Economic Watch

Portugal

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Economic Analysis

Europe
Chief Economist
Miguel Jiménez
mjimenezg@bbva.com

Katerina Deligiannidou
aikaterini.deligiannidou@bbva.com

Agustín García Serrador
agustin.garcia@bbva.com

Elvira Prades
elvira.prades@bbva.com

Portuguese economy continues in recession

With mild positive signs from confidence

- The majority of economic indicators keep pointing to a strong recession in the short term.
- External trade remains the only source of growth.
- Our short-term model (BBVA-MICA) forecasts a GDP fall of -0.7% q/q for Q1, after the drop by -1.3% in Q4.
- Confidence continues falling, but has been less negative over the past three months.
- Inflation has been moderating recently and is temporarily high due to VAT increases.
- We maintain our view that, given the recession and the challenges ahead, it will be difficult for Portugal to return to markets by 2013, but the good pace of structural reforms and the commitment of Portugal with fiscal consolidation suggests that public debt will not be restructured.

1. Economic Outlook

Confidence continues to deteriorate in Portugal but more slowly...

Although economic confidence remains in low levels, there has been a noticeable improvement during the last three months, according to the Economic Sentiment Indicator (ESI) of the European Commission. In particular, the economic sentiment has been improving since December (cumulatively gaining 2 points), although results for February are pointing to only a slight gain compared to January (+0.2p). By sector, the latest survey showed a deterioration in construction and manufacturing, while the business climate for services increased somewhat. In the same direction, the economic activity indicator included in the monthly survey conducted by INE, reverted its negative trend, showing a slight improvement in January.

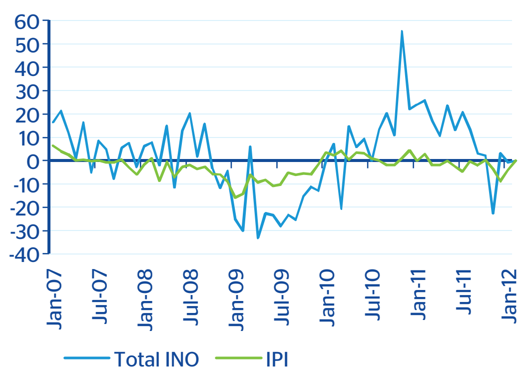
Nevertheless, the economic climate indicator, also from the monthly survey of INE, is a little more pessimistic, as the index fell slightly in February, reaching a new minimum, driven mainly by construction and manufacturing, while some recovery was evident in trade and services.

...while the industrial sector picked up, though the rebound is likely to be short-lived, as indicated by new orders

After falling during the last two months of 2011, industrial production rebounded in January (+1.2% m/m, seasonally adjusted), mainly thanks to the manufacturing sector, that gained almost 4% on the month. Still, looking at the less volatile 3-month moving average for the three months ending in January, industrial activity fell by -1%. In contrast, industrial new orders (INO) followed the opposite path, with considerable growth during the last two months of 2011, while registering a fall of -2.35% m/m at the beginning of 2012, owing to less demand for new business abroad. The three month moving average for INO in January was +1.4%, offsetting the negative news from industrial production.

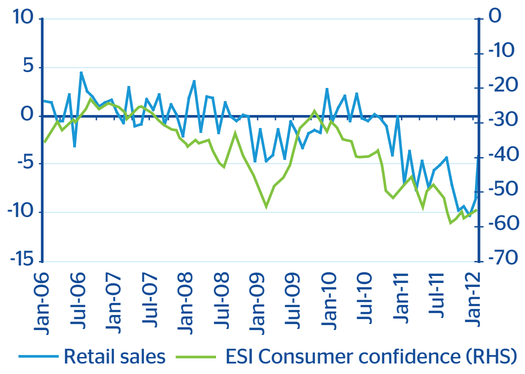
The services sector remains weak, as the services turnover index retained its negative trend, which was interrupted only in December (+2.8% m/m), losing -4.7% m/m in January. Employment, hours worked and salaries in the service sector, all decreased further, falling on average by almost 6% on the year. Nonetheless, the monthly economic survey of INE showed that investment weakening was milder in January, owing to the less negative evolution of construction. Indeed, construction activity improved at the beginning of the year, gaining 2.5% during January, and leading to a positive three-month moving average (+1%, after -2% in Q4).

