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August 20, 1990

To: Members of the Executive Board

From: The Secretary

Subject: Portugal - Staff Report for the 1990 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1990 Article IV consultation with Portugal, which will be brought to the agenda for discussion on a date to be announced.

Mr. Spitäller (ext. 4546) or Mr. Molho (ext. 8558) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

PORTUGAL

Staff Report for the 1990 Article IV Consultation

Prepared by the Staff Representatives for the 1990 Consultation with Portugal

Approved by Massimo Russo and S. Kanesa-Thasan

August 14, 1990

I. Introduction

A staff team consisting of Messrs. Spitàller, Molho, Cottarelli and Sebastiao (all EUR), and Mrs. Campbell (ETR) as secretary, visited Lisbon on June 21 to July 2, 1990 to conduct Article IV consultation discussions with Portugal. The mission met with the Minister of Finance and the Governor of the Bank of Portugal, as well as with other ministry and central bank officials, and with representatives of the trade unions and the Employers' Federation.

The previous interim consultation discussions were held in Lisbon in May 17-31, 1989 and the staff report was submitted to the Executive Board on July 26, 1989 for information.

At the conclusion of the 1988 Article IV consultation discussions with Portugal (EBM/88/122, 8/3/88), Executive Directors commended the authorities on the strong economic performance of Portugal over the previous three years but, noting that signs of overheating were beginning to emerge, recommended financial policy tightening. They also encouraged the authorities to pursue structural reform in various areas.

Portugal has accepted the obligations of Article VIII, Sections 2, 3 and 4 and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

II. Recent Economic Developments and Policies

1. Background to the discussions

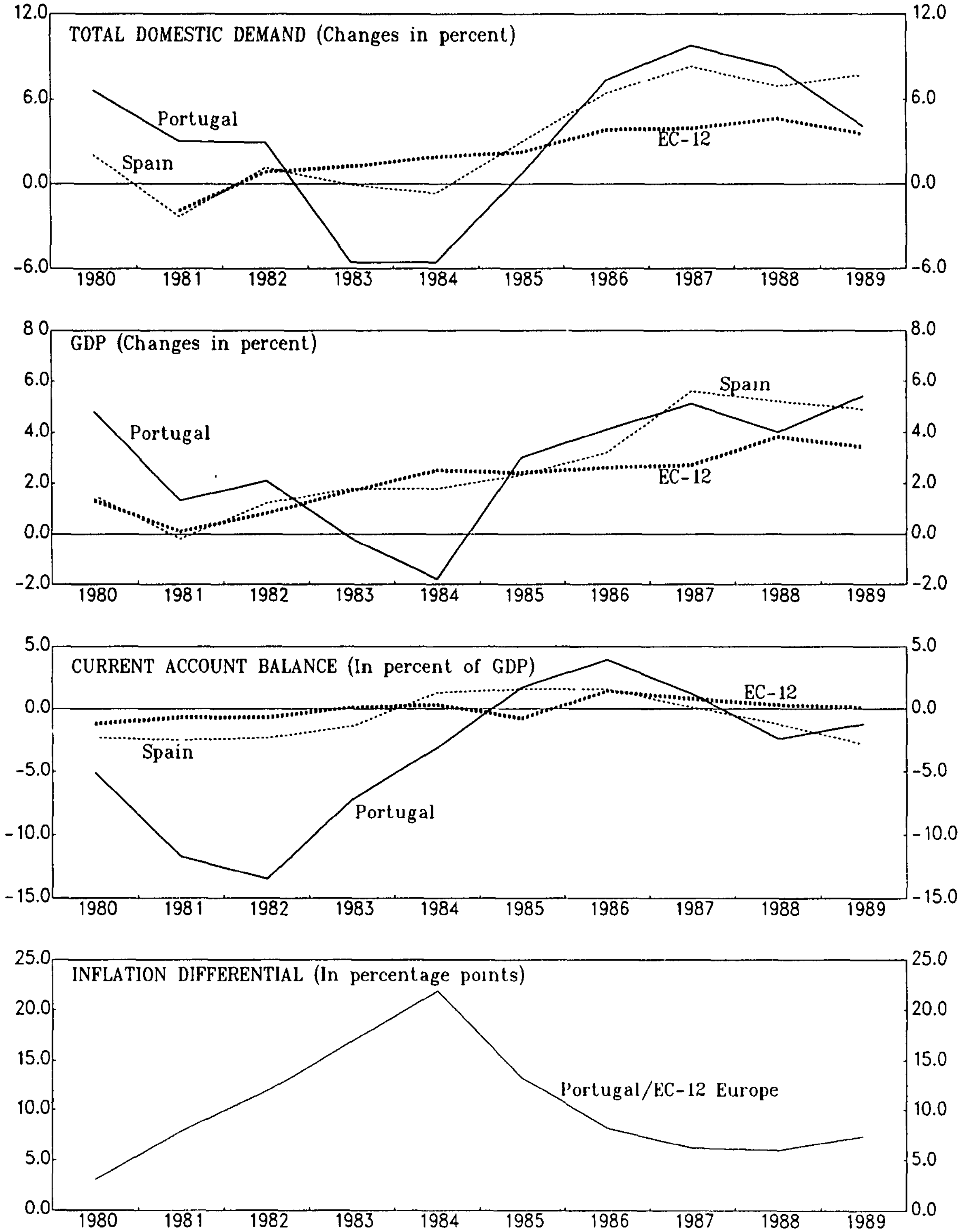
Accession to the EC in 1986 in the context of favorable domestic and external conditions has launched the Iberian peninsula on a sustained economic boom. Portugal, like Spain, has recorded rates of increase in demand well above those in partner countries (Chart 1 and Tables 1 and 2). In both, investment has played a crucial role, buoyed by sales and profit opportunities on domestic and foreign markets. This, together with conspicuous improvements in productivity induced a strong expansion of GDP, likewise markedly faster than abroad. Though per capita income, particularly in Portugal, remains substantially below average levels in Europe, the gap has steadily narrowed.

Rapid output growth and general wage moderation, consistent with the distribution of value added in favor of profits, raised capacity utilization to peak levels and brought about sustained gains in employment so that, in Portugal, the unemployment rate declined below 5 percent. With mounting demand pressure in goods and labor markets, inflation has remained generally high, more recently arresting and reversing any earlier tendency of inflation convergence. Inflation in Portugal in 1989 and the first half of 1990 was, on average, more than four times that in the ERM core countries. With the sights of Portugal set on early participation in the ERM, substantial progress on inflation convergence is a matter of urgency. Indeed, if the first stage of transition to EMU is to be completed by 1992, and the second stage begins in 1993, Portugal may, on the current EC interpretation of the Delors Plan, have to make the transition to the narrow ERM band by that time.

Portuguese membership in the EC has eased the external constraint that would otherwise have cut short the economic expansion. Net EC transfers, on the order of 1 1/2-2 percent of GDP per annum, have provided direct support to the external current account, while additional financial support has come from the capital account. Foreign direct investment, in particular, propelled by perceived cost and productivity advantages, and by the reallocation of international resources in the process of European integration, more than financed the current account deficit in 1989. Despite the continued prepayment of foreign debt, gross foreign exchange reserves rose by US$4.5 billion in 1989. On competitiveness, the situation has remained broadly manageable, with exports consistently gaining market shares, notwithstanding the real effective appreciation of the escudo. On the import side, the attendant decline in relative import prices has helped remove domestic demand pressure through imports.

