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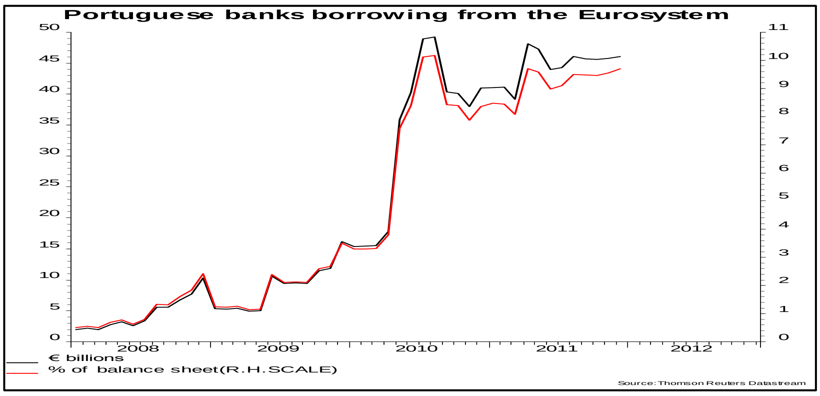
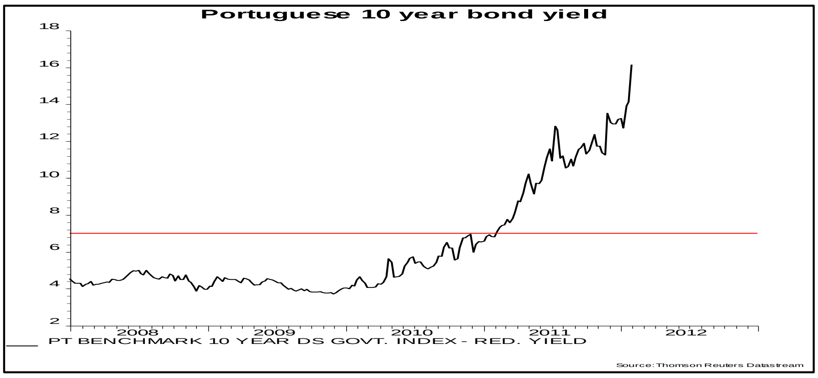
Jefferies European Economic Commentary

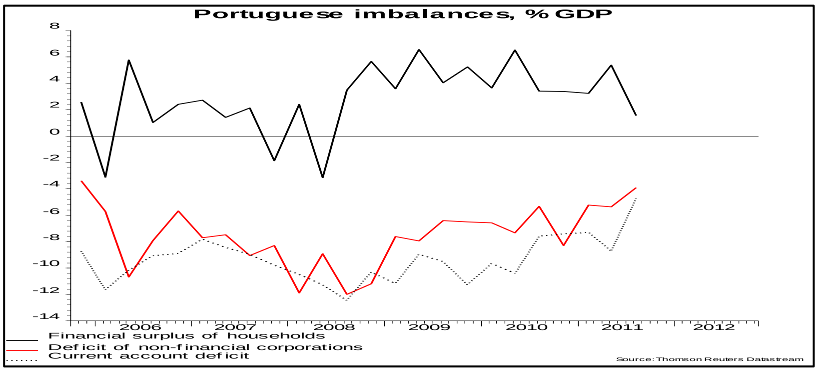
GLOBAL FIXED INCOME

Portugal: Focus on the fundamentals

As more parallels are drawn between Portugal & Greece, it is important to perhaps draw attention to some key differences. For one thing, Portuguese banks need for liquidity is no higher now than the middle of 2010, before Portuguese bond yields first breached 7%. Liquidity provision was €46.6bn in December, still less than 10% of the banks' balance sheet (see first chart below). This compares with around 30% in the case of Greece and almost 20% for domestic Irish banks. Moreover, in their December review of Portugal the IMF expected the country to be running a small primary surplus this year and despite recession, for general debt to peak at 118.1% of GDP in 2013 (see table page 2), below the 120% "target" for Greece by the end of the decade. (Also bear in mind that the IMF in September was forecasting a figure for Greece of almost 190% of GDP in 2012). And, analysis of the latest Financial Accounts for Portugal paint a picture of the economy's imbalances painfully, but slowly adjusting (third chart below).







