Portugal under mounting pressure to accept financial bailout

By Paul Mitchell
15 January 2011

Portugal is under mounting pressure to accept an international financial bailout.

Reports in the media over the weekend said that Germany, France and other euro zone countries were pushing Portugal to seek a European Union-International Monetary Fund loan package estimated at €50-100 billion.

The scenario now being played out with Portugal resembles that which took place before Ireland went cap in hand to the EU-IMF in December. For several weeks, the Irish government and top EU leaders denied reports that the country would need to accept outside aid before it eventually took €70 billion.

As in Ireland, the bailout will mean international financial institutions effectively taking direct control of the Portuguese economy and implementing spending cuts and austerity measures even more severe than those being carried out by the Socialist Party (PS) government, which has led to massive cuts in public services, wages and jobs and a rise in taxes. Portugal has experience of IMF intervention in 1977 and in 1983, which resulted in huge attacks on the living standards of the working class and deep recessions. But these pale in comparison against the scale of the present attack. An indication of what is planned is the IMF's 2010 report on sovereign debt, which says there should be virtually no increase in Portugal's public spending for the next 20 years.

The PS government is seeking to cut the budget deficit to 4.6 percent of gross domestic product this year from last year's estimated 7.3 percent and to 3 percent in 2012. However, the country still has to borrow about €20 billion this year to finance its deficit and pay back previous loans.

In effect, an indirect bailout is already taking place as the European Central Bank (ECB) is the only buyer of Portuguese sovereign debt sold through government bonds in auctions on the financial markets. The interest rate premium on Portuguese sovereign debt has almost doubled over the last year to about 7 percent, above the 6 percent interest Ireland has to pay on its bailout money. Germany pays just 3 percent in comparison. This week's auction of over €1 billion in 10-year Portuguese bonds was hailed as a great success by the markets and the media, which claim it takes the pressure off Portugal to agree to a bailout. In reality the bonds were sold at 6.7 percent, only slightly down from the rate at the last sale in November last year. And again it was the ECB that bought the majority of the bonds. The rates on four-year debt actually rose from 4 percent to 5.4 percent.

The rise in interest rates has fuelled speculation over the last few days that Portugal will be forced to seek a bailout. An EU diplomat told AFP that, "There is a lot of pressure on Portugal. Every European country wants Portugal to make more budget savings than planned, and several countries want it to ask for external financial aid." Another official said, "I think we're getting closer" to EU-IMF intervention. Financial analysts added to the speculation that a bailout is imminent. "If market spreads keep rising, Portugal has little chance of escaping a bailout," said Barclays Capital research director in Paris, Laurence Boone. Deutsche Bank economists Gilles Moec and Marco Stringa added, "It would be rational for Portugal to call for external help sooner rather than later."

Government leaders in Portugal, Spain, Germany and the European Commission denied reports that talks were taking pace over a bailout. German Chancellor Angela Merkel declared, "We never pushed countries into doing something and we will not do this either." European states have to decide for themselves whether they require help, she added.

However, reports suggest German Finance Minister Wolfgang Schäuble met his French counterpart, Christine Lagarde, to discuss the issue last week. It will no doubt feature heavily at next week's meeting of euro zone finance ministers called to discuss "a more comprehensive response to the debt crisis." On the agenda are more austerity measures, tougher bank stress tests, structural reforms of labour markets and pension schemes and "completing the reform of euro zone economic governance."

Attempts to increase the size of the €440 billion European Financial Stability Facility (EFSF) will also be made. European Commission President Jos&; Manuel Barroso said the "financing capacity must be reinforced, the scope of activities... should be widened."

"It's a precautionary measure that makes sense ... but we are not in any way implying we will use it for country A or B," Barroso added.

Portugal's Prime Minister José Sócrates declared, "Portugal is not going to ask for financial assistance because it is not needed…We have the necessary conditions to raise debt in the market.”

“Rumours and speculation [would] only help the speculators acting against Portugal and against the euro”, he added.

