous services (including the health service) and the local administration. The authorities have outlined in the letter of intent the specific steps they are taking to strengthen control over expenditures by peripheral public entities (autonomous funds and services and the local authorities). They also intend to continue the policy of progressive elimination of consumer subsidies through the price mechanism. In this respect, the Supply Fund which receives the revenue from the gasoline tax and subsidizes essential foodstuffs (cereals, milk and vegetable oils) as well as fuel oil, is expected to record a surplus of Esc 16 billion in 1984 (compared with virtual equilibrium in 1983) in reflection of significant increases in the prices of those commodities. This surplus is to be utilized to repay some of the arrears accumulated by the Supply Fund toward the enterprises which import petroleum products and the subsidized foodstuffs.

Preliminary estimates suggest that, in the absence of corrective actions, the borrowing requirements of the public enterprises would tend to rise significantly in relation to GDP in 1984, despite the expected moderation in their labor costs (projected to rise on average by less than 20 percent) and despite substantial cutbacks in their investment programs. The increase in the borrowing requirements of the public enterprises reflects in part the mounting burden of servicing their domestic and external debt, often incurred to finance inappropriate investments in the past. In some instances, the increase in the borrowing requirements is related to the need to begin repayments of arrears accumulated by the public enterprises toward their domestic suppliers in recent years. In the case of the electricity company, it is also a reflection of a continuing accumulation of arrears in the payment of electricity bills by both public and private customers. In order to secure a decline in the borrowing requirements of the public enterprises to around 5.5 percent of GDP in 1984 (Table 3) the Portuguese authorities have already implemented a number of increases in charges for public services, including electricity rates, public transport fares and water charges, and have committed themselves to further ones, notably in the postal and telecommunication areas and in the surcharge for electricity. Further cuts in the investment programs of some enterprises, equivalent to 7 percent of total fixed investments of the public enterprises' sector, have also been decided. In order to improve the financial position of the electricity company, the Government has taken steps to stop the accumulation of arrears of municipalities to the company and to raise electricity rates in some municipalities which currently enjoy preferential rates.

The authorities will complement the measures aimed at moderating the borrowing requirements of the public enterprises in 1984 with a comprehensive program of physical and financial restructuring of ailing companies, both in the industrial and in the transport sector. Negotiations have begun with the IBRD for its technical and financial support to this effort, through a public enterprises restructuring loan (PERL) which is currently expected to be approved in the fourth quarter of 1984 for a period of one year. The progress in the restructuring program will be reviewed with the Fund staff in the autumn of 1984, at which time the 1985 budget will also be discussed with the staff. The restructuring effort will be accompanied by institutional reforms designed to increase the responsibility of the management of public enterprises, to strengthen the mechanisms of financial control and to improve the flow of information between the Government and the enterprises. As a first step in this direction, the authorities have set up an interministerial committee, with the participation of the Bank of Portugal, to review on a monthly basis the recent and prospective developments of the borrowing requirements of the General Government and of the public enterprises, and to decide on the allocation of domestic and external credit among them, as well as on any corrective measures that may be needed to keep the public sector borrowing requirements within the targeted limits.

d. External policies

The Portuguese authorities recognize the importance of a competitive exchange rate in promoting the targeted improvement in the external accounts. The 12 percent effective devaluation of the escudo in June 1983 restored the real exchange rate to a level nearly 10 percentage points below the previous historical lows (in the second half of 1979) in terms of both relative consumer prices and relative unit labor costs (Chart 1). The strong competitive position was undoubtedly a factor behind the exceptional performance of exports. The real exchange rate has appreciated slightly in recent months but, on the assumption of a deceleration of inflation to around 23 percent by year-end and of an increase in unit labor costs on the order of 19-20 percent, is expected to remain significantly below the previous historical low. The authorities intend to keep the adequacy of the rate of monthly effective depreciation under review, also in the light of the export performance, and would be prepared to make adjustments in it if needed, in consultation with the Fund.

In keeping with their commitment to a relatively liberal trade system, the authorities rolled back in March 1984 the import surcharge from the 30 percent to which it had been raised in January 1983 to the former level of 10 percent.

The Portuguese authorities intend to limit resort to external borrowing in 1984 to levels consistent with the targeted improvement in the current and overall balance of payments. For this purpose limits have been agreed on the increases in total external debt (excluding foreign liabilities of the Bank of Portugal and short-term liabilities of the banking system, which are subject to a net foreign assets test) and in its short-term component (also excluding liabilities of the Bank of Portugal and of the banking system) (Table 2). Of the total US$1,250 million projected net capital inflow of nonmonetary debt (of which up to US$200 million is expected to be of a short-term nature), over 65 percent is expected to finance the General Government. Public enterprises are likely to take up the balance, either directly or (as in the case of agricultural commodity credits (CCC's) through the intermediation of the domestic banking system. The private sector has not been historically a large borrower abroad, and is expected to reduce slightly its foreign indebtedness in 1984. Terms typically obtained by Portuguese borrowers abroad compare favorably with those of most developing countries, in terms of both spreads and grace periods. The monetary authorities have generally managed smoothly the access of domestic borrowers to foreign markets, although coordination was difficult in 1982 when resort to external borrowing reached a record level. Significant effort has been put in improving both the ex ante control and the ex post recording of external borrowing operations. Nevertheless, revisions to external debt statistics remain sizable and further improvement in this area is desirable.

The debt service ratio is expected to reach a relatively high level (about 36 percent of foreign exchange earnings) in 1984, as grace periods on the loans contracted to finance the large current account deficits in 1981-82 begin to expire. The staff has prepared scenarios of developments in the external debt and its service during the rest of this decade, on alternative assumptions concerning the path of the current account of the balance of payments during the period. Three scenarios are presented in Table 7, together with the main underlying assumptions. One (Scenario A) could be characterized as "stop-go", assuming a substantial easing of policies in 1985-86 leading to a renewed deterioration of the current account and eventually to a new contractionary phase in 1987-89. Scenario B assumes the same cumulative current account deficit as in Scenario A but spread evenly over the period. Scenario C hypothesizes a gradual but sustained adjustment in the current account, to equilibrium by 1989. Scenario A highlights the costs of a new stop-go cycle: the debt service ratio would remain above 32 percent throughout the decade and total debt would rise to over US$20 billion, or more than 2 1/2 times the value of reserves at current gold market prices. Moreover, the permissible growth of imports in volume would average only 3.7 percent a year between 1985 and 1990, severely constraining the growth of domestic demand and output. Scenario B demonstrates the gains, in terms of both the debt service ratio and the permissible growth of imports, from a more steady policy course. Under this scenario the debt service ratio would decline to below 29 percent by 1990, and the real rate of growth of imports would average 5 percent a year, providing the room for a more rapid expansion of demand and output. Finally, under scenario C the debt service ratio would decline to below 27 percent at the end of the decade, external debt would remain below US$18 billion and the permissible growth of imports in volume would average about 4 percent a year.

