

**FOR
AGENDA**

SM/08/298
Correction 1

September 29, 2008

To: Members of the Executive Board
From: The Secretary
Subject: **Portugal—Staff Report for the 2008 Article IV Consultation**

The attached corrections to SM/08/298 (9/9/08) have been provided by the staff.

Factual Errors Not Affecting the Presentation of Staff’s Analysis or Views

Page 8, Figure 1: corrected series for net FDI of the euro area in the bottom left panel, rescaled.

Page 11, para. 12, line 12: removed “...to close to Italian levels...”

Page 12, Box 1, para. 2, line 9: for “...an decrease...” read “...a decrease...”

Page 15, para. 17, line 5: removed “...significantly...”

Page 19, figure on “Age-related spending...”: added footnote.

Page 20, left figure, title: for “...interbank borrowing...” read “...wholesale funding...”

Page 21, para. 29, line 7: for “...issue securities to retain in their portfolio to use...”
read “...increase their portfolio of securities that can be used...”

Page 29, Table 1, line 27, column 2: for “...4.4...” read “...3.0...”

column 3: for “...1.1...” read “...2.0...”

column 4: for “...8.2...” read “...7.4...”

line 28, column 2: for “...6.9...” read “...6.7...”

column 3: for “...4.7...” read “...3.2...”

column 4: for “...4.3...” read “...4.8...”

line 39, column 1: for “...56.8...” read “56.9...”

Page 31, Table 3, line 1, column 2: for "...62,094..." read "...61,986..."

line 2, column 2: for "...59,946..." read "...59,838..."

line 7, column 2: for "...6,291..." read "...6,183..."

line 9, column 2: for "...71,240..." read "...71,082..."

line 17, column 2: for "...6,554..." read "...6,396..."

line 18, column 2: for "...4,532..." read "...4,374..."
column 6: for "...3,678..." read "...3,634..."

line 19, column 6: for "...1,767..." read "...1,812..."

line 20, column 2: for "...-9,146..." read "...-9,096..."

line 21, column 2: for "...-9,146..." read "...-9,096..."
column 9: for "...-4,420..." read "...-4,452..."

line 23, column 2: for "...40.2..." read "...40.1..."

line 28, column 2: for "...4.2..." read "...4.1..."

line 30, column 2: for "...47.8..." read "...47.7..."

line 38, column 2: for "...4.4..." read "...4.3..."

line 48, column 4: for "...155,446..." read "...155,289..."
column 8: for "...162,833..." read "...162,510..."

Page 33, Table 5, line 3, column 5: for "...6.2..." read "...6.1..."

line 19, column 6: for "...10.8..." read "...11.4..."

line 20, column 8: for "...54.7..." read "...55.0..."

line 21, column 8: for "...53.3..." read "...53.4..."

line 22, column 8: for "...57.5..." read "...57.6..."

line 23, column 8: for "...39.5..." read "...39.6..."

line 28, column 8: for "...91.7..." read "...91.4..."

Page 34, Table 6, line 16, column 3: for "...56.8..." read "...56.9..."

Page 36, Table 8, second bullet: add “In some cases,” before “Bank of Portugal” in the first line under Status column.

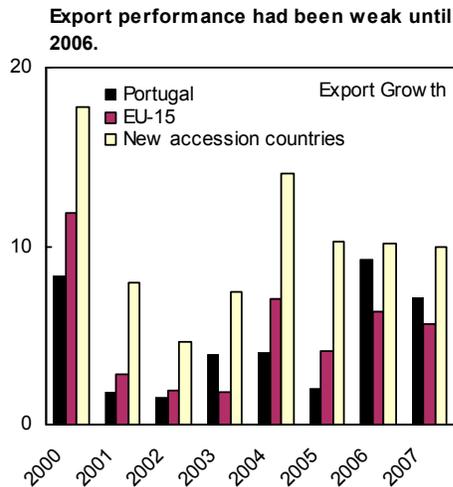
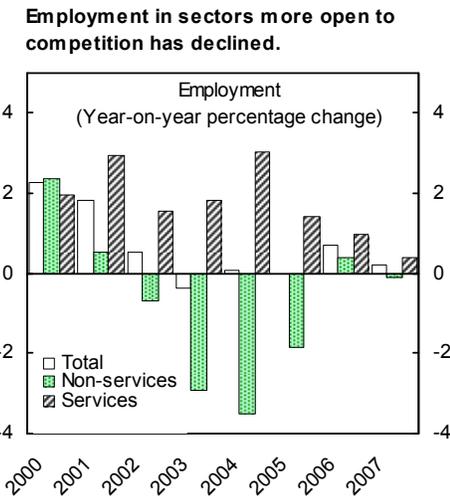
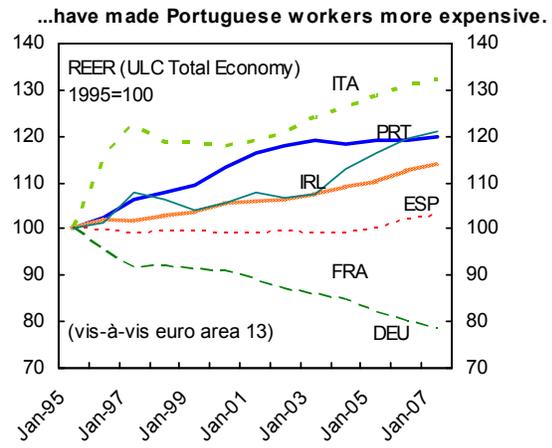
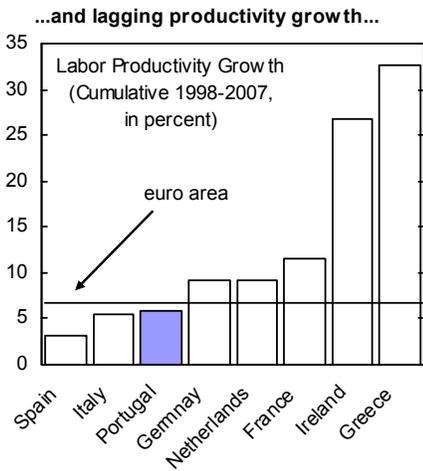
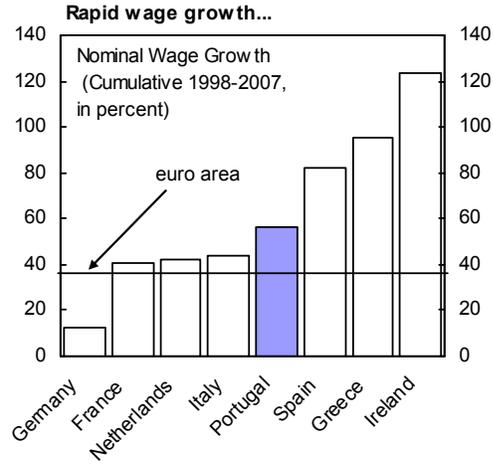
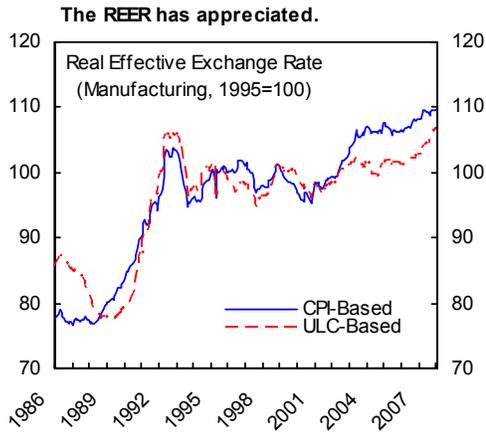
Questions may be referred to Mr. Daniel (ext. 39698), Ms. Honjo (ext. 34163), and Mr. Xiao (ext. 38725) in EUR.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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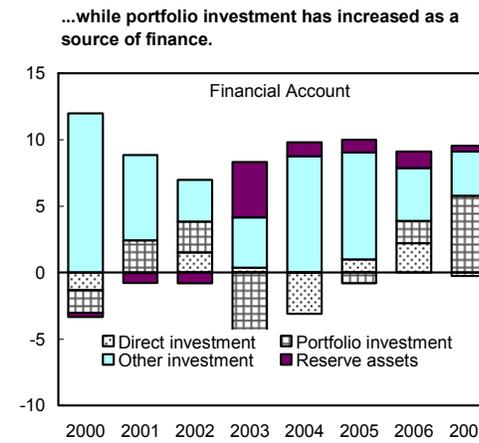
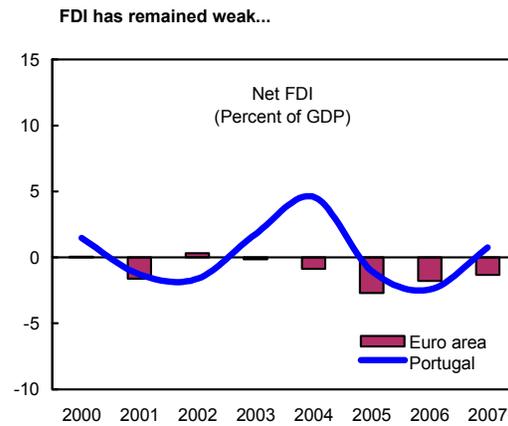
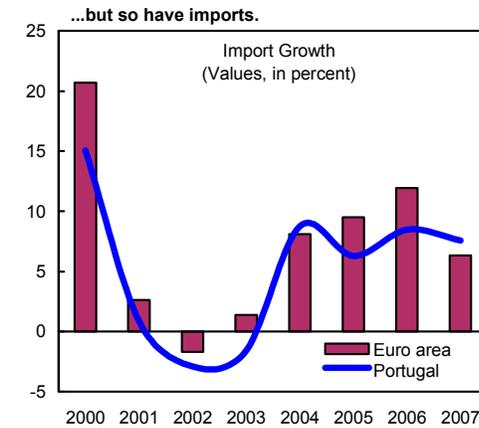
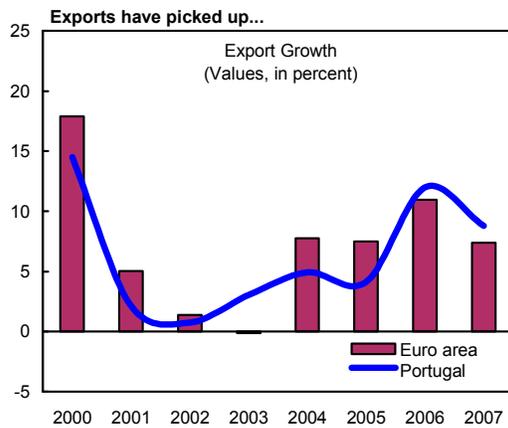
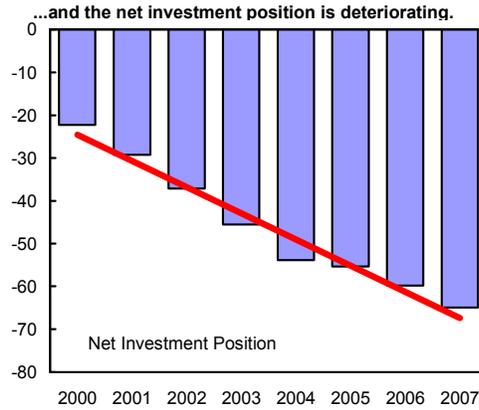
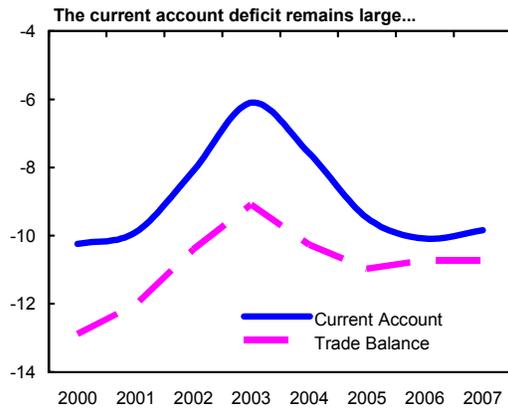
Other Distribution:
Department Heads

