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SUPLEMENTO

Portuguese escudo

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Portuguese escudo

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Portugal's President, Ramalho Eanes, is now openly expressing his disgust and disappointment at the failure of the country's main political parties to permit even the minimal political stability which would be necessary if his country's grave and continuing economic crisis is to be addressed. For their part, the politicians – particularly the former Prime Minister and leader of the Socialist Party, Dr Mário Soares – have been accusing the President of secret political ambitions. He sees himself, they say, as a Portuguese Charles de Gaulle, a presidential figure of grandeur and greatness waiting to seize the moment to 'save the nation'.

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There have been many signs that this open political bickering is starting to weaken the authority and public standing of President Eanes – just when Portugal's creditors were beginning to reassure themselves that the President, at least, had remained above the political in-fighting, and was placing a high priority on the need for economic reform. Among criticisms advanced by high-ranking members of the Socialist Party recently was a statement to the effect that Eanes' military background had led him to over-emphasise the virtues of economic order and stability. That such statements could be made by persons quite likely to feature in a Portuguese Cabinet within the reasonably near future, should have been enough to make even the most sanguine of the country's creditors reach for their tranquillisers. The international financial community remains puzzled about what is happening in Portugal, and is beginning to wonder whether a further Portuguese crisis is imminent. This is a perfectly reasonable deduction, since all the conditions for a return to political chaos and economic debauchery are evident in Lisbon at the present time.

Since the so-called 'flower revolution' of April 1974, when the armed forces brought down the Caetano regime, Portugal has put up with no less than 11 governments. Six of these held office prior to the promulgation of the democratic constitution in April 1976. That Portuguese democracy has survived for as long as it has, is little short of miraculous – and owes nothing at all to the competence of the elected governments. Dr Mário Soares, whose cynical political opportunism can surely no longer be hidden from even the most befuddled leftist, has systematically set out to wreck the efforts of his successors to establish stability. As users of this service will be aware, Dr Soares carried his country to the brink of bankruptcy in the course of two years of staggeringly incompetent and irresponsible government.

Not content with that achievement, he now appears to be seeking to create an impossible situation for the President – doubtless in the hope that the Head of State will again turn to him in desperation. In mid-1978, for example, Dr Soares' Socialist Party (the largest single political grouping in Parliament) played a prominent part in bringing about the downfall of the first 'technocrat' government (that of Sr Nobre da Costa), which had been appointed by the President following the collapse of the Socialist-Centrist coalition. President Eanes then retained sufficient strength and good sense to refuse Dr Soares' pleas for one more chance to

Month	US$ 1	US$ 2	US$ 3	DM 1	DM 2	DM 3	£ 1	£ 2	£ 3
Oct 1978	0·2317	−36·9	−37·6	0·3996	−66·2	− 98·4	0·1104	−21·6	−12·6
Nov	0·2130	−42·0	−43·2	0·4094	−65·4	− 94·9	0·1092	−22·4	−13·0
Dec	0·2178	−40·7	−42·5	0·3963	−66·5	− 98·3	0·1067	−24·2	−14·6
Jan 1979	0·2116	−42·3	−44·9	0·3963	−66·5	− 97·8	0·1063	−24·5	−14·7
Feb	0·2101	−42·8	−45·1	0·3894	−67·1	− 99·0	0·1038	−26·3	−16·0
Mar	0·2072	−43·5	−45·7	0·3874	−67·2	− 98·9	0·1003	−28·8	−18·3
Apr	0·2041	−44·4	−45·2	0·3866	−67·3	− 98·0	0·0993	−29·5	−17·7
May	0·2005	−45·4	−46·6	0·3843	−67·5	− 98·4	0·0974	−30·8	−18·9
Jun	0·2047	−44·2	−45·7	0·3763	−68·2	−100·7	0·0939	−33·3	−21·6
Jul	0·2062	−43·8	−45·5	0·3752	−68·3	−100·7	0·0885	−37·1	−26·4
Aug	0·2030	−44·7	−46·7	0·3718	−68·6	−101·2	0·0901	−36·0	−24·6
Sep	0·2041	−44·4	−46·4	0·3555	−69·9	−105·6	0·0927	−34·2	−21·7
17 Oct	0·1999	−45·5	−48·4	0·3607	−69·5	−104·1	0·0932	−33·8	−21·4

Table 1: Changes in the value of the Portuguese escudo in terms of three trading currencies. Column key: 1 = Currency units per Portuguese escudo (10) (end-month rates), 2 = Post-Smithsonian percentage change in the escudo's external value in terms of listed currencies; 3 = Effective change differential against other currencies since Smithsonian: end-month rates (National Westminster Bank data).

govern. Instead, he made it clear that if Dr Soares continued to employ his parliamentary advantage to make orderly government impossible, then elections would be called.

