RESEARCH

Portugal Economic Watch

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Economic Analysis

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The economy will grow at around 1.2% in 2014

Exports will continue to be the main driver of growth, but the incipient recovery of private domestic spending will be visible

- **The MICA-BBVA model forecasts zero QoQ growth in 1Q14**
  Confidence and activity data were contradictory in the first quarter of the year. On the one hand, confidence data (consumer and industry), as well as retail sales, continued their upward path in 1Q14 (Figures 3, 4 and 6). Meanwhile, in contrast, the quarterly average for industrial production (Figure 5) fell because of the March result and, in part, because of the sharp uptick in 4Q13 in capital and durable consumer goods. Incorporating these two effects into our MICA-BBVA model, GDP may have stagnated in 1Q14 (Figure 2), in line with our forecast for slight growth in the first half of the year (around +0.1% QoQ), before an acceleration in the second half (around 0.3% QoQ).

- **Improved domestic demand in 2H13, and its continuation at the beginning of this year, has lifted our forecast for 2014…**
  The recovery gained traction in 4Q13, with the momentum of domestic demand surprising to the upside, and this made a positive contribution to Portugal's good economic performance, also helped by the foreign sector (Figure 1). The latest retail sales figures point to this recovery in domestic demand having continued into the beginning of the year, with more private consumption and some resilience in investment, supported by improved confidence and better financial conditions. While we acknowledge that the upward trend in exports of goods to February faltered in March, dropping sharply (Figures 7 and 8), this was due to temporary factors and we should see a recovery in the next few months; what is more, this fall may have been offset by services exports (mainly tourism). All in all, our updated forecasts continue to reflect a contribution from the foreign sector, although it will lose relative importance, while the recovery in domestic demand has led us to revise our growth forecast for 2014 upwards by 0.4pp to 1.2%, accelerating again in 2015 to 1.5%.

- **… but exports will continue to be the main driver of growth**

  Exports grew by 6.1% throughout 2013, supported by both the recovery in global demand and the moderation in domestic prices (after the reduction in labour prices by a little more than 3% since 2007), which partly offset the euro appreciation. Over the horizon forecast, exports should grow at a relatively strong rate again (our forecast is for 5.1% in 2014 and 4.9% in 2015, compared to an average growth of 5% between 1996 and 2008), practically unchanged from our previous forecast. Although there has been some deceleration in the growth of some emerging economies, it ought to be clearly offset by the better outlook for the eurozone as a whole, particularly Spain (the combined share of exports to Spain, Germany and France is 47%).

  The strength of exports will be crucial in the recovery of investment, but greater momentum in imports will reduce the weight of the contribution of net exports to growth down to 0.8pp, and then 0.4pp, in 2014 and 2015 (also unchanged from our forecast three months ago).

  Over the forecast horizon, investment will continue to benefit from buoyant global demand, but now from a stronger internal demand than forecast three months ago as well. As a result, our forecasts include increased investment in 2014 (3.2%, after contracting around 7% in 2013) before accelerating in 2015 (4.5%).

  With this uptick in activity, employment rose by around 1.6% YoY in 1Q14, visible from a significant fall in the unemployment rate of around 2,4pp YoY, down to 15,1% in 1Q14 (Figure 11). Disposable household income improved by 1.8% in 2013 (after heavy falls over the two previous years) which, together with continued improvement in consumer confidence and low inflation (0.2% in 2014 and 0.9% in 2015), will impact on growth in private consumption in 2014 (around 0.4%, up from our earlier forecast by 0.2pp), which will gain momentum next year (0.8%). Finally, the ongoing fiscal adjustment will continue to be reflected in the reduction in public spending, although once most of the adjustment has been introduced (Figure 18) and the weight of the public sector has been reduced, our forecasts indicate a more moderate fall in public consumption (- 1.8% in 2014 and - 0.5% in 2015) after the drops of around 5% in 2011 and 2012.

- **Fiscal accounts published to March indicate the budget deficit will be met comfortably**

  In its latest review of the programme, the Troika maintained the deficit targets it had set at 4% and 2.5% for 2014 and 2015, respectively, highlighting the government's commitment to keeping to them and the application of compensatory measures should the Constitutional Court block some. Everything points to the government being able to meet the deficit target for this year, even with room to spare, given that in the first quarter of 2014 public sector accounts comfortably met the EUR1.7bn limit established for the period, recording a deficit of only EUR825.5mn (Figures 15 and 16).

