ECONOMIC ANALYSIS

Portugal: The economy is set to grow at around 2% in 2015

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Domestic demand will continue to be the key driver for growth, supported by the improved confidence of economic agents and the low oil price

- GDP grew by 0.4% QoQ in 1Q15, thus keeping up the pace of the previous quarter (Figure 1), although this was below our forecasts of a pick-up to 1% QoQ (consensus: 0.5% QoQ). The detailed breakdown of growth at the beginning of the year still has not been released, but the figures out suggest that behind this stabilisation of growth there is a rise in domestic demand, although private consumption and investment should have grown at sub-estimate rates. Moreover, inventories should have made a notably negative contribution, along with virtually negligible input from net exports.
- Over the first quarter of 2015, confidence readings stabilised at high levels (Figure 3), with the European Commission's economic sentiment indicator (the ESI) ahead of pre-crisis levels. The initial values for 2Q15 show a strong rebound, both in the services sector, which is recovering from a rather weaker first quarter, and in manufactures, while consumer confidence is falling back slightly after five quarters in succession of progress.
- This fine data has partly been mirrored in the activity indicators: industrial production has interrupted its fall in 1Q15 after two quarters of contractions, while, after the considerable slip in the three previous quarters, retail sales have come up by 3% QoQ (Figures 5 and 6). The negative streak can be found in how exports have evolved, and after posting +4% QoQ in 4Q14, goods sales abroad have dropped by 2.7% QoQ in 1Q15, despite the weaker EUR, though in line with the lower growth for industrial orders from abroad (Figures 7 and 8) and with a slowdown in the emerging markets, especially Angola, where the economy has been hit hard by the oil price fall.
- The trend of a diminishing unemployment rate was interrupted in 1Q15, after seven quarters of falling fast. Job creation lost steam in 4Q14 (0.7% YoY after 1.9% YoY), for which reason in the next few months we are expecting a stabilisation or a slower decrease in the unemployment rate (Figure 11), which in March stood at 13.5% of the labour force. On the other hand, the falling pattern in labour costs in the business sector that had been seen in recent quarters has become more pronounced (-2.9% YoY in 4Q14 after -1.2% YoY), especially as regards their wage component (Figure 12), while a powerful contraction has been recorded in the public sector due to a base effect from the end of 2013.

- In April, headline inflation (the HICP) quickened by 0.1pp to 0.5% YoY, owing to a slowing of the drop in energy product prices, though also to the rise for non-processed foods. On the other hand, the major slowdown in services inflation means that core inflation was reduced by 0.2pp to 0.6% YoY in April (Figures 13 and 14).
- For this second quarter, the most recent data available suggests that the economy could be growing at a relatively steady pace. Of the two factors which our MICA-BBVA model provides, one of which is more stable and the other more volatile, and with only very limited data available at this stage, the more stable of the two points to a growth rate of around 0.5% QoQ[1].
- This stability in the economy's growth rate contrasts with our forecast of a rebound in activity at the beginning of the year followed by a significant easing of the pace in 2Q15. Nonetheless, it does not mean any great change to our scenario. We now expect relatively robust and stable growth, which should lead to an AAGR of around 2% for the year as a whole.
- Within our forecast horizon, the factors which underlie the developments regarding the various components of demand are still positive. Household confidence and low inflation should boost the rally in private consumption to the extent that it grows at a solid rate of around 0.5% QoQ in the coming quarters. Consequently, private consumption should grow at c.2% in 2015, dropping off the pace slightly in 2016 to reach 1.7%. The fundamentals behind the rise in investment, which were already noted in 2014, are still in place (improved domestic demand and a recovery of external demand, above all within the eurozone, together with a reduction in borrowing costs and a gradual improvement in access to credit). Added to these are lower production costs (linked to oil) and better business confidence, which should be reflected in an increase in investment. This we expect to grow at about 3.9% in 2015 and pick up speed to 4.2% in 2016. The improvement in domestic demand will, in turn, continue to fuel an increase in imports (5.2% in 2015 and 4.8% in 2016) in parallel with a larger rise in sales abroad (5.9% in 2015 and 5% in 2016), buoyed by the helpful exchange rate, for which reason net exports should make a slightly positive contribution within the forecast horizon. The only component which will continue to contract will be public sector consumption, which is subject to the fiscal adjustment process (-0.8% in 2015), but which could lift itself a little in 2016 (0.4%). All in all, we expect the economy to grow at around 2% in 2015 and 2016. There are, however, risks to the downside which affect this forecast, which are mainly to do with a possible slowdown in external demand and especially the consolidation of the eurozone's recovery, upon which the Portuguese export sector is highly reliant and where its progress is also key to shoring up recovery for investment (Figure 9).
- The budget implementation for the first quarter shows a shortfall of EUR874mn, which is over the figure of EUR835mn for the same period the previous year. This is mainly due to the increased expenditure on interest and infrastructure in February (although the latter is due to a calendar-related issue), while revenues are growing to a lesser extent. The government has forecast a fiscal deficit of 2.7% for the whole of 2015, in line with our estimates (Figure 18).

