ECONOMIC ANALYSIS

Portugal: The rate of recovery remains weak but stable in 4Q14

Miguel Jiménez / Agustín García / Diego Torres / Massimo Trento / Ana María Almeida Claudino

So far this final quarter, the confidence indicators have held to a rather more optimistic view than that of the less positive (but scanty) activity data available. However, exports continue to rise, although dependent on the rate of recovery by the key trading partners and the movements in oil prices.

The recovery held firm in 3Q14, confirming our forecast

Throughout the third quarter, the Portuguese economy registered growth of 0.3% QoQ, as was the case in 2Q14, but this time thanks to the performance of domestic demand, particularly private consumption, unlike last quarter, which was based more on external demand. Investment continued to recover (2.2% QoQ) and the improvement in domestic demand prompted an increase in imports which resulted in a negative contribution of net exports.

With the figures available for 4Q14, our MICA-BBVA model forecasts that recovery will continue at a rate similar to 3Q14, with growth of 0.2% QoQ.

The end-of-year indicators are mixed, although exports are holding to their positive trend

The confidence indicators have improved again in the final quarter, after the moderation seen over the summer. However, real data only partially match this optimism: with information limited to October activity, industrial production has still not really taken off (-0.4% compared to the average for 3Q14), even though the manufacturing component of the European Commission's Economic Sentiment Indicator, the ESI, has risen in the last few months. Household confidence continues to improve, but in October retail sales contracted by 2.6% from their average the previous quarter, although this might be a downwards correction of the 3Q14 bounce (+2.9% QoQ). On the other hand, exports are holding to their positive trend by rising strongly in October, growing 6.8% faster than in 3Q14, when they had increased by 3% QoQ.

Employment continues to grow in 3Q14

The Portuguese labour market has experienced a swift reduction in unemployment (-2.2pp over the last twelve months), mainly as a result of four consecutive quarters of job creation (+2.1% YoY in 3Q14). In October, however, there was a slight increase in the rate of unemployment, although it was the first uptick in twenty-one months, so it would be premature to diagnose a change in trend. Meanwhile, labour costs in the private sector have moderated again (-1% in 3Q14 following on from -1.5% YoY), especially in the wage component (-0.8% YoY), but are due to increase in the final quarter, with the upwards review of the minimum wage (effective from October).

Inflation remains stable in November

Food prices stopped falling towards year end, and, despite the price fall in energy and the moderation in services inflation, headline inflation (HICP) accelerated in October (+0.1% YoY) and remained stable in November. Core inflation accelerated to 0.4% YoY (following 0.3% YoY in October). Nevertheless, the outlook for the coming months is for further moderation, given the recent sharp fall in oil prices.

The public deficit will meet its target of 4% of GDP in 2014

The improvement in domestic demand and the good news on unemployment have had a positive effect on fiscal revenues, which stand at higher levels than initially forecast, while budgetary execution to October is also indicating a reduction in spending. The fiscal deficit (excluding one-off measures) ought, therefore, to come comfortably under the threshold of 4% of 2014 GDP. For 2015, the government forecasts a deficit of 2.7%, 0.2pp above the target set out in the Budget Strategy Document in April. Meeting that deficit will rely on maintaining the rate of recovery and on the effect of the measures presented in the 2015 budget, about which the IMF and the European Commission have their reservations; they estimate that the Portuguese economy will grow less than the government believes, and that some of the measures will not be as effective as expected.

Portugal

National accounts: 0.3% QoQ growth in 3Q14

GDP grew by 0.3% QoQ in the third quarter of 2014. The improvement in consumption offset the negative contribution of net exports.

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

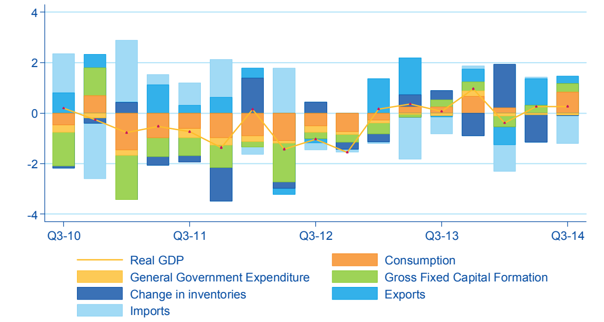
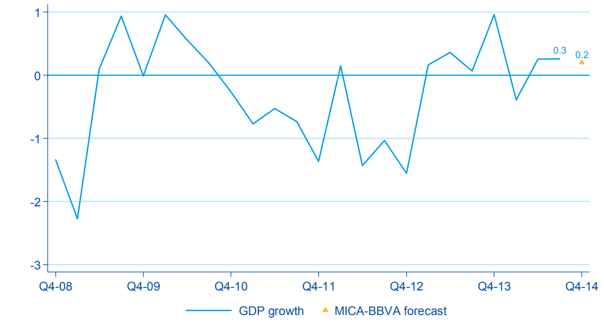


Figure 2
MICA-BBVA: GDP growth (%QoQ) and forecasts*



Confidence: The Economic Sentiment Indicator continues to rise in 4Q14

According to the EC's ESI index, business confidence continued to improve at the beginning of 4Q14, both in services and in industry, as was the case with consumer confidence, which was higher than the average for 3Q14.

