ECONOMIC ANALYSIS

Portugal: The recovery is progressing faster than forecast

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The recovery gained traction in 4Q14, more than expected

- GDP grew by 0.5% QoQ in the final quarter of 2014 (Figure 1), above the forecasts for a relatively stable recovery (BBVA Research and the consensus: 0.3% QoQ), following 0.3% the quarter before. This acceleration in activity is down to a solid recovery in net external demand, the result of a hearty increase in exports and a fall in imports, while private consumption has decelerated. This figure confirms our forecast of 0.9% growth for 2014 as a whole (up from -1.4% in 2013). This annual growth was due to the behavior of domestic demand which contributed positively to the recovery (+ 2pp after -2,4pp in 2013); among its components, improvements in private consumption (2.1% after -1.4%) and investment (2.3% after -6.3%) stand out, while the contraction in public consumption moderated and reduced to -0.7% in 2014, after -1.9% in 2013. The contribution of net external demand was negative (-1,1pp after 1pp in 2013), reflecting a stronger growth in imports of goods and services than the improvement observed in exports.

The MICA-BBVA model is, for the moment, estimating 1Q15 growth of 0.4%

- Using the information available to date (still limited to January's confidence indicators), our MICA-BBVA model estimates quarterly GDP growth of around 0.4% QoQ in 1Q14 (Figure 2).
- We saw a slight improvement in confidence throughout the fourth quarter of 2014 (Figure 3), with the European Commission's economic sentiment indicator, the ESI, returning to pre-crisis levels. The first set of figures for 1Q15 remains high, thanks to the improvement in consumer confidence and to the manufacturing sector index, although there is a minor deterioration of confidence in the services sector.
- However, these positive figures have not passed through into the activity indicators: Industrial production contracted for the second quarter in a row (-1.3% QoQ after -0.4% in 3Q14), and retail sales, having performed well in the previous three months, shrank by 2.4% QoQ (Figures 5 and 6). The good news is to be found in the behaviour of exports, which registered a 2.8% QoQ growth in 3Q14: external sales of goods have increased by 3.6% QoQ in the last quarter of last year, encouraged by the euro's depreciation and the growth in industrial orders from abroad (Figures 7 and 8).
- The trend in the reduction of the unemployment rate was broken in 4Q14, after six quarters of rapid falls, and came in at 13.5% (Figure 11). Employment grew again for the fifth consecutive quarter, although at a slower rate than in 3Q14 (0.5% YoY after 2.1% YoY). On the other hand, wages in the business sector have dropped more sharply (-2.9% in 4Q14 after -1.2% YoY), while those in the public sector are registering a severe contraction (-15.5% in 4Q14 after +2% YoY), because of the Christmas bonus paid in the last quarter of 2013, which was not paid in 2014.
- In January, headline inflation (HICP) edged down 0.1pp to -0.4% YoY, a result of another fall in the price of energy products, but also because of the moderating inflation in services (Figures 13 and 14), reducing core inflation also by 0.1pp too, to 0.3% YoY in January.

We expect 1.5% growth in 2015 and 1.8% in 2016

- On our forecast horizon, the improvement in the labour market and in household confidence and the low level of inflation ought to support private consumption, although this may nevertheless moderate in 2015 to 1.9%, after the disappearance of the strong but temporary spending uptick in households at the end of 2013. Improved domestic demand and high levels of business confidence ought to support the consolidation in investment (3.2% and 3.5% in 2015 and 2016 respectively). The recovery of its European trading partners, together with favourable exchange rate conditions, will result in an increase in exports over our forecast horizon (4.6% in 2015 and 5.4% in 2016), and we estimate that imports will moderate their growth, meaning that net external demand will make practically no contribution, either in 2015 or 2016. The only component to continue shrinking in 2015 will be public consumption, subject to the budget adjustments, but it may edge up in 2016 (by 0.4%). All told, we estimate that the economy will grow by 1.5% in 2015, accelerating to 1.8% in 2016.
- The central government deficit narrowed in 2014 compared to the year before, and this improvement was greater than expected in both the original budget and in its subsequent modifications; although revenues grew less than expected (0.8% instead of 2.5%), public expenditure shrank by 1.4%, against the forecast increase of 0.9%. Excluding one-off measures, the deficit ought to come in comfortably at below 4% (about 3.8%) of GDP in 2014. For 2015, the government forecasts a further deficit reduction, bringing it down to 2.7% of GDP, but this reduction is mostly cyclical. Our estimates suggest that the structural correction will be 0.5pp of GDP in 2015, which would put the structural deficit at 1.6%; if we add this to the still high level of debt, it is essential that the government continues to push through the structural reforms underway in order to reduce one of the as-yet unresolved problems.