1: Our short term MICA-BBVA is a dynamic factor model which uses the information from short-term indicators to capture the common cyclical component which they share with GDP. The main aim is to provide a realtime monthly composite indicator for economic activity. Given the particular volatility of the data series in the Portuguese economy, the model includes two factors, one which charts the trend-cycle component for activity, and another which captures high frequency volatility. The first quarter GDP data (0.4% QoQ) is much more in line with the trend-cycle component (0.7%) than with the sum of both components (1%), for which reason using only this component seems to be the best solution to track trend developments in the economy, and so this is how we shall report this from now onwards.

Portugal

National accounts: growth of 0.4% QoQ in 1Q15

GDP recorded growth of 0.4% QoQ in 1Q15, the same as in 4Q14, primarily due to the increased domestic demand. Moreover, inventories are likely to have made a considerable negative contribution, together with practically negligible input from net exports. Our MICA BBVA model, though with very little data available for 2Q15, points to the economy continuing to advance at a relatively stable rate, or else picking up slightly, this quarter.

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

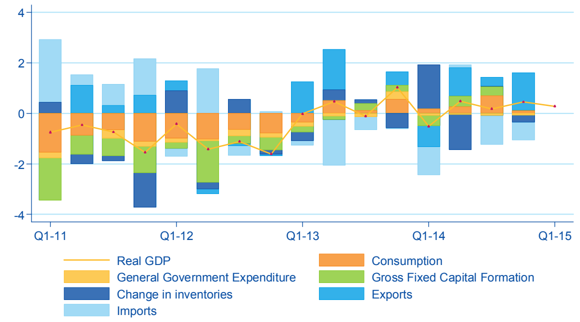
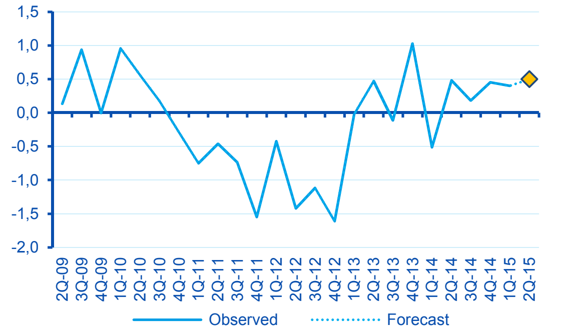


Figure 2
MICA-BBVA: GDP growth and forecasts (% QoQ)*



Confidence: the economic sentiment indicator improved in April

According to the ESI, business confidence rose again in April. Industry continues on its positive course, while services show a clear rebound in confidence, after dropping back in 4Q14 and 1Q15.

