

ECONOMIC ANALYSIS

Portugal: stable growth, in spite of external question marks

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The Portuguese economy's recovery stabilised in the third quarter, in spite of certain external sources of uncertainty. Improved domestic demand, especially private consumption, remains the chief driver of growth.

- Confidence data drifted back a fraction over 3Q15 (Figure 3), with the European Commission's economic sentiment indicator (the ESI) retreating on weaker manufacturing sector confidence, which failed to be offset by the improvement in household confidence, while the services index held stable at a level some way above its historical average.
- All of this is finding its reflection in the activity indicators for which data to August are available. Industrial production grew less vigorously compared to 2Q15, when it rose 3% QoQ (Figure 5), and retail sales bounced back significantly having slipped in the previous quarter, suggesting a pick-up in private consumption. With respect to exports, the fall observed to August hints that progress by sales abroad will be far more modest in Q3 following the surge seen in 2Q15. Exports came down, both within and outside the EU, with the prolonged fall in demand from Angola especially significant. This is also consistent with thinner industrial orders from abroad (Figures 7 and 8). Despite all this, the showing by imports was even tamer, which means that net exports should make a positive contribution to growth.
- After a second quarter of 2015 in which the performance by domestic demand was the engine of GDP growth (0.4% QoQ, the same as in Q1) (Figure 1), the activity and confidence figures suggest that the recovery will forge ahead at a relatively steady pace, propped up by factors that are both domestic (primarily private consumption) and external. Based on the data available thus far, our short-term MICA-BBVA model estimates growth of about 0.4-0.5% QoQ in Q3 (Figure 2).
- The unemployment rate, which broke off from its falling trend in 1Q15 after seven quarters, resumed its downward course in notable fashion in 2Q15 and then rallied a little in August, reaching 12.4%, which was 1.2pp below the level of twelve months earlier (Figure 11). Job creation accelerated slightly in 2Q15 (1.7% YoY after 1.5% YoY), growing at roughly the pace it had recorded throughout 2014. On the other hand, private sector labour costs rose by less than in the previous quarter (2.4% YoY in 2Q15 after 4.5% YoY), especially as regards its wage component (2.9% YoY, after 4.8% YoY), while in the public sector labour costs dropped back by 0.3% YoY (Figure 12).

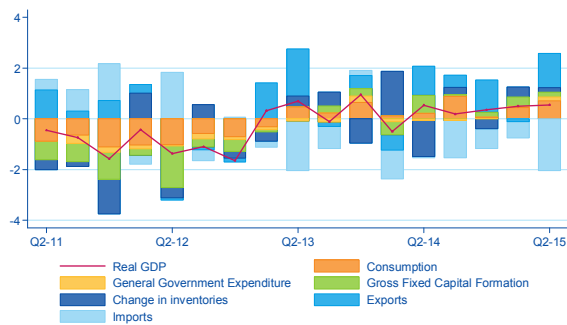
- In September, harmonised headline inflation (HICP) rose by 0.2pp to 0.9% YoY, owing to a spike in the core components (1.2% YoY, after 0.7% YoY in August) and non-processed food prices, which more than made up for the heavier fall in energy prices (Figures 13 and 14). Non-energy industrial goods prices, as well as those of services, were almost entirely responsible for the upturn in the core index, which fundamentally arose from a base effect in the transport component from September 2014 and in part reflects the solidity of domestic demand.
- The deficit for the public administrations to August 2015 was around 2.3% of GDP (-EUR4bn) in cumulative annual terms, which was about 0.4pp below the figure for the first eight months of 2014. This was predominantly due to the rise in tax revenues (5.3%), combined with reduced spending (-0.3%) on account of the base effect from the suspension of public sector wage cuts, effective since June 2014 (Figure 18). Despite this, the historical performance of revenue and expenditure over the last four months of the year poses a threat not only to the official deficit forecasts (government: 2.7%, BBVAe: 2.6%), but also to an exit from the excessive deficit procedure, as has been predicted by the IMF, which forecasts that Portugal will record a deficit of 3.1% of GDP at year-end.

Portugal

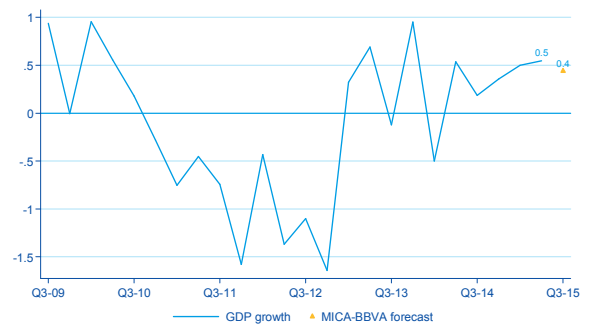
National accounts: forecast growth of around 0.4-0.5% QoQ in 3Q15

In 2Q15, GDP grew at an identical rate to the previous quarter, of 0.5% QoQ, mainly due to the rise in domestic demand. Net exports made a negative contribution. Our MICA-BBVA model for 3Q15 suggests that the economy should continue to advance at a relatively steady pace of 0.4-0.5% QoQ.