Portugal

National accounts: 0.5% QoQ growth in 4Q14

The increase in quarterly GDP is mainly accounted for by a solid recovery in net external demand, the result of robust growth in exports and a fall in imports. Private consumption, however, has decelerated.

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

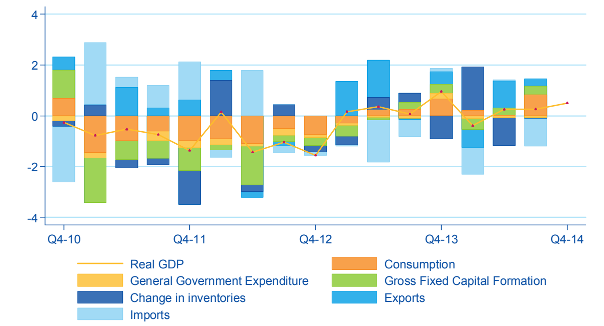
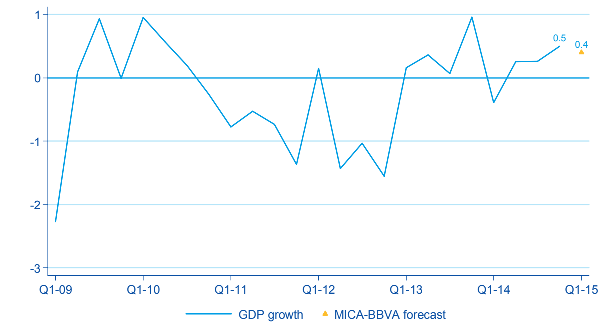


Figure 2
MICA-BBVA: GDP growth (% QoQ) and forecasts *



Confidence: the economic sentiment index continues at high levels at the beginning of 1Q15

According to the ESI, business confidence stayed at pre-crisis levels in January. Industry and consumer confidence continued to perform positively, while there was a moderation of confidence in services, although it remained high.

Figure 3
Confidence (ESI) and coincident activity indicator *

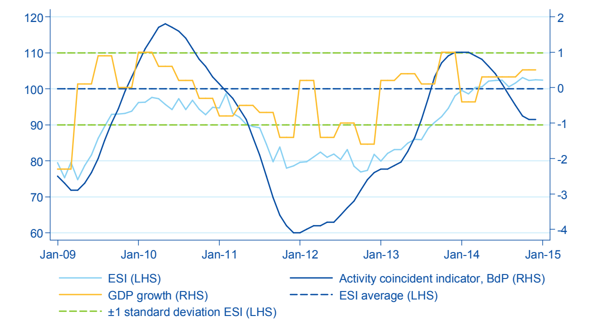
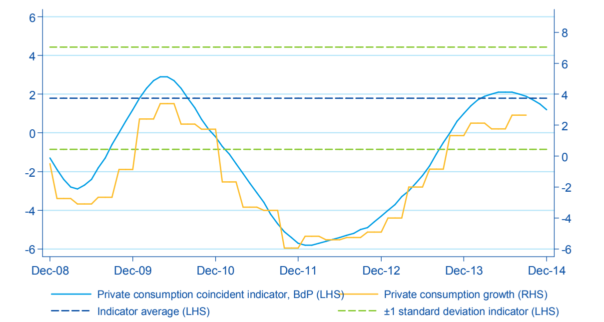


Figure 4
Coincident consumption indicator and private consumption (% YoY)*



Activity: industrial production falls, as do retail sales in 4Q14

The recovery in industrial production did not take off in 4Q14 (-1.3% QoQ compared to 3Q14). Retail trade slumped by -2.4% QoQ in 4Q14, after a good result in 3Q14 (+3% QoQ)

Figure 5
Industrial production (% YoY) and confidence*

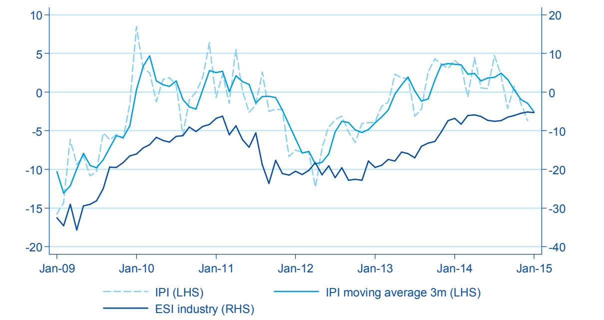
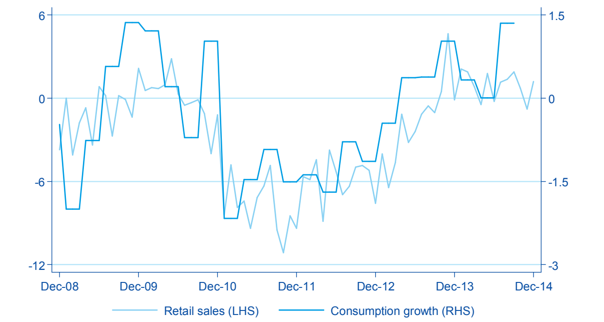