Portugal Has Lost Competitiveness...

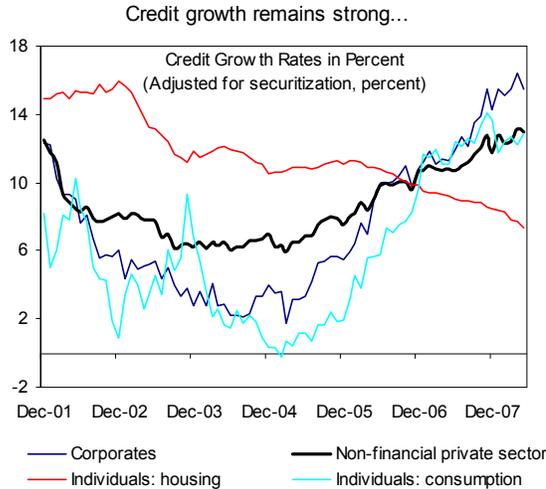


Sources: OECD Economic Outlook; AMECO; National Institute of Statistics (INE); Eurostat; European Commission; and IMF staff calculations.

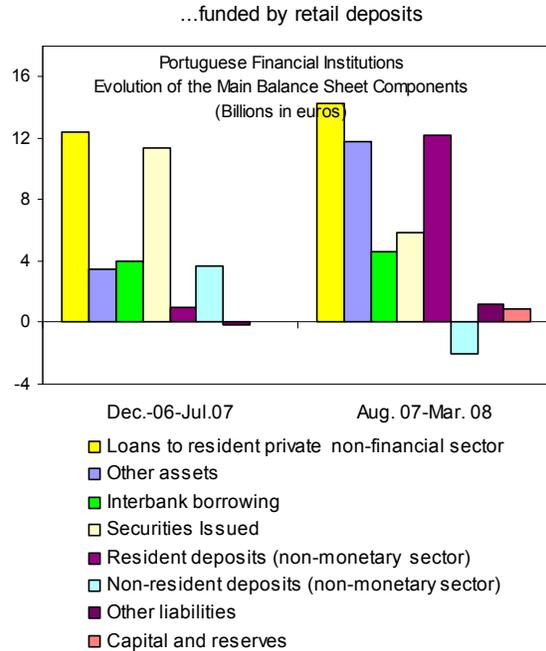
...And the External Accounts Remain Weak
(Percent of GDP, unless otherwise indicated)



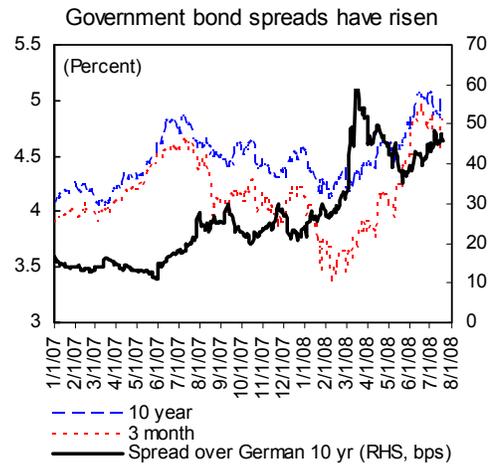
Source: Bank of Portugal.



Source: Bank of Portugal.



12. **The financial system has come under pressure but has so far weathered the storm.** While write-offs arising from U.S. subprime exposure were minimal, CDS spreads for the main banks increased substantially, equity prices declined, and banks' funding through securities dried up. Debt issuance shows signs of recovery in 2008:Q2, although funding costs have increased and maturities shortened. Declining equity valuations of banks' portfolios and employee pension funds and increasing borrowing costs have dented profitability. The stock market has fallen by more than other EU countries (though this reflects larger prior gains), government bonds spreads have risen, and corporate borrowing spreads have widened. Housing price growth remains flat in real terms, with real house prices at their long-term average.



III. OUTLOOK AND RISKS: DOMESTIC

IMBALANCES AGGRAVATED BY GLOBAL TENSIONS

13. **Staff project growth to slow to about 1 percent in 2008, and to about ¼ percent in 2009.** Key factors behind the slowdown are spillovers from the weaker global outlook (Box 1), higher commodity prices, the stronger euro, and the fallout from the financial turbulence. Thereafter, staff project a modest recovery towards potential and gradual adjustment in the stretched balance sheets, with household consumption growth below that of GDP and business investment growing modestly, constrained by Portugal's still-large

competitiveness gap and weak economic prospects, but with some further structural reform and rebalancing of growth towards the external sector as wages and prices are contained.

14. **Risks to growth seem tilted to the downside.** In particular, the balance sheet adjustment—prompted by the global financial turbulence—could be more rapid, dampening growth over the next few years, which could be exacerbated by failure to implement structural reforms. On the upside, exports could strengthen, driven by somewhat stronger partner country growth and the ongoing restructuring process, especially in the short term.

Box 1. Portugal: Growth Spillovers

Portugal is becoming increasingly integrated in the global economy, and growth appears to have become more synchronized with its partners.

How much might a slowdown in the EU or the U.S. affect growth in Portugal? Staff analysis, based on VAR methodology, suggests that a one percentage point decrease in the quarterly growth rate of the EU would lead cumulatively to one-third of a percentage point decrease in Portugal's quarterly growth rate, while a one percentage point decrease in the quarterly growth rate of the U.S. would lead cumulatively to a decrease in Portugal's quarterly growth rate by 0.2 percentage points.

Portugal's economy is particularly sensitive to developments in Spain. Staff estimates suggest that, based just on trade links, a one percentage point decline in Spain's real growth would lead to a decline of about half a percentage point in Portugal's real exports and 0.14 percent in GDP. Given the latest WEO exercise projects growth to slow by some 3 percentage points in Spain between 2007–09, this would lower Portuguese growth by about half a percentage point over this period.

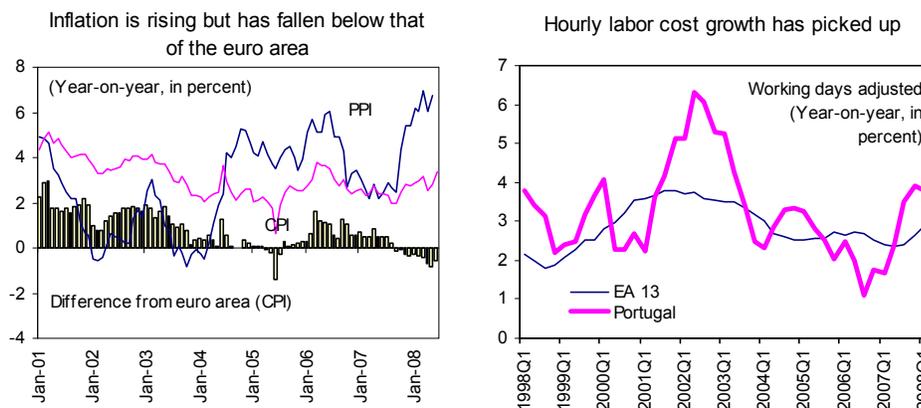
Correlation of GDP Growth Between Portugal and Other Economies

	Correlation (1981–95)	Correlation (1996–2007)
Spain	0.8	0.5
Germany	0.2	0.6
France	0.7	0.7
United Kingdom	0.0	0.6
United States	-0.2	0.6
Netherlands	0.4	0.9
Belgium	0.5	0.4
Italy	0.5	0.6

Correlation of Stock Market Returns with Portugal

	1993–99	2000–07
United States	0.17	0.91
United Kingdom	0.53	0.93
Spain	0.81	0.92
Germany	0.78	0.90
France	0.44	0.88

15. **Inflation should stay below the euro area average, though wage growth and high producer prices pose a threat.** The continued weak economy, combined with the VAT rate reduction in July, should allow inflation to moderate in the second half of the year and remain below the euro area average. The risks though are for higher inflation in the near term, as recent stronger wage growth and higher producer price rises may yet be passed on.



16. **The current account deficit is projected to widen, through 2009 but narrow gradually thereafter.** Higher oil prices alone are likely to increase imports by some 3 percent of GDP between 2004–08. In the medium term, import growth is projected to moderate in line with weakening domestic demand and export shares to be maintained, resulting in the current account moderating slightly to about 10 percent of GDP by 2013 (with the income account deficit rising to 7 percent of GDP). The main downside risks are that domestic demand does not moderate and competitiveness deteriorates.