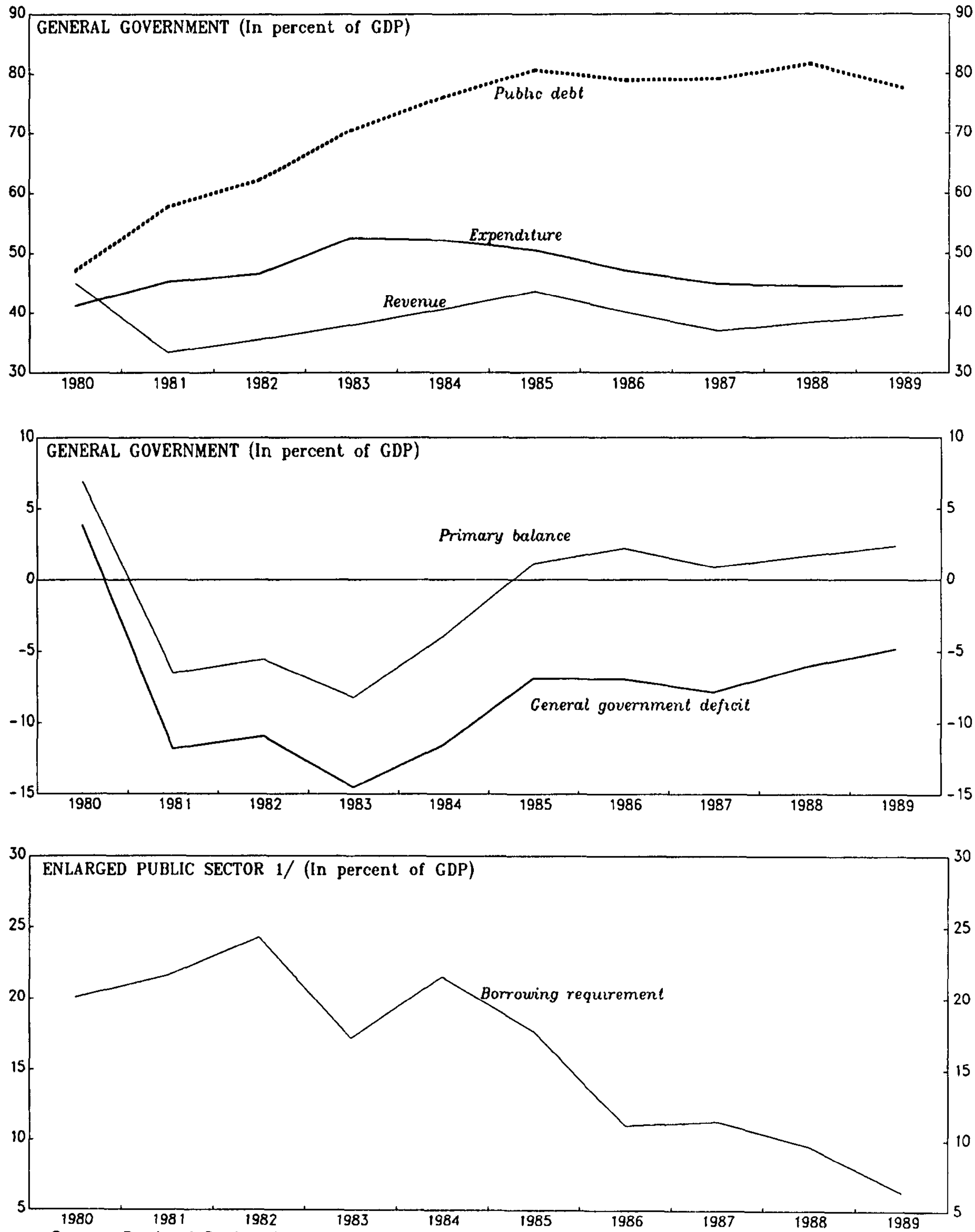
The stance of fiscal policy, on the whole over the past few years, has involved some withdrawal of fiscal stimulus, particularly as regards the enlarged public sector, including the public enterprises (Table 1 and Chart 2). Arguably, while it moved in the right direction, fiscal adjustment was not sufficiently decisive, given the stubbornness of inflation. Much of this adjustment was attributable to the operation of automatic stabilizers on the revenue side rather than to discretionary policy restraint. At the same time, structural improvements were carried out, including the implementation of a VAT system and the rationalization and modernization of income taxes along lines followed in other industrial countries. Even so, Portugal still has one of the lowest tax burdens in Europe, with the ratio of its total tax revenues to GDP at 33.4 percent in 1989, compared with an EC average of 40.0 percent.

CHART 1
PORTUGAL
COMPARATIVE PERFORMANCE OF PORTUGAL AND EC-12 EUROPE, 1980-1989 1/



Source Bank of Portugal, Annual Report, several issues, IMF, World Economic Outlook, May 1990, and EC, European Economy.
1/ From 1986 onward, Spanish indicators are in line with revised national account figures

CHART 2
PORTUGAL
FISCAL INDICATORS, 1980-1989



Source. Bank of Portugal.

1/ Includes general government and nonfinancial public enterprises

On the exchange rate, policy continues to be that of a crawling peg. Despite the widening of the inflation differential vis-à-vis partner countries to 8 percentage points in 1989, the rate of crawl has involved a 3 percent nominal effective depreciation of the escudo in 1989, with a view to maintaining a nonaccommodating stance of policy (Charts 1 and 3, Table 1). Interest, credit and monetary policy have been recently characterized by attempts to phase out direct credit ceilings and to replace them by indirect means of monetary control. Rising interest rates and financial innovation have at any rate increased the scope for disintermediation, with credit ceilings increasingly circumvented by new types of domestic credit operations, as well as frustrated by capital inflows. This has shown that, as the balance of payments opens up, it becomes increasingly difficult to target independently interest rates and money, on the one hand, and the exchange rate, on the other. It has also borne out that, pro tanto, fiscal and structural policies have to play a more decisive role in fighting inflation.

2. Developments and policies in 1989-90 (1st half)

Developments in 1989 proved favorable on a number of counts. For the year as a whole, domestic demand growth slowed to 4.1 percent from 8.4 percent in 1988. The attendant output effect was compensated by a change from negative to positive in the contribution of the foreign balance to GDP growth. In the event, growth accelerated to 5.4 percent from 4.0 percent in 1988, in addition to being better balanced. The expansion of the economy was broad-based. Consumption and investment grew at a marked, if decelerating pace; exports rose sharply across the board, fueled in particular by new mining products coming on stream. Import expansion proved relatively modest, involving a significant decline in the measured volume elasticity with respect to aggregate demand, owing to its change toward a less import intensive composition. On the supply side, the buoyancy of output reflected an acceleration of productivity gains combined with sustained employment growth. The largest sectors, services and manufacturing, expanded by close to 5 percent, with additional support coming from agriculture, energy and construction.

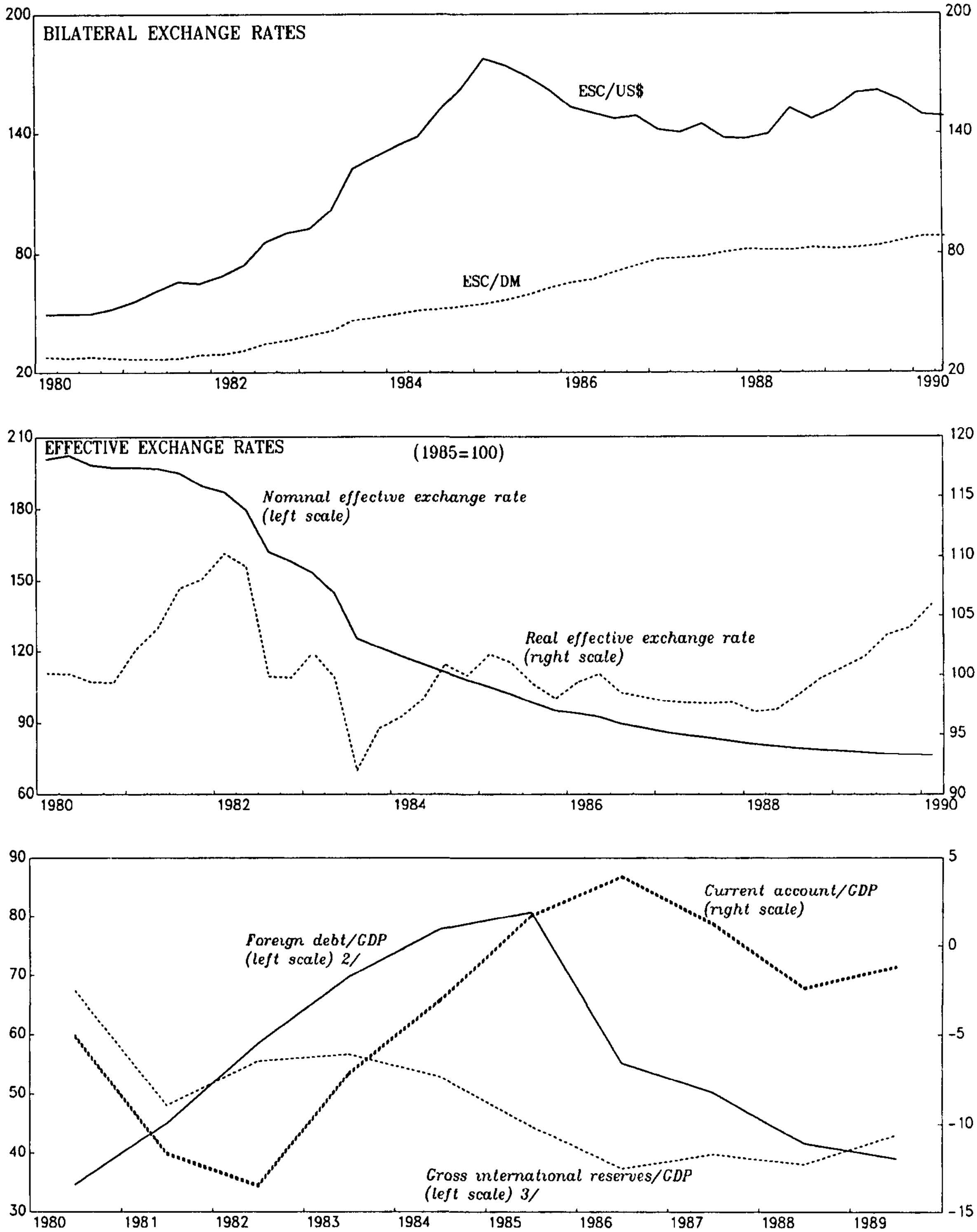
In the labor market, unemployment declined to below 5 percent of the labor force, with male unemployment down to 3 1/2 percent and female unemployment at 7 percent, notwithstanding rising labor force participation. Substantial inroads have also been made into youth and long-term unemployment, with the share of the latter declining by 10 percentage points over the past four years. While shortages of labor, particularly skilled labor, have become more prominent, pronounced wage moderation in the economy as a whole continued. According to published information, the average real consumer wage declined slightly in 1989.

