

Economic Watch

Portugal

Madrid, March 19, 2014
Economic Analysis

Eruope

Miguel Jiménez González-Anleo
Chief Economist
mjimenezg@bbva.com

Agustín García Serrador
Senior Economist
agustin.garcia@bbva.com

Diego Torres Torres
Economist
diego.torres.torres@bbva.com

Pablo Budde
pablo.budde@bbva.com

Massimo Trento
massimo.trento@bbva.com

With the contribution of:

The Directorate Planning
and Financial
Management

Ana Claudino
ana.claudino@bbva.pt

After the positive surprise of 4Q13, the recovery continues at the beginning of the year

Our MICA-BBVA model estimates growth of +0.2% QoQ in 1Q14, with an upward bias

- **GDP growth surprised to the upside in 4Q13, driven by investment and exports**

GDP grew by 0.6% QoQ in the fourth quarter of 2013, compared with the forecast of a relatively steady recovery rate (about 0.2% QoQ). Behind this acceleration of activity are both the strength of investment (3.3% QoQ) and the contribution of net exports (Figure 1). However, after sharp falls in activity recorded in late 2012 and the first quarter of 2013, annual GDP was down 1.4% (BBVA Research: -1.5%).

- **Household expectations continue on the recovery path and are reflected in higher retail sales at the beginning of the year**

Since early last year, household expectations have continued to improve and are now higher than the historical average (approximately one standard deviation higher). Part of this optimism may be due to the improvement in the labour market, and would be responsible for the boost in retail sales which increased in January, rising nearly 4% on average for 4Q13 (Figures 4 and 6), in a context of rather volatile behaviour.

- **Industrial production on an upward trend which is likely to continue, given more positive business confidence levels**

In the last two months of 2013, the economic sentiment indicator for the European Commission (ESI) rose significantly, getting closer to its historical averages; nevertheless, business confidence improved more moderately in January and the index fell in February. This higher level of confidence reflects the positive trend in industrial production at the end of 2013, and has continued at the beginning of 2014, driven by export orders that remain resilient (Figure 5).

- **Exports increase at the beginning of the year, with higher bias towards eurozone countries**

After rising in 4Q13, exports maintained the growth trend in early 2014, increasing 1.9% in January over the previous quarter's average. The main destination of these exports continues to be eurozone countries, whose recovery is observed from 2Q13 and reflects the improving economic activity among the member countries; on the other hand, exports to extra-eurozone countries remain practically flat (with a slight decline), perhaps due to a stronger euro. If one adds to this that the indicator of order volumes has increased, it is likely that this trend will continue and that net exports could again contribute to growth in 1Q14 (Figures 7-10).

- **The MICA-BBVA model points to moderate growth in 1Q14**

With the data available so far, which are mainly confidence indicators, our MICA-BBVA model estimates quarterly GDP growth of around 0.2% QoQ in 1Q14 (compared with 0.1% QoQ in our baseline scenario, see Figure 2), which, added to the positive surprise of growth in late 2013 and the upward revision of 0.1pp in 3Q13 GDP growth, implies a positive carry-over effect on growth in 2014 of about 0.3pp. This biases upwards our 0.8% forecast for this year, which will be pushed above 1%, if the moderate growth scenario continues for the rest of the year.

- **Unemployment decreases, mainly through rising employment, but still at high levels and above the eurozone average**

The unemployment rate remained at 15.3% in January, in a clear downtrend, with a reduction of 2.3pp YoY (17.6% in January 2013). In 4Q13 employment was created, continuing the trend that began in 2Q13 (Chart 11).

- **Inflation at negative rates from the sharp drop in energy prices**

Headline inflation (HCPI) slowed again in February to negative rates (-0.1% YoY), mainly due to falling energy prices (-2.1% YoY) and transport (-2% YoY), while housing, water, electricity, gas and other fuel tariffs increased, so that core inflation remained at 0.1% in February (Figures 13 and 14).

- **The 2013 deficit came in below target, and initial data for 2014 is positive**

Fiscal adjustment in 2013 worked better than expected, with a deficit estimated to be around 4.5% of GDP (excluding the recapitalisation of BANIF), below the target of 5.5%. This good performance was mainly due to higher tax revenues (13.1% YoY), well above the anticipated increase (8.9% YoY), in part explained by the increase in personal income tax, the improvement in the labour market and the economy recovering since the second quarter.