17. **The authorities recognized that the macroeconomic outlook, driven by external shocks, had deteriorated significantly.** The Bank of Portugal's recently revised projections are broadly in line with staff's for 2008, and the somewhat higher growth in 2009 is largely due to their more positive external assumptions. The Ministry of Finance is also likely to revise down their projections in the forthcoming budget. The authorities underscored, however, that achievements over the past two years have placed Portugal in a stronger position to face the current adverse shocks from the financial market turmoil and higher commodity prices.

Comparison of Growth Outlook
(Percent)

	2007		2008				2009				2010		2011		2012	2013	
	BoP	MoF	OECD	EC	Staff	BoP	MoF	OECD	EC	Staff	MoF	Staff	MoF	Staff	Staff	Staff	
Real GDP	1.7	1.2	1.5	1.6	1.7	1.0	1.3	2.0	1.8	1.6	0.8	2.2	1.5	2.2	1.7	1.8	1.8
Private consumption	0.7	1.3	1.4	1.4	1.2	1.0	0.7	1.7	1.6	1.4	0.9	1.8	1.1	1.9	1.1	1.1	1.1
Public consumption	0.1	-0.2	-1.1	0.5	0.3	-0.6	0.0	-0.6	0.5	0.5	-0.6	-0.3	-0.3	1.1	0.4	0.4	0.4
Gross fixed investment	3.0	1.0	3.5	3.0	2.9	1.6	1.2	5.5	3.1	1.4	1.5	5.7	1.9	5.5	1.8	1.6	1.6
Exports	8.1	4.4	5.3	4.0	4.6	4.2	4.0	4.7	5.3	4.2	3.5	5.1	5.0	5.2	4.9	4.9	4.8
Imports	5.2	3.3	4.3	3.7	3.3	3.2	2.1	4.5	4.3	2.8	2.9	5.0	3.3	5.3	3.1	2.9	2.9
CPI inflation	2.4	3.0	2.6	3.0	...	3.2	2.5	2.2	2.2	...	2.1	2.0	2.1	2.0	2.1	2.1	2.1
Partner countries real imports	5.8	...	4.9	...	...	4.8	...	4.2	...	...	3.5	6.7	5.0	6.7	4.9	4.9	4.8
Current account	-9.9	...	...	-11.6	-10.1	-11.7	...	...	-11.6	-9.4	-12.0	...	-11.6	...	-11.1	-10.5	-9.9
Current account (including capital transfers)	-8.6	-10.6	-8.5	...	...	-10.4	-11.1	-8.7	...	...	-10.7	-8.7	-10.3	-8.6	-9.8	-9.2	-8.6

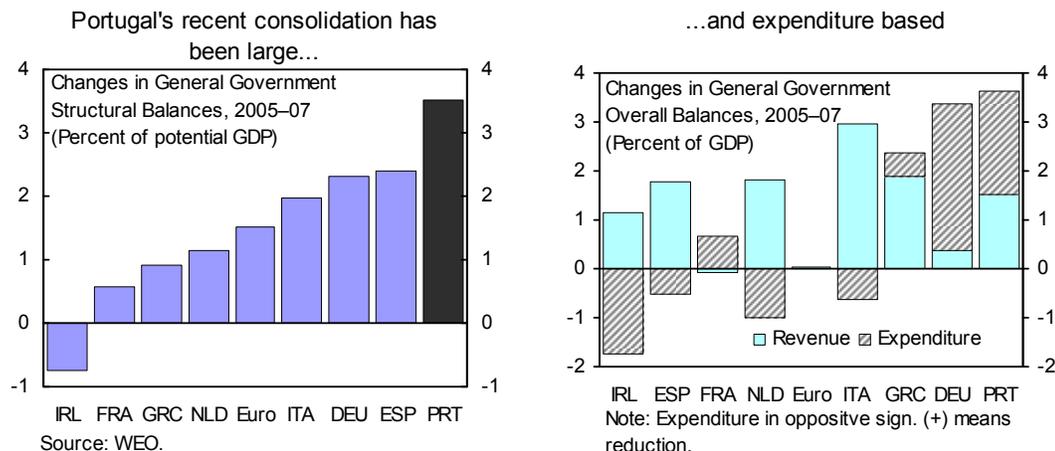
Sources: Bank of Portugal Economic Bulletin (Summer 2008); Ministry of Finance (May 2008); OECD Economic Outlook (June 2008); EC Spring Economic Forecasts 2008; and IMF staff projections.

IV. THE POLICY AGENDA: PROMOTING ADJUSTMENT AND GROWTH

18. **Policies should focus on fostering the smooth unwinding of macro imbalances to address the main challenges to domestic¹ stability:** i) achieving fiscal soundness; ii) ensuring financial stability; and iii) enhancing growth and competitiveness. Given the rigidity of the economy and the accumulated macro imbalances, meeting these challenges will likely prove long and demanding—marginal changes are not enough, and a critical mass of supply-oriented reforms is necessary to rebalance growth to the external sector and reignite the convergence process.

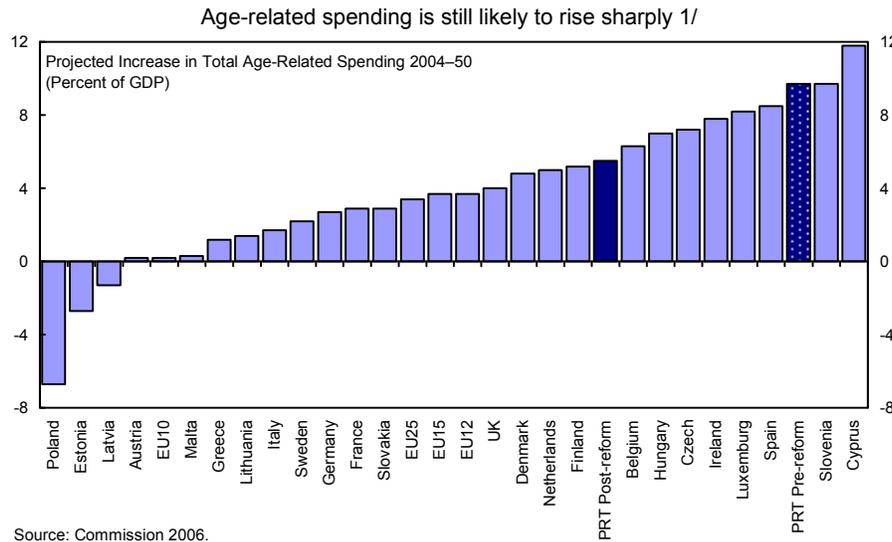
A. Challenge 1: Achieving Fiscal Soundness

19. **Decisive action has reduced fiscal imbalances and enhanced credibility, putting the fiscal accounts on a stronger footing to face the current more difficult economic circumstances.** Since 2005, the deficit has fallen by 3½ percentage points of GDP to 2.6 percent of GDP in 2007—the lowest level for some 30 years, allowing Portugal to exit the Excessive Deficit Procedure a year earlier than envisaged and the debt-to-GDP ratio to fall. The consolidation has, appropriately, been driven by containing primary current spending. Revenue overperformance has also contributed, due in significant part to enhanced revenue administration. While euro area countries in general have also improved their fiscal position over the past two years on the back of favorable cyclical conditions, the improvement was largest in Portugal.



¹ Accounting for less than 2 percent of euro area GDP and financial assets, and 4 percent of euro area country current account imbalances, Portugal has only a minimal impact on the union's balance of payments and hence external stability.

recent commodity price and interest rate increases should continue to be targeted, temporary, offset by other measures, designed to maximize the supply response, and to avoid distorting price signals. Indeed, as the heightened spreads on Portugal's government debt indicate, there is little room for maneuver, and the costs of slippage are high. The MTO may also need eventually to be improved upon to address longer-term pressures such as population aging.



25. **The fiscal authorities agreed with staff on the extent of the needed consolidation.** They acknowledged that the previously envisaged consolidation of 0.8 percent of GDP in 2009 had become less realistic given economic developments, and to ensure the credibility of achieving the MTO and to not undermine gains achieved so far, structural consolidation of at least a ½ percent of GDP should be targeted. The new fiscal targets would be spelled out in the context of the 2009 Budget to be published in October.

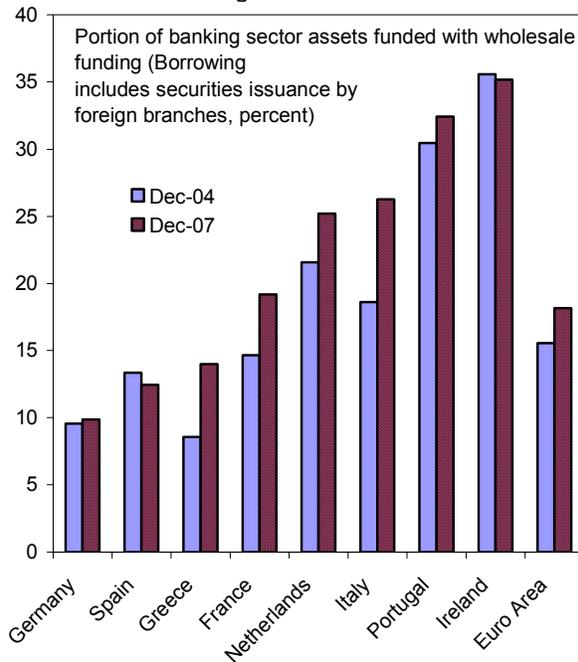
26. **Efforts to enhance the quality, transparency, and durability of fiscal consolidation need to continue.** In particular, progress should continue to be made on performance-based budgeting and a binding medium-term framework. Continued progress needs also to be made on divesting and reforming public enterprises, including greater use of performance evaluation, centralizing the ownership function in the Ministry of Finance, and enhancing transparency in public accounts. Especially in the current economic context, the program to make public agencies pay on time needs to be strictly enforced and possibly made more ambitious.

