RESEARCH

Economic Watch

Portugal

Madrid,
September 20, 2012
Economic Analysis

Europe
Chief Economist
Miguel Jiménez
mjimenezg@bbva.com

Sonia López Senra
sonia.lopez.senra@bbva.com

Agustín García Serrador
agustin.garcia@bbva.com

Elvira Prades
elvira.prades@bbva.com

The economy is set to contract further in 3Q

- GDP fell 1.2% q/q in 2Q12, in line with expectations, dragged down by the sharp decline in domestic demand
- Available data for the third quarter (most of which are still qualitative) suggest that the slowdown is easing
- Our MICA-BBVA model shows that GDP could contract by around 0.6% q/q in the third quarter
- The troika's 5th evaluation is positive but the government has announced new fiscal consolidation measures for 2013

1. Economic outlook

Despite the sharp economic contraction seen in 2Q12 (-1.2% q/q), available data for the third quarter suggest that the slowdown in GDP may be easing (-0.6% q/q). Foreign trade remains the main economic support and while exports are feeling the effects of the global slowdown in demand, they are still growing at a healthy pace, although the sharp decline in imports reflects the extreme weakness of domestic demand. However, this is allowing the current account deficit to be corrected much more rapidly than expected, as noted by the troika in its last report. The troika has also given the green light to the sixth tranche and raised fiscal targets for this year and 2013 and 2014, providing more room for the adjustment. Nonetheless, the Portuguese government has had to announce additional measures to achieve these objectives in 2013. Lastly, Portugal is still on schedule to return to the markets from mid 2013. The improved financial markets following the ECB's announced intervention has made this goal more plausible than it was three months ago.

GDP contracted by 1.2% q/q in 2Q12, in line with expectations, dragged down by the sharp fall in domestic demand

The current fiscal adjustment, in addition to the deleveraging of the private sector, the decline in confidence and the worsening labour market were all behind the fall in domestic demand (-2.7pp vs. -0.1pp in 1Q12). However, the drop in private (-0.8% q/q) and public consumption (-0.1% q/q) was less than in the first quarter, although investment (-10.3% q/q) showed a greater than expected slump. While the contribution of net exports to GDP increased (+1.5pp), 2Q data were slightly less optimistic as exports grew only 0.7% q/q, implying that the positive contribution owed mainly to the sharp decline in imports (-3.3% q/q).

Available 3Q data suggest that the slowdown is easing

The EC Economic Sentiment Indicator rose in August, reversing the fall seen in July, due to improved confidence in the industry, services and construction sectors. Although quantitative data are only available for July, these indicate the same trend. Retail sales (3month moving average) indicate that household spending increased in July, breaking the sharp decline observed in the previous quarter. Further, industrial production recovered, partly offsetting the drops of previous months, while the downturn in industrial orders also eased off, due especially the strong performance of foreign orders. In sum, all these indicators suggest that domestic demand could have been slightly less negative than in the previous quarter.

Foreign trade data for July reflect that even though exports continued to decline, they were still growing at a healthy pace, while the fall in imports has intensified over the past few months. Therefore, we expect foreign trade to continue to support growth while at the same time allowing the net trade deficit to be rapidly corrected. Specifically, the 12-month cumulative deficit in the balance of trade to July stood at -4,689 million euros, or the equivalent of 2.8% of GDP. This is a considerable change from the high of -12.8% seen in January 2009, and the trend has become more pronounced in the past few months. The adjustment of Portugal's economic imbalance owes mainly to the improvement in the balance of goods, with exports remaining on a healthy growth path thanks to exports to emerging markets. Additionally, the slowdown in imports initiated in the second quarter of 2011 has eased. The balance of services also remains strong although service exports are showing signs of moderating.

Our MICA-BBVA model points to further GDP contraction in 3Q12

Based on the partial information available for the third quarter of the year, relating above all to confidence indicators, we expect GDP to fall by 0.6% q/q, in line with our macroeconomic scenario which forecasts a GDP contraction of 2.7% for 2012 (slightly more optimistic than the 3% contraction estimated in the troika's last report). Our -0.3% forecast for 2013 has downside risk due to the recently-announced fiscal measures, together with the likely negative carry-over effect of the Spanish economy; although it could also benefit from the more buoyant financial markets and the easing of tension resulting from the measures announced recently by the ECB.

