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The Economic Adjustment Programme for Portugal

Eight and Ninth Review – Autumn 2013

Accompanying the document

Proposal for a

COUNCIL IMPLEMENTING DECISION

amending Implementing Decision 2011/344/EU on granting Union financial assistance to Portugal

{COM(2013) 747 final}

EUROPEAN COMMISSION
DIRECTORATE GENERAL ECONOMIC AND FINANCIAL AFFAIRS

The Economic Adjustment Programme for Portugal

Eight and Ninth Review – Autumn 2013

EXECUTIVE SUMMARY

A joint EC/ECB/IMF mission met with the Portuguese authorities in Lisbon between 16 September and 3 October to assess compliance with the terms and conditions set out in Memorandum of Understanding as updated following the Seventh Review of the Portuguese Economic Adjustment Programme. The objectives of the Programme are to restore sound public finances, improve competitiveness and put Portugal's economy back on the path of sustainable growth and job creation. This report provides an assessment of compliance and summarises the findings of the mission.

Amid early signs of a recovery in economic activity, programme implementation remains broadly on track. External adjustment is ongoing, with Portugal gaining export market shares for the third year in a row. Against this background, the Portuguese authorities remain determined to achieve the objectives of the programme despite increasingly challenging circumstances in the third year of implementation.. Building on the significant achievements since the beginning of the programme, the authorities persevere in their efforts to complete the remaining required fiscal adjustment and important and wide-ranging structural reforms continue to be implemented. Nevertheless, the government's financing conditions have deteriorated since the summer, after the political crisis in July has raised market concerns about the government's commitment to the reform programme while its capacity to continue the economic adjustment has been put into question by a series of far-reaching Constitutional Court rulings against key policy measures.

Following the favourable growth surprise in the second quarter, economic activity is now projected to contract by 1.8 percent in 2013 before expanding by 0.8 percent in 2014. This represents an upward revision of 0.5 and 0.2 percentage points, respectively. The situation in the labour market stabilised in line with economic activity, with total employment increasing by 0.8 percent in the second quarter and unemployment, after peaking at 17.6 percent in February/March, falling back to 16.5 percent in August. However, labour-market conditions remain a source of major concern, notably with a youth unemployment rate in excess of 40%. The steady rebalancing of the economy towards the tradeables sector continues and the current account balance is forecast to reach a surplus of about 1 percent of GDP this year via a combination of impressive growth in exports and a sustained compression of domestic demand.

The programme's 2013 fiscal deficit target of 5.5 percent of GDP (not accounting for the cost of bank restructuring) is within reach. Budget execution has been generally supported by solid revenue performance and improved expenditure control. Nevertheless, underperformance in some parts of the budget is posing challenges. The government is addressing these challenges with a combination of permanent and one-off measures, including by drawing down the provisional budget allocation, reducing the funds available to line ministries, and setting up a one-off tax and social security contribution debt recovery scheme. Public sector reforms continue with a view to, amongst others, strengthening financial management, reforming the revenue administration including reinforcing the fight against tax evasion, streamlining public administration, restructuring state-owned enterprises, improving the efficiency of the health sector and reducing costs of public-private partnerships.

Fiscal adjustment will continue in 2014 and the 4 percent of GDP deficit target for 2014 will be maintained, as agreed in the context of the Seventh Review.. In view of an expected negative net carry-over from the 2013 budget execution, the adjustment needs in 2014 have increased. Nevertheless, reflecting a thorough assessment of the balance between the necessary fiscal adjustment, economic growth, and financing prospects, it was agreed to reaffirm the fiscal deficit target of 4 percent of GDP, underscoring the authorities' commitment to successfully achieving the objectives under the programme. To enhance the equity and efficiency of public spending, the key consolidation measures to be proposed in the budget for 2014 appropriately aim at *rationalising and modernising public administration, improving the sustainability of the pension system, and achieving cost savings across ministries. A rigorous implementation of the 2014 draft budget will be a decisive step in the transition to a post-programme environment. In the event that some of the measures were to be found unconstitutional, the government would need to reformulate the draft Budget in order to meet the agreed deficit target. However, in view of the rapidly shrinking room of manoeuvre in identifying appropriate consolidation measures this would imply increasing risks to growth and employment and reduce the prospects for a sustained return to financial markets. Possible changes to the 2014 budget would have to be re-assessed in the context of the next programme review.*

Portuguese banks have significantly improved their capital ratios and, with a more balanced funding structure and available liquidity, are in a good position to withstand short periods of uncertainty and cope with a potential further deterioration in asset quality. Banks continued to experience negative net profits in the first half of 2013, burdened by the recognition of impairments and provisions, the negative evolution of net interest income and high funding costs. On the positive side, deposits have been stable throughout all segments and deposit rates in the system have gradually decreased. Borrowing from the Eurosystem is mainly through long-term facilities and represents about 9 percent of Portuguese banks' liabilities by end-September. The financial sector continued its deleveraging at an elevated pace on the back of weak loan demand and reached a loan-to-deposit ratio of 122 percent at the end of the second quarter. Low consumer confidence and the reluctance of the corporate sector to leverage keep new lending volumes under pressure. Measures to ensure adequate funding for viable small- and medium-sized companies are being implemented, including initiatives to encourage the diversification of financing sources.

The programme's agenda of structural reforms is well advanced and effective implementation will be key to sustaining competitiveness gains. Important progress has been made in the areas of labour markets. The reform of severance pay for fair dismissals marked a significant step, and the government is committed to working on amendments to the important labour code provisions that were recently declared unconstitutional. The reform of the judiciary is near completion and some of the measures such as the new Code of Civil Procedure and the adoption of the Judicial Organization Act represent milestones in improving the efficiency of the court system and speeding up claims enforcement. The authorities are also committed to stepping up efforts to reduce rents in the sheltered sectors, particularly network industries and regulated professions. A comprehensive reform of corporate income tax is being implemented which, while respecting fiscal consolidation targets, will help improve Portugal's investment and growth perspectives. Progress is being made, although with some delays, in the reduction of barriers to doing business via easing of administrative burdens and licensing procedures. The authorities are also committed to exploring the scope for new initiatives, which will be especially important in view of the need to foster competitiveness and job creation.

The combined eighth and ninth reviews confirm that programme implementation continues. Public debt remains sustainable; it is now expected to peak at 127.8 percent in 2013 and to decline thereafter. Portugal successfully sold 10-year bonds in May, the first long term bond sale since the programme's start. Having spiked toward 8 percent in July, the current yield on 10-year bonds is somewhat above 6 percent. However, trading volumes in Portuguese debt are thin and the outlook for debt market access by mid-2014 remains challenging. Reaffirmed ownership and resolute implementation of the programme will be essential to ensure the country's return to full market financing.

The successful completion of the combined Eight and Ninth Reviews will release EUR 3.7 billion from the EU and EUR 1.9 billion from the IMF, bringing overall financing to around EUR 72 billion (more than 90 percent of the total envelope). These disbursements could take place in November 2013 subject to the approval by ECOFIN and Eurogroup for the EU loans and the IMF Executive Board for the IMF loan. The government's programme is supported by loans from the European Union amounting to EUR 52 billion and a EUR 26 billion Extended Fund Facility with the IMF.

I. INTRODUCTION

1. The report assesses compliance with the terms and conditions set out in the Memorandum of Understanding as updated following the Seventh Review of the Portuguese Economic Adjustment Programme. The assessment is based on the findings of a joint European Commission (EC)/European Central Bank (ECB)/International Monetary Fund (IMF) staff mission to Lisbon from 16 September to 3 October.[1] In accordance with the Council Implementing Decision amending Implementing Decision 2011/344/EU on granting EU financial assistance to Portugal[2], the mission assessed compliance with the conditionality associated with the eighth disbursement and progress towards the key objectives of the programme of sound public finances, restoring competitiveness and putting Portugal's economy back on the path of sustainable growth and job creation. It also revised the specific policy conditionality while keeping unchanged its main objectives.

2. The Economic Adjustment Programme was agreed by the Ecofin Council on 17 May 2011 and by the IMF Executive Board on 20 May 2011. The programme, which covers the period 2011-2014, entails an external financing by the European Union, the euro-area Member States and the IMF of some EUR 78 billion[3], for possible fiscal financing needs and support to the banking system. One third will be financed by the European Union under the European Financial Stabilisation Mechanism (EFSM), another third by the European Financial Stability Facility (EFSF), and the remaining third by the IMF under an Extended Fund Facility.

3. A successful completion of the combined Eighth and Ninth Review will pave the way for the release of the next loan instalment of around EUR 5.6 billion. This instalment will bring EU and IMF financing to around EUR 72 billion, representing more than 90 percent of total available financial assistance.

II. ECONOMIC DEVELOPMENTS AND OUTLOOK

MACROECONOMIC OUTLOOK

4. Economic growth in the second quarter surprised on the upside, increasing by 1.1 percent quarter-on-quarter (q-o-q), following a 0.4 percent contraction in the first quarter. Growth in the second quarter was primarily driven by domestic demand, of which 0.3 pp was contributed by private consumption and 0.5 pp by changes in inventories. Gross fixed capital formation (GFCF) was flat in the second quarter; however, this figure was boosted by an aircraft purchase, excluding which the contribution of GFCF would have been of around -¼ pp. The growth contribution of net exports fell from 1.9 pp in the first quarter to 0.4 pp in the second as continued strong export growth was offset by fast growing imports partly explained by the afore-mentioned aircraft purchase but also by crude oil stocking in light of the relatively low oil prices. Hard and soft short-term indicators have continued their upward trend since the beginning of the year, pointing to a progressive bottoming out of the recession.

5. The macroeconomic outlook has been moderately revised upward compared with the forecast of the 7th programme review. While recent short-term indicators are consistent with the projected turnaround of economic activity towards the end of this year, the acceleration of GDP in the second quarter was to a large extent driven by one-off factors. The macroeconomic outlook has therefore been revised upward only moderately compared with the previous projection, largely reflecting the mechanical impact of the better-than-expected second quarter growth on the annual average growth rates. Real GDP is now forecast to contract by 1.8 percent in 2013 and to expand by 0.8 percent in 2014, corresponding to an upward revision by 0.5 pp and 0.2 pp respectively (see Table 1 for comparison with other projections). Growth is expected to be predominantly driven by net exports while the negative contribution of domestic demand is forecast to shrink from 3.7 pp in 2013 to 0.2 in 2014.

[1] The cut-off date for the macro-economic and fiscal projections of this report is 15 October 2013.

[2] OJ L 269 of 14.10.2011

3 The IMF share of the Programme was set in Special Drawing Rights (SDR). Due to a weakening of the Euro against the SDR compared with May 2011, the projected pay-out by the IMF in Euro has become higher, so the current projected Programme total is around EUR78.5 billion.

The labour market situation eased in the second quarter. Total employment increased by 0.8 percent, following a cumulative decline in employment of 4.3 percent in the previous two quarters. However, tourism and agriculture were the main contributing sectors to the employment expansion, raising questions regarding its durability. After peaking at 17.6 percent in February and March, the unemployment rate has fallen back to 16.5 percent in August. Unemployment would have been higher had the fall in employment not been partly offset by a concomitant decline in labour market participation. Youth unemployment, while also retreating from its April peak of 40.4 percent, remains of particular concern. Employment is forecast to contract by some 4 percent in 2013 and by another ½ percent in 2014, unchanged from the outlook of the 7th programme review. By contrast, the unemployment rate has been revised down by some 1 pp in 2013 and ¾ pp in 2014 and is now forecast to average at 17.4 percent in 2013 and 17.7 percent in 2014.

Table 1: Selected real GDP projections

	2013	2014
EIU (October 2013)	-1.5	0.5
PT authorities State Budget 2014 (Sept 2013)	-1.8	0.8
OECD (May 2013)	-2.7	0.2
Consensus (October 2013)	-1.9	0.1
COM 8-9th review (November 2013)	-1.8	0.8
Banco de Portugal (October 2013)	-1.6	0.3

6. **Rebalancing towards the export sector continues at a faster than expected pace.** Exports have been booming since the beginning of the year with a broad-based contribution of various sectors and significant gains in market shares for both goods and services exports. However, the surprisingly large increase in imports in the second quarter is likely to have been driven by various one-off factors (aircraft purchase, crude oil) and should subside in the forthcoming quarters. The current account balance is now forecast to reach a surplus of about 1 percent of GDP this year, revised up from 0.1 percent in the outlook of the 7th programme review, and to continue improving over the forecast horizon.

Table 2: Macroeconomic projections of the 8th and 9th programme reviews

	8th-9th Review (Sept 2013)				7th Review (March 2013)				*Difference (pp)*			
	2012	2013	2014	2015	2012	2013	2014	2015	*2012*	*2013*	*2014*	*2015*
	year-on-year volume change											
Gross domestic product	-3.2	-1.8	0.8	1.5	-3.2	-2.3	0.6	1.5	-0.1	0.6	0.1	0.0
Private consumption	-5.4	-2.5	0.1	0.7	-5.6	-3.5	0.1	1.0	0.2	1.0	0.0	-0.3
Public consumption	-4.8	-4.0	-2.8	-2.2	-4.4	-2.6	-2.0	-1.9	-0.4	-1.4	-0.8	-0.3
Fixed investment	-14.3	-8.5	1.2	3.7	-14.5	-7.7	2.5	4.9	0.2	-0.9	-1.4	-1.2
Exports of goods and services	3.2	5.8	5.0	5.3	3.3	0.8	4.4	4.9	-0.1	5.1	0.6	0.4
Imports of goods and services	-6.6	0.8	2.5	3.7	-6.9	-3.9	3.1	4.3	0.3	4.6	-0.5	-0.5
	contributions to real GDP growth											
Domestic demand excl. inventories	-6.9	-3.7	-0.3	0.7	-7.1	-4.1	0.0	1.1	0.2	0.4	-0.3	-0.5
Change in inventories	0.3	0.0	0.0	0.0	0.1	-0.1	0.0	0.1	0.2	0.1	0.0	0.0
Net trade	3.8	2.0	1.0	0.8	4.0	1.8	0.6	0.4	-0.2	0.1	0.5	0.4
Employment (y-o-y change)	-4.2	-3.9	-0.5	0.4	-4.2	-3.9	-0.5	0.4	0.0	0.1	0.0	0.0
Unemployment rate (level)	15.9	17.4	17.7	17.3	15.7	18.2	18.5	18.1	0.2	-0.8	-0.8	-0.8
HICP (y-o-y change)	2.8	0.6	1.0	1.2	2.8	0.7	1.0	1.5	0.0	-0.1	0.0	-0.3
Current external balance (% of GDP)	-1.9	0.9	0.9	1.0	-1.9	0.1	0.1	0.0	0.0	0.9	0.8	1.0
General government net lending (% of GDP)	-6.5	-5.9	-4.0	-2.5	-4.8	-5.5	-4.0	-2.5	-1.7	-0.5	0.0	0.0
General government consolidated gross debt (% of GDP)	124.1	127.8	126.7	125.7	123.0	122.4	123.7	122.5	1.1	5.5	3.0	3.2

Source: European Commission

7. **Inflation in consumer prices is decreasing.** HICP inflation dropped to 0.7 percent in the first half of this year, significantly below the euro-area rate of 1.6 percent. Annual average inflation is forecast to remain at 0.6 percent this year and to reach 1 percent in 2014. The re-instatement of two monthly bonus payments for public-sector wages (equivalent to a 16.7 percent increase in public sector wages) has a discernible effect on total-economy labour costs and will also impact on the GDP deflator in 2013.

8. **Uncertainties with regard to the macroeconomic outlook are high.** On the one hand, the on-going broad-based improvement of high frequency indicators suggests that the economy may have posted positive growth in the third quarter of this year, again beating expectations. In addition, important progress has been achieved in reforming the corporate income tax regime, the judicial sector and cutting red tape, which may pave the way for more dynamic investment. These factors would imply a slight upside risk to the headline growth forecast for

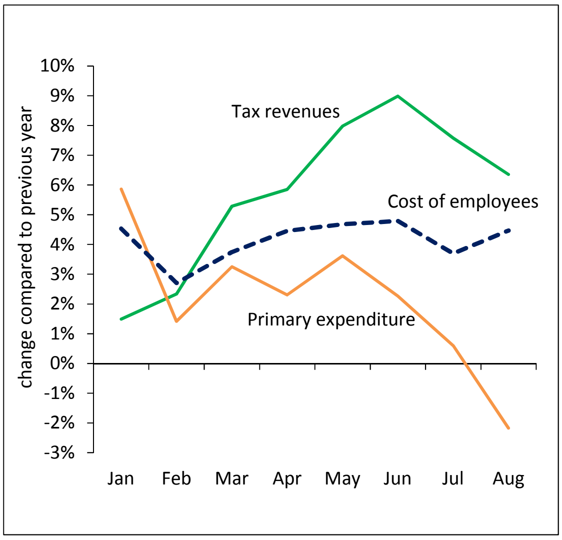
2013 and 2014. On the other hand, the sustainability of the projected recovery in 2014-15 is contingent on positive developments in trade flows and financial markets , which remain fragile. The ability of Portugal to progressively regain access to the sovereign bond market at more favourable interest rates remains a key forecast assumption, also underpinning confidence in the broader economy; a failure or significant delay in re-accessing markets would have a significant negative impact on the prospects for economic growth. In addition, household and corporate deleveraging pressures could weigh more heavily on private consumption and investment than is assumed in the baseline forecast, while the export performance strongly hinges on the assumed recovery in the euro area economy.

FISCAL DEVELOPMENTS

9. In cash terms, budgetary execution in the first eight months of the year was in line with the supplementary budget targets. Budget execution up to August recorded an improvement in the government cash deficit (net of extraordinary factors) by about 0.6 percent of GDP, compared with the same period of last year, supported by a solid performance of state tax revenues and a generally tight execution of expenditure. At the same time, shortfalls in non-tax revenues and overspending in some specific expenditure categories weigh on the outlook for budgetary execution.

