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The Global Agenda Portugal



Policy still matters

Recent macroeconomic achievements might appear underscored by the current global conditions. Yet, wide-ranging reforms keep on sustaining general progress.

Fiscal overachiever

Investors with an eye on Portugal should not be deceived by statistics. There is more tangibility to Portugal's solid performance over the past two years than what the abstract nature of numbers might reveal. Prime Minister José Socrates's broad reform program has shed significant light on the once gloomy picture of the Portuguese economy inherited in 2005. The outstanding improvement in fiscal consolidation teamed with key structural reforms aimed at modernizing the Portuguese economy has enhanced overall growth and led to satisfactory results. Very few would disagree that the taming of public finances has been the key factor in the success of his comprehensive strategy as it has substantially reactivated economic growth. The contraction of fiscal deficit from 6.1 % of GDP in 2005 to 2.6 % in 2007 further strengthens efforts towards economic convergence with the EU. Meanwhile, output growth has sparked within the last two years, reaching 1.9 % in 2007 from the meager figure of 0.6 % in 2005, with a decrease to 1.4 % in 2008, largely due to the external economic slowdown.

All that said, Minister of Economy Manuel Pinho, acknowledges that difficult challenges lie ahead and persists in stimulating growth and development.



Manuel Pinho,
Minister of Economy and Innovation

"It has been a tremendous achievement to bring the budget deficit down and it allows us significant flexibility", Pinho remarks. Global economic deterioration is hampering every EU member's growth and Portugal is no exception. However, Minister Pinho recognizes that "in each crisis there are opportunities." Therefore securing the fiscal results together with improving the business environment and enhancing the adaptability of the labor market shall prove vital for Portugal to consolidate its converging path towards its wealthier EU peer countries.

Going global

Nevertheless, Pinho acknowledges that the reform process must be deepened if Portugal is to reap all the benefits that global trade has to offer. In

this regard, important steps have been taken towards encouraging Portuguese business to be more proactive in the international scene. As the Portuguese poet Fernando Pessoa once put it, "Wise is he who enjoys the show offered by the world." Minister Pinho himself seems to have made

the famous quote somewhat a leitmotif in his tenure by embarking on numerous trips overseas and paving the way for strategic alliances between Portuguese firms and trade partners in countries ranging from Venezuela and Libya to Angola, Brazil and China. "It is a must for Portugal to diversify our internationalization efforts, not only in terms of risk management but fundamentally because of the enormous growth potential that these emerging economies pose for Portuguese business", Minister Pinho concludes.

Making it SIMPLEX

The government has already made significant progress in improving the business environment and simplifying bureaucracy, a hampering factor to Portugal's productivity until recently. The ambitious and broad-ranging SIMPLEX program continues to improve the business climate. Its priority on business licensing in 2008 has proven well placed, with more than 29,132 new companies set up this year—quite a feat within the context of the current international economic slowdown. Furthermore, the recent public administration reforms have contributed to enhance public sector productivity, which further alleviates the fiscal burden on the state.

Flexing muscles

But it has been on the labor front where the government has made significant progress by striking an agreement among social partners and endowing the rather rigid labor market with extensive flexibility. In a country where the automatic extension of collectively-agreed contracts was the norm, the shortening of time for dismissals should render fixed-term contracts less attractive to firms. This shall ultimately bring about flexibility to a labor market that definitely needs it in order to boost productivity. ●



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Tandem of talent: Gare do Oriente, Lisbon's emblematic railway station, is the result of architect Santiago Calatrava's vision skillfully engineered by CONSULGAL.

If there is one sector in Portugal that epitomizes the adjustment to the new world economy, it is the mould making industry. This key Portuguese industry supplies quality injection moulds to companies all over the world, most of them in the automotive sector, positioning itself at the forefront of the global economy. With new emerging markets coming strong into the automobile scene, Portuguese mould makers could reap some gains in these remarkably competitive countries. João Oliveira Cortez, CEO of CELOPLÁS, a technical polymer manufacturing company that witnessed a 15 % growth last year, is betting on India "since we can offer our world-class know-how and they can of-

fer us a large market."