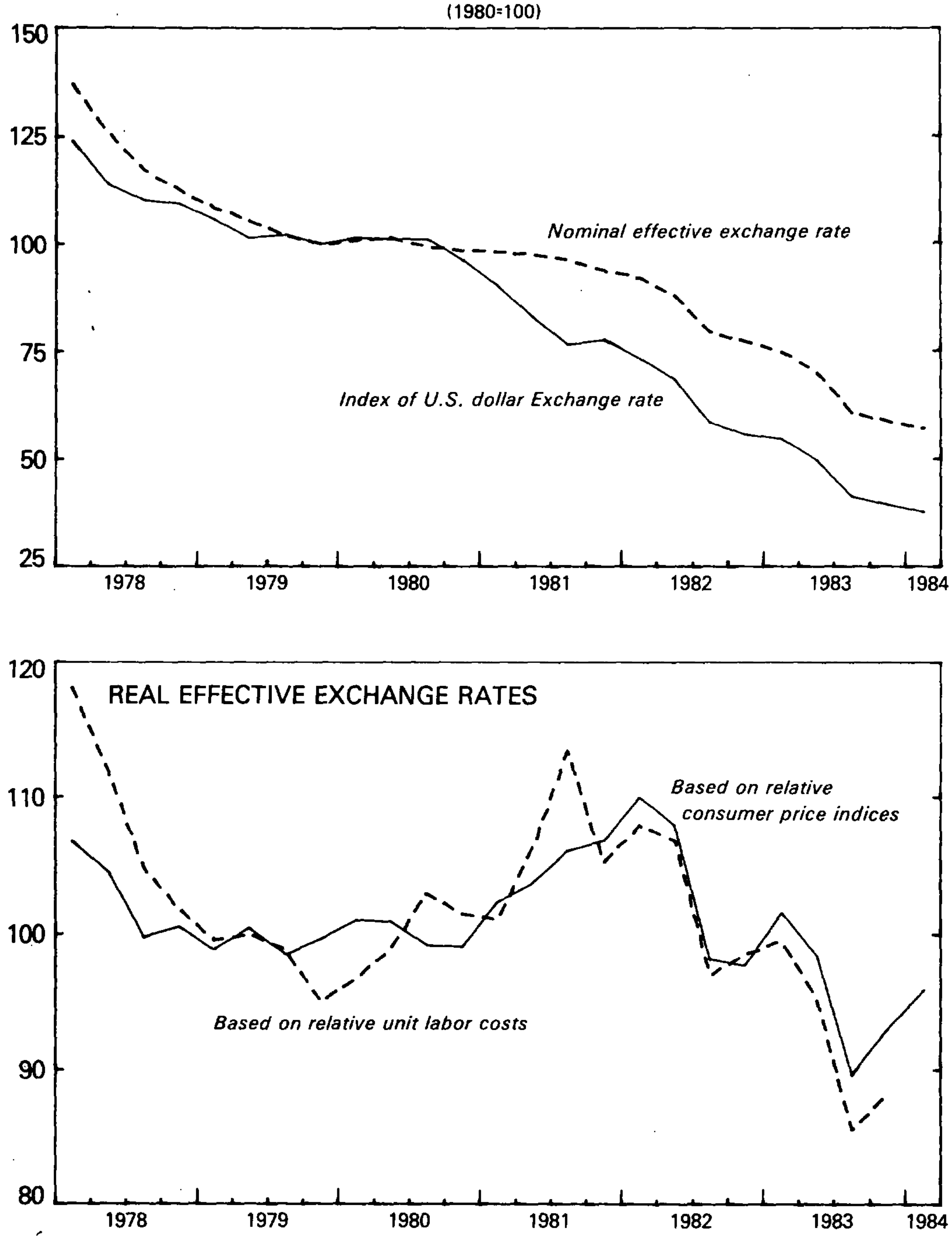
In order to explore the implications of a controlled use of Portugal's relatively large gold reserves to moderate the increase in the external debt and its service, the three scenarios were repeated under the assumption that a part (US$400 million a year) of the current account deficit (or of debt amortizations) would be financed through sales of gold. The results of these simulations suggest that, for any given path of the current account deficit, such a policy would contribute to a significant moderation in the external debt and its service, but would have little impact on the permissible rate of growth of imports.

CHART 1

PORTUGAL

EXCHANGE RATE INDICES

(1980=100)



All three scenarios point, to various degrees, to the fact that, in the absence of substantial structural changes, the room for sustained growth of demand and output in the Portuguese economy is likely to remain narrow in the next several years. Among the structural changes that would help ease the trade-off between the balance of payments and growth are policies aimed at promoting a more rapid growth of exports of goods and services, a greater inflow of foreign direct investments (which currently account for about 10 percent of total net capital inflows) and a reduction in the elasticity of imports to demand. EC accession, now targeted for 1986, is expected to have a significant positive impact on the growth of both foreign exchange earnings and capital inflows. It is also, however, likely to result in increased import penetration, especially in the agricultural sector, which is characterized by very low productivity levels.

3. Performance criteria and phasing of purchases

The program for 1984 contains the following quantitative performance criteria for July 31, 1984, September 30, 1984 and December 31, 1984 (Table 2): a) ceilings on total domestic credit extended by the banking system, b) ceilings on domestic bank credit to the enlarged public sector, net of time deposits of the latter, c) ceilings on the increases in total disbursed external debt of the nonmonetary sector, d) ceilings on the increases in short-term disbursed external debt of the nonmonetary sector, and e) ceilings on the cumulative loss in net foreign assets of the banking system from January 1, 1984.

The undrawn balance of the arrangement (SDR 278.6 million) has been rephased. It is to be disbursed in three equal installments, contingent upon observance of these performance criteria (Table 8).

III. Staff Appraisal

The adjustment effort, in support of which the Portuguese authorities requested in September 1983 a stand-by arrangement with the Fund, has begun to produce significant results. The current account deficit of the balance of payments was halved in 1983 to a level below the program target, and confidence appears to have been restored in international capital markets. The improvement in the external position reflected not only a substantial decline in domestic demand and imports but also a strong growth of exports, boosted by a favorable competitive position. The rate of inflation, after a sharp acceleration largely due to administered price adjustments, has begun to decelerate in recent months, in reflection of the tightness of financial policies and relative moderation in labor costs.

The Portuguese authorities recognize that further progress in 1984 is essential, both in adjusting the balance of payments and in reducing inflation. The program outlined in the letter of intent envisages the maintenance of a cautious stance of financial policies, designed to promote the targeted deceleration of inflation and to strengthen the balance of payments. Within the overall credit restraint, emphasis is placed on a further reduction in the borrowing requirements of the enlarged public sector, so as to allow a significant increase in the rate of growth of domestic credit to the private sector. The extension of the ceilings on domestic credit to the public sector, to include the public enterprises, represents an important innovation, which should make a contribution to ensuring a better allocation of domestic credit, and promote further improvements in the finances of the public sector. The authorities intend to complement fiscal and financial restraint with policies aimed at securing continued wage moderation and the maintenance of a strong competitive position. In the view of the staff, these policies, if carried out with determination, should ensure the targeted improvements in the current account and in inflation. At the same time, they should allow a modest recovery of output in the latter part of the year.

It is essential that the gains secured through the adjustment effort in 1983 and 1984 not be reversed through an abrupt easing of policies in 1985 and beyond. The scenarios of external debt developments over the medium term discussed above clearly highlight the dangers of a new stop-go cycle as well as the gains, in terms of both the debt service burden and the room for growth of imports and demand, which a continued, albeit more gradual, adjustment effort beyond 1984 would allow. However, those scenarios also point to the fact that, in the absence of substantial structural changes, the external constraints on growth are unlikely to ease for the Portuguese economy in the foreseeable future. It would then appear essential that, in the medium-term recovery program the authorities are beginning to prepare, priority be given to actions that would improve the trade-off between growth and the balance of payments. These actions should be aimed at promoting a larger inflow of nondebt capital and a more rapid growth of earnings from exports of goods and services, and at reducing import dependence.

A sustained growth of exports and of nondebt capital inflows would be fostered by the maintenance beyond 1984 of a sound and steady stance of financial policies, as well as of a realistic exchange rate policy. A steady reduction in the public sector's share in financial resources will be essential to a sustained recovery of productive investment, especially in export-oriented industries. The staff would urge the Portuguese authorities to carry out with determination the policies outlined in the letter of intent aimed at securing a steady improvement in the finances of the General Government and of the public enterprises over the medium term, especially the tax reform, the control of public expenditures and the restructuring of ailing public companies. The temptation should be resisted in the next few years to embark on new large public investment projects which do not have substantial potential for foreign exchange earnings or savings, and which are not commensurate with financing possibilities. Also important to promote domestic and foreign investments would be steps to modernize and increase flexibility in the labor and capital markets, such as changes in the labor legislation and unemployment insurance scheme, on the one hand, and the creation of a broader range of financial instruments and institutions, as well as a gradual liberalization of capital controls, on the other.

