BBVA | RESEARCH

Economic Watch

Portugal

Madrid, May 21, 2012
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

Positive surprises in Q1-12, but the economic outlook remains gloomy

- **Economic confidence has improved in recent months, more than expected, but remains at very low levels**
- **GDP fell less than expected in Q1-12 (-0.1% q/q) but could contract again by around -0.4% q/q in Q2-12**
- **Recent positive surprises in economic data suggest that there are upside risks to our estimate of GDP growth for 2012 (-2.9%)**
- **Fiscal targets for 2012 remain within reach**

1. Economic Outlook

There have been some positive surprises in economic data during the first months of 2012. The GDP contraction during the first quarter of the year was much milder than expected, at -0.1% q/q instead of -0.6% q/q, recovering from the -1.3% fall in Q4-11. According to the flash estimate released by the INE, the reason can be found in a less negative contribution of domestic demand, while the positive contribution of net exports declined, as imports registered a smaller fall than in the previous quarter. Indicators available for Q2 (still very few) suggest that the economic outlook should not be as bad as seen at the end of 2011. For the current quarter, we have revised our MICA-BBVA model projection slightly upwards to -0.4% q/q (from -0.6% q/q previously). Overall, these figures suggest that the Portuguese GDP contraction in 2012 could be lower than our estimation of around -2.9% (and well below official estimates by the Troika and the Bank of Portugal at -3.3%/-3.4%), more consistent with an annual GDP fall of around -2%.

We continue to expect a gloomy economic situation for coming quarters. On the one hand, the net exports contribution to growth, the main driver over past quarters, is losing ground as global demand is slowing. On the other hand, domestic demand is not expected to fully recover any time soon, as the fiscal consolidation effort will intensify during 2012 and will continue in 2013, while the correction of private imbalances will also proceed. Overall, these prospects are subject to developments in the eurozone as a whole, where the most recent surge of financial strains was reflected in a sharp deterioration of confidence in April. For the eurozone, we expect a fall in economic activity in Q2-12 of -0.1% q/q, according to our MICA-Model for the area.

Economic confidence has improved in recent months, but remains at very low levels

The European Commission (EC) economic sentiment indicator registered an upward path at the beginning of 2012, in contrast with that observed in the whole eurozone, but it remained at very low levels (2 standard deviations below its long-term average), thus signalling that the Portuguese economy remains in contractionary territory. Across sectors, services confidence was flat during the last two months, while industrial sentiment in April saw a noticeable improvement. This could be reflecting a still robust demand from abroad that sustains better production expectations for coming months, while less encouraging signs are showed by the drop in domestic orders.

Fiscal consolidation and the ongoing correction of private imbalances will continue to take their toll on households' spending

The European Commission indicator for consumer confidence has improved slightly in recent months, after the sharp worsening seen at the end of 2011. However, it remains around historical low levels, suggesting that private consumption will continue to fall in coming quarters, but at a more moderate pace than that seen in Q4-11. This picture is also in line with hard data. Retail sales, despite remaining weak, also exhibited a less negative trend, as they fell by -0.5% q/q in Q1-12 after shrinking by -6.9% in Q4.

Overall, drivers of private consumption do not point to any significant improvement in the short-run, as the labour market conditions are worsening, with unemployment accelerating to 15.3% in March, while credit conditions also became slightly tighter in Q1-12. The recent moderation in inflation (around -0.6pp since end-2011) is the only positive support for consumption. Inflation is expected to slow further in coming months due to the disappearing impact of tax increases (July 2010 and January 2011) throughout this year, along with a depressed domestic demand.

Industrial production was also more positive in Q1-12, but doubts persist

Activity in industry reversed its negative growth trend, which was dominant in Q4-11 and registered moderate positive monthly growth rates in Q1-12. However, on a quarterly basis it declined by -0.6% q/q over Q4-11, when it fell by -3.8% q/q. New orders contracted significantly during the same period, mostly domestic ones, which do not bode well for the continuation of a clear pickup in industrial output during Q2-12, which is mainly due the recent slowdown in global demand. Building activity continued contracting, but with a less negative trend.

The support from net exports has started losing ground

Also worrying signs came from the weakening of the foreign sector, which has been the main driver of activity in recent months. Exports slowed considerably up to February (latest data available), as they have increased by 0.4% over Q4-11 (2.1% q/q). At the same time, imports increased up to February by 3.1% over the last quarter of 2011, thus interrupting the sharp downward trend observed in previous quarters. The slower expansion of exports along with stronger imports was in line with the INE flash estimation, which stressed the lower contribution of net exports in Q1-12. However, import data from the trade balance, as expressed in current prices, is likely to be determined by recent increases in energy products. This, combined with a depressed domestic demand, lead us to continue seeing foreign demand as the main driver of growth for coming quarters.

2. Fiscal targets for 2012 remain within reach

Portugal presented its Stability and Growth Plan for 2013-2016 at the beginning of May. The plan remains in line with the adjustment program of the troika. Among other things, there will not be any further increases in taxes, while the primary and the total spending limit will be set in 2013 by 3.2% and 2.1% lower respectively. At the same time, as part of efforts to trim its budget deficit and boost economic output, the government has decided to cut four public holidays temporarily for five years, starting in 2013.