Geographically concentrated between the towns of Marinha Grande and Oliveira de Azeméis, the Portuguese mould making industry consists of 535 SMEs that employed a workforce of 8,350 in 2007. This geographical proximity creates a competitive advantage for these companies with a unique co-operation scheme among them. Their ability to use specialized shops for different uses along the value chain of plastic moulds, in combination with state-of-the-art technology, enable all suppliers to attain produce of the highest quality, at a reasonable price and quickly delivered. This production process, coupled with an aggressive

marketing policy generated 298 million euros in exports in 2007; in other words, 90 % of the industry's total output value, spread out over 70 countries around the globe. Indeed this "fantastic plastic machine" is a model ambassador of the "Made in Portugal" brand. ●

INNOVATION Brain is the name of the game

Science, technology and innovation are at the heart of EU policies. When Prime Minister Socrates unveiled his brainchild Technological Plan in 2006, an agreement was crystallized with the Massachusetts Institute of Technology (MIT) that laid down the basis for co-operation and partnership in strategic fields such as renewable energy, engineering, science and technology. "Portugal is committed to change the role of technology in the economy", the MIT Portugal Program National Director, Paulo Ferrão asserts. Ferrão does not exaggerate if one considers that in 2006 every ministry saw their respective budgets sliced by an average of 6 %, while the Minister of Science & Technology Minister Mariano Gago saw his increase by 58 %. Mr. Gago is going to need every cent if he wants to turn the current situation around. According to Eurostat, the lowest share of employment in high-tech sectors in the EU27 is to be found in the Portuguese region Centro, with a meager 1 %. This explains why Socrates's government has established further alliances with other prestigious institutions, such as Carnegie Mellon University. "CMU is the leader in the area of computer science and it is amongst the top ten in US in the field of engineering", says Victor Barroso, National Director of CMU Program at Lisbon. "Our main objective is to bring companies to the educational system so we can make a cluster that generates synergies in this competitive field", Barroso concludes. ●

Engineering the world

CONSULGAL is a Portuguese company established in 1983 that provides engineering services of excellence to Portugal and the world. "We are basically engineers and managers who provide technically sophisticated solutions to complex constructive challenges such as airports and railways", explains Rogério Monteiro Nunes, CEO of CONSULGAL. The environmental awareness that emerging economies are quickly developing is hindered by the lack of technical know-how that modern, dynamic engineering requires. Consequently, "this is a big area for CONSULGAL to grow given our proven expertise", emphasizes Mr. Nunes. CONSULGAL has successfully undertaken the most challenging constructions inside Portugal and abroad, the airport of Madeira being a distinctive example that gave CONSULGAL the World's Construction Prize in 2004. When you are a small country, you have to find the way to grow and to take advantage of what you have", concludes Mr. Nunes. ●

Striking the right formula

Portugal reverses its heavy dependence on fossil fuels and becomes a leading green powerhouse.

Rich in energy

When Minister of Economy Manuel Pinho claimed that crisis brings about opportunities, he meant it. Deprived of oil, gas and coal, Portugal was only able to meet 17% of its energy needs from domestic sources in 2005. The rest had to be imported. Moreover, Portugal generated 58% of its electricity from imported oil, a heavy dependency that further hampered Portugal's ability to reactivate economic growth under permanent price volatility. Meanwhile, experts in the field blamed Portugal's waste of energy due to its inability to tap into its considerable energy resources derived from its unique climate. In this scenario the PS government launched the National Strategy for Energy aimed at securing supply, liberalizing energy markets and guaranteeing environmental sustainability. Three billion Euros were made

ready to be invested in renewable sources of energy aiming at developing wind, solar, wave and biomass technologies.

