Interview with Poul Thomsen, November 19, 2011 -- Expresso

Some people in Portugal are claiming that we need more time to meet the fiscal targets and eventually more money. Do you agree with this view?

This depends on the strength of the economy. Given how we see the economy developing, I think that the program targets and financing are appropriate. Our assessment after this second review is that the program is off to a good start. The government is doing a lot already. It is clearly an ambitious program, there are no doubts about that, and we understand that it also requires a lot of sacrifices from the Portuguese people. Our financing is a way of making this adjustment less painful and execute it over a longer period of time. And again, looking to the economy right now, I think the timetable and the financing are ok. But if the recession goes deeper, we might need to reconsider the pace of fiscal adjustment.

You said that it was an ambitious program. But is it possible?

I think it is possible [feasible].

Did the Portuguese government try to negotiate next year's deficit target?

There has been no argument about 4,5% target next year. But my understanding is that the government agrees with the way I just explained it. Let's see how the economy is responding.

And in terms of the size of the financial envelope – the 78 billion – is troika, and IMF in particular, open to discuss?

The financing is adequate. It goes well beyond what is normal under IMF-supported program. I think it's fine. We even allowed for a reduction in T-bills level. This is not usual under IMF programs. Usually, countries are expected to roll over the existing T-bills, even in they are in worse shape. We are therefore providing liquidity support for the banking system. In addition, two thirds of the 78 billions come in the first year. This is unusually front-loaded.

Do you believe that Portugal will be able to return to the markets in 2013?

I think it is possible. In 2013, hopefully the situation in periphery is better and Euro zone crisis has come to an end. And, of course, it assumes that the adjustment takes place.

With the markets functioning well…

Yes. And provided we return to a situation where what happens in Portugal depends only on what happens in Portugal.

That is not happening now.

Obviously the problems in the Euro zone affect Portugal as well, and for that we need a comprehensive solution to this crisis.

Did Socialist Party delegation convince you that there are enough buffers in 2012 budget to cut only of to the two subsidies (Christmas and holidays)?

They expressed some views on that. Here you have to understand how we work. We don't come to Portugal saying what should be done. We agree on overall targets for the budget but they can be achieved in different ways, and the mix of polices is up to the government. This being said, the fact is that Portugal is an economy with a problem of competitiveness. Cuts in public sector wages are a way to influence wages in the private sector. I support this 2012 budget. It is a very ambitious and strong budget, but I am not saying that the chosen policy mix is the only way of doing it.

In your opinion, is there any buffer in the budget, as the Socialist Party claims?

This program is based on appropriate conservative assumptions. If things turned out a little bit better there would be a buffer. But there are no significant buffers there.

You were one of the main enthusiasts of the fiscal devaluation that was abandoned. Now troika is talking about wage cuts in private sector. Is this an alternative for abandoning the fiscal devaluation?

First, let me clarify our position. It is not a requirement in the program to cut private sector wages. But remember that Portugal has a problem of competitiveness that must be addressed. Fundamentally, there are two ways of adjusting. You can reduce wages, which in effects means that the country is becoming poorer, or you can become more productive to afford these wages. The preferred way is obviously through higher productivity.

Or do both at the same time.

Of course. For some enterprises the best way of restructuring is reduction in wages to keep people employed. Basically, what I am saying is that there is a need for flexibility in wages to ensure they are better aligned with productivity. But if this program is all about cutting, and cutting, and cutting, I don't think it will work.

Do you still believe that fiscal devaluation was the right solution?

I do. I still hope someday I get a call from government saying "we are going to do it". (Laughs) That would be great. But you cannot always get what you want.

Comparing with the alternative 30 minutes increase in working day, is it better or worse?

We have not yet analyzed the full implications of the changing working hours. I do not want to give you a firm answer on it. But I don’t think it is a substitute for fiscal devaluation.

Was this proposed by our government?

Yes. There is an understanding that we need to do more on structural reforms. This is an area where the program is doing particularly well, although we would have liked to see the fiscal devaluation implemented. But fiscal devaluation was never considered a silver bullet kind of measure. The challenge or the government is now to accelerate reforms in other areas to be sure that we get the supply response from other measures.

How will Portugal grow with all this tightening in fiscal policy?