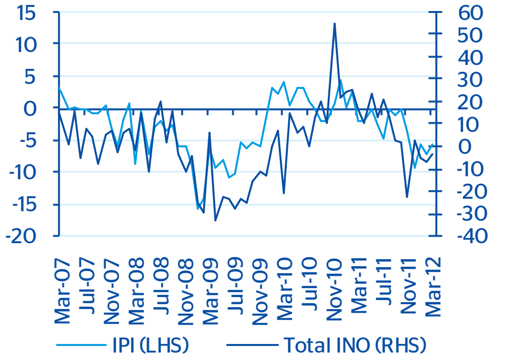
In the meantime, the Portuguese authorities continue reaffirming their determination to proceed with the fiscal and structural adjustments required by the Program signed with the troika, while reiterating that there will be no need for a second bailout, or more time to adjust their public accounts. The prime minister also declared that further measures (additional to the ones already included in the adjustment program) are not necessary, and that the deficit would shrink to 3% of GDP by 2013, and to just 0.5% of GDP in 2016.

The EC, in its spring forecasts, confirmed that the structural adjustment amounted to 3.25% of GDP in 2011, net of one-offs, and that the deficit target of 4.5% of GDP for 2012 remains within reach, in line with Portugal's consolidation efforts at around 5% of GDP for this year. Also according to the EC, the structural balance over 2011-13 is forecast to improve by about 7pp. of GDP, while debt is projected to stabilise at 117% of GDP in 2013.

In our view, absent a sharp deterioration of the European environment, Portugal will probably reach the fiscal targets. According to our calculations, the public deficit would reach 4.6% of GDP in 2012 and fall to 1.1% by 2016, while gross debt would reach 111% of GDP this year, before peaking at 115% in 2013. Budget execution data so far reveals that the deficit has widened in Q1-12, compared to the same period in 2011, with a deficit at 0.3% of GDP versus a surplus of 0.3% in Q1. At this point in the year, however, it is too early to draw conclusions about the final result for 2012.

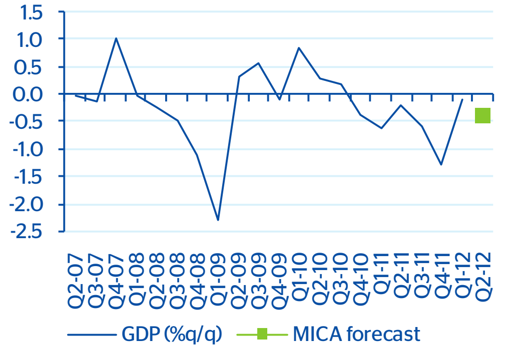
3. Tables and graphs

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



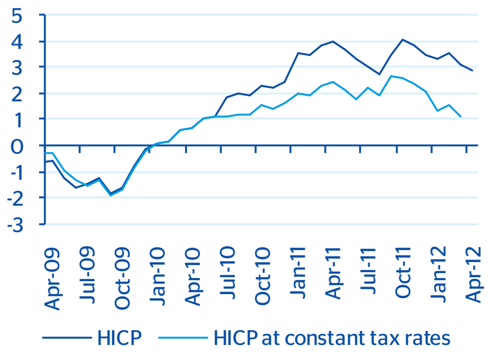
Source: Eurostat and BBVA Research

Chart 2
Portugal: GDP (%q/q) and MICA model indicator



Source: Eurostat and BBVA Research

Chart 3
Portugal: Inflation %y/y



Source: INE, Eurostat and BBVA Research

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

Source: INE and BBVA Research

Table 1
Portugal: Economic indicators

		Hard Data						
		Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Q4 11	Q1 12
Industrial Production	m/m	-2.58	-1.50	0.23	0.47	2.32	-1.65	1.01
	y/y	-3.55	-9.32	-5.71	-7.21	-5.77	-4.33	-6.23
Industrial New Orders	m/m	2.38	3.84	-5.62	2.52	-1.22	1.12	-1.44
	y/y	-22.76	2.73	-5.46	-7.13	-3.02	-6.00	-5.20
Retail Sales	m/m	-2.58	2.65	-1.91	1.94	-2.24	-1.17	-0.74
	y/y	-9.29	-9.99	-6.91	-8.23	-4.80	-9.67	-6.65
Unemployment (harmonized)	%	14.00	14.60	14.80	15.00	15.30	14.1	14.9
	Δ	0.4	0.6	0.2	0.2	0.3	0.5	0.2
HICP	m/m	-0.14	0.06	0.34	0.14	1.21	0.28	0.57
	y/y	3.83	3.50	3.35	3.55	3.14	3.78	3.47
HICP ex energy & seas.food	m/m	-0.26	0.19	-0.31	0.00	1.32	0.1	0.3
	y/y	2.04	2.17	1.97	2.22	1.94	2.26	2.12
Exports	m/m	18.26	10.58	8.1	6.0	8.8	-4.4	7.6
	y/y	16,51	4,75	13,65	13,50	8,30	12,42	11.8

		Soft Data						
		Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12
ESI	Level	80.2	73.9	74.6	75.7	75.9	77.1	78.5
	Δ	4.4	-6.3	0.7	1.1	0.2	1.2	1.4
ESI Employment exp.	Man. Level	-10.3	-11.8	-10.8	-12.9	-13.5	-14.7	-14.6
	Ser. Level	-18.2	-18.6	-19.8	-15.8	-15.7	-15.7	-19.1
EC Services	Level	-23.5	-31.6	-30.7	-29.2	-29.0	-30.7	-30.7
	Δ	-0.2	-8.1	0.9	1.5	0.2	-1.7	0.0
EC Industry	Level	-17.7	-21.0	-21.5	-20.5	-21.3	-20.2	-18.3
	Δ	6.0	-3.3	-0.5	1.0	-0.8	1.1	1.9
EC Consumer	Level	-57.2	-58.4	-56.5	-56.0	-53.9	-52.5	-52.6
	Δ	1.7	-1.2	1.9	0.5	2.1	1.4	-0.1

Note: Blue colour: improvement. grey: deterioration. white: neutral
Note: quarterly figures are averages
Source: Eurostat. European Commission and BBVA Research

DISCLAIMER