Figure 6
Retail sales (% YoY) and private consumption (% QoQ)*



* Source: Haver Analytics and BBVA Research

Foreign sector: goods exports continue on the up

Goods exports improved by 5.1% MoM in December, and held at above their 3Q14 average, at +3.6% QoQ. Exports of services, meanwhile (especially tourism), continued to grow.

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

Figure 8
Exports (% YoY) and export orders *

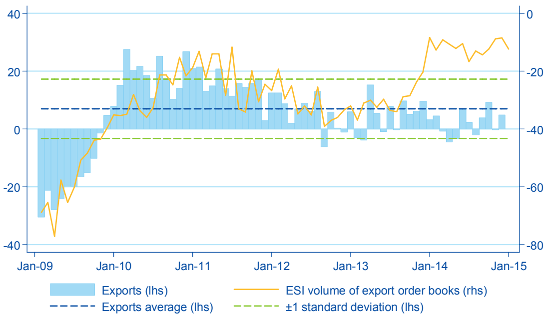


Figure 9
International trade by destination (% YoY)* sa %*

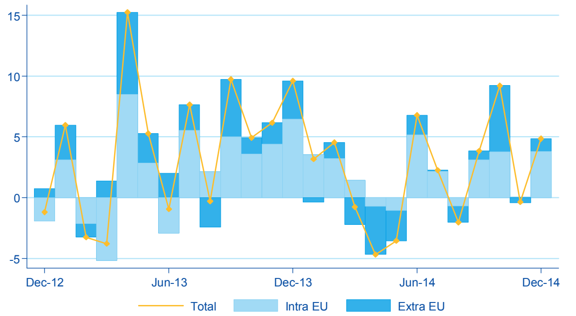
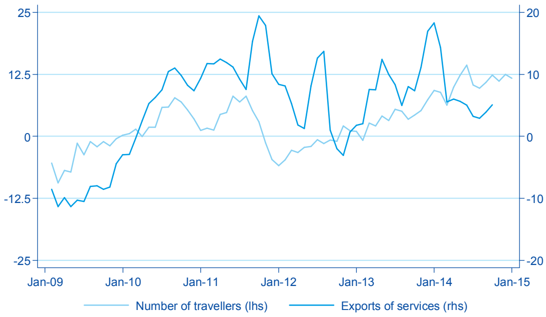


Figure 10
Tourism and services exports (% YoY, 3pMA)*



Labour market: an interruption in the fall of unemployment

After showing a swift reduction in unemployment in the last two years, 4Q14 saw the end of the trend, with the unemployment rate holding at 13.5%. Private sector wages have shrunk again (-2.9% YoY after -1.2% YoY in 3Q14).

Figure 11
Unemployment rate (%) and employment expectations*

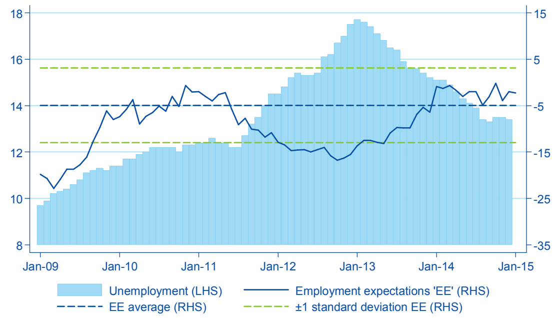
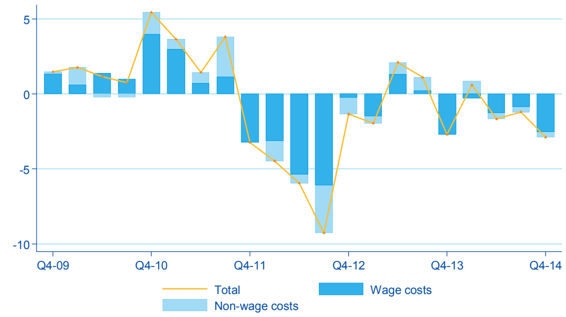


