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THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

BULLETIN

No. 72 (667), 23 May 2014 © PISM

The End of Portugal's Bailout Programme: A Sign of Hope for the Eurozone?

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Portugal has left the European Union/International Monetary Fund three-year bailout programme without renewal. It is the third eurozone Member State to take such a step, which may be interpreted by the international financial markets as a sign of the end of the eurozone's economic troubles. This takes place against a backdrop of new circumstances, such as ongoing reform of the eurozone architecture, in which economic governance instruments such as the banking union, the fiscal compact and the European Semester are gradually being introduced. It is also a small victory for the supporters of austerity policy, notably Germany. Portugal could be used as an example to the other eurozone countries in trouble, to motivate them to continue harsh reform path. Although Poland tackles problems of a different scale, it should assess the Portuguese case in its budget consolidation plans.

Portugal is the third eurozone country (following Ireland and Spain, at the end of 2013 and beginning of 2014) to quit the joint EU/IMF assistance programme valued at €78 billion (EFSM—€26 billion, EFSF—€26 billion, IMF—€26 billion). Only Greece and Cyprus continue to receive assistance. In consequence, the markets have assessed the country debts safer—Standard & Poor's gives a stable instead of previously negative outlook, and Moody's upgraded the rating to Ba2 at the beginning of May, placing it on review for further upgrade. Additionally, the interest rate on 10-year government bonds have decreased from around 6.03% since the beginning of 2014, to 3.77% in May, which also suggests a return to confidence in the Portuguese economy.

A Green Light for the Eurozone. The decision of each of the eurozone states to exit bailout was received with support from the markets as well as from the Eurogroup. A third such event is a moderately positive sign for the future of the eurozone, and a moderate counterweight to the aggravating economic troubles of Italy or France. Certainly, the weight of Portugal's problems is not equal to Italy's, yet the eurozone still needs confirmation that the reaction to the crisis is adequate. One should add to this the increasingly positive economic forecasts for the eurozone (the Purchasing Managers Index is at around 53 points), which means expectations that businesses will improve their performance. Also, the EC's growth predictions for 2014 are around 1.4%, an improvement on previous forecasts, and the budget deficit outlook suggests a slight fall. This means that the worst part of the crisis could be behind the eurozone.

With the exception of Cyprus, this is also the case for the other states in the bailout programme. In 2014, the Greek economy is expected to grow for the first time since the crisis, and Spain could reach 1% growth. Ireland's economy grew slightly in 2013, and this year could be above eurozone average. Similar improvement is expected regarding the labour markets, with exception of Cyprus. The highest unemployment is expected to be in Greece and Spain (26%) and the lowest in Ireland (11.9%). Moreover, February's forecasts for 2014 are more optimistic than the previous ones for the same year. The financial markets perceive the developments within these countries as positive, resulting in decreasing bond yields. For example, Greece's 10-year bond yields are now at 6.25%, Spain's at 2.93%, and Ireland's at 2.67%. It is important that even Greece, hit hard by the crisis, returned to the bond market in April. This means that, although the performances of these states remain worse than the rest of world, it is nevertheless a step in right direction, and provides a strong base for further improvement.

Unresolved Challenges for Portugal. The post-bailout eurozone states have survived the worst of the economic crisis, but they remain weak. This is also true of Portugal, which is in a fragile position. Before the application for a bailout it was a country that recovered faster than other Western European states. When the crisis arrived from Greece, via growing interest rates and subsequent rating downgrades, the Portuguese performance was downgraded, plunging the country into a three-year recession. The 2011 developments put Portugal in a difficult position, forcing it to apply for international assistance. Since then, the Portuguese government has conducted harsh reforms, including tax hikes (including sales tax, but not corporate tax), freezes and cuts of salaries in the public sector, €8 billion worth of privatisation of corporations (mainly electricity and postal services), and was forced to give up the so-called golden share in Portugal Telecom. It made substantial cuts in public health care spending and reformed the judicial system to speed up trials. It liberalised labour markets, notably in services, which in consequence lowered labour costs and made the economy more export oriented. It also focused on vocational training and on tackling youth unemployment.