Three years down the line, Portugal produces 42.1% of its energy consumption from renewables, hosts the largest solar station in the world, has the first wind power park in Europe and is the pioneer in producing electricity from waves. This is just the beginning. Prime Minister José Socrates intends to upgrade the current installed capacity of 2,526 MW of wind power to 5,700 MW by 2010. This new goal will place Portugal in the frontline of renewable energy and make it, along with Austria and Sweden, one of the three nations that most invest in this sector. "Portugal is one of the nations in the world with the most hydroelectric potential still left to explore. Biofuels are going to be one of our main energy

bets," said Prime Minister José Socrates.

Igniting entrepreneurship

Among other achievements, the National Strategy for Energy has successfully encouraged private investment to seize the enormous business potential that renewables have to offer. Licenses were attributed to the private sector to install 1,500 MW of wind energy and compete in the production of electricity with state-owned EDP. Grupo Painhas was one of the first companies to tap into the field of wind power, taking advantage of energy liberalization in Portugal. Today, the group is the biggest service provider contracted by EDP and one of the top five for REN. Likewise, Painhas' waste management branch Paresidel has become the largest producer of biogas from land fill, with a total installed capacity of 9 MW. "Now we are working with 14 municipalities in a public-private partnership aimed at producing photovoltaic energy in Talavera, near Spain's Badajoz," explains Helena Painhas, director of the group.

New challenges

These achievements represent a significant contribution to the development of renewables in both Europe and Portugal, but they also pose new challenges to the EU's internal energy market. The volatility of renewables puts at risk the stability of the grids. "Renewables represent a wide window of opportunities for technology development with the aim at guaranteeing the quality of the grid," warns José Penedos, CEO of REN, the national grid company. However investment efforts need to be simultaneous across nations if the internal energy market is to become a reality. "the time for a level playing field has come," says Penedos. Europe seems in urgent need to tackle the long-standing issue of its energy grid both in terms of infrastructure and regulation, a vision that the President of the EC, Durão Barroso shares too. "We will not have the EU energy grid based on infrastructure only. We must have the harmonization of regulations too," concludes Penedos. ●

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Making the right connections

IPS: In present times, financial markets seem to be remarkably volatile. You stress that volatility might actually be an advantage for REN. Why?

JP: REN, like any other company responsible for managing both the grid of electricity and gas, is the kind of business that is remunerated through the level of its yearly investments. Likewise, national grids have by their nature a remarkably predictable cash flow, net results being quite foreseeable. Therefore, it is a safe value for pension funds, families and individuals, particularly in these times of high volatility. To me, REN represents the best investment that any investor can make among the top 20 companies that trade on the Lisbon Stock Exchange (PSI-20). In fact, REN was rated third in the Accountability Rating Portugal 2008, which evaluates corporate governance, its relationship with shareholders and the long-term sustainability of its actions towards society, markets and environment.

IPS: Last time we met with you, greater harmonization between Portugal and Spain was at the heart of the debate about MIBEL. How much closer are both countries in this regard?

JP: Unfortunately, we are not as close as I forecast two years ago because the speed at which we are going forward is not the most convenient one. Regulatory harmonization is a precondition for establishing a regional energy market such as MIBEL. What we have today is an interconnection with physical capacity to exchange energy. Currently we are exchanging circa 8 terawatt hours per year across the border between Portugal and Spain, which represents about 15 % of the yearly

INSIDER: JOSÉ PENEDOS, CEO OF REDE ELÉCTRICA NACIONAL



energy consumption in Portugal. This phenomenal figure can suggest two very differing realities though: either it underlines the increased energy interchange, as a result of enhanced harmonization; or it can stress market opportunities deriving from pricing differences between Portugal and Spain. Unhappily, it is the latter reality the one we are witnessing at present, which is far from suggesting any progress in regional harmonization. The more similar the regulatory frameworks between two countries are, the fewer the opportunities to make money from energy trading and consequently the more benefits for the final consumer.

IPS: You suggest that in the near future, Portugal could be supplying gas throughout Europe from the PETS at Sines. Is this really feasible?