Figure 12
Labour costs in the business sector (% YoY)*



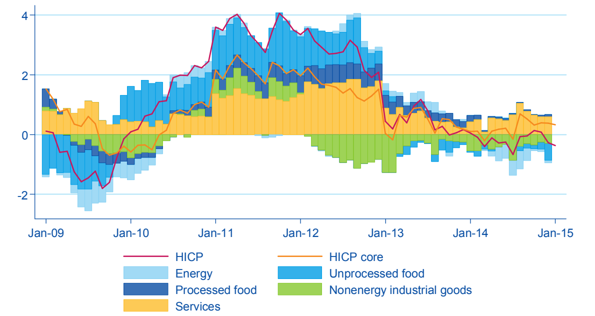
* Sources: Haver Analytics and BBVA Research

Prices: inflation remained negative in January

Headline inflation (HICP) edged down by 0.1pp to -0.4% YoY, due to the intensification of the price fall in energy products. The moderation in the price of services led core inflation to decelerate to 0.3% 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

Despite lower-than-expected revenues, the severe cut in public administrations' expenditure means that the deficit target of 4% of GDP will be met.

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

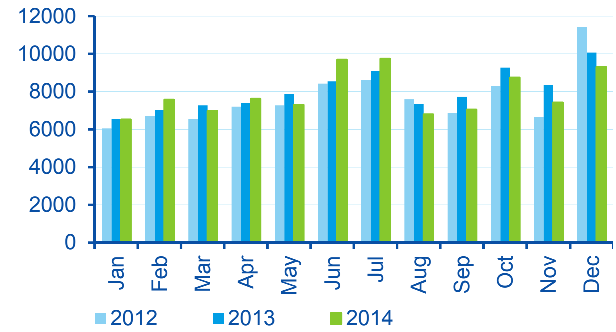


Figure 16
Government revenue (comparison with the previous year)*

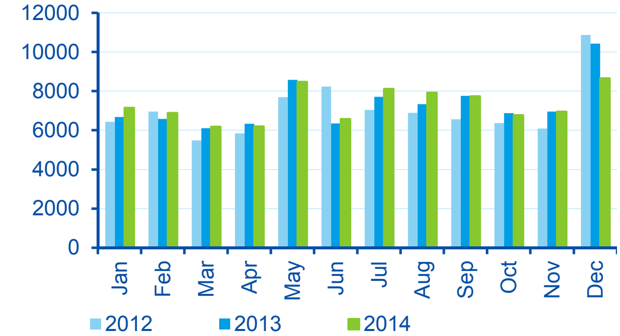


Figure 17
Public and private debt (% of GDP)

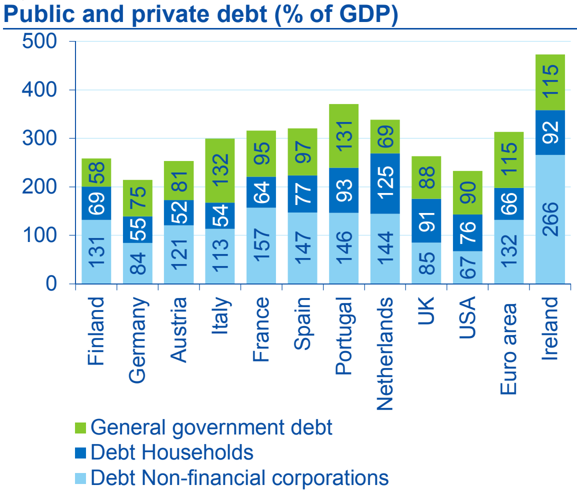
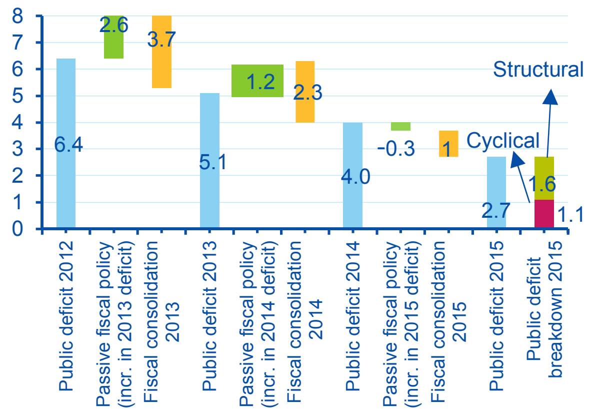


Figure 18
Breakdown of fiscal deficit (cyclical and structural)*



* Sources: Haver Analytics and BBVA Research

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