**Figure 1
GDP (% QoQ) and breakdown by component (pp)***



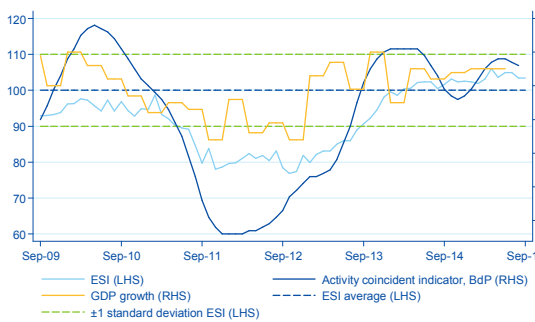
**Figure 2
MICA-BBVA: GDP growth and forecasts (%QoQ)***



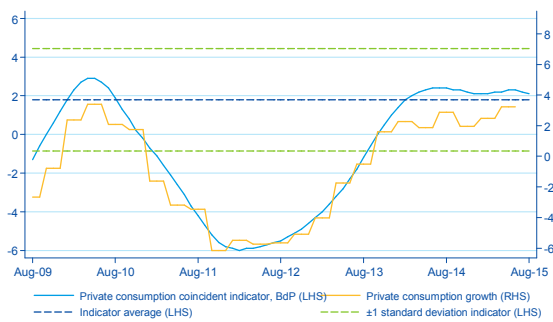
Confidence: the economic sentiment indicator eased in September

According to the ESI, business confidence fell in 3Q15, although it remains above its historical average. By component, household confidence improved and is still stable in the services sector, while it fell in manufactures.

**Figure 3
Confidence (ESI) and coincident activity indicator***



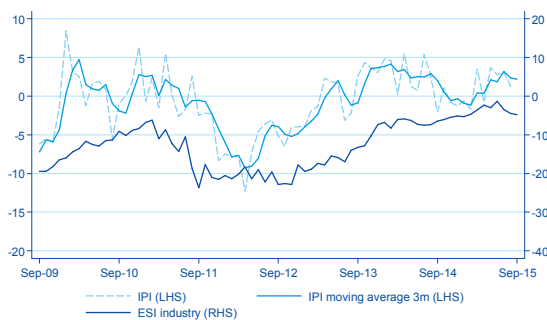
**Figure 4
Coincident consumption indicator and private consumption (% YoY)***



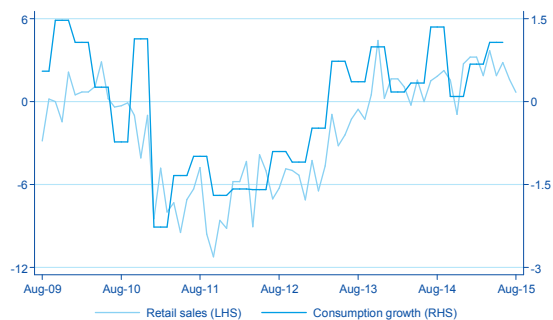
Activity: industrial production moderated while retail sales rallied

Industrial production fell 0.5% MoM in August and was 1% up on the 2Q15 average, when it grew 3% QoQ. On the other hand, retail trade rose 1.3% MoM in August and was 1.9% up on the 2Q15 average.

**Figure 5
Industrial production (% YoY) and industrial confidence***



**Figure 6
Retail sales (% YoY) and private consumption (%QoQ)***



* Fuente: HAVER y BBVA Research

Foreign sector: exports to countries outside the EU dropped away

The slowdown in global demand made itself felt in a reduction in exports to August (-0.5% against 2Q15), especially to countries outside the EU. On the other hand, imports plunged in a correction of the significant rise in 2Q15.