Portugal

National accounts: The MICA-BBVA model estimates zero growth in 1Q14

GDP grew by 0.6% QoQ in the last quarter of 2013, more than expected. Solid investment and the acceleration in exports account for this performance. With the data available, our real time model continues to forecast GDP stagnation in 1Q14.

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

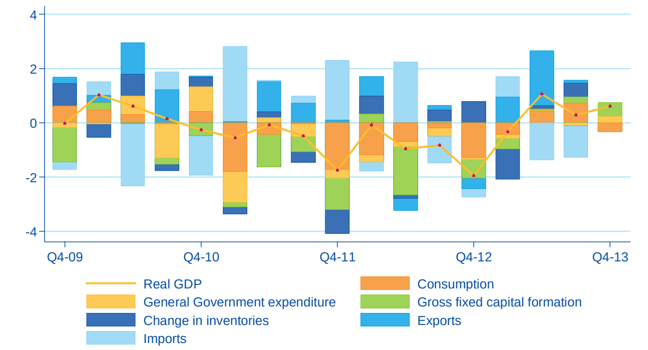
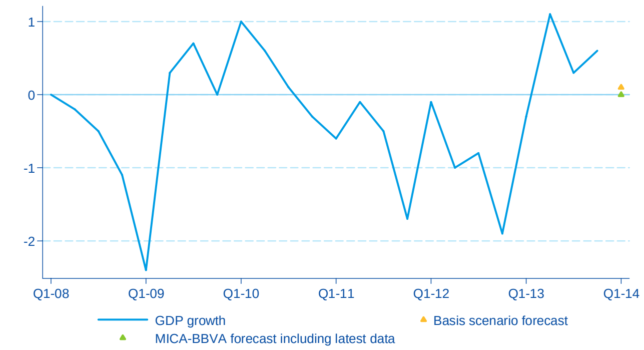


Figure 2
MICA-BBVA: GDP growth (%QoQ) and forecasts*



Confidence: the ESI indicator shows definite improvement in 1Q14, reaching its historic average

According to the EC's indicator (ESI), business confidence has remained at around its historic average. Consumer confidence, on the other hand, continues to grow strongly

Figure 3
Confidence (ESI) and coincident activity indicator*

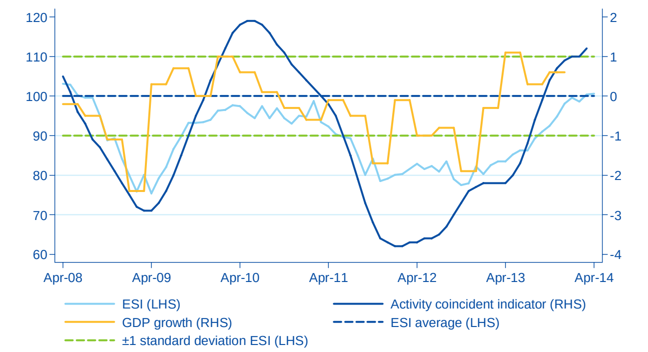
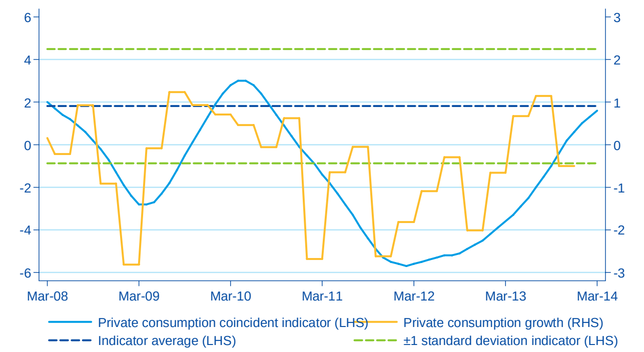


Figure 4
Private Consumption Coincident Indicator and Private consumption (%YoY)*



Activity: industrial production falls and retail sales recover in 1Q14

Industrial production contracted in the first quarter of the year, mainly because of the surprising fall in March (-4.8% MoM), but up to a point it was to be expected after the strong growth in 4Q13 (equipment and consumer durables). On the other hand, retail trade recovered in 1Q14.

