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Europe Flash

Portugal

Madrid, 5 February 2013
Economic Analysis

Europe

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The recession will be somewhat more moderate in the first quarter

Compliance with the 2012 deficit target should help Portugal access to financial markets

- **The MICA-BBVA model suggests that GDP shrank by 0.9% q/q in 4Q12**

  Our short-term model based on almost-complete data through December (except for a few quantitative indicators), estimates that the pace of contraction in economic activity in the last quarter of the year was similar to the contraction seen in the previous two quarters, i.e. around -1% q/q. Accordingly, Portuguese GDP would have shrunk by 3% in 2012 as a whole, somewhat more than was projected a few months ago (-2.8%). However, these projections contrast with the coincident activity indicator released by the Bank of Portugal, which suggests that the decline in activity has eased off since the second half of last year.

  The available data for the current quarter are very limited, being confined to the sentiment indicators available for January. In any event, the data are not very positive, since they evidence again a slight decline in the wake of the improvements in November and, especially, in December, although the January figure was slightly above the average for 4Q12 as a whole. Though it is only a preliminary reading, our MICA-BBVA model estimates that GDP contraction may have been slightly less negative in the first quarter of the year, at around half a GDP point.

- **The austerity measures continue to strangle domestic demand**

  Following the notable moderation in the negative contribution by domestic demand in Q3 (-0.2pp, from -2.7pp in Q2), the data available for the fourth quarter confirm that this was temporary and the economy was severely hampered in the final quarter of 2012. In particular, industrial output (-4% q/q in Q4) coupled with a decline in industrial orders, shored up only partly by external orders, and weak domestic demand suggest that investment contracted again. Retail sales through December (-6.3% q/q in Q4) suggest that the decline in private consumption intensified at the end of 2012, reflecting the further deterioration in the labour market (with unemployment up by around 0.3pp in 4Q, to the 16.5% December reading) as well as the sharp drop in household disposable income during 2012 (around -3% until 3Q12). Lastly, the fiscal consolidation which enabled the fiscal target to be met in 2012 further squeezed public consumption.

- **Exports weakened, although the drop in imports will result in a positive net export contribution**

  Seasonally-adjusted trade balance series are only available through November, but they point to a weakening of exports in the fourth quarter, raising concerns regarding the sustainability of what has been the main driver of economic growth in the last two years. This weakening could be linked to the decline in activity throughout the eurozone at the end of last year, which was seen in all member States. In particular, exports grew at a robust pace in October (2% m/m) but this was not enough to offset the sharp decline in September, and resulted in a drop in October-November exports of around 2% compared to Q3. However, the slower pace of wane in imports (-3% through November vs. Q3) suggests that net exports will again contribute positively to growth in Q4 (after draining 0.7pp in Q3), in line with our scenario.

  Expectations of a slight recovery in central-European countries underpin our view that the foreign sector will continue to shore up economic growth in 2013 and, coupled with the fall in imports, will further correct the current account imbalance.

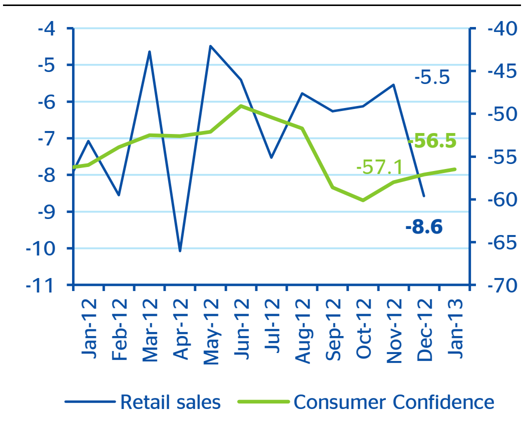
- **The 5% deficit target for 2012 was met**

  Preliminary deficit figures from the Finance Ministry indicate that the government met the 5% deficit target agreed with the troika for 2012. However, we are still awaiting confirmation of the inclusion of revenues raised from airport concessions (€800mn, i.e. around 0.5% of GDP).

- **Access to financial markets is looking increasingly feasible**

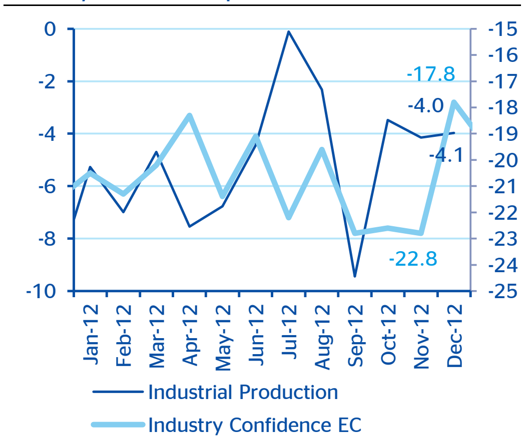
  Compliance with the 2012 fiscal target, together with the measures announced for 2013, should boost markets confidence, which in January already allowed Portugal to issue long-term debt. Specifically, it launched a €2.5bn 5Y issue at 4.89% yield with strong demand (€12bn), mainly foreign.

Graph 1
Consumer Confidence remains at very low levels



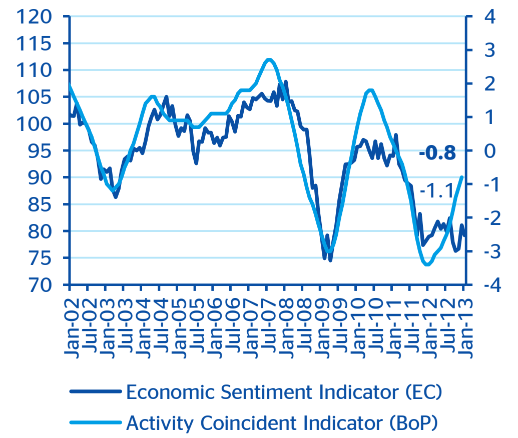
Source: European Commission and Eurostat

Graph 2
Industry does not improve



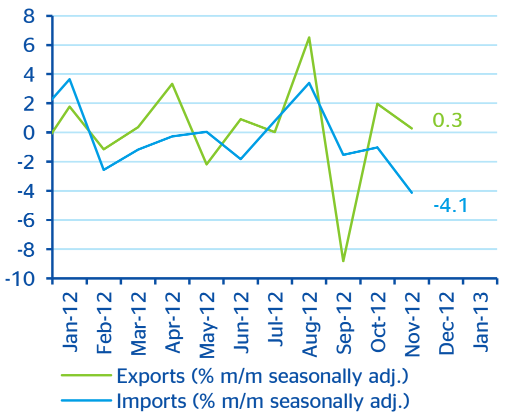
Source: European Commission and Eurostat

Graph 3
Coincident Indicator for Activity (Bank of Portugal) shows slightly improvement



Source: Bank of Portugal and European Commission

Graph 4
Exports weaken



Source: Bank of Portugal

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