Chart 1
Portugal: Industrial sector



Source: Eurostat and BBVA Research

Chart 2
Portugal: Retail sales & consumer confidence



Source: Eurostat and BBVA Research

Consumption prospects remain gloomy

Consumer confidence took a positive break in February, as it improved marginally. The ESI survey also confirmed the improvement, with the respective index gaining 2.1p in February (or 4.5p cumulative over the last three months). Nonetheless, sales in retail stores have been falling since September, except for December due to Christmas sales. In January retail trade fell back by -2.7% m/m. According to the monthly economic survey conducted by INE, the reduction in private consumption was less pronounced in January, as a result of lowered negative contribution of consumption of non-durables. Nevertheless, the negative contribution of private consumption to GDP growth was maintained in Q4 of 2011 at –2.0pp.

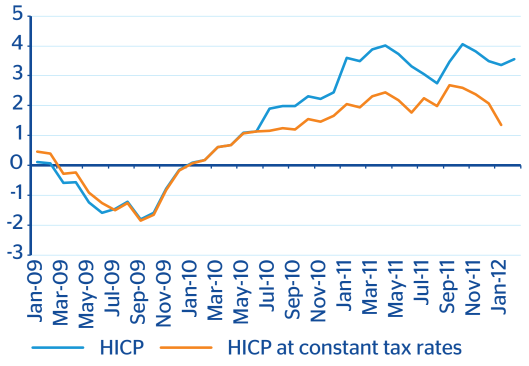
What makes the prospects for consumption and activity in general darker, are the recent developments in the labour market. The unemployment rate accelerated by 1.6pp in Q4, leading to a rate of 14%, suggesting that private consumption will remain weak in coming quarters, consistent with the need of adjustment of the Portuguese economy, which has a high consumption to GDP ratio and a still high external deficit.

Exports are the main source of growth

In the three months to January, exports continued growing, though with the yearly rate of acceleration slightly weaker (+10.9% after +11.9% in Q4), while imports kept falling, a little more rapidly than before (-7%, after -10.2% in Q4). As a result, the trade deficit narrowed by €2.08bn. Exports grew by 1.1% m/m in January, while the three-month moving average growth was +0.2%. Exports outside the EU are behaving more strongly than those inside it (+30.5% against +4.6% yearly, over the last three months). Similarly, imports from countries outside the EU increased by +17.7%, while imports from EU countries fell by -14.0% over the last three months on a yearly basis.

All in all, we see the already positive contribution of net exports to growth to continue in the course of Q1 of 2012, as the weakening of external demand is much less pronounced than the deterioration of domestic demand. This will have a favourable impact on the current account deficit, which stood at a still very high 8.6% of GDP in 2011 and is estimated to fall back to 6.4% in 2012 and below 3% in 2016, according to the IMF.

