MACROECONOMIC ANALYSIS

Portugal: moderate, but stable, growth in 3Q14

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The MICA-BBVA model forecasts growth of 0.2-0.3% QoQ in the third quarter

The recovery continues, albeit slowly, in 3Q14

After a second quarter 2014 in which the performance of net exports (0.8pp, up from –1.9pp in 1Q14) was the main driver for GDP growth (0.3% QoQ, up from -0.5% QoQ in 1Q14) (Figure 1), the activity and confidence data available suggest that the recovery, while slow, will continue at a steady rate in 3Q14, this time sustained by domestic factors, while the contribution made by the exterior sector may shrink. With data available to date, our short-term MICA-BBVA model estimates growth of 0.2-0.3% QoQ in the third quarter (Figure 2).

The confidence and activity indicators point to a stabilisation in the rate of economic progress

The European Commission's economic sentiment indicator (ESI) has remained at high levels in the third quarter, improving in all sectors apart from construction. Industrial production grew by 1.4% over the average for 2Q14, in line with the confidence indicators in the industry (Figure 5), and the notable increase in retail sales (+3.4% up from the 2Q14 average) is a sign of improving consumer confidence, together with the positive change in the unemployment rate and low inflation, heralding renewed growth in private consumption after the fall in 2Q14. In respect of external demand, exports and imports continued their positive trend to August; on the export side, moderation in foreign orders augurs a reversal of this behaviour in the coming months, linked to the deterioration in the eurozone as a whole, while improved domestic demand may continue to sustain the increase in imports.

The improvement in the job market continues

Unemployment continued to fall faster than expected, to 14% in August, shrinking by 2.1pp over the last twelve months, while job creation has strengthened (2% QoQ en 2Q14), in an overall context of wage moderation in the private sector (Figures 11 and 12): labour costs have fallen over the second quarter (-1.8% compared to 0.5% YoY), particularly in their wage component (-1.5% YoY).

Inflation stabilises in September

After seven months at negative rates, headline inflation (HICP) remained stable in September (0.0% YoY after -0.1% YoY), thanks to the moderation in the fall in food prices, particularly fresh food (Figures 13 and 14). However, the deceleration in services prices, particularly transport and communications, has lowered core inflation by 0.2pp in September (0.4%, down from 0.6% YoY).

We still expect growth of around 1% in 2014, supported by domestic demand

The recovery of private consumption throughout the second half should be a reflection of the positive performance of the unemployment rate and high levels of household confidence. In general, domestic demand fundamentals ought to take over from net exports as the principal driver for growth (Figure 1): the public sector will drain off less of this growth than in previous years, and investment could be encouraged by the sound business confidence data over the last few months. On the other hand, despite the increase in exports, the strength of domestic demand is having a direct impact on the increase in imports, which will result in limiting the contribution made by net exports.

The deficit, close to achieving the target of 4% of GDP in 2014

The improvement in domestic demand and the positive performance of unemployment have also had a positive effect on government revenues, which are at higher levels than initially estimated. This ought to offset the increased expenditure arising from the court rulings that civil service wage cuts were unconstitutional. When it presented the Budget for 2015, with the corrections introduced by the new SEC2010 national accounting system, the government confirmed that the deficit (excluding one-off measures) will be 4% of GDP this year and that the annual adjustment of the structural balance, at 0.6pp (Figure 18), will comply with the medium-term target.

In respect of 2015, the first post-adjustment budget has an austere tone in order to exit the Excess Deficit Procedure after six years, and estimates a deficit of 2.7%, 0.2pp above the target set in April's Fiscal Strategy Document.

Portugal

National accounts: the MICA-BBVA model estimates 0.2-0.3% QoQ growth in 3Q14

GDP grew by 0.3% QoQ in the second quarter of 2014. The fall in consumption (both public-sector and private) was offset by the recovery in exports.

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

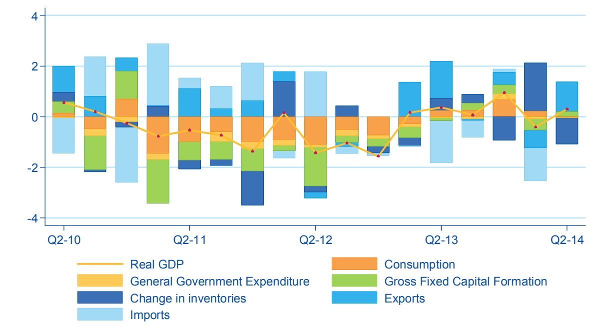
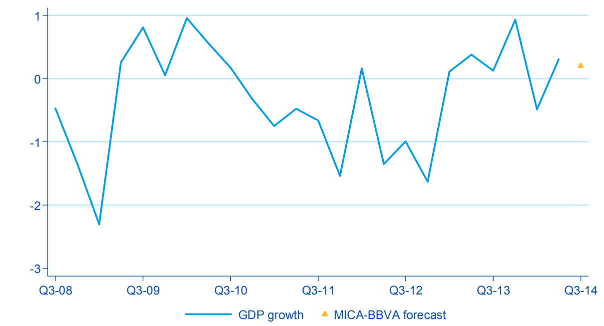