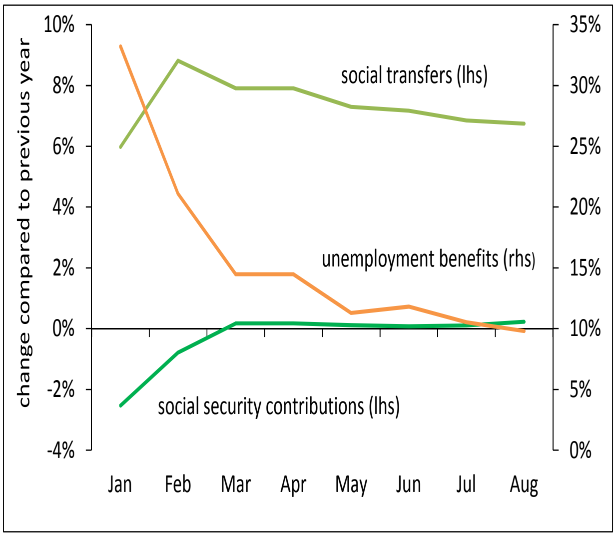
10. State tax collection in the first eight months of the year was robust. The good performance is driven by direct taxes, which up to August grew by 19 percent whereas indirect taxes fell by 2.3 percent, compared with the same period of last year. Both personal income and corporate income tax collection were ahead of target as a result of enhanced revenue collection efforts (e.g. efficiency of the large taxpayer office), as well as policy measures introduced earlier this year, such as the changes in the advanced payments mechanism or the introduction of limits to loss offsets for corporate taxation. A better-than-expected macroeconomic performance may also have contributed to the improved collection of these taxes. VAT revenues up to August fell by 2.1 percent, in line with the projections of the supplementary budget. It is worth noting, however, that VAT collection has improved in some of the sectors where incentives were introduced for final customers to ask for invoices (notably, in the restaurant and hotel sector). A decline was also recorded for other indirect taxes except for the circulation tax and the tax on alcoholic beverages. Stamp duties were clearly below target, mainly owing to the low execution of the newly introduced tax on high-value properties.

Graph 1. Budget execution: Tax Revenues, Cost of Employees and Primary Expenditure: January-August (cash-data)



Note: includes non-consolidated data for the State and Autonomous Funds and Services. Primary expenditure includes data for the State subsector only.
Source: Ministry of Finance and Commission services

Graph 2. Budgetary outturn for Social Security in 2012: January – August (cash-data)



Note: includes data for Social Security
Source: Ministry of Finance and Commission services

11. Expenditure execution in the first eight months of the year was broadly in line with the supplementary budget projections, but overruns are likely in the rest of the year. Risks of overruns stem, in particular, from interest payments (which are paid mainly in October), the outstanding 14th salary bonus payment (as the share of public sector workers who opted for deferred payment in November could be high) and some delays in the execution of other expenses. In addition, receipts from some non-tax revenues (sales and other current and capital revenue) have been below expectations while some outlays, such as the contribution to the EU budget, have turned out higher than projected. The fiscal gap implied by the expected over-run in expenditure and shortfall in non-tax receipts will be compensated by a number of ad hoc measures (see below).

12. Social Security recorded a positive cash balance in the first eight months of the year. This is explained by the extraordinary transfer from the State agreed in the supplementary budget and increased transfers from the European Social Fund. Social security contributions are broadly in line with the estimates of the supplementary budget. However, one of the measures introduced in 2013, namely social contributions from unemployment and sickness benefits above minimum levels, is yielding less than expected due to technical implementation problems following its redesign after the ruling of the Constitutional Court in April. Nevertheless, the overall collection of social contributions is in line with projections due to the over-performance of the "extraordinary solidarity contribution" (CES) on pensions, the better macroeconomic environment and increased collection efficiency. On the expenditure side, unemployment benefits and subsidies to employment support are now expected to be lower than initially planned on the back of a more favourable labour marketsituation. Social transfers are expected to be substantially larger than in the previous year due to the reinstatement of the two bonus pension payments, but this effect was already budgeted. The public sector pension regime (Caixa Gral de Aposentações – CGA) is expected to require additional state transfers to compensate for the underperformance of one of the measures introduced in the 2013 budget (the inclusion of cash supplements in the contributions' base).

13. Budget execution in other sectors of general government is broadly in line with expectations. The balance of state-owned enterprises continued improving up to August owing to cost-reduction efforts and voluntary redundancy programs and despite strains from the reinstatement of the 13th and 14th bonus salaries. On the other hand, receipts from the reprogramming of EU funds have turned out lower than planned. In the health sector, significant cost reductions since 2010 have been partially reversed in 2013 as a result of the reinstatement of the 13th and 14th bonus salaries and the increase in contributions to the public sector pension system. The reduction in budget transfers to the sector as a whole which also translated into a significant reduction of transfers to SOE hospitals has led to an underfunding and resulted in a renewed build-up of arrears (see below). Local governments' budget execution is in line with projections, despite the somewhat subdued collection of the recurrent property tax (*Imposto Municipal sobre Imóveis*, IMI) up to August. However, it has to be taken into account that 2013 is the first year that the IMI collection is based on three installments instead of two, which makes the accurate intra-annual profile of IMI collection difficult to assess. At the regional level, budgetary execution of the Autonomous Region of Açores is in line with projections and that of the Autonomous Region of Madeira better than expected, supported among other factors by a good performance of corporate income tax and strict expenditure control.

14. In national account terms, the government deficit in the first half of 2013 reached 7.1 percent of GDP. Excluding the extraordinary capital injection to BANIF, the deficit in the first semester amounted to 6.2 percent of GDP, which represents an improvement by 0.6 pp of GDP compared with the deficit in the same period of last year - if one-offs are excluded. The attainment of the 5.5 percent of GDP deficit target for the whole year is contingent on overcoming a number of challenges, as some deviations from the national accounts estimates underlying the supplementary budget were identified during the mission (see below).

Arrears

15. Whereas the overall amount of arrears is lower than at the beginning of the year, progress in preventing new arrears from accumulating is mixed. The implementation of the 'Support Programme for the Local Economy' (PAEL) is behind a large drop in local government arrears. The overall envelope of the programme amounts to about EUR 800 million, which is below the EUR 1 billion initially envisaged. The Court of Auditors already cleared most of the programmes submitted by the municipalities and about EUR 400 mn have already been transferred, while another EUR 200 million still awaits approval by the Court of Auditors. It is likely that a part of the remaining EUR 200 million will not be disbursed until the end of this year. All in all, local government arrears should at least be halved by the end of the year compared with the EUR 1.2 billion outstanding in January. The Autonomous Region of Madeira is gradually implementing its strategy to pay arrears after the European Commission's Competition Directorate General cleared the operation involving a EUR 1.1 billion state-guaranteed loan. In the health sector, after successfully concluding the negotiations with the pharmaceutical industry in September, the second debt settlement programme, worth EUR 432 million, will soon take off. Even if a substantial decrease in the stock of arrears is to be expected by the end of the year, new arrears are still being accumulated in some sectors – particularly SOEs hospitals – in spite of the commitment control law. SOEs hospitals accumulate about EUR 34 million of new arrears per month which compares with about EUR 75 million last year. Although the reduction is significant, more efforts are needed to reach the overall target of halting any further accumulation. In the coming weeks, a follow-up IMF-led technical assistance mission will analyse the functioning of the commitment control law, particularly in problem areas such as SOE hospitals.

Table 2: Stock of arrears January-July 2013 (in EUR million)

	2013 (1)						(2)	(3)=(2)-(1)	
Subsector of the General Government	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**∆ *Jul-Jan***	**% total**
Central Government excluding NHS	54	57	54	61	56	53	55	1	2%
NHS classified in General Government	23	28	26	48	14	20	32	9	1%
Reclassified entities	19	18	18	19	19	18	18	0	1%
Local Government	1,234	1,158	1,130	1,084	991	949	902	-331	31%
Regional Government	946	945	952	1,073	1,061	1,066	911	-35	32%
Total	2,274	2,206	2,180	2,284	2,141	2,107	1,918	-357	66%
Total Consolidated	2,199	2,133	2,107	2,217	2,077	2,047	1,864	-335	65%
Other entities outside General Government									
Enterprises excluding NHS	40	45	49	50	51	56	74	34	3%
NHS incorporated hospitals	727	784	773	817	858	917	951	224	33%
p.m.: health sector inside + outside GG	750	812	799	864	872	937	982	232	34%
TOTAL	2,966	2,962	2,929	3,084	2,986	3,020	2,888	-77	
p.m.: percent of GDP	1.8	1.8	1.8	1.9	1.8	1.9	1.8		

Source: Ministry of Finance and Commission serv ices

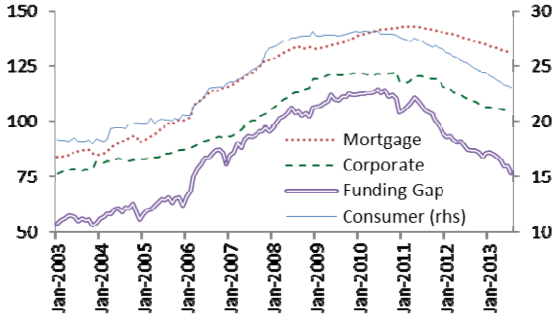
Note: Consolidated data concerns data net of intra-gov ernment sector arrears. Total amounts adjusted for arrears' settlement.

FINANCIAL MARKETS AND FINANCIAL SECTOR DEVELOPMENTS

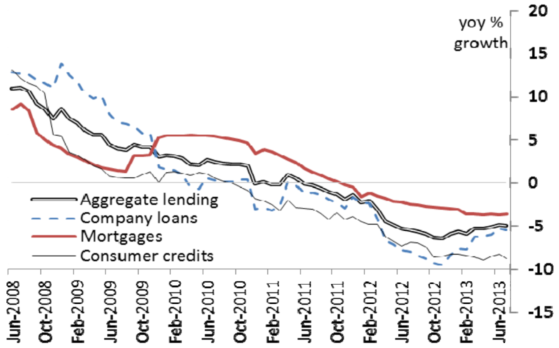
16. The provision of bank lending to the non-financial private sector continues to decline, although at a slower pace. New corporate lending over the last 12 months has been 20 percent below the past decade's annual average, while new loans under a EUR 1 million ceiling are about 25 percent below the corresponding average. Fresh monthly mortgages amount to roughly a sixth compared with the decade's average which is partly explained by the high interest rates on mortgages compared to pre-Lehman years, but mainly by low consumer confidence. As housing loans typically have a longer maturity than loans to non-financial corporations, the mortgage stock fell by 3.6 percent between July 2012 and July 2013 whereas loans to companies contracted by 5.5 percent. New consumer credit was a bit more than half the previous decade's average causing the stock of outstanding loans to fall by 8.7 percent over the same period (Graphs 3 and 4).

Graph 3: Loan stock evolution per segment

Graph 4: Yearly growth per loan segment



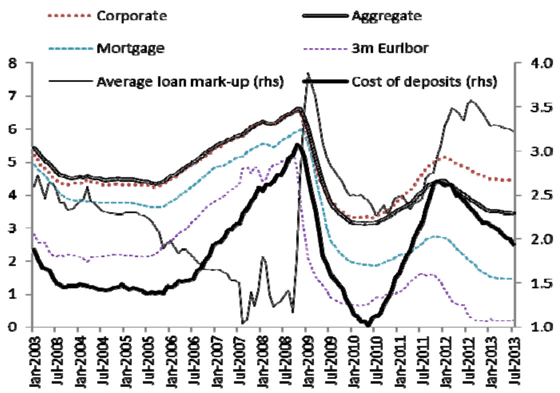
Source: Bank of Portugal



Source: Bank of Portugal

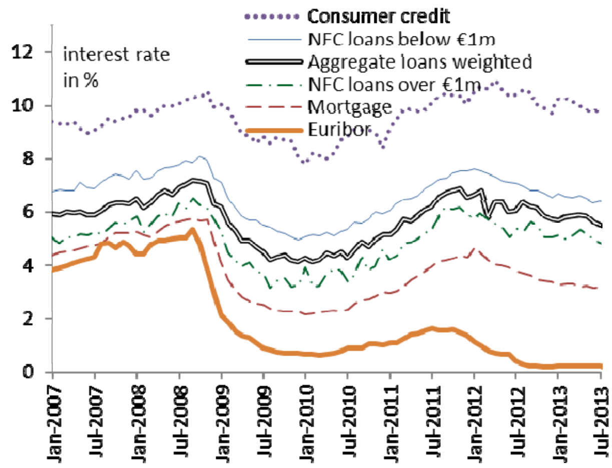
17. Reduced remuneration of deposits has fed through to lower loan rates. Due to better capitalisation and increased system liquidity Portuguese banks have reduced deposit remuneration rates thus contributing to reduce their overall cost of funding. The improved funding situation has led to higher competition in lending, in particular for lower risk SMEs resulting in slightly declining lending rates for this corporate segment compared with the situation one year ago (Graph 6). This can be traced in the average loan mark-up on Euribor, expressed as a difference between the latter and the interest banks earn on aggregate loans (Graph 5).

Graph 5: Nominal interest rate earned by loan stock segment and average loan mark-up



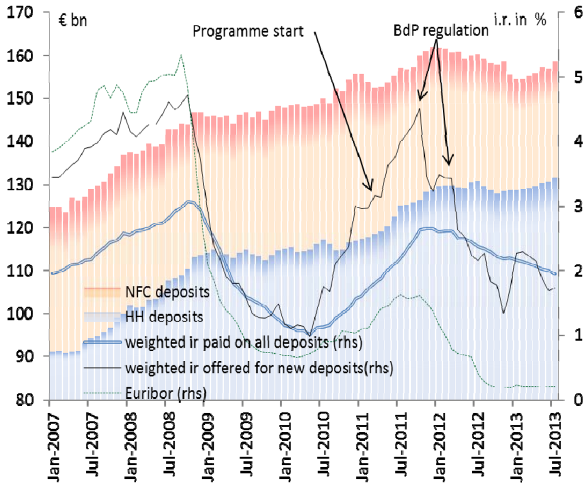
Source: Bank of Portugal

Graph 6: Interest rate for new loans, evolution per segment



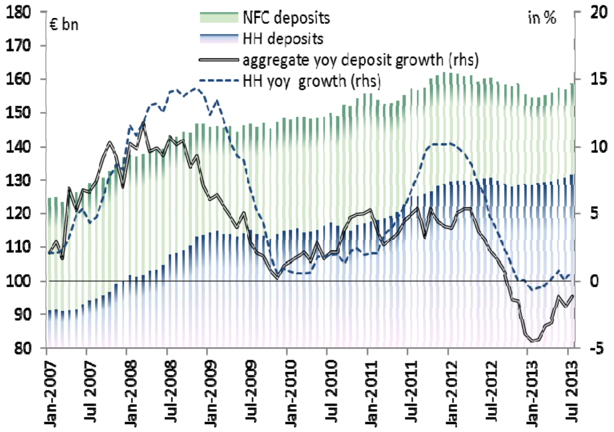
Source: Bank of Portugal

Graph 7: Lower deposit remuneration slowly brings down the cost of funding



Source: Bank of Portugal,

Graph 8: Deposit growth by segment



Source: Bank of Portugal,

18. Household deposits are growing again, while corporate deposits are no longer declining. Deposit interest rates continued to come down in 2013. In Portugal, the share of longer term deposits in the deposit base is higher than in other euro area countries. Consequently, it takes relatively longer for the flow of new deposits to influence the stock's average interest rate (Graph 7). The weighted cost of deposits fell below 2 percent in July. Overall, deposits have been growing again since the start of the year when the decline in company deposits stopped. Due to the reinstatement of the 13th and 14th salary in the public sector, household deposits reached a new all-time high in July, with the underlying upward trend presumably driven by precautionary savings (Graph 8).

Table 3: Soundness indicators

%	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Return on Equity (1)	7.2	7.6	7.1	6.7	6.2	4.3	2.4	-3.8	6.3	1.0	-0.3	-4.2	-3.8	-7.2
Gross Income on Assets	2.5	2.6	2.6	2.7	2.4	2.5	2.5	2.5	2.6	2.7	2.6	2.5	2.1	2.1
Cost to Income Ratio	57.7	57.1	57.2	57.6	59.1	58.3	59.0	61.4	56.1	52.9	56.5	58.9	67.5	68.9
Non-Performing Loans	5.5	5.6	5.9	5.3	5.7	6.3	6.9	7.4	8.1	9.2	9.9	9.8	10.4	10.6
Coverage Ratio	62.9	62.1	60.2	60.8	59.5	57.9	55.5	57.8	53.5	51.2	50.9	54.4	54.1	54.1
Capital Adequacy Ratio (2)	11.3	10.9	11.0	11.1	11.4	11.0	10.1	10.7	10.7	12.3	12.3	12.6	13.0	13.1
Core Tier 1 Ratio (3)	7.8	7.8	8.0	8.1	8.4	8.7	8.5	9.6	9.6	11.2	11.3	11.5	11.9	11.9
Loan-to-deposit ratio	163.4	166.6	158.4	157.8	156.7	149.7	146.2	140.2	136.9	136.3	133.3	127.9	124.0	122.6

(1) Income before minority interests /Average shareholders equity before MI
(2) Excluding the banks in resolution
(3) The Core Tier 1 ratio according to Programme definition and excluding the banks in resolution

Profitability prospects remain weak for most Portuguese banks. Subdued economic activity and high unemployment in recent years has put pressure on the balance sheets of banks. The banking sector has accumulated losses for an extended period, recording only one quarter of positive net profits over the past two years. Over EUR 1 billion of losses in the first half of 2013, of which EUR 765 million alone in the second quarter, clearly highlight the strains under which the banking sector remains, with a meaningful portion of the losses explained by the recognition of losses associated with non-performing loans. In addition to the gradual deterioration in the quality of assets, banks have experienced a squeeze on net interest income (down by 29 percent yoy) as a result of a combination of persistently low interest rates and falling new lending volumes.(see Table 3). The costs of CoCos have added to the already high funding costs since the beginning of 2013. Going forward, asset quality may deteriorate further, although at a slower pace, while net income is projected to recover from 2014 onwards. The net interest margin of banks should remain low also due to the banks' limited scope for re-pricing their assets. However, the major improvements in capital and funding structures coupled with the available liquidity put the banking sector in a better position than a year ago.