In the balance of payments, the current account deficit was halved to 1.2 percent of GDP in 1989, as the already noted favorable developments in the volume of exports and imports, and rising EC transfers, more than offset a deterioration in the terms of trade. In part, this deterioration appears to have been a matter of restraining export prices for textiles, which amount to 30 percent of total merchandise exports, to increase market shares at a time when competition from China weakened; in the first half of 1990, these prices have been allowed to recover. Indicative of the restructuring and rising strength of total Portuguese exports were the buoyancy of nontraditional exports, particularly investment goods. Continuing the recent trend, Portugal is estimated to have further raised its market share of manufacturing trade in the five major EC countries in 1989.

Substantial changes also occurred in the capital account, where the surplus rose sharply in 1989, to 9.6 percent of GDP, notwithstanding continued prepayment of foreign debt. Together with the narrowing of the current account deficit, this involved more than a doubling of the overall balance of payments surplus, and a rise in net official reserves to a level equivalent to 12 months of merchandise imports. The dominant components of capital inflows were foreign direct investment, which was more than twice the size of the current account deficit, and short term nondebt flows including errors and omissions. The latter included increases in trade credits, in the wake of the further liberalization of exchange controls on those credits, and unrecorded inflows, attracted by the favorable interest rate differential. The high domestic interest rates relative to foreign interest rates adjusted for exchange rate expectations also induced increasing recourse to medium- and long-term foreign borrowing by the private sector, all attesting to the progressive integration of Portugal into the international financial market. The improvements in the external accounts also extended to the developments in external debt and debt service. Total external debt declined to 39 percent of GDP at end-89, compared to a peak of 80 percent in 1985, not least on account of prepayment of government debt. For the first time since 1980, when the value of official reserves was buoyed by the extraordinary increase in the market price of gold, the stock of external debt fell in 1989 below the stock of gross international reserves (Chart 3). Debt service payments in 1989, excluding amortization payments, fell below 12 percent in relation to exports of goods and services, which is about one-third of its 1984-85 peak.

On the inflation front, however, the situation deteriorated further in 1989, with increases in the CPI accelerating to an average 12.6 percent from 9.6 percent in 1988. After the conspicuous overshooting of the 1988 inflation target (6.5 percent) the extent of inflation in 1989 came as a surprise. Wage earners became disenchanted with incomes policies that had been premised on ex-ante indexation of wages to the inflation target and on catch-up provisions in the event of overshooting. As that provision was not enacted, except, partially, for civil servants, consensus broke down in the

CHART 3
PORTUGAL
EXTERNAL SECTOR DEVELOPMENTS, 1980-1990 1/



Source: Bank of Portugal, Annual Report, and International Financial Statistics, IMF.
1/ 1990, first quarter.
2/ End-of-period stock of total foreign debt.
3/ End-of-period stock of gross international reserves, with gold valued at market prices

Tripartite Council of Social Bargaining, made up of representatives from government and the social partners. In the process, while wage moderation continued through 1989, contractual increases in the first half of 1990 increased markedly, as did wage drift. This has to be seen in the context of further accelerating inflation, from 11.6 percent in December 1989 to around 14 percent in May/June 1990. Indications are that this latest acceleration of inflation came as a surprise also to the Portuguese authorities. Indeed, there had been reasons to believe that, with a deceleration of inflation in the second half of 1989 from 13.7 percent in August to 11.6 percent in December, inflation was now on a downward trend, largely in response to the tightening of financial policy in 1989.

On fiscal policy, the general government deficit narrowed in 1989 to 4.9 percent of GDP from 6.1 percent in 1988, more markedly than initially budgeted. The authorities succeeded in restraining expenditures in relation to GDP in a number of areas, including goods and services; subsidies; and public investment. There was also a leveling off in interest payments in 1989, associated partly with the narrowing deficit, and partly with the decline in treasury bill rates in 1988. The widening differential between real GDP growth and the real effective interest rate was a further factor in the decline of interest payments in relation to GDP. Yet, the gains on this count were ephemeral, and are bound to be reversed in 1990, owing to the delayed effect on the budget of the increase in interest rates in the second half of 1989. Moreover, what progress in expenditure restraint was made, was offset by the increase in disbursement of net transfers from the EC under the structural-funds, which require matching budgetary outlays. In all, therefore, while some improvements were made in expenditure composition, overall expenditure in 1989 in relation to GDP remained broadly unchanged (Table 1).

On the revenue side, a major reform of the income tax was put in place, replacing a plethora of schedular income taxes with a modern, comprehensive personal income tax system. In addition, the system of deductions was streamlined with a view to making it transparent, widening the tax base and controlling evasion. Since some tax payments under the old regime fell due in 1989, and since the new regime came into effect in the same year, taxes were paid under both regimes, boosting revenues. However, these effects were partly offset by a decline in the ratio of indirect taxes to GDP on account of the deceleration in consumption and investment spending in the wake of the direct credit controls described below. In all, the total revenue ratio to GDP rose by 1.2 percentage points, accounting for the entire reduction in the budget deficit. As for the enlarged public sector borrowing requirement, including public enterprises, the corresponding reduction was more pronounced, as the government continued to assume predetermined amounts of enterprise debt. In turn, the effect on the government debt was cushioned by using the proceeds from the privatization of selected enterprises to retire debt. The rising trend in the ratio of government debt to GDP was thus reversed.

In the area of monetary policy, the authorities attempted to maintain a restrictive stance by tightening direct controls on credit and raising interest rates. In March 1989, direct restrictions were imposed on consumer credit including, bans on hire purchase of selected consumer durables, and minimum down payment requirements on purchases of automobiles. Further restrictive measures included increases in reserve requirements and a tightening of credit ceilings, which in 1989 were extended to include the public sector. This spurred banks to sell some of their stock of government paper to private households and firms but the resulting room for credit extension to the private sector was limited by a tightening of overall ceilings. As a result, domestic credit expansion to the private sector decelerated to a rate well below the rate of inflation as did the growth of the targeted liquidity aggregate (Table 1). However, including the rapid rise in foreign borrowing, and in new forms of credit not affected by the ceilings, effective credit expansion was in the order of 19 percent. Total private sector financing expanded even more rapidly, as it also includes direct sales of securities, credit from nonmonetary financial intermediaries, and self-financing. All told, liquidity remained ample, despite the apparent tightening of credit controls.

On interest rates, the main developments in 1989 included increases in the official intervention rate, treasury bill rates, bank lending rates, mortgage rates, and rates paid on excess bank liquidity deposited with the central bank. Bank deposit rates, however, changed little so that bank spreads widened. The main factor braking the pace of consumption and, in the process, investment appears to have been the direct control of consumer credit, with credit ceilings and interest rates playing a lesser role. At the same time, the widening interest rate differential in favor of Portugal, well in excess of the rate of crawl of the escudo, and the attendant capital inflow exacerbated the difficulties of controlling domestic liquidity.