Figure 3
Confidence (ESI) and coincident activity indicator*

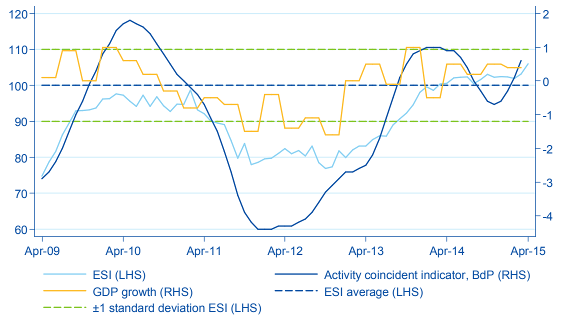
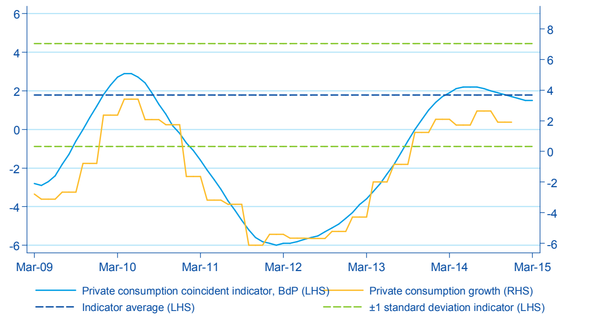


Figure 4
Coincident consumption indicator and private consumption (% YoY)*



Activity: Industrial production stable and retail sales rebound in 1Q15

Industrial production was up in March (1.4% MoM) and remains stable with respect to the average for 4Q14, when it fell 0.6% QoQ. Retail trade registered a figure of +3% with respect to the previous quarter (-1.8% QoQ in 4Q14).

Figure 5
Industrial production (% YoY) and industrial confidence*

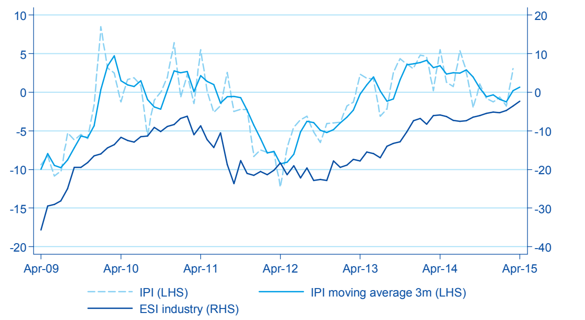


Figure 6
Retail sales (% YoY) and private consumption (% QoQ)*

* Source: HAVER and BBVA Research

External sector: the figures for the trade balance and industrial orders point to a smaller contribution from net exports

Despite the notable rise in March, exports are down (-2.7% QoQ) wrt to the average for 4Q14, due to the sharp fall in January. On the other hand, imports also dropped wrt 4Q14 (-3.7% QoQ)