Figure 5
Industrial output (% YoY) and industrial confidence (ESI)**

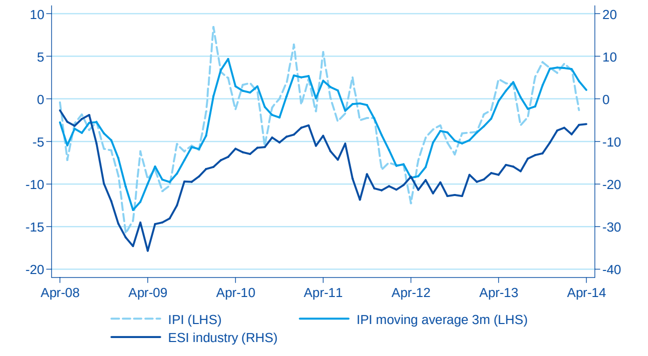
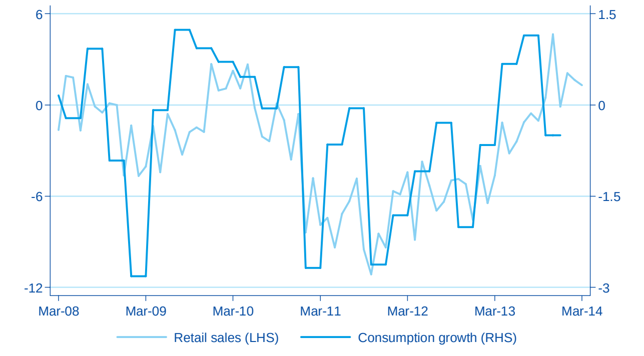


Figure 6
Retail trade (% YoY) and consumption growth (% QoQ)*



*Source: HAVER Analytics and BBVA Research

Foreign sector: goods exports fall but are offset by the increase in services and tourism exports

Goods exports interrupted their February growth trend and fell strongly in March, dropping 3.7% over the previous quarter's average. Imports of goods also went down, although at a lower rate (-0.9% QoQ).