Since the first half of 1990, credit ceilings have been replaced by indicative targets, as a first step toward indirect controls. Concomitantly, the authorities have attempted to increase the share of excess bank liquidity tied up in high-yield time deposits with the central bank. This has not produced any shortage of credit or liquidity; on the contrary, mounting capital inflows have further exacerbated the task of liquidity control. In addition, with the 1990 Budget targeting a widening of the fiscal deficit, the overall stance of fiscal policy has also become expansionary, at a time of strong demand and inflation pressures.

III. The Policy Discussions

The discussion with the Portuguese authorities addressed the current state and short-term prospects of the economy with a view to assessing its likely development in 1990 as a whole. This was followed by a review of the exigencies of policy in the area of the public finances, industrial relations, money, interest and exchange rates, and structural reform. The broader context and medium-term dimension for the discussions was provided by Portugal's expressed desire to continue to catch-up with the EC, and by its scheduled progressive economic and financial integration into the single European market.

1. The state of the economy and its prospects for 1990

There was agreement that, despite measures introduced in 1989, and despite the operation of automatic stabilizers in the public finances, the pressure of demand continued to be excessive in the presence of capacity constraints, undermining progress on the inflation front. The authorities thought that "true inflation" was likely to be overstated significantly by "measured" inflation because the CPI was based on the pattern of consumption in the early 1980s, and did not reflect the increasing importance of imports in domestic expenditure. Since the rise in import prices has recently been below the rise in the prices of domestic goods and services, proper account of the role of import prices would probably lower the measured CPI increase, unless adjustment of profit margins removed price differentials at the retail level. Also, no account was taken of the increasing importance of supermarkets whose prices were considerably lower than those in the retail shops customarily covered in the CPI compilations. Indeed, according to some reports, the loss of customers to supermarkets has induced retail shops to raise their prices, counting on demand from less mobile consumers, so as to protect their profit margins. Other reasons cited were the likely overstatement of increases in unit labor costs because of failure to distinguish between increases in part-time and full-time employment. Measuring full-time equivalents would probably show lower growth in employment, and hence, higher productivity growth than officially reported. This more than offset the fact that actual wage increases were running about 1-2 percentage points above measured increases. None of this, however, was meant to detract from the conclusion that inflation was too high and had to be brought down. The wage moderation that had marked the last few years showed signs of coming to an end, with indications of wage push evident in the most recent contractual agreements. The authorities regarded this as a sign that the inflation process might be broadening, increasing the urgency of effective countermeasures.

On current trends, the prospects for the Portuguese economy in 1990 point to a reacceleration of domestic demand, as discretionary credit controls are increasingly circumvented, household saving rates continue to decline with steady employment growth, financial innovation, and ample liquidity, and as disposable income is increased in a variety of ways, including adjustments in pensions and civil service salaries, and a 20 percent general increase in tax brackets to correct for past fiscal drag. In addition to the revival of consumption, and the likely rebuilding of inventories, fixed investment is also expected to accelerate, responding to favorable sales prospects at home and abroad. Other factors expected to spur investment included the continuing strong inflow of foreign direct investment, and the need to increase capacity. In sum, the authorities and the staff agreed that demand was likely to be up by 1/2 percentage point for the year, to a total exceeding 4 1/2 percent. The contribution of the foreign balance to GDP growth was expected once again to become negative, partly because exports were bound to decelerate from their exceptionally strong increase in 1989, and partly because aggregate demand would shift toward a more import intensive composition, involving a declining share of exports and a correspondingly rising share of domestic demand, including inventories. As a result, GDP growth would decelerate to around 4 percent, but still higher than in partner countries.

The current account deficit in the balance of payments would again widen, reaching 2 1/2 percent of GDP, despite rising transfers from the EC and improvement in the terms of trade. The authorities expressed the view that competitiveness was apparently not at risk, despite measured increases in the real exchange rate. The level of unit labor costs and prices was still lower in Portugal, and real appreciation merely meant that the gap was narrowing. Also, Portugal was seen as capable of increasing its market shares again in 1990. In the sectors facing increasing foreign competition, profit margins could probably be trimmed, without jeopardizing overall profit positions. In the capital account, current trends were projected to persist, particularly as regarded foreign direct investment. This, together with the large inflows, attracted by arbitrage opportunities in the first half of the year, was apt to generate a further surplus in the overall balance of payments, and a further rise in foreign exchange reserves.

In the labor market, the authorities argued that the effective unemployment rate was lower than the 5 percent reported in 1989, which to a large extent reflected temporary unemployment of women in agriculture. This meant that with the official unemployment rate projected to decline toward 4 percent in 1990, demand pressure in the labor market was bound to increase. Inasmuch as the inflationary carryover already exceeded 11 percent in mid-1990, achievement of the official inflation objective of 10 percent was unlikely. On current trends, an acceleration in the average inflation rate to around 13 percent was not excluded.

2. Policy exigencies in the short term

There was general agreement that a withdrawal of fiscal stimulus was called for to cool the economy. In their explanations why, on the contrary, fiscal policy was set to impart an expansionary impulse to demand, the authorities pointed out that at the time that the 1990 Budget was drawn up, in the latter part of 1989, the pressure of demand was thought to be decelerating. This turned out to be overly optimistic, but meanwhile detracted from the urgency of fiscal adjustment, the more so as the deficit in 1989 had been reduced by more than had been targeted earlier. Also, the Government felt that certain adjustments were in order to restore the purchasing power of pensions; compensate for the pronounced fiscal drag during 1988-89, and the increase in the tax burden associated with the transition from the old to the new income tax system; and reform the salary structure of the civil service, to ensure competitiveness with the private sector. In the event, the budget deficit in 1990 would widen by as much as 2 1/2-3 percentage points of GDP, despite expenditure restraint in other areas, improved control over treasury operations, a commitment to maintaining a primary surplus, exclusion of supplementary appropriations, and the incentive to expenditure saving introduced by allowing appropriations to be carried over into the future. The expenditure ratio to GDP would increase not only on account of mounting public consumption, but also on account of lagged effects from increases in interest rates in the second half of 1989.

On the revenue side, the once-and-for-all rise of the revenue ratio in 1989, attributable to the coincidence of taxation under the old and new systems, was not to be repeated, and the 20 percent increase in tax brackets would further lower receipts. Asked whether indirect taxes could be raised selectively, and whether expenditure appropriations could be delayed, the authorities mentioned impending increases in excise taxes on tobacco and alcohol as factors that would help keep the budget on track. They also noted that, with the budget predicated on an overly optimistic inflation target of 10 percent, avoiding an overshooting of the targeted budget deficit would prove to be a challenge.

As for the 1991 Budget, to be drawn up in the fall, the authorities agreed that restraint was essential. There would be room to increase the VAT without impairing consistency in the EC context; possibilities include narrowing VAT zero-rating and raising the standard rate (even if this led to a widening rate differential vis-à-vis Spain, any resulting cross-border shopping was not considered a significant problem on a national scale). Expenditure could be reduced by restraint on current spending and by scaling back public investment not related to EC transfers. Finally, full realization of the privatization planned, and the use of its proceeds to retire public debt, should lower the burden of debt and service payments.

For rapid progress in reducing inflation, the authorities agreed that fiscal restraint should be complemented with incomes policy. The trade unions have already expressed their willingness to resume negotiations with the Government and with business.

Turning to monetary policy, the authorities stressed that the pursuit of independent interest and exchange rate policies had increasingly become impracticable as a result of the progressive liberalization of foreign exchange markets. As the policy of a preannounced rate of crawl of the escudo had gained credibility, interest rate arbitrage entailed even less risk than would be the case if the escudo had participated in the ERM. Although nonresidents were still barred from investing direct in the domestic money market, they could do so indirectly, by engaging in swap operations with banks. Such arbitrage operations had led to official reserve gains on the order of US$1 1/2 billion during two weeks in June 1990 alone, following speculation about Portugal's early accession to the ERM. The massive scale of capital inflows made it virtually impossible to maintain the existing mix of exchange rate and interest rate policies in a regime of free capital mobility. In addition, as excess bank liquidity was drawn into high yield time deposits with the central bank, and as foreign exchange reserves surged, the central bank balance-sheet total rose rapidly. This situation could not be sustained long, given the adverse asset-liability interest rate differential and the resulting adverse effects on central bank profits.