In January 2014, public sector accounts recorded a EUR636mn surplus, which is a good beginning to the year if compared to 2013 (EUR114mn) and the average of 2011-12 (EUR398mn). Increased tax revenues and improved collection of indirect and direct taxes, mainly the latter, are behind this good performance. Moreover, expenditures stayed at virtually the same levels as a year ago (Figures 15 and 16).

On 13 March, the president of Portugal chose not to sign into law a decree increasing civil servants' contributions to health care (about 0.1% of GDP). This decree was part of additional measures presented to offset the non-application of pension convergence, following its annulment by the Constitutional Court. Even when bearing in mind the non-application of this decree, we continue to expect that the 2014 deficit will be in line with the 4% target.

Portugal

National accounts: the recovery gains traction in 4Q13 and the economy grows more than expected (0.6% QoQ)

GDP grew by 0.6% QoQ in the fourth quarter of 2013, more than expected (BBVA Research: 0.2%; Consensus: 0.1%). The strength of investment and accelerating exports are behind this performance. The recovery should continue in 1Q14 (+0.2% QoQ)

Chart 1

GDP (%QoQ) and contribution by component (pp)*

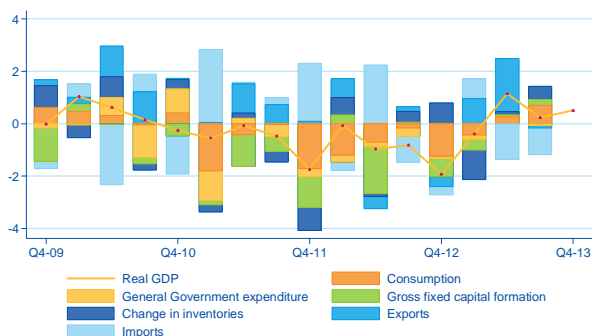
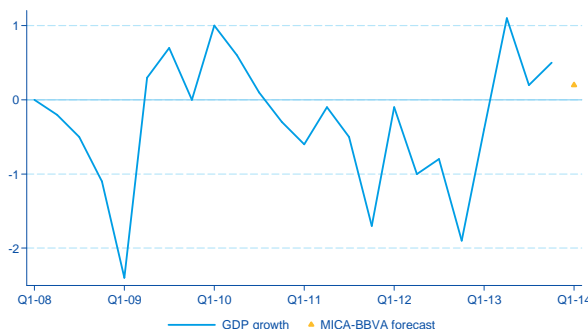


Chart 2

MICA-BBVA: GDP growth (%QoQ) & forecasts*



Confidence: the positive trend which started a year ago ends in February

According to the EC indicator (ESI), business confidence remains below its historical average, posting 98.6 points in February and interrupting the trend of improvement that had lasted a year. Consumer confidence, however, continues to grow strongly.

Chart 3

Confidence (ESI) & coincident activity indicator*

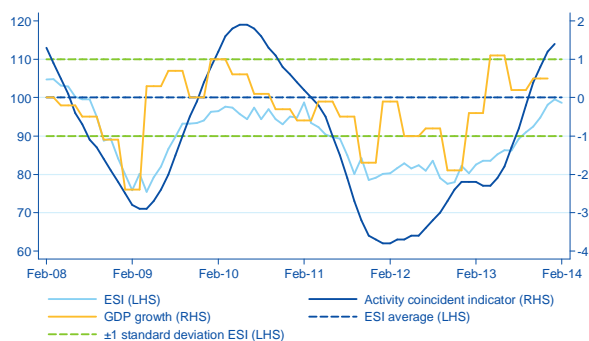
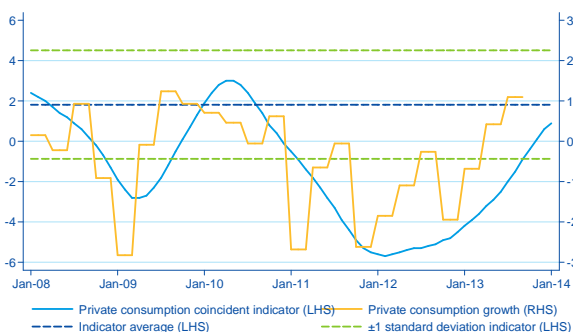


Chart 4

Private Consumption Coincident Indicator and Private consumption (%YoY)*



Activity: industrial production and retail sales improve in January

Industrial production continues to increase in January hand-in-hand with external demand, and retail sales bounce (6.7% MoM) after declining by 1.7% QoQ in 4Q13.