There is no doubt that this has a negative impact on growth. We project growth of -3% next year. I am concerned about the fact that we are having fiscal consolidation and financial deleveraging at the same time, but with the current prospects for the economy, I think the targeted adjustment is achievable. If we come back and we see the economy going down more than expected and the fiscal multipliers are higher than expect, then of course we could reconsider.

When you say worse than expected in what magnitude of downturn are you thinking about? 4%, 5%, ….

Next year we have -3% for growth, and we expect a recovery to start taking hold in early 2013. I do believe that this is possible if there are structural reforms.

But do you have a number in your mind?

If output is much weaker then we would need to reconsider targets and policies. Hopefully, we don’t get there. We want to avoid being like a dog chasing its tail, in the sense that weaker GDP leads to the need for more fiscal tightening, which in turn leads to even deeper recession, etc. To avoid this we need an early supply response, by accelerating structural reforms.

Banks are concerned with rules for recapitalization, in particular, the three years for the banks buying out the public position. Do you share this kind of concerns of the bankers?

As often in economics, there are conflicting objectives. On one hand, we do not want taxpayers to bail-out banks. On the other, we don’t want to nationalize banks and have bureaucrats running banks. I think the proposal on the table strikes an appropriate balance between potential conflicting objectives. Banks get a chance of government putting shares with no voting rights and this is a pretty long period to adjust. This is the right way of doing it. This is a sound balance.

Did you meet the bankers?

My colleagues did. I did not this time.

Did they express these concerns?

Yes. They did express concerns.

But in your opinion the law is balanced?

I think so.

The government still needs to transfer around 2,7 billion in banks pension funds to meet deficit target. Is there any risk of failure?

From a fiscal point of view, there is no doubt that there is a shortfall this year of around 1,5% of GDP. I am not too worried about this because the government has put an ambitious program for 2012 on the table. This means basically that the fiscal program is catching up. In the meantime, the government is considering using pension transfers as one-off measure this year to overcome the gap resulting from the fiscal shortfall. If the government goes ahead with this measure, it should be done in a way that doesn't transfer liabilities to the taxpayers. There are safeguards in that regard. And of course, attention should be given to the fact that unfunded pension liabilities might exist in the banks' pension funds and could affect banks capital needs.

What are the main risks of the Portuguese budget for the next year?

There are a number of risks for Portugal next year. Clearly the external environment is one. If you look at the budget, another risk would be whether the growth and revenue projections are realistic. We think so, but it's an area of uncertainty. If we look at this year budget, we know that Portugal has a problem with expenditure control. We have reforms in the program to deal with this problem, but they take time to bear fruit. Hopefully this will happen fast enough to achieve our targets for expenditure reduction.

Can you expect other surprises like Madeira?

I've been in this business too long not to expect surprises, but I have no indications from where they will be coming.

Did you discuss the financing of the public transportation companies with the government?

We discuss with the authorities their ambitious strategy to reform government-owned enterprises, including those in the transport sector.

But the markets are closed and how will these companies make the rollover of the debt next year since this was a matter that was not included in the agreement?

I hear people saying that but I disagree. The program is not about bailing out every single company that has an affiliation with the public sector. These enterprises have been able in the past to borrow. In this regard, we have put significantly more money into the program than what was needed to finance de public deficit and the medium long term debt. We put money in to reduce the stock of T bills. That's a way of injecting liquidity into the system, to prevent a credit crunch. I cannot understand why people say that we forgot about these companies. Moreover, what about the small and medium enterprises that cannot find capital? I am more concerned about that. When I was here last time I started hearing people saying that such companies had difficulties in obtaining working capital. And this time around I heard this even more. This is something that we really want to follow very closely. This is another area where there are risks to the program.

But the banks say that they cannot finance everything. If they lend to public transportation companies they do not lend to other companies. How do you solve that?

We will have to look at whether credit conditions under the program have become too tight. So far they have not. There is no credit crunch. Credit has started only recently to show a growth decline (or negative rate of change). But this is an economy that is contracting so some contraction in credit would not be a problem. What we need to ensure is that the tightening of credit is not what is causing the recession. Another point is that it is also important to make sure that banks allocate credit to the right places. There is no doubt that Portugal has one of the most leveraged banking system inside the Euro zone. You can say that the Portuguese economy is addicted to credit. And in the new equilibrium you will likely need to live with less total credit, so it's very important that you allocate it to the rights places, above all to the dynamic enterprises in the export sector that you will have to rely upon to lead you out of the crisis.