Figure 7
Exports and imports (% YoY, 3p moving average)*

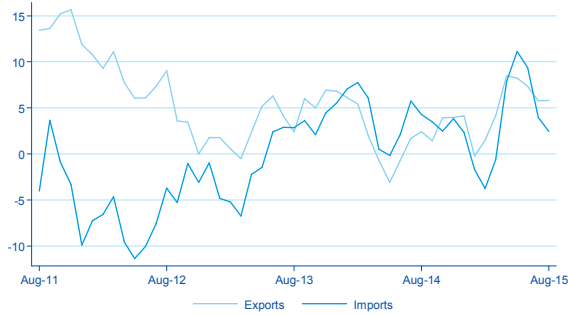


Figure 8
Exports (% YoY) and export orders*

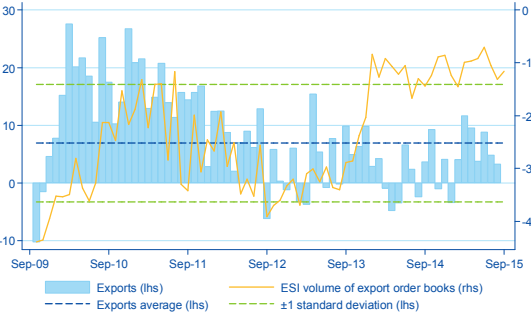


Figure 9
International trade by destination (% YoY, sa)*

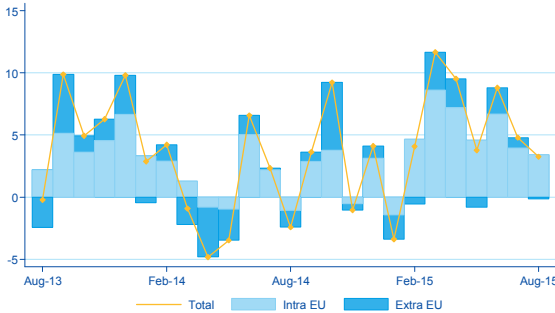
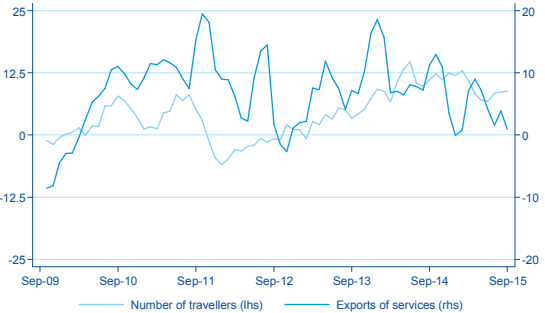


Figure 10
Tourism and services exp. (% YoY, 3p mov. av)*



Labour market: unemployment continued its fall

After the notable fall in unemployment in 2Q15, the rate continued to drop despite the minor correction in August, and stood at 12.4%. There was a slight acceleration in job creation (1.7% YoY in 2Q15 after 1.5% YoY) and private wages rose at a slower pace (2.4% YoY in 2Q15 after 4.5% YoY).

Figure 11
Unemployment rate (%) and employment expectations*

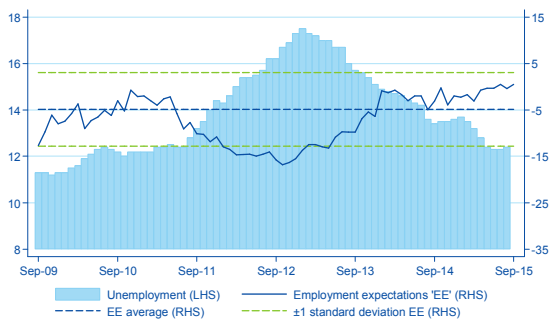
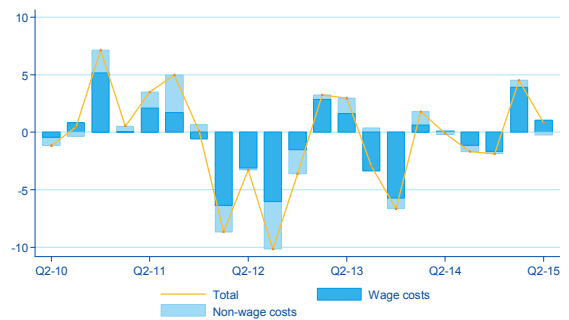


Figure 12
Labour costs in the business sector (% YoY)*



* Fuentes: HAVER y BBVA Research

Prices: headline and core inflation rose in September

Headline inflation (HICP) picked up by 0.2pp in September and stood at 0.9% YoY, due to the rise in the prices of all components (except energy). On the other hand, core inflation rose by 0.5pp to 1.2% YoY.