Chart 5

Industrial output (% YoY) and industrial confidence (ESI)**

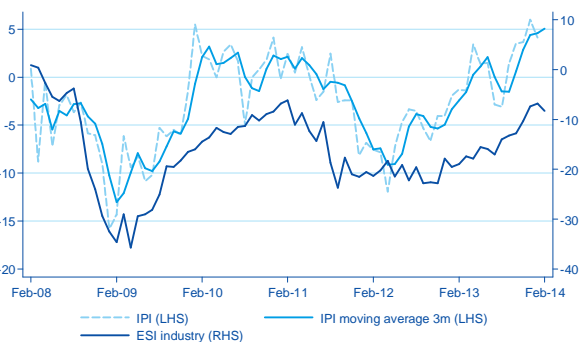
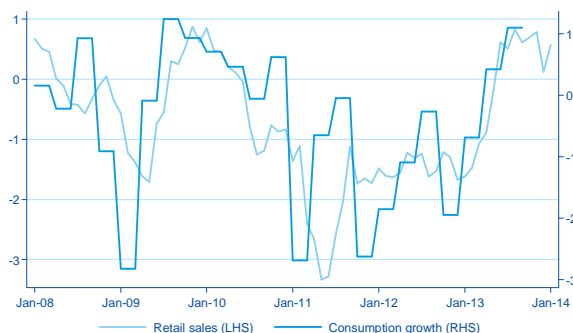


Chart 6

Retail trade (% 3m/3m) and consumption growth (% QoQ)*



*Source: HAVER Analytics and BBVA Research

Foreign sector: export orders suggest continued export growth for 1Q14

In 4Q13, exports increased 2.2% on 3Q13 and, with the January data, they are further improved by 1.9% on the average of the previous quarter, while growth in imports, much more volatile, was sharper (5.4% MoM).

