How Portugal, managed to way out of the recent European economic crisis and where it stands today?

Introduction

Portugal's experience of the euro crisis was a nasty hybrid of Greece and Italy. Yet today it's doing far better than both.

The country's job market, for instance, looks better now than the beginning of the crisis in 2010.

This experience is almost unique within the euro area. From the perspective of the share of people with a job, Portugal looks much more like … Germany than for instance, Spain! Portuguese people seem to be more … restrained, less-extrovert, law-abiding, and disciplined in the rules.

Despite the European Central Bank's bond-buying, the Portuguese government is still paying a larger share of the country's economic output in interest than it was in 2010.

There is no single reason why Portugal has (sort of) succeeded where others failed, but we're going to try to explain the main points.

Synoptic context

Like Greece, Portugal had spent the pre-crisis period amassing foreign debts in a currency the government couldn't print. In anticipation of joining the euro, Portugal's current account deficit widened from essentially zero to an average of 8 % (per cent) of GDP in 1999 – 2007.

Over the same period, **external debt ballooned to roughly 200 %** (per cent) of GDP, driven primarily by banks raising money abroad to fund domestic mortgages.

After the fall of the U.S investment bank Lehman Brothers Holding Inc. in September 2008, there was a dramatic slow-down in the Portuguese economy.

This made Portugal extremely "open" to various financial attacks coming from the "international markets"! When private foreign financing disappeared, the country was forced to appeal for loans to the European "Institutions" (such as the European Central Bank, the European Financial Stability Facility (EFSF), the European Commission and despite all the above factors there was an unique involvement with the International Monetary Fund (IMF)). These official creditors were barely sufficient to replace private lenders. **Portugal's external debts peaked at around € 415 bn (billions) in 2010,** having as an impact the following year the lending of the total amount of € 78 billion from EFSF and IMF.

Despite all this, Portugal, like Italy, didn't enjoy a pre-crisis boom. Portugal's economy grew just 6 % (per cent) between the beginning of 2002 and the beginning of 2008.

The result is that while Portugal's depression was shallower in comparison than Greece's, the two countries both ended up back where they were at the start of the millennium by the trough in 2013!

Portugal's fiscal position

Part of the explanation is that overall economic performance has done much better than domestic demand. While consumption and investment are still "depressed" / or if you prefer … in a funk, export revenues have grown by more than half since 2008. At the same time, imports have grown by only a tenth and all of that growth was in 2017. The result is that the net trade position has improved by about €20bn, or more than 10 % (per cent) of Portugal's GDP.

Based on casual observations, **tourism seems like it should be a big part of the story**. **(1)** It sometimes feels hard to find someone from the western European countries who hasn't recently holidayed in Portugal! Is it an unlikely hypothesis? Net exports of travel and transportation services rose from a little over € 6bn in 2008 to about € 14bn in 2017. In other words, a little more than a third of the total improvement in the trade balance can be explained by the growing appeal of destinations such as: the capital city, Lisbon, Sintra, (suburb of the capital) the Algarve, (south coast area), the city of Porto with the Douro river area, and so forth.

The boom in tourism and measures such as reduction of VAT (Value Added Tax) from 23 % (per cent) to 13 % (per cent) have helped bars, restaurants, and commerce in general!

In 2017 tourists have reached 21 million, losing the previous record of 19.1 million in 2016. The number of tourists in recent years is steadily rising above the country's tourism forecasts by 2027, with an annual growth of 8% (per cent).

However, tourism already accounted for about 21 % (per cent) of export revenues in 2008. The tourism boom is impressive, but only somewhat more impressive than the boom in Portugal's other exports.

Portuguese earnings from selling goods to the rest of the world - particularly manufactures related to the Iberian motor vehicle supply chain - grew by more than 40 % (per cent) from 2008 through 2017.

The recent boom in domestic demand has led to a boom in imports and a modest deterioration in the trade balance not including travel and transportation. Fortunately for Portugal, tourism revenues have increased enough to offset this.

That gets us to the next part of the story: the ECB's delayed efforts to end the financial crisis and the ensuing recovery in domestic spending on investment and durable goods.

Parathesis of some account figures

Between 1995 and 2001, inflation-adjusted investment spending grew by nearly 60 % (per cent). This was unsustainable and associated with a massive increase in borrowing as real interest rates fell. Once Portugal actually joined the euro, investment spending fell sharply and never recovered.