Figure 7
Imports and imports (% YoY, 3p MA)*

Figure 8
Exports (% YoY) and export orders*

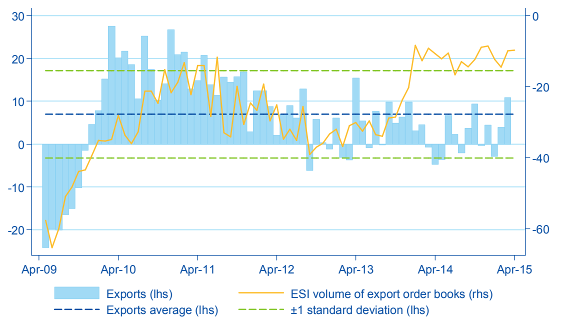


Figure 9
International trade by destination (% YoY, sa)*

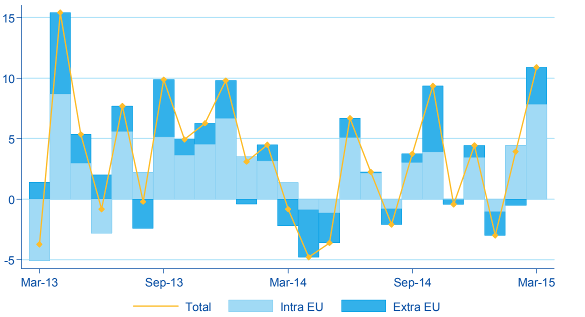
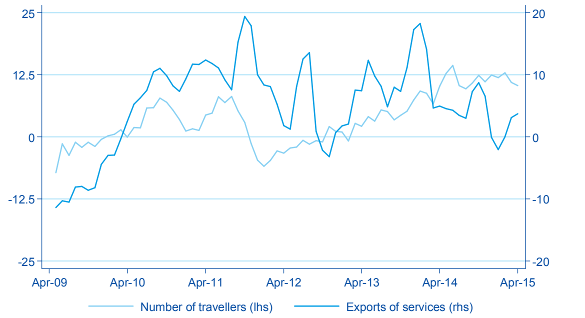


Figure 10
Tourism and services exports (% YoY, 3p MA)*



Labour market: a break in the reduction of unemployment

In recent months there has been stabilisation of the unemployment rate (13.5% in March), with job creation easing off the pace of growth in 4Q14 (0.7% YoY after 1.9% YoY). Private sector wages have again come down (-2.9% YoY after -1.2% YoY in 3Q14).

Figure 11
Unemployment rate (%) and employment expectations*

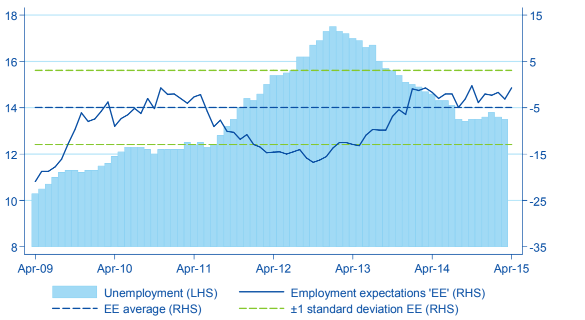
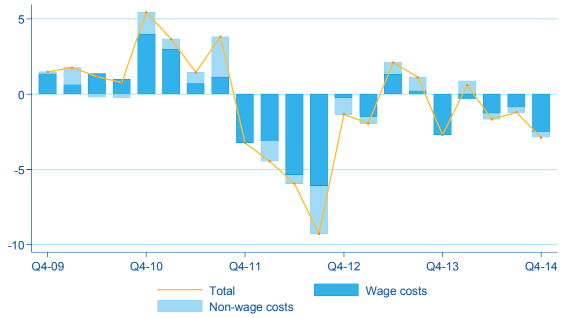


Figure 12
Business sector labour costs (% YoY)*



* Sources: HAVER and BBVA Research

Prices: headline inflation saw an upturn in April, while core inflation slowed down

Headline inflation (HICP) has accelerated by 0.1pp to 0.5% YoY, due to a slowdown in the fall of energy product prices. On the other hand, the loss of momentum in services inflation means that core inflation has slowed down by 0.2pp to 0.6% YoY in April.

Figure 13
Inflation: headline and core (% YoY)*

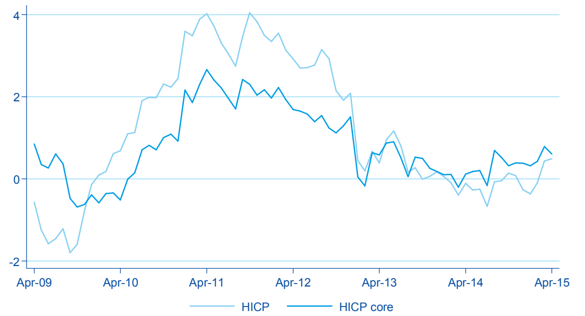
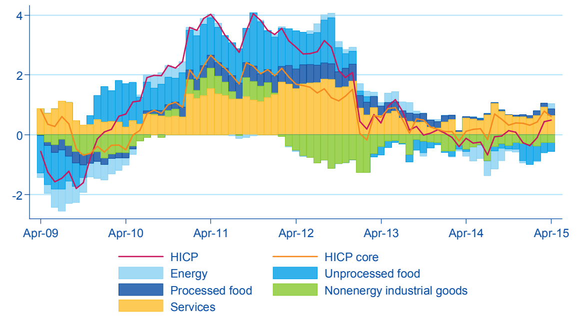


Figure 14
Inflation by components (contribution in %)*



Public sector: budget expenditure rose at the beginning of the year

The figures for budget implementation in March showed a higher rise in expenditure than in revenues. Government estimates indicate a narrowing of the deficit for 2015 as a whole to 2.7% of GDP, from 3.7% in 2014.