The depth of the structural reforms made by the government was so great that even the officials boasted of it and suggested that the other countries should follow Portugal's example. Moreover, the "Troika" (the European Commission, the European Central Bank, and the International Monetary Fund), stated that Portugal had outperformed compared to expectations regarding the economy. The negative trade balance due to focus on exports has been reduced significantly (from as low as minus 12.6% in 2009, to minus 3% of GDP in 2013). External debt was also reduced by around 10%.

Nevertheless, Portugal's post-bailout situation will be very fragile. During 2014 there will be only a slight recovery of about 0.8% of GDP growth. Compared to the beginning of the bailout programme, many areas of the economy still need to be improved. The most visible challenge is substantial government debt reduction, which is still unfavourably high (126.6% GDP), although it is still below the peak in 2013, when it reached 129.4% of GDP. The continuation of debt consolidation would amplify social tensions, arising from the high level of unemployment. Portugal also remains highly exposed to foreign capital, its net international investment position is down by 118.7% of GDP (so the net external liabilities still exceed the country's GDP), and except for Greece, this is the worst result in the EU and one of the worst in the world. The other problem is continuing high unemployment and the massive exodus of skilled and unskilled labour, including in the public sector.

Advocating Austerity? The positive projections of economic performance for the eurozone bailout states is perceived as the result of implementing the reforms agreed as part of the rescue packages. This also means that imposed austerity might actually have worked for the bailout states. If so, this strengthens Germany's arguments for implementing austerity to tackle economic problems, which could strengthen Germany's voice regarding economic governance of the eurozone. By gaining ground in the argument that the current direction works, Germany disarms its opponents not only in terms of the measures to tackle crisis situations, but also in terms of the future architecture of the eurozone.

But there is another side to the coin. Some experts perceive the exit from bailout as the evasion from further reforms, which could be imposed by as conditions of further assistance. From such a perspective, the German austerity-oriented approach to economic policy in the eurozone, as well as Berlin's views on further integration, would be met with reluctance. This point of view should however be modified to take into account two facts. First, the tightening of coordination of national economic policies has already taken place, and the post-bailout countries still will be under scrutiny. Second, the Portuguese government wishes to use this exit to promote itself, and has already declared that it will continue on the same path.

Conclusions and Recommendations. Even though this situation does not represent the end of economic troubles for post-bailout states, or for the eurozone as a whole, the positive correlation between the post-bailout states' improved economic situation and more strongly coordinated economic policies favours the idea to push forward with deeper economic governance. One may expect that, during the upcoming European summits, EU leaders will be more enthusiastic towards stronger economic governance than before. Additionally, this would put a stronger pressure on Greece and Cyprus to continue unpopular reforms, and would furthermore put moderate pressure on non-bailout yet poorly performing countries, such as France or Italy.

The most advantageous solution for Poland regarding the future of economic integration would be to support the existing governance instruments, notably the European Semester and its macroeconomic imbalances procedure, as well as arguing for country specific recommendations to be used to their full potential. This instrument, due to its comprehensiveness, periodicity and involvement of the Member States in the process, enables the forging of effective solutions to boost states' competitiveness. In the case of greater significance of this Semester, a more powerful European Commission as the guardian of this instrument's effectiveness is also in Poland's interests.

Poland's economy is different from Portugal's. However, some useful lessons can be learned from the Portuguese case. The first is to reduce the level of exposure to foreign lenders. Poland's net international investment position is only half as bad as Portugal's, yet it is still far from satisfactory. This is extremely important, as Poland, with its floating currency, is exposed to variable debt. Also, Portugal's difficulties experienced of conducting fiscal policy at high levels of debt should be a warning to Poland not to allow such situation to develop. The next lesson is about the benefits of improved competitiveness, which affects a nation's economic performance. Thus Poland should concentrate on developing competitiveness, to avoid a middle income trap.