

MACROECONOMIC ANALYSIS

The economy will grow by about 0.8% in 2014

Europe Unit

Downward revision to our forecasts to reflect the drag effect of the first quarter. Expected growth of 0.4% QoQ in 2Q14.

Investment and exports hampered activity in 1Q14

The data so far available suggest that the surprising fall in GDP in 1Q14 (-0.6% QoQ) was mainly due to temporary factors: on the one hand, following the strong rebound in late 2013, investment fell markedly, especially due to the stagnation of the construction sector as a result of the poor weather conditions earlier this year; on the other hand, exports of goods reflected the sharp contraction in the sale of refined petroleum products, after a refinery outage between February and April. In the second quarter, these conditions seem to have partly reversed.

High levels of confidence are only partially borne out in activity data

In recent months, the continuous improvement in the level of consumer confidence, encouraged by the positive unemployment data, has not been reflected in an increase in retail sales. On the contrary, following the sharp drop in 1Q14, industrial production has recovered up to May, as suggested by the business confidence index, rebounding 1.8% from the previous quarter, despite the fall in exports of goods and external orders.

Unemployment is declining, but still above the eurozone average

The unemployment rate fell again in June to 14.1%, a reduction of 2.5pp in the last twelve months (16.6% in June 2013), a clear downward trend, which in 1Q14 has been accompanied by an acceleration in labour costs (+2.5% QoQ), especially in the non-wage component. However, after three consecutive quarters, job creation has been interrupted (-0.2% QoQ, compared to an average of +0.7% QoQ in the previous three quarters).

Inflation was negative in the second quarter

Prices of unprocessed foods continued to fall in June, keeping overall inflation (HICP) at negative rates for the fourth consecutive month (-0.2% YoY). Nevertheless, the prices of the other components are relatively stable and core inflation remained positive in June (+0.2% YoY), after a timid acceleration in the last three months.

Net exports will be the main driver of growth in 2Q14

The MICA-BBVA model estimates growth of 0.4% QoQ in 2Q14. Our forecasts point to the external sector being the main driver of growth in 2Q14, after draining 0.8pp in the first quarter: goods exports remain weak, but the strong increase in exports of services (mainly tourism) and stagnant imports should result in positive net exports. Moreover, the high level of consumer confidence, encouraged by the positive trend in the unemployment rate, is not reflected in a significant increase in consumption, which should pick up only slightly, at rates similar to those of the first quarter. Public spending will continue to decline, conditioned by the process of fiscal consolidation, while investment, after collapsing in 1Q14, will grow, especially given the rebound in construction. However, we expect a significant negative contribution from inventories, which should result in a weak contribution from domestic demand.

The gradual improvement of domestic factors will lead the recovery in 2014 and 2015

Beyond the BES crisis, which we do not expect to have a significant impact at the macroeconomic level, the recovery should gain momentum in the second half of the year. But for 2014 as a whole, the drag effect of the sharp drop in the first quarter leads us to revise downwards our growth forecast to 0.8% (from 1.2%) and raise it slightly to 1.6 % in 2015 (from 1.5%). Domestic demand will play a leading role in recovery: we expect private consumption to increase gradually in 2014 and 2015 (0.9% and 1.3% YoY, respectively, 50bp higher a year compared to our previous forecast), driven by an improving labour market, household confidence and low inflation. Investment will continue to recover (1.1% in 2014 and 3.6% in 2015), but at a slower pace than initially envisaged, due to the disappointing data for 1Q14 and weaker exports (+3.6% vs. +6.1% in 2013). In turn, improving domestic demand will result in a sharp increase in imports (+4.6% in 2014 and +4.7% in 2015), such that net exports will make a negative contribution to growth in 2014 and a positive but limited contribution in 2015. The only component that will continue to contract is public consumption, hampered by the government's budget restrictions (-0.9% and -1.4% in 2014 and 2015).