Figure 7
Exports and imports (% quarterly rate, sa)*

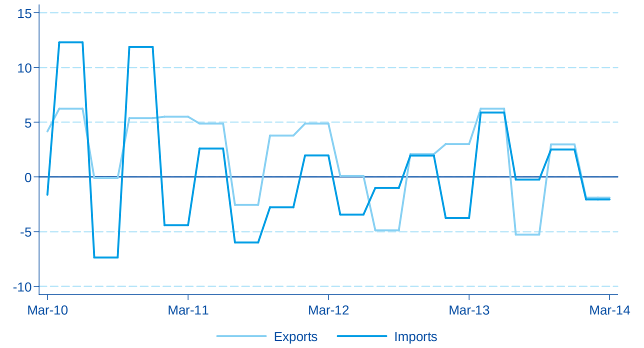


Figure 8
Exports (% YoY) and volume of export order books*

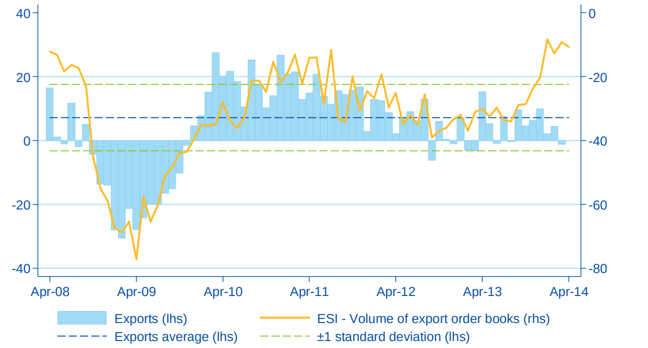


Figure 9
International trade by destination (% YoY)*

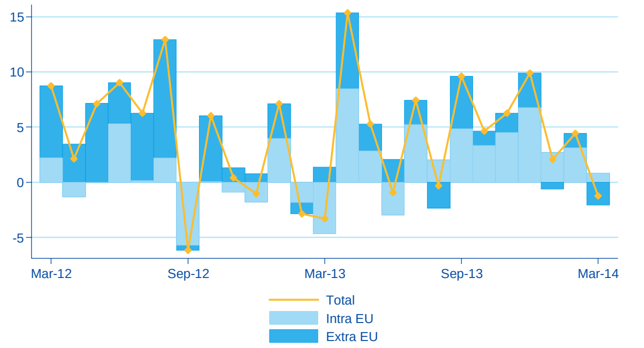
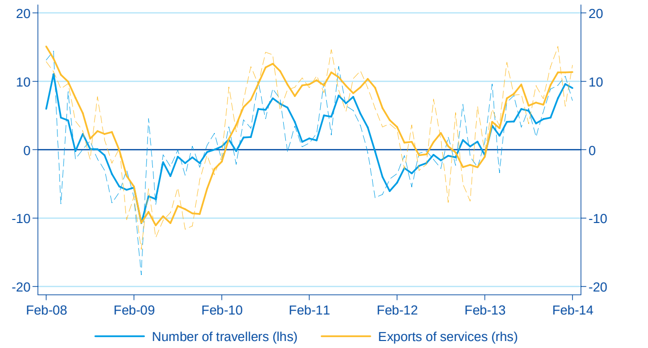


Figure 10
Tourism and service exports (% YoY)*



Labour market: the job creation trend continues, as does the reduction in labour costs

The unemployment rate stabilised in March at 15.2%, after a clear downwards trend, with a 1.5pp reduction in the last twelve months (16.7% in March 2013). In 1Q14 employment was created again, continuing the trend begun in the second quarter of 2013.

Figure 11
Unemployment rate (%) and employment expectations*

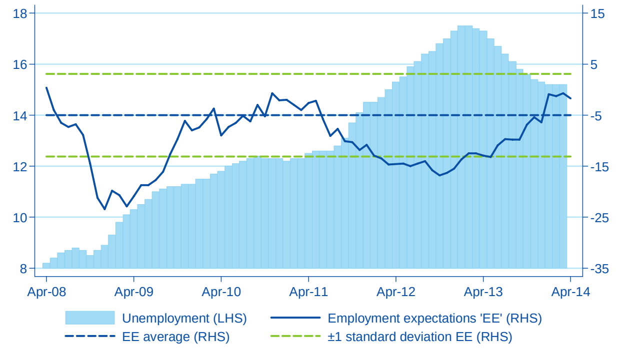
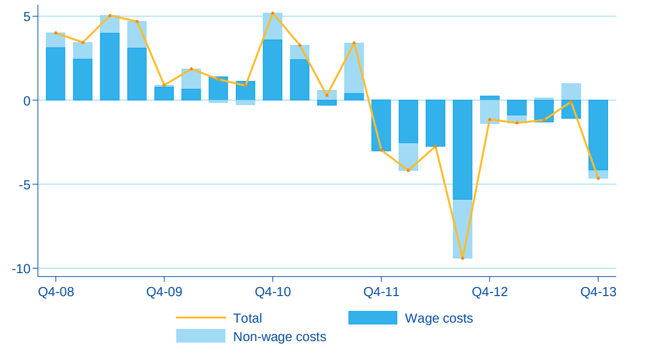


Figure 12
Labour costs in the business sector (% YoY)*



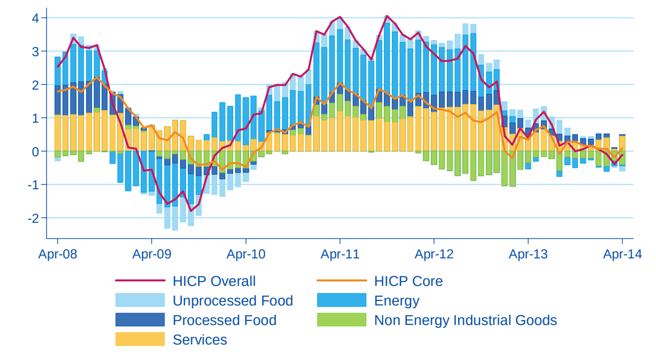
* Source: HAVER Analytics and BBVA Research

Prices: inflation remains negative in April, but accelerating slightly

Headline inflation (HICP) remained in negative territory in April but accelerated slightly to -0.1% YoY, due mainly to the fall in non-energy industrial goods prices. Core inflation, on the other hand, moved upwards into positive territory, to 0.1% YoY.