Among measures to reduce the dependence on imports, the staff would regard as crucial the prompt adjustment of domestic administered prices of imported products to changes in foreign prices and the promotion of energy conservation, particularly through adequate pricing policies for energy products. In view of the heavy import dependence in the agricultural sector and of the foreseeable difficulties that EC accession, now targeted for 1986, will entail in this area, a high priority should be given to policies designed to improve productivity in agriculture.

It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

IV. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

A. 1984 Consultation

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Portugal, in the light of the 1984 Article IV consultation with Portugal conducted under Decision No. 5392-(77/63) adopted on April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Portugal maintains a system virtually free of restrictions on current payments and transfers for current international transactions, and welcomes the authorities' commitment to the maintenance of this system.

B. Stand-By Arrangement

1. Portugal has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Portugal (EBS/83/196, Sup. 1, October 7, 1983), and the letter of the Minister of Finance and Planning and the Governor of the Bank of Portugal, annexed to the stand-by arrangement, dated September 9, 1983, in order to reach understandings with the Fund regarding policies and measures which Portugal will pursue through February 15, 1985.

2. The letter of the Minister of Finance and Planning and the Governor of the Bank of Portugal, dated June 19, 1984, shall be attached to the stand-by arrangement for Portugal, and the letter of September 9, 1983 shall be read as supplemented by the letter of June 19, 1984.

3. Portugal will not make purchases under the stand-by arrangement that would increase the Fund's holdings of Portugal's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12 1/2 percent of quota during any period in which the data at the end of the preceding period indicate that:

(i) the ceilings on total domestic bank credit at end-July 1984, end-September 1984 and end-December 1984; or

(ii) the ceilings on net domestic bank credit to the enlarged public sector at end-July 1984, end-September 1984, or end-December 1984; or

(iii) the ceilings on increases in the total disbursed external debt of the nonmonetary sector at end-July 1984, end-September 1984, or end-December 1984; or

(iv) the ceilings on increases in the short-term external debt of the nonmonetary sector at end-July 1984, end-September 1984, or end-December 1984; or

(v) the ceilings on the cumulative loss in net foreign assets of the banking system since the beginning of 1984 at end-July 1984, end-September 1984, or end-December 1984.

specified in paragraphs 7 and 8 of the letter of June 19, 1984 have not been observed.

4. Paragraph 4(e) of the stand-by arrangement for Portugal (EBS/83/196, Sup. 1), shall be amended to read as follows:

(e) during the entire period of the stand-by arrangement, while Portugal has any overdue financial obligation to the Fund, or if Portugal ...

5. Purchases under the stand-by arrangement for Portugal (EBS/83/196, Sup. 1), which amounted to SDR 166.4 milion on July 30, 1984, shall not, without the consent of the Fund, exceed the equivalent of SDR 166.4 million until September 15, 1984; SDR 259.3 million until November 15, 1984; and SDR 359.3 million until February 15, 1985.

Table 1. Portugal: Summary of the Balance of Payments, 1981-84

(In millions of U.S. dollars)

	1981	1982	1983 Program	1983 Outturn 1/	1984 Program
Exports, f.o.b.	4,088	4,108	4,535	4,553	5,050
Imports, f.o.b.	9,282	8,941	8,385	7,637	7,560
Merchandise trade balance	-5,194	-4,833	-3,850	-3,084	-2,510
Services, net	-544	-1,092	-880	-773	-790
Of which:					
Tourism, net	777	609	670	581	720
Investment income, net	-975	-1,256	-1,250	-1,054	-1,300
Transfers, net	2,888	2,680	2,730	2,131	2,050
Of which:					
Emigrants' remittances	2,832	2,599	2,660	2,118	2,000
Current balance	-2,850	-3,245	-2,000	-1,686	-1,250
As percent of GDP	(11.5)	(13.2)	(9.3)	(8.0)	(6.0)
Medium- and long-term capital	1,853	2,585	1,075	1,310	1,050
Short-term capital 2/	848	783	-215	-500	200
Overall balance	-149	123	-1,140	-876	--
Change in net foreign assets of commercial banks 3/	43	-15	--	-190	--
Change in official net foreign assets 3/	106	-108	1,140	1,066	--
Memorandum items: (percentage change)					
Market growth	-0.6	2.0	3.0	3.5	6.3
Effective exchange rate	-3.6	-13.9	-22.3	-20.5	-15.0
U.S. dollar/escudo rate	-18.7	-22.6	-36.0	-39.5	-26.5
Export, f.o.b., unit value (in escudos) 4/	13.3	16.5	37.5	26.8	27.5
Export, f.o.b., volume 4/	-2.1	10.8	8.5	20.0	10.0
Import, c.i.f., unit value (in escudos) 4/	21.1	17.3	32.0	28.9	28.5
Import, c.i.f., volume 4/	5.8	5.5	-3.4	-8.8	-3.0

Sources: Data provided by the Portuguese authorities; and Fund staff estimates and projections.

1/ Provisional estimates.

2/ Includes errors and omissions.

3/ Negative sign denotes an increase.

4/ Merchandise trade, customs basis.

Table 2. Portugal: Quantitative Performance Criteria

	Dec. 31, 1983 Program	Dec. 31, 1983 Outturn	July 31, 1984	Sept. 31, 1984	Dec. 31, 1984
	(In billions of escudos)				
Credit ceilings					
Total domestic bank credit	2,774.5 1/	2,538.6 5/	2,875 5/6/	2,929 5/6/	3,106 5/6/
Net domestic bank credit to the General Government	617.3 1/	582.7	...	...	...
Net domestic bank credit to the enlarged public sector 2/	...	954.2 5/	1,125 5/6/	1,110 5/6/	1,168 5/6/
	(In millions of U.S. dollars)				
External debt ceilings					
Total disbursed external debt of the nonmonetary sector 3/	13,800	13,233	...	...	...
Increase in the same	...	...	616	1,113	1,250
Short-term external debt 4/	3,800	3,044	...	...	...
Increase in the same	...	...	200	150	200
Net foreign assets test					
Cumulative loss in net foreign assets since the beginning of the relevant year	1,600	635	450	150	100

Source: Portugal's letters of intent to the Managing Director, September 1983 and June 1984.

1/ Adjusted for Esc 12 billion excess of external credit to the Government with respect to targeted amount of Esc 60 billion.

2/ The enlarged public sector includes the General Government (as in the monetary statistics definition), the 51 statutory public enterprises, the Sines Port Authority and the Vegetable Oils Import Board (IAPO).

3/ Excludes foreign liabilities of the Bank of Portugal and short-term liabilities of the banking system.

4/ Excludes foreign liabilities of the Bank of Portugal and of the banking system.

5/ Does not include domestic credit counterpart of external credit to public enterprises obtained through domestic banks (notably CCC credits). If these were included, figure for total domestic bank credit at end-December 1983 would be Esc 2,684.9 billion.

6/ The ceilings on total domestic bank credit and on domestic bank credit to the public sector are to be automatically adjusted upward (or downward) up to the escudo equivalent of US$100 million for any shortfall (excess) of the net inflow of external credit to the enlarged public sector with respect to the following amounts: US$615 million by July 31, 1984, US$1,121 million by September 30, 1984 and US$1,364 million by December 31, 1984.