Portugal

National Accounts: The MICA-BBVA model estimates growth of 0.4% QoQ in 2Q14

GDP fell 0.6% QoQ in the first quarter of 2014. Falling investment and exports is behind this performance. Based on the available data, our real-time model estimates GDP growth of 0.4% QoQ in 2Q14

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

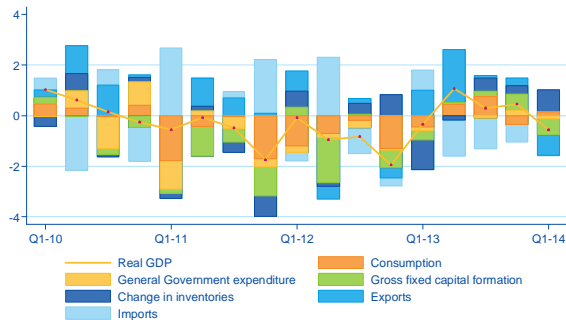
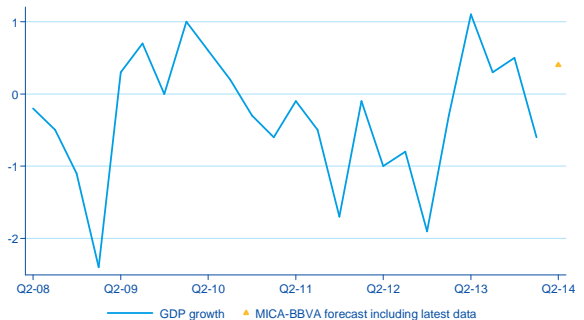


Figure 2
MICA-BBVA: GDP growth (%QoQ) and forecasts*



Confidence: The economic sentiment indicator recorded a marked improvement in 2Q14

According to the EC indicator (ESI), business confidence is above its historical average in 2Q14. Moreover, the strong growth in consumer confidence continues

Figure 3
Confidence (ESI) and Coincident Activity indicators*

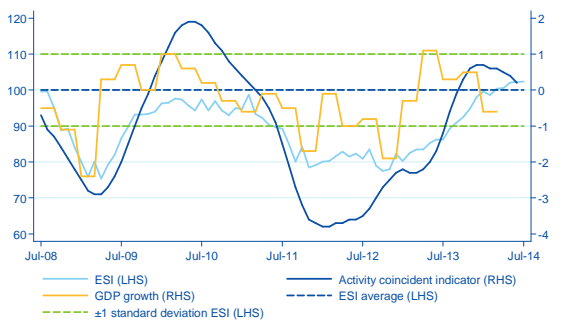
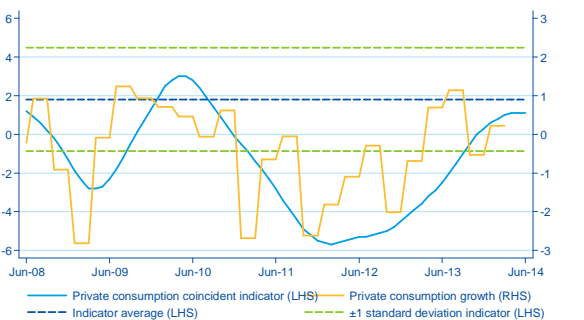


Figure 4
Private Consumption Coincident Indicator and Private consumption (% YoY)*



Activity: Industrial production bounced and retail sales fell in 2Q14

Industrial production increased in 2Q14, after a surprising drop in 1Q14 (-2% QoQ) mainly due to the recovery of the construction sector. The retail trade is showing signs of weakness (-1.7% QoQ) despite high levels of consumer confidence

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

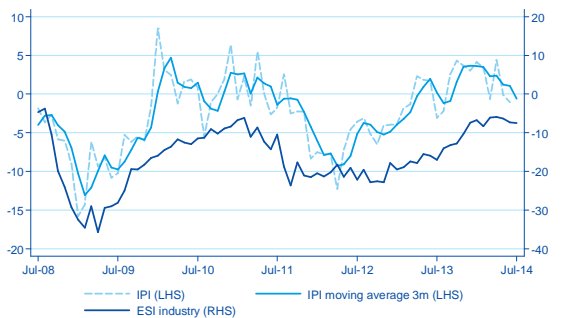


Figure 6
Retail trade (% YoY) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

External sector: Exports of goods fall will be offset by increased services and tourism exports

Goods exports remain weak since February, and up to May they had contracted by 2.5% on average for the previous quarter. However, exports of services, especially tourism, offset that weakness

