SM/85/237
Correction 2

CONTAINS CONFIDENTIAL
INFORMATION

September 10, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Portugal - Staff Report for the 1985 Article IV Consultation

The attached page 1 of SM/85/237 (8/19/85) is reissued to include the name of the Executive Director for Portugal.

Att: (1)

Other Distribution:
Department Heads

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CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

PORTUGAL

Staff Report for 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985 Article IV Consultation

Approved by L. A. Whittome and J. T. Boorman

August 16, 1985

I. Introduction

A staff team consisting of Mrs. T. Ter-Minassian, Messrs. E. Spitaeller D. Nellor (all EUR), E. Kalter (ETR), A. Lopez-Claros (EP-EUR), and, as secretary, Ms. A. Munante (EUR) visited Lisbon from June 18 to July 2, 1985 to conduct Article IV consultation discussions. The staff met with the Prime Minister, the Minister of Finance and Planning, the Governor and Deputy Governors of the Bank of Portugal and with officials in the Ministries of Finance and Planning, Industry and Energy, Labor, and in the Bank of Portugal. Mr. Zecchini, Executive Director for Portugal, attended some of the meetings as an observer. The previous consultation discussion had taken place from May 28 to June 20, 1984, and the staff report was considered by the Executive Board on July 30, 1984, concurrently with a review of the stand-by arrangement which had been approved by the Board on October 7, 1983 for the period to February 28, 1985 in the amount of SDR 445 million (118 percent of quota). A waiver of the nonobservance of the ceiling on the increase in the short-term external debt for July 31, 1984 was granted by the Executive Board on December 17, 1984 (EBS/84/259, 12/10/84). The Portuguese authorities did not request waivers of the ceilings on domestic credit to the enlarged public sector for September 30, 1984 and December 31, 1984 which were exceeded. Therefore, at the end of the stand-by arrangement, SDR 185.7 million remained undrawn.

In January 1985 the Portuguese authorities informed the Managing Director that, in view of the improvement in the external accounts in 1983 and 1984, they did not wish to request a new stand-by arrangement for 1985. They expressed, however, their intention to maintain close contact with the Fund and requested that the staff review the performance under the 1983-84 stand-by and issue a report on its findings to the Executive Board. A staff team consisting of Mrs. T. Ter-Minassian and Mr. E. Spitaeller (both EUR) visited Lisbon from February 25 to March 1, 1985 to conduct this review. A report on the staff visit (EBS/85/116, 5/9/85) was circulated for information to the Executive Board on May 9, 1985.

On May 31, 1985 Fund holdings of Portuguese escudos amounted to SDR 918.8 million (244 percent of quota) of which SDR 312.6 million (83 percent of quota) corresponding to drawings under the compensatory financing facility.

Since June 1983, Portugal has been governed by a coalition of Socialists (PS) and Social Democrats (PSD). Following a national congress of the PSD in May 1985, its new leadership decided to withdraw from the coalition. The inability to form a new Government that would enjoy a majority in Parliament led the President of the Republic to dissolve Parliament after ratification of the EC accession treaty in July. New parliamentary elections are scheduled for October, to be followed by local and then presidential elections early in 1986. The present Government is to remain in power in caretaker capacity until a new Government is formed after the parliamentary elections. Political uncertainties, which may last well into next year, are likely to constrain the room for maneuver in economic policy in the near term.

II. Report on the Discussions

1. Recent economic developments

Between 1979 and mid-1985 the Portuguese economy has come full circle. Expansionary financial policies and a loss of competitiveness resulted in a shift of the current account of the balance of payments from virtual equilibrium in 1979 to a deficit on the order of 13 percent of GDP in a matter of three years, forcing by mid-1983 a sharp reversal of course which over the next two years restored near balance to the external account. The developments leading to the adoption by the Portuguese authorities of an adjustment program for 1983-84 supported by a stand-by arrangement with the Fund have been described in earlier documents (Portugal--Staff Report for the 1983 Article IV consultation, SM/83/88, 5/18/83; and Recent Economic Developments, SM/83/94, 5/25/83). Here it is sufficient to recall the salient features of these developments. Over the period 1979-82, the authorities pursued expansionary fiscal and monetary policies involving a rapid growth of the monetary and credit aggregates and a widening of the public sector deficit, including the public enterprises, from the equivalent of about 16 percent of GDP in 1979 to 22 percent in 1982. During the same time the net savings balance of the private sector declined from the equivalent of 16 percent of GDP to 9 percent. The factors involved in this decline were initially large increases in real wages and real disposable income and subsequently declines in real interest rates and the savings rate. Total domestic demand in Portugal grew cumulatively by 13.3 percent in real terms during 1980-82, in contrast with virtual stagnation in Portugal's trading partners. At the same time competitiveness deteriorated significantly and the terms of trade registered a cumulative loss of 11 percent. As a result the current account deficit in the balance of payments widened from the equivalent of 0.3 percent of GDP in 1979 to 13.2 percent in 1982 (Table 1), and the external debt rose from