Table 3. Portugal: Public Sector Operations, 1982-84

(In billions of escudos)

	1982	1983 1/ Program	1983 1/ Outturn	1984 2/	1983 1/ Percentage change	1984 2/ Percentage change
General Government						
Current revenue	563.7	774.0	768.1	980.0	36.3	27.6
Direct taxes	138.9	196.0	195.0	228.0	40.4	16.9
Indirect taxes	261.0	361.0	359.5	478.0	37.7	33.0
Social security contributions	140.3	167.0	166.0	195.0	18.3	17.5
Nontax revenue	23.5	50.0	47.6	79.0	102.6	66.0
Current expenditure	643.9	836.0	824.2	1,072.0	28.0	30.0
Wages and purchases	280.7	340.0	337.6	407.0	20.3	20.6
Subsidies 3/	79.9	108.0	112.2	144.0	40.4	28.3
Transfers	182.2	227.0	227.5	282.0	24.9	24.0
Interest payments	101.1	161.0	146.9	239.0	45.3	62.7
Current deficit	80.2	62.0	56.1	92.0		
Capital revenue	14.7	13.0	16.0	17.0	8.8	6.3
Capital expenditures	100.2	114.0	122.0	144.0	21.8	18.0
Investment	71.4	78.0	81.0	83.0	13.5	2.5
Transfers	28.8	36.0	41.0	38.0	42.4	-7.3
Net lending	25.8	27.0	30.3	49.0	17.4	61.7
Overall deficit	191.5	190.0	192.4	245.0		
Treasury operations and other adjustments (net)	27.5	39.0	12.7	7.0		
Borrowing requirements	219.0	229.0	205.1	252.0		
Financed by:						
Domestic bank credit	156.9	167.0	119.0	127.0		
External credit	53.4	60.0	80.0	120.0		
Other	8.7	2.0	6.1	5.0		
Public enterprises						
Borrowing requirements	191.5	...	140.2	163.0		
Financed by:						
Domestic bank credit	24.2	...	106.7	86.5		
External credit	153.4	...	25.6	71.5		
Other	13.9	...	7.9	5.0		
Memorandum items: (In percent of GDP)						
Tax revenue	29.3	31.2	31.5	31.6		
Total general government expenditure	41.7	42.2	42.7	43.5		
Of which:						
Interest payments	5.5	6.9	6.5	8.3		
General government borrowing requirements	11.8	9.9	9.0	8.7		
Public enterprises borrowing requirements	10.4	...	6.2	5.7		
Enlarged public sector borrowing requirements	22.2	...	15.2	14.4		

Source: Data provided by the Portuguese authorities.

1/ Estimates.

2/ Forecasts.

3/ Including repayments of arrears of the Supply Fund to public enterprises that import essential foodstuffs and petroleum products.

Table 4. Portugal: Monetary Survey, 1982-84

(In billions of escudos; end of period)

	1982	1983 Outturn	1984 Program	1983 Program (Percentage changes)	1983 Outturn (Percentage changes)	1984 Program (Percentage changes)
Net foreign assets of the banking system	569.5	760.1	764.0			
(In millions of U.S. dollars)	(5,719.0)	(4,850.0)	(4,850.0)			
Total domestic credit	2,080.9	2,538.6 1/	3,106.0 1/	27.5 3/	20.3	21.0 1/
Of which:						
To enlarged public sector	727.0	954.2	1,168.0 1/	... 3/	25.4	19.0 1/
To General Government	462.2	582.7 1/	710.0	26.5	19.1	16.9
To public enterprises	264.8	371.5	458.0	...	40.3	23.3
To private sector 2/	1,353.9	1,584.4	1,938.0	...	17.0	22.3
Total assets	2,650.4	3,298.7	3,870.0	24.0 3/	23.0	16.5 3/
M1	599.9	652.0	730.0	10.0	8.7	12.0
Time deposits of residents 4/	1,052.3	1,274.5	1,572.0	25.4	21.1	23.3
M2	1,652.2	1,926.5	2,302.0	19.9	16.6	19.5
Emigrants' deposits	488.8	650.8	866.0	36.5	33.1	33.0
Nonmonetary financial institutions	23.1	25.7	28.0			
M2*	2,164.1	2,603.0	3,196.0	23.1	20.3	22.8
Nonmonetary liabilities	81.8	115.7	113.5			
Exchange rate valuation	218.2	392.7	390.0			
Other items, net	186.2	187.4	170.5			
Memorandum items:						
Percentage change in total domestic and external credit 5/	28.7	18.2	21.0			
Percentage change in total domestic and external credit to the enlarged public sector	33.9	21.8	21.7			
Percentage change in velocity of M2* 6/	-3.0	5.0	-0.8			
Interest rate on six-month deposits 7/	21.5	28.0	28.0			

Source: Data provided by the Portuguese authorities.

1/ Performance clauses.

2/ Including state participated enterprises and nonmonetary financial institutions.

3/ Percentage changes calculated including in total domestic credit (credit to the public sector) Esc 168.7 billion as counterpart of revaluation of gold reserves in February 1980.

4/ Excluding time deposits of public sector.

5/ The percentage changes in the external credit component are calculated by reference to the flow of borrowing in each year converted at average exchange rates.

6/ Through the year.

7/ End of period.

Table 5. Portugal: Selected Economic Indicators, 1981-84

(Annual percentage changes)

	1981	1982	1983 1/		1984 2/
			Program	Outturn	
Real demand and output					
Gross domestic expenditures	3.3	3.5	-3.7	-7.2	-4.7
Private consumption	2.3	2.0	-1.6	-1.0	-2.0
Public consumption	6.2	3.5	2.0	4.0	2.5
Gross fixed investment	4.6	2.9	-3.5	-7.5	-13.0
Increase in inventories 3/	--	1.3	-2.6	-6.2	-0.5
Foreign balance 3/	-2.5	--	2.6	8.1	3.9
GDP at market prices	0.8	3.5	-1.1	-0.5	-1.4
Labor market					
Employment	1.2	-0.3	-1.0	... 4/	-1.0
Unemployment rate (levels)	8.2	7.4	11.0	10.4 4/	11.0 4/
Wage per man	19.7	19.6	20.0	19.5	19.0
Unit labor costs in industry	19.5	17.9	20.0	16.2	18.0
Prices					
Consumer prices (average)	20.0	22.4	25.0	25.5	29.0
Consumer prices (through the year)	25.0	18.8	28.5	33.9	23.0
GDP deflator (average)	18.1	21.4	24.4	24.2	27.0
Disposable income of households	20.3	23.2	...	18.8	22.9
Households' savings ratio (levels)	28.3	27.3	...	23.9	21.8

Sources: Data provided by the Portuguese authorities; and Fund staff projections.

1/ Provisional estimates.
2/ Forecasts.
3/ Contribution to GDP growth.
4/ Based on a new methodology in the labor force survey adopted by the Institute of Statistics since January 1983.

Table 6. Portugal: External Debt Outstanding and Debt Service Ratio, 1981-83

(In millions of U.S. dollars; end of period)

	1981		1982		1983 Program		1983	
	Total	Of which: Short-term	Total	Of which: Short-term	Total	Of which: Short-term	Total	Of which: Short-term
General Government	2,209	3	2,865	—	3,365	--	3,435	—
Bank of Portugal	962	250	670	120	807	100	1,089	300
Other monetary institutions and nonmonetary financial sector	947	58	1,469	57	1,649	50	1,771	71
Public enterprises	5,861	2,766	7,747	3,514	7,794	3,500	7,381	2,902
Nonfinancial private sector	998	258	910	171	865	200	706	132
Total	10,977	3,335	13,661	3,862	14,480	3,850	14,382	3,405
Of which:								
Public and publicly guaranteed	4,160	254	4,730	176	...	...	5,835	343
Bank guaranteed	909	12	816	6	...	...	660	10
Memorandum items: (in percent)								
Share of short-term debt	30.4	...	28.3	...	26.6		23.7	...
Ratio of debt to GDP 1/	47.9	...	65.8	...	76.8		82.9	...
Ratio of debt to foreign exchange earnings 1/ 2/	120.7	...	161.0	...	159.7		172.4	...
Ratio of debt to gross international reserves 3/	99.7	...	119.1	...	...		146.4	...
Ratio of debt service 4/ to foreign exchange earnings	22.7	...	28.7	...	27.8		28.2	...