The Socialist leader is an astute enough politician to have realised that elections at that time, with the record of his most recent administration fresh in the voters' minds, would have brought about the decimation of his (by then badly divided) political group. Accordingly, in late October 1978, the President was able to appoint the second of his 'technocrat' Prime Ministers, Sr Carlos Mota Pinto. The new incumbent was promised the support of the Socialist Party in Parliament.

But, like most of Dr Soares' promises, this one turned out to be worthless when the former Prime Minister saw potential political advantage accruing to him if he broke it. In fact, barely six months passed before the Socialists began openly to make life impossible for the new government. In March this year, the so-called 'austerity' budget presented to Parliament by the Finance Minister of the day, Sr Jacinto Nunes, was rejected by the House – thanks mainly to opposition by the Socialist Party, which considered the budget too restrictive. This event marked the beginning of a campaign obviously directed at bringing about the government's downfall.

Following the defeat of his budget proposals, Sr Mota Pinto offered his resignation, which President Eanes refused. The government, hopelessly torn between the pressures being exerted by the International Monetary Fund on the one hand and their impossible parliamentary position on the other, was finally toppled in early June – after the House had carried two censure motions put down by Dr Soares. The Socialist leader worked so hard at this, that it was obvious that his target was at least as much the President himself as the unfortunate Prime Minister. In a 3,000-word document presented to Parliament, Dr Soares accused the Mota Pinto Government of having contributed to an 'extremely grave deterioration' of the political situation in Portugal during its period in office. The Cabinet was described by Dr Soares as 'arrogant' and 'ideologically aggressive', while a conflict and polarisation of political forces had allegedly been created between the country's two main democratic institutions, Parliament and the Presidency. While not saying so openly, this particular point quite clearly conveyed the impression that President Eanes was running the country without proper reference to Parliament. The document issued by Dr Soares was provocatively entitled 'In Defence of Democracy'.

At the same time, in the press and outside Parliament, an insidious campaign was mounted, largely by Dr Soares' followers, against the President. Apart from his allegedly Gaullist ambitions, to which reference has already been made,

Portuguese escudos per:	22 Aug	29 Aug	5 Sep	12 Sep	19 Sep	26 Sep	3 Oct	10 Oct	17 Oct
US dollar	49·222	49·256	49·208	49·179	49·557	49·257	49·210	49·747	50·023
Deutschemark	26·875	26·901	27·018	27·177	27·423	27·916	27·908	27·950	27·728
Swiss franc	29·670	29·611	29·744	30·177	30·535	31·182	31·078	30·891	30·314
French franc	11·550	11·552	11·585	11·633	11·734	11·921	11·905	11·905	11·831
Japanese yen	0·2243	0·2219	0·2223	0·2213	0·2218	0·2240	0·2193	0·2205	0·2136
Pound sterling	109·200	110·950	110·350	109·300	106·350	107·800	107·450	107·950	107·300

Table 2: Rates of exchange for the Portuguese escudo against six major currencies, 22 August-17 October 1979 (average of official buying and selling rates on the regulated market).

it is now being suggested that President Eanes wishes to form a political party in his own image — capable of capturing the confidence and imagination of voters. There can be little doubt that such a party, based on a programme of common sense and stability, would provide a powerful challenge to the existing political factions. To his credit, however, and despite his justified disgust with the politicans, there seems to be little sign, for the moment, that the President is thinking of forming such a party.

