

November 16, 2015

Political Turmoil in Portugal

Portugal held parliamentary elections on October 4, 2015, in which the incumbent center-right Social Democratic Party received the most votes but fell short of an outright majority. Historically, as part of the Portuguese political process, the country's president tasks the party that receives the most votes with forming a government. However, in this case, the center-left opposition party and some far-left parties have formed a coalition, together garnering a majority of votes and currently awaiting presidential approval to form a government and take control from the center-right party.

This week, we will look at the current political environment in Portugal. First, we will start with a brief history of Portugal. We will then turn to the economic conditions leading up to the most recent elections and discuss the election results, the change in coalition powers and the possible path of developments going forward. As always, we will conclude with market ramifications.

Brief History

Portugal is the western-most country of Europe, and has a population of 10.5 mm,¹ or 2.1% of the EU population. Due to its geography, Portugal has been influenced by Western European and North African powers. Portugal has been active in naval trade throughout most of its history. The country has some natural reserves of metals and minerals, but fishing and agriculture

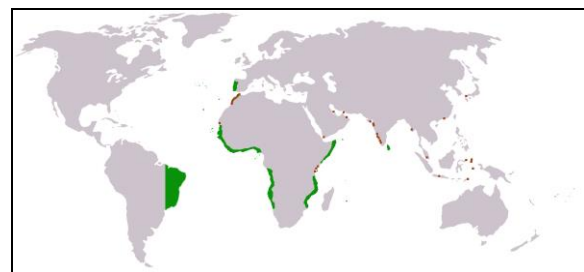
also contribute meaningfully. Additionally, cork and wine are major exports.



(Source: worldatlasbook.com)

The areas of modern-day Portugal have been controlled by various powers. Throughout history, the Roman Empire, Germanic tribes, the Moors from North Africa, Spain and France have all controlled parts of the country. An independent Kingdom of Portugal was established in 1139 AD. Portugal slowly expanded south as its army conquered the Moorish territories, taking the area with the current capital of Lisbon.

During the 15th and 16th centuries, Portugal established itself as a naval power. Its navy's reach spanned the globe, setting up various naval trading posts and forts.



(Source: Wikipedia²)

¹ 2013 data

² "[Portuguese Empire map](#)." Licensed under CC BY-SA 3.0 via Commons.

The map above shows the locations of the kingdom’s colonies, influences and trading posts at the end of the 16th century. The widespread empire supported Portugal’s trade dominance. Spice trade was especially profitable for the kingdom.

The kingdom had to defend its domestic territories from various European powers as well as make military excursions into North Africa. As the costs of maintaining and controlling its foreign territories rose, the empire weakened, losing its controlling spice trade position to the Dutch. During the Dutch-Portuguese War (1601-1661), the Dutch navy attacked the Portuguese overseas trading posts, gaining most of the outposts in the Far East and South Asia. However, Portugal maintained its outposts in South America and Africa.

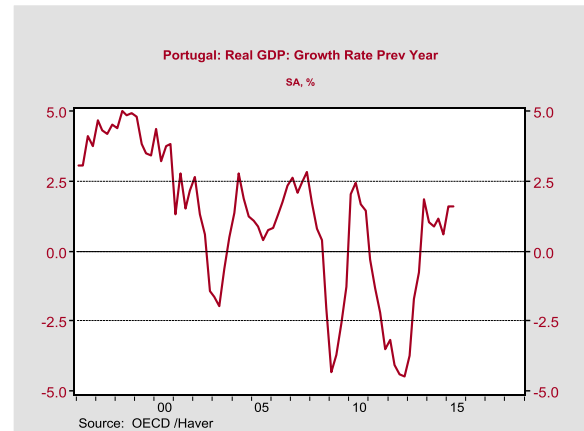
The first Portuguese republic, which was established in 1910, was characterized by general government dysfunction. After going through nine presidents and 44 ministers during its short life span, the first republic fell in a military coup in 1926.

In 1932, the second republic was established. Antonio de Oliveira Salazar became the prime minister and his new constitution was accepted via referendum. Salazar’s rule was essentially a conservative dictatorship. Although Salazar died in 1970, his authoritarian rule was maintained until a military coup following the Carnation Revolution restored democracy in 1974. Elections were held during the constitutional monarchy and both the republics, but the first truly democratic elections were held in 1975. Since then, Portugal has enjoyed a fairly balanced political representation, with a plurality of political parties (including a communist party that survives to this day). The two parties with the widest support are a center-left and a center-right party.