B. Challenge 2: Ensuring Financial Stability

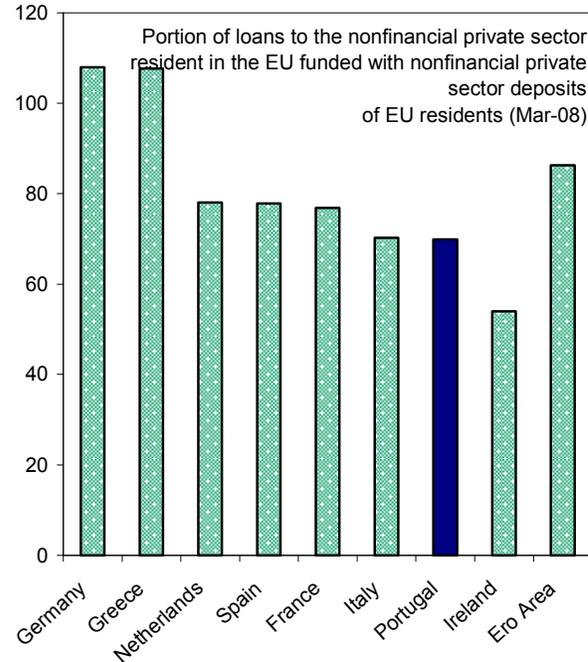
27. **While Portugal's financial system remains sound and well supervised, vulnerabilities have risen.** Portuguese banks' reliance on wholesale funding raises liquidity risks, and banks are exposed to market risk through employees' pension funds and banks'

own investment portfolios. High household and corporate debt increases credit risk given rising interest rates and the weak macroeconomic outlook, and loan concentration in some banks to certain sectors and large exposures appears significant.

Portuguese banks rely relatively heavily on wholesale funding...



...and less on deposits.



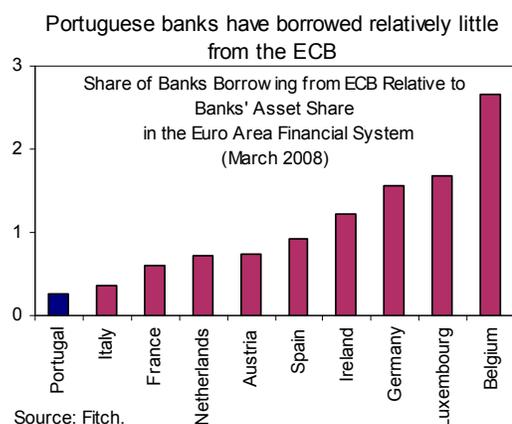
Sources: BIS, Locational Banking Statistics; and ECB, aggregated balance sheet of euro area monetary financial institutions.

28. Staff's stress tests indicate that the current environment poses risks, although these seem manageable, and the system should be resilient.

- Simulation of the evolution of the main balance sheet components indicate that while credit growth will likely decelerate, it would not grow more slowly than nominal GDP. A credit crunch seems unlikely except in a rather extreme scenario where banks cannot rollover maturing securities and a large proportion of interbank loans, for example, due to a worsening of the global liquidity situation.
- Analysis of corporate balance sheets suggests that declining profits and increasing interest rates could almost triple existing corporate nonperforming loans. Nevertheless, bank profitability, provisioning and capital levels should provide

adequate buffers to absorb this shock, although some banks would likely need to reinforce their capital positions.⁵

- Liquidity shocks are more of a concern but again seem largely manageable. Compared to peers, Portuguese banks' liquidity appears a little low in general on some measures, but at the consolidated level, banks are required to cover 90 percent of one-month liabilities plus financing gaps over a one-year horizon with liquid assets.



29. **The authorities are well aware of the vulnerabilities and have been pro-active in addressing them.** Banks with weaker capital ratios have been strongly encouraged to raise capital, and two large private banks and one small one have increased capital through rights issuance and profit allocation, while others have announced plans to increase capital by year-end. Banks were recently encouraged to increase their portfolio of securities that can be used as collateral for central bank lending as a precautionary liquidity measure, although Portuguese banks have made relatively little use of ECB funding due to the increase in retail deposit funding. The Bank of Portugal has enhanced monitoring of banks' liquidity positions and banks' plans to address potential liquidity shortfalls.

30. **These measures are welcome, and some further enhancements to the financial stability framework could be considered.** Many of these are already under consideration, including in the context of ongoing changes in the international financial architecture. To further strengthen liquidity supervision, a zero maturity gap could be required at the 15-day or one-month horizon and, in line with recommendations from the Basel Committee, haircuts for structured products might warrant reconsideration. The Bank of Portugal should ensure that banks have appropriate internal limits on sectoral credit concentrations and large exposures, in compliance with the internal controls instructions. Stress tests could be more proactively used to assess the adequacy of capital buffers. If Tier I capital ratios were to fall significantly below 7 percent, banks should be encouraged to raise capital. In the context of Basel II implementation, banks' own risk-management models should be validated. The transition to full economic provisioning might also usefully be completed.

⁵ Stress tests of corporate balance sheets assumed a 30 percent decline in profitability and 100 b.p. increase in financing costs. Bank stress tests assumed that NPLs would reach 3 percent of total loans, in line with the corporate stress test and historical data, and a 50 b.p. decline in net interest margins. Banks were required to maintain current provisioning levels.

31. **In the context of EU-wide revision of deposit insurance schemes, the opportunity should be taken to further enhance the deposit guarantee fund (FGD).** In particular, the maximum period for the payment of guaranteed deposits could be substantially shortened. Consideration could also be given to updating the guaranteed amount, setting a target coverage ratio for FGD resources, including the minimum cost principle for the FGD, and to altering the provider of emergency FGD lending from the Bank of Portugal to the Ministry of Finance.

32. **Given Portugal's external imbalances, household savings need to rise over time.** Recent reforms of the social security system and the benefits of enhancing banks' domestic retail funding also call for more proactive promotion of household savings. A key channel for such savings are occupational pension schemes, but these are relatively undeveloped—consideration should be given to conducting a public financial literacy campaign and to introducing “soft compulsion” schemes that require opting out of, rather than into, occupational pension schemes (e.g., the U.K.'s “National Pensions Savings Scheme” or the New Zealand “Kiwisaver” plan).

33. **The authorities welcomed staff recommendations to further enhance the financial stability framework, indicating that many of the measures were already under consideration.** On further strengthening liquidity supervision, requiring banks to implement a zero maturity gap at the 15-day or one-month horizon would be considered, but this was not a priority as most banks tend to maintain net positive liquidity positions for those time horizons. The authorities agreed that transition to economic provisioning on an individual basis, similar to what is already implemented at the consolidated level, would be desirable. While acknowledging the difficulties in setting the appropriate parameters to conduct stress tests in the current environment, the authorities considered that they could take more advantage of banks' internal stress tests for supervisory purposes. The areas for enhancing the FGD would also be considered in the context of EU-wide revision.

C. Challenge 3: Enhancing Growth and Competitiveness

34. **At the root of Portugal's problems lies a severe lack of productivity.** This in turn reflects a rigid economy, as well as other structural factors relating to human capital and the justice system. Unlike other EU countries, including those with weak growth (such as Italy), unemployment has risen, apparently structurally as the historical relationship with the output gap seems to have broken down. Employment protection legislation remains among the most restrictive in the OECD, and total factor productivity growth has been

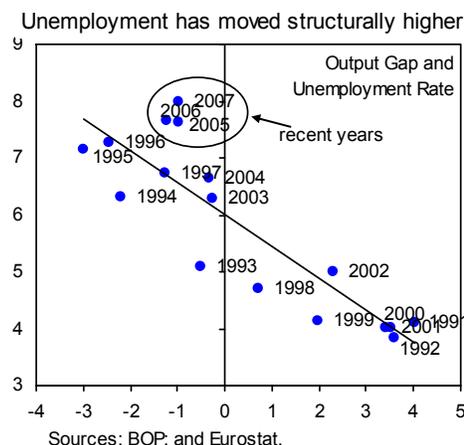


Table 1. Portugal: Selected Economic Indicators, 2003–09
(Changes in percent, except as otherwise indicated)

	2003	2004	2005	2006	2007	Proj.		Latest	
						2008	2009		
Domestic economy									
Real GDP	-0.8	1.5	0.9	1.4	1.7	1.0	0.8	0.9	Q1 08
Real domestic demand	-2.1	2.7	1.6	0.7	1.1	0.8	0.8	2.2	Q1 08
Private consumption	-0.1	2.5	2.0	1.7	0.7	1.0	0.9	1.9	Q1 08
Public consumption	0.2	2.6	3.2	-1.4	0.1	-0.6	-0.6	0.4	Q1 08
Gross fixed investment	-7.4	0.2	-0.9	-0.7	2.8	1.6	1.6	3.0	Q1 08
Foreign sector contribution	1.5	-1.4	-0.8	0.6	0.5	0.1	0.0	-1.4	Q1 08
Savings-investment balance (percent of GDP)									
Gross national savings	16.8	15.5	13.1	12.1	12.4	10.4	9.8	...	...
Private	18.1	17.9	16.3	13.7	12.4	10.6	9.9	...	...
Government	-1.4	-2.4	-3.3	-1.6	-0.1	-0.2	-0.1	...	...
Gross domestic investment	22.9	23.1	22.6	22.2	22.2	22.4	22.5	...	...
Private	19.8	20.0	19.6	19.9	19.8	20.1	20.1	...	...
Government	3.1	3.1	2.9	2.3	2.4	2.3	2.5	...	...
Resource utilization									
Employment	-0.4	0.1	0.0	0.7	0.2	0.4	0.4	1.1	Q1 08
Unemployment rate	6.3	6.7	7.6	7.7	8.0	8.0	8.0	7.6	Q1 08
Real potential GDP	1.7	1.5	1.5	1.4	1.5	1.2	1.3	...	...
Output gap	-0.3	-0.3	-0.9	-0.9	-0.7	-0.9	-1.4	...	...
Labor productivity	-0.4	1.4	0.9	0.6	1.5	0.6	0.4	...	...
Compensation per worker (whole economy)	3.5	2.6	3.5	2.4	2.4	2.3	2.3	...	...
Unit labor costs (whole economy)	3.9	1.2	2.5	1.7	0.9	1.7	1.9	...	...
Prices									
Consumer prices (harmonized index)	3.3	2.5	2.1	3.0	2.4	3.2	2.1	3.4	Jun08
GDP deflator	3.2	2.4	2.5	2.8	3.0	2.2	2.2	2.2	Q1 08
External accounts									
Export volume (goods)	5.8	3.0	2.0	7.4	6.8	3.5	2.1	2.1	Q1 08
Import volume (goods)	-0.2	6.7	3.2	4.8	5.1	3.2	2.6	6.1	Q1 08
Export unit value (goods and services)	-1.4	1.5	1.9	4.2	2.9	3.0	1.8	3.2	Q1 08
Import unit value (goods and services)	-1.8	2.2	3.2	3.9	1.8	5.0	1.5	5.4	Q1 08
Current account (percent of GDP)	-6.1	-7.6	-9.5	-10.1	-9.9	-12.0	-12.7	...	...
Nominal effective exchange rate	3.2	0.8	0.1	0.2	1.3	...	...	2.9	May08
Real effective exchange rate (CPI based)	4.4	1.0	0.1	0.6	1.8	...	...	1.9	May08
General government finances (percent of GDP)									
Revenues	42.5	43.1	41.6	42.4	43.1	43.6	43.6	...	...
Expenditures	45.5	46.5	47.7	46.3	45.8	45.9	45.7	...	...
Overall balance	-2.9	-3.4	-6.1	-3.9	-2.6	-2.2	-2.2	...	...
Excluding one-off measures	-5.3	-5.5	-6.1	-3.9	-2.7	-2.4	-2.2	...	...
Government debt, Maastricht definition	56.9	58.3	63.6	64.7	63.6	63.4	63.5	...	...
Financial variables 1/									
National contribution to euro area M3 2/	4.3	5.7	5.8	3.4	9.0	...	...	13.7	May08
Credit to the private sector 3/	6.4	6.1	7.7	8.7	9.9	...	...	10.5	April08
Interest rates (percent)									
Overnight rate	2.3	2.2	2.4	3.5	3.8	...	...	4.0	Jun08
Deposit rate, up to two years	2.0	2.0	2.1	2.7	3.6	...	...	3.6	April08
Loans granted to nonfinancial corporations	4.4	4.3	4.4	5.4	6.2	...	...	6.1	April08
Government benchmark bond	4.4	3.6	3.5	4.0	4.5	...	...	5.0	Jun08