JP: This new step is not only feasible but it would lay down a new foundation for Europe's internal energy market. Portugal and Spain have very unique conditions in terms of liquefied natural gas (LNG) as they share 7 LNG terminals all together. Considering that in the whole of Europe there are just 15 LNG stations, the Iberian

Peninsula could very well constitute an alternative platform of LNG input in Europe, which would ultimately favour the diversification of gas supplies. Electricity is currently being exchanged across borders without any obstacle, this should be also the case for LNG.

IPS: Two years ago we spoke about the 'energy paradox' that Portugal was facing and the role of renewables to overcome the country's excessive fossil energy dependence. Today, Portugal produces 42 % of its electricity capacity from renewables. However this kind of energy poses a severe challenge for the grid networks. How is REN surmounting this challenge?

JP: Portugal has a very ambitious program whereby 45 % of the annual consumption of energy is to be satisfied with renewables by 2010. The target is to reach an installed capacity of 6,000 megawatts by 2010 and ultimately 7,500 by 2014. If attained Portugal would rank 4th among the top wind-energy producing countries in the world. Although these achievements represent a significant contribution to the development of renewables both in Portugal and Europe, they also cause severe stress in the grids due to their volatile nature. Therefore, we must invest in mechanisms that help to control the feeding of wind energy into all European grids, Portugal's included. This is today the biggest challenge at REN. We need to develop "smart grids" that supplies double flows of energy to the consumer, both as a producer and as an end user. REN is part of this global challenge. Smart grids in distribution must be aligned with smarter grids of transmission. Both must be achieved at the same time. From our part (transmission), we are completely devoted to achieving this goal. ●

ON SOLID GROUND

Despite global financial unrest, Portugal's banks boast good health.

While the G-20 summit in Washington brainstormed on the reform of the international finance architecture, world financial markets persisted on their roller-coaster ride. Rescue plans for the banking systems on both sides of the Atlantic have brought about a significant degree of stability to last weeks' turbulences, and depositors' confidence progressively restored. As any other European economy, Portugal has felt the impact of the current volatile conjuncture, with the Lisbon Stock Exchange losing 20% of its ground in the month of October. Yet, the resilience that Portuguese banks have consolidated during the bonanza of recent years suggests that they shall overcome this situation without any major complications. In a recent visit to Brussels, Portuguese Deputy Minister of Finance, Emanuel Augusto Santos, reassured public opinion that "our banking system is solid."

To a large degree, the solidity of the banking system is due to the central banker Banco de Portugal (BdP) and its proactive role in addressing certain vulnerabilities. Banks with weaker capital ratios have been subject to enhanced monitor-

ing on their respective liquidity positions. Likewise, BdP has requested all banks to increase their solvency rates up to 8%, which will lead some banks to increase capital. Experts in the matter emphasize that Portugal's banking sector is not as exposed to toxic assets as other US and European institutions, mainly due to the retail nature of Portuguese banks, as well as their conservative nature of lending. Therefore, they should be in good condition to keep on going about "business as usual", as Minister of Economy and Innovation Manuel Pinho concludes.

"Banco BIC-Portugal is designed to enhance the vast potential of the relationship between Portugal and Angola." — Luís Mira Amaral

New kid on the block

Meanwhile, the performance of the emerging economies continued to be favorable in 2007, benefiting from little exposure to subprime credit, from a positive juncture in the commodity market and from a strong accumulation of external reserves. China, Brazil and Angola's respective GDP growths of 11.4%, 5.4% and 23%, clearly illustrate this point. Aware of the increasing importance of these markets, Minister Pinho emphasizes the need for Portuguese businesses to go international. While most Portuguese businesspeople establish relations from Portugal to these strategic markets, there is one case in which the trend is reversed. Banco BIC de Portugal is born from the will of former managers and shareholders of Banco de Fomento de Angola to create a