Sources: Bank of Portugal; and staff estimates.

1/ With debt valued at end of year exchange rates. 1983 program figure was valued at Esc 123 per U. S. dollar.

2/ Foreign exchange earnings from exports of goods and nonfactor services plus remittances.

3/ With gold valued at the quarterly average London market price.

4/ Excluding amortizations of short-term debt.

Table 7. Portugal: External Debt Scenarios, 1984-90

(In millions of U.S. dollars except as otherwise indicated)

	1984	1985	1986	1987	1988	1989	1990
Main assumptions (percent changes unless otherwise indicated)							
Merchandise exports (f.o.b. in U.S. dollars)							
Volume	10.0	7.0	7.0	7.0	7.0	7.0	7.0
Unit value 1/	1.0	4.0	4.0	4.0	4.0	4.0	4.0
Exports of nonfactor services (in U.S. dollars)	10.5	11.0	11.0	11.0	11.0	11.0	11.0
Remittances (in U.S. dollars)	-8.5	4.0	4.0	4.0	4.0	4.0	4.0
Interest rates on nonconcessionary loans (levels) 2/	11.0	10.0	9.0	9.0	8.0	8.0	8.0
Short-term debt outstanding (in millions of U.S. dollars; end of period)	3,600	3,500	3,400	3,300	3,200	3,100	3,000
Current account deficit (in millions of US$)							
Scenario A	1,250	1,800	2,300	1,300	600	--	--
Scenario B	1,250	1,000	1,000	1,000	1,000	1,000	1,000
Scenario C	1,250	1,000	800	600	400	--	--
Results							
Scenario A							
Debt outstanding (end of period)	15,491	17,151	19,281	20,381	20,751	20,491	20,201
Debt service ratio 3/ (in percent)	36.3	34.0	31.4	34.8	36.0	34.5	32.3
Gross borrowing	6,305	6,965	7,316	6,745	6,573	6,111	6,164
Interest payments	1,394	1,549	1,613	1,749	1,637	1,604	1,549
Permissible growth of imports of goods and services in U.S. dollars (in percent)	-2.0	14.1	13.6	-1.1	4.7	5.6	11.4
Scenario B							
Debt outstanding (end of period)	15,491	16,351	17,181	17,981	18,751	19,491	20,201
Debt service ratio 3/ (in percent)	36.3	33.5	30.2	33.0	33.4	30.6	28.9
Gross borrowing	6,305	6,165	6,016	6,445	6,813	6,691	6,684
Interest payments	1,394	1,509	1,482	1,546	1,461	1,484	1,509
Permissible growth of imports	-2.0	5.4	10.2	9.3	10.9	9.8	9.8
Scenario C							
Debt outstanding (end of period)	15,491	16,351	16,981	17,381	17,551	17,291	17,000
Debt service ratio 3/ (in percent)	36.3	33.5	30.1	32.7	32.8	29.4	26.6
Gross borrowing	6,305	6,165	5,816	6,045	6,213	5,651	5,564
Interest payments	1,394	1,509	1,473	1,510	1,389	1,348	1,293
Permissible growth of imports of goods and services in U.S. dollars (in percent)	-2.0	5.4	8.2	7.7	9.7	7.4	11.2

Source: Staff calculations.

1/ The terms of trade are assumed unchanged from 1985-90.

2/ Effective cost of borrowing (including spread, fees, etc.). Average grace period on nonconcessionary loans is assumed to be three years.

3/ Interest on total debt plus amortization of medium- and long-term debt/foreign exchange earnings from exports of goods and nonfactor services and remittances.

Table 8. Portugal: Schedule of Purchases and Repurchases, 1983-84

(In millions of SDRs)

	Oct. 15, 1983 1/	Mar. 15, 1984 1/	Jul. 31, 1984 2/	Aug. 1984-Sept. 1984 2/	Oct. 1984-Dec. 1984 2/	Jan. 1985-Feb. 1985 2/
Purchases	354.75	69.65	54.60	92.87	92.87	92.86
Stand-by arrangement	96.75	69.65	--	92.87	92.87	92.87
Ordinary resources	(64.50)	(34.83)	--	(46.44)	(46.44)	(46.44)
Borrowed resources	(32.25)	(34.82)	--	(46.43)	(46.43)	(46.43)
Compensatory financing	258.00	--	54.60	--	--	--
Repurchases	--	--	--	--	--	--
Stand-by arrangement	--	--	--	--	--	--
Compensatory financing	--	--	--	--	--	--
Net purchases	354.75	69.55	54.60	92.87	92.87	92.87
			(In percent of quota)			
Total Fund holdings (cumulative)	237.5	212.7	227.2	251.9	276.5	301.2
Excluding compensatory	137.5	144.2	144.2	168.8	193.5	218.2

Source: International Monetary Fund.

1/ Actual.
2/ Proposed.

Fund Relations with Portugal

(As of May 31, 1984; in millions of SDRs)

I. Membership status

Portugal became a member of the Fund on March 29, 1961. Portugal continues to avail itself of the transitional arrangements under Article XIV of the Articles of Agreement.

A. Financial Relations

II. General department

(a) Quota: SDR 376.6 million.
(b) Total Fund holdings of escudos: SDR 771.3 million (204.8 percent of quota).
(c) Fund credit: SDR 424.4 million (112.7 percent of quota).
Of which:
SDR 99.3 million (26.4 percent of quota) under credit tranches;
SDR 67.1 million (17.8 percent of quota) under enlarged access;
SDR 258.0 million (68.5 percent of quota) under the compensatory financing facility.
(d) Reserve tranche position: SDR 30 million.
(e) Current operational budget: no use of the Portuguese escudo is planned in the current budget.
(f) Lending to the Fund: Portugal is not a participant.

III. Stand-by or Extended Arrangements and Special Facilities

(a) Current stand-by arrangement:
(i) Duration: from October 7, 1983 through February 28, 1985.
(ii) Amount: SDR 445 million (118.2 percent of quota).
(iii) Utilization: SDR 166.4 million (44.2 percent of quota).
(iv) Undrawn balance: SDR 278.6 million (74.0 percent of quota).

(b) Previous stand-by arrangements:
On April 25, 1977 the Executive Board approved a one-year stand-by arrangement with Portugal in the first credit tranche for an amount equivalent to SDR 42.4 million (36.3 percent of quota). The full amount of the arrangement was drawn in May 1977.
On June 5, 1978 the Executive Board approved a one-year stand-by arrangement in the second credit tranche for an amount equivalent to SDR 57.4 million. No drawings were made under the stand-by.

(c) Special facilities:
On October 7, 1983 the Executive Board approved a request for a drawing under the Compensatory Financing Facility in the amount of SDR 258 million (68.5 percent of quota or 100 percent of Portugal's previous quota).

IV. SDR Department

(a) Net cumulative allocation: SDR 53.3 million.
(b) Holdings: SDR 0.9 million or 1.8 percent of net cumulative allocation.
(c) Current designation plan: Portugal is not included in the current plan.

V. Administered accounts

Not applicable.

VI. Overdue obligations to the Fund

None.

