Portuguese government continues austerity following ministerial resignations

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Portugal's prime minister and Social Democratic Party leader Pedro Passos Coelho claimed to have found a "formula" with his Popular Party (CDS-PP) coalition partners to "ensure all conditions of stability for the government and for the country."

This follows the resignation of two key CDS-PP ministers last week—Finance Minister Vítor Gaspar and Foreign Minister Paulo Portas, who is also CDS-PP leader. Passos Coelho stated that he had no intention of resigning himself, declaring, "I will not quit or abandon my country. I am confident that we will be able to surpass this difficulty … I hope this internal crisis can be overcome very quickly."

The prime minister has already warned the Portuguese people to "prepare for new sacrifices" in order to avoid a second bailout. In May 2011, shortly before it lost power, the previous Socialist Party (PS) government negotiated a three-year €78 billion ($101 billion) bailout package with the "troika" comprising the European Union (EU), International Monetary Fund (IMF) and European Central Bank (ECB), in return for severe austerity measures.

Spokesman Steffen Seibert said the German government was "confident" that the Portuguese government will continue with the structural reforms agreed with the troika, adding what it had achieved so far was "impressive". European Commission Economics Minister Olli Rehn said the country had to continue with the "difficult but necessary measures to restore confidence in the sustainability of public finances"—a demand that will be drummed home when troika officials begin their next review of the economy on July 15.

On July 1, Gaspar said in his resignation letter that he was stepping down because of increasing public opposition to austerity and a lack of political backing in the government. Gaspar added that he had also lost some of his credibility because economic targets had been missed as a result of lower than expected tax revenues and domestic demand. Gaspar had won the applause of EU leaders for his imposition of budget cuts, with Rehn praising him for his "valuable work" and "unwavering commitment."

Within hours, as a sign he would press ahead with the troika's demands, Passos Coelho appointed Treasury Secretary Maria Luís Albuquerque as Gaspar's successor. ECB chief Mario Draghi said that with Albuquerque at the helm Portugal's economy was "in safe hands." German Finance minister Wolfgang Schäuble explained that she was a "key figure" who would ensure a "seamless transition."

Shortly before Luís Albuquerque's investiture on July 2, Portas also resigned, saying he disagreed with her appointment. Portas has been lobbying for more emphasis on "growth" rather than austerity—meaning measures to pump money to the banks and corporations—explaining, "There are known political differences I had with the Minister of Finance. His personal decision to leave allowed the opportunity for a different economic and political cycle. A choice made by the prime minister would therefore be especially careful and consensual."

"The prime minister intended to follow the path of mere continuity in the Ministry of Finance. I respected it but disagreed," Portas added.

The political crisis sent the Lisbon stock market down by 5 percent and bank shares slumped by 10 percent on July 3. The stock-market regulator had to intervene to stop a run on four companies by temporarily banning sales of their stock.

Interest rates on Portuguese government debt soared past the 7 percent level—generally regarded as

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unsustainable—to touch 8.1 percent. Back in May, the government was able to borrow €3 billion by issuing a ten-year bond at 5.7 percent interest, encouraging the belief that the country would be able exit the bailout programme and begin borrowing again in the private markets next year.

The crisis has reawakened speculation that Portugal will have to apply for a third extension of the time needed to pay back its bailout loan. But failing that, and if high interest rates continue, the country might need a further bailout and "haircuts" for those holding its debt similarly to what occurred in Greece and Cyprus.

There were also fears of the Portuguese crisis spreading across the EU. The head of the Eurogroup of eurozone finance ministers, Jeroen Dijsselbloem, said, "the situation is worrying. So I'm calling on Portugal to take responsibility."

Schäuble tried to brush the fears aside, declaring with ringing insincerity, "I think the euro is now viewed on the world's financial markets as so stable that domestic political situations in individual countries... don't mean a crisis for the stability of the euro as a whole."

European commission president and former Portuguese Prime Minister José Manuel Barroso warned Portugal's elite that the "financial credibility built up by Portugal could be jeopardised by the current political instability… This delicate situation requires a great sense of responsibility from all political forces and leaders."

President Anibal Cavaco Silva is due to begin talks with the parties today. Under the constitution, the president can dissolve parliament and invite opposition parties to form a government.

The opposition Socialist Party (PS) is demanding a snap election two years ahead of schedule, with PS leader António José Seguro declaring, "The country needs a new government with democratic legitimacy."

Cavaco Silva has consistently argued that this would be a disaster for the country. According to opinion polls, although the PS has about 36 percent of the vote compared to the PSD's 26 percent, it does not have a majority and would have to form a coalition—probably with the Communist Party (PCE) and/or the Left Bloc (BE).

Not only did the PS negotiate the bailout package, but it has supported the PSD's austerity measures—arguing only that they should be carried out more slowly. The PCE and BE limit their opposition to the deep crisis with calls for the terms of the bailout to be renegotiated.

Two years of brutal cuts have caused a recessionary spiral that shows no sign of ending. Government spending, investment and domestic demand are declining sharply. The economy contracted 3.3 percent last year and will probably contract by 2.3 percent this year. Even in the years that follow, Portugal's potential growth rate is less than 0.5 percent a year, according to the Organisation for Economic Cooperation and Development (OECD), because the export growth needed to stimulate the economy is so uncertain. A quarter of all Portugal's trade, for example, is with Spain, which is experiencing similar problems.

For the working class, the austerity programme has been a disaster. Unemployment is nearly 18 percent, with nearly one million workers without jobs. Only an estimated 44 percent of the jobless receive unemployment benefits. Unemployment among youth is 43 percent, with thousands forced to emigrate. Since 2008, according to the OECD, small, generally family-run businesses have suffered a "massive decline," with more than half of cafés and restaurants closing.

Charities are warning that the welfare safety net is on the verge of collapse, with many children and elderly living in poverty. State pensions over €250 a month have been frozen since 2011 and those above €660 a month have been cut by up to 10 percent.

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