19. Banks have become less restrictive in financing the economy[4]. In a context of improved solvency and more available liquidity, credit spreads on new loans have been gradually declining, although a relatively high

[4] See also the conclusions from the Bank Lending Survey, July 2013, Banco de Portugal.

risk perception remains one of the main drivers of supply constraints as reported by banking sector sources. In parallel, credit standards and terms applied to new lending have not shown any major changes. However, there is a general tendency towards adopting slightly less restrictive criteria in terms of lending margins and non-interest charges. These affirmations are also reflected in the perception that non-financial corporations convey when applying for new or rolling over their credit; only 10 percent of firms active in the services sector or manufacturing industry mention bank credit access as a major hurdle for their business development plans. However, that number rises to 55 percent for construction and real estate related firms. Lending to households remains depressed midst low consumer confidence and general reluctance to spend both on housing and on durable goods. Nonetheless, credit standards and conditions in the household segment remain broadly unchanged and the view of banking sources is that the decline in new household lending is mostly justified by demand side factors, including the low albeit improving consumer confidence levels and the continued subdued situation in the real estate market.

III. PROGRAMME IMPLEMENTATION

20. The joint EC/ECB/IMF staff mission concluded that the implementation of the programme is broadly on track.

Table 4: Summary of compliance with policy conditionality for the Eighth and Ninth Review

	Status
Fiscal policy	For 2013, the Q3 quantitative performance criteria on the general government cash-adjusted deficit and debt are within reach. In national accounts terms, some deviations on the budgetary execution with respect to the supplementary budget have been identified, but the government has taken corrective measures to secure the 5.5 percent of GDP deficit target. However, the improvement of the structural balance will be lower than initially expected due to the incomplete implementation of some measures and replacement by one-offs. Part of the 2013 slippage will carry over to the next year, partially shifting the fiscal effort necessary to continue the consolidation path. The fiscal adjustment towards the 4 percent of GDP deficit target in 2014 will predominantly proceed on the basis of the public expenditure review and other smaller-scale measures as defined in the draft Budget.
Fiscal-structural	<u>Public finance management:</u> The reform of the Budget Framework Law is ongoing, although with some delays with respect to the original schedule. Given the envisaged scope of the reform, the deadline for submission to Parliament was postponed to the first quarter of 2014, following a report identifying the main areas of reform. In order to ensure a rapid and complete implementation after approval, an action plan identifying the operational changes necessary will also be prepared. The authorities are executing the action plan for public financial management defined in the 2013 budget. <u>Revenue administration:</u> The recent VAT e-invoicing reform is improving efficiency in the fight against tax evasion and supporting tax collection. The information gathered following recent reforms on data transmission will underpin further analysis of the current tax compliance situation and prompt targeted audits. Ongoing projects to strengthen compliance are making good progress, whilst there are some delays in the recruitment of tax inspectors and the restructuring of the local tax administration network. <u>Regional and local administration reform:</u> The new regional and local finance laws were approved and will enter into force at the beginning of 2014. The reduction of the number of parishes from 4050 to 2882 became effective after the local elections as the newly elected officials took office. Budget execution in Madeira and Azores is in line with expectations. <u>Public administration reform:</u> The process of staff reduction is ahead of the programme objective (reducing staff across all layers of government by 2 percent per year from 2012 to 2014) as a 6 percent reduction relative to end-2011 was already achieved by June 2013. The application of shared services for financial resources in the central administration ('GeRFiP') and for human resources in the Ministry of Finance ('GeRHuP') is improving management efficiency.

	State-owned enterprises (SOEs): The new legal regime for SOEs was published (Decree-Law 133/2013, 3 October) and shall enter into force by 3 December. The shareholder's role is given to the Ministry of Finance and a new dedicated taskforce will be appointed to carry out the tasks that are now centrally monitored by the Ministry. Debt management, risk derivative instruments and cash position of SOEs shall be centrally managed by the treasury agency. Health: Policy implementation continues broadly in line with programme deadlines. Reforms have delivered substantial efficiency gains and related savings and a large stock of overdue debt will be paid by the end of this year (though not fully eliminated). Increased labour costs have nevertheless absorbed some of these savings and, as a result, the authorities will have to intensify existing reforms. The authorities reconfirmed their commitment to implement a hospital reform which is ongoing and to continue to fine-tune the set of measures concerning pharmaceuticals, notably in hospital settings where savings have been slower to materialise.
Financial sector	Monitoring banks’ potential capital shortfalls: Further to the reflection the OIP findings in the implementation of the SIP recommendations on asset quality and stress testing methodologies, the update of the treatment of collective impairments was finalised. Results of the review of the impairments in the credit portfolios of the eight largest national banking groups (only components more strongly affected by business cycle) confirmed the adequacy of the level of impairments booked in the balance sheet and the resilience of the banking system with respect to solvency. Supervisory organisation: BdP is carrying out the preparatory work leading to the conclusion of a thematic review of banks' operational capacity in the area of loan restructuring and asset recovery. A new supervisory function was set up within the BdP and the assessment of the distressed loans management framework is ongoing. Ex-BPN legacy management: Parvalorem concluded the competitive bidding process to outsource the management of the credits currently held by Parvalorem, having awarded the contract to two contractors. Early intervention, resolution and deposit guarantee framework: BdP concluded the analysis of the recovery plans of the eight largest banking groups. Guidelines to the system are being finalised. The Resolution Fund is up and running since Q1 2013 and received due contributions from the banks. A dedicated resolution unit was set up within BdP. Financing alternatives for the corporate sector: The preliminary detailed assessment on the grouped issuance of corporate debt has been submitted but issuance was postponed to mid-2014. The first draft of the amendments to the rules governing the commercial paper market was submitted and discussed. Government-sponsored credit lines: An external audit of the National Guarantee System was conducted and a roadmap presented with a set of milestones to be accomplished. The first quarterly monitoring report on the allocation of government-sponsored credit lines was submitted. Corporate insolvency: The authorities released in July the first quarterly monitoring report on the implementation of the new restructuring tools. The results of a survey of insolvency stakeholders were presented.
Reform of labour, goods and services markets	Labour market and education: The third stage of the severance payments reform was implemented on 1 October 2013. It reduces severance payments up to 12 days per year of work. The measures taken to further facilitate the conclusion of agreements at firm level have not yet produced effects. In addition, the Constitutional Court ruled against part of the revisions of the definition of fair dismissal introduced by the revised Labour Code in August 2012. In the area of education, the monitoring tool has been further enriched and the number of trust agreements signed is beyond expectations; the setting up of the professional schools of reference is behind schedule. Energy: Implementation of the electricity costs reduction and tariff debt elimination by 2020 is on-going. The new update report of the energy tariff debt dynamics shows that the elimination of the tariff debt by 2020 would require real electricity

	price increases of close to 2 percent per year and even then the tariff debt will not be eliminated without additional measures. The negotiations on the Sines and Pego power plants have reached an impasse. Following the submission of the report on the CMEC scheme and the process for extension of the concession of the public hydro resource, further analysis of, and discussions on the consequences of the report and the potential need for additional measures will continue in the next review. The remuneration scheme for co-generation facilities that do not use a renewable source of energy was revised. A new energy levy on generators is under preparation. Its impact on the tariff debt and end user prices will have to be monitored. Transport: There is little progress to be highlighted as most reforms are delayed. Policy reforms in ports are urgent to increase their efficiency and ability to be competitive in international markets. Further progress is required to ensure operational balance of the rail infrastructure manager by 2015. A clear long-term strategy for the transport sector is still missing. The transfer of the CP Carga terminals to REFER is expected by the end of the year. Services and professions: Progress on the adoption of the legislative amendments to align legislation with the principles of the Services Directive has continued steadily. However the Construction laws have further delays. The submission of the revised bylaws to the Parliament following the adoption of the horizontal framework law on public professional associations is delayed. Some progress is observed in making the Point of Single Contact fully operational.
Reform of framework conditions	Housing market: The process of updating rental contracts signed before 1990 and their gradual transition to the general system has started. The Monitoring Committee which has been set up to monitor the impact of the reform has already delivered its first quarterly report. Competition and sectorial regulators: The framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs) was published in August 2013. The corresponding amendments to the bylaws of the NRA will be approved by the government by end of November. Judicial system: Remarkable progress has been achieved in implementing the ambitious programme of judicial reform. Significant headway has also been made in reducing the backlog of court cases. Business environment: The recently introduced VAT cash accounting regime is expected to improve the financial and cash flow situation of businesses. The Commission considers that Decree Law 62/2013 of 10 May adopted by the government is not fully in line with the New Late Payments Directive 2011/7/EU. Licensing: A draft Base Law for Soils, Territorial Planning and Urbanism has been submitted to Parliament and some other pieces of legislation have been adopted to make a more business-friendly regulatory system. However, most legal reforms envisaged to ease licensing requirements to businesses are behind schedule.
Data submission	Requirements under the Programme have been observed. Work is ongoing to improve further data submission.

FISCAL POLICY

Fiscal consolidation in 2013

21. The general government cash-adjusted deficit for programme purposes reached EUR 4,795 million up to August. This is well below the third quarter target of EUR 7,300 million established in the performance criteria of the Memorandum of Economic and Financial Policies (MEFP), and leaves room for accommodating the cumulative deficit of the month of September. The achievement of this cash position was possible due to relatively robust tax revenue growth and expenditure control in the first eight months of the year, as described above. However, the remainder of the year will put substantial strain on some items, especially on the expenditure side (e.g. interest payments, reinstatement of 14th bonus salary and pension). Budgetary challenges have also been identified as a result of lower-than-expected non-tax revenues.

22. The mission has revised the 2013 fiscal projections in national accounts terms and identified some deviations with respect to the supplementary budget. These include a capital injection into BANIF (0.4 percent of GDP), which is however not considered for programme purposes. The remaining deviations stem from shortfalls related to the reprogramming of EU funds and the postponement of the sale of a port concession and other factors such as the underperformance of some non-tax revenues, the transfer to Greece of dividends from Greek bonds holdings in Banco de Portugal's investment portfolio, lower than expected contributions to the public employees' pension scheme and expenditure overruns on the wage bill and on intermediate consumption. The net effect of these slippages is estimated to increase the 2013 deficit by 0.5 percent of GDP (excluding the capital injection into BANIF). The net effect would have been higher had the provisional budget allocation of 0.3 percent of GDP not been used to partly offset the overruns.

23. The government has taken corrective measures (equivalent to 0.5 percent of GDP) to ensure that the 5.5 percent of GDP deficit target (net of bank recapitalisation costs) is met. These include, notably, the reduction of available funds for investment and tighter control on intermediate consumption of line ministries amounting to an overall 0.1 percent of GDP. In addition, the government has announced a debt recovery scheme for taxes and social security contributions to be implemented before year end and expected to yield about 0.4 percent of GDP in 2013. Overall, the budget deficit target of 5.5 percent of GDP for 2013 remains in reach subject to the successful implementation of the corrective measures as well as continued tight expenditure control during the rest of the year, as announced by the government.

24. The fiscal effort as measured by the improvement in the structural balance is expected to be limited to 0.5 percent of GDP this year. This falls slightly short of the 0.6 percent envisaged at the 7th review. The expected underperformance is explained by budgetary overruns as detailed above and the delayed implementation, and/or the overestimation in the yields, of some consolidation measures, especially the measures introduced with the supplementary budget in response to the Constitutional Court (CC) ruling of April 2013. The government had reacted promptly to the CC ruling in April by proposing replacement measures, but some of these measures, such as the reprogramming of the EU funds or the changes to the unemployment and sickness benefits, proved to be technically difficult to implement within the necessary timeframe. The negative opinion of the CC at the end of August on the requalification scheme also required the modification of the relevant proposal to accommodate the concerns of the Court. The political crisis in July and the subsequent government reshuffle also delayed the implementation of some measures. In addition, in purely mechanical terms the improvement in the macroeconomic conditions has enhanced the cyclical component of the deficit reduction at the cost of the structural component.

Fiscal consolidation in 2014

25. The government has reaffirmed its commitment to the 4 percent of GDP deficit target for 2014. The fiscal projections are underpinned by consolidation measures with an estimated net amount of 2.3 percent of GDP, including permanent measures and some one-offs. In net terms, more than 70 percent of the measures are expenditure reducing (80 percent in gross terms). In spite of a projected improvement in the macroeconomic outlook, these measures are needed to cater for a negative primary balance drift of 0.5 percent of GDP reflecting, amongst others, the carry-over from the slippage in 2013 to 2014 and the rebuilding of the provisional budget allocation (see Table 5). Offsetting this effect will therefore require a higher consolidation effort in 2014 than envisaged at the 7th review. In fact, the cumulative value of the consolidation package necessary to achieve the agreed fiscal targets has not changed (i.e. about EUR 4.7 billion over 2013-2014). However, a part of the effort has been shifted to 2014 since the initially planned frontloading to 2013 of about 0.8 percent of GDP of the consolidation package has been achieved only partially. All in all, the structural balance is expected to improve by 1.1 percent of GDP in 2014 (see Table 6).

Table 5: Arithmetic of the government deficit: from the deficit in one year to the next

(+) means balance-improving impact; (-) means balance-reducing impact	% of GDP
2011 balance (observed)	**-4.3**
p.m. 2011 balance (without one-offs)	**-7.3**
Primary balance drift in 2012	-4.0
Change in interest expenditure	-0.3
Dissipation of one-offs and non-recurrent effects from previous year	-3.0
Consolidation measures	5.8
One-off measures	-0.6
2012 balance (observed)*	**-6.5**
p.m. 2012 balance (without one-offs)	**-5.8**
Primary balance drift in 2013	-3.0
Change in interest expenditure	0.0
Dissipation of one-offs and non-recurrent effects from previous year	0.6
Consolidation measures	4.5
Reistatement of the 13th and 14th salary and pension	-1.5
One-off measures	-0.1
2013 balance (target)*	**-5.9**
p.m. 2013 balance (without one-offs)	**-5.8**
Primary balance drift in 2014	-0.5
Change in interest expenditure	0.0
Dissipation of one-offs and non-recurrent effects from previous year	0.1
Consolidation measures	2.2
One-off measures	0.1
2014 balance (target)	**-4.0**
p.m. 2014 balance (without one-offs)	**-4.1**

Balance in year t equals balance in year t-1 plus nominal primary balance drift in year t, plus the impact of the change in interest expenditure in year t, plus the impact of the dissipation of the one-offs and non-recurrent measures from year t, plus the impact of new consolidation measures in year t.

The Primary Balance Drift includes the change in the balance level that would take place without discretionary measures, removing the effect of one-off measures. It includes the impact of economic activity on the balance, including the composition of growth, and the structural increase in expenditure in real terms, e.g. the increase in pension expenditure.

* For the purposes of the Programme, the budget deficit in 2012 would exclude the impact of CGD recapitalisation (about 0.5% of GDP), and in 2013 BANIF recapitalisation (about 0.4% of GDP).

26. **The fiscal consolidation is predominantly based on the savings measures identified in the framework of the public expenditure review (PER)**. The PER package is an important element of the broader reform of the State with the objective of increasing equity and efficiency in the provision of public services and social transfers. The PER aimed at identifying savings and the potential for streamlining processes in the public administration with the direct involvement of line ministries. The savings identified include permanent expenditure-reducing measures of EUR 3.1 billion (1.8 percent of GDP)] in 2014. The PER measures act along three main axes: (1) reduction of the public sector wage bill; (2) pension reform and (3) sectoral expenditure cuts across line ministries and programmes. The reduction in the wage bill in 2014 aims at diminishing the size of the public-sector work force while shifting its composition towards higher-skilled employees, aligning the public sector work rules with those of the private sector and making the remuneration policy more transparent and merit-based. Specific reforms include the implementation of a requalification scheme that would allow to adjust the skills of the workforce to the public sector needs, aligning public sector working hours with those in the private sector (i.e. increase from 35 to 40 hours work week), introduction of a bank of hours, reduction in holiday entitlements, the implementation of a mutual agreement redundancy scheme (which is estimated to generate one-time upfront costs of slightly more than 0.1 percent of GDP) and the introduction of a single wage scale as well as the streamlining of wage supplements. A comprehensive pension reform will generate another important part of the savings and will be based on equity principles and income progressivity, thereby protecting the lowest pensions. Specifically, the reforms aim at reducing the current differences between the civil servants' system (CGA) and the general

system and at increasing the statutory retirement age by changes to the sustainability factor. The 'extraordinary solidarity contribution' introduced in 2013, worth 0.3 percent of GDP, will be maintained. However, this measure will be adapted to take into account the cumulative impact of other pension reforms . Survivors' pensions of both CGA and the general pension regime will be streamlined, in particular in cases where these accumulate with other pensions. Finally, savings in intermediate consumption and expenditure programmes across line ministries will be substantially stepped up.

Table 6: Fiscal targets and structural adjustment 2011-2015

	2011	2012	2013	2014	2015
Budget balance	-4.3	-6.5	-5.9	-4.0	-2.5
Programme budget balance	-4.3	-6.0	-5.5	-4.0	-2.5
Budget balance, net of one-offs	-7.3	-5.8	-5.8	-4.2	-2.5
Structural balance	-6.5	-4.2	-3.7	-2.6	-1.8
Primary balance	-0.3	-2.1	-1.6	0.3	1.7
Structural primary balance	-2.5	0.2	0.7	1.7	2.5
Fiscal adjustment	3.5	2.6	0.5	1.0	0.8
Fiscal effort (EDP definition)	2.3	2.3	0.5	1.1	0.9

27. In addition, the government will implement some smaller-scale permanent revenue consolidation measures worth about 0.4 percent of GDP. These measures aim at further improving the efficiency and equity in the current tax and benefit system and reducing excessive rents in some sectors. These include an increase in the corporate tax rate on expenses related to company cars, higher excises for tobacco and alcohol, a surcharge on the car tax on diesel passenger vehicles, removing fiscal exemptions in property taxation for pension and real state funds as well as caps to the social security contributions of members of statutory bodies. In addition, a special levy on energy will be imposed to boost tax receipts and with the additional effect of curbing excessive rents from the energy sector. Part of the revenue generated by this levy will be used to reduce the tariff debt. The levy on financial institutions (banking system) will be increased and the fee on media spectrum will be introduced. Finally, the government plans to sell online gambling licences and to tax this activity, regularising a growing market that is currently not properly regulated.

28. A number of one-off measures also aim to contribute to the achievement of the deficit target, more than offsetting the one-off costs related to the mutual agreement termination of public sector employment contracts. These measures consist of the transfer of the CTT (postal service) health fund to the government sector, the sale of aport and silos concessions as well as special dividends earned on the sale of excess oil reserves from a public company.