One way of redressing the situation was to reintroduce capital controls which, if effective, would dampen capital inflows. This could pave the way for increases in interest rates on treasury paper so as to induce a substitution of treasury paper for bank deposits and thus reduce the central banks' interest-bearing liabilities. Alternatively, if capital controls could not be made effective, the flexibility of either the exchange rate or domestic interest rates would have to be increased to reduce potential gains from interest arbitrage. Finally, an attempt could be made to combine the two alternatives. The authorities shared the view of the mission that greater flexibility of the exchange rate would, in current circumstances, tend to strengthen the escudo relative to the 3 percent depreciation under the existing crawling peg regime. A complete freeing of the exchange rate, even on a temporary basis, was ruled out on account of its potentially adverse real effects. A more limited flexibility could be introduced by placing a band of 1-1 1/2 percent on either side of the crawling peg. If the escudo went to the top of such a band, the maximum annual depreciation would be on the order of 1-1 1/2 percent rather than the current 3 percent. Apart from increasing the riskiness of arbitrage operations, a relative strengthening of the exchange rate under a more flexible system would dampen the rise in import prices, thus helping to bring down inflation. Measures to reduce market imperfections that may have hampered the pass-through of lower import prices to the ultimate consumers would strengthen this effect.

For the time being, while announcing that they may increase exchange flexibility in the future, the monetary authorities have opted for temporary administrative controls on capital inflows, coupled with a revision of their intervention policy in the domestic money market. In late June 1990, nonresidents were barred from engaging in forward purchases of escudos for a period of 90 days, which in effect curtailed their ability to arbitrage between the domestic and foreign money markets (see also RED, Appendix I). In addition, as of July 1, 1990, a nonremunerated deposit requirement was imposed on foreign financial borrowings by Portuguese enterprises, with a view to reducing the cost advantage of foreign loans. Finally, as of late June 1990, the monetary authorities discontinued the practice of pegging interest rates in the short-term money market. Instead, the authorities would intervene at their discretion, and did so to bring about a sharp reduction in short-term rates, thereby limiting the scope for interest rate arbitrage.

3. The medium term

The discussion of medium-term prospects centered on the planned convergence of inflation and fiscal policy to EC norms in the years to 1995. Its achievement is to involve close collaboration of the EC under its surveillance mandate in the context of the EC convergence decision. (On March 12, 1990 the Council of Ministers adopted a decision on the attainment of convergence of economic policies and performances; for details, see European Economy, Supplement A, No. 3, Commission of the European Communities, March 1990.) The plan targets a deceleration of inflation to 4 1/2 percent and a narrowing of the government deficit to 3 percent of GDP by 1995. The adjustment is to be brought about through a combination of expenditure restraint, on the one hand, particularly on public sector employment, on subsidies to enterprises, on transfers and investment spending unrelated to the receipt of structural funds from the EC, and on interest payments, as the proceeds of the privatization program (targeted to yield Esc 1 trillion, equivalent to 15 percent of GDP, during 1989-94) are applied to reductions in the public debt, and revenue increases, on the other hand, particularly through increases in VAT and improvements in tax administration. With this fiscal adjustment, complemented by wage moderation and higher interest rates, inflation is expected to decelerate as targeted. The rate of depreciation of the escudo is also to slow down prior to entrance into the ERM. Without fiscal adjustment, the government deficit would widen and the public debt increase in relation to GDP, with the result that inflation rates would not converge, thus barring entrance into the ERM. The crawling peg would have to be continued, without modification. Alternative scenarios along similar lines are provided by the staff in Chart 4, with details given in Appendix II to the RED.

4. Structural reform

In the area of structural reform the discussion touched on the restructuring of banks and bank supervision along the lines of relevant EC directives; on privatization; on the medium-term prospect for EC transfers; and on trade and exchange liberalization.

On the implementation of the Second Banking Directive, the authorities expected that Portugal would fulfill its commitments on schedule. Work was proceeding to ensure compliance with the required standards for bank solvency ratios, and for banking supervision on a consolidated basis. While most private banks were said to be in a strong position and had no difficulty in implementing the required regulations, some public banks were still undercapitalized. The authorities intended to remedy this situation through acquisitions and mergers, with part of the proceeds of privatization used to recapitalize the weaker institutions. 1/ In time, this would also improve the ability of Portuguese banks to weather increased competition in a single financial market. The Portuguese authorities have already opened up the domestic financial market to foreign firms, which should also help in the necessary transformation.

In the area of privatization, the authorities preferred an eclectic case-by-case approach. The necessary legal framework was already in place to permit the gradual but complete sale of financial and nonfinancial public enterprises. The authorities have authorized the participation of foreign investors except in the case of financial institutions, which are to remain under domestic control. The program has been implemented on target during 1989-90.

On EC transfers, the prospective disbursement of structural funds through 1993 is expected to yield the equivalent of 2-2 1/4 percent of GDP per annum. They had already helped markedly to improve infrastructures, assist agriculture, and raise the skills of the work force through training programs, but could be even better employed in the future. There was room for improvement in the use of funds for vocational training, in particular, as well as for rationalization of the program for support to industry and agriculture. The authorities would like greater flexibility in the use of funds, allowing them to finance general-purpose education. Disbursement of the funds undoubtedly increased pressure on prices, at least over the short term, but this was regarded as a small cost relative to the expected medium-term benefits.

The pace of liberalization of the exchange system was recently accelerated. Controls on capital outflows have been eased ahead of time and

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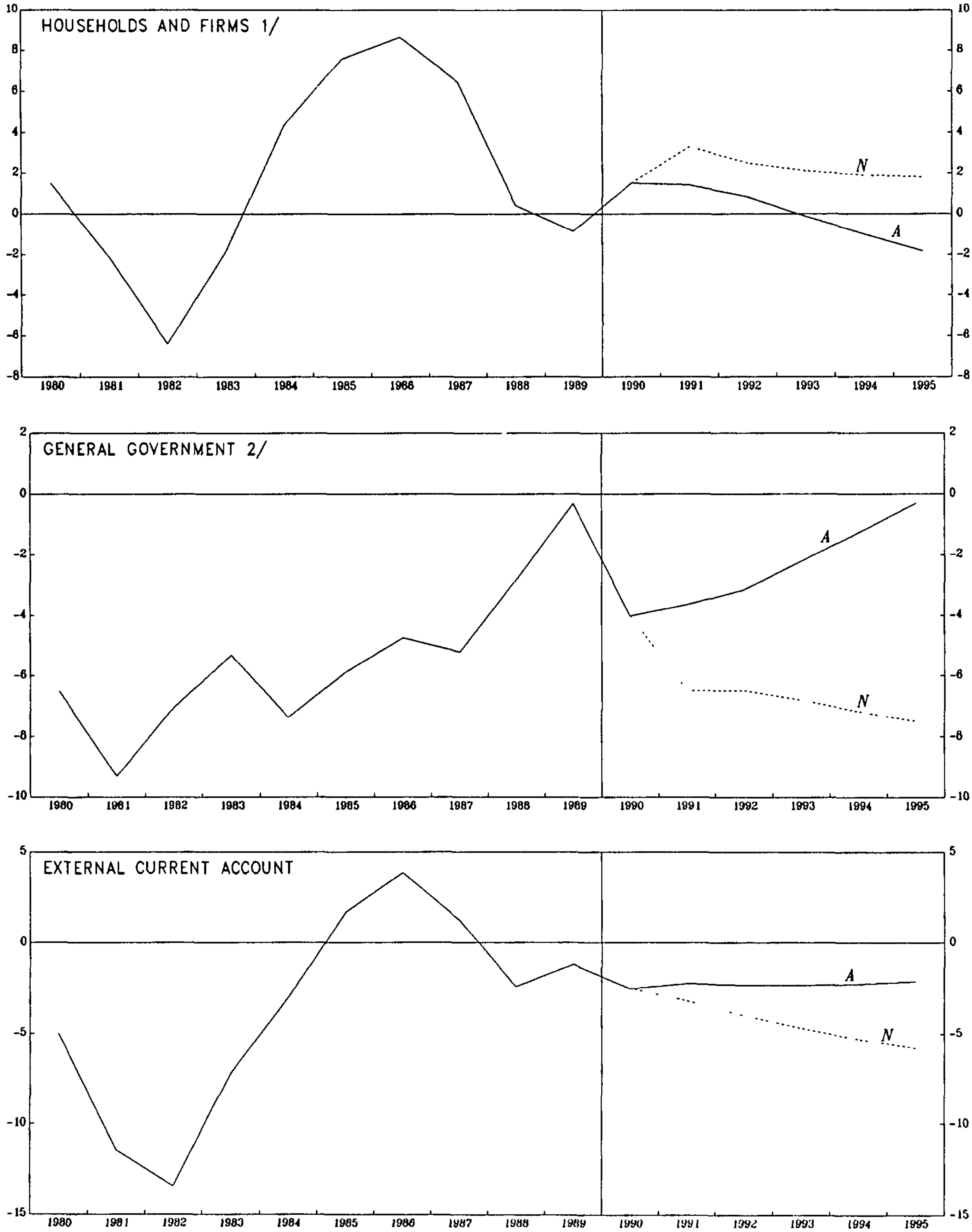
1/ See RED, Appendix IV, for a more detailed description of Portugal's commitments and accomplishments in this area.