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financial institution from scratch-Banco BIC Angola- and develop a business platform in Europe. Although a sister company, Banco BIC de Portugal is managerially independent and was established to "support Portuguese investments in Angola, in close relationship with BIC Angola," explains Luís Mira Amaral, CEO of Banco BIC-Portugal. The importance of Angola to Portuguese investors has escalated exponentially, currently representing their top non-European market, which had been the U.S. in 2007. Amaral, former CEO of state-owned Caixa Geral de Depósitos 4 years ago, acknowledges the enormous challenge that it is "to create a bank from scratch in these difficult days for the global economy but the potential

of our project is larger than the size of our ambition". Angola's economy enjoys a particularly optimistic moment these days and hence represents an enormous opportunity for Portuguese business. In 2007, Portuguese exports to Angola increased 39%. Banco BIC-Portugal, explains Amaral, "is designed to enhance the vast potential of the relationship between Portugal and Angola." Amaral is aware of the increasing

competition that Banco BIC-Portugal is going to find in Angola, where most of the big Portuguese names are already established since a long time ago. However, BIC-Portugal's CEO is confident on the newborn institution's competitiveness based on the deep knowledge of the Angolan market, which is reinforced with their strategic relationship to BIC-Angola, voted last year the best bank in Angola. ●

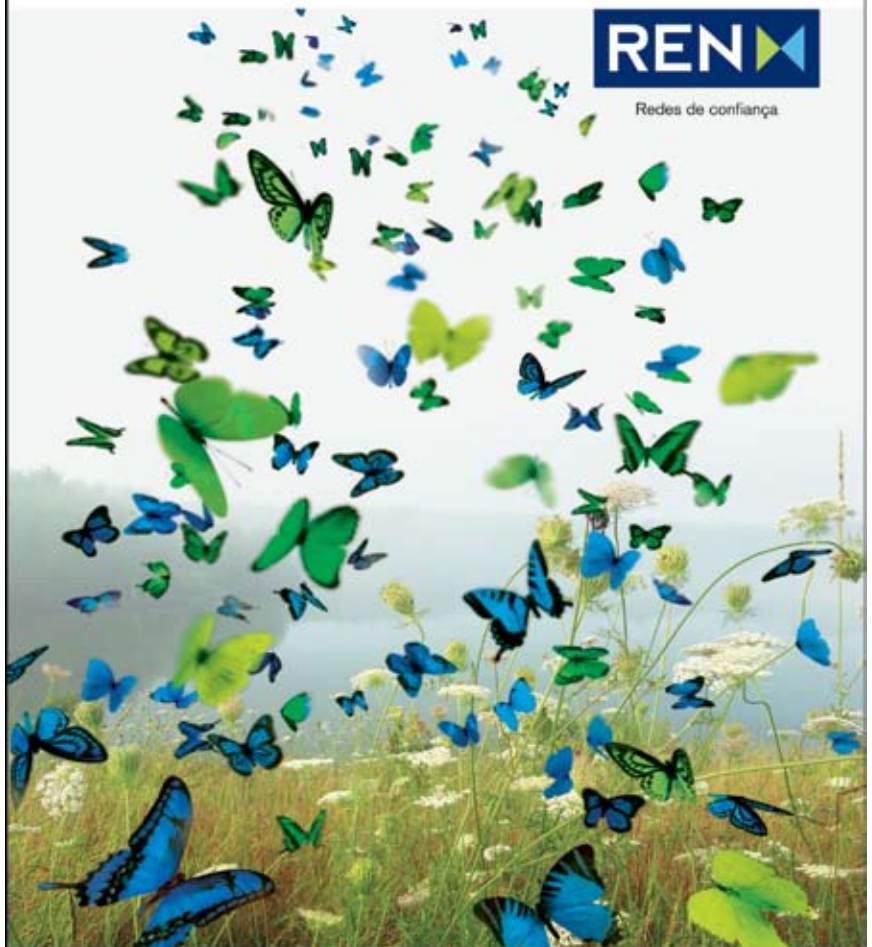
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The success of banking as usual