Sócrates said Portugal’s 2010 budget deficit would fall “clearly below” the government’s target of 7.3 percent of GDP and that it would be able to continue servicing the country’s debt. He added that economic growth last year was estimated at 1.3 percent, compared with an initial forecast of 0.7 percent. “To cut the deficit in this way and almost double growth would be considered a considerable achievement in any country,” he said.

Spanish Finance Minister Elena Salgado insisted, “Portugal will not need any external aid…I think that Portugal will not need any bailout because it is meeting its targets. It has structural weaknesses but it is carrying out the needed reforms.”

Spain is particularly vulnerable because it is Portugal’s largest trade partner and its biggest creditor, with Spanish banks holding over €70 billion of Portuguese debt. Spain is also mired in a deep economic crisis itself and there is widespread talk that it is next in line for a bailout, an event that would threaten the existence of the euro and the EU itself. Spain is the fourth largest economy in the euro zone at around 10 percent, whereas Greece, Ireland and Portugal only account for around two percent each. Like Portugal, Spain is also auctioning bonds this week.

According to Goldman Sachs’s top European economist Erik Nielsen, “The outcomes will not decide anything in themselves but if yields [interest rates] drift higher again then we’ll surely be one step closer to the announcement of rescue packages for these two countries.”

There are already signs that Portugal is falling into another recession. The Bank of Portugal said this week that the austerity measures are severely impacting the economy. It has revised its forecast of zero growth next year made just three months ago to a 1.3 percent drop. Portugal would go into its second recession in three years. The bank said pay cuts, tax increases and increasing unemployment could cause domestic demand to slump by 3.6 percent this year and investment by 6.8 percent. Exports are still expected to grow 5.9 percent in 2011 but down from the 9 percent increase in 2010.

Bank of Portugal governor and European Central Bank Governing Council member Carlos Costa warned that the budget cuts would fail if measures to promote growth and create jobs were not found. “A process confined to budget consolidation and reducing external imbalances without a process of returning the Portuguese economy to the path of sustainable growth is an ephemeral response ... which will make this an episode of a stop-and-go process,” he said. Costa said Portuguese companies had too much debt and “resort more to self-financing and reinforcing their own capital”—i.e. further cuts in labour costs, pension schemes etc.

Recent figures from Spain’s national statistics institute (INE) show the terrible situation facing workers. Portugal has one of the largest gaps between rich and poor in the EU. According to INE, a fifth of the population survives on less than €360 per month or €4,320 per year. Nearly 85 percent of pensioners live on less than €360. A third of young people (aged between 16 and 34) would be in poverty if they had to live on their wages alone.

Unemployment is 11 percent. One in three full time workers—almost one million—earns less than the minimum wage of €475 per month, which in real terms is 15 percent lower than in 1974, when the dictatorship fell. Nearly 40 percent of workers work in “precarious” part-time or temporary employment and earn nearly 40 percent below the average of full time workers.

Charities, at the same time as their donations have decreased, report a significant rise in pleas for help from desperate families unable to cope with their bills.

Last November, a general strike brought Portugal to a halt. Millions of workers from the public and private sector stayed away from work to protest the PS government’s budget and austerity measures. The strike was a sign that workers want to fight. However, they face not only the PS government but also the opposition right-wing Social Democratic Party, the US and European governments, the IMF, the bond markets and other global financial institutions and the media—who are all applying maximum pressure on the PS to make sure it does not relent in its attacks on the Portuguese working class.

The forces lined up against the working class are aided and abetted by the Communist Party-led General Confederation of Portuguese Workers (CGTP) and the PS-aligned General Union of Workers (UGT). They called November’s action in order to dissipate the nationwide opposition to the austerity measures while they collude with the government and employers to smuggle them in. This month the minimum wage was due to be increased by the paltry €25 annual amount agreed in 2006, but the unions have agreed to a €10 increase and promises that the remainder will be “mulled over” later in the year.

Left to the unions, all remnants of social welfare will be destroyed and the working class driven further into poverty.