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

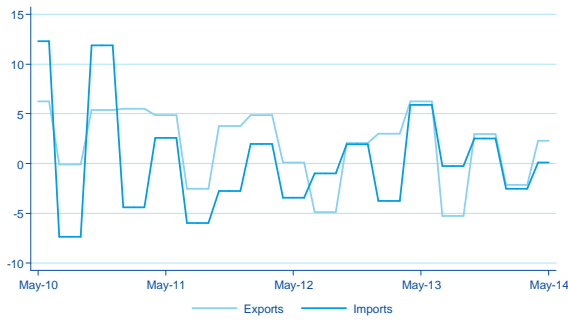


Figure 8
Exports (% YoY) and volume of export order books*

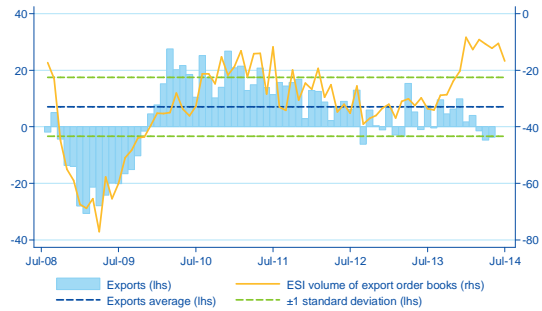


Figure 9
International trade by destination (% YoY)*

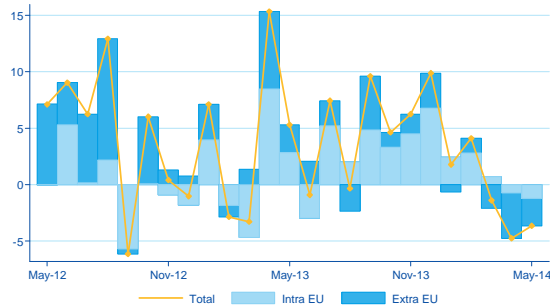
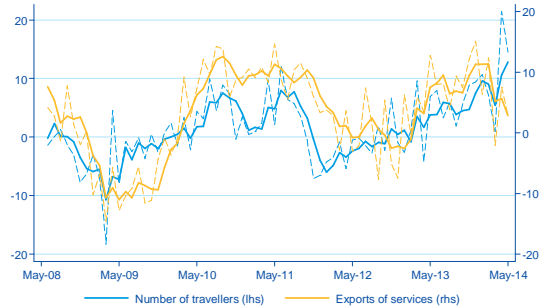


Figure 10
Tourism and service exports (% YoY)*



Labour market: Increasing labour costs and falling unemployment

The unemployment rate has fallen 2.5pp in a year to 14.1%, on a clear downward trend, resulting in some upward pressure on wages (2% QoQ in 1Q14) and job creation has halted (-0.2% QoQ, compared to an average of +0.7% QoQ in the three previous quarters)

Figure 11
Unemployment rate (%) and employment expectations*

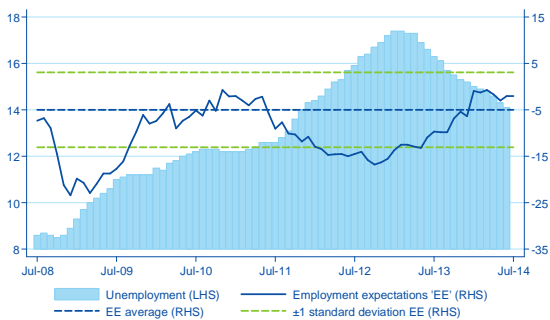
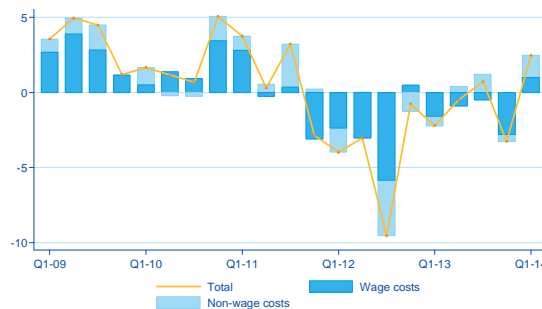


Figure 12
Labour costs in the business sector (% YoY)*



* Sources: Haver Analytics and BBVA Research

Prices: inflation remains at negative rates in June

Headline inflation (HICP) remained in negative territory in June (-0.2% YoY), mainly due to falling prices of unprocessed food. Core inflation, moreover, remained at 0.2% YoY.