29. The legislative processes underpinning the PER reforms are underway but some measures have suffered setbacks. The mutual agreement redundancy scheme is already in place for the less qualified public sector employees. Other schemes targeted to specific public sector functions are currently under preparation. The implementation of the 40-hour work week has already started while simultaneously being assessed by the Constitutional Court. The requalification scheme has been revised to address the constitutional concerns raised by the Court at the end of August. Overall, several of the legislative and regulatory amendments necessary to implement the PER reforms are already in force or await Parliamentary approval. Other legislative changes were submitted to Parliament in October or are implemented through budget provisions and should enter into force as of 1 January 2014. In order to mitigate the political and legal risks, it will be important to seek broad political support. The President of the Republic has the right to submit reform proposals which are potentially contestable from a constitutional point of view to a prior legal review by the Constitutional Court which has to be completed within four weeks. Should some of the measures be found unconstitutional, either following such a review or after a legally binding Court ruling, the government would have to reformulate the Budget in order to meet the agreed deficit target. However, in view of the rapidly shrinking room of manoeuvre in identifying appropriate consolidation measures this would imply increasing risks to growth and employment and would reduce the prospects for a sustained return to financial markets.

30. As part of the reforms to boost competitiveness and growth, the Portuguese government is undertaking a comprehensive reform of the corporate income tax (CIT), due to come into force as from 2014. The reform, ambitious in scope, has been carefully designed by a reform Committee and submitted to public consultation over the summer. It encompasses a substantial simplification of the tax structure, reduces compliance and administrative costs and revamps the tax code to make Portugal more attractive to foreign investment, whilst applying strict anti-abuse provisions. Notably, it also aims at gradually lowering the marginal tax rate to stimulate higher investment and growth. It reduces the strong debt-bias of the Portuguese corporate tax system and extends the loss carry-forward-period. Simulations of the EU Commission's QUEST model (calibrated for Portugal) show a positive impact of the CIT reform on the Portuguese economy in the medium term. Yet, it will also generate overall revenue losses in the early years that need to be financed within the existing budgetary envelopes.

Fiscal consolidation over the medium term

31. Sustained fiscal consolidation beyond the programme period should bring the deficit below 3 percent of GDP in 2015. Under the current macroeconomic scenario permanent fiscal consolidation measures amounting to about 1.2 percent of GDP will be necessary to reach the 2.5 percent deficit target in 2015. This translates into a fiscal effort, as measured by the change in the structural balance, of 0.9 percent of GDP and an improvement in the structural primary balance from 1.7% of GDP to 2.5% of GDP (see Table 6). The package adopted by the government on 2 May already defines about 0.3 percent of additional measures through further reductions in the wage bill and expenditure cuts across line ministries and programmes. Going further, the government is committed to fulfil the requirements of the fiscal compact of a structural deficit of 0.5 percent of GDP by 2017.

Debt developments

32. The debt-to-GDP ratio is expected to peak at 127.8 percent in 2013 and to decline thereafter. The upward revision with respect to the 7th review is explained by the correction of the 2012 debt data, which is now slightly higher, and the non-realisation of some short-term debt reducing operations. In particular, the Social Security Financial Stabilisation Fund is now expected to increase its holding of Portuguese Government Bonds more progressively and privatisation receipts will be mostly retained in Parpublica as the company will possibly be reclassified within the general government in September 2014 when the new ESA 2010 enters into force. Moreover, the Treasury cash balances at the end of the year are estimated to be higher by about EUR 2 billion. These effects are somewhat mitigated by a better nominal GDP projection. Assuming further that the Medium Term Objective (MTO) of a structural deficit of 0.5 percent will be reached from 2017 on, the debt-to-GDP ratio would be on a steeper downward path falling below 100 percent in the second half of the next decade.

FISCAL STRUCTURAL REFORMS

Fiscal policy framework

33. Portugal remains committed to further strengthening Public Financial Management. The Ministry of Finance has set up a Reform Unit with the broad remit of revising the Budget Framework Law, which is currently fragmented, imprecise in some areas and too detailed in others. An IMF-led technical assistance mission took place in July 2013 recommending a deep restructuring of the law to be organised along the major phases of the budget preparation and execution cycle, reducing the detailed requirements of budget documentation and improving the provisions of cash management and auditing. The new law should also reform the organisational structure by empowering programme coordinators and modernising the financial departments in line ministries. Finally, the classification structure of the budget should be simplified. Given the scope of the reform, the deadline for submission to Parliament of a draft law was postponed to the first quarter of 2014 following a report by the Reform Unit assessing the strengths and weaknesses of the BFL and providing suggestions for amendments including a new structure. Adequate implementation of the law will be key to success; therefore, an action plan operationalizing the implementation of the law will be prepared by the eleventh review. A follow-up technical assistance mission is expected before the end of the year. In parallel to the preparatory works to reform the BFL, the authorities are executing the action plan for public financial management defined in the 2013 Budget and reinforcing the implementation of the commitment control.

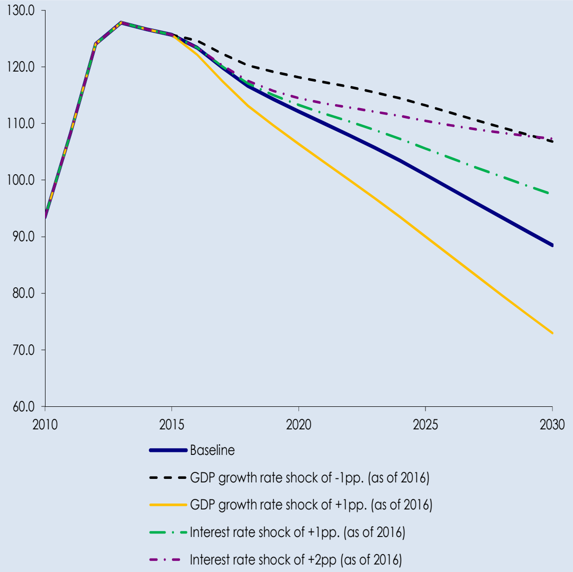
Box 1: Public Debt and Fiscal Sustainability in Portugal

Under the programme scenario, government debt is projected to peak at 127.8 percent of GDP in 2013 before starting a gradual decline. The baseline long-term calculations shown below incorporate the programme scenario up to 2017. The programme scenario includes fiscal consolidation measures up to 2015 and showing no-policy-change for the outer years. More details on these figures are shown in Table 7 in the annex. The turning point in 2014 is the result of achieving a small primary surplus, combined with a positive, albeit still modest, GDP growth rate. After 2017, it is assumed that: (i) the structural primary fiscal balance remains unchanged at a surplus of 2.6 percent of GDP; (ii) nominal interest rates are around 4.5 percent; (iii) nominal GDP growth fluctuates between 3.5 and 4 percent; (iv) ageing costs are taken into account following the Commission's 2012 Ageing Report projections; and (v) the expected fiscal impact of PPPs costs and bank recapitalisation costs of EUR 12 billion over the programme period are factored into the analysis.

Full compliance with the programme's consolidation path ensures a gradual decline of the debt ratio over the longer term. Nevertheless, for a significant number of years the debt ratio would remain higher than before the current crisis. The graphs in this box present a sensitivity analysis with respect to macro-economic risks, the effect of alternative fiscal consolidation paths, and the potential impact of contingent liabilities such as reclassifications and other changes in the government perimeter.

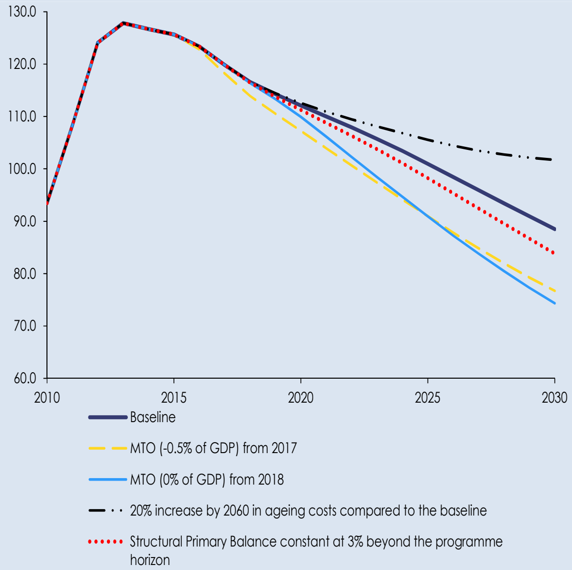
Graph I illustrates the sensitivity of the debt trajectory to macro-economic assumptions by considering a shock to real GDP growth and hikes in interest rates as from 2016. A lower GDP growth rate by one percentage point or a higher interest rate on maturing and new debt by two percentage points would put at risk the declining trend over the medium term, although the effect of these shocks are now mitigated compared with the analysis of the previous review reflecting more favourable growth prospects during the programme timeframe. An interest shock of 1 percentage point would slow down the pace of debt reduction but keep the declining trend. Conversely, a positive shock to growth in the medium-term on account of the structural reforms undertaken may result in visibly lower debt-to-GDP ratios and a faster pace of debt reduction.

Graph I: Macroeconomic risks-growth and interest rates (debt as percent of GDP)



Source: Commission services

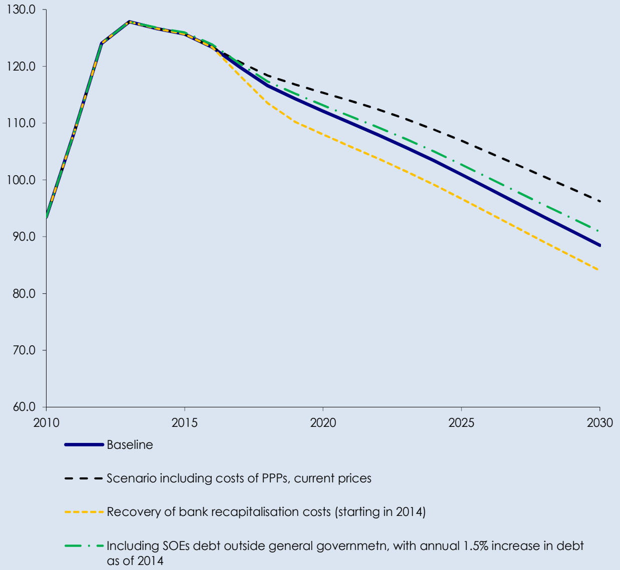
Graph II: Fiscal consolidation and ageing costs (debt as percent of GDP)



Source: Commission services

Additional fiscal consolidation beyond 2015 and the programme horizon would clearly accelerate the debt reduction path (Graph II). In particular, reaching the Medium Term Objective (MTO) of a structural deficit of 0.5 percent in 2017 as per Fiscal Compact requirements would require a cumulative fiscal effort of about 1.2 percent in 2016 and 2017 and reaching a primary surplus of nearly 4.0 percent. Maintaining the MTO over the longer term horizon will require primary surpluses of up to 3.9 percent up to 2020, declining gradually to close to 3.0 percent over the following decade. Under these assumptions, the debt to GDP ratio would accelerate its decline already in 2016, falling below 100 percent in the second half of the next decade and maintaining the sustainable downward path thereafter. A slower pace of consolidation but aiming at a more ambitious MTO of 0 percent would also bring down the debt-to-GDP ratio in the long run. On the other hand, if ageing costs are allowed to rise significantly (simulated as a 20 percent increase)*, the fall in the ratio would be severely curtailed, stabilising at a high level in the absence of compensating fiscal consolidation.

Graph III: Changes in general government perimeter (debt as percent of GDP)



Source: Commission services

Graph III illustrates the impact of changes in the government perimeter. The inclusion of all gross costs of PPPs and the debt of all state-owned enterprises (SOE) classified outside general government would lead to an increase in government debt, especially if further increases in SOE debt are not reined in. The ongoing renegotiation of PPPs contracts will limit the cost of a reclassification scenario. The envisaged privatisation programme combined with the necessary reforms to reduce SOEs operational costs and a strategy to reduce their debt burden will also contain the risks stemming from SOEs. By the same token, a quick repayment of the bank recapitalisation funds to the government would quicken the adjustment towards lower debt-to-GDP ratios

Overall, the debt sustainability analysis reveals that the debt reduction path of the baseline is robust across a wide range of scenarios. Even in a setting which combines a number of adverse shocks, a solid reduction path is attainable if fiscal responsibility is maintained after the end of the programme period.

* According to the EU ageing report Portugal is part of the low risk countries where the increase in age related expenditure is amongst the lowest in Europe.

Revenue administration

34. The recent tax administration reforms have improved efficiency in the fight against tax evasion but further **efforts are required.** . The government has successfully put in place the VAT e-invoicing reform that introduced mandatory invoicing and electronic transfers of invoice data for all businesses and transactions. The information gathered in the centralised database allows improving the effectiveness of the tax administration in fighting tax evasion by, for example, tracking potential mismatches between the VAT amounts invoiced and the amounts deducted/paid by taxpayers and better targeting audits when irregularities are detected. It is now important to enhance the operational capacity for analysing the data in a timely and effective manner. The scheme that introduced tax incentives for consumers to ask invoices in certain sectors is also proving successful, as demonstrated by the growth of the VAT base and collection in those sectors in the last months (which compares to the negative evolution in the aggregate collection of all other sectors). Whilst these have been promising steps forward, fighting fraud and evasion must remain a top priority, all the more because incentives for tax and social security evasion may increase against the backdrop of a still weak economy and liquidity constraints of taxpayers.

35. Most revenue administration initiatives are progressing as planned. The pilot compliance projects for high-net-wealth individuals and self-employed professionals continue to be reinforced, as well as plans for phasing in a risk management unit. The improved information from the unified monthly tax returns and the unified form on independent workers' annual revenue will be key inputs for a risk analysis of the compliance situation. The operational plans for the rationalisation of the local tax administration network are ready and the authorities remain committed to the target of closing 25 percent of local tax offices by the year end. There are delays in the target of increasing the number of tax inspectors to 30 percent of the tax administration staff, which should be achieved by the end of 2013.

36. The scheme for the settlement of tax debt and overdue social contributions approved in early October could have a short-term positive impact on tax collection but has potential downsides. Moreover, by normalising the tax situation of debtors it may alleviate financial hardship and facilitate access to community funds requiring a regularised tax situation. The frequent repetition of such schemes, however, would undermine tax compliance and the government's credibility in enforcing the tax law, thereby eroding tax morale and promoting evasion. The government has committed to forego any such tax debt recovery schemes in the future (the last such scheme occurred in 2002).

Regional and local governments

37. Regional and local policy frameworks have been strengthened. The new regional and local finance laws have been approved and will enter into force at the beginning of 2014. As laid down in the Memorandum, they adapt the local and regional budgetary frameworks to the principles and rules of the revised Budgetary Framework Law, strengthen fiscal accountability, limit the scope for lower tax rates in the Autonomous Regions, strengthen the auditing and enforcement powers of the central tax administration, and include requirements for data provision to support the revenue projections. The revision of the laws was done in close consultation with stakeholders. The reduction of the number of parishes from 4050 to 2882 became effective after the local elections as the newly elected officials took office. While most of the jobs in the parishes are on a voluntary basis, the authorities estimate that direct savings of EUR 8.8 million per annum will be attained from the elimination of bodies and functions, but more important yet hard-to-quantify gains are expected from economies of scale and a better quality of merged services.

38. Budget execution and public sector reforms in the two autonomous regions are on track. In Madeira, budget execution is in line with expectations, both due to increasing revenue – reflecting higher tax rates and a good performance of the regional economy - and contained expenditure. Arrears accumulation has been reversed in the summer following some repayment of the stock of arrears. Negotiations on the two motorway PPPs with the aim of achieving important savings have started and the regional authorities are, despite some initial difficulties, confident of reaching agreement later this year. There is also some progress on the restructuring and privatisation of Madeira's SOEs. In the Azores, due to good expenditure control and strong revenues – following a good season of tourism and agriculture as well as higher tax rates – the budget (in terms of public accounts) showed a small surplus of EUR 1.2 million in August and arrears have come down to EUR 3.7 million. A small budget deficit of EUR 27 million is expected at end-2013, and for 2014 the objective is to reach a balanced budget, in spite of lower State transfers. SOEs in the Azores have undergone a process of consolidation and are overall in balance.

Public administration reform

39. Public administration reform continues to make good progress. In addition to the respective measures in the context of the public expenditure review, the process of staff reduction is ahead of the programme objective (staff reduction across all layers of government by 2 percent per year in 2012-14) as a 6 percent reduction relative to end-2011 was already achieved by June 2013. This resulted essentially from early retirement, the termination of fixed-term contracts (mainly teachers) and restrictions on new recruitment. The application of shared services for financial resources in the central administration ('GeRFiP') and for human resources in the Ministry of Finance ('GeRHuP') is improving management efficiency, but will take more time than expected for the about 10,000 employees of the tax administration across the country. The Labour Law for Public Workers, of which a draft was submitted to the Parliament by end-October [prior action], consolidates the fragmented legal bases for public administration employees and facilitates a more consistent application. A programme measure to review the regulation of associations and observatories was modified to take into account, on the one hand, the legal heterogeneity of observatories with only few being public and, on the other hand, the high number of 40,000 private associations. Now it is foreseen that authorities will review public financial support to private associations on the basis of information becoming available through a new legal obligation to regularly report on benefits granted by the public administration to the private sector (Law 64/2013).

SOEs, PPPs and privatisations

40. The new framework law for state-owned enterprises (SOEs)[5] has been published and will enter into force on 3 December. It encompasses a set of changes including the Ministry of Finance's enhanced shareholder role (and similarly municipalities' role vis-à-vis local SOEs) and the creation of a new taskforce inside the ministry to cope with the enhanced responsibilities for the whole SOEs spectrum, particularly the consolidated financial planning and monitoring and the first level legality checks. At the same time, SOEs indebtedness is now subject to clear limits for long-term debt and risk derivative instruments, with the public debt agency (IGCP) assuming a key monitoring role. The SOEs cash position will also in the future be centrally managed by IGCP.