Chart 3
Portugal: Inflation %y/y

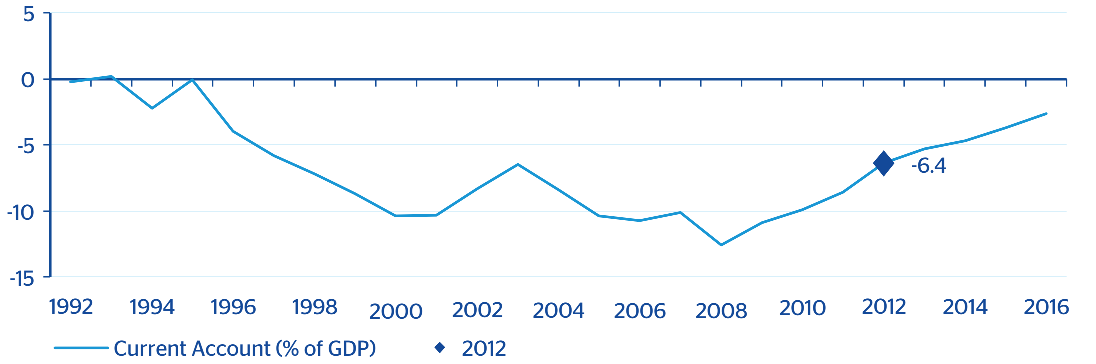


Source: INE, Eurostat and BBVA Research

Chart 4
Portugal: Exports and imports

Source: Eurostat and BBVA Research

Chart 5
Portugal: Current account balance as % of GDP



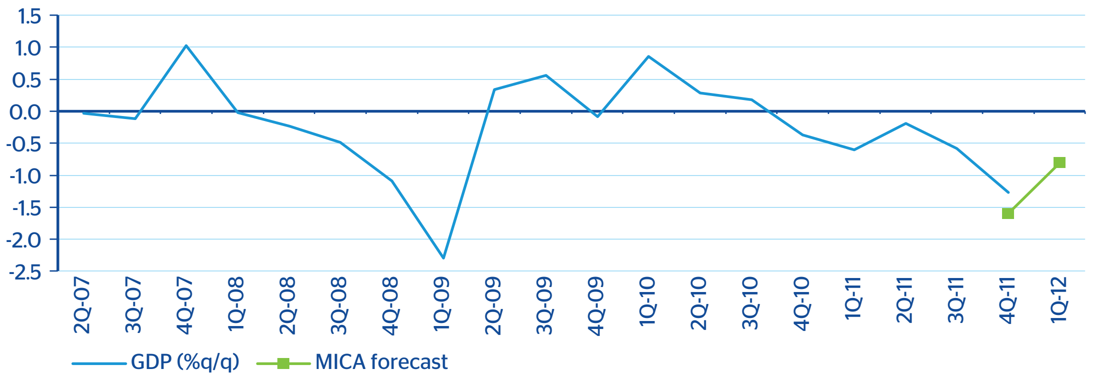
Source: IMF and BBVA Research

Our short-term model forecasts continued negative growth in Q1

Economic activity dropped by -1.3% q/q in Q4, slightly less than what we expected (-1.6% q/q). By component, the strong contribution of net exports to growth (+3.2pp) did not suffice to offset the strong negative contribution of domestic demand (-4.5pp), which was split almost equally between consumption (-2.2pp) and investment (-2.3pp). Looking forward, our short-term GDP forecast model (MICA) points to a contraction of 0.7% q/q in Q1, while for the whole year we expect a contraction of -2.7%, somewhat higher than the -3.3% foreseen by the European Commission (as at February 2012).

The INE has also published the decomposition of growth for 2011. During the last year as a whole, GDP fell by -1.6%, with a whooping negative contribution of domestic demand to growth by -6.2pp, especially due to the fall of private consumption (-3.9%) and investment (-14%). The external sector supported growth with a net contribution of 4.6pp, thanks to the weakness of imports. Indicatively, exports grew by +7.4%, while imports were weaker by -5.5%.

Chart 6
Portugal: GDP (%q/q) and MICA model indicator



Source: Eurostat and BBVA Research

Inflation decelerates, but more slowly than anticipated

After the peak surpassing 4% y/y in October, consumer inflation has been gradually easing, reaching a six month low in January and rising slightly in February to 3.6%. After the exclusion of volatile items, inflation stands at 2.2%. Recently, the upward pressures originate in housing, water, electricity and gas. The Portugal – Eurozone HICP differential widened by 0.2pp to 0.9pp in February. Looking ahead, further moderation is expected, as the monthly rate remains virtually flat, except for a 0.5% increase observed at the beginning of the year. The positive differential of Portuguese inflation vis-à-vis the eurozone average is due to VAT increases by mid-2011 and early 2012. Without such changes, inflation would be below 2%.