Sources: Bank of Portugal; Ministry of Finance; National Statistics Office (INE); and IMF staff estimates and projections.

1/ End-of-period data.

2/ Excludes currency in circulation held by nonbank private sector.

3/ Includes securitized loans. Also corrected for loan write-offs and reclassifications.

Table 2. Portugal: Balance of Payments, 2002–13

	2002	2003	2004	2005	2006	2007	Proj.					
	2008	2009	2010	2011	2012	2013						
	(Billions of euros)											
Current account	-11.0	-8.5	-10.9	-14.1	-15.7	-16.0	-19.7	-20.7	-20.8	-20.7	-20.4	-20.0
Trade balance	-14.1	-12.6	-14.8	-16.4	-16.7	-17.5	-19.4	-19.8	-19.7	-19.5	-19.0	-18.5
Exports fob	27.5	28.4	29.8	31.0	34.7	37.8	40.5	42.7	45.5	48.4	51.5	54.7
Imports fob	41.6	41.0	44.5	47.4	51.4	55.3	59.9	62.5	65.3	67.9	70.5	73.2
Services, net	3.3	3.6	4.0	3.8	4.8	6.2	6.7	7.1	7.8	8.5	9.3	10.1
Exports	10.9	10.9	11.9	12.3	14.2	16.3	17.5	18.4	19.5	20.7	22.0	23.2
Imports	7.6	7.3	7.8	8.4	9.4	10.1	10.8	11.3	11.8	12.2	12.7	13.2
Of which												
Tourism	3.8	3.7	4.0	3.7	4.0	4.5	5.1	5.5	6.0	6.6	7.2	7.8
Exports	6.1	5.8	6.2	6.2	6.7	7.4	8.1	8.6	9.2	9.9	10.6	11.4
Imports	2.2	2.1	2.2	2.5	2.7	2.9	3.0	3.1	3.2	3.3	3.4	3.6
Income	-3.2	-2.3	-3.0	-3.9	-6.3	-7.4	-9.7	-10.8	-11.6	-12.5	-13.4	-14.3
Current transfers, net	3.0	2.9	2.8	2.3	2.5	2.6	2.7	2.8	2.8	2.8	2.8	2.8
Private remittances, net	2.6	2.2	2.2	1.9	2.2	2.6	2.7	2.7	2.7	2.7	2.7	2.7
Official transfers, net	0.4	0.7	0.6	0.4	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital account	2.0	2.6	2.2	1.7	1.2	2.1	2.2	2.2	2.3	2.4	2.5	2.6
Current account (including capital transfers)	-9.0	-5.8	-8.7	-12.4	-14.5	-14.0	-17.5	-18.5	-18.5	-18.3	-17.9	-17.4
Financial account	8.3	5.1	9.3	13.1	13.3	15.0	17.5	18.5	18.5	18.3	17.9	17.4
Direct investment	2.1	0.5	-4.4	1.5	3.5	-0.4	2.7	2.9	2.7	2.7	2.8	2.9
Portuguese investment abroad	0.2	-5.8	-6.0	-1.7	-5.6	-4.5	-1.5	-1.5	-1.9	-2.0	-2.1	-2.2
Foreign investment in Portugal	1.9	6.3	1.6	3.2	9.0	4.1	4.2	4.4	4.5	4.7	4.9	5.1
Portfolio investment, net	3.1	-6.5	0.0	-1.2	2.6	9.4	8.2	8.7	8.7	8.6	8.4	8.2
Equity securities	2.5	8.0	4.3	3.1	-0.3	-2.3	1.5	2.4	2.7	2.7	2.7	2.6
Long-term debt securities	-0.2	-11.4	-11.2	-5.8	4.1	7.8	5.2	4.6	4.3	4.2	4.1	4.0
Money market instruments	0.8	-3.1	7.0	1.5	-1.3	3.9	1.6	1.7	1.7	1.7	1.6	1.6
Financial derivatives	0.0	0.1	-0.1	-0.2	-0.2	0.7	0.1	0.1	0.1	0.1	0.1	0.1
Other investment, net	4.3	5.2	12.3	11.5	5.6	4.7	6.4	6.7	7.0	6.9	6.6	6.2
Of which												
Monetary financial institutions	8.8	9.4	1.7	6.7	14.9	8.2	...	...	...	...	...	...
Of which												
Short-term	-1.2	-2.8	-1.8	-5.0	5.7	7.9	...	...	...	...	...	...
Long-term	10.0	12.2	3.6	11.7	9.2	0.3	...	...	...	...	...	...
Reserve assets	-1.1	5.8	1.5	1.4	1.9	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.6	0.8	-0.6	-0.6	1.1	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Net international investment position 1/	-77.6	-82.5	-92.9	-105.9	-125.5	-148.8	-166.3	-184.7	-203.2	-221.5	-239.4	-256.8
Direct investment, net	-22.2	-20.7	-16.9	-18.1	-25.9	-30.5	-33.3	-36.2	-38.8	-41.6	-44.3	-47.2
Portfolio investment, net	-24.9	-21.0	-20.5	-20.9	-25.8	-37.9	-46.1	-54.8	-63.5	-72.1	-80.5	-88.7
Financial derivatives	0.5	0.0	-0.6	-0.1	0.0	-0.1	-0.2	-0.3	-0.4	-0.5	-0.7	-0.8
Other investment, net	-47.9	-50.9	-63.5	-75.6	-81.4	-88.1	-94.6	-101.3	-108.3	-115.1	-121.7	-127.9
Reserve assets	16.9	10.1	8.6	8.8	7.5	7.8	7.8	7.8	7.8	7.8	7.8	7.8
Nominal GDP	135.4	138.6	144.1	149.1	155.4	162.8	168.0	173.1	179.5	186.5	193.9	201.6
	(Percent of GDP)											
Current account	-8.1	-6.1	-7.6	-9.5	-10.1	-9.9	-11.7	-12.0	-11.6	-11.1	-10.5	-9.9
Current account (including capital transfers)	-6.6	-4.2	-6.1	-8.3	-9.3	-8.6	-10.4	-10.7	-10.3	-9.8	-9.2	-8.6
Of which: balance of goods and services	-7.9	-6.5	-7.5	-8.4	-7.6	-6.9	-7.6	-7.4	-6.7	-5.9	-5.0	-4.2
Net international investment position 1/	-57.3	-59.5	-64.5	-71.0	-80.7	-91.4	-99.0	-106.7	-113.2	-118.8	-123.5	-127.4
Direct investment, net	-16.4	-14.9	-11.7	-12.1	-16.7	-18.8	-19.8	-20.9	-21.6	-22.3	-22.9	-23.4
Portfolio investment, net	-18.4	-15.2	-14.2	-14.0	-16.6	-23.3	-27.5	-31.7	-35.4	-38.7	-41.5	-44.0
Financial derivatives	0.4	0.0	-0.4	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3	-0.4
Other investment, net	-35.4	-36.7	-44.1	-50.7	-52.3	-54.1	-56.3	-58.5	-60.3	-61.7	-62.8	-63.4
Reserve assets	12.5	7.3	6.0	5.9	4.8	4.8	4.7	4.5	4.4	4.2	4.0	3.9

Sources: Bank of Portugal; and IMF staff calculations.

1/ End-of-period data.