Chart 7

Exports and imports (quarterly rate, sa %)*

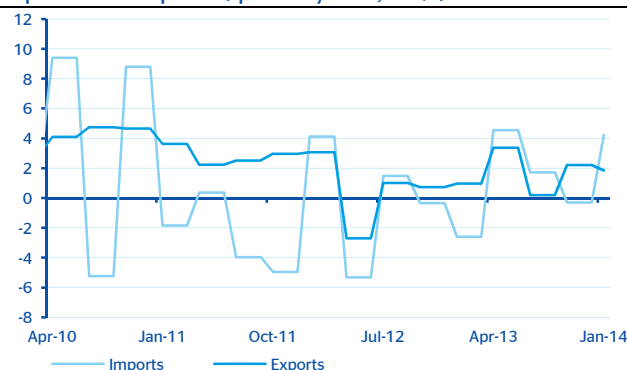


Chart 8

Exports (% YoY) and volume of export order books*

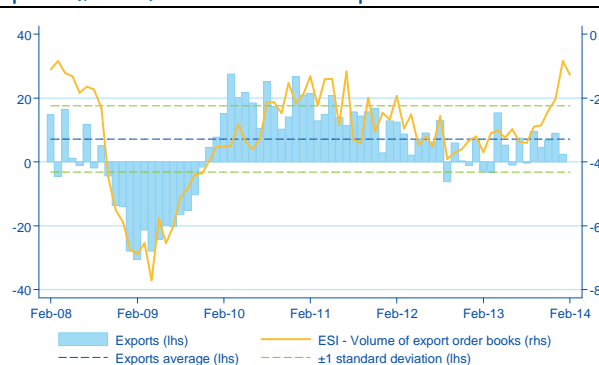


Chart 9

Exports by destination (% YoY)*

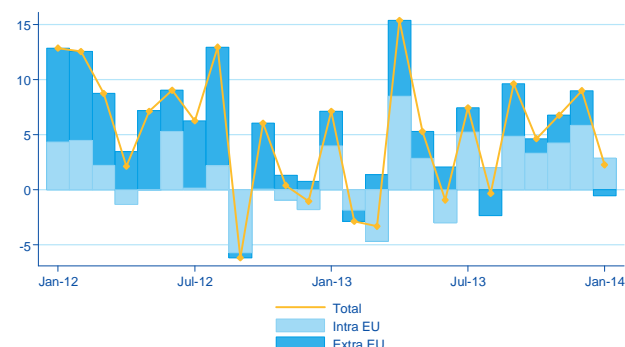
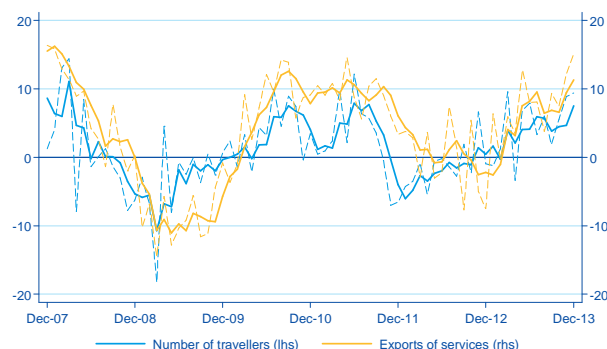


Chart 10

Tourism and service exports (% YoY)*



Labour market: unemployment is still above the eurozone average

The unemployment rate remained stable in January at 15.3%, an improvement of 2.3pp when compared with the figure of 2013. Employment was created in 4Q13, continuing the trend that began in the second quarter of 2013.

Chart 11

Unemployment rate (%) and employment expectations*

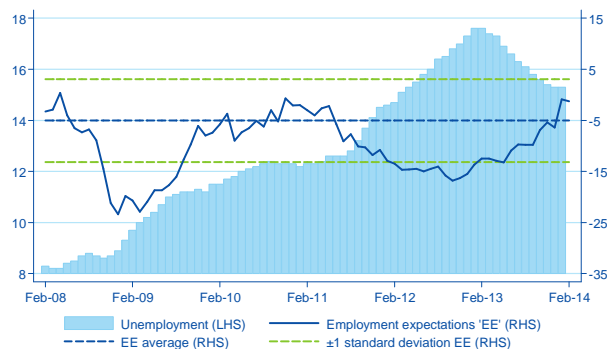
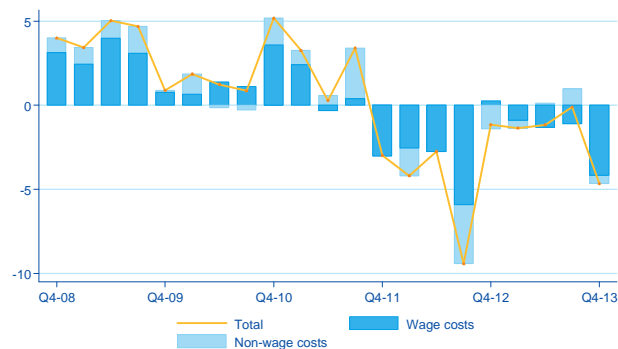


Chart 12

Labour costs in the business sector (% YoY)*



* Source: HAVER Analytics and BBVA Research

Prices: inflation back to negative rates in February

Headline inflation (HICPI) slowed again in February to negative rates (-0.1% YoY), mainly due to falling energy prices (-2.1% YoY), while core inflation remained at 0.1% YoY.

Chart 13

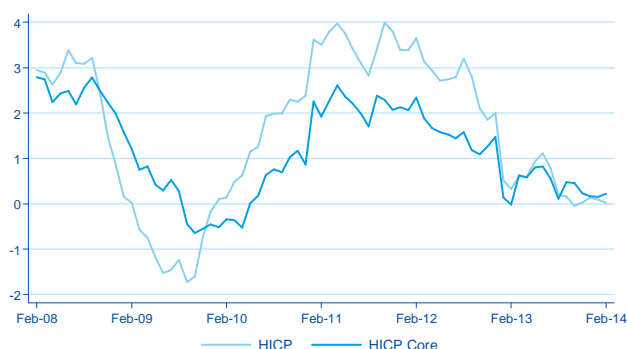
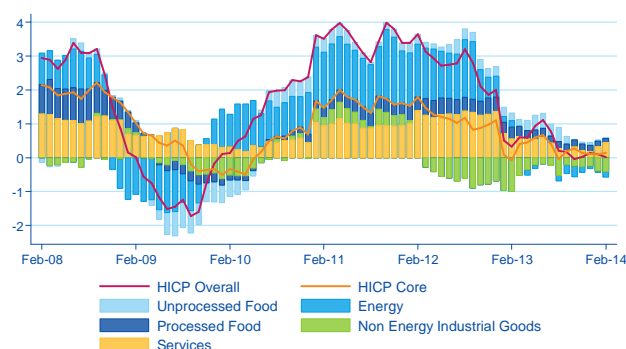
Headline and core inflation rate (% YoY)*