The crisis made things even worse. By the time of the lowest point in 2013, real investment spending in Portugal was 12 % (per cent) lower than it had been in the mid-1990s.

There have been some interesting shifts in the composition of investment during this period.

First, essentially all of the growth since 2013 has come from the nonfinancial corporate sector. Both infrastructure spending and homebuilding have remained "depressed" at roughly half their pre-crisis levels.

Business **ca**pital **ex**penditures = Capex **(2)** is more likely to boost productivity and therefore longer than other forms of investment, this should be good news for Portugal in the years ahead.

Another way to visualize these compositional shifts is to look at investment spending by category. Construction is still the "largest piece of the pie", but its importance has shrunk dramatically as businesses spend more on machinery, equipment, and software.

The recovery in investment has been accompanied a major recovery in household spending on big-ticket items such as cars, appliances, and furniture. This category of consumption has grown by about 76 % (per cent) since the start of 2013.

A friendly nation driven to EU … by need ?

When Portugal found itself in a debt crisis, beginning in 2010, the EU imposed tough austerity measures, while Chinese companies have pumped billions of Euros -as Foreign Direct Investment (*FDI*) - into this Iberian country. They have purchased a number of Portuguese firms, including: the previously state-owned power grid operator REN, the nation's largest insurance company, private hospitals as well as banks (e.g. Millennium bank) and becoming a junior partner at the airline TAP. Although critics -coming from various factors- describe it as a "sellout"!

It’s a fact that over the past several years, Portugal has emerged as one of the strong supporters of Chinese investment in Europe.

It’s also a fact that during the debt crisis, Beijing came to Lisbon's rescue. China, for instance, bought Portuguese government bonds, which nobody else wanted to buy at the time!

Who can reject that while the “troika” (EFSF, EU, and IMF) was determining Portugal's fate, China was buying Portuguese companies? That trend has continued.

The Chinese also control several small electricity suppliers in Portugal. Most recently, they also wanted to acquire the largest electricity provider, EDP (Energias de Portugal). The takeover attempt hasn't yet succeeded probably because of concerns expressed by the United States since EDP also has operations in the US.

Is therefore Portugal on the silk road of China which ends to an economic and political dependence?

Only recently, the Council of the European Union announced that the EU would in future monitor more closely non-European, particularly Chinese, investments in key European industries.

We can't ignore the fact that on 15th of March 2019 the US ambassador to Portugal George Glass has spoken out yet again to denounce Portuguese plans for further business with China.

Just two weeks since he called a press conference to warn of the involvement of Chinese tech giant Huawei in Portugal's developing 5G network. Mr. Glass has announced that **"under no circumstances" will the US approve officially the Chinese bid** to take over EDP.

There's some skepticism

The European Central Bank (ECB), which deserves a large … "chunk" (large piece) of the blame for the severity of Portugal's crisis, also deserves some credit for the quickly snap-back (return) of Portugal's economy.

As we know, banks play a crucial role in market economies. They decide who can get finance and on what terms and can make or break investment decisions. For markets and society to function, individuals and companies need access to credit.

As in many other European countries, businesses in Portugal are heavily dependent on local banks for financing. Those banks, in turn, often hold large amounts of local sovereign bonds and often fund themselves by borrowing from foreign savers.
Whether or not this model is a good idea in "normal" times, but it was a disaster once European officials decided they would respond to the financial crisis by inserting credit risk into the European sovereign debt market.

To remember, sovereign debt is a central government's debt. It is debt issued by the national government in a foreign currency in order to finance the issuing country's growth and development.

This reaction of ECB, is sort of ridiculous and dangerous without **the creation of some new safe asset -such as a common European bond- to replace national government bonds**. Unfortunately the old tactics in this matter remain even nowadays on the EU policy agenda mainly due to Germany's leverage.

One result was that Portuguese bonds lost value. Portuguese banks were no longer able to use those assets as collateral to fund their borrowing, or at least not nearly as much as they used to. The banks responded by strangling credit supply to their borrowers.

After the ECB decided with delay it should backstop the sovereign market just like any normal central bank, Portuguese lenders (and others) started to recover.

The European Central Bank's bond-buying has also helped the housing market, both by making it easier for Portuguese to borrow and bid up (increase) in bid house prices and also by encouraging foreigners to buy housing in Portugal for vacation or investment purposes (e.g. Golden Visas).