Figure 3
Confidence (ESI) and coincident activity*

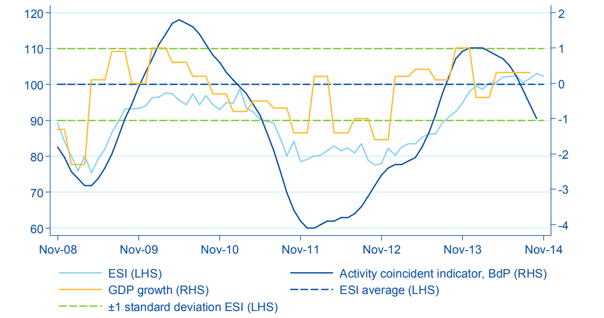
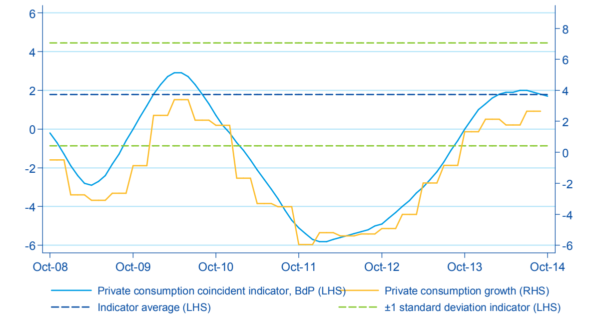


Figure 4
Coincident consumption indicator and private consumption (%YoY)*



Activity: industrial production shrinks, as do retail sales at the outset of 4Q14

Industrial production did not recover at the start of 4Q14. Retail trade also corrected downwards the robust uptick it posted in 3Q14 (+2.9% QoQ), supported by high levels of consumer confidence.

Figure 5
Industrial production (%YoY) and confidence*

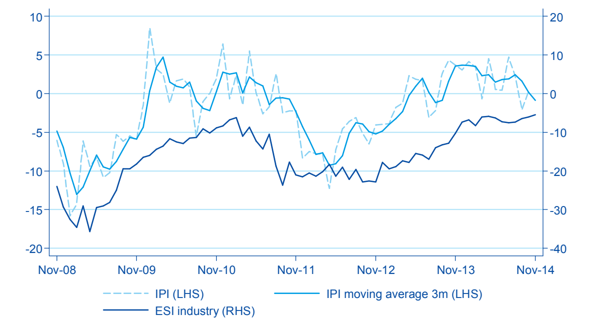
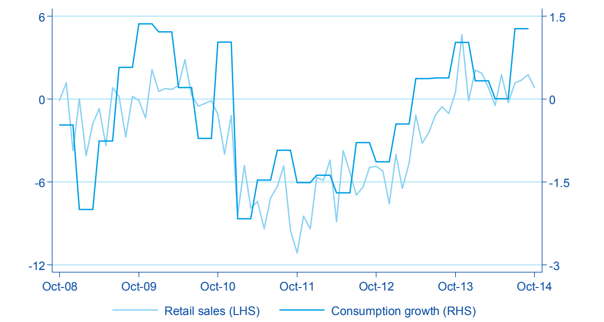


Figure 6
Retail sales (% YoY) and private consumption (% QoQ)*



* Source: Haver Analytics and BBVA Research

Foreign sector: goods exports continue to recover

Goods exports continued to improve after the poor prints at the beginning of the year. Services exports continued growing too, even though tourism may be showing signs of cooling at the beginning of 4Q14.

