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Debt Worries Shift to Portugal, Spurred by Rising Bond Rates

By LANDON THOMAS Jr. APRIL 15, 2010

LONDON — Next target: Portugal.

Speculators have begun to zero in on another small member of Europe's troubled monetary zone, highlighting the same economic flaw that brought Greece to the verge of insolvency: a chronically low savings rate that forces a reliance on the now-diminishing appetite of foreign investors to finance persistent deficits.

Just as investors are turning their attention to the next vulnerable country, Greece moved a step closer on Thursday to activating a $61 billion rescue package, as Prime Minister George A. Papandreou asked the European Union and the International Monetary Fund to meet in Athens next week.

The aid package agreed on last weekend — aimed at calming fears of a Greek default — has not yet had its desired effect. The yield on Greek 10-year bonds briefly topped 7.3 percent Thursday, not far from the 7.5 percent it was at before the rescue package was announced. Interest rates on 10-year government bonds for Portugal have also been rising, hitting a high of 4.5 percent on Thursday.

Though Greece's finance ministry said its request for talks did not necessarily mean it would draw from the funds, it contributed to anxiety that helped push down the value of the euro by 0.008, to 1.3576 against the dollar.

It all raises the prospect that the loan package for Greece, the result of months of political haggling, may be nothing more than a bandage on a wound that shows little sign of healing.

Some analysts think the Greek bailout may have an opposite, more harmful long-term effect. Instead of ushering in a period of lower rates and market calm, it could prompt investors to test Europe's — and in particular Germany's — stomach for a rescue of other troubled European economies, beginning with Portugal.

The bailout might even create an incentive for the coalition government in Lisbon, which has already pushed through painful spending cuts, to ease up a bit, knowing that a rescue package with concessionary interest rates from Europe and the I.M.F. could lie just around the corner.

"Now there will be more fiscal profligacy in Europe, more political fractures and ultimately the possibility that some countries might want to leave the euro zone," said Joachim Fels, an economist at Morgan Stanley. The euro zone is made up of the 16 countries that use the euro.

That Greece and Portugal are among those in the worst trouble is well known, with both likely to be encumbered by high debt, weak competitiveness and stagnant growth for years. But another factor contributing to their troubles is their savings rates — 6 percent of gross domestic product for Greece and 7.5 percent for Portugal. These are low for developed countries. In contrast, Italy has a savings rate of 17.5 percent, Spain 20 percent, France 19 percent and Germany 23 percent.

For Athens and Lisbon, it is a risky combination: low reserves of capital when the cost of new debt is increasing, while their ability to generate tax revenue to pay for these obligations is shrinking because of tough austerity measures.

Portugal's debt, at just under 90 percent of gross domestic product, is lower than Greece's 113 percent level. The government in Lisbon has taken pre-emptive steps to cut spending and raise taxes.

Portugal's financing needs for the year, while high at 24 billion euros, or $32.7 billion, are not as onerous as Greece's. On Wednesday, the government was able to raise two billion euros comfortably on the bond market.

But Tim Lee of pi Economics, a consultancy based in Stamford, Conn., said a country's savings rate, more than its deficits or debt-to-G.D.P. ratio, is the best measure of an economy's ability to pay down its debt.

On that basis, Greece and Portugal remain highly vulnerable.

"The severely negative net national savings rate highlights the fact that the government deficit cannot easily be financed domestically," Mr. Lee said, "making it difficult for these countries to emerge from their debt trap."

Mr. Lee pointed out that Greece and Portugal are not the only countries so afflicted. The United States and Britain, with savings rates of 10 percent and 12 percent, respectively, are also among the world's worst savers. But Greece and Portugal, as members of the euro zone, do not have the luxury of printing money to depreciate their currencies and thus export their way to recovery.

Portugal has suffered in this respect perhaps even more than Greece. Portuguese exporters have been losing market share to competitors since entering the common currency in 2000. That, in turn, has pushed the government to borrow from abroad to finance the current account deficit, pushing debt to its current levels.

More seriously, Portugal — unlike Greece, Ireland and Spain — did not experience the positive effects of the long period of growth reflecting low interest rates earlier this decade. That is because it did not benefit from a housing or consumer boom and thus did not see any improvement in its G.D.P. per capita over the last 15 years, according to research by Deutsche Bank.

Accordingly, analysts say, it will be difficult for Portuguese politicians to persuade their already pinched populace that more sacrifices — like public-sector wage cuts or higher value-added taxes — are necessary.

Fitch has already downgraded the country's debt over doubts that Portugal can cut its deficit of 9 percent of G.D.P. Olli Rehn, the European commissioner for economic and monetary affairs, warned Portugal this week that further steps were needed to cut its deficit.

Gilles Moëc, an economist for Europe at Deutsche Bank, said, "It is going to be a long and painful process for Portugal, and there are questions about whether they can do it." He added, "It's a reminder that there is an issue here."

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