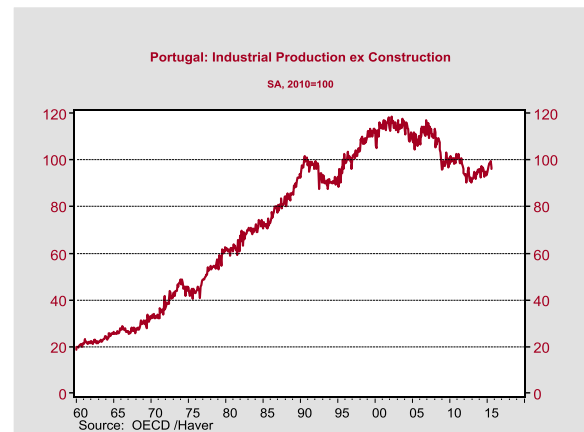
Economy

Portugal joined the EU in 1986 and was a founding member of the Eurozone in 1999. The Eurozone crisis pushed Portugal into a recession that started in 2011 and lasted for 10 consecutive quarters. The country’s inability to repay or refinance its debt led to a bailout by the troika (ECB, IMF, EU) in 2011.

As the chart below indicates, the country’s economic growth has suffered and remains volatile.

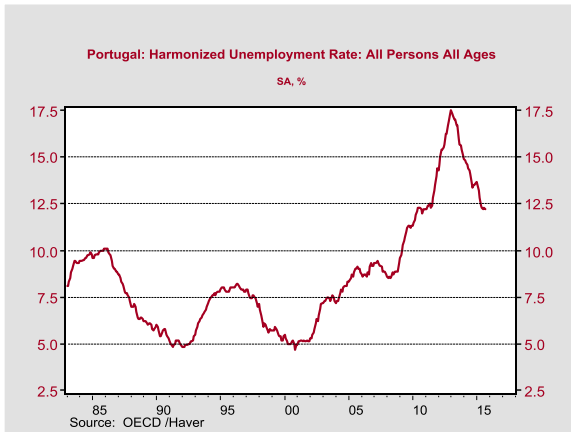


Industrial production fell, and although it has recovered from its lows, it has not reached an expansionary stage.

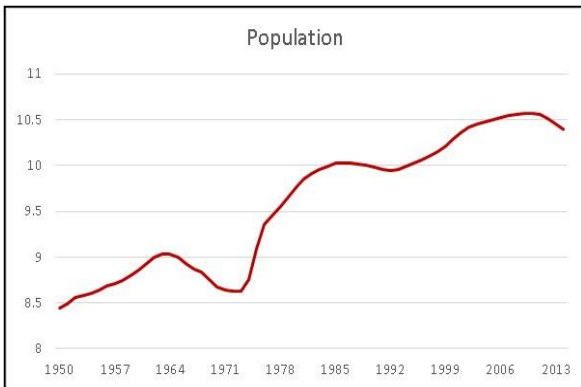


The unemployment rate surged during the recession, peaking at 17.5% in 2013. It has also recovered since, mostly due to

emigration and the recently imposed labor market reforms.



First, emigration, especially youth emigration, has become a major problem for the country. Youth unemployment³ surpasses the overall unemployment by a wide margin. The current general unemployment rate stands at 12.2%, while youth unemployment stands at 31.6%.



It is estimated that 0.5 mm people, mostly young people, have emigrated due to the country’s sluggish growth. The chart above shows the total population of Portugal since 1950. In the short term, emigration alleviates the crisis, since there are fewer people competing for jobs and benefits. However, in the long term, a shrinking

³ The youth unemployment rate is the proportion of the youth labor force that is unemployed, defined as persons between the ages of 15 and 24.

workforce means fewer working people paying taxes and, more importantly, a falling aggregate demand that would not be enough to support economic growth.

Second, the bailout-imposed labor market reforms have recently showed an optical improvement in labor markets and economic growth measures. However, it also means that the macroeconomic measures have improved without reflecting changes in the overall quality of life.

2015 Parliamentary Elections

The significance of the most recent parliamentary elections was not the political parties that ran and enjoyed popular support, but rather which parties were *not* present. At a time when anti-establishment parties have generally been gaining popularity in Europe, these parties are not widely supported on the Portuguese political landscape.

The incumbent center-right Social Democratic Party won the most votes, at 38.6%, slipping from its outright majority support of 50.4% achieved in the 2011 elections. The center-left opposition Socialist Party garnered 32.3% of votes, increasing its support from 28.0% in the previous elections. The left-wing Left Bloc doubled its seats in the parliament, receiving 10.2% of the votes, up from 5.2% in 2011.