Figure 15
Budget expenditure (against the previous year)*

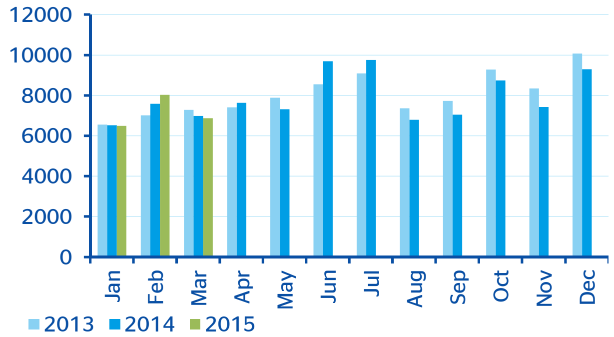


Figure 16
Tax revenues (against the previous year)*

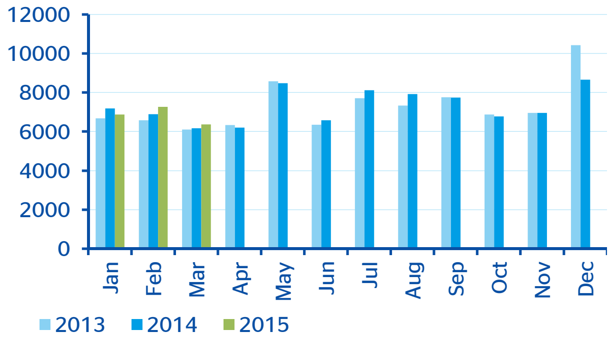


Figure 17
Public and private sector borrowing (% of GDP)

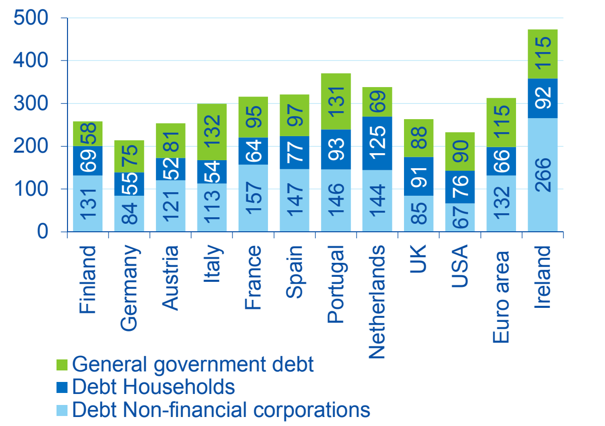
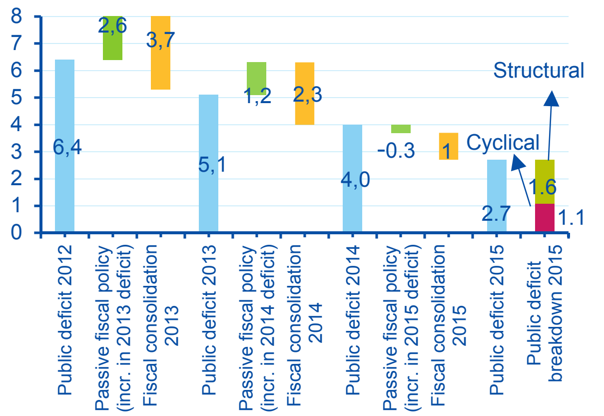


Figure 18
Breakdown of the fiscal deficit (cyclical and structural)*



* Sources: HAVER and BBVA Research

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