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Portugal's government collapses

The next domino

LISBON

The resignation of José Sócrates as prime minister is likely to lead not only to an early election but also to the next euro-zone bail-out

IN IRELAND a bail-out by the euro zone's rescue fund helped force the government to call (and lose) an early election. In Portugal an early election may force the government to accept a bail-out. The question is: which government?

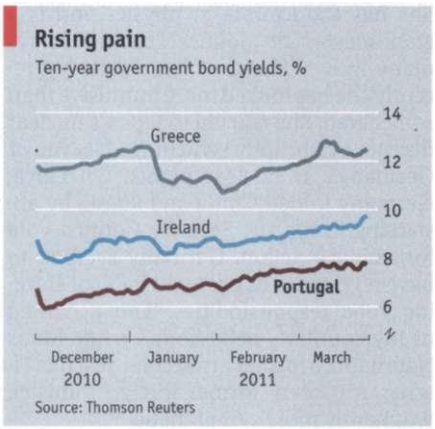
This week's defeat of the minority Socialist government led by José Sócrates in a parliamentary vote on austerity measures-the fourth package in 12 months-triggered his prompt resignation as prime minister. But it also created a political vacuum in which nobody may have enough authority to negotiate any bail-out.

Few doubt that Portugal is close to the moment when it has no alternative but to seek help from the European Financial Stability Facility (EFSF), the euro zone's bail-out fund. But economists say the crisis increases the chances that Portugal will need European Union funds within days. The finance minister, Fernando Teixera dos Santos, said that a failure to pass the austerity measures would create "additional difficulties...which I doubt we will be able to bear on our own." Announcing his resignation, Mr Sócrates predicted that an IMF/EU bail-out would result in even harsher measures than those that he had tried to push through parliament.

Aníbal Cavaco Silva, Portugal's conservative president, will now begin meetings with political parties in an effort to fill the void. In the two or three months before a new election can be held, he might try to put together a "grand alliance" of the main parties. Or he could appoint a transitional, non-partisan, "technical government". A third option is to keep Mr Socrates as a caretaker with limited powers.

Gilles Moec, head of European economic research at Deutsche Bank, suggests a "technical cabinet" would be better placed to negotiate a bail-out. But he argues that the Irish experience will probably deter other European countries from cutting a deal with a government that now lacks the clear backing of its parliament.

Mr Socrates's measures, which included a special tax of as much as 10% on pensions above €1,500 ($2,100) a month, were drafted with input from the European Central Bank and the European Commission as an "additional guarantee" that Lisbon would meet its fiscal targets. But Pedro Passos Coelho, leader of the centre-right Social Democrats (PSD), the main opposition party, refused to back them. The PSD has a clear lead in the opinion polls. And unlike Mr Socrates, who has fiercely resisted a bail-out, Mr Passos Coelho is ready for one. Antonio Garcia Pascual of Barclays Capital suggests that the PSD might feel it has little to lose from a bail-out if the blame falls on Mr Socrates's government instead.



Portugal's bond yields have already soared higher than at any time since the country joined the euro (see chart). Yet Emilie Gay, an economist with Capital Economics, notes that Portugal's budget deficit is lower than in most other troubled euro-zone economies. The country's most serious challenge, she says, is to avoid "another lost decade" of low growth. Since the start of the euro in 1999 Portugal has been among the slowest-growing economies in the club, despite being its poorest member.

Ms Gay concludes that Portugal is likely to become the third peripheral euro-zone country to need a bail-out. Yet to overcome the deep-seated structural problems that have held the economy back will take not just rescue money but ambitious reform as well. The country's need to issue debt is only €2 billion or so a month. Although that is small by most measures, and the government may have enough cash to meet redemptions in April, Portugal could struggle to last until June. The markets are expecting action long before then. In mid-March Moody's, a rating agency, downgraded Portuguese debt.

Portugal's political turmoil and its urgent need for a rescue will now loom large at an EU summit this week, which may put off a deal to expand the bail-out fund and fail to sign a new "pact for the euro". If EU leaders have to bail out Portugal, they may find they have already used quite a big chunk of their fund. Judging by experience, the markets will swiftly move on to attack the Spanish. The bail-out fund can quite easily finance Portugal. It is not clear that it could deal with Spain.

Fonte: The Economist, London, v. 398, n. 8726, p. 61, 26 March e 1 April 2011.