41. The SOEs overall operational balance was achieved by end-2012 but this is not assured for 2013 and beyond. SOEs, in particular in the transport sector, have been undergoing a comprehensive restructuring programme including the optimisation of services, an update of tariffs (prices and system) and a significant

[5] Decree-Law 133/2013, of 3 October.

reduction in personnel since the beginning of the programme. However, further restructuring will be necessary to ensure that operational balance at sector level is also assured by 2013 and beyond, given that the reinstatement of the 13th and 14th salaries in the public sector is posing significant new challenges to expenditure reduction. At the same time, the government is working on strategies to deal with the heavy indebtedness of several SOEs. Águas de Portugal (AdP), the holding company of several inter-municipal water companies, is undergoing a significant restructuring, including mergers to foster the sustainability of the sector in the mainland, while the regulatory framework is being adapted to the future corporate framework in the sector.

42. Privatisation plans continue even though the programme target in terms of proceeds has already been achieved. The Council of Ministers decided on 10 October to privatise up to 70 percent of the postal company CTT through an initial public offering until the end of the year, hand in hand with – and subject to – the revision of the postal sector's regulatory framework and the definition of the concession. The sale of EGF, the waste management company within AdP, is delayed by one quarter with binding offers now expected for early 2014. The privatisation of CP Carga (freight subsidiary of CP) and of TAP (national air carrier) will proceed as soon as market conditions allow. Meanwhile, efforts to improve their operational balance and profitability will continue. Public transport services in Lisbon and Oporto (Carris and Metro de Lisboa; STCP and Metro do Porto) are being restructured with a view to opening their concessions to private operators.

43. The administrative capacity to deal with PPPs is improving. Revised contracts on the basis of the preliminary agreements regarding [nine] road concessions that were successfully renegotiated between the Grantor and the Concessionaires remain to be approved by the lending consortia and the Court of Auditors. The revised contracts are expected to achieve important savings in 2013 and beyond. The preliminary agreements bring sustainability and certainty back to the sector, with a fairer burden sharing between public and private partners thereby correcting errors from previous renegotiations. More than half of the savings to the budget result from a decrease in shareholders' internal rates of return. Lower costs from operation, maintenance and major repairs – also stemming from a downward revision of regulatory requirements in line with EU standards (completed by end of October) – play a crucial part in the expected savings. Lending banks are to contribute with more flexible guarantees and alternative risk mitigation tools (e.g. the State gives real tolls collection as collateral to compensate for lower debt service coverage ratios) that enable lower cash flow requirements to each project without jeopardising its financial soundness. The Ministry of Finance's PPPs central unit (UTAP) is playing a pivotal role in delivering valuable financial and legal expertise to these renegotiations. UTAP is also providing consultancy services to road PPPs renegotiations in the Autonomous Region of Madeira and is helping the Ministry of Internal Affairs in auditing the technical performance of the joint emergency and security network system (SIRESP). The tender for the new Hospital Lisboa Oriental PPP, launched in 2008 but suspended before awarding, was reassessed and terminated. Nevertheless, the importance of the project to the on-going hospital reform was confirmed and UTAP, together with the Ministry of Health, will now assess if the project should be developed as a typical public investment project through a traditional public procurement procedure or alternatively as a PPP (which would be the first project to which the PPPs framework law approved in 2012 is applied).

Healthcare sector

44. Policy implementation is continuing broadly in line with programme deadlines. The ongoing reforms have already produced important savings: in 2013, with expenditure in the National Health Sector (NHS) expected to be about 14 percent lower than in 2010 (corresponding to EUR 1.3 billion in savings). In a context of reduced budget transfers to the sector (-11 percent since 2010), all cost categories show a consistent reduction and the consolidated deficit of the sector (Central Government and SOEs together) shows a significant reduction from EUR 818 million in 2010 to a forecasted EUR 65 million in 2013. In addition, by the end of 2013, an important stock of overdue debt will have been paid through the debt settlement programme (about EUR 1.9 billion). While arrears have not been fully eliminated (a stock of about EUR 500 million remains to be paid), their accumulation rate and payment time have been reduced.

45. The healthcare sector faces major challenges related to increasing labour costs and lower State transfers. Given the high share of wages in overall expenditure, the reinstatement of the 13th and 14th bonus payment has led to significant cost pressures in 2013. In addition, in 2014 the sector may face additional budget cuts (of about 160 million) if alternative horizontal expenditure-reducing measures do not materialise. This limits the sector's ability to tackle the existing stock of arrears and may even lead to their renewed increase. As a result, the authorities will have to intensify ongoing reforms, notably the centralised purchasing of goods and services and the on-going hospital reform. A further agreement with the pharmaceutical industry may also be crucial to contain spending in this area.

46. Revenues from moderating fees (co-payments) and fees charged to cross-border/foreign patients have continued increasing in 2013. While the increase in revenue was somewhat lower than expected, these fees presumably also dampened expenditure since the number of unnecessary emergency consultations have apparently decreased at the same time. The authorities continue improving the billing and collection process and have set a goal of 90 percent collection for SOEs.

47. Regarding pharmaceuticals, the authorities continue fine-tuning the set of measures adopted since 2011. These measures have led to important savings on spending on outpatient pharmaceuticals. Public spending fell by 11.6 percent in 2012 and by an additional 7 percent in the first half of 2013. Private spending associated with cost-sharing saw a 12 percent reduction in 2012 and an additional 11 percent reduction in the first half of 2013. Savings on inpatient pharmaceuticals in hospitals have been slower to materialise. In 2012, spending stayed around EUR 930 million, once discounts are accounted for, and therefore slightly above the target of about EUR 840 million. The target can still be achieved with the collection of about 94 million due to the claw-back agreement with the pharmaceutical industry. In 2013, spending remained broadly unchanged (0.5 percent reduction in the first half of the year). The overall (outpatient plus inpatient) spending targets for 2012 (1.25 percent of GDP) and 2013 (1 percent of GDP) are to be achieved through a combination of measures including the application of an international price reference system in the hospital sector, administrative price reductions and the implementation of the claw-back agreement with the industry for 2013.

48. The share of e-prescription is now more than 99 percent in NHS facilities and 83 percent in private practices. Additional steps are planned to further reduce the cases for manual prescription. Regarding compulsory INN (active substance) prescription, concerns raised by the observed increase in the use of exemptions to INN prescriptions are being addressed of the authorities. The improved e-prescription system allows for both prescription and dispensing information on the basis of which the authorities can investigate divergent behaviour of both pharmacies and doctors. In about 44 percent of all cases the 5 cheapest medications are dispensed, which represents a slight reduction from earlier in the year, probably related to the increase in exemptions. Therefore, the authorities are considering an additional set of measures that are to enhance a greater dispensing and use of outpatient generic medicines in order to achieve the 2013 target of 45 percent of all outpatient prescription reimbursed by the NHS (currently at 39 percent). Regarding inpatient generic medicines, centralised purchasing, the implementation of the national formulary and a 40 percent target for generics in hospitals are among the measures currently in preparation.

49. With regard to primary care, the authorities continue to take steps to create new family care units (USFs), ensure that all the population is served by family doctors and implement patient medical records. These measures aim at reducing the current share of patients not covered by family doctors. In addition, the system of electronic medical records can improve safety of care and avoid the duplication or unnecessary use of services such as diagnostics.

50. Regarding the hospital sector, important savings were realised in 2012 and authorities continue to focus on further cost reductions and efficiency increases. Operational costs went down by 6 percent in 2012 compared with 2011 (about EUR 316 million). In 2013, overall operating costs may remain more or less at the level of 2012, mostly because of the increase in the remuneration of employees (reinstatement of 13th and 14th salary bonus payment). All other categories of costs show a reduction in the first half of 2013 compared with the same period of 2012. In this context, authorities reconfirmed their commitment to implement the ongoing hospital reform. The main concern now is to finalise the 3-year strategic plans for hospitals which are to deliver important cost reductions from now to 2016. These plans are based on the general targets for hospital reorganisation by region and the respective overall savings of EUR 400 million in the best case scenario. These additional savings will be the result of further merging, restructuring, closing or redistribution of departments and the consequent reduction of beds and reallocation of staff. While unavoidable, this remains a particular difficult reform which is unpopular with both the population and staff.

51. The use of centralised purchasing is advancing, but there is still room for further extension, notably in areas outside medicines and for which centralised procurement is not compulsory for SOE hospitals. The on-going centralised tenders now cover a substantial list of goods but also services and IT and the authorities have presented a plan for further centralised purchasing. The authorities also continue to develop a uniform coding for medical devices and, as a consequence of which more centralised tenders will become possible. This is important as medical devices constitute an important share of hospital costs and have not seen as substantial a reduction as other cost items. Centralised purchasing is expected to contribute significantly to the further reduction in hospital costs in 2014.

FINANCIAL SECTOR

52. Banks' solvency levels are adequate for the current needs. Banks' own funds increased substantially in the past year boosted primarily by capital injections of EUR 5.6 billion ??? from the Bank Solvency Support Facility (BSSF) by which a total of EUR 12 billion has been earmarked for possible bank recapitalisations. However, the central bank remains vigilant and continues to closely monitor the banks' capital positions through regular stress tests and both onsite and offsite thematic assessments. At banking sector level, the Core Tier 1 ratio stands at a comfortable 11.9 percent, enough to cover immediate bad debt costs and weather the foreseen deterioration of the loan portfolio and short periods of volatility surrounding the sovereign. This capital buffer remains considerable across the board when using the new CRD IV rules for evaluating banks' own funds. In a hypothetical scenario of a full implementation of the CRD IV/CRR guidelines, only two out of the top eight banks would not be able to meet the 7 percent Common Equity Tier 1 (CET1) ratio. Banco de Portugal is currently developing a transition approach to introduce the new capital rules applicable from January 2014.

53. The crisis management toolkit has been improved allowing effective intervention in troubled banks. Portugal, similar to many European countries, lacked domestic resolution tools. This restricted the authorities' intervention powers in failing banks, ultimately exposing taxpayers to major losses. The key objective of the newly created resolution framework is to make resolution feasible without systemic disruptions and without burdening the State. Hence, the Resolution Fund, entirely financed by local lenders through yearly contributions and proceeds from the bank levy, is an integral part of the new framework and has been operational since end Q1-2013. It held about EUR 55 million by end-September 2013. Banco de Portugal has put in place a dedicated bank resolution team that can quickly borrow staff resources from other divisions of the bank if the need arises. The resolution framework is supplemented by a recapitalisation law (adopted by the Parliament in May) enabling Banco de Portugal to propose mandatory recapitalisation operations. The recapitalisation legislation is currently adjusted to the new European state aid rules.

54. Taking advantage of new regulatory tools, the corporate and household debt restructuring is proceeding, thus contributing to a smoother deleveraging of the private sector. Further to the implementation of the banking sector legislation aimed at monitoring and mitigating excessive credit risk and at promoting an orderly debt restructuring of bank household clients, the Banco de Portugal presented aggregated system data on the out-of-court debt settlement of defaulted bank loans. While preliminary figures suggest that the legislation actually encourages the voluntary settlement of debts overdue, a key goal of the framework is to promote the restructuring of debts via agreement between the parties (under the general regime). The Banco de Portugal remains vigilant in regard to the correct application of the framework., The authorities have completed a survey of insolvency stakeholders to inquire about the appropriateness of the existing corporate debt restructuring tools and possible gaps or bottlenecks. The survey findings allow the authorities to consider possible incremental improvements to the new corporate insolvency and recovery system implemented in 2012. To support the efforts aiming at the successful restructuring of viable companies facing temporary financial difficulties, three state/bank-funded investment vehicles worth EUR 220 million were set up («Revitalizar» funds).

55. Steps were taken to expand the use of commercial paper as an alternative financing source for companies, notably SMEs. A detailed draft legislative proposal to modify the regulatory environment applicable to the commercial paper market was prepared. Concrete taxation measures forming part of the enhancements to the commercial paper regime are still to be presented, as well as an assessment of the respective budgetary implications. The final proposal is expected to be approved by the Council of Ministers by end-November.

56. Proposals to improve the governance of the National Guarantee System and the allocation of government-sponsored credit lines to SMEs were presented. The NGS has contributed to the financing of SMEs in Portugal since its inception in the mid-nineties and, through its guaranteed credit system, has approximately EUR 2.9 billion of outstanding exposures in guarantees to SMEs.. However the system shows some deficiencies at the level of pricing mechanisms and risk management capabilities which hinder a fully efficient allocation of the dedicated financial resources to SMEs. Furthermore, while the financial supervision of the system's mutual guarantee societies and the management company of the counter guarantee fund follow a model in line with international best practice, weaknesses were found in the supervision and public disclosure of the counter guarantee fund, which are an obstacle to the effective management and monitoring of the State's exposure to the NGS operations. The system's scrutiny mechanisms in place from a public accounting perspective remain unclear. Therefore, building on the recent external audit to the NGS and on a set of policy recommendations, the authorities submitted a plan containing measures to improve the performance of the government-sponsored credit lines and the governance of the NGS. These measures will be implemented by January 2014. Regular reporting on the implementation of the above measures will be carried out. With these changes in place, it is expected that the credit lines will bring further advantages for SMEs, budgetary risks for the state will be reduced and, more generally, the credibility of the system will improve. The authorities prepared the first quarterly report on the allocation of these credit lines.

57. The stock-taking exercise aiming at streamlining and centralising the management of EU structural funds continues. By Resolution of the Council of Ministers, the authorities approved in June a new institutional model for the governance of the European structural funds aiming at a better political??? coordination of the funds as a whole, and at the concentration of the programming, coordination, certification and payment functions in a single institution. Accordingly, in August, the IFDR, IGFSE and QREN Observatory were abolished and merged into a new body, the Development and Cohesion Agency (*Agência para o Desenvolvimento e Coesão, I. P.*), At the same time, the authorities continue developing an initiative that aims at improving the effectiveness of structural funds for the 2014-2020 programming period, to be allocated to the private sector. This entails setting up a 'specialised financial institution' on the basis of existing structures. The potential fiscal risks linked to the implementation of such an initiative will be monitored closely, while the fulfilment of the relevant EU competition law will be observed.

58. The authorities are exploring possible additional initiatives to improve financing opportunities for SMEs. The authorities are actively contributing to the current EU-level discussions on the setup of new innovative risk sharing financial instruments to support the provision of finance to SMEs in Europe, including Portugal. Such instruments rely on public and private resources. On the public side, the instruments being explored resort to the combination of national allocations under the ESIF, EU programmes dedicated to SMEs (COSME and Horizon 2020) and resources from the EIB and the EIF. The public participation aims at boosting private sector resources and incentivising capital market investments in SMEs. Furthermore, building on the recent agreement on a State guarantee for existing and future exposures of the EIB to the Portuguese economy, the EIB is expected to step up its efforts to facilitate the financing of the corporate sector in Portugal, in particular the economically viable SMEs operating in the tradable sectors.

STRUCTURAL REFORMS

Reform of labour, goods and services markets

Labour market

59. The labour market performance in the second quarter showed some positive signs. According to the National Statistics Office, unemployment decreased by 66,200 persons and employment increased 72,400 persons in the second quarter. According to the authorities, only a quarter of the change in unemployment can be explained by seasonal effects (strong employment effects in the agriculture and tourism sectors). Active labour market programmes, such as 'Impulso Jovem', could have contributed to the strong fall in youth unemployment.. Furthermore, around a quarter of all new employment contracts were permanent ones. In terms of qualifications, absolute increases were strongest up to secondary education, with tertiary education flat. However, the youth unemployment rate remains very high at 36.8 percent and, in order to foster the integration of young people in the labour market, the Government is further committed to implement a Youth Guarantee.

60. The third stage of the severance payments reform was implemented on 1 October 2013. Severance payments for open-ended contracts were reduced from 20 to 12 days per year of work. For temporary contracts, severance payments were reduced from 20 to 18 days during the first three years of contract. Accumulated rights up to the date of the entry into force of the new rules are preserved. Simultaneously, the government has enacted two compensation funds that will cover part of the severance payments. Employers will contribute with 1 percent of the wage of new hires to the compensation funds. Three quarters of the contribution will be used by the employer upon dismissal of the employee (or will revert to the employer in case of contract termination without right to severance payment). The remaining quarter of the contribution is allocated to a mutual fund which will be used by the social security when employers fail to meet their obligations under the severance payments rules. Until 2015, firms can apply for reimbursement from the State of their contributions to the funds.

Box 2: Cost Competitiveness Developments in Portugal

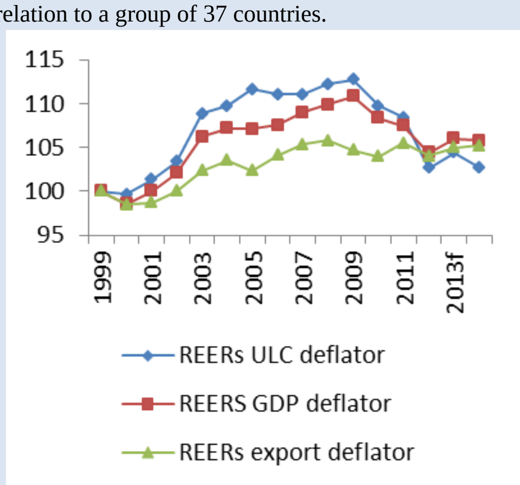
This Box describes recent cost competitiveness developments in Portugal. The appreciation of the Real Effective Exchange Rates (REER) based on unit labour costs GDP deflators peaked in 2009 (Graph 1). Since the peak until 2012 the ULC-deflated REER depreciated by about 6 percent. This was determined by a fall in ULC of about the same magnitude, which was a result of a cumulative productivity increase of about 4.5 percent and a fall in the nominal compensation per employee of about 1.4 percent (Graph 2).

The adjustment in REERs was accompanied by a strong decline in the employment rate and a sharp increase in the unemployment rate. The recent wage adjustment has been determined by wage cuts in the public sector and has been market-driven in the private sector, in light of high unemployment rates. Collective agreements at sectoral level have almost stagnated, while the number of firm-level collective agreements has been similar to the previous years, thus covering a relatively low proportion of workers. However, collective bargaining has an important role to play for the adjustment of the Portuguese economy.