CHART 4
PORTUGAL

FLOW OF FUNDS, 1980-95

(In percent of GDP)



Source 1980-89, Bank of Portugal, 1990-95 staff projections
A - Adjustment scenario
N - Non adjustment scenario
1/ Savings minus investment While the savings rate is higher in scenario A, the faster growth of investment makes for a relatively lower net savings position.
2/ The balance in this chart differs from the overall fiscal balance in Chart 2, panel 2, in that it excludes capital transfers and net lending of the general government to public and private enterprises.

inflows are to be liberalized again as soon as conditions permit. 1/ The most recent trade liberalization measures involved the lifting of quotas on wine imports from non-EC countries, and of quotas on imports of pork from all countries, which were announced in June 1990. Further developments in this sector must await the conclusion of negotiations on the reform of the EC's Common Agricultural Policy, which are still under way. 2/

IV. Staff Appraisal

In an otherwise bright picture, the deteriorating inflation performance is the one blemish. After several years of demand expansion, at rates markedly higher than on average in the EC, capacity constraints are increasingly being felt and the economy shows clear signs of overheating. Also, the effective opening up of the capital account in the balance of payments, in the presence of a nominal interest rate differential substantially larger than the rate of depreciation of the escudo under the current exchange rate regime, has involved rapid overall credit and liquidity expansion. All this has spurred inflation and inflation expectations, exacerbated by insufficient competition in the distribution system, and rigidities in agriculture. Hitherto, with real wage increases below productivity gains, there has been no impetus to inflation from the cost side; but it cannot be taken for granted that this situation will continue.

On fiscal policy, the dial stands unequivocally on expansion. The fiscal deficit is to widen in 1990 by some 3 percentage points in relation to GDP, involving a leveling off of the revenue ratio, and a 3 percentage point rise in the expenditure ratio, largely on account of salary reforms in the public sector. A widening of the budget deficit on this scale imparts an expansionary impulse to demand, which is highly inappropriate in the current circumstances. There is thus a clear case for action in the spirit of recent commitments that the Government has made to maintain a primary surplus; control treasury operations; and rule out supplementary expenditure appropriations. Indeed, additional measures may need to be adopted to restrain expenditure and raise revenues.

In the area of monetary policy, the demand effects of direct credit restraints, including indicative ceilings, are waning as those restraints are increasingly being circumvented. Shifts from bank credit to quasi-credit operations, combined with shifts in the composition of households'

1/ See RED, Chapter IV and Appendix I for a more detailed description of recent exchange measures.

2/ For a more detailed description of the current trade system and of the Portuguese position on matters under negotiation in the GATT's Uruguay Round, see RED, Appendix II.

financial assets, have changed the meaning of the standard monetary and credit aggregates. Above all, however, there is the massive inflow of funds from abroad which makes it nigh impossible to control the expansion of credit to the private sector, and of liquidity. Accordingly, notwithstanding the overfunding of the public sector on the domestic market and the use of the proceeds to retire foreign debt, monetary policy inevitably risks to be ineffective. In this connection, there is yet another problem which has taken on unsustainable proportions. With the country flush with liquidity, the reserve assets of the Bank of Portugal have been soaring, but, even after adjustment for exchange rate changes, they are remunerated at markedly lower rates of interest than the average rate paid on central bank liabilities, with attendant adverse effects on profits.

The stances of exchange rate and interest rate policies remain difficult to reconcile. With the rate of crawl of the escudo fixed at 3 percent per annum, the interest rate differential in favor of the escudo makes it an extremely attractive risk-free investment. The authorities consider lowering longer term domestic interest rates as inappropriate, partly because private savers are to be assured positive real returns after-tax and partly because banks have to be induced to surrender liquidity to the central bank. At the same time, high domestic interest rates cannot perform their role in dampening credit demand, as long as cheaper credit is available from abroad.

The staff appreciates the reasons that spurred the authorities to stop absorbing liquidity at fixed rates through daily interventions in the short-term interbank money market, but cautions that it may be hard to keep, for long, the resulting decline in short-term rates from spreading to the longer maturities. The staff also appreciates the need to roll back the liberalization of nonresident transactions in the forward exchange market and to impose a nonremunerated deposit requirement on foreign financial borrowing. With controls effectively administered, with the effective interest rate differential narrowed, and with the cost of interest arbitrage increased, the inflow of liquidity from the external sector should be curtailed. Nevertheless, the staff shares the authorities' view that capital controls can be only a temporary expedient and are bound to lose their effectiveness over time.

Accordingly, to ensure that capital inflows do not once again undermine the anti-inflationary stance of monetary policy, the staff recommends a change in the exchange rate regime. In particular, to reduce the scope for riskless arbitrage, the rate of crawl of the escudo could be set to occur within a band. With capital inflows reduced more effectively through the combination of administrative controls and greater exchange risk, the relative autonomy of domestic interest rate policy would be easier to maintain.

Such a system, in which moreover the escudo is likely to be relatively stronger than under current arrangements, may be regarded as conducive to faster disinflation at home and hence greater convergence of Portugal's inflation rate with rates prevailing elsewhere in the EC, paving the way to entry into the ERM.

On the challenge of disinflation, the staff would stress the importance of fiscal restraint. Adopting measures of fiscal restraint already this year would help the Government in carrying out its intention of significantly reducing the fiscal deficit in 1991 and, with further help from incomes policies, bear down on inflation. This would make for a better balanced policy mix, lowering the burden on monetary policy and lessening the need for capital controls and exchange rate flexibility.

For the medium term, the frame of reference is provided by the strategy mapped out in the official medium-term adjustment plan and the process of surveillance under the EC convergence decision. The staff notes that the objectives for convergence of the budget deficit and the ratio of public debt to GDP, in particular, will have to be met at the same time that the effective interest rate on the public debt is bound to increase in the context of shifting the composition of the public debt to higher-cost domestic debt. In this light, timely and sustained fiscal adjustment, improvements in debt management, and maximum possible efforts on privatization are in order. Expenditure restraint should be combined with indirect tax increases, consistent with EC harmonization criteria, and with sustained improvements of tax administration, geared in particular to curtailing company tax evasion.

In the area of structural policies, the staff notes the commitments undertaken by the Portuguese Government in the context of agreements with the EC, including the implementation of the Second Banking Directive, the liberalization of capital flows, and the opening up of an agricultural sector that remains restrictive. Certain agricultural import restrictions that have been maintained outside the CAP should be eliminated in time while, within the CAP, the authorities should support further liberalization in the context of the Uruguay Round. Sustained efforts will also have to be made to increase the productivity of investment in both human and physical capital and to reduce market imperfections so as to enhance competition. With human resources and productive structures strengthened, with net transfers and nondebt capital inflows from the EC continuing on a significant scale, and with expectations of continued buoyancy, the gap in the living standards between Portugal and its European partners should continue to narrow.

It is recommended that the next Article IV consultation with Portugal be conducted in accordance with the bicyclic procedure.