B. Nonfinancial Relations

VII. Exchange rate arrangements

Portugal maintains a crawling peg system for the escudo, based on a basket of currencies of major trading partners (weighted by the shares of each country in Portugal's trade flows, tourism, and emigrants' remittances). Following a 9.4 percent devaluation in 1982, the competitive position of Portugal was restored to the level prevailing at the end of 1980, but a further erosion took place subsequently as the rate of monthly depreciation was maintained at 0.75 percent, or less than the inflation rate differential between Portugal and its main trading partners. On March 24, 1983 the monthly rate of depreciation was increased to 1 percent and the escudo was also depreciated by 2 percent in effective terms. Following continuous pressure on foreign exchange reserves, on June 22, 1983 the authorities announced a further devaluation of the escudo by 12 percent in effective terms. The escudo continues to be depreciated at the rate of 1 percent a month. On May 31, 1984, US$1 was worth Esc 139.8.

VIII. The last Article IV consultation was concluded in March 1983 and the staff report (SM/83/88, 5/17/83) was discussed by the Executive Board on June 13, 1983. At that time the following decision was adopted:

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Portugal, in the light of the 1983 Article IV consultation with Portugal conducted under Decision No 5392-(77/63) adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).

2. The Fund notes with satisfaction that Portugal maintains a system virtually free of restriction on current payments and transfers for current international transactions and welcomes the authorities' commitment to the maintenance of such a system.

Portugal is on a 12-month consultation cycle.

Basic Data

Area and population		
Area		34,312 square miles
Population (1981 estimate)		10 million
GDP per capita (1983 estimate)		US$2,050

Income and expenditure in 1983 (at current prices)	In billions of escudos	In per cent
Private consumption	1,570	69
Public consumption	334	15
Gross capital formation	657	29
Exports of goods and services	729	32
Aggregate expenditure	3,290	145
Imports of goods and services	1,015	45
GDP at market prices	2,275	100

Selected economic indicators (annual percentage change)	1981	1982	1983 Estimate
Real domestic demand	3.3	3.5	-7.2
Real GDP at market prices	0.8	3.5	-0.5
Wage per man	19.7	19.6	19.5
Consumer prices	20.0	22.4	25.5
Unemployment rate (level)	8.2	7.4	10.4
Broad money, year-end	28.6	25.7	20.3
Domestic credit, year-end	28.6	24.5	20.3
Public sector accounts (as per cent of GDP)			
General Government			
Tax revenue	28.9	29.3	31.5
Total expenditure	41.6	41.7	42.7
Borrowing requirements	11.5	11.8	9.0
Public enterprises borrowing requirements	...	10.4	6.2
Balance of payments (in millions of U.S. dollars)			
Exports	4,088	4,108	4,553
Imports	9,282	8,941	7,560
Trade balance	-5,194	-4,833	-3,084
Net invisibles	2,344	1,588	1,358
Current account balance	-285	-3,245	-1,686
Medium- and long-term capital	1,853	2,585	1,310
Short-term capital	848	783	-500
Overall balance	-14.9	123	-876
Foreign exchange reserves, year-end	467	391	353
External debt outstanding, year-end	10,977	13,661	14,382
Gold, year-end (in millions of ounces)	22.0	22.0	20.4
Effective exchange rate (per cent change)	-3.6	-13.9	-20.5

Sources: Data provided by the Portuguese authorities; and staff estimates.

Portugal--Main Targets, Assumptions and Elements of the Revised Program for 1984

I. Targets

1. A reduction in the current account deficit of the balance of payments from around US$1.7 billion or 8 percent of GDP in 1983 to US$1.25 billion or 6.0 percent of GDP in 1984.

2. The net foreign assets of the banking system, which declined by US$271 million in the first quarter of 1984, are targeted to recover during the rest of 1984 to the level prevailing at the end of 1983.

3. A reduction in the rate of consumer price inflation from 34 percent at the end of 1983 to 23 percent by the end of 1984.

4. A reduction in the consolidated deficit of the enlarged public sector from 15.2 percent of GDP in 1983 (22.2 percent in 1982) to 14.4 percent in 1984.

II. Assumptions

1. The revised program for 1984 assumes a 4.7 percent decline of real domestic demand and a 1.4 percent contraction of real GDP.

2. Foreign exchange receipts in U.S. dollars are projected to increase by 7.1 percent in 1984.

3. The U.S. dollar value of imports is projected to fall by 1 percent in 1984.

4. The revised program assumes the velocity of M2* (money and quasi-money including emigrants' deposits) to decline by 0.8 percent.

III. Main Elements of the Revised Program

1. Public sector policies

(a) The coverage of the ceiling on the public sector for 1984 was widened to include not only the combined position of the General Government and the Supply Fund but also the public sector enterprises so that the new ceiling on the public sector covers the consolidated deficit of the enlarged public sector. The targeted improvement in this deficit is to be achieved through a containment of expenditures by the General Government, wage restraints and cuts in the investment programs of public enterprises, increases in charges for public services, including electricity rates, public transport fares and water charges, as well as increases in the prices of oil products, cereals, vegetable oils, and sugar which are imported by public enterprises.

(b) Consistent with the targeted improvement in the overall deficit of the enlarged public sector, ceilings are set on domestic bank credit to the enlarged public sector. These ceilings would imply a deceleration in the growth of such credit from 25.4 percent during 1983 to 19.0 percent during 1984.

2. Money and credit

(a) Ceilings are set on total domestic bank credit implying an increase in such credit of 21.0 percent during 1984, compared with 20.3 percent during 1983. This rate of growth is consistent with the targeted decline in inflation to 23 percent by end-1984, a modest pickup in real output and the recovery of the loss in net foreign assets experienced in the first few months of 1984.

(b) Effective June 21, 1984 the Bank of Portugal will only set the rate on time deposits of maturity of six months to one year (currently at 28 percent), leaving the banks to choose the levels of the rates on deposits of different maturities. Also, steps will be taken to promote financial savings, especially of small savers, for example by expanding the scope of passbook savings accounts.

3. Prices and wages

(a) In addition to the administered price increased mentioned above, the Government will implement a policy of ensuring an adequate pass through of import costs to the prices of subsidized commodities.

(b) Wage increases will continue to be contained significantly below the rate of inflation, with wage settlements in the public sector enterprises targeted not to exceed 20 percent.

4. External policies

(a) The system of depreciating the exchange rate vis-à-vis a weighted basket of partner countries currencies at the rate of 1 percent a month is to be continued in order to maintain an adequate level of competitiveness. The development of the competitive position is to be kept under review.

(b) The exchange system is to be kept free of restrictions on payments and transfers for current international transactions. In addition, the import surcharge was rolled back in March 1984 from 30 percent to 10 percent.

(c) More effective control is to be sought over resort to external borrowing in order to improve the debt service burden. To this end, ceilings have been set on the total disbursement of external debt as well as on the short-term component of such debt.

June 20, 1984
Lisbon, Portugal

CONFIDENTIAL

Letter of Intent

Dear Mr. de Larosière,

1. The Portuguese Government which took office a year ago was confronted from the outset with a sharply deteriorated economic situation, marked by a deficit of the current account of the balance of payments in excess of 13 percent of GDP, financing difficulties in international capital markets, and weakened confidence at home and abroad. The Government promptly embarked on a substantial adjustment effort, involving measures to reduce domestic demand, which in previous years had grown at rates considerably faster than in Portugal's main trading partners, and to promote a sustained recovery of foreign exchange earnings. These measures were reviewed in our letter of September 9, 1983 in which we requested, on behalf of the Portuguese Government, the support of the International Monetary Fund to our adjustment program through a stand-by arrangement in the amount of SDR 445 million for the period October 1983 through February 1985. We are now writing to you to review the progress to date in the implementation of this program, and to outline the specific features of economic policies that we propose to adopt for the rest of the program period. We are confident that these policies are appropriate to the objectives of the program, warranting continuing support by the Fund.