Table 3. Portugal: General Government Accounts, 2004–13 1/

			(0)	(1)	(2)			(3)	(4)	(5)	(6)	Staff Projections				
	2004	2005	SGP 06	Apr 07	Actual	SGP 06	Apr 07	SGP 07	Prel.	2008	2009	2010	2011	2012	2013	
(Millions of euros)																
Total revenues	62,164	61,986	63,641	65,601	65,912	66,628	67,879	68,831	70,213	73,287	75,386	78,242	81,406	84,614	87,974	
Current receipts	57,040	59,838	61,523	64,033	64,162	65,034	66,513	66,675	68,753	71,036	72,924	75,380	78,217	81,327	84,556	
Tax revenue	32,716	34,958	37,258	37,592	37,656	39,417	39,638	40,021	40,433	41,588	42,359	43,868	45,482	47,291	49,168	
On goods and services	20,400	22,384	23,649	...	23,995	24,726	24,969	24,699	24,541	24,901	25,089	26,054	26,966	28,038	29,151	
Direct taxes	12,316	12,574	13,609	...	13,662	14,691	14,669	15,323	15,892	16,686	17,270	17,814	18,516	19,253	20,017	
Social security contributions	17,573	18,697	18,684	19,347	19,360	19,526	20,026	20,254	20,702	21,746	22,398	23,044	23,876	24,826	25,812	
Other current revenues	6,750	6,183	5,580	7,094	7,145	6,091	6,849	6,400	7,618	7,702	8,166	8,468	8,858	9,211	9,576	
Capital revenues	5,124	2,148	2,119	1,568	1,750	1,595	1,367	2,155	1,460	2,251	2,463	2,862	3,189	3,287	3,417	
Total expenditures	67,007	71,082	70,669	71,656	71,941	72,538	73,166	73,701	74,470	77,038	79,166	81,886	85,175	88,524	92,000	
Primary current expenditures	56,687	60,786	60,819	61,968	62,365	62,322	63,313	63,507	64,235	66,451	67,747	69,619	72,355	75,232	78,219	
Compensation of employees	20,342	21,541	21,207	20,958	21,165	21,010	21,189	20,744	21,006	20,857	20,797	21,215	22,032	22,908	23,818	
Intermediate consumption	5,728	6,316	6,194	6,174	6,428	6,393	6,424	6,587	6,670	7,217	7,250	7,243	7,500	7,798	8,107	
Subsidies	2,170	2,339	1,787	2,144	2,155	1,803	1,556	1,911	1,901	2,053	2,241	2,309	2,394	2,489	2,588	
Social transfers	25,438	27,516	28,235	29,067	29,221	29,394	30,465	30,878	31,308	32,778	33,815	35,143	36,576	38,031	39,541	
Other	3,008	3,075	3,395	3,625	3,397	3,722	3,679	3,387	3,350	3,547	3,644	3,709	3,853	4,006	4,165	
Interest payments	3,820	3,900	4,364	4,354	4,313	4,770	4,628	4,737	4,608	4,957	5,318	5,647	5,834	6,028	6,229	
Capital expenditures	6,501	6,396	5,487	5,333	5,264	5,446	5,225	5,458	5,627	5,630	6,102	6,620	6,986	7,264	7,552	
Fixed capital formation	4,525	4,374	3,747	3,558	3,612	3,634	3,678	3,646	3,920	3,987	4,188	4,596	4,851	5,044	5,244	
Net lending	1,976	2,022	1,740	1,775	1,651	1,812	1,547	1,811	1,707	1,644	1,914	2,024	2,135	2,220	2,309	
Overall balance 2/ 3/	-4,844	-9,096	-7,027	-6,055	-6,029	-5,910	-5,287	-4,871	-4,257	-3,751	-3,780	-3,644	-3,769	-3,910	-4,026	
Excluding one-off measures	-7,895	-9,096	-7,027	-6,055	-6,029	-5,910	-5,287	-4,871	-4,452	-4,087	-3,780	-3,644	-3,769	-3,910	-4,026	
(Percent of GDP)																
Total revenues	43.1	41.6	41.7	42.2	42.4	41.7	41.8	42.4	43.1	43.6	43.6	43.6	43.7	43.6	43.6	
Current receipts	39.6	40.1	40.3	41.2	41.3	40.7	41.0	41.0	42.2	42.3	42.1	42.0	41.9	41.9	41.9	
Tax revenue	22.7	23.4	24.4	24.2	24.2	24.7	24.4	24.6	24.8	24.8	24.5	24.4	24.4	24.4	24.4	
On goods and services	14.2	15.0	15.5	...	15.4	15.5	15.4	15.2	15.1	14.8	14.5	14.5	14.5	14.5	14.5	
Direct taxes	8.5	8.4	8.9	...	8.8	9.2	9.0	9.4	9.8	9.9	10.0	9.9	9.9	9.9	9.9	
Social security contributions	12.2	12.5	12.2	12.5	12.5	12.2	12.3	12.5	12.7	12.9	12.9	12.8	12.8	12.8	12.8	
Other current revenues	4.7	4.1	3.7	4.6	4.6	3.8	4.2	3.9	4.7	4.6	4.7	4.7	4.8	4.8	4.8	
Capital revenues	3.6	1.4	1.4	1.0	1.1	1.0	0.8	1.3	0.9	1.3	1.4	1.6	1.7	1.7	1.7	
Total expenditures	46.5	47.7	46.3	46.1	46.3	45.4	45.1	45.4	45.8	45.9	45.7	45.6	45.7	45.7	45.6	
Primary current expenditures	39.3	40.8	39.8	39.9	40.1	39.0	39.0	39.1	39.5	39.6	39.1	38.8	38.8	38.8	38.8	
Compensation of employees	14.1	14.4	13.9	13.5	13.6	13.2	13.1	12.8	12.9	12.4	12.0	11.8	11.8	11.8	11.8	
Intermediate consumption	4.0	4.2	4.1	4.0	4.1	4.0	4.0	4.1	4.1	4.3	4.2	4.0	4.0	4.0	4.0	
Subsidies	1.5	1.6	1.2	1.4	1.4	1.1	1.0	1.2	1.2	1.2	1.3	1.3	1.3	1.3	1.3	
Social transfers	17.6	18.5	18.5	18.7	18.8	18.4	18.8	19.0	19.2	19.5	19.5	19.6	19.6	19.6	19.6	
Other	2.1	2.1	2.2	2.3	2.2	2.3	2.3	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	
Interest payments	2.7	2.6	2.9	2.8	2.8	3.0	2.9	2.9	2.8	3.0	3.1	3.1	3.1	3.1	3.1	
Capital expenditures	4.5	4.3	3.6	3.4	3.4	3.4	3.2	3.4	3.5	3.4	3.5	3.7	3.7	3.7	3.7	
Overall balance	-3.4	-6.1	-4.6	-3.9	-3.9	-3.7	-3.3	-3.0	-2.6	-2.2	-2.2	-2.0	-2.0	-2.0	-2.0	
 Excluding one-off measures 3/	-5.5	-6.1	-4.6	-3.9	-3.9	-3.7	-3.3	-3.0	-2.7	-2.4	-2.2	-2.0	-2.0	-2.0	-2.0	
Memorandum items:																
One-off measures	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0	
Structural balance (excluding one-off measures) 4/	-5.4	-5.8	-3.4	-2.7	-3.5	-2.6	-2.2	-2.1	-2.4	-2.1	-1.6	-1.4	-1.4	-1.5	-1.5	
Primary balance (excluding one-off measures) 4/	-2.8	-3.5	-1.7	-1.1	-1.1	-0.7	-0.4	-0.1	0.1	0.5	0.9	1.1	1.1	1.1	1.1	
Primary structural balance	-2.7	-3.1	-0.5	0.1	-0.7	0.4	0.7	0.8	0.4	0.9	1.4	1.7	1.7	1.6	1.6	
Public debt (Maastricht definition)	58.3	63.6	67.4	64.7	64.7	68.0	65.1	64.4	63.6	63.4	63.5	63.2	62.9	62.5	62.1	
Real increase in primary current spending	3.8	4.6	...	...	-0.2	...	...	...	0.0	1.2	-0.3	0.5	1.8	1.8	1.8
Nominal GDP (millions of euros)	144,128	149,124	152,787	155,289	155,446	159,601	162,205	162,510	162,756	167,983	173,074	179,544	186,457	193,872	201,569	
Output gap (percent of potential output)	-0.3	-0.9	-2.7	...	-0.9	-2.4	...	-2.2	-0.7	-0.9	-1.4	-1.5	-1.4	-1.4	-1.3	
Real GDP growth (percent)	1.5	0.9	1.4	1.3	1.4	1.8	1.8	1.8	1.7	1.0	0.8	1.5	1.7	1.8	1.8	

Sources: Ministry of Finance; and IMF staff estimates.

1/ For 2008–10, staff projections are based on unchanged policies, and the envisaged savings from the reforms that have already been introduced (for example, of the social security system), and thereafter unchanged structural primary balance.

2/ Structural balance calculated using staff's estimate of the output gap.

3/ One-off measures consist of the transfer of the postal pension fund in 2003, the state enterprises pension funds in 2004, securitization and asset sales.

4/ Calculated using the staff's estimates of potential output. Asset sales, including UMTS receipts, the transfer of pension funds and securitization are netted.

Table 4. Portugal: Medium-Term Scenario
(Changes in percent, unless otherwise indicated)

