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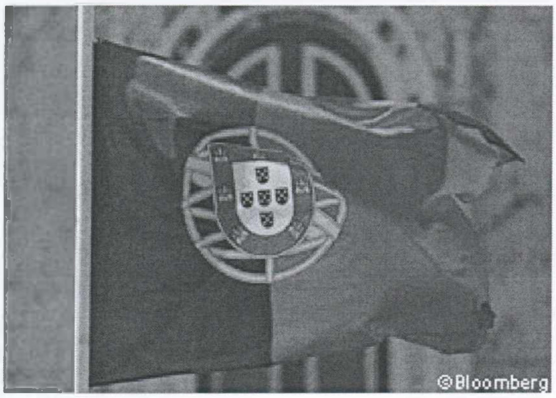
149

Portugal seeks flexibility on bail-out

By Peter Wise in Lisbon



Portugal is to ask the European Union and International Monetary Fund for changes to its €78bn financial rescue agreement to help lift the country's debt-stricken economy out of recession.

Pedro Passos Coelho, prime minister, said he would seek "greater flexibility" to channel finance to companies in an effort to stimulate economic growth.

"We will propose some adjustments to our financial and economic assistance programme to take into account economic realities and the evolution of the main [economic] variables," he said at a meeting of Latin American and Iberian leaders in Paraguay on Sunday.

The Portuguese economy is forecast to contract by 4.9 per cent over 2011 and 2012, with unemployment reaching a record 13.4 per cent, after the government introduced additional austerity measures to meet fiscal targets agreed under the bail-out programme.

Mr Passos Coelho said he would propose the adjustments to officials from the so-called troika – the EU, IMF and European Central Bank – in November when they review Portugal's progress with the rescue agreement.

The prime minister, whose centre-right coalition took office in June, insisted Portugal would meet the fiscal objectives agreed with the troika. These require a cut in the budget deficit from 9.8 per cent of gross domestic product last year to 5.9 per cent in 2011 and 4.5 per cent in 2012.

Some economists and opposition politicians said the renegotiation could focus on alleviating some austerity measures and giving Portugal more time to reduce government deficits.

Others said the proposed changes were likely to turn on bank financing. The €78bn rescue fund includes €12bn to help Portuguese banks strengthen their capital.

The Bank of Portugal estimates banks will need €7.8bn to comply with a mandatory scheme for bolstering bank defences agreed by the EU. But the government wants to ensure banks do not strengthen their capital ratios by cutting off credit to companies.

Some banks, reluctant to tap the €12bn fund because it would imply state ownership of part of their capital, have called for the government to settle massive public sector bank debts instead.

The centre-left Socialists, the main opposition party, called on Mr Passos Coelho to detail the changes he was proposing and specify the financial amounts involved before parliament votes later this month on a tough austerity budget for 2012.

The Socialists, who negotiated the bail-out agreement before losing power in a general election, also criticised the prime minister for making "such an important statement" during an overseas visit and without any prior consultation with opposition parties.

Rui Martins dos Santos, a senior economist with Banco BPI, a leading Portuguese lender, said it was in the interest of Portugal's international creditors to alleviate the terms of the rescue agreement.

"Greece shows that it is counter-productive to attempt to meet fiscal targets by endlessly increasing austerity," he said. "The risk is that countries will be pushed into a depressive spiral."

Some economic targets were beyond the control of governments, he added. "The focus should be on implementing an agreed set of measures rather than on hitting specific targets by a set deadline. More austerity is not always the shortest route to positive results."

Mr Passos Coelho has introduced tough additional austerity measures in an effort to keep Portugal on track with its deficit targets as the outlook for economic growth deteriorates.

In October, the Bank of Portugal revised its forecast downwards, projecting a 2.2 per cent contraction in the economy in 2012, compared with the 1.8 per cent contraction it forecast in July. The government subsequently adjusted its own forecast downwards, projecting a 2012 contraction of 2.8 per cent.

Mr Martins dos Santos said a less aggressive deleveraging programme for Portuguese banks would help free up funds that lenders could use to finance companies and help lift economic growth.

Settling public sector bank debts, which analysts estimate to total about €40bn, would also make more finance available for the productive sector, he said.

Under Portugal's bail-out agreement, the country's banks were already required to increase their core tier one capital ratios, the main measure of financial strength, from the current minimum level of 7 per cent to 9 per cent in 2011 and 10 per cent in 2012.

The new EU bank recapitalisation scheme obliges them to factor in additional coverage for their sovereign debt exposure, requiring them to raise more capital than previously envisaged to reach the 9 per cent level.

Francisco Louçã, leader of the Bloco Esquerda, a leftwing group with eight parliamentary seats, said the government's aim in adjusting the rescue programme was only to ease pressures on Portuguese banks, not to alleviate the austerity facing families.

Economists estimate that the 2012 budget proposals, accumulated with earlier cuts, will reduce average public sector pay by more than 20 per cent in 2012 compared with 2010.

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