When he brought about the downfall of Sr Mota Pinto's Government on 7 June, Dr Soares clearly thought that the President would have no option but to ask him (Soares) to form a government. It was thought to be clear that government by technocrats was no longer a sensible option; while elections, the only alternative to Dr Soares, would be extremely expensive for the country — both politically and economically. Immediately following the Prime Minister's resignation, Dr Soares held a press conference at which he stressed that a general election would be undesirable, and strongly hinted at his willingness to govern. It is an indication of the contempt President Eanes feels for the Socialist leader that he obviously considered yet another caretaker government, followed by elections later this year or in early 1980, to be preferable to a further term of government under Dr Soares. Accordingly, he appointed Sra Maria de Lourdes Pintasilgo, Portugal's former Ambassador to UNESCO, as Prime Minister — until elections could be held on 2 December. No disrespect is intended to Sra Pintasilgo, who creates a favourable impression, if it is said that her period in office is hardly likely to have been attended by any fundamental or far-reaching decisions, which Portugal's current predicament so clearly demands.

One of the consequences of Portugal's political impasse has been an inevitable delay in the conclusion of negotiations with the International Monetary Fund concerning the third \$50 million tranche of the standby loan. This, as it happens, has been less serious for the country than might have been the case — since existing and potential creditors have turned out to be far less rigid than they were in 1977 and 1978, when conceding further loans to the country. Previously, Portugal had been forced to wait for long periods for desperately needed finance, while interminable negotiations with the Fund were dragged to a conclusion. Since mid-1979, however, Portugal has found increasing favour with the international financial community.

Thus it was announced in May that the country had broken the 1% spread barrier for the first time — with a nine-year \$100 million euroloan being extended to the Caixa Geral de Depósitos, at a split margin of 7/8% for the first four years, and 1% for the rest of the term. Subsequently, arrangements were completed for a \$300 million euromarket credit which would be extended to the Portuguese Republic by US, West German, Swiss and British commercial banks. The spread applied to this second loan was 3/4% above LIBOR for the first eight years, and 5/8% for the last two years.

Three distinct reasons can be identified for the comparative ease with which Portugal is raising finance from the international financial community, despite the rapid inflation and chronic political instability which the country is experiencing. In the first place, the state of Portugal's finances has ~~improved sharply~~ since mid-1978 — due mainly to a 44% increase in immigrant remittances, which reached an annualised rate of about \$1.6 billion. This, together with the credits the country has received, had raised Portugal's foreign exchange reserves at the end of 1978 to their highest level for four years — and had facilitated the reduction of the escudo's monthly 'crawling peg' devaluation against a basket of trading currencies, from 1.25% to 1%. The change in devaluation policy was an important cosmetic adjustment.

Secondly, the sharp increase in the market price

Date	Index	1	2	3
18 Dec 1971	100·00	27·250	1·1826	0·1408
29 Dec 1972	102·31	27·000	1·1859	0·1577
31 Dec 1973	99·85	25·676	1·0528	0·1676
31 Dec 1974	99·34	24·547	0·9822	0·1735
31 Dec 1975	95·36	27·351	0·9578	0·1807
31 Dec 1976	85·29	31·469	0·7493	0·1867
30 Dec 1977	64·55	39·724	0·5286	0·1313
29 Dec 1978	51·31	45·922	0·3963	0·1067
30 Mar 1979	49·53	48·258	0·3874	0·1003
29 Jun	49·06	48·853	0·3763	0·0939
26 Jul	48·58	48·508	0·3752	0·0885
29 Aug	48·34	49·256	0·3718	0·0901
28 Sep	47·78	48·990	0·3555	0·0927
17 Oct	47·98	50·023	0·3607	0·0932
24 Oct	47·73	50·450	0·3580	0·0939
31 Oct	47·73	50·674	0·3562	0·0951

Table 3: Rates of exchange for the Portuguese escudo, with an index of the currency's post-Smithsonian trade-weighted value (18 December 1971=100). Column key: 1=Portuguese escudos per US\$1; 2=Deutschemarks per Esc10; 3=Pounds sterling per Esc10.

Esc per:	Dec 1978	Mar 1979	Jun 1979	Sep 1979
US dollar	46·47	48·00	49·00	49·30
Pound sterling	92·15	97·81	106·53	107·28
Deutschemark	24·69	25·80	26·56	28·07
Swiss franc	29·21	28·57	29·60	31·22
French franc	10·76	11·20	11·46	11·94
Spanish peseta	0·65	0·70	0·74	0·75

Table 4: Rates of exchange for the Portuguese escudo (end-period data).