Portugal's relatively healthy job market

The total number of hours worked in Portugal 2017 was 7 % (per cent) lower than the number of hours worked in 2007 while the number of jobs was down about 5 % (per cent).

The links between these figures and the strong employment population are massive emigration and a slowdown in immigration.
From 2008 through 2016, about 340.000 people left Portugal and about 220.000 came in. The numbers are even extreme when focusing just on Portuguese citizens: 320.000 out versus 120.000 in, for a net loss of 200.000 since 2008. That's more than 4 % (per cent) of the total number of people working in Portugal in 2016. In 1999 - 2007, net immigration boosted the Portuguese population and workforce by about 313.000 people.

Hundreds of thousands of jobless Portuguese fled to the bits of the European Union where they could find work, particularly Germany and the UK. That flattered / made attractive the employment rate but it represents a large -and probably permanent- loss of human capital.

On the bright side, it's encouraging that Portugal's fiscal position has managed to improve as much as it has despite the loss of so many working-age people.

Moreover, moving to find work is exactly how Americans respond to severe localized recessions. The pace of emigration has slowed significantly from the peak in 2012 - 2013.

As we mentioned, the € 78 billion international rescue plan imposed austerity on Portuguese citizens and **about 15% (per cent) of the labor force was driven to unemployment.** However, the country managed to exit the economic adjustment program in May 2014, -due to a **parliamentary agreement between the well-established political parties-** this solution without this implying that European Commission and IMF oversight will not continue until 2035, when the country is expected to have repaid 75% (per cent) loan received. **(3)**

Even so, these numbers suggest the Portuguese recovery has a long way to go. –

References:

(1)

At the same time in Greece, they exceeded € 14.6 billion in revenue from tourism in 2017, recording an increase of 10.8% compared to 2016. This development, according to the data of the Bank of Greece, reflects an increase in incoming tourism traffic by 7, 4 % (per cent) reaching 30.1 million tourists.

Mortgage in the recession but a key factor in reducing unemployment is tourism in Greece, according to a study by the Institute of the Association of Greek Tourist Enterprises (INSETE), as the total contribution of the sector to the GDP of the country ranges between 22,6 % (per cent) and 27.3 % (per cent) to 40.3 to 48.5 billion.

(2)

Capital expenditures (CAPEX) * and operating expenses (OPEX) represent two basic categories of business expenses. They differ in the nature of the expenses and in their respective treatments for tax purposes.

(3)

Greece's public debt grew at the end of the third quarter of 2018 at € 334.988 bn, exceeding by € 21.493 bn in the third quarter of 2017 and by € 11.610 bn in the second quarter of 2018, according to Greek statistics (ELSTAT) or the quarterly non-financial accounts of the General Government. The increase is mainly due to the disbursement of the last loan installment of the 3rd Memorandum of € 15 bn from the European Stability Mechanism (ESM).

Greece's public debt corresponded to 182.2% of Gross Domestic Product (GDP) in the third quarter of 2018, a figure that is once again by far the highest in the European Union. Today, according to the **Eu**ropean **Stat**istical Office (Eurostat) Greece is the “debt champion” followed by Italy with 133% of GDP public debt, and Portugal with 125%. On the other hand, Estonia (only 8%), Luxembourg (21.7%) and Bulgaria (23.1%) had the lowest debt as a percentage of GDP.

Information:

Capex or Capital expenditures are the funds that a business uses to purchase major physical goods or services to expand the company's abilities to generate profits. These purchases can include hardware (such as printers or computers), vehicles to transport goods, or the purchase or construction of a new building. The type of industry a company is involved in largely determines the nature of its capital expenditures. The asset purchased may be a new asset or something that improves the productive life of a previously purchased asset. If the asset's useful life extends more than a year, then the company must capitalize the expense, using depreciation to spread the cost of the asset over its designated useful life as determined by tax regulations. Capital expenses are most often depreciated over a five -to-10 year period but may be depreciated over more than two decades in the case of real estate.

On the other hand, those expenditures required for the day-to-day functioning of the business, like wages, utilities, maintenance, and repairs, fall under the category of **Opex**, or Operational expenditure.

Sources:

Bank of Portugal, Bank of Greece, Eurostat Statistics, World Bank, Organization for the Economic Co-operation and Development, Deutsche Welle, Institute of the Association of Greek Tourist Enterprises, Hellenic Statistical Authority, http://www.eetep.gr/erotiseis-kai-apantiseis-esr-gia-aytdioikitikes-ekloges-2019/