2. The troika's 5th evaluation is positive but new fiscal consolidation measures have been announced for 2013

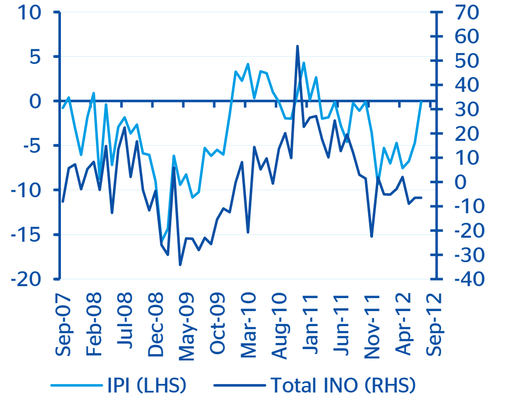
Following the conclusion of the troika's fifth evaluation and the go ahead for the sixth tranche, the Portuguese government has announced a raft of new consolidation measures for 2013, even though the troika has eased its deficit targets from -4.5% to -5% this year and from -3.5% to -4.5% in 2013. There are two main reasons for this. Firstly, the Constitutional Court has ruled the projected elimination of the extra salary payments for public employees in 2013 to be unconstitutional, forcing the government to take compensating actions. Secondly, as reflected in budgetary execution data to July, public revenues are lower than expected even though the decline in activity is in line with expectations. This higher elasticity of public revenues to GDP is probably the result of growth which is more skewed towards exports than was expected and exports generate lower tax revenues than internal consumption.

To offset these deviations and set budgetary targets for next year, the government has announced a raft of fiscal measures including raising the social security contributions paid by employees by 7pp to 18%, while the amount contributed by employers will be reduced from 23.75% to 18%, and reductions in pension payments. This measure will reduce real salaries and improve competitiveness, in addition to generating an estimated net fiscal saving of 3,560 million euros. Other fiscal measures to be implemented next year include higher special taxes, a review of income tax brackets and increased control over costs, subsidies and social benefits (see table 2). All these measures are expected to lead to savings of 4,900 million euros (2.8% of GDP).

In terms of access to the markets, the schedule remains unchanged despite Portugal's additional financing needs. The country is expected to be able to turn to the markets for financing from mid 2013. Further, the European authorities have stated their willingness to continue to support Portugal so long as it complies strictly with the conditions of the aid programme.

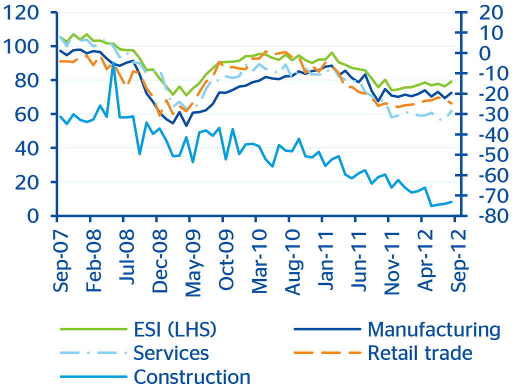
3. Tables and charts

Chart 1
Portugal: Industrial sector (y/y%)



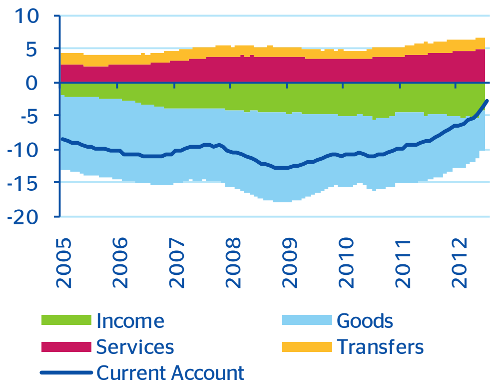
Source: Eurostat and BBVA Research

Chart 2
Portugal: confidence by sector



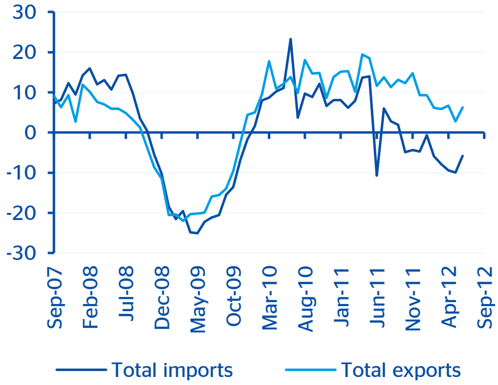
Source: Eurostat and BBVA Research

Chart 3
Portugal: current account (% GDP)



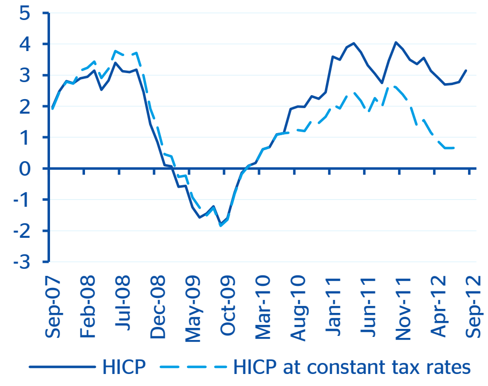
Source: Bank of Portugal

Chart 4
Portugal: exports and imports (% y/y)



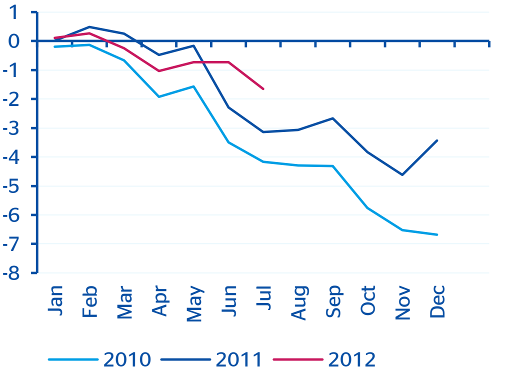
Source: INE and BBVA Research

Chart 5
Portugal: inflation (% y/y)