Figure 2
MICA-BBVA: GDP growth (%QoQ) and forecasts*



Confidence: The Economic Sentiment Indicator stabilises at high levels in 3Q14

According to the ESI, the EC's indicator, business confidence rose above its historic average in 3Q14. Meanwhile, consumer confidence to September is above the 2Q14 average.

Figure 3
Confidence (ESI) and coincident activity calendar*

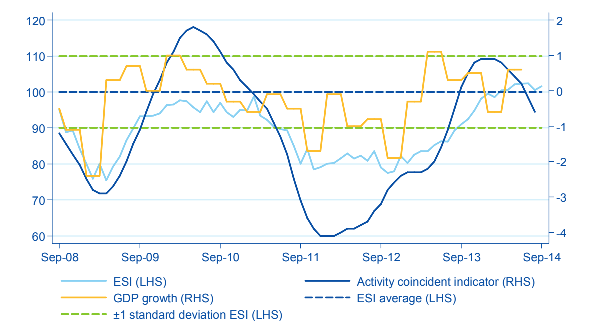
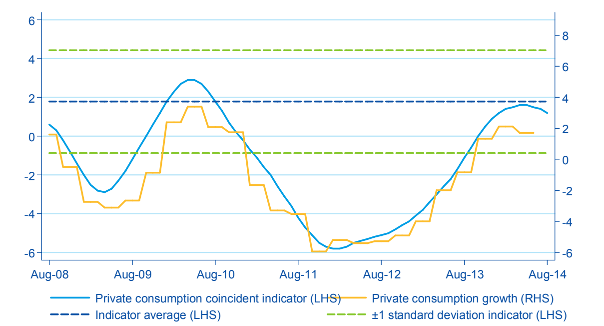


Figure 4
Coincident consumption indicator and private consumption (%YoY)*



Activity: both industrial production and retail sales increase to August

Industrial production increased in August and was higher than in 2Q14. Retail sales are bouncing back strongly (+3.4% over an average of 2Q14), supported by high consumer confidence levels.

Figure 5
Industrial production (%YoY) and confidence*

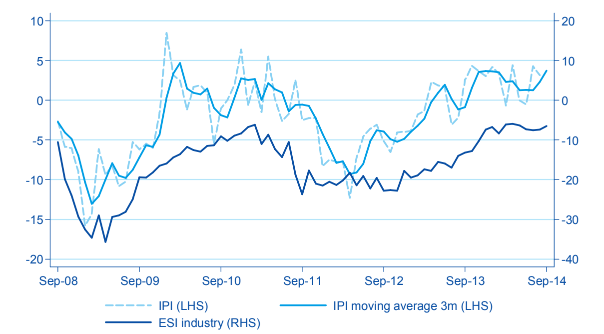
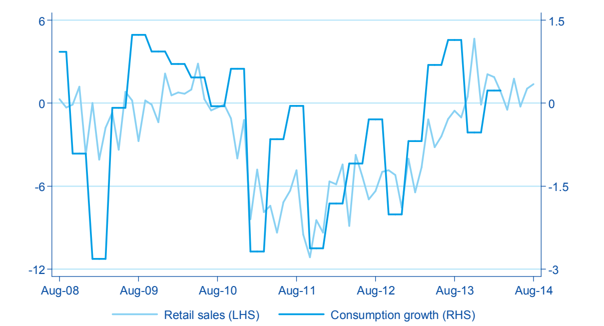


Figure 6
Retail sales (% YoY) and private consumption (% QoQ)*



*Source: Haver Analytics and BBVA Research

Foreign sector: goods exports continue to recover

Goods exports continue to improve after the poor results at the beginning of the year. Meanwhile, services exports continue to increase, although the tourism sector may be cooling down in 3Q14.