2. The main objective of our stabilization effort in 1983, which was to strengthen the balance of payments, was achieved. Despite a considerably weaker than expected performance of remittances, which were adversely affected by external developments, the current account deficit declined from the equivalent of US$3.2 billion (13.2 percent of GDP) in 1982 to under US$1.7 billion (8 percent of GDP) in 1983 or more than US$300 million below the program target. The deficit in the overall balance of payments was contained below US$900 million, significantly less than projected in the program. The improvement in the external accounts reflected both a sizable decline in imports and a rapid growth of exports, boosted by a strong competitive position. The performance of the foreign balance cushioned the effects on output and employment of the necessary reduction in domestic demand.

An important role in the external adjustment was played by the containment of the borrowing requirements of the General Government to the equivalent of 9 percent of GDP, compared with nearly 12 percent of GDP in 1982, through extraordinary tax measures, sizable increases in a broad range of administered prices and cuts in public expenditures. At the same time, the borrowing requirements of the statutory public enterprises were reduced by over 4 percentage points in relation to GDP, through efforts to moderate their labor costs, cutbacks in their investment program and a rundown of stocks. Nevertheless, given the virtual drying up of their net external financing, net domestic bank credit to these enterprises increased by 40 percent last year, absorbing 22 percent of total domestic credit expansion.

The marked reduction in the total borrowing requirements of the public sector made an important contribution to the deceleration in the growth of the monetary and credit aggregates. Partly in reflection of the external financing difficulties in the first several months of the year, the rate of growth of total financing to the economy declined to 18 percent in 1983 from 29 percent in 1982, while the growth of domestic bank credit decelerated to 20 percent from over 24 percent in 1982. The tightening of financial policies, especially pronounced against the background of the sharp rise in consumer prices, was accompanied by a marked increase in interest rates. The rise in labor costs remained relatively moderate, helping to preserve the gains in competitiveness achieved in the course of 1983 through a 20 percent effective depreciation of the escudo, and contributing to the needed reduction in domestic demand.

3. In shaping economic policies for 1984, the Government has set as a major objective a further reduction of the current account deficit of the balance of payments to at most the equivalent of US$1 1/4 billion, which, in the light of current conditions in foreign capital markets and of scheduled amortizations of the outstanding external debt of Portugal, should be financeable without significant loss in net foreign assets of the banking system. Given the prospects for external demand and prices and the prospective development of our competitive position, we expect the achievement of this balance of payments target to be consistent with a gradual recovery of demand and output in the latter part of this year. Another important objective of the Government is to secure a substantial reduction in the rate of inflation in the course of 1984. The 12-month rate of increase in consumer prices has already decelerated from a peak of 34 percent in December 1983 to around 30 percent in the first five months of 1984 despite adverse developments in some agricultural prices. It is our intention to continue to gear financial policies toward promoting a further sustained decline in the rate of inflation to around 23 percent by year-end. The recent adjustments in administered prices of petroleum, subsidized commodities and public services, needed to secure a further improvement in the public sector finances, are likely to prevent a faster deceleration in consumer prices in 1984.

Particularly through its wage policy in the public sector, the Government has succeeded so far in securing continued moderation in wage increases, which are expected to remain on average below 20 percent in 1984. Such a moderation in labor costs is essential to preserving an adequate competitive position, thereby promoting continued strong growth of exports and supporting output and employment. The present policy of effective depreciation of the escudo at the rate of 1 percent a month appears broadly appropriate in the light of the current level and the expected development of competitivenes. We intend to keep this policy under review, in the light of developments in relative costs and prices between Portugal and its main trading partners and in foreign exchange earnings during the course of the year, and we will be prepared to make adjustments in the rate of monthly depreciation if, in consultation with the Fund staff, this appears to be appropriate.

4. The Portuguese Government recognizes that an important contribution to the needed adjustment of the economy, both in the balance of payments and in the inflation performance, in 1984 and beyond must come from the public sector. Specifically, it is the Government's intention to secure a further reduction in the consolidated borrowing requirements of the enlarged public sector (defined to include the General Government and the statutory public enterprises) in relation to GDP equivalent to around 1 percentage point, to at most 14.5 percent of GDP. The scope for achieving a more substantial reduction in these borrowing requirements is constrained in 1984 by the disappearance or even the likely reversal of some temporary factors which contributed to their improvement in 1983, such as the extraordinary tax measures and the rundown of stocks of some public enterprises and by the adverse impact of the domestic recession on revenues of the General Government and of some public enterprises. The Government, however, is committed to taking in 1984 action in a number of areas concerning the finances of the public sector which will lead to further significant improvements in these finances in 1985 and beyond.

The 1984 budget targeted a reduction of the deficit of the General Government to below 7 percent of GDP, to be achieved primarily through a containment of expenditures, which, excluding interest payments on the public debt, were expected to show a sizable decline in real terms. Information on the implementation of the budget so far points to the likelihood of some shortfalls in tax revenues and social security contributions with respect to the initial projections, largely in reflection of the greater than anticipated weakness in economic activity. Also, additional outlays are likely to be needed for selected public investments in the depressed construction sector and for increases in equity capital of some public enterprises (notably the chemical company and the railways) which are facing an unsustainable liquidity squeeze. As a result, the deficit of the General Government could exceed 8 1/2 percent of GDP in 1984. In order to help contain the deficit, the Government will take steps to reduce the rate of spending of budgetary appropriations from an average of 90 percent in recent years to around 85 percent.

Extrabudgetary activities, especially Treasury operations, have resulted in increased cash financing requirements for the General Government in recent years. The Government intends to review the current institutional framework with a view to eliminating all extrabudgetary operations in the medium term. In particular, for 1984 Treasury operations compatible with the borrowing requirements of public enterprises referred to below are targeted to be negative on a net basis. Accordingly, the interministerial committee on public enterprises referred to in paragraph 5 below will closely monitor developments in this area, and will adjust downward bank credit to public enterprises to the extent that net repayments by these enterprises to the Treasury fall short of the targeted amount.

Preliminary estimates point to the likelihood that, in the absence of further corrective actions, the borrowing requirements of the public enterprises would tend to rise significantly in relation to GDP in 1984, despite the expected moderation of their labor costs (projected to rise on average by less than 20 percent) and despite significant cutbacks in their proposed investment programs. The increase in their borrowing requirements reflects in part the mounting burden of servicing their domestic and external debt, often incurred to finance inappropriate investments in the past. In some instances, the increase in the borrowing requirements is related to the need to begin repayments of arrears accumulated by the public enterprises in recent years toward their domestic suppliers. In the case of the electricity company (EDP) it is also a reflection of the continuing accumulation of arrears in payments of electricity bills by both public and private customers.

In order to secure the containment of the borrowing requirements of these enterprises to at most 6 percent of GDP in 1984, the Government has already implemented a number of increases in charges for public services, including electricity rates, public transport fares and water charges, as well as increases in the prices of oil products, cereals, vegetable oils and sugar which are imported by public enterprises. The Government will continue to implement a policy of ensuring an adequate pass through of import costs to the prices of subsidized commodities. Further cuts in the investment programs of the electricity, steel and telecommunication companies and the Sines Port Authority, amounting to the equivalent of 7 percent of the total public enterprises' investment program, have been decided. In order to improve the financial position of the electricity company, the Government has taken steps to stop the accumulation of arrears of municipalities to the company. The latter will be instructed to raise electricity rates in some municipalities, which currently enjoy preferential rates, to the agreed levels over the next few months.

5. The Government recognizes the need for a sustained effort beyond 1984 to secure further reductions in the deficits of both the General Government and the public enterprises. A comprehensive reform of the tax system, to make it more equitable and responsive to developments in economic activity, is essential for this purpose. As first steps in this direction, the Government intends to introduce the value-added tax in the 1985 budget and to begin in the second half of this year a review of the existing structure of direct taxation, with the aim of implementing its reform within the next two to three years. The ongoing efforts to recover arrears in payments of taxes and social contributions and to reduce evasion through improved administration and enforcement, will be continued and strengthened. Also, in the preparation of the 1985 budget the Government will undertake a thorough review of the existing schemes of fiscal incentives and exemptions, which in recent years have resulted in a growing erosion of the tax base, with the aim of significantly reducing their scope and cost to the budget.