	1996–2003	2004	2005	2006	2007	Proj.					
						2008	2009	2010	2011	2012	2013
Real GDP	2.8	1.5	0.9	1.4	1.7	1.0	0.8	1.5	1.7	1.8	1.8
Real domestic demand	3.1	2.7	1.6	0.7	1.1	0.8	0.8	1.0	1.1	1.1	1.1
Private consumption	2.9	2.5	2.0	1.7	0.7	1.0	0.9	1.1	1.1	1.1	1.1
Public consumption	3.2	2.6	3.2	-1.4	0.1	-0.6	-0.6	-0.3	0.4	0.4	0.4
Gross fixed investment	3.5	3.2	-1.0	-0.3	3.0	1.6	1.5	1.9	1.8	1.6	1.6
Public	4.2	2.7	-2.3	-22.4	6.7	-1.4	6.8	6.4	3.2	1.4	1.4
Private	3.9	-0.1	-0.7	2.7	2.3	2.0	1.0	1.5	1.5	1.5	1.5
<i>Structure</i>	3.0	-1.8	-3.2	-5.4	-0.2	1.2	1.2	2.1	1.3	0.9	0.9
<i>Equipment and machinery</i>	5.0	2.3	1.3	3.7	5.4	2.0	2.0	2.0	2.0	2.0	2.0
Change in stocks (contribution to growth)	-0.1	0.7	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance (contribution to growth)	-0.5	-1.4	-0.8	0.6	0.5	0.1	0.0	0.4	0.5	0.6	0.6
Exports of goods and services (real)	4.9	4.0	2.0	8.7	8.1	4.2	3.5	5.0	4.9	4.9	4.8
Exports of goods and services (nominal)	6.1	5.6	3.9	13.2	11.2	7.3	5.4	6.6	6.4	6.4	6.3
Imports of goods and services (real)	5.3	6.7	3.5	5.2	5.2	3.2	2.9	3.3	3.1	2.9	2.9
<i>Real imports of partner countries (WEO)</i>	7.0	8.9	7.6	8.4	5.8	4.8	3.5	5.0	4.9	4.9	4.8
<i>Export market share (2000=100)</i>	103.9	93.7	88.7	89.0	90.9	90.9	90.9	90.9	90.9	90.9	90.9
<i>Terms of trade</i>	0.3	-0.7	-1.3	0.2	1.1	-1.9	0.3	0.5	0.4	0.5	0.5
Savings-investment balance (percent of GDP)	-7.4	-7.6	-9.5	-10.1	-9.9	-11.7	-12.0	-11.6	-11.1	-10.5	-9.9
Gross national savings	18.5	15.5	13.1	12.1	12.4	10.7	10.6	11.0	11.3	11.8	12.2
Private	18.3	17.9	16.3	13.7	12.4	10.9	10.7	10.9	11.3	11.7	12.2
Government	0.2	-2.4	-3.2	-1.6	-0.1	-0.2	-0.1	0.1	0.0	0.0	0.1
Gross domestic investment	25.9	23.1	22.6	22.2	22.2	22.4	22.5	22.5	22.4	22.3	22.1
Private	22.1	20.0	19.5	19.9	19.8	20.1	20.1	20.0	19.8	19.7	19.5
Government	3.7	3.1	3.0	2.3	2.4	2.3	2.5	2.6	2.6	2.6	2.6
Resource utilization											
Population (15–64)	0.2	0.6	0.4	0.0	0.3	0.1	0.0	-0.1	-0.2	-0.1	-0.1
Labor force	2.3	0.5	1.0	0.8	0.6	0.4	0.4	0.3	0.2	0.2	0.2
Employment	2.5	0.1	0.0	0.7	0.2	0.4	0.4	0.5	0.5	0.5	0.5
Labor force participation rate	73.8	77.5	77.9	78.5	78.7	79.0	79.3	79.7	80.0	80.2	80.5
Unemployment rate	5.3	6.7	7.6	7.7	8.0	8.0	8.0	7.8	7.5	7.2	7.0
Potential output	2.4	1.5	1.5	1.4	1.5	1.2	1.3	1.6	1.7	1.7	1.7
Output gap	0.9	-0.3	-0.9	-0.9	-0.7	-0.9	-1.4	-1.5	-1.4	-1.4	-1.3
Labor productivity	1.4	1.4	0.9	0.6	1.5	0.6	0.4	1.0	1.2	1.3	1.3
Nominal wage (whole economy)	4.7	2.6	3.5	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.3
Real wage (whole economy)	1.8	0.1	1.3	-0.7	0.0	-0.9	0.2	0.2	0.2	0.2	0.2
Unit labor costs (whole economy)	4.4	1.2	2.5	1.7	0.9	1.7	1.9	1.3	1.1	1.0	1.0
Consumer prices (harmonized index)	2.9	2.5	2.1	3.0	2.4	3.2	2.1	2.1	2.1	2.1	2.1

Table 5. Portugal: Selected Financial Indicators of the Banking System, 2000–07
(Percent)

	2000	2001	2002	2003	2004	2004 1/	2005 1/	2006 1/	2006 2/	2007 2/
Capital adequacy										
Regulatory capital to risk-weighted assets*	9.2	9.5	9.8	10.0	10.4	10.2	11.3	10.9	11.0	10.2
Regulatory tier I capital to risk-weighted assets*	7.6	7.3	7.1	7.1	7.3	7.0	7.1	7.7	7.8	6.7
Capital (net worth) to assets 3/	5.8	5.5	5.6	5.8	6.1	5.1	5.8	6.4	6.2	6.2
Asset composition and quality										
Sectoral distribution of loans to total loans*										
Households	48.2	47.7	48.4	48.3	49.3	49.3	50.7	52.8	52.8	52.5
<i>Of which</i> : housing	36.3	36.8	38.4	38.6	39.4	39.4	41.2	42.9	42.9	42.2
Construction	8.1	8.6	8.4	8.8	8.7	8.7	8.9	8.4	8.4	8.3
Manufacturing	8.0	7.8	7.6	7.6	6.8	6.8	6.2	5.5	5.5	5.3
Agriculture	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.6	0.6	0.7
Services	24.8	26.7	27.5	28.7	27.9	27.9	27.0	26.6	26.6	26.6
NPLs to gross loans* 4/	2.2	2.2	2.3	2.4	2.0	1.5	1.5	1.3	1.2	1.3
Specific provision to NPLs 4/	67.7	66.8	62.8	73.0	83.4	72.2	79.0	80.5	83.9	75.7
NPLs net of provisions to capital* 4/	7.3	7.5	9.1	6.7	3.3	4.8	3.3	2.7	2.2	3.5
Large exposure to capital* 4/	...	...	119.9	94.1	91.4	97.5	75.5	88.7	86.9	91.8
Earnings and profitability										
ROA (post-tax)*	0.9	0.8	0.7	0.8	0.8	0.6	0.9	1.1	1.0	1.0
ROE (post-tax)*	15.1	14.9	11.7	13.9	12.8	11.4	14.5	15.6	16.9	15.2
Interest margin to gross income*	62.9	65.8	65.0	60.0	58.1	60.0	54.8	55.0	55.7	57.7
Noninterest expenses to gross income*	58.2	57.6	59.1	57.4	57.2	71.7	58.3	53.4	53.5	53.2
Personnel expenses to noninterest expenses	61.8	59.5	59.3	59.3	58.6	59.9	57.7	57.6	56.8	55.0
Trading and fee income to total income	29.5	25.5	26.1	27.7	29.1	33.0	40.9	39.6	38.8	37.4
Spread between reference loan and deposit rates 5/	4.1	4.3	3.6	3.4	3.1	3.1	3.1	3.5	3.5	3.7
Stock price index of bank shares 6/	107.9	92.9	69.3	72.1	80.7	80.7	100.5	135.4	135.4	142.0
Liquidity										
Liquid assets to total assets* 7/	...	15.3	12.5	17.1	15.4	15.2	14.8	13.5	13.1	12.6
Liquid assets to total short-term liabilities* 7/	...	89.0	85.6	108.6	115.2	108.6	95.1	91.4	96.0	88.2
Loans as percent of deposits*	116.0	122.7	129.5	129.1	128.3	130.9	137.5	145.6	146.7	154.9
FX liabilities to total liabilities 8/	10.7	9.9	9.0	9.0	7.9	7.9	8.3	8.9	8.9	10.1
Sensitivity to market risk										
Net open position in FX to capital*	...	...	7.1	4.7	3.9	4.0	4.5	6.1	5.9	4.7
Net open position in equities to capital	...	...	1.8	0.2	1.8	1.8	1.3	2.6	2.6	2.3

Sources: Bank of Portugal; and IMF staff estimates.

Note: * denotes Core Financial Sector Indicators.

1/ For 2005 and 2006 the figures are for the sample of institutions that are already complying with IAS, accounting as of December 2004 for about 87 percent of the usual aggregate considered. To ensure comparability, the figures for 2004 for this subsample are also presented.

2/ The sample of banking institutions under analysis was expanded in order to include the institutions that adopted IAS only in 2006.

3/ On accounting basis; consolidated.

4/ On a consolidated basis. NPLs are defined as credit to customer overdue. For comparable 2004 and 2005 figures. The concept of NPL is only applicable at an individual level and for prudential purposes. The following definition of NPL's will be used: principal and interest past due for more than 90 days (amount overdue only) + future installments of loans fallen due and classified as doubtful, according to criteria that include initial maturity, the time elapsed since the first installment fallen due, and the relative importance of fallen due installments in each loan.

5/ Based on weighted averages of lending rates to households and to nonfinancial corporations and of deposit interest rates for the two sectors.

6/ PSI Financial Services (Euronext Lisbon); 01/01/2000 =100.

7/ Three-month residual maturity horizon.

8/ FX liabilities include foreign currency deposits and deposit-like instruments of resident nonmonetary sector and claims of nonresident vis-à-vis resident monetary financial institutions (excluding Bank of Portugal).

Table 6. Portugal: Indicators of External and Financial Vulnerability, 2001–07
(Percent of GDP, unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007
External indicators							
Exports (goods, annual percent change in euro)	3.5	14.5	2.1	0.8	3.1	4.9	4.1
Imports (goods, annual percent change in euro)	8.3	15.1	0.9	-2.9	-1.6	8.8	6.3
Terms of trade (goods and services, annual percent change)	0.5	1.6	0.4	-0.7	-1.3	-3.3	5.0
Current account balance	-9.9	-8.1	-6.1	-7.6	-9.5	-10.1	-9.8
Current account balance (including capital transfers)	-9.0	-6.6	-4.2	-6.1	-8.3	-9.3	-8.6
Capital and financial account balance	9.3	7.6	5.6	7.6	9.5	10.1	9.8
<i>Of which</i> : inward portfolio investment (debt securities, etc.)	9.2	7.9	9.0	7.6	9.9	6.7	11.2
inward foreign direct investment	5.4	1.4	4.6	1.1	2.1	5.8	2.5
other investment liabilities (net)	6.4	3.1	3.8	8.1	7.3	4.3	2.2
Central Bank foreign liabilities (billions of euro) 1/	8.3	8.7	2.7	8.6	12.8	6.8	6.3
Foreign assets of the financial sector (billions of euro) 2/	60.3	59.0	69.6	73.9	80.4	85.0	93.6
Foreign liabilities of the financial sector (billions of euro) 2/	95.7	102.0	116.2	118.1	128.2	150.6	162.7
Exchange rate (per U.S. dollars, period average)	1.12	1.06	0.88	0.80	0.80	0.80	0.73
Financial market indicators							
Public sector debt (Maastricht definition)	52.9	55.6	56.9	58.3	63.6	64.7	63.5
Money market rate—three month Euribor (period average in percent)	4.3	3.3	2.3	2.1	2.2	3.1	3.8
Money market rate (real, in percent)	-0.1	-0.3	-0.9	-0.3	0.1	0.1	1.4
Stock market index (PSI 20, 1992=3000)	7,831	5,825	6,747	7,600	8,619	11,198	13,019
Share prices of financial institutions (2005=1000)	977	735	764	856	1065	1435	1506
Spread of 10-year benchmark bond with euro bond yield (percentage points)	0.11	0.08	0.04	0.00	0.00	0.06	0.09
Financial sector risk indicators							
Foreign exchange assets (billions of euro) 3/	7.0	5.9	4.9	4.6	4.8	5.2	...
Deposits in foreign exchange (billions of euro) 4/	5.5	3.7	4.9	5.4	5.1	6.2	...
Share of foreign deposits in total deposits (percent) 4/	4.1	2.8	3.5	3.7	3.1	3.6	...
Share of real estate sector in private credit 5/	53.7	55.7	57.9	60.1	63.0	63.7	...
Share of nonperforming loans in total loans 2/ 6/	2.1	2.1	2.1	1.8	1.7	1.5	1.5
Risk-based capital asset ratio 7/	9.5	9.8	10.0	10.2	11.3	11.0	10.2
Return on equity for the banking system	17.8	14.1	16.2	13.1	19.4	20.6	18.0
Household debt							
Percent of disposable income	90	97	103	110	116	123	129
Percent of GDP	64	68	73	78	83	88	91
Nonfinancial corporate debt (percent of GDP)	95	95	100	99	104	107	114

Sources: Bank of Portugal; Ministry of Finance; IMF, Balance of Payments Yearbook database; and IMF staff estimates.