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

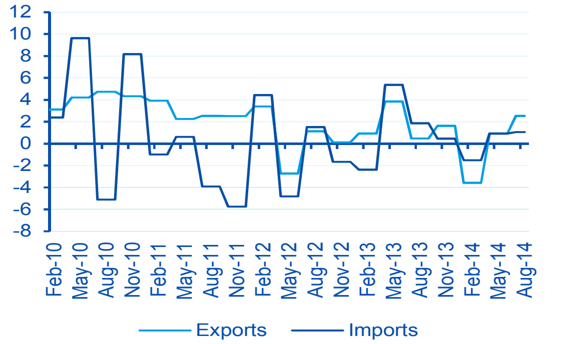


Figure 8
Exports (% YoY) and export orders *

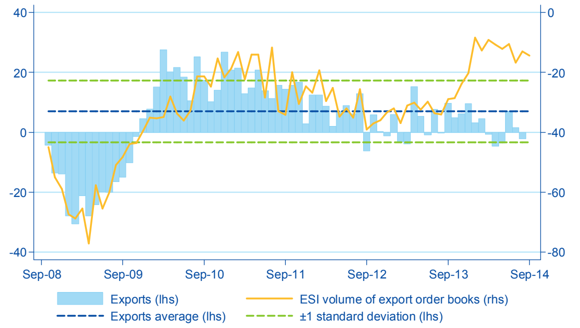


Figure 9
International trade by destination (% YoY)*sa %)*

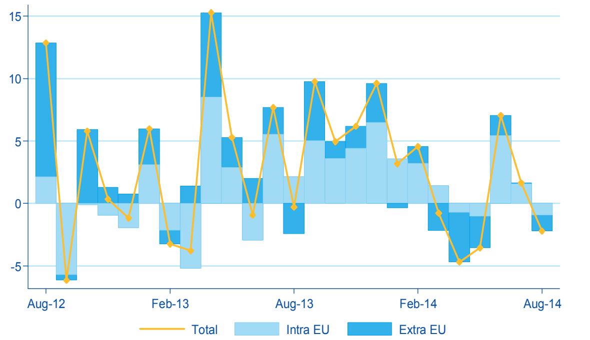
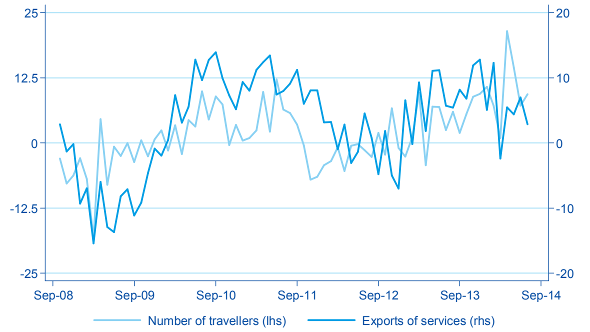


Figure 10
Tourism and services exports (% YoY)*



Labour market: labour costs fall and the unemployment rate is still going down

The unemployment rate has fallen by 2.1pp in a year, to 14%, in a clear downward trend, although this is not putting upward pressure on wages (-1.8% YoY in 2Q14) and, once again, more jobs were created (2% QoQ).

Figure 11
Unemployment rate (%) and employment expectation*

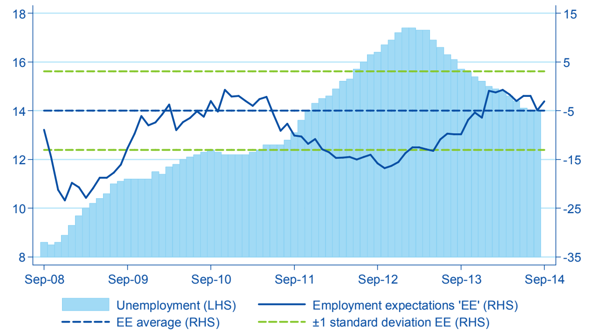
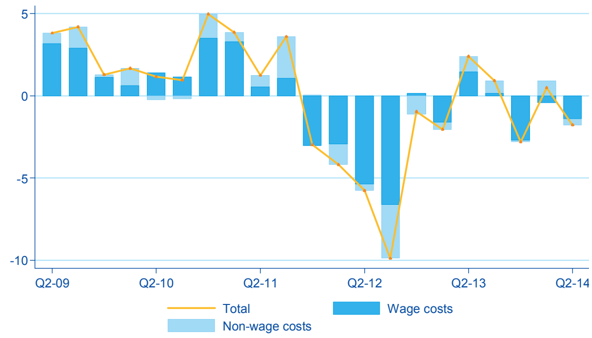


Figure 12
Labour costs in the business sector (%YoY)*



* Sources: Haver Analytics and BBVA Research

Prices: inflation unchanged in September

Headline inflation (HICP) was stable in September (0.0% YoY from -0.1% YoY), due mainly to the lower fall in fresh food prices. Core inflation, meanwhile, decelerated to 0.4% YoY.