Chart 14

Inflation by component (contribution in %)*


Public sector: the first data of 2014 are positive, thanks to high revenues

In January 2014, general government accounts recorded a EUR 636mn surplus. Behind this performance is a larger collection of indirect and direct taxes, mainly the latter.

Chart 15

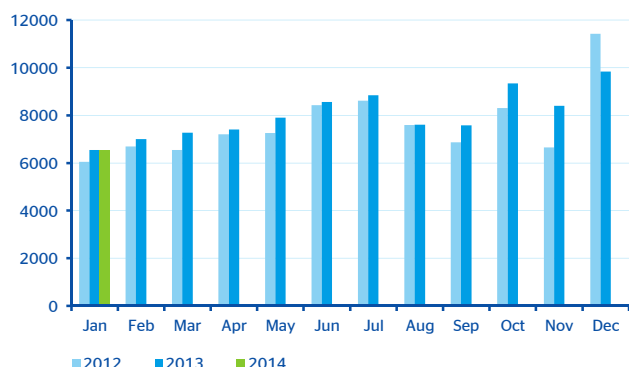
Government expenditure (comparison with the previous year)*


Chart 16

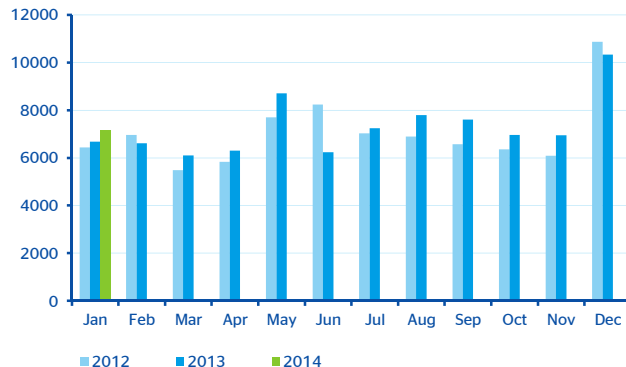
Government revenue (comparison with the previous year)*


Chart 17

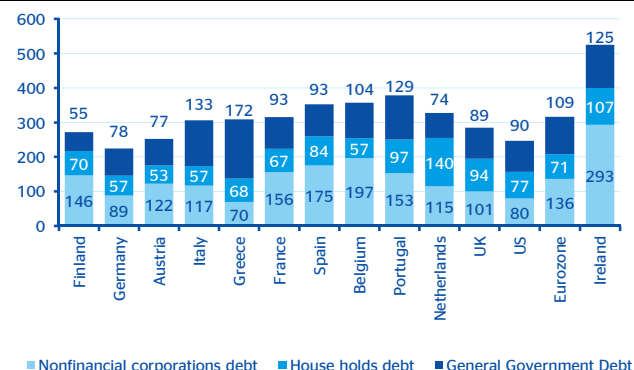
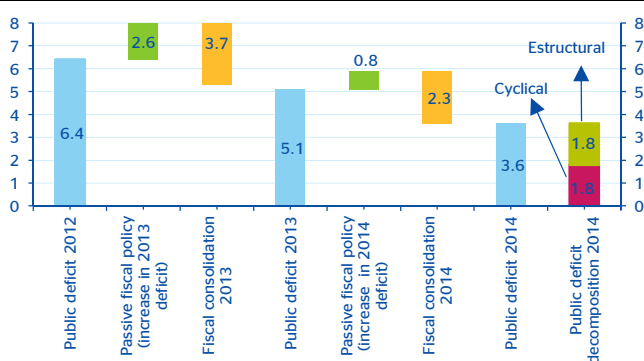
Public and private debt (% of GDP)


Chart 18

Breakdown of fiscal deficit (cyclical and structural)*


* Source: HAVER and BBVA Research

DISCLAIMER

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.