1/ Reserves and foreign liabilities refer to the Bank of Portugal.

2/ Banks only.

3/ Non-euro area currencies assets vis-à-vis the resident and nonresident nonmonetary sector.

4/ Deposits in non-euro area currencies by the resident nonmonetary sector and liabilities in non-euro area currencies by the nonresident nonmonetary sector.

5/ Real estate defined as the sum of total credit by monetary financial institutions to individuals for housing and to nonfinancial corporations for construction and real-estate activities; private credit defined as total domestic credit excluding the general government. Stocks adjusted for securitization operations.

6/ NPL concern households and nonfinancial corporations.

7/ Capital over risk-weighted assets. Consolidated data for the banking system.

Table 7. Portugal: External Debt Sustainability Framework, 2003–13
(Percent of GDP, unless otherwise indicated)

	Actual										Projections					Debt-stabilizing noninterest current account 6/ -1.7
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013					
1 Baseline: external debt 1/	154.6	160.6	176.4	183.4	194.4	200.7	206.5	210.9	214.8	217.8	220.3					
2 Change in external debt	5.9	5.9	15.8	7.0	11.0	6.3	5.8	4.4	3.8	3.1	2.4					
3 Identified external debt-creating flows (4+8+9)	-6.7	-2.1	4.8	-0.4	0.1	2.7	1.8	-0.1	-0.9	-1.8	-2.4					
4 Current account deficit, including capital transfers and excluding interest payments	0.3	2.0	4.2	3.0	1.0	1.9	1.7	1.3	0.7	0.0	-0.7					
5 Deficit in balance of goods and services	6.5	7.5	8.4	7.6	6.9	7.6	7.4	6.7	5.9	5.0	4.2					
6 Exports	28.3	28.9	29.0	31.4	33.2	34.6	35.3	36.2	37.1	37.9	38.7					
7 Imports	34.9	36.3	37.4	39.1	40.2	42.1	42.7	42.9	43.0	42.9	42.9					
8 Net nondebt creating capital inflows (negative)	-7.6	-2.4	1.8	-2.6	-0.8	-2.4	-3.0	-3.0	-2.9	-2.8	-2.7					
9 Automatic debt dynamics 2/	3.9	4.1	4.1	6.3	7.6	3.3	3.1	1.6	1.3	1.0	1.0					
10 Contribution from nominal interest rate	1.0	-2.0	-1.4	-2.3	-2.7	-1.7	-1.5	-3.0	-3.4	-3.7	-3.8					
11 Contribution from real GDP growth	-4.2	-3.7	-4.0	-4.8	-5.1	-3.6	-4.3	-4.4	-4.4	-4.5	-4.5					
12 Contribution from price and exchange rate changes 3/	12.6	8.1	11.1	7.4	10.9	3.6	4.0	4.6	4.7	4.9	4.8					
13 Residual, including change in gross foreign assets (2-3)	545.6	556.2	608.4	583.4	585.1	581.0	585.1	582.2	579.2	574.8	569.4					
External debt-to-exports ratio (percent)	47.7	51.4	60.2	65.9	69.5	75.3	79.7	83.2	86.1	89.3	80.1					
Gross external financing need (billions of euros) 4/	34.4	35.7	40.4	42.4	42.7	44.8	46.0	46.4	46.2	46.1	39.7					
In percent of GDP						216.2	216.2	215.6	215.1	214.7	214.2		-9.2			
Scenario with key variables at their historical averages 5/																
Key macroeconomic assumptions																
Real GDP growth (percent)	-0.8	1.5	0.9	1.4	1.7	1.0	0.8	1.5	1.7	1.8	1.8					
GDP deflator (change in domestic currency)	3.2	2.4	2.5	2.8	3.0	2.2	2.2	2.2	2.1	2.1	2.1					
Nominal external interest rate (percent)	3.2	3.0	2.7	3.7	4.7	5.1	4.6	4.6	4.5	4.5	4.5					
Growth of exports (euro terms, in percent)	2.2	5.9	3.9	13.0	10.6	7.3	5.2	6.5	6.3	6.3	6.1					
Growth of imports (euro terms, in percent)	-1.8	8.5	6.5	8.9	7.6	8.2	4.4	4.3	4.1	3.8	3.8					
Current account balance, excluding interest payments	-0.3	-2.0	-4.2	-3.0	-1.0	-1.9	-1.7	-1.3	-0.7	0.0	0.7					
Net nondebt creating capital inflows	7.6	2.4	-1.8	2.6	0.8	2.4	3.0	3.0	2.9	2.8	2.7					

1/ Refers to gross external debt.

2/ Derived as $[-g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both noninterest current account and nondebt inflows in percent of GDP. Averages are for the period 1998–2007.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both noninterest current account and nondebt inflows in percent of GDP) remain at their levels of the last projection year.

Table 8. Portugal: Status of Implementation of FSAP Main Recommendations

Recommendation	Status
Short-term stability issues	
<p>▶ Continue to carefully monitor key risk areas:</p> <ul style="list-style-type: none"> - household debt, especially toward more vulnerable subgroups of household borrowers; - corporate debt developments; <p>- banks' lending concentrations; and</p> <p>- banks' external borrowing and the associated pricing and liquidity risks.</p> <p>▶ Continue to ensure bank capital levels are consistent with the evolving risk outlook and if necessary impose additional capital requirements using the discretion available under Basel II.</p> <p>▶ Continue to foster banks' systems to accurately measure, monitor, and adequately control risks, and further strengthen the BdP's supervisory capacity in this area.</p> <p>▶ Perform further stress testing on the financial system at appropriate intervals, taking into account banks' linkages with the insurance sector and their employee pension funds.</p>	<p>Results of the new round of the wealth survey have become available in early 2008.</p> <p>Refinement of existing statistics for cohorts of corporate sector and development of credit risk analytical tools were introduced.</p> <p>Instruction 17/2007 on concentration risks require banks to adopt internal limits on exposure concentrations to certain sectors and regions. However, banks have yet to establish this internal limits.</p> <p>The frequency of liquidity monitoring has been increased. In early 2008 banks were required to report liquidity stress test results and contingency plans to deal with prolonged wholesale funding distress.</p> <p>In some cases, Bank of Portugal has been proactive encouraging banks to increase capital, particularly in recent months. Most major banks have either increased capital or announced capital increases.</p> <p>Banks' risk management systems have been enhanced recently following the adoption of Basel II. BdP's capacity in this area is also being strengthened namely in the context of the adoption of a risk rating system (MAR).</p> <p>A new run of stress-tests encompassing the whole range of materially relevant risks to the banking system is programmed to take place in the second half of 2008.</p>
Structural and longer-term issues	
<p>▶ Improve the judicial framework for debt recovery by speeding up court processes in particular.</p> <p>▶ Enhance the financial independence of the securities and insurance supervisors, Comissão do Mercado de Valores Mobiliários (CMVM) and the Instituto de Seguros de Portugal (ISP).</p> <p>▶ Transfer the management of the guarantee fund for Motor Third Party and workers compensation from the ISP to other organizations.</p>	<p style="text-align: center;">Not yet Implemented</p> <p>The Government has approved the inclusion of a permanent provision on the subject of the surplus and the freezing of CMVM budget lines that will be published and come into force this summer. There is also a proposal for the revision of the Ministerial Order setting CMVM supervisory fees. The ISP has already submitted to the Government a proposal to amend its Charter in order to replicate the provision that has been included in the State Budget Law since 2006, setting out that the general budgetary and public accountancy rules regarding freezing of funds, carry-over and use of surplus, and the twelfth expenditure system are not applicable to ISP.</p> <p>The draft law that implements the transfer of the management of the Guarantee Fund for Motor Third Party and Workers Compensation Fund from the ISP to a new public company was in public consultation until 14th of July and it now under scrutiny by the Government.</p>
Refinements to supervisory and safety net arrangements	
<p>▶ Fully implement the new system for risk profile assessment of credit institutions and other financial intermediaries, as planned; and</p> <p>▶ In insurance supervision, set appropriate fit and proper criteria for members of governing bodies of insurance undertakings and intermediaries, strengthen corporate governance requirements, and establish rules or guidelines on market conduct regarding the problem of fraud.</p>	<p>Banco de Portugal's risk assessment system (MAR) is already in force. During 2008, and after being fully tested during 2007, throughout its application to a sample of institutions, this methodology is being used to guide on-site examinations to all the major banks. Additionally, Banco de Portugal is under development a software tool to support MAR.</p> <p>A draft law, currently under Government consideration after a period of public consultation, will:</p> <ol style="list-style-type: none"> a) Set fit and proper requirements for senior management; the supervisory authority could recommend the replacement of a senior manager that does not comply with the fit and proper requirements; b) Establish a duty for insurance undertakings to approve and monitor standards of business conduct and ethical behavior code for the industry; d) Require insurance undertakings to establish a specific and autonomous complaint management function and to set out an Ombudsman; e) Introduce an obligation to insurance undertaking to have a policy regarding the prevention, detection and report of insurance fraud.