Item	1976	1977	1978
Exports, f.o.b.	1,826	2,331	2,797
Imports, f.o.b.	3,921	4,531	4,831
Trade balance	−2,095	−2,200	−2,034
Invisible balance	855	1,012	1,460
Current account balance	−1,240	−1,188	− 574
Net long-term capital	29	96	734
Net short-term capital	74	587	− 175
Errors and omissions	70	− 57	353
Overall balance	−1,067	− 335	338

Table 5: Portugal's balance-of-payments, 1976-78, in millions of US dollars.
Source: International Monetary Fund.

of gold substantially improved Portugal's ability to raise finance abroad. As noted in earlier issues of this service, nearly all the credits which Portugal obtained during 1977and 1978 were secured against a proportion of the country's gold reserves, valued at current market prices. Because the market price of gold has risen substantially since the loans were contracted, the volume of gold sold has been less than the amounts originally pledged. This has meant that some of the collateral has been returned to Lisbon, and may be employed for securing additional credits.

According to data published by the International Monetary Fund, the volume of gold held in Lisbon remained virtually constant from October 1978 onwards — despite the necessity of the country having had to pledge some of it as collateral with the Bank for International Settlements. At current market prices, Lisbon's gold reserves are worth almost $9 billion.

Thirdly, the attitude of the US Government towards Portugal's credit requirements softened considerably following agreement to permit the United States' continued use of a strategic mid-Atlantic air base in the Azores. Renewal of this agreement had been held up since the 1974 'revolution', initially because the ruling radical junta of officers suspected Washington (probably correctly) of having tried to ferment a

Quarter	Non-gold reserves[1]	Gold[2]
1977 Q1	134	27·55
1977 Q2	76	27·65
1977 Q3	158	25·76
1977 Q4	366	24·11
1978 Q1	265	23·08
1978 Q2	288	22·16
1978 Q3	799	22·12
1978 Q4	871	22·13
1979 Q1	659	22·12
Apr	593	22·12
May	563	22·12

Table 6: Portugal's reserves of gold and foreign exchange.
Notes: [1]In millions of US dollars; [2]In millions of fine Troy ounces.
Source: International Monetary Fund.

right-wing separatist movement on the archipelago, which was poverty-stricken even before the economic debauchery of the 1974-77 period had started. Failure to resolve this matter may well have contributed towards the hard line attitude taken by Washington towards the Soares Government in 1977 and early 1978 (see especially Volume 10, Number 6, pages 136-143 of this service).

That the US Air Force base is of exceptional importance to Washington is evident from the scale of preparations being made to facilitate the airlift of US men and armour on a massive scale to the Middle East. Its importance was also indirectly corroborated in March this year when Dr Andrei Aksenov, Deputy Director of the Soviet Institute of Oceanography, held a press conference in which he claimed that a Soviet Survey ship had recently discovered the lost City of Atlantis. Although he promised that the Institute would shortly publish photographs showing the remains of the underwater city, Dr Aksenov has not surfaced since his press announcement. Portuguese officials in the Azores believe the story was invented to cover more serious investigations motivated by Moscow's wish to be fully informed about the United States' base. Soviet incursions in and around the islands have increased dramatically — with submarines reported close to Terceira in January and a sharp increase in traffic by cargo ships and cruise liners being reported.

The improvement in Portugal's relations with Washington has been so beneficial that the US Security Assistance Program for fiscal 1980, under the International Security Assistance Act of 1979, allocated $82.2 million worth of aid to Portugal — of which $50 million was earmarked for balance-of-payments support. (Note the inclusion, to facilitate Congressional approval, of such financial assistance authorisation within *military* legislation). Although the country's healthy reserves position is based to a marked extent on the speculation-driven price of gold, this is a sound enough basis for sovereign loan transactions under prevailing permissive lending conditions. But the trend of Portugal's non-gold reserves since late 1978 has been somewhat alarming. Between November last year and May 1979, they declined by $434 million, to $563 million.