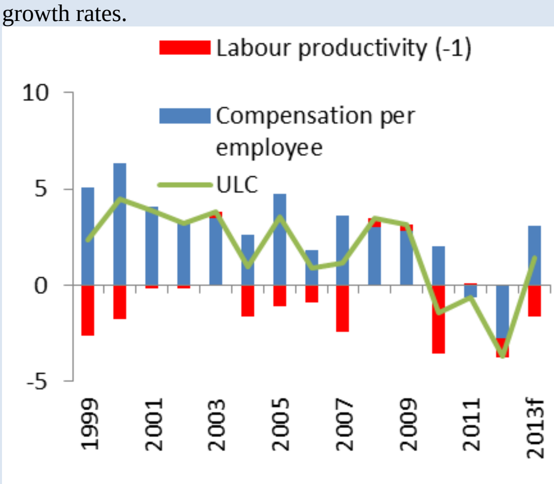
Portugal recorded a very significant adjustment in the current account, which declined from a deficit of 12.6 percent of GDP in 2008 to a forecast positive balance in 2013. This process was mostly linked to demand contraction. Nonetheless, the export sector grew at an accelerated pace, and REER developments could have played a role. However, the adjustment in the current account balance has to be seen against a very high negative Net International Investment Position (NIIP), which needs to decrease over the medium term. Portugal's negative NIIP was around 116 percent of the GDP in 2012 and have not yet entered on a declining path.

Going forward, REER adjustment needs to continue to make current account adjustment durable once demand recovers and to bring NIIP at prudent position. Wage moderation is still needed. Major nominal wage decreases might not be needed, but, as long as the market-driven process towards wage moderation persists, wage floors need to evolve in such a way to make this process possible, with a view to facilitate the absorption of unemployment while ensuring external rebalancing.

Graph 1 – Broad and narrow measures of REERs in relation to a group of 37 countries.



Graph 2 – Unit labour costs and components, y-o-y growth rates.



Source: DG ECFIN AMECO database and Eurostat.

61. The Constitutional Court ruled that part of the revisions of the definition of fair dismissal introduced by the Labour Code revision of August 2012 were not in line with the Portuguese Constitution. In case of redundancies, the Labour Code revision had eliminated a tenure rule that an employer needed to follow (in case of a redundancy in a section with multiple identical posts) and established that the employer decides on which worker(s) to dismiss, based on objective and non-discriminatory criteria. The revision had also abolished the need for the employer to prove that there were no other suitable positions in the firm for the employee at risk of being dismissed. In addition, the Labour Code had introduced changes to the definition of dismissal based on unsuitability, making them possible without prior changes to the work place and abolishing the need for the employer to prove that there were no other suitable positions in the firm for the employee at risk of being dismissed on grounds of unsuitability. These three important changes to the Labour Code in terms of improving labour-market flexibility have been ruled unconstitutional by the Court. The authorities are now looking into alternative reform options that can achieve a similar impact as the provisions ruled unconstitutional while respecting the Court ruling. Several other changes to the labour code were deemed constitutional, notably performance-related dismissals, the bank of hours, the reduction in overtime compensation, the suspension of four public holidays, and the elimination of up to 3 days of leave, even though some of these changes – as foreseen in the revision to the labour code – cannot prevail over arrangements in collective agreements if not changed within two years. In addition, the authorities are considering possible changes in the definition of unfair dismissals with a view to tackling labour market segmentation and improving employment creation of open-ended contracts.

62. Measures taken to further facilitate the conclusion of agreements at firm level have not yet produced effects. Following the tripartite agreement of March 2011 and the MoU, the Labour Code revision of August 2012 introduced the possibility that sectoral collective agreements regulate the conditions under which the agreement could be changed at firm level on matters related to functional and geographic mobility, working time and remuneration. In addition, the firm-level threshold for unions to be able to delegate the conclusion of firm-level collective agreements to works councils has been reduced from 500 to 150 workers. A report prepared by the authorities has concluded that no use has been made yet of these new provisions. In fact, collective bargaining at sectoral level decreased drastically since 2010, while firm-level collective bargaining remained stable. The sharp decline in the overall number of new collective agreements is problematic in view of the important role of collective bargaining in absorbing the high unemployment levels.

63. The authorities continued to implement measures to improve the role of Active Labour Market Policies. The authorities have presented a description of the functioning of the job counselling / job search assistance and the activation / sanctions systems. It was considered that there is further scope to improve the role of these systems in facilitating the transition from unemployment to employment, in particular by improving the profiling and strengthening activation. There was good progress in implementing the action plan to revamp the Public Employment Services, with the majority of the measures already concluded. There are some positive results in terms of job placements and job offers. The authorities are also preparing a plan to increase the cooperation with the private sector in placing the unemployed. Training is being adapted to the changing profile of the unemployed and there is an attempt to reinforce short training modules to reduce risks of lock-in effects, while maximising the number of unemployed that receive training. Dual-apprenticeship systems and education and vocational training will continue to be important priorities. More efforts will be made to monitor the extent to which training contributes to increasing employability.

Education

64. Reforms in the education sector are advancing well even though some measures are somewhat delayed. The monitoring tool aimed at enhancing the information available regarding the national education network has been further enriched. This tool is expected to be an essential source of information for better targeted and more efficient policy decisions and is now fully operational. The authorities have also approved a very significant number of additional school autonomy agreements. Once signed, the total number of agreements will be more than 200, going much beyond the initial objective of 80 agreements for the school year 2013/2014. As a result, around 25 percent of public schools will enjoy enhanced autonomy. The government is still working on possible improvements in the financing of schools in order to take better account of evaluation and performance criteria. The setting up of the professional schools of reference is behind schedule. They will not be operational before the next school year as the government is still drafting the relevant legislation and negotiating protocols with the business sector. Reporting on the latest developments in the apprenticeship system and the latest cycle of external evaluation of schools is of sufficient quality. The government will outline in future programme reviews options for improvements of the system of external evaluation.

Energy

65. The measures ensuring energy regulator's independence and its capacity to guarantee an efficient and competitive functioning of the energy sector are being gradually phased in. Important amendments to the ERSE bylaws were published in June 2013. Following the publication in August of the framework law on functioning of National Regulatory Authorities, ERSE's bylaws will be further amended to ensure compliance with the framework law's provisions.

66. Rent-reducing measures implemented so far to eliminate the tariff debt by 2020 and ensure the sustainability of the system appear to be insufficient. The June update of the energy tariff debt dynamics up to 2020 shows a clear worsening relative to the forecasts presented in 2012 and more recent figures indicate that the elimination of the tariff debt by 2020 would require real electricity price increases of close to 2 percent per year,

½ percentage point above initial projections and raising further concerns about the impact of the tariff on competitiveness. The report also shows that the increase in the real electricity price would not be sufficient to eliminate the tariff debt and additional measures would need to be taken despite the fact that the government has already implemented most of the measures agreed by the Council of Ministers in May 2012. The most significant additional measure envisaged by the government is the introduction of a contribution on energy generators preventing windfall profits resulting from the increase in electricity prices in the MIBEL market caused by the levy on the Spanish generators. This measure, though welcome to counter a perverse effect on wholesale prices, is not a cost reducing and sustainability-enhancing measure. Meanwhile, negotiations on the Sines and Pego power plants, which were expected to achieve some savings, reached an impasse. The remuneration scheme for co-generation was revised and establishes that existing co-generation facilities that do not use a renewable source of energy will transition into market remuneration after 10 years, receiving in the meantime the new tariff set by executive order. A new energy levy on generators is under preparation. EUR 100 million of the levy's revenue will stay in the state budget while the remainder will be channelled to reduce the electricity tariff deficit. At this stage the details are not known and two aspects need to be closely monitored: i) ensuring that this levy will not translate into further end-user price increases; ii) gauging the implications of the this levy in terms of the impact and feasibility of other cost-reducing measures foreseen to address the sustainability of the electrical system. Annual audits of co-generation plants to ensure that plants which do not fulfil the requirement for co-generation do not receive support are on-going. Finally, the report on the CMEC scheme and the process for extension of the concession of the public hydro resource has been delivered. Further analysis on the implication of the report and potential measures to address the points identified as sources of distortion will be presented at the next review.

67. The authorities have presented the plan to create a single logistics operator for switching suppliers (OLMC). According to this plan the single platform will be created no sooner than October 2014. This long delay is explained by the necessity to create the electricity platform from scratch. An independent logistics operator is important to ensure a non-discriminatory treatment of all electricity providers and a smooth supplier switching process. Until the electricity suppliers switching platform is fully unbundled from the incumbent, the responsibility to ensure a level playing field for the new entrants will fall to a large extent on the energy regulator and the competition authority.

Telecommunication and Postal

68. Significant steps towards compliance with the Court of Justice ruling of 7 October 2010 have been undertaken recently. The tenders for the designation of the universal service provider(s) through an efficient, objective, transparent and non-discriminatory mechanism were launched. The activities under tender 1 (universal service connection to a public communications network at a fixed location and telephone services to the public) and awarded to independent operators. The activities under tender 2 – public pay phones – were awarded to the incumbent. The third tender 'providing a comprehensive directory and a full-service inquiry' was not completed due to the lack of proposals. At the time of drafting the report, the final assignments for tenders 1 and 2 are still pending and the historical contract with the incumbent operator has not yet been cancelled. The contract for activities under tender 3 will be directly awarded for a maximum period of 1½ years. Meanwhile, the authorities will redesign the terms of the tender so as to make it more attractive for the bidders.

69. The amended framework for the provision of universal service for postal services is about to be adopted. These amendments will bring the postal law and the concession contract with the incumbent operator - CTT - in line with the European Directives. This is an important milestone in the opening-up of the postal sector to competition. The new framework also ensures that after the year 2020 the postal universal service will be subject to competitive pressure as in 2020 the current designation period for the incumbent operator will expire.

Transport

70. The implementation of some of the transport measures is delayed. With regard to ports, policy decisions are urgently required to ensure that efficiency gains and cost-savings are passed on to port customers and that the port operation concession holders respect minimum performance criteria as provided for in the 5+1 Plan presented last year. As to railways, the unbundling of CP Carga freight terminals are dependent on a final valuation of these assets and will then be transferred to REFER, the rail infrastructure operator, by the end of the year. REFER is expected to present a coherent strategy towards reaching operational balance for discussion at the next review, as significant additional effort is needed in this respect. The launch of public transport concessions in Lisbon and Oporto has been postponed and is not expected before the first quarter of 2014. The adoption of the long-term vision for transport, setting out and prioritising medium-term transport infrastructure investments, is waiting for input from the recently created Working Group on this matter; this group is expected to present a final report on key transport projects for the coming multi-annual financial framework 2014-2020 shortly. Lastly, the government is drafting the by-laws for the new transport regulator due by the end of November. The timely adoption of the by-laws is essential to ensure an effective regulatory oversight in the transport sector.

Services and professions

71. Work on the improved sector-specific legislation has progressed but the adoption of the regulatory framework for the construction sector is delayed. The construction laws were originally foreseen to be sent to Parliament by the end of 2012 and are now expected to be sent to Parliament only by15 October 2013. The fees charged for authorisations and certificates as well as the value of the yearly regulatory taxes in the construction sector will be revised in order to ensure their proportionality in time for the adoption of the construction laws. Concerning the other sector-specific legislative amendments, progress in aligning legislation with the principles of the Services Directive has continued steadily. 59 out of 68 legal regimes have been submitted by the government for publication or for subsequent adoption by the Parliament, as required by the legislative framework. Legislative amendments for the remaining sectors should be adopted by the end of the year.

72. The report compiling the final results of the second phase of investigation of regulated professions without professional associations has been finalised and submitted as required. Following the recommendations of the Commission for the Regulation of Access to Professions, this second phase report identified requirements on access to professional activities that are no longer justified or proportionate.

73. Following the adoption of the horizontal framework law on public professional associations the professional bodies' bylaws and internal rules are being amended accordingly. The law is a first step towards ensuring a more open access for the exercise of some highly regulated professions and an improvement in the legal framework applicable to public professional associations. To complete the reform on highly regulated professions, the amended professional bodies' statutes and internal rules will be approved by the government and subsequently submitted to Parliament with the aim of bringing them in conformity with the principles laid down in the law and removing requirements that are not justified or proportionate. However, the submission of these revised bylaws to the Parliament is delayed and is now expected by the end of the year.

74. Progress has been made on the work to improve the functioning of the Point of Single Contact ("Balcão do Empreendedor"). A clear roadmap and work programme is in place and updated monthly. The operational deliverables needed for this reform will be completed by the next review. The "Zero Authorisation" project that abolishes authorisations/licensing and substitutes them with a declaration to the PSC is fully operational and the platform is available to all levels of administration, including all municipalities. Some further simplification may be needed to ensure better usability by businesses.

Reform of framework conditions

Housing market

75. The process of updating rental contracts signed before 1990 and their gradual transition to the general system has started. The full implementation of the system was dependent on information relating to tenants' personal income in 2012, which was made available in June. In addition, all complementary legislation following the publication of the Housing Rental Market has been adopted. The "Balcão do Arrendamento" is fully operational; it has already dealt with more than 2 000 requests of eviction. The Monitoring Committee which has been set up to monitor the impact of the reform has already delivered its first quarterly report. The data and information regarding the impact of the reform are still limited given the short time elapsed since its full implementation. A fully-fledged first evaluation of the impact of the reform is expected by early 2014. The revaluation of the housing stock has been completed, giving rise to an increase of 115 percent in the cadastral value of the housing stock.

Competition and sectoral regulators

76. Progress to ensure the functioning of the Competition authorities and National Regulator Authorities has been steady. The framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs), including those relating to their independence and autonomy, was published in August 2013. The proper and timely implementation of the new by-laws of the respective regulators is essential to confirm that the new legal framework is a significant step forward. The corresponding amendments to the bylaws of the NRA will be approved by the government by end of November.

Judicial system

77. Considerable progress has been made in the ambitious programme of judicial reform. Several major structural changes to the judicial system have already entered into force or are about to do so. Among them are the comprehensive new Code of Civil Procedure that came into force in September and aims at speeding up civil and commercial litigation, a new Judicial Organisation Act to streamline the court system, and improved regulation of enforcement agents.

78. Significant headway has also been made in reducing the backlog of court cases. A special task force was created to examine pending cases and has successfully closed 45 percent of the cases existing up to May 2011. In addition, the resolution rate has greatly improved. In the first quarter of 2013, the number of cleared enforcement cases has increased by 158 percent compared with fourth quarter of 2012.

79. The efficiency of the enforcement system will continue to be further enhanced by the measures adopted in the new Emergency Law 4/2013. This law introduced a set of urgent measures to combat the remaining backlog of cases, and were included in the new Civil Procedure Code. Another proposed law (Procedimento Extrajudicial Pré-Executivo) will create a pre-trial triage which will, in particular, be able to identify cases to be settled out of court.

80. New laws will strengthen the authority and financing structure of the oversight body for enforcement agents and insolvency administrators. Together with the new fee structure that incentivises speedy enforcement, these bills will significantly strengthen the discipline and efficiency of the enforcement profession, and hasten the clean-up of long-pending cases.

81. The new Code of Civil Procedure that came into force in September is the most comprehensive re-think in almost a century, and has been widely praised by legal professionals. Among the Code's provisions are a limit of 10 on the number of witnesses that each party can call in civil cases, and tight new restrictions that make it harder for parties to delay hearing dates. The proper implementation of the new Code of Civil Procedure is supported by an extensive team of IT specialists, who, on the request of judges, court clerks and other members of legal profession introduce the necessary changes in the instantaneous fashion. Also, a task force of experts provide rapid answers on the new procedures prescribed by the Code.

82. The Judicial Organisation Act was adopted by Parliament in June and will enter into force in 2014. The law sets out a major streamlining of the judiciary, reducing the number of courts and improving efficiency through the creation of court clusters to allow for greater economies of scale and professional specialization. It also sets workload standards and performance targets for courts and judges, and makes it possible to allocate resources, including judges, where bottlenecks occur. The law constitutes a significant change in the organisation and management of the judiciary with a greater focus on performance accountability and service delivery, bringing Portugal in line with best practice elsewhere in Europe.

83. The Competition Court, set up in 2012 has been properly resourced and is fully operational, responding well to an increased workload.

Box 3: Reforms in the Judicial Sector

The scope of the judicial reforms was stipulated in the "Justice" part of the Memorandum of Understanding. The reforms were possible thanks to good cooperation between the Portuguese authorities and the EC, ECB and IMF. The MoU foresaw several cornerstone reforms: the new regulatory framework for the enforcement agents, the new Code of Civil Procedure and the Judicial Organisation Act which triggered changes in by-laws, kick-started new IT systems and applications, and necessitated various temporary task forces.

New Code of Civil Procedure

The Code of Civil Procedure (Law 41/2013) came into force in September 2013. The Code facilitates the swift conduct of the proceedings by the judges and the parties. The new Code limits the number of witnesses for each party to a maximum of ten and makes it harder for parties to delay the hearing date. It foresees the closure of civil and commercial cases that are inactive for 6 months due to the inactivity of the parties. The Code also foresees the closure of enforcement cases wherein debtor's assets have been searched for 3 months without success and neither the creditor nor the debtor have been able to indicate specific assets to be seized. The Ministry of Justice allocated significant human resources to the implementation of the Code. Programmers, technicians, technical coordinators and project managers dedicated 17,820 hours to this project. The IT system (CITIUS) was installed on over 13,000 clients' computers and 335 servers in 1½ months. A helpdesk of 85 technicians provides direct support to the courts. A task force of experts provides rapid answers and training on the new procedures prescribed by the Code. Since the publication of the Code on 26 June, 3 decree-laws and 7 ordinances have been enacted to further implement specific aspects of the new Code.

The Judicial Organisation Act

The Act adopted by Parliament in June (Law 62/2013 replacing Law 3/99) will enter into force in 2014. It provides for a streamlining of the judiciary, reducing the number of courts of first instance from 234 to 23. By enlarging each first instance court's territorial jurisdiction and aligning them with the administrative districts, it aims at improving efficiency through the creation of court clusters to allow for greater economies of scale and professional specialisation. It foresees setting annual and triennial strategic objectives agreed upon between the Ministry of Justice and the Councils for the Judiciary. Other reforms include the introduction of process management, improvement and clarification of the function of court managers, and a possibility of electronic processing of the same process for the secretarial acts at various points of the court.