On the expenditure side, the Government intends to moderate substantially the pace of increase in public employment by taking concrete steps to promote mobility within the civil service, the autonomous services and the local administration, and to continue the efforts to rationalize expenditures on health and education. In order to strengthen control over expenditures by peripheral public entities, commercial banks will be required to enforce strictly the statutory limits on loans to local authorities and to report on a monthly basis information on these loans to the Ministry of Finance. They will also be required to secure authorization by the Ministry of Finance for loans to autonomous public funds and services. Over the longer term, it is the authorities' intention to eliminate gradually the existing autonomous funds by integrating them into the Central Government budget. The policy of progressive elimination of consumer subsidies through the price mechanism will be continued, and its impact on the standard of living of the lower income groups moderated through selective income support mechanisms. It is the Government's intention to improve the existing scheme for unemployment compensation, in order to create the conditions for increased mobility of the labor force. The cost of the proposed scheme to the budget will be offset by a combination of appropriate expenditure and revenue measures.

The measures designed to ensure the containment of the borrowing requirements of the public enterprises in 1984 will be accompanied by a determined beginning of a program of structural adjustment in this sector, which is crucial to sustained improvement in the finances of public enterprises over the medium term. Budgetary support to ailing public enterprises will be linked to restructuring programs, which will begin to be implemented in the next few months and will be partly designed in collaboration with the IBRD. The progress in this area will be reviewed with the Fund staff in the autumn of 1984. The restructuring programs will be accompanied by institutional reforms designed to increase responsibility of the management of public enterprises, to strengthen the mechanisms of financial control and to improve the flow of information between the Government and the enterprises. A determined effort will be made fully to identify existing arrears among public enterprises and to and from the General Government, and to proceed with an orderly settlement of these arrears.

As a first step toward improving the authorities' control over the public sector finances and to ensure compliance with the ceilings referred in paragraph 7 below, the Government has set up a committee (chaired by the Minister of Finance) of the Secretaries of State of the Budget, Treasury, Finances, Planning, Industry, Energy and Transport, with the participation of a member of the Board of the Bank of Portugal. This committee will meet at least once a month to review the developments to date and those expected over the next few months in the borrowing requirements of the General Government and of the public enterprises and to decide the allocation of domestic and external credit among them. The Minister of Finance will inform the Council of Ministers of developments in this area and propose any corrective measures that may be required.

The committee will be supported by a technical staff charged with the task of centralizing and analyzing the monthly reports that the major public entities and enterprises will be required to submit on recent and prospective developments in their financial position.

6. Monetary policy so far has been conducted broadly in accordance with the indicative targets set out in the letter of intent of September 9, 1983. We intend to gear the rate of growth of the monetary and credit aggregates in the second half of the year toward securing the targeted decline in inflation to 23 percent by end-1984, a modest pickup in real output and the recovery of the loss in net foreign assets experienced in the first few months of this year. It is also our intention to promote, through a more flexible interest rate policy, a reversal of the increase in velocity which occurred in 1983. For this purpose, effective July 1, 1984, the Bank of Portugal will only set the rate on time deposits of maturity of six months to one year (at 28 percent), leaving the banks free to choose the levels of the rates on deposits of different maturities. The Bank will keep the appropriateness of the level of the pivot rate under review and will be prepared to adjust it in the light of changing circumstances, particularly developments in the rate of inflation and in foreign interest rates. Steps will be taken to promote financial savings, especially of small savers, for example by expanding the scope of passbook savings accounts. The level and structure of lending rates will also be kept under review, and the authorities will make adjustments as appropriate in the light of developments in inflation and in interest rates abroad.

7. In order to give effect to the financial policies outlined above, the authorities have set the following ceilings on domestic bank credit through the end of 1984. Total domestic bank credit extended by the banking system (which stood at Esc 2,538.6 billion on December 31, 1983) will not exceed Esc 2,875 billion on July 31, 1984, Esc 2,929 billion on September 30, 1984 and Esc 3,106 billion on December 31, 1984. Within this ceiling, it is intended to limit domestic bank credit to the public sector and to 53 public enterprises (namely the 51 statutory public enterprises, the Sines Port Authority and the Vegetable Oil Import Board (IAPO), which stood at Esc 954.2 billion on December 31, 1983 to at most Esc 1,125 billion on July 31, 1984, Esc 1,110 billion on September 30, 1984 and Esc 1,168 billion on December 31, 1984. These limits are predicated on the assumption that the net increase in external credit to the public sector and the 53 public enterprises will reach US$615 million by July 31, 1984, US$1,121 million by September 30, 1984 and US$1,364 million by December 31, 1984. The ceilings on domestic bank credit to the public sector and the public enterprises and the ceilings on total domestic bank credit will be automatically adjusted upward (downward) for any shortfall (excess) of external credit to the public sector and the public enterprises with respect to the targeted amount up to the escudo equivalent of US$100 million (calculated at the average exchange rate for the relevant period).

8. The Government intends to limit resort to external borrowing to levels consistent with the targeted improvement in the current account of the balance of payments. To this end the authorities will limit in 1984 the increase in Portugal's disbursed external debt outstanding (including short-term and nonguaranteed debt but excluding foreign lia liabilities of the Bank of Portugal and short-term liabilities of the banking system) which stood at US$13,233 million at the end of 1983, to no more than US$616 million on July 31, 1984, US$1,113 million on September 30, 1984 and US$1,250 million on December 31, 1984. Within this ceiling, the increase in short-term external debt disbursed, excluding foreign liabilities of the Bank of Portugal and of the banking system, which stood at US$3,044 million at the end of 1983, will not exceed US$200 million on July 31, 1984, US$150 million on September 30, 1984, and US$200 million on December 31, 1984. The cumulative loss in net foreign assets of the Bank of Portugal and the banking system from January 1, 1984, which amounted to US$271 million on March 31, 1984 should not exceed US$450 million on July 31, 1984, US$150 million on September 30, 1984 and US$100 million on December 31, 1984.

It is the intention of the Government to promote a sustained reduction in the external debt service burden over the medium term through policies aimed at securing a sustained growth of exports of goods and services, at reducing import dependence especially in the agricultural sector and at promoting a larger inflow of nondebt foreign capital.

9. The Government is committed to the maintenance of a trade and payments system virtually free of restrictions on payments and transfers for current international transactions. During the balance of the stand-by program the Government will refrain from the introduction of new restrictions or the intensification of existing ones on payments and transfers for current international transactions or on imports for balance of payments reasons. The Government will also strengthen its efforts to ensure a liberal administration of import licensing regulations.

10. The Government believes that the policies set forth in this letter are in keeping with the objectives of the program but, in consultation with the Fund, it will take any further measures that may be necessary. Progress in the implementation of the program will be reviewed with the Fund staff during the fourth quarter of 1984, at which time the 1985 budget will also be discussed. Purchases under the stand-by arrangement, which amount to SDR 166.4 million to date, will not exceed SDR 166.4 million until September 15, 1984, SDR 259.3 million until November 15, 1984 and SDR 352.1 million until February 15, 1985, and will be contingent upon the observance of the performance criteria set out in paragraphs 7 and 8 above. After the period of the stand-by arrangement and while any

Fund holdings of escudos above the first credit tranche include currency purchased under this stand-by arrangement, the Government will consult with the Fund, at the initiative of the Government or at the request of the Managing Director, concerning Portugal's balance of payments policies.

Sincerely yours,

Ernani Rodrigues Lopes
Minister of Finance and Planning

Manuel Jacinto Nunes
Governor, Bank of Portugal