When negotiating with the International Monetary Fund, the Portuguese agreed to try to meet three specific targets. These involved the balance-of-payments, the rate of inflation and the central government budget deficit. Only in the case of the balance-of-payments have the Portuguese even approached the established targets. The crawling peg devaluation of the escudo, together with high interest rates, helped to reduce the current account deficit in 1978, to $974 million — compared with $1,188 million in 1977. This meant that Portugal was able to meet the Fund's target of a deficit not in excess of $1 billion during the year ending in April 1979. Other than the 44% increase in workers' remittances and the mentioned currency devaluations, the main factors which contributed to this improvement were a sharp rise in tourist revenues (which rose by 57%), an increase in the value of manufactured exports (which increased by 20%), and a considerable reduction in the growth rate of imports (+ 5%).

Given this record, it is surprising that the Portuguese authorities accepted only reluctantly, and after considerable pressure from the Fund, a target current account deficit of $800 million for the year to April 1980. On 10 October, the Bank of Portugal's half-year report revealed that the country's trade deficit declined by 8.8% during the first half of the calendar year, to $1.2 billion, reflecting the impact of a relatively tight domestic monetary policy and the administered devaluation of the escudo. Imports reportedly increased by 15.4% to $2.8 billion, but the value of Portuguese exports advanced by 43.4%, to $1.6 billion. This shortfall was substantially offset by an 83.2% increase in tourist revenue (earning the country $229 million) and by a 67.2% increment in emigrant remittances (worth $1 billion). As a result, the current account deficit fell by 67%, to $276 million; and the central bank is now predicting that the 1979 outcome will be a deficit of $400 million — more than 50% below last year's result. The authorities believe, furthermore, that the negative impact of this year's oil price increases will have been offset during the third quarter by a seasonal flow of funds from tourism and emigrants' remittances.

But the recent escalation of oil price increases seems bound to catch up with the country in the end. Nor do the government's perfunctory energy-saving measures hold out much hope of any reduction in consumption of petroleum and its derivatives, which continue to increase far more rapidly than the country can possibly afford. Something more effective than the package presented to the public on 17 July, is required. This consisted of nothing more drastic than speed restrictions of 100 km per hour on motorways (80 km per hour on ordinary roads), and a reduction in the number of filling stations which could remain open on Sundays.

A second strong reason for doubting that the Portuguese can expect their current account improvement to last is the continued abject performance of the country's agricultural sector. The weather this year has not helped. In January, rain delayed sowing, and reduced acreage sown by 11% compared with 1978 data; while the application of fertilisers were delayed. In February, the north and centre of the country suffered the worst flooding for more than a century — when four major rivers burst their banks. Over the country as a whole, the area sown to wheat was reduced from its 1978 total by about 50%, while coarse grain plantings declined by 20%. This means that imports of essential foodstuffs will be substantially higher than was the case last year.

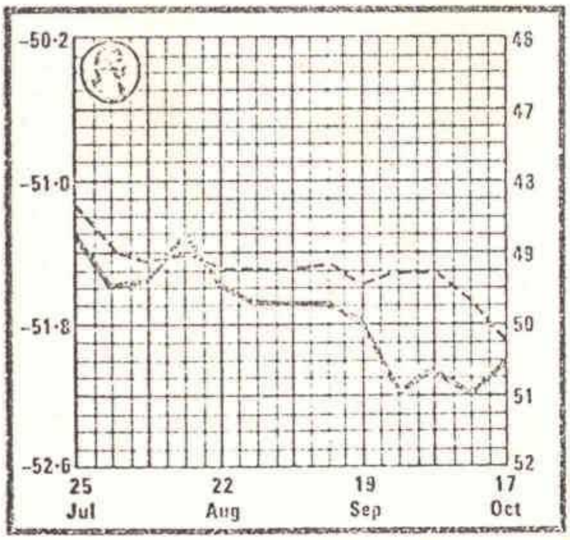
Thirdly, it is quite obvious that invisible receipts from workers' remittances and tourism depend to a large extent on the maintenance of domestic stability. This was certainly the lesson learned after 1974. During the upheavals experienced in that year and in 1975 revenues from these sources dwindled to a mere fraction of their normal levels. Accordingly, the decline in the level of foreign exchange reserves recorded since early this year may have been significant — since it coincided with the open challenge to Sr Mota Pinto's administration by Dr Soares. Admittedly, the situation appears to have subsequently improved; but the deepening economic recession in Europe will, in any case, soon take its toll of workers' remittances.