The Enforcement Agents' Framework

The MoU put a particular stress on the efficiency of the enforcement process which complements the declaratory process in debt recovery. Specially constituted task forces audited all civil and commercial enforcement cases all pending 1,208,842 cases in May 2011 and closed 541,775 (45%). The courts and enforcement agents also stepped up clearance of all enforcement cases, including those filed after May 2011. These efforts were aided by the enactment of Decree-Law 4/2013.

The functioning of the Commission for the Efficiency of Enforcement Procedure (CPEE) has been improved through more effective IT tools. The CPEE has, on the basis of ordinance 2/2012, access to several IT systems, i.e. of the courts (CITIUS) and of the enforcement agents (SISAAE). This resulted in a tighter supervision. In Q2 2013, 266 enforcement agents were inspected vs. 16 in Q2 2012. In Q1 2013, 22 disciplinary proceedings were concluded by imposing penalties. CPEE will be replaced by the Comissão de Acompanhamento dos Auxiliares de Justiça (CAAJ) which will supervise and regulate enforcement agents and insolvency administrators. CAAJ will be an independent entity focussing on the efficiency of the enforcement and insolvency judicial systems and on the quality standards of the legal professions at stake.

Ordinance 308/2011 introduced a more transparent regime for the bank accounts of enforcement agents, enabling an easier identification of all transactions performed through bank accounts related to an enforcement case. The new fee structure of the Ordinance 225/2013 aligned the costs of the enforcement action to the tasks of the enforcement agent.

Alternative Dispute Resolution (ADR)

Several ADR regimes were revised, i.e. the civil and commercial arbitration regime (Law 63/2011) and the justice for the peace court regime (Law 54/2013) while others were created, i.e. the mediation regime (Law 29/2013) and the tax arbitration regime (Decree-law 10/2011 and Ordinance 112-A/2011). The promotion of ADR is in line with out-of-court mechanisms envisaged in other areas, i.e. in the field of companies' and debts' restructuring (PER and SIREVE).

High value cases (cases above EUR 1 Million)

One of the reforms undertaken on the basis of the MoU focussed on the issue of the high number of outstanding high value tax cases. All the efforts put by the courts, special task forces and the Tax Administration started to bring positive results in 2013. While the number of filed cases show a decreasing trend, the ration of cases won by the tax office increases.

A significant role in the increase of the efficiency of tax courts in terms of cases over EUR 1 Million was played by the special task forces of judges assigned to tribunals in Lisbon and Oporto by Law 59/2011. The number of pending cases in the courts of 1st instance decreased although the number of appeals is increased. A permanent solution dealing in a structured way with this category of tax cases is currently under discussion.

Business environment

84. Liquidity constraints on non-financial corporations continue to be an issue of concern. The Decree Law 62/2013 of 10 May adopted by the government is not fully in line with the New Late Payments Directive 2011/7/EU. The main provision which is considered not to be in line with the Directive is Article 12 of the Decree Law, which provides that the deadline of a maximum of 60 calendar days to proceed to the payment of commercial transactions involving public entities providing healthcare will not be fully applicable until 31 December 2015. Microcorporations and small firms are however outside the scope of this exception. The Directive states that, as from 16 March 2013, Member States must ensure that in commercial transactions in the health sector the period of payment does not exceed 60 days following the receipt of the invoice by the debtor. The argument provided by the Portuguese authorities for such an exception is that full compliance both with the Directive and with the ongoing strategy for the settlement of arrears, which was agreed in the context of the programme, would entail a very significant cash disbursement with a very negative fiscal impact. The Commission has requested additional information to the Portuguese authorities and could launch an infringement procedure in the coming months for non-compliance.

85. The recently introduced VAT cash accounting regime will improve the financial and cash flow situation of businesses. Companies opting for this regime will pay/deduce the VAT when the payments from their customers/to their providers take place, rather than when the invoices are actually issued, as is currently the case. The measure applies to companies from all sectors of the economy with a turnover of up to EUR 500,000 and it entered into force on 1 October.

Licensing

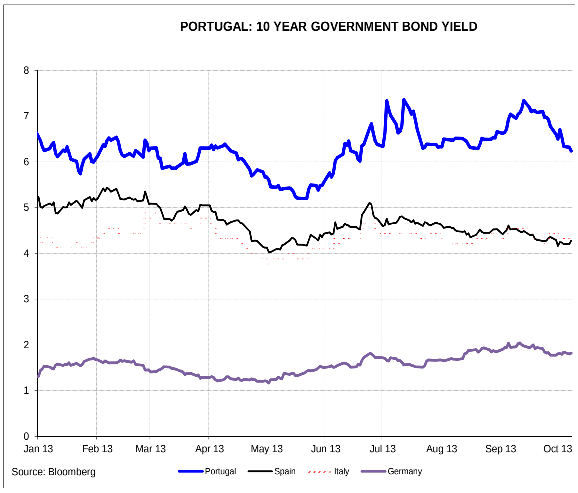
86. Most legal reforms envisaged to ease licensing requirements to businesses are behind schedule. This delay concerns almost all sectors in which reforms are awaited such as territorial planning, industry, geology, commercial or tourism activities. The recent changes in some of the Secretaries of State dealing with these various reforms seem to be a main reason for this delay. Moreover, in some cases the government has decided to change the approach and therefore legal texts do not build on the work that had been carried out by the previous teams. The high number of legal provisions to be adopted poses some concerns regarding the administrative capacity to adopt all of them over the next months. The New Legal Regime on Urbanism and Building (RJUE), which is expected to be adopted by November 2013, is a critical piece of complementary legislation on which progress in other areas depends. Progress has been achieved in some areas, such as (1) a draft Base Law for Soils, Territorial Planning and Urbanism submitted to Parliament; (2) the adoption of a Decree Law which fast-tracks the decisions regarding licensing requirements of investment projects over EUR 25 million; (3) the adoption of a new Environmental Impact Evaluation regime, whose compliance with the European legal is being assessed by the Commission; and (4) two ordinances on industrial licensing.

IV. PROGRAMME FINANCING

87. Since late spring, when sovereign bonds traded at pre-programme levels, market sentiment towards Portugal has deteriorated significantly. Global factors became less favourable for vulnerable sovereigns over the summer as the expectation of upcoming Fed "tapering" led to upward pressure on sovereign yields more generally. Real money investors started exiting riskier investments by shifting into safer sovereigns, which now offered a more attractive yield. The political crisis in Portugal, which erupted in early July, also raised investor concern about the government's stability and its commitment to the reform programme. Another Constitutional Court ruling against an important fiscal measure raised further doubts about the government's capacity to push through the necessary reforms. As a consequence, investors demanded higher premiums to reflect increased sovereign risk and Portuguese bond yields decoupled from other European sovereigns.

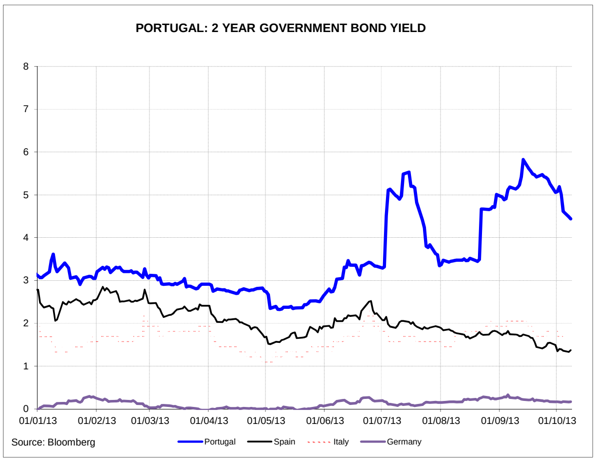
88. The Portuguese Treasury has tapped the domestic market for sovereign financing. Since May, the Treasury has increased the net issuance of Treasury bills by EUR 2.4 billion, mainly concentrating on longer maturities in this segment. Sales of retail debt products also made a small contribution to sovereign financing, and the Treasury expects this trend to continue. To that end, the Treasury introduced a new medium-term product in early October for the retail market, which is expected to deliver cost savings in relation to the current pricing of 5-year bonds. Privatisation receipts amounting to EUR 1 billion were recorded in September. Furthermore, in July the Social Security Financial Stabilization Fund was granted permission to invest up to EUR 4 billion of its foreign reserves into domestic sovereign debt.

Graph 9. 10-Year Government Bond Yield



Source: Bloomberg

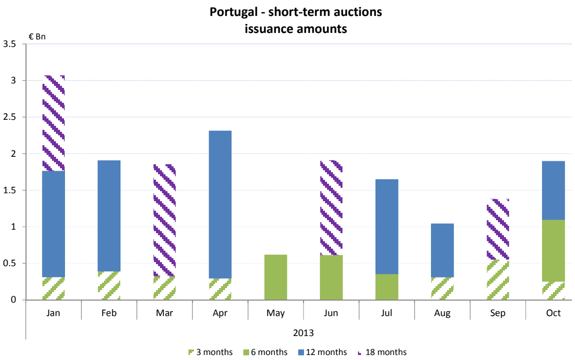
Graph 10. 2-Year Government Bond Yield



Source: Bloomberg

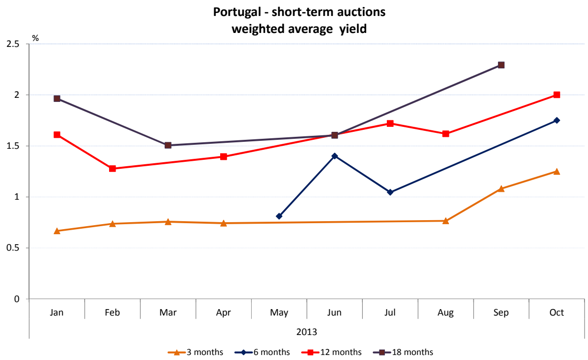
89. Portugal's market access depends heavily on the governments' commitment and ability to implement the programme. The very low liquidity in the market seen in September, particularly in the short end on the yield curve, showed that investors were waiting to see whether the government was willing and capable to pursue the programme or whether, on the contrary, declining social support and adjustment fatigue would force it to step down its ambition and slow the implementation of reforms. Past experience shows that market sentiment reacts very quickly in response to policy choices affecting the country's economy and sovereign debt level. The government's restated commitment to the fiscal deficit targets and planned reforms have already triggered positive reactions in the market and brought more risk-tolerant investors back to Portuguese bonds. However, implementation of the agreed measures and policies in the coming months will be crucial in restoring the prospects for regaining full market access.

Graph 11. Short-term auctions issuance amounts



Source:

Graph 12. Short-term auctions weighted average yield



Source:

90. Assuming full disbursement of programme financing, Portugal is fully funded for the remainder of the programme period, but restoration of market access is nevertheless vital for the Portuguese economy. The Treasury has accumulated a fairly large cash buffer, which stood at nearly EUR 15 billion by end-September. Together with the remaining official loan disbursements and assuming broad roll-over of Treasury bills, the funding – under current assumptions - will be sufficient to cover the sovereign needs until at least the middle of next year. The use of the above-mentioned domestic market sources could extend the coverage period further. At the same time, considerable down-side risks to the public finances exist, stemming from the accumulation of arrears, losses of state owned enterprises or budgetary slippages. While regaining market access at sustainable yields is not urgent for the sovereign, it is imperative for the wider economy, as Portuguese banks' and corporates' access to finance is closely linked to that of the sovereign. Looking to the post-programme period, restoring market access is essential in light of debt redemptions falling due in the second half of 2014.

91. The successful completion of the combined 8th and 9th reviews will pave the way for the disbursement of around EUR 5.6 billion, of which some EUR 3.7 billion will come from the EU and around EUR 1.9 billion from the IMF. With the disbursement of this tranche, more than 90% of the total financing envelope under the programme will have been disbursed.

ANNEXES

ANNEX 1: ASSESSMENT OF COMPLIANCE: MONITORING TABLE

2.7. The BdP will continue to strengthen its supervisory organisation […]. Launch a thematic review of banks' operational capacity in the area of loan restructuring and asset recovery to be completed by [October 2013].	**Observed.** New organizational structure in the supervision departments. The assessment of distressed loans management framework is currently ongoing.
2.9. The BdP continues to monitor on a quarterly basis the banks' potential capital […]. In this context, banks reflect the OIP findings in the implementation of the SIP recommendations on asset quality and stress testing methodologies [ongoing], with the update of the treatment of collective impairments expected to be finalised at the latest by [end-June 2013].	**Observed.** The review of the impairments in the credit portfolios of the eight largest national banking groups have confirmed the adequacy of the level of impairments booked in the balance sheet and the resilience of the banking system in what concerns its solvency.
2.12. Outsource the management of the credits currently held by Parvalorem to a professional third party […] through a competitive bidding process by [mid-2013], at the latest.	**Observed.** Loans in Parvalorem were split into four specific asset segments. Two successful bidders were awarded the contracts (on 14 August) to manage two segments each.
2.13. The early intervention, resolution and deposit guarantee framework has been strengthened. Conclude the implementing measures, in particular: (a) analyse the recovery plans of the top 8 banks [end-June 2013] and of the remaining banks [Ongoing]; (b) issue guidelines to the system on recovery plans by [September-2013]; (c) prepare resolution plans on basis of the reports to be provided by banks [Ongoing]. The resolution fund was set up and its funding arrangements concluded. The initial contributions by banks will be settled by [mid-June 2013] and the annual contributions by [end-September 2013].	**Observed.** Recovery plans analysis has been completed and gaps were identified. System guidelines are being finalized. The Resolution Fund is up and running since Q1 2013 and received from banks both the initial contribution (June) and yearly contribution (September). BdP dedicated a unit of six employees (full time equivalents) for resolution and plans to add further staff. The unit will formulate the resolution plans based on the reports provided by the banks.
2.16. […] Prepare quarterly reports on the implementation of the new restructuring tools with the first report due by [end-June 2013]. Conduct a survey of insolvency stakeholders to inquire about the appropriateness of the existing debt restructuring tools and possible gaps or bottlenecks by [end-July 2013]. […].	**Observed.** The authorities delivered in July the first quarterly monitoring report on the implementation of the new restructuring tools. A survey of insolvency stakeholders was conducted and its results presented in a report.
2.18. The Ministry of Finance, the BdP, and other stakeholders, have put forward a set of measures to encourage the diversification of financing alternatives to the corporate sector. i. focus the scope and prioritise the measures to be implemented [Ongoing]. ii. finalise a detailed assessment of the grouped issuance of corporate debt to obtain capital market financing [end-April 2013]. iii. prepare a first draft of the necessary amendments of the rules governing the	**Partially observed.** The preliminary detailed assessment on the grouped issuance of corporate debt has been submitted. The issuance was postponed to mid-2014. The first draft of the amendments to the rules governing the commercial paper market was submitted and discussed. The draft text already underwent a set of restricted consultations. The review of tax implications is pending.

commercial paper market by [end-June] and review any potential tax implications.	
2.19. Assess scope for improving the performance and governance of existing government-sponsored credit lines […]. Establish a quarterly monitoring and reporting mechanism on the allocation of the government sponsored credit lines aimed at facilitating access to finance to SMEs, with the first report due by [end-June 2013]. Conduct an external audit of the National Guarantee System, with a report of the main findings and policy recommendations to be submitted by [end-April 2013].	**Observed.** The authorities delivered in July the first quarterly monitoring report on the allocation of government-sponsored credit lines. The external audit of the National Guarantee System has been duly conducted and policy recommendation presented in a roadmap with a set of milestones to be accomplished.

ANNEX 2: COMMISSION SERVICES MACROECONOMIC PROJECTIONS 2012-2017

Table 1: Use and supply of goods and services (volume)

Annual % change	2012	2013	2014	2015	2016	2017
1. Private consumption expenditure	-5.4	-2.5	0.1	0.7	0.9	1.0
2. Government consumption expenditure	-4.8	-4.0	-2.8	-2.2	-0.9	-0.9
3. Gross fixed capital formation	-14.3	-8.5	1.2	3.7	4.1	4.3
4. Final domestic demand	**-6.8**	**-3.7**	**-0.3**	**0.6**	**1.1**	**1.2**
5. Change in inventories	--	--	--	--	--	--
6. Domestic demand	**-6.7**	**-3.7**	**-0.3**	**0.7**	**1.1**	**1.2**
7. Exports of goods and services	3.2	5.8	5.0	5.3	5.5	5.5
7a. - of which goods	4.1	5.6	4.9	5.5	5.5	5.5
7b. - of which services	0.7	6.6	5.3	4.9	5.5	5.5
8. Final demand	**-4.2**	**-1.1**	**1.3**	**2.1**	**2.5**	**2.6**
9. Imports of goods and services	-6.6	0.8	2.5	3.7	4.4	4.6
9a. - of which goods	-6.4	1.2	2.7	3.8	4.5	4.7
9b. - of which services	-7.8	-1.5	1.5	3.5	4.3	4.0
10. Gross domestic product at market prices	**-3.2**	**-1.8**	**0.8**	**1.5**	**1.7**	**1.8**
Contribution to change in GDP						
11. Final domestic demand	-7.1	-3.7	-0.3	0.6	1.0	1.1
12. Change in inventories + net acq. of valuables	0.1	0.0	0.0	0.0	0.0	0.0
13. External balance of goods and services	3.8	2.0	1.0	0.8	0.6	0.6

Table 2: Use and supply of goods and services (value)

Annual % change	2012	2013	2014	2015	2016	2017
1. Private consumption expenditure	-4.0	-2.0	1.1	2.0	2.4	2.5
2. Government consumption expenditure	-11.6	2.9	-3.9	-4.4	-0.1	-0.1
3. Gross fixed capital formation	-13.9	-10.6	2.4	6.6	6.9	7.2
4. Final domestic demand	**-7.2**	**-2.5**	**0.3**	**1.5**	**2.7**	**2.8**
5. Change in inventories	--	--	--	--	--	--
6. Domestic demand	**-7.0**	**-2.4**	**0.3**	**1.5**	**2.7**	**2.8**
7. Exports of goods and services	4.6	5.2	5.9	6.4	6.6	6.6
8. Final demand	**-4.0**	**-0.3**	**2.0**	**3.0**	**3.9**	**4.1**
9. Imports of goods and services	-5.3	-1.4	2.6	4.4	5.2	5.4
10. Gross national income at market prices	-2.3	-1.1	0.3	1.8	3.1	3.2
11. Gross value added at basic prices	-3.4	0.7	1.6	2.3	3.3	3.4
12. Gross domestic product at market prices	**-3.5**	**0.1**	**1.7**	**2.5**	**3.4**	**3.5**