Figure 13
Inflation: headline and core (% YoY)*

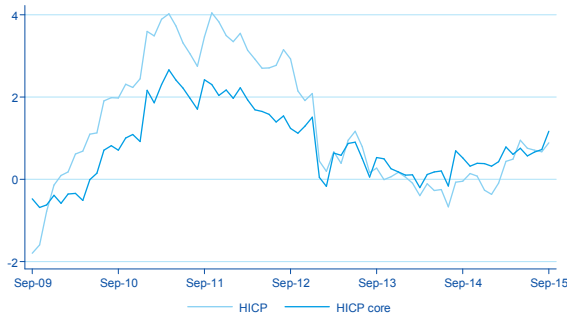
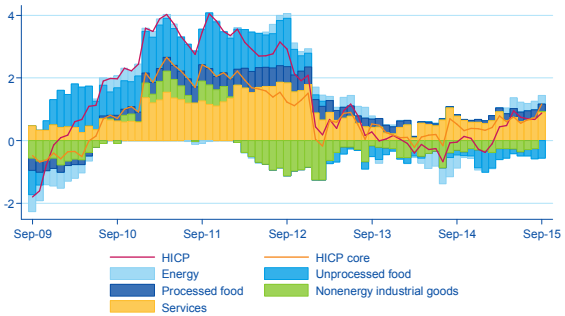


Figure 14
Inflation by component (contribution in %)*



Public sector: the cumulative deficit to August poses risks to hitting the target

Between January and August, the reduction in taxes and the rise in revenues were lower than budgeted for, which means that in the last four months of the year, when spending has historically been at its highest, the deficit target of 2.7% of GDP is at risk.

Figure 15
Fiscal expenditure (compared to previous year)*

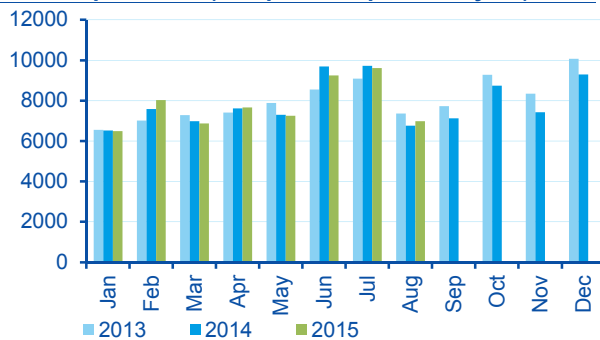


Figure 16
Fiscal revenues (compared to previous year)*

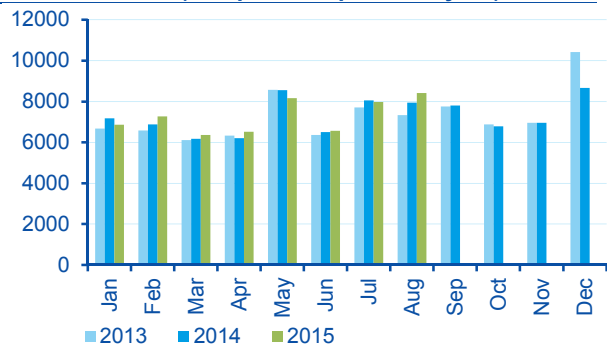


Figure 17
Public and private debt (% of GDP)

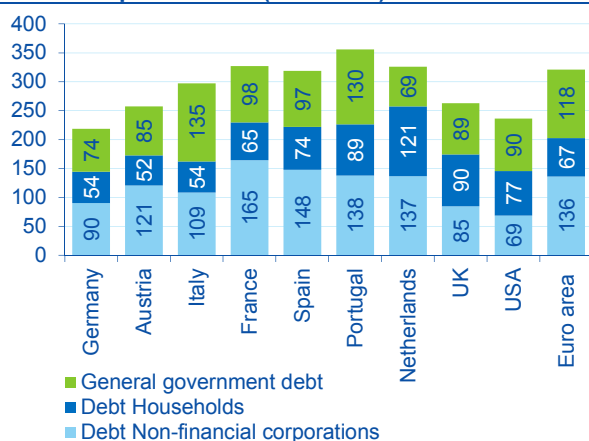
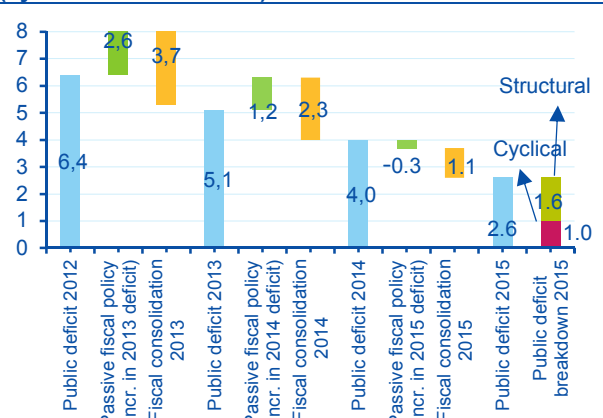


Figure 18
Decomposition of fiscal deficit (cyclical and structural)*



* Fuentes: HAVER y BBVA Research

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