Portugal’s president tasked the incumbent party with forming a coalition government as it won the most votes in the election. This was significant as it made it the first austerity government in Europe not to be voted out of office.

However, two weeks after the elections, the left-wing parties joined forces to form a coalition and oust the center-right coalition. The Socialist Party joined with the Left Bloc

and far-left Unitary Democratic Coalition, which encompasses the communist and the green party. This new left-wing coalition totals 50.8% of the votes, allowing it to form a government without any right-wing support, an unprecedented allegiance.

Degrees of Austerity

The ideologies of the center-left and center-right parties are similar. Both parties are committed to continuing austerity programs that were started during the 2011-2012 sovereign debt crisis. The main differences between the parties are the degree and speed at which austerity is to be implemented.

The center-left party supports reducing the budget deficit to 1.5% of GDP in 2019 from the current level of 3.0%. At the same time, the center-right supports cutting the deficit to 0.2% over the same time frame.

Government debt remains high, but again both the establishment parties agree on cutting it from the current 128.0% of GDP. The center-left proposes cutting it to 112.0% and the center-right proposes cutting it to 107.6% in 2019. As Mario Centeno, Portugal's finance minister, said, "It's not the direction, but the speed of travel" that the establishment parties disagree on.

Thus, not surprisingly, both the establishment parties support austerity and remaining in the Eurozone, but surprisingly, anti-establishment parties are not prevalent.

Where are the Anti-Establishment Parties?

Essentially, the anti-establishment parties received low levels of popular support, even after the stringent austerity measures imposed by the European bailout. There are four main reasons why the anti-establishment movement has not gained momentum in Portugal.

First, as mentioned before, the high levels of youth emigration have removed the frustrated youth.

Second, the communist party has existed on the Portuguese political map since 1974 and has provided an outlet for the disenfranchised population. However, during the most recent elections, the coalition of communist and far-left parties gained a marginal share of the votes compared to the 2011 elections.

Third, many European countries have seen anti-establishment movements emerge in response to the refugee inflows. Portugal has been detached from the immigrant crisis due to its location at the tip of the continent. Additionally, Portugal's sluggish economic growth has not made it an attractive destination for refugees.

Fourth, and perhaps most importantly, the low voter turnout signals voter apathy. Many voters believe that the election outcome does not make a difference in the bigger picture. Portuguese voters observed the Greek elections, in which the general referendum rejected the austerity measures only to have even more stringent austerity measures applied.

The Left-Wing Coalition

A left-wing coalition majority government is unprecedented in Portuguese politics. Although the majority of the coalition is represented by the center-left, the concessions that the moderate party has had to make with the far-left parties could change the political discourse.

The far-left parties do not support the austerity measures and are actually against staying in the Eurozone. However, the new coalition has indicated that the new government will support staying in the

Eurozone. It will also support slow implementation of fiscal reforms. Thus, the new coalition is likely to be less stringent on austerity measures, but not necessarily oppose them.

However, there are various issues that the coalition will need to agree on aside from fiscal reforms, which generally fall into three categories. First, the far-left parties support suspension or reversal of privatization plans, including the planned privatization of TAP-Air Portugal, the national airline. Second, the far-left supports suspension of labor market reforms, such as public sector wage cuts and reinstating four bank holidays. Third, the far-left supports increasing social benefits and cutting taxes.

All these measures would work against the center-left goal of cutting government debt and deficits. Thus far, the unified left-wing coalition has indicated that it will not support any of these more radical measures. Although the far-left parties lack the support to move any of these measures ahead by themselves, they do have the power to block the center-left propositions unless the establishment party supports at least some of their objectives.

Ramifications

The political scene in Portugal will likely remain volatile until the new coalition has taken power. The country's president has to approve the left-wing coalition, and he has indicated that he believes that an anti-EU and anti-austerity coalition could be dangerous for the government. Thus, internal politics are likely to remain in turmoil in Portugal.

However, given that the most powerful left-wing party in the coalition holds moderate views and supports austerity to a certain degree, it is likely that Portugal will accept policies to remain in the Eurozone, including austerity. Although maintaining the balance of the political process remains complex, Portugal is not likely to devolve into the "next Greece."

Thus far, financial markets have not discounted for additional political turbulence in Portugal, and we believe that, although the situation merits close following, it holds a very low likelihood of deteriorating to a point where the country would leave the Eurozone or reject austerity unconditionally.

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