Quarter	1	2	3
1977 Q1	7·2	7·2	26·0
1977 Q2	6·4	14·1	29·2
1977 Q3	−1·8	12·0	21·4
1977 Q4	0·1	12·2	12·2
1978 Q1	4·1	4·1	8·9
1978 Q2	5·4	9·7	7·9
1978 Q3	4·5	14·7	14·9
1978 Q4	6·3	21·9	22·0
1979 Q1	8·7	8·7	27·3
1979 Q2	6·5	15·8	31·7

Table 7: Changes in Portugal's consumer price index. Column key: [1] Quarter-on-quarter, [2] Accumulated over year, [3] Year-on-year data.

Finally, the fact that domestic inflation is now far above the target level will inevitably slow down the rate of export expansion, and increase the value of imports, especially in view of the government's decision to reduce the crawling peg devaluation routine to 1% per month. Recent official inflation data (see *Table 7*) suggest that prices in Portugal have been increasing at an annualised rate of over 30%, rather than the annualised rate of 23% mentioned recently in the *Financial Times*, compared with the Fund's target of 18% over 1979 as a whole.

It should be remembered, too, that the official cost-of-living indices in Lisbon and Oporto are



Trade-weighted percentage movements of the Portuguese escudo from Smithsonian parities (left-hand axis, solid line), on the National Westminster Bank measure; with the escudo's exchange rate against the US dollar (broken line, right-hand axis).

notorious for grossly understating the real rise in living costs. In the most recent months for which statistics were available as this issue was being prepared, officially-admitted monthly increases in the indices amounted to between 3.2% and 3.3%. Translated into annualised terms, this is equivalent to an inflation rate of 47%. The reduced monthly devaluations imply an annual escudo devaluation of 12.6% against a basket of the currencies of Portugal's main trading partners. As the average inflation rate in these countries is most unlikely to exceed 15%, his means that Portuguese exports are losing competitiveness at a rate of at least 20% per annum.

There can be no mystery about the main cause of persistent inflation in Portugal: namely, the chronic central government deficit. This, of course, has been emphasised in this service on many previous occasions. The International Monetary Fund tries to insist on target reductions; the Portuguese simply refuse to implement them. It is, in fact, quite futile to blame the authorities for their failure. They simply do not possess the parliamentary strength to carry through the necessary austerity measures, which is why a general election is to be held on 2 December. The pathetic story of the 1979 budget illustrates this only too clearly.

In March 1979, the Minister of Finance, Sr Jacinto Nunes, presented what had been intended to be an austerity budget to Parliament. The forecast deficit was to have amounted to Esc 78.5 billion, compared with the 1978 target of Esc 60 billion — and an actual deficit last year of some Esc 75 billion. This was grossly in excess of the Fund's target of 6% of Gross Domestic Product, which is itself extremely 'generous', when compared with the conditions the Fund lays down for many other debtor countries.

It is an indication of the Portuguese legislature's flight from reality that even this was rejected as having been too restrictive. A revised version of the budget proposals, incorporating a substantially increased budget deficit forecast, was approved in May. Then, at the end of the month, the opposition — led by Dr Mário Soares' Socialist Party — proposed no less than 60 amendments to the already approved budget, as part of their plan to bring the government to its knees. Amongst the most significant amendments were the abolition of the tax on the 'thirteenth month salary' (annual bonus of one month's salary), which had already been reduced from 60% to 35% between March and May. Additionally, substantial further allocations for local government spending, were incorporated. Most of these amendments were agreed by the House, with the consequence that Portugal is now labouring with a *forecast* budget deficit of no less than Esc 87 billion ($1.8 billion). If last year's experience is anything to go by, the actual outcome could be some 20% higher than this projection. This will guarantee the absolute impossibility of bringing inflation under control, or of Portugal's deep-seated economic distortions being corrected.

Portugal's recent experiences clearly illustrate that a firm and rational economic policy is incompatible with populist democracy — particularly when exploited by cynical power-seekers like Dr Soares. The country's international creditors may accordingly find themselves wishing that criticisms of President Eanes for his alleged 'political ambitions' may turn out to be self-fulfilling prophecies.