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

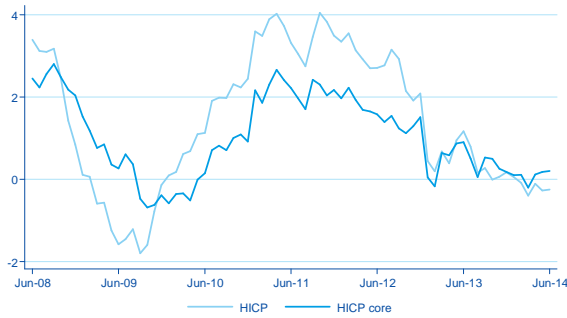
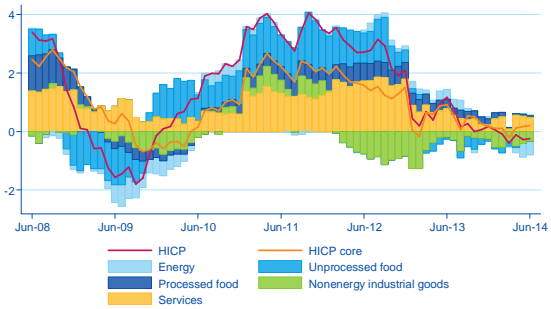


Figure 14
Inflation by component (contribution in %)*



Public finances: the fiscal accounts to June are slightly above 2013

Until June 2014, the general government accounts recorded a deficit of EUR4,192bn, slightly above the 2013 data (EUR4,042.7bn).

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

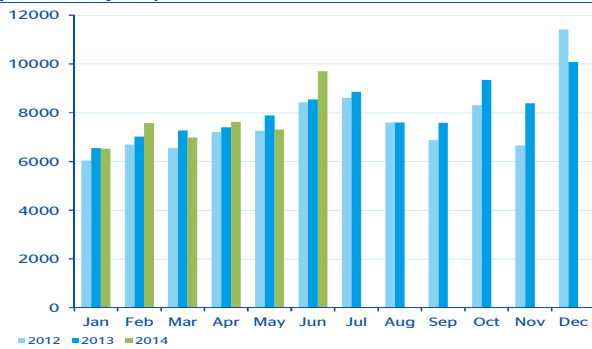


Figure 16
Government revenue (comparison with the previous year)

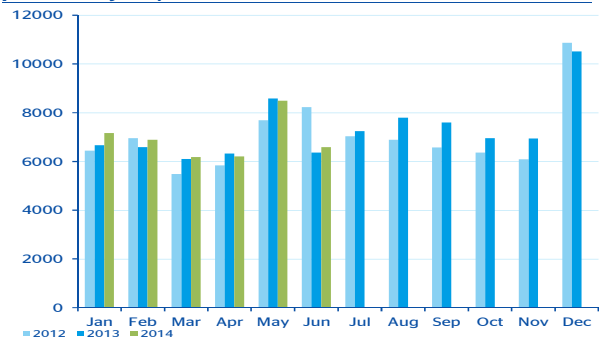


Figure 17
Public and private debt (% of GDP)

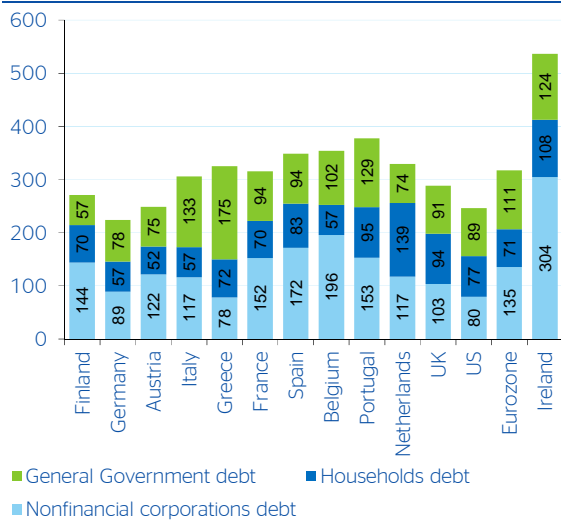
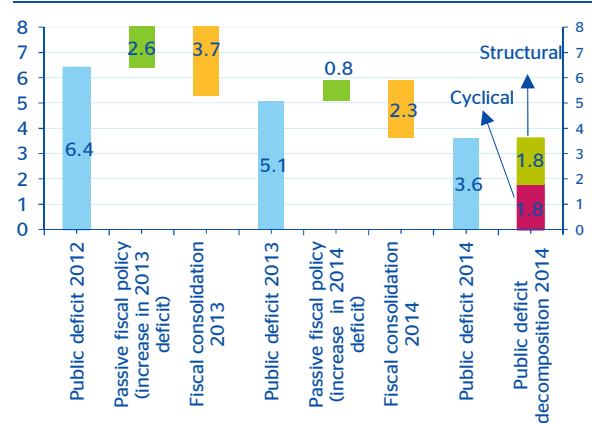


Figure 18
Breakdown of fiscal deficit (cyclical and structural)*



* Sources: Haver Analytics and BBVA Research

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