Table 3: Implicit price deflators

% change in implicit price deflator	2012	2013	2014	2015	2016	2017
1. Private consumption expenditure	1.5	0.6	1.0	1.2	1.5	1.5
2. Government consumption expenditure	-7.2	7.2	-1.1	-2.2	0.8	0.8
3. Gross fixed capital formation	0.4	-2.3	1.2	2.7	2.7	2.8
4. Domestic demand	**-0.4**	**1.3**	**0.6**	**0.8**	**1.6**	**1.6**
5. Exports of goods and services	1.4	-0.6	0.8	1.0	1.0	1.0
6. Final demand	**0.1**	**0.8**	**0.7**	**0.9**	**1.4**	**1.4**
7. Imports of goods and services	1.4	-2.2	0.1	0.6	0.8	0.8
8. Gross domestic product at market prices	**-0.3**	**1.9**	**0.9**	**1.0**	**1.7**	**1.7**
HICP	**2.8**	**0.6**	**1.0**	**1.2**	**1.5**	**1.5**

Table 4: Labour market and cost

Annual % change	2012	2013	2014	2015	2016	2017
1. Labour productivity (real GDP per employee)	1.0	2.2	1.3	1.0	1.1	1.2
2. Compensation of employees per head	-2.0	2.5	-0.8	-0.2	0.4	0.5
3. Unit labour costs	**-3.0**	**0.3**	**-2.1**	**-1.2**	**-0.7**	**-0.7**
4. Total population	-0.4	-0.7	-0.1	-0.1	0.0	0.0
5. Population of working age (15-64 years)	-1.0	-0.3	-0.1	0.0	0.0	0.0
6. Total employment (fulltime equivalent)	-4.2	-3.9	-0.5	0.4	0.6	0.6
7. Calculated unemployment rate - Eurostat definition (%)	**15.9**	**17.4**	**17.7**	**17.3**	**16.8**	**16.2**

Table 5: External balance

levels, EUR bn	2012	2013	2014	2015	2016	2017
1. Exports of goods (fob)	47.7	50.0	52.9	56.4	60.1	64.1
2. Imports of goods (fob)	55.4	54.8	56.3	58.8	61.9	65.3
3. Trade balance (goods, fob/fob) (1-2)	**-7.7**	**-4.7**	**-3.4**	**-2.4**	**-1.8**	**-1.2**
3a. p.m. (3) as % of GDP	***-4.7***	***-2.9***	***-2.0***	***-1.4***	***-1.0***	***-0.6***
4. Exports of services	16.2	17.2	18.3	19.3	20.6	22.0
5. Imports of services	9.5	9.2	9.3	9.7	10.2	10.7
6. Services balance (4-5)	**6.7**	**8.0**	**8.9**	**9.6**	**10.4**	**11.3**
6a. p.m. 6 as % of GDP	***4.0***	***4.8***	***5.3***	***5.6***	***5.8***	***6.1***
7. External balance of goods & services (3+6)	**-1.0**	**3.3**	**5.6**	**7.2**	**8.6**	**10.1**
7a. p.m. 7 as % of GDP	***-0.6***	***2.0***	***3.3***	***4.2***	***4.8***	***5.5***
8. Balance of primary incomes and current transfers	-2.2	-1.7	-4.0	-5.5	-6.3	-7.1
8a. - of which, balance of primary income	*-4.0*	*-6.0*	*-8.3*	*-9.7*	*-10.5*	*-11.3*
8b. - of which, net current Transfers	*1.8*	*4.3*	*4.3*	*4.2*	*4.2*	*4.2*
8c. p.m. 8 as % of GDP	*-1.3*	*-1.0*	*-2.4*	*-3.2*	*-3.5*	*-3.8*
9. Current external balance (7+8)	**-3.2**	**1.5**	**1.5**	**1.7**	**2.3**	**3.0**
9a. p.m. 9 as % of GDP	***-1.9***	***0.9***	***0.9***	***1.0***	***1.3***	***1.6***
10. Net capital transactions	3.5	4.4	4.6	4.3	4.6	4.7
11. Net lending (+)/ net borrowing (-) (9+10)	**0.3**	**5.9**	**6.1**	**6.1**	**6.9**	**7.7**
11a. p.m. 11 as % of GDP	***0.2***	***3.6***	***3.6***	***3.5***	***3.9***	***4.2***

Table 6: Fiscal accounts

	2012	2013	2014	2015	2016	2017
% of GDP						
Indirect taxes	13.7	13.3	13.4	13.5	13.5	13.4
Direct taxes	9.3	11.2	11.1	11.1	11.0	11.0
Social contributions	11.6	12.0	11.6	11.3	11.1	10.9
Actual	9.1	9.4	9.2	9.1	9.0	8.9
Imputed	2.5	2.6	2.4	2.2	2.1	2.0
Sales and other current revenue	4.9	5.6	5.5	5.7	5.6	5.7
Sales	2.8	2.9	2.7	2.7	2.7	2.7
Other current revenue	2.1	2.7	2.8	2.9	2.9	2.9
Total current revenue	**39.4**	**42.0**	**41.7**	**41.6**	**41.3**	**41.0**
Capital transfers received	1.5	1.2	1.1	1.1	1.1	1.1
Total revenue	**40.9**	**43.2**	**42.8**	**42.7**	**42.5**	**42.1**
Compensation of employees	10.0	10.6	9.4	8.8	8.5	8.2
Intermediate consumption	4.5	4.7	4.6	4.4	4.3	4.2
Social transfers in kind via market producers	4.5	4.5	4.3	4.1	4.0	3.9
Social transfers other than in kind	18.0	18.7	18.5	18.1	17.9	17.6
Interest paid	4.3	4.3	4.4	4.4	4.4	4.4
Subsidies	0.6	0.7	0.8	0.7	0.7	0.7
Other current expenditure	2.6	2.7	2.8	2.6	2.5	2.5
Total current expenditure	**44.5**	**46.4**	**44.7**	**43.1**	**42.4**	**41.6**
Gross fixed capital formation	1.7	1.9	1.8	1.7	1.7	1.7
Other capital expenditure	1.3	0.9	0.3	0.4	0.4	0.4
Total expenditure	**47.4**	**49.1**	**46.8**	**45.3**	**44.5**	**43.7**
General Government balance (EDP)	**-6.5**	**-5.9**	**-4.0**	**-2.5**	**-2.0**	**-1.6**
General Government balance (Programme)	**-6.0**	**-5.5**	**-4.0**	**-2.5**	**-2.0**	**-1.6**
% change						
Indirect taxes	-4.1	-2.5	2.7	3.5	3.4	2.5
Direct taxes	-9.5	20.9	1.0	2.3	3.2	3.2
Social contributions	-9.1	3.6	-1.1	-0.6	1.3	1.6
Sales and other current revenue	4.2	13.9	0.3	5.3	2.7	4.1
Total current revenue	**-6.0**	**6.8**	**0.8**	**2.3**	**2.7**	**2.7**
Capital transfers received	-68.0	-22.4	-4.6	5.8	4.8	5.3
Total revenue	**-12.3**	**5.7**	**0.7**	**2.4**	**2.6**	**3.0**
Compensation of employees	-15.0	6.3	-6.6	-4.0	-0.7	0.0
Intermediate consumption	-6.4	6.1	-1.2	1.0	2.2	1.0
Social transfers in kind via market producers	-5.9	-0.9	-1.8	-3.5	0.5	0.5
Social transfers other than in kind	-0.5	4.5	0.2	0.6	1.9	1.9
Interest paid	4.1	0.5	1.8	3.2	4.6	3.8
Subsidies	-17.4	20.0	4.8	1.8	2.5	1.0
Other current expenditure	-4.8	4.9	7.3	-2.6	2.5	3.2
Total current expenditure	**-5.4**	**3.8**	**-1.5**	**-1.4**	**1.6**	**1.9**
Gross fixed capital formation	-38.6	12.5	-2.8	-3.6	3.5	3.5
Other capital expenditure	-11.0	-27.5	-65.1	45.3	2.5	3.1
Total expenditure	**-7.3**	**3.2**	**-2.9**	**-1.2**	**1.6**	**2.0**
Nominal GDP, EUR bn	165.1	165.3	168.2	172.3	178.2	184.5

Table 7: Government debt developments

	2012	2013	2014	2015	2016	2017
EDP deficit (% of GDP)	**-6.5**	**-5.9**	**-4.0**	**-2.5**	**-2.0**	**-1.6**
EDP gross debt (% of GDP)	124.1	127.8	126.7	125.7	123.5	120.0
	levels, EUR bn					
EDP deficit	**-10.7**	**-9.8**	**-6.8**	**-4.4**	**-3.6**	**-3.0**
Gross debt	204.8	211.4	213.0	216.6	219.9	221.5
Change in gross debt	19.6	6.5	1.6	3.7	3.3	1.6
Nominal GDP	165.1	165.3	168.2	172.3	178.2	184.5
Real GDP	170.4	173.4	172.1	169.5	166.7	163.6
Real GDP growth (% change)	**-3.2**	**-1.8**	**0.8**	**1.5**	**1.7**	**1.8**
Change in gross debt (% of GDP)	11.9	3.9	1.0	2.1	1.9	0.9
Stock-flow adjustments (% of GDP)	5.4	-2.0	-3.1	-0.4	-0.2	-0.8
	% of GDP					
Gross debt ratio	**124.1**	**127.8**	**126.7**	**125.7**	**123.5**	**120.0**
Change in gross debt ratio	15.8	3.8	-1.2	-1.0	-2.3	-3.4
	Contribution to change in gross debt					
Primary balance	2.1	1.6	-0.3	-1.8	-2.4	-2.8
"Snow-ball" effect	8.2	4.1	2.2	1.3	0.3	0.2
of which						
Interest expenditure	*4.3*	*4.3*	*4.4*	*4.4*	*4.4*	*4.4*
Real growth effect	*3.5*	*2.2*	*-1.0*	*-1.9*	*-2.1*	*-2.2*
Inflation effect	*0.4*	*-2.5*	*-1.2*	*-1.3*	*-2.1*	*-2.0*
Stock-flow adjustments	**5.4**	**-2.0**	**-3.1**	**-0.4**	**-0.2**	**-0.8**
Implicit interest rate	*3.9*	*3.5*	*3.5*	*3.5*	*3.6*	*3.7*

ANNEX 3: INDICATIVE FINANCING NEEDS AND SOURCES

Financing needs and sources (EUR billion)

	2011 Jun-Dec	2012 Year	2013 Year	2014 Year	2011-2014 Total
Public sector deficit	**11.3**	**13.3**	**13.9**	**11.5**	**50.0**
Treasury balance [1]	7.1	8.9	8.9	6.7	31.7
Other public sector cash needs [2]	4.2	4.4	5.0	4.7	18.3
Amortization [3]	**9.5**	**27.8**	**11.0**	**13.9**	**62.2**
Medium- and long-term debt (incl debt exchange)	4.9	16.6	6.2	13.9	41.6
Other debt (retail, repos, incl SOE), net	4.6	11.2	4.8	0.0	20.6
Banking support [4]	**1.0**	**7.5**	**1.6**	**0.5**	**10.6**
Financing needs	**21.8**	**48.6**	**26.5**	**25.9**	**122.8**
Market financing	**-6.4**	**8.9**	**7.9**	**12.4**	**22.8**
Medium- and long-term debt	0.0	3.6	5.5	12.5	21.5
T-Bills, net	-6.4	5.3	2.4	0.0	1.3
Own resources [5]	**-5.7**	**12.3**	**8.6**	**5.6**	**20.8**
EU-IMF loan	**34.0**	**27.4**	**10.0**	**7.8**	**79.2**
EFSM/EFSF	21.0	19.3	6.6	5.1	52.0
IMF [6]	13.0	8.2	3.4	2.7	27.2
Financing sources	**21.8**	**48.6**	**26.5**	**25.9**	**122.8**

SOURCE: Portuguese authorities and Commission services' estimates.

1/ Calendar-year cash basis.

2/ Includes financing to state-owned enterprises, contributions to the ESM and the economic adjustment programme for Madeira, and repayment of arrears.

3/ Central government, excl. T-Bills.

4/ From 2012 includes actual banking sector needs; for 2011 - payments to BSSF.

5/ Includes privatisation receipts, use of deposits, pension fund assets and centralisation of cash management of general government entities.

6/ Numbers do not add up to EUR 26 bn due to changes in EUR-SDR rate compared to beginning of programme; SDR rate of October 2013 projections applied for 2013-2014 disbursements, no revisions for 2011-2012 data.

Table 9: Planned quarterly disbursements (EUR billion)

Review	Period covered by disbursement	Approximate disbursement period	Loan disbursements[1]	of which IMF[2] (1/3)	of which EU (2/3)
Approval	Jun-Sept 2011	Jun-11	18.9	6.5	12.4
1	Q4-2011	Sep-11	11.6	4.0	7.6
2	Q1-2012	Dec-11	8.0	2.8	5.2
3	Q2-2012	Apr-12	14.8	5.1	9.7
4	Q3-2012	Jul-12	4.0	1.4	2.6
5	Q4-2012	Oct-12	4.3	1.5	2.8
6	Q1-2013	Jan-13	1.6	0.8	0.8
7	Q2-2013	Apr-13	2.8	0.7	2.1
8 & 9	Q3/Q4-2013	Nov-13	5.6	1.9	3.7
10	Q1-2014	Jan-14	2.7	0.9	1.8
11	Q2-2014	Apr-14	2.5	0.9	1.6
12	Q3-2014	Jun-14	2.6	0.9	1.7
	TOTAL		79.4	27.4	52.0

[1] *Data is subject to revision due to EUR - SDR fluctuations.*

[2] *IMF disbursements are defined in SDR. Actual disbursement in EUR is subject to changes in the EUR-SDR exchange rate*

ANNEX 4: PROVISION OF DATA (REPORTING REQUIREMENTS)

During the programme, the following indicators and reports shall be shared with the European Commission, the ECB and the IMF by the authorities on the agreed periodic basis. Data for past periods should also be included in subsequent transmissions in case of revision. Other indicators may also be requested to and reported by the Portuguese Authorities.

	To be provided by the Ministry of Finance (or INE)	
1.	Data on cash balances of the State Budget. Data will include detailed information on revenue and expenditure items, in line with monthly reports that are published by the Ministry of Finance (MoF). Data on tax revenue should be decomposed in gross tax revenue received and tax reimbursements paid by the State (detailed per main individual taxes)	Monthly, 3 weeks after the end of the month
2.	Data on the cash balances of the other parts of General Government (Autonomous Funds and Services, Social Security and Other entities, including Incorporated State-owned enterprises (ISOEs) or extra-budgetary funds (EBF) not part of the State Budget, but which are, under the European System of Accounts (ESA95) and ESA95 Manual on Government Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government; [Regional and Local Governments (*Administrações Regionais and Locais*); Regional and local government-owned enterprises or companies, foundations, cooperatives, and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government, as defined in paragraph 4 of the TMoU) – progressively enlarged	Monthly, as soon as the data are available and no later than 7 weeks after the end of the month
3.	Accrual data on budget execution of the National Health System (NHS)	Monthly, 3 weeks after the end of each month
4.	Consolidated cash data on the General Government budget execution initially comprising the Central Government and Social Security and enlarging progressively the scope as in indicated in the TMoU, MoU and MEFP	Monthly, 7 weeks after the end of each month
5.	Publish information on: number of general government staff on a quarterly basis (no later than 45 days after the end of the quarter); stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, special mobility condition flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. The regional and local administration will transmit the necessary information. Information on employment in SOEs (central, local and regional) and other public entities and/or bodies will also be compiled	Quarterly, no later than 30 days after the end of the quarter (as of March 2012)
6.	Consolidated account on an accrual basis of the non-financial SOEs that are classified within the Central Government	Quarterly, 90 days after the end of the quarter (as of March 2012)
7.	Data on the past and projected financing needs of SOEs, including for the major SOEs details on the financing needs for the operational balance, capital expenditure, interest payments and debt principal repayments	Monthly, 4 weeks after the end of the month
8.	Data on arrears of: • the General Government, detailed by subsector • the incorporated (SOEs) government-owned hospitals that are not part of the General Government • other non-financial SOEs that are not part of the General Government	Monthly, 7 weeks after the end of each month (as of September 2011)

9.	Information on Public-Private Partnerships (PPP) related revenue and expenditure, for those PPP reclassified within the General Government (in line with paragraph 5.2 of the TMoU)	Monthly, 30 days after the end of the each month
10.	New guarantees granted by the State to SOEs, PPPs, banks and the non-financial private sector	Monthly, 30 days after the end of each month
11.	Detailed information on called guarantees of the State	Monthly, 30 days after the end of each month
12.	Data on proceeds from asset sales by the Central, Regional and Local Government	Monthly for Central Government Quarterly for Regional and Local Government 30 days after the end of reference period
13.	Quarterly data on General Government accounts as per the relevant EU regulations on statistics, showing also the main items of the transition from cash balances to the General Government balances in national accounts	Quarterly, 90 days after the end of each quarter
	To be provided by ESAME	
14.	Report on progress with fulfilment of economic policy conditionality on a quarterly basis. In addition, a short summary report should be sent on a monthly basis	Quarterly (report), two weeks after the end of each quarter. Monthly (short summary report) two weeks after the end of each month for which a report is not due.
	To be provided by the Debt Management Office	
15.	Accrual data on interest spending of the State	Quarterly, 7 weeks after the end of the quarter
	To be provided by the Ministry of Labour	
16.	Data on labour market as follows: a. layoffs by type b. collective agreements by type and number of collective agreements that are extended by the Ministry of Labour to non-signatory firms c. number of collective agreements that regulate the use of the Bank of Hours working time arrangement d. proportion of unemployed receiving unemployment benefits e. distribution of the unemployed in terms of amount of benefits received (mean of benefits received, median, number of unemployed receiving an unemployment benefit amount equal to the IAS and number of unemployed receiving the maximum amount of unemployment benefits allowed) f. unemployment duration	Every six months, 6 weeks after the end of each semester
	To be provided by Ministry of Justice	
17.	Publishing quarterly reports on recovery rates, duration and costs of corporate insolvency cases	Quarterly, starting in 2011 Q3, within four months after the end of each quarter.