Table 1. Portugal: Selected Economic Indicators, 1985-90

(Changes in percent, except as otherwise indicated)

	1985	1986	1987	1988	1989	1990 1/
Domestic economy						
Real domestic demand	0.6	7.3	9.8	8.2	4.1	4.8
Real GDP	3.6	4.3	5.1	4.0	5.4	4.0
Real foreign balance (contribution to GDP growth)	2.3	-3.2	-5.0	-4.9	0.6	-1.5
Employment	-0.5	0.2	2.6	2.6	2.2	2.0
Unemployment rate	8.5	8.4	7.1	5.7	4.9	4.9
Average wage per worker 2/	21.7	17.1	12.0	8.6	10.0	12.0
Unit labor costs 3/	22.2	10.2	16.4	8.3	13.0	13.0
Annual average inflation rate (CPI)	19.3	11.7	9.4	9.6	12.6	13.0
GDP deflator	21.6	17.8	12.2	12.5	12.8	13.0
External accounts						
Export volume 4/	10.6	8.7	11.2	10.2	20.7	12.0
Import volume 4/	3.0	18.7	27.6	21.9	11.0	12.0
Export unit value 4/	15.5	2.5	8.9	9.5	6.1	6.0
Import unit value 4/	11.0	-8.4	6.7	7.1	7.8	6.7
Trade balance (in billions of U.S. dollars, f.o.b.) 5/	-1.5	-1.7	-3.6	-5.5	-5.2	-6.0
Services and factor payments (net) 5/	-0.4	-0.1	0.3	0.1	0.2	-0.2
Transfers (net) 5/	2.2	2.9	3.8	4.3	4.4	4.9
Current account 5/						
In billions of U.S. dollars	0.4	1.1	0.4	-1.1	-0.6	-1.3
In percent of GDP	1.9	3.9	1.2	-2.6	-1.2	-2.5
Escudo/US$ exchange rate 6/	170.4	149.6	140.9	144.0	157.5	150.0
Nominal effective exchange rate index 7/	100.0	90.8	84.1	79.5	77.1	76.1 8/
Real effective exchange rate index 7/	100.0	99.0	97.7	98.0	102.4	107.2 8/
Foreign exchange reserves 7/ (in billions of U.S. dollars)	1.4	1.4	3.2	5.1	9.8	11.0 9/
Financial variables						
General government balance 10/	-6.9	-6.9	-7.9	-6.1	-4.9	-7.5
Primary balance 10/	1.2	2.2	0.9	1.7	2.4	1.5
General government revenues 10/	43.7	40.1	37.0	38.4	39.6	38.1
General government expenditures 10/	50.6	47.1	44.8	44.6	44.5	45.6
Public sector borrowing requirement 10/ (including public enterprises)	17.7	11.0	11.3	9.6	6.3	9.4
Direct public debt 10/	69.2	69.5	71.5	74.2	71.1	69.3
Liquidity of residents (L-)	29.0	25.9	16.8	14.8	8.8	5.0 11/
Total credit	20.0	13.5	10.7	11.0	4.3	3.4 11/
Domestic credit	20.2	22.2	11.3	11.9	11.1	-2.5 11/
Of which:						
Credit to the General Government	28.4	30.9	24.7	20.0	-2.5	6.0
Credit to public enterprises	19.9	30.4	-3.2	-5.0	-2.9	1.7
Credit to the private sector	15.6	13.4	7.9	11.5	9.9	2.1
Interest rates (end-period)						
Maximum administered lending rate	26.5 12/	18.0 12/	18.5 13/	17.0 14/	...	...
Indicative lending rate 15/	...	...	...	18.2	20.4	22.0
Minimum administered rate on time deposits 16/	24.0	15.5	14.0	13.0	13.0	14.0

Sources: Bank of Portugal and Ministry of Finance.

1/ Staff estimates for the full year, unless otherwise noted.
2/ Nominal wage increases implicit in collective wage settlements.
3/ Unit labor cost in manufacturing.
4/ Merchandise trade (customs basis).
5/ Transaction basis.
6/ Period average.
7/ IMF, International Financial Statistics. Foreign exchange reserves include ECU balances.
8/ April 1990.
9/ May 1990.
10/ In percent of GDP.
11/ 1990 Monetary Program; first half of 1990, year-on-year average consistent with 2 percent increase of credit to public enterprises and private sector on exclusion of treasury bonds.
12/ Loans between 90 and 180 days.
13/ Since March 1987 there has been only one administered lending rate for loans over 180 days.
14/ Until September 15, 1988. Since then lending rates are free.
15/ Average rate quoted by the Portuguese Bankers Association since November 1988.
16/ Rate on time deposits between six months and one year.

Table 2. Portugal: Selected International Comparisons, 1980-89 1/

(Changes in percent, except as otherwise indicated)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Domestic demand										
Portugal	6.6	3.0	2.9	-5.6	-5.6	0.6	7.3	9.8	8.2	4.1
Partner countries 3/4/	0.9	-1.5	0.7	1.6	2.4	2.7	4.0	3.9	4.4	3.6
Spain	2.0	-2.3	1.1	-0.1	-0.7	2.9	6.4	8.3	6.9	7.7
G-7 Europe 2/	1.6	-1.5	0.8	1.7	2.1	2.0	3.7	3.8	4.3	3.3
EC-12	...	-1.9	0.8	1.2	1.9	2.2	3.8	3.9	4.6	3.5
GDP										
Portugal	4.8	1.3	2.1	-0.2	-1.8	3.0	4.1	5.1	4.0	5.4
Partner countries 3/5/	1.2	0.1	0.6	2.0	2.8	2.6	2.7	2.9	3.7	3.4
Spain	1.5	-0.2	1.2	1.8	1.8	2.3	3.2	5.6	5.2	4.9
G-7 Europe	1.2	0.3	0.8	1.8	2.5	2.4	2.6	2.6	3.8	3.5
EC-12	1.3	0.1	0.8	1.7	2.5	2.4	2.6	2.7	3.8	3.4
CPI										
Portugal	16.6	20.0	22.4	25.5	29.3	19.3	11.7	9.4	9.6	12.6
Partner countries 4/6/	12.3	11.6	9.9	7.5	6.3	5.4	3.2	3.0	3.2	4.6
Spain	15.5	14.6	14.4	12.2	11.3	8.8	8.8	5.2	4.8	6.8
G-7 Europe	12.7	11.7	9.8	7.1	5.9	5.4	2.6	2.8	3.2	4.9
EC-12	13.5	12.1	10.5	8.6	7.4	6.1	3.5	3.2	3.6	5.2
Unemployment rate										
Portugal	7.8	7.6	7.5	7.7	8.3	8.5	8.4	7.1	5.7	4.9
Spain	11.4	14.3	16.4	18.2	20.1	21.5	21.0	20.5	19.5	17.3
G-7 Europe	5.3	6.7	8.0	9.0	9.5	9.8	9.9	10.0	9.4	8.8
EC-12	6.4	8.1	9.5	10.0	10.8	10.8	10.8	10.4	9.8	0.9
Current account balance in percent of GDP										
Portugal	-5.1	-11.5	-13.5	-7.2	-3.1	1.7	3.9	1.2	-2.4	-1.2
Spain	-2.3	-2.5	-2.3	-1.4	1.3	1.6	1.6	0.1	-1.2	-2.8
G-7 Europe	-0.9	-0.3	-0.2	0.4	0.5	0.9	1.6	0.9	0.4	0.3
EC-12	-1.2	-0.7	-0.7	0.1	0.3	-0.8	1.4	0.8	0.3	0.1
General Government balance in percent of GDP										
Portugal 7/	-9.5	-11.5	-12.7	-10.8	-13.4	-11.9	-10.2	-10.5	-9.3	-5.6
Spain (including ICO)	-2.6	-3.9	-5.6	-4.8	-5.5	-7.0	-6.0	-3.2	-3.0	-2.0
G-7 Europe	-3.2	-3.9	-4.4	-4.3	-4.4	-4.2	-4.0	-3.7	-3.2	-2.4
EC-12 7/	...	-5.3	-5.5	-5.3	-5.3	-5.2	-4.8	-4.3	-3.6	-2.9
Private fixed investment in percent of GDP										
Portugal	28.6	29.9	30.9	24.4	19.4	17.2	19.0	23.8	25.9	26.6
Spain	22.1	17.4	16.1	15.3	14.0	13.3	14.5	16.8	18.9	20.1
G-7 Europe	20.0	17.8	17.0	16.4	16.5	16.0	16.6	17.0	17.9	18.2
Public debt in percent of GDP (GNP)										
Portugal	38.1	47.3	50.7	56.6	62.4	69.2	69.5	71.5	74.2	71.1
Spain 8/	...	19.4	24.0	29.0	36.0	41.5	41.8	42.0	41.0	39.9
G-7 Europe	28.1	30.2	32.7	35.5	37.8	40.1	41.6	42.6	42.9	42.6
Monetary aggregate 9/										
Portugal	28.8	23.8	24.1	16.8	24.6	29.0	25.9	16.8	14.8	8.8
Spain	...	...	16.6	16.0	14.1	13.2	11.9	14.2	11.0	10.5 10/
G-7 Europe	9.8	10.8	10.7	11.1	8.6	9.1	9.4	9.8	8.9	...
EC-12	11.9	10.8	11.9	10.7	9.9	10.0	10.3	11.0	10.6	10.8

Source: Bank of Portugal, Annual Report, several issues; IMF, World Economic Outlook, May 1990; and EC, European Economy.