2. The troika sees the adjustment program on track

Official creditors completed their third review of Portugal's economic program during February, releasing the next €14.9bn tranche, to be delivered in April, after giving a positive verdict on the progress of the program, and noticing that policies and economic adjustment continue as planned.

The troika highlights that steps have been taken to increase competitiveness, to boost growth and improve overall labor market conditions complementing the ongoing reform of public enterprises, the court system, of tax policies and of the public administration. The government has also agreed a program for the autonomous region of Madeira. On the financial sector, the reforms and the deleveraging are underway and effort is made to ensure that credit flows to companies in need.

For the future, Troika expects economic activity to remain subdued in 2012, with an estimated contraction of 3.3%, driven by domestic demand. For 2013, a weak rebound is expected, mainly as a result of stronger exports and private investment.

Our broad view on Portugal continues to be that Portugal is implementing measures to achieve a sharp consolidation in 2012, with enough measures to achieve the deficit target of -4.5% of GDP if the growth projections are met. The deficit results for the first two months of the year were below target, although given the volatility of monthly deficit figures and the impact of one-off items, it is far too early to conclude anything from it. Overall, we continue to think that it will be very difficult for Portugal to return to markets by mid-2013, as expected, but we do not foresee a restructuring in the horizon as Portugal is taking decisive reforms to reduce its (large) imbalances and weaknesses. We also think that the efforts made are recognized by European authorities, who will continue to support the Portuguese economy as needed.

Table 1
Portugal: Economic indicators

		Hard Data						
		Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Q3 11	Q4 11
Industrial Production	m/m	-5.91	0.56	-2.9	-1.15	1.16	-0.14	-1.16
	y/y	-2.09	0.34	-3.44	-8.9	-4.19	-2.3	-4
Industrial New Orders	m/m	-4.37	-2.79	2.58	4.07	-2.35	-0.83	1.29
	y/y	2.97	2.11	-22.69	3.1	-0.79	12.3	-5.8
Retail Sales	m/m	-4.66	-3.15	-2.58	2.3	-2.7	-0.24	-1.14
	y/y	-7.06	-9.72	-9.29	-10.29	-8.47	-5.5	-9.8
Unemployment (harmonized)	%	13	13.6	14	14.6	14.8	12.7	14.1
	Δ		0.6	0.4	0.6	0.2		0.54
HICP	m/m	0.61	0.91	-0.14	0.06	0.34	0.1	0.3
	y/y	3.47	4.05	3.83	3.5	3.35	3.1	3.8
HICP ex energy & seas.food	m/m	0.69	0.3	-0.26	0.19	-0.31	0.1	0.1
	y/y	2.42	2.3	2.04	2.17	1.97	2	2.2
Exports	m/m	-0.65	1.34	0.49	-0.97	1.11	1.87	0.29
	y/y	14.22	16.12	18.24	10.63	12.43	14.17	14.99
		Soft Data						
		Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12
ESI	Level	81,0	75,8	80,2	73,9	74,6	75,7	75,9
	Δ	-4,8	-5,2	4,4	-6,3	0,7	1,1	0,2
ESI Employment exp.	Man. Level	-7,7	-10,1	-10,3	-11,8	-10,8	-12,9	-13,5
	Ser. Level	-13,3	-16,7	-18,2	-18,6	-19,8	-15,8	-15,7
EC Services	Level	-21,1	-23,3	-23,5	-31,6	-30,7	-29,2	-29
	Δ	-1,9	-2,2	-0,2	-8,1	0,9	1,5	0.2
EC Industry	Level	-18,7	-23,7	-17,7	-21	-21,5	-20,5	-21,3
	Δ	-8,2	-5,0	6,0	-3,3	-0,5	1,0	-0.8
EC Consumer	Level	-52,8	-58,9	-57,2	-58,4	-56,5	-56,0	-53,9
	Δ	-2,6	-6,1	1,7	-1,2	1,9	0,5	2,1

Note: quarterly figures are averages
Source: Eurostat and BBVA Research

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