Post-Program Monitoring with IMF

Following the expiration of Portugal's Extended Fund Facility (EFF) arrangement on June 30th and the decision of the IMF Executive Board on July 30th, **Portugal will engage in post-program monitoring (PPM) with the International Monetary Fund**.

The IMF's press release is available here.

Constitutional Court Ruling

On July 30th the Constitutional Court (**CC**) **confirmed the constitutionality of** the measures included in the 2014 Supplementary Budget: (i) the **broadening of the Extraordinary Solidarity Contribution (CES)** to monthly pensions above €1000; (ii) the partial **transfer to the State of the employer's contribution to ADSE**.

Fiscal Adjustment

Up to June, the **General Government budget deficit** on a cash basis was €4.192M**,** about **€149M higher than the deficit in the first half of 2013**.

Cumulative Central Administration expenditure grew by 4.2% y-o-y up to June, namely due to (i) the payment of the holiday bonus in June, while in 2013 the payment occurred in November, (ii) the non-application of public wage bill cuts in June following the CC ruling of May 30th and (iii) higher interests and other charges.

Cumulative State Tax Revenue (in net terms) grew by 4.3% y-o-y up to June. This performance results from the increase in direct taxes (5.6%) and indirect taxes (3.3%), including VAT (3.8%).

Further information is available here.

Public Debt

General Government Gross Debt fell from €225.9bn in April **to €224.5bn in May**, marking the first monthly decrease since December 2013. The stock **continued to fall in June, standing at €223.3bn**.

Banco de Portugal information is available here.

Financial Markets

On July 2nd, the Debt Management Agency **(IGCP) issued USD 4.5bn maturing in October 2024** with a yield of 5.23% - an amount equivalent to € 3.3bn and a **euro-equivalent yield of 3.65%**. It is Portugal's first USD transaction since 2010 and the **largest USD sovereign benchmark since 2005**.

On July 25th, **Moody's upgraded Portugal's** government bond **rating by one notch (from Ba2 to Ba1) and assigned a stable outlook,** mainly due to the Government's' strong commitment to fiscal consolidation and the accumulated cash buffer.

Banking System

Banco de Portugal announced the application of a resolution measure to Banco Espírito Santo, which:

- **Creates a new institution, named Novo Banco ("New Bank")**, clean of problematic assets and endowed with adequate capital and liquidity.
- **Reinforces financial stability.** It entirely preserves deposits, the provision of banking services, the jobs and the business relationships established with Banco Espírito Santo.
- **Ensures taxpayers are not called to bear the costs**. The equity capital of Novo Banco is fully underwritten by the Resolution Fund. Since the Fund is recent and does not currently hold the necessary financial resources, it will take out a loan from the Treasury, to be reimbursed by the sale of Novo Banco or the banking system in 2 yrs.

Official press releases from Banco de Portugal, the Ministry of Finance, the European Commission and the CEO of Novo Banco are available online.

Deferred Tax Assets (DTAs)

The Government submitted to Parliament a **Draft Law adopting an optional special regime for DTAs** arising from the tax non-deductibility of expenses and negative equity changes. The regime encompasses DTAs **arising from losses from credit impairments and from post-employment and long-term employee benefits**.

The legal framework will **be applied to all companies from the financial and non-financial sector operating in the Portuguese economy that opt to adhere** to the special regime for deferred tax assets. It is **expected to enter into force on January 1st, 2015**, with the first tax credits being recognized as of 2016.

The proposed law is **similar in nature to** what has already been introduced in **Spain and Italy**, but also includes a **distinct feature aimed at offsetting the impact on public accounts that can arise when financial or non-financial corporations present losses**. The feature may be described as follows:

- In case annual accounting losses are presented, financial and non-financial **corporations must constitute a special reserve**, in the amount of 110% of the tax credit received.
- Simultaneously, **conversion rights are issued and attributed to the State**. These rights can be sold and grant their holder the right to request the issuance of common shares by incorporation of the special reserve into share capital.
- **Sale proceeds earned by the State from selling these conversion rights** to current shareholders (preference rights are given) or other investors, **will mitigate the impact of the DTA policy on public finances**.

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