Figure 13
Headline and core inflation rate (% YoY)*

Figure 14
Inflation by component (contribution in %)*



Public sector: fiscal accounts, available to March, well within the limit set by the Troika

To March 2014, public sector accounts recorded a deficit of EUR846mn (EUR825.5mn using the performance criterion), well within the limit set by the Troika of EUR1.7bn.

Figure 15
Government expenditure (comparison with the previous year)*

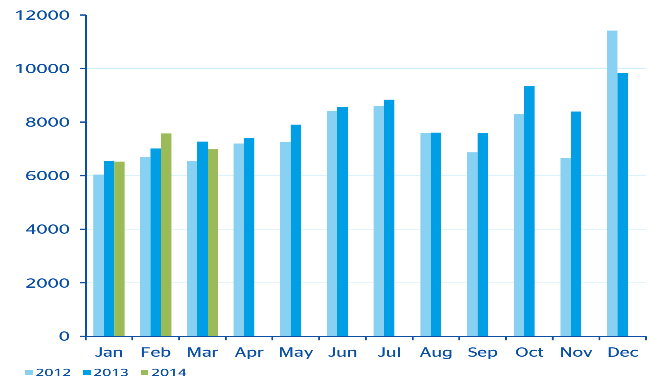


Figure 16
Government revenue (comparison with the previous year)*

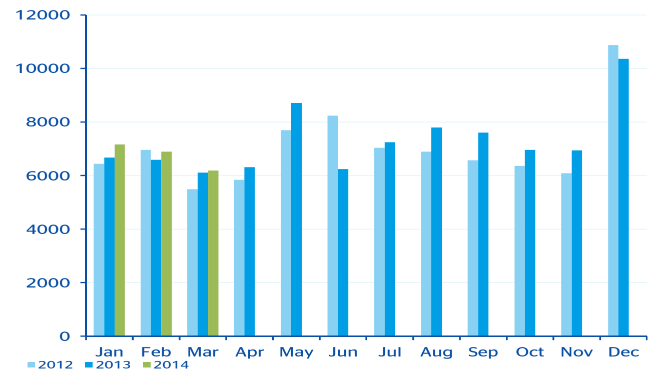


Figure 17
Public and private debt (% of GDP)

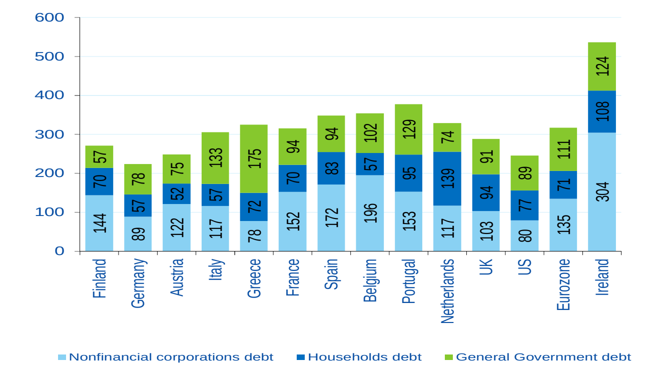
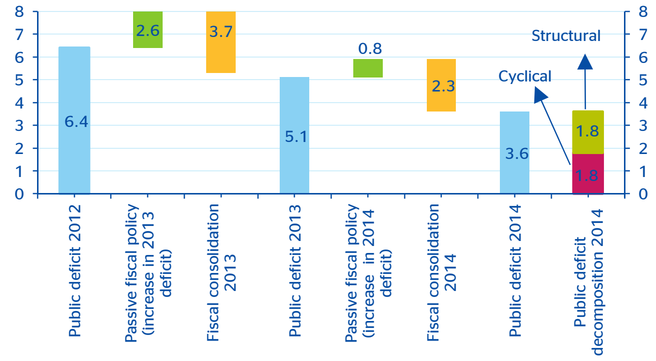


Figure 18
Breakdown of fiscal deficit (cyclical and structural)*



* Source: HAVER Analytics and BBVA Research