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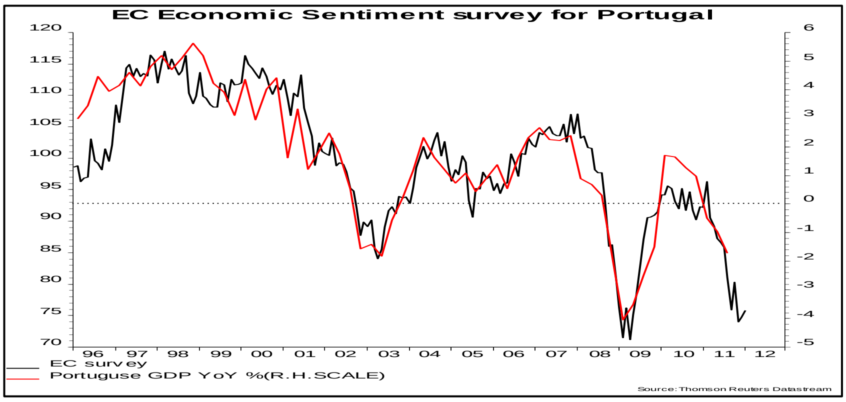
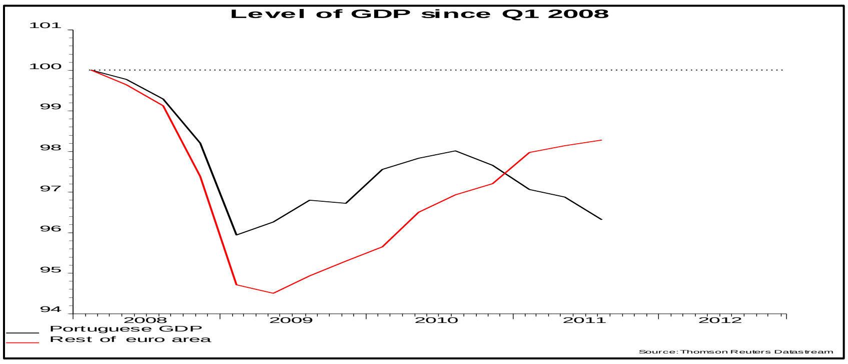
Clearly, much can happen in the weeks ahead – for one thing latest BIS data highlight how exposed Portuguese banks are to Spain (see final table) an economy also now in recession. With the total balance sheet of Portuguese banks around €475bn, this puts the exposure of its banks to Spain at just over 15% of total bank assets.

And, for consistency the IMF will likely have to revise their Portuguese numbers, on the back of the revisions they made to the larger economies two weeks ago. Two weeks ago the IMF revised down their estimate of the level of Spanish GDP for end 2013 by almost 5 percentage points, a substantial revision in the space of effectively 3 months, compared to their September estimates. The correlation between Spanish and Portuguese is far from perfect. But, the more economies around Portugal slip into recession, the harder it will be for there to not to be some slippage on the IMF's plans, especially as the IMF's December's numbers for Portugal were effectively predicated going forwards on export growth of between 5.5% and 6.5% a year for the economy.

Certainly, it is not difficult to go from a figure of 118.1% for government debt-GDP to 130%, but it is also important to stress that the IMF probably views Portugal in a very different light to Greece. From the outset they would have probably attached a higher probability for Portugal coming through the other side. Not only were the starting point of Portugal's debt dynamics very different, the willingness to adopt arguably long-overdue and painful structural reforms higher, but it was not that long ago (some ten years) Portugal tightened fiscal policy to then hit its budget targets under the original Stability and Growth Pact; the only issue is that fiscal tightening then was on a much smaller scale and the resulting recession was not so severe as we are seeing at the moment.





IMF December 2011 Review of Portugal									
	2008	2009	2010	2011	2012	2013	2014	2015	2016
GDP	0	-2.5	1.3	-1.6	-3	0.7	2.4	2.2	2
Consumption	0.8	-2.9	0.7	-5.2	-6	-0.9	1.3	0.8	0.6
General government deficit, % GDP	-3.7	-10.1	-9.8	-5.9	-4.5	-3	-2.3	-1.8	-1.8
Primary deficit, % GDP	-0.6	-7.3	-6.8	-1.6	0.5	2.2	3	3.4	3.3
General government debt, % GDP	71.6	83	93.3	107.2	116.3	118.1	116	113.7	111.7
Source: IMF									

Portuguese bank exposure to other countries, end September $ bn							
	Total	European banks	Spain	Germany	France	UK	US
Total foreign claims	182.6	175.8	78.8	30	25.8	23.4	5
To public sector	27.7	26.4	6.5	7.9	5.4	1.8	0.8
Banks	29.7	27.8	4.7	8.7	6.3	3.2	1.6
Non-bank private sector	125.2	121.6	67.6	13.4	14.1	18.4	2.6
Other potential exposures	101	50.3	19.5	7.1	4.8	11.9	49.9
Derivative contracts	11.3	9.4	2.6	0.8	2.2	3	1.7
Guarantee extended	70.8	22.5	4.1	6.2	0.5	8	48.1
Credit commitments	19	18.4	12.9	0.1	2.1	0.9	0.1
Source: BIS January 2012							
Note: Total = 24 countries							

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