Source: INE, Eurostat and BBVA Research

Chart 6
Portugal: budget execution



Source: DGO and BBVA Research

Table 1
Portugal: economic indicators

		Hard Data							
		Apr-12	May-12	Jun-12	Jul-12	Aug12		Q1 12	Q2 12
Industrial Production	m/m	-6.61	4.08	-1.04	1.52	n/a	q/q	0.04	-2.29
	y/y	-7.55	-6.77	-4.67	-0.11	n/a			
Industrial New Orders	y/y	2.11	-8.93	-6.53	-6.49	n/a	q/q	4.81	-3.99
Retail Sales	m/m	-2.86	3.41	0.00	0.11	n/a	q/q	-0.34	-1.36
	y/y	-9.77	-4.35	-5.38	-7.95	n/a			
Unemployment (harmonized)	%	15.40	15.50	15.70	15.70	n/a	prom 3m	14.83	15.53
	Δ	0.30	0.10	0.20	0.00	n/a			
HICP	m/m	0.06	-0.11	0.03	0.23	0.41	q/q	0.99	0.08
	y/y	2.92	2.70	2.71	2.77	3.15			
HICP ex energy & seas.food	m/m	0.01	0.02	0.01	-0.11	0.27	q/q	0.67	0.12
	y/y	1.69	1.65	1.58	1.39	1.54			
Exports	y/y	2.95	8.43	9.78	6.79	n/a	q/q	4.56	0.95
Imports	y/y	-12.73	-9.24	-3.47	-6.22	n/a	q/q	-0.77	6.12
		Soft Data							
		Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12
ESI	Level	75.70	75.90	77.10	78.50	77.00	77.90	76.40	79.10
	Δ	1.1	0.2	1.2	1.4	-1.5	0.9	-1.5	2.7
ESI Employment exp.	Man. Level	-12.90	-13.50	-14.70	-14.60	-14.50	-15.00	-14.50	-14.00
	Ser. Level	-15.80	-15.70	-15.70	-19.10	-19.80	-16.00	-13.90	-13.60
EC Services	Level	-29.20	-29.00	-30.70	-30.70	-29.30	-32.70	-32.80	-28.60
	Δ	1.50	0.20	-1.70	0.00	1.40	-3.40	-0.10	4.20
EC Industry	Level	-20.50	-21.30	-20.20	-18.30	-21.40	-19.10	-22.20	-19.60
	Δ	1.00	-0.80	1.10	1.90	-3.10	2.30	-3.10	2.60
EC Consumer	Level	-56.00	-53.90	-52.50	-52.60	-52.10	-49.10	-50.40	-51.70
	Δ	0.50	2.10	1.40	-0.10	0.50	3.00	-1.30	-1.30

Note: Blue colour: improvement. Grey: deterioration. White: neutral; Note: quarterly figures are q/q rates
Source: Eurostat, European Commission and BBVA Research

Table 2
Austerity measures announced in September 2012

Spending		
Spending on public wages	Wages	Rationalisation of salaries in the public sector to bring them into line with the private sector.
		Following the ruling of the Constitutional Court, public employees will recover one of their extra salary payments in 2013, which will be paid proportionally over 12 months.
	Hiring	More rapid downsizing of the public sector
Investment		Rationalisation of investment projects carried out by public companies, reducing transfers, and also projects carried out by public/private companies.
Pensions		Pensions of between €1,500€-€2,000/month will be cut by 3.5%, pensions of between €2,000-€4,165/month by 3.5% and pensions of over €4,165/month will be reduced by 10%.
		Pensioners will continue to receive two extra payments if they are entitled to less than €600/month and only one extra payment if they receive less than €1,000/month. They will receive no extra payments if they receive more than that amount.
Social benefits		Rationalisation of access to social benefits and guarantees over control mechanisms.
Unemployment benefit		New rules will be applied to obtain unemployment benefit and more restrictive criteria will apply.
Revenues		
Direct taxes (IRS)		The number of income tax brackets will be reduced. The maximum marginal rate will be maintained at 46.5%.
Capital gains tax		This tax will be increased to 26.5% and the current withholding system will be revised.
Property tax		The tax on capital gains on property sales will be increased from 21% to 26.5%. A new tax will be charged for properties worth over 1 million euros (the rate to be applied is not yet known).
Social security contributions		Social security contributions paid by employees in both the public and private sector will be increased by 7 pp from 11% to 18%.
		While the contribution paid by the employer will be reduced from 23.75% to 18%.
Other taxes		A tax on luxury goods will be introduced.
Measures to prevent tax evasion		There will be more pressure to prevent tax evasion and transfers and payments to accounts in tax havens will be subject to stricter control.

Source: BBVA Research

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances; investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates´ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.