Figure 7
Exports and imports (% YoY, 3pMA)*

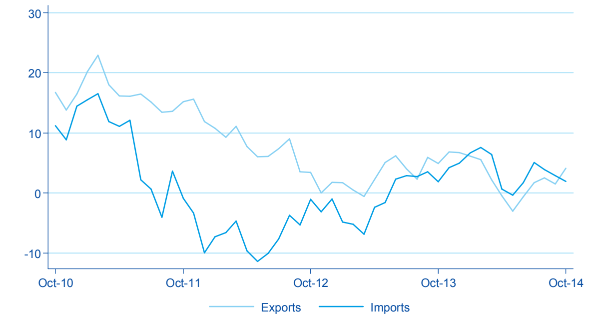


Figure 8
Exports (% YoY) and export orders *

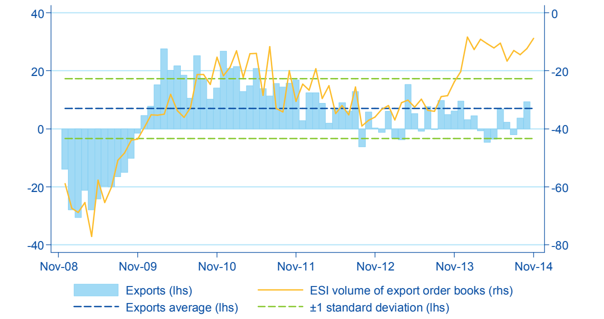


Figure 9
International trade by destination (% YoY)*sa %)*

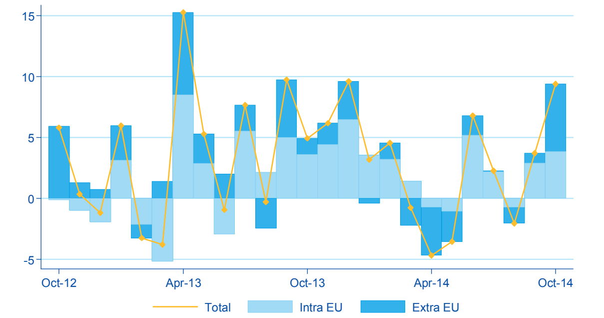
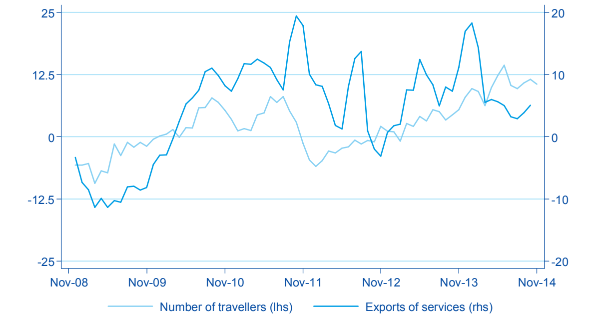


Figure 10
Tourism and services exports (% YoY, 3pMA)*



Labour market: labour costs fall and employment is still being created

The unemployment rate has fallen by 2.2pp in a year, in a clear trend to the downside (despite the slight correction in October), but this is still not putting upward pressure on wages (-0.8% YoY in 3Q14) and, once again, more jobs were created (1.1% QoQ in 3Q14).

Figure 11
Unemployment rate (%) and employment expectation*

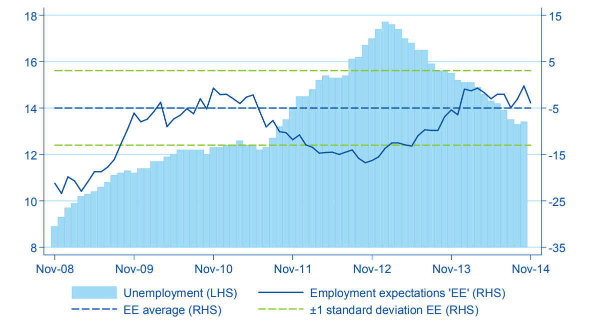
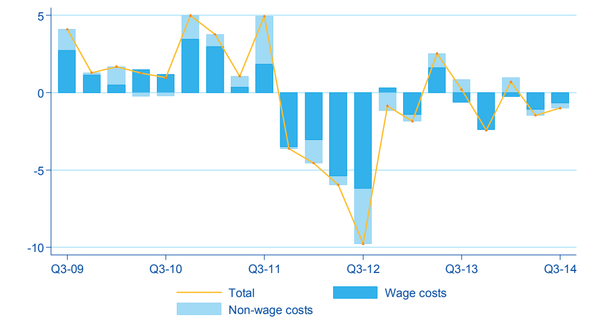


Figure 12
Labour costs in the business sector (%YoY)*



* Sources: Haver Analytics and BBVA Research

Prices: inflation remains stable in November

Harmonised headline inflation (HICP) remained stable in November (0.1% YoY), despite the fall in energy prices and the moderation in the inflation of services, while core inflation has accelerated a little to 0.4% YoY.