Figure 13
Inflation rate, headline and core (%YoY)*

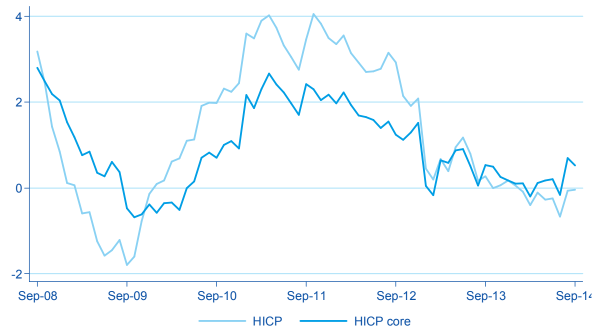
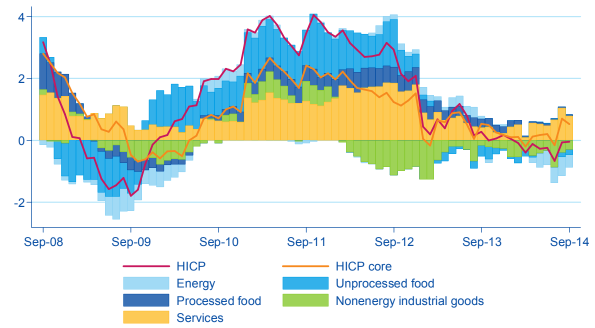


Figure 14
Inflation by components (contribution by %)*



Public finances: the fiscal accounts, close to reaching the budget target

To August 2014, the public administration's accounts indicate that the new deficit target, of 4% of GDP, will be met. Although expenditure has risen more than in previous year, this is due to a change in the calendar of payments to public sector employees and old-age pensioners, in compliance with the Constitutional Court's rulings.

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

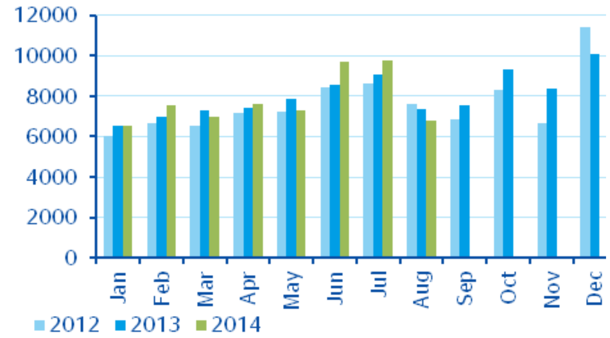


Figure 16
Government revenue (comparison with the previous year)*

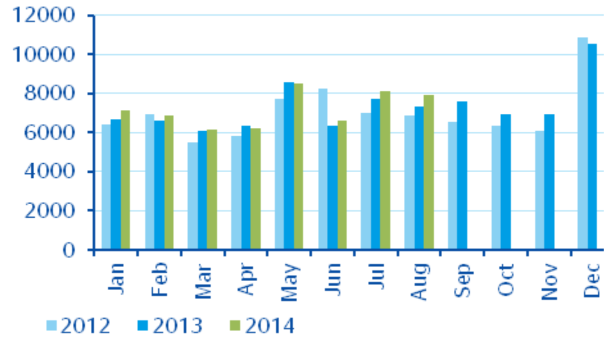


Figure 17
Public and private debt (% of GDP)

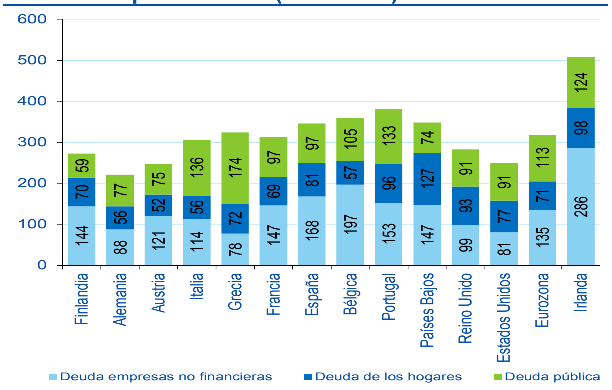
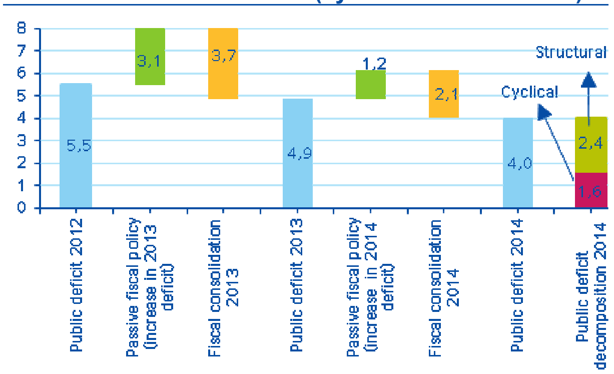


Figure 18
Breakdown of fiscal deficit (cyclical and structural)*



* Sources: Haver Analytics and BBVA Research

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