1/ From 1986 onward, Spanish indicators are in line with revised national account figures.

2/ Weighted average of Germany, France, Italy, and the United Kingdom using as weights the average U.S. dollar value of their GDP in preceding three years.

3/ Weighted by the geographic distribution of Portugal's 1986-88 average exports.

4/ Composite based on data for industrial countries only, which are trading partners of Portugal.

5/ Composite based on data for countries that together accounted for at least 90 percent of trade of Portugal.

6/ Import weighted proportional to 1986-88 average imports by geographic distribution.

7/ Public sector borrowing requirement (General Government) including extra-budgetary operations such as treasury lending to public enterprises and debt take-over operations.

8/ Data for Spain refer to the general government (including ICO).

9/ Liquidity of residents (L-) for Portugal. ALP for Spain. M2 for G-7 Europe, except M3 for the United Kingdom and for Germany, M2 + CDs for Japan, through-the-year changes.

10/ Adjusted to include "Transferencias de Activos."

Fund Relations with Portugal

(As of June 30, 1990; in millions of SDRs)

I. Membership status

Portugal became a member of the Fund on March 29, 1961. Portugal accepted the obligations under Article VIII, Sections 2, 3, and 4, of the Articles of Agreement on September 12, 1988.

A. Financial Relations

II. General department

(a) Quota: SDR 376.6 million.

(b) Total Fund holdings of escudos: SDR 261.5 million (69.44 percent of quotas).

(c) Fund credit: None.

(d) Reserve tranche position: SDR 115.1 million.

(e) Current operational budget: SDR 46.6 (purchases)
SDR 8.9 (repurchases).

(f) Lending to the Fund: None.

III. Stand-by or Extended Arrangements and Special Facilities

(a) There is no current stand-by arrangement.

(b) Previous stand-by arrangements:

On April 25, 1977 the Executive Board approved a one-year stand-by arrangement for 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 arrangement.

On October 7, 1983 the Executive Board approved a stand-by arrangement for the period to February 28, 1985. The arrangement was for an amount equivalent to SDR 445 million (118.2 percent of December 1983 quota). The undrawn balance at the conclusion of the arrangement was equivalent to SDR 185.7 million (49.3 percent of quota).

(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). A further drawing under the CFF in the amount of SDR 54.6 million (14.5 percent of quota) was approved by the Executive Board on July 30, 1984.

IV. SDR Department

(a) Net cumulative allocation: SDR 53.3 million.

(b) Holdings: SDR 37.58 million or 70.5 percent of net cumulative allocation.

(c) Current designation plan: SDR 0.7 million.

V. Administered accounts

Not applicable.

VI. Overdue obligations to the Fund

None.

B. Nonfinancial Relations

VII. Exchange rate arrangements

The exchange rate of the Portuguese escudo is determined by a crawling peg based on a weighted basket of currencies of major trading partners. For 1990, the authorities continue to target an effective depreciation of the escudo of 3 percent through the year. End-June 1990, the U.S. dollar was worth Esc 146.72.

VIII. Portugal is on a bicyclic consultation procedure. The last Interim Article IV consultation discussions were held in May 1989 and the staff report (SM/89/150, 7/27/89) was not discussed by the Executive Board.

Portugal--Basic Data

Area and population			
Area			34,312 square miles
Population (1989 estimate) 1/			10.5 million
GDP per capita (1989 estimate)			US$ 4,542.1

Income and expenditure in 1989 (at current prices)	In billions of escudos		(Percent of total)
Private consumption	4,550.7		63.6
Public consumption	1,152.1		16.1
Gross fixed investment	2,097.2		29.3
Domestic demand	7800.0		109.1
Exports of goods and services	2,618.9		36.6
Aggregate demand	10,418.9		145.7
Imports of goods and services	3,266.9		45.7
GDP at market prices	7,151.9		100.0

Selected economic indicators (annual percentage change)	1987	1988	1989
Real domestic demand	9.8	8.2	4.1
Real GDP at market prices	5.1	4.0	5.4
Nominal wages 2/	12.0	8.6	10.0
Consumer prices	9.4	9.6	12.6
Unemployment rate (level) 3/	7.1	5.7	4.9
Broad money, year-end 4/	16.8	14.8	8.8
Domestic credit, year-end	11.3	11.7	2.9
Public sector accounts (as percent of GDP)			
General Government			
Total revenue	37.0	38.4	39.6
Of which:			
Tax revenue	32.6	35.1	34.8
Total expenditure	44.8	44.6	44.5
Primary balance	0.9	1.7	2.4
Overall balance	-7.9	-6.1	-4.9
Borrowing requirement 5/	11.3	9.6	6.3
Balance of payments (in millions of U.S. dollars)			
Merchandise exports	9,268	10,875	12,782
Merchandise imports	12,849	16,393	17,934
Trade balance	-3,581	-5,518	-5,152
Current account balance	444	-1,064	-551
In percent of GDP	1.2	-2.6	-1.2
Medium- and long-term capital	194	843	2,560
Of which:			
Direct foreign investment	316	659	1,396
Short-term debt capital	1,273	1,826	1,858
Overall balance	1,911	1,605	3,867
Foreign exchange reserves, year-end 6/	3,205	5,083	9,826
External debt outstanding, year-end	18,464	17,362	17,780
Gold, year-end (in millions of ounces)	20.06	16.07	16.05
Nominal effective exchange rate (percent change)	-7.4	-5.5	-3.0
Average exchange rate			
Escudo per U.S. dollar	140.88	143.95	157.46

Sources: Data provided by the Portuguese authorities; IMF, International Financial Statistics; and staff estimates.

1/ Resident population.
2/ Contractual wages.
3/ Narrow definition which encompasses the unemployed actively seeking a new job in the four weeks previous to the survey.
4/ Resident's liquid assets (L-).
5/ Borrowing requirement of the enlarged public sector (General Government plus non-financial public enterprises).
6/ Including ECU balances.

Portugal--Selected Social and Demographic Indicators 1/

Area	
Total land area	34,312 sq. miles
Population and vital statistics	
Resident population	10.5 million
Urban population (percent of total)	32.3
Population age structure (in percent)	
0-14	22.1
15-64	65.1
65 and above	12.8
Infant mortality rate (per thousands)	5.9
Life expectancy at birth	73.3
Of which:	
Women	76.8
Health and nutrition	
Per capita supply of proteins (grams per day)	94
Persons per physician	412
Labor force (in thousands)	
Total labor force	4,628.0
Total employment	4,395.0
Primary sector	829.0
Industry	1,545.4
Services	2,020.6
Unemployed	233.0
Education	
Literacy rate	84.0
Pupil-teacher ratio	
Primary education	17.0
Secondary education	12.0
University students per thousand population	24.6

Source: World Bank, Social Indicators of Development, 1989.

1/ Estimates refer to the latest available year between 1980 and 1988.

Statistical Issues

1. Outstanding statistical issues

a. Government finance

No monthly or quarterly data are reported for publication in IFS. Annual data through 1987 correspond to data reported by the GFS correspondent to the Bureau of Statistics.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Portugal in the August 1990 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Banco de Portugal, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in August 1990 IFS
Real Sector	- National Accounts	1988
	- Prices: WPI	June 1990
	CPI	January 1990
	- Production	n.a.
	- Employment	Q3 1987
	- Earnings	
Government Finance	- Deficit/Surplus	1987 (partial)
	- Financing	1987 (partial)
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	August 1989
	- Deposit Money Banks	August 1989
	- Other Banking Institutions	n.a.
Interest Rates	- Discount Rate	May 1990
	- Bank Lending/Deposit Rates	Dec. 1989/May 1990
	- Bond Yields	April 1990
External Sector	- Merchandise Trade: Values	April 1990
	Prices	December 1986
	- Balance of Payments	Q4 1989
	- International Reserves	May 1990
	- Exchange Rates	June 1990