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

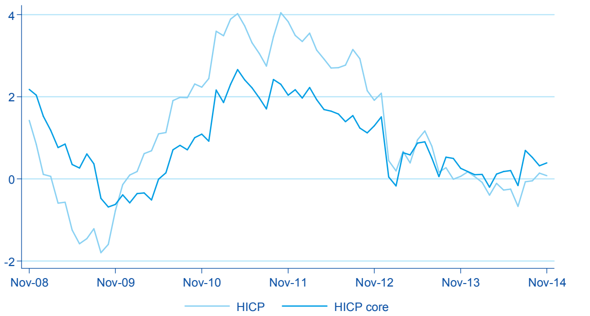
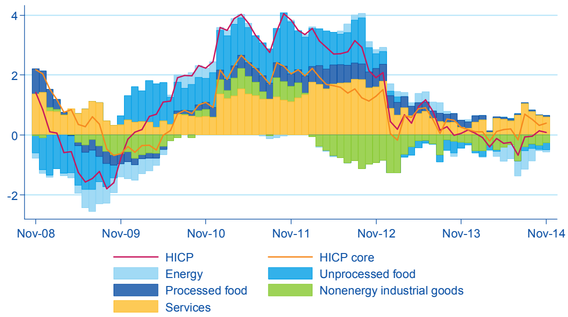


Figure 14
Inflation by components (contribution by %)*



Public sector : fiscal accounts, in line with the budget target

To October 2014, the public administrations' accounts indicate that they will meet the deficit target of 4% of GDP, thanks to a cyclical improvement which is accelerating revenues and limiting public spending.

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

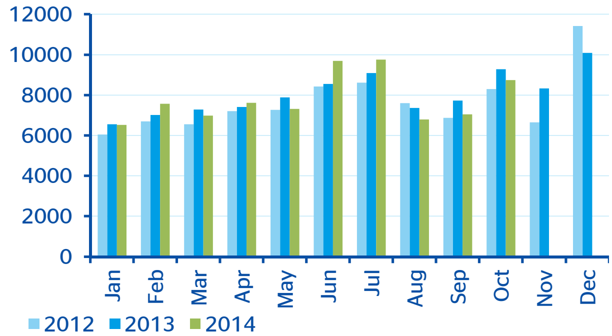


Figure 16
Government revenue (comparison with the previous year)*

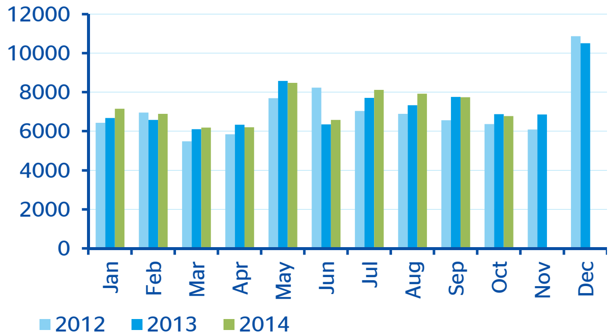


Figure 17
Public and private debt (% of GDP)

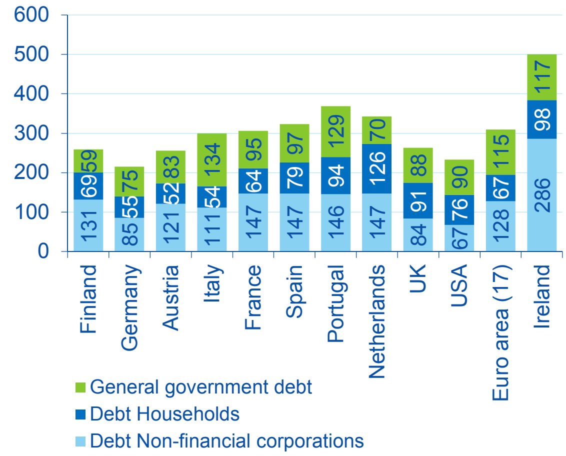
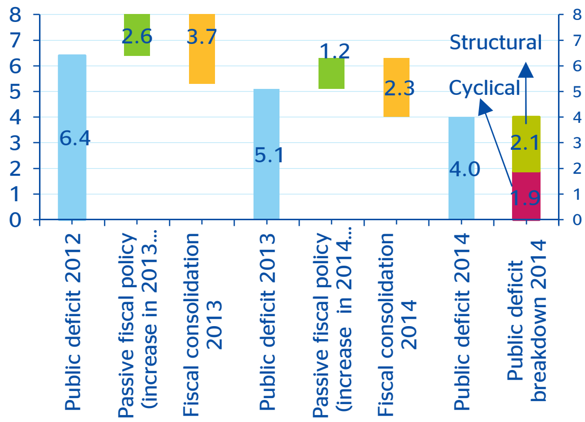


Figure 18
Breakdown of fiscal deficit (cyclical and structural)*



* Sources: Haver Analytics and BBVA Research

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