Grupo Banco Espírito Santo

In the recent past, the financial system witnessed a detachment from traditional banking in favor of more abstract, derivative-based practices that many would agree have largely contributed to the ongoing financial crisis today. It has not been the case for Grupo Banco Espírito Santo (BES), which boasts a long tradition in banking, its business philosophy remaining unchanged since its foundation. "We have a history of 139 years, during which we have traditionally developed long-term commercial relationships with our clients," says Ricardo Espírito Santo Bastos Salgado, Managing Director of International Premium Unit (IPU). "In the U.S. as well as in Europe, investment banks as well as retail banks, subverted their main business of serving the customer by making propriety trading their core business. They became hedge funds de facto. "We never engaged in this practice, so that is why we do not have a problem today," concludes José María Espírito Santo Ricciardi, from Espírito Santo Investment. In any case, what is clear is that the collapse of the financial system has restored the industry to its origins of old banking, where BES has a long-established expertise. BES has managed to diversify its sources and establish a stable financial base of 63% of deposits coming from its clients. This large client base allows BES to reduce its dependence on medium-term financing. Nevertheless, "we have prepared a re-pooling of our asset base in order to enable us to discount it as a reserve on our balance sheet, if there is ever the need to," reassures Pedro Fernandes Homem, Executive Board Director of BES.

With capital and solvency secured at home, BES is in a position to embark on its quest for internationalization. "In the past five years, Portuguese firms are expanding abroad not only through export base diversification, but also through JVs, start-ups and partnerships. This is the reason why we created IPU, within

the Corporate Banking Area," explains Salgado. In order to achieve it, BES is set to be the primary bank of Portuguese and Spanish companies expanding their business in what Salgado defines as "the Atlantic Strategic Triangle." "The Strategic Triangle is the set of markets that constitutes BES's platform for internationalization. They are grouped in terms of cultural affinity, geographical proximity and natural extension. These markets are Angola, Brazil, Maghreb and Spain". In this regard, BES wants to tap into the increasing business opportunities that the shifting trends in globalization are posing

"Our focus is to become an Iberian bank with international presence."

—Ricardo Espírito Santo Bastos Salgado

for Iberian business. "Developed economies are expected to maintain modest growth rates, while emerging economies should outperform the former by 2 to 5 times", Fernandes Homem explains. In fact, developed economies grew at an average of 2.7 in 2007 whereas emerging economies grew at a staggering 7.9 % on average during the same period. At the same time, these high rates of growth are being complemented by lower risk environments, further luring FDI to these newcomers that further enhances their respective output growth. Only in 2007, 204 private equity funds invested \$ 59 billion in capital commitments in emerging markets, a 77.71 % increase in comparison to the previous year.

Today, the Group's main objective is to support the internationalization and sophistication of Iberian companies, for BES considers Spain a natural extension of the

Ricardo Espírito Santo Bastos Salgado,
*Managing director,
International Premium Unit*



Portuguese market. Fernandes Homem considers that BES is in a privileged situation to expand internationally "as we are well positioned in the corporate segment in Portugal". At the same time, by fostering an integrated Iberian approach, BES can provide Spanish companies valuable assistance in deploying their business not only in Portugal, but also in emerging markets where Portugal enjoys a cultural affinity (Angola, Brazil). Likewise, BES can help Angolan and Brazilian companies to tap into international capital and markets by leveraging on its local know-how in related markets. Fernandes Homem illustrates this case by pointing out that "700 Brazilian companies export to Angola, 2,600 Brazilian companies export to Spain, and 2,700 Spanish companies export to Brazil. BES can make a difference in these interrelations, given its unique position in all 3 markets".

All in all, BES's international expansion responds to its commitment to support Portuguese and Spanish companies in global markets. "Growth is not an end in itself, but the consequence of a strategy that makes sense" Ricardo Bastos Salgado emphasizes. "Today, 36 % of the Group's banking comes from the international domain because our clients are increasingly more active in international markets". Bastos Salgado labels BES's international growth as "organic", where mergers and acquisitions are driven by the need to reinforce its presence in a specific market because the opportunity is there. Looking at the data, the size of the opportunity will not leave the investor indifferent: the net income weight of BES's Strategic Triangle on the overall international operations increased from 30% in First Quarter of 2007 to 61% in First Quarter of 2008. ●



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