

ECONOMIC ANALYSIS

Portugal: the growth rate of the economy stabilises

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The MICA-BBVA model forecasts growth of 0.4% for the third quarter, similar to the second quarter data released in August, which was worse than we expected. Growth in 2015 will be below 2%. Domestic demand will remain the main engine of growth, while supporting external demand weakens

- GDP grew by 0.4% QoQ in the second quarter of 2015, maintaining the pace of the previous two quarters (Figure 1), but slightly below our forecast of a slight acceleration to 0.6% QoQ (consensus 0.5% QoQ). The composition of growth reveals that behind this stabilisation is a substantial increase in domestic consumption, particularly private but also public, while investment contracted after four quarters with a positive sign (weighed mainly by construction after the rebound of 1Q15) and net exports had a negative contribution to growth, as the strong increase in imports overrode the recovery of foreign sales.
- During the second quarter of 2015, the trend of improving confidence continued (Figure 3), with the economic sentiment indicator of the European Commission (ESI) above pre-crisis levels. The first data for 3Q15 show increased confidence in both the services sector, which is still recovering from a weak first quarter, and in the consumer sector, while the manufacturing sector moderated slightly after three consecutive quarters of improvement, but remains above its historical average.
- These data are being reflected in activity indicators. Industrial production fell slightly after the rebound in 2Q15, while retail sales are increasing from the previous quarter, after their reduction over the previous three months (Figures 5 and 6). No trade balance data are available yet for the third quarter, but the decline in industrial orders from abroad could result in a slowdown of goods exports, which in 2Q15 grew 3.4% QoQ, as they may accuse the moderation in global demand. On the other hand, imports are likely to suffer a downward correction during 3Q15, following an increase of 9.4% QoQ in the previous quarter (Figures 7 and 8).
- The unemployment rate, whose downward trend was interrupted in 1Q15 after seven quarters of decline, has again declined significantly in 2Q15 and in July stood at 12.1%, two points less than twelve months earlier (Figure 11). Job creation accelerated slightly in 2Q15 (1.7% YoY after 1.5% YoY), growing at about the same rate as it did throughout 2014. Moreover, labour costs in the private sector rose less than in the previous quarter (0.8% YoY in 2Q15 after 4.5% YoY), especially in the wage component (1.2% YoY after 4.9% YoY) while in the public sector labour costs decreased by 2% YoY (Figure 12).
- In July, headline inflation (HICP) slowed down by a tenth to 0.7% YoY, due to the falling prices of energy products and moderation in the pace of growth in the prices of unprocessed food. Moreover, core inflation registered an increase of 0.1pp in July to 0.7% YoY (Figures 13 and 14).
- For the third quarter, although only with limited information and basically only with regard to confidence, our MICA-BBVA model suggests that the economy may be growing at the same pace of about 0.4% QoQ. This stability in the pace of expansion with slightly lower than expected growth in 2Q15 puts a downward bias on our forecast scenario (see [Europe Economic Outlook 3Q15](#)) of about 0.3pp in annual growth for the whole of 2015, to about 1.7%. For 2016, we maintain our growth forecast of 2%.

- For the forecast horizon, we expect that the factors underlying the evolution of the different components of domestic demand remain positive. The household confidence, low inflation and improved labour market should continue to drive the recovery in private consumption, which should grow at solid rates in both 2015 and 2016. The fundamentals behind the increase in investment, which were already present in 2014, remain robust - improvement in domestic demand, lower financing costs and a gradual improvement of access to credit - although somewhat weaker than three months ago, due to the moderation in global demand. However, if to the aforementioned we add lower production costs (due to oil prices) and business confidence at high levels, investment could register a significant increase both this year and next. Improving domestic demand will continue to drive imports, in parallel with an increase in sales abroad encouraged by the favourable exchange rate. Therefore, net exports should have either no or a slightly negative contribution on the forecast horizon; as will public consumption, that remains subject to the fiscal adjustment process.
- The general government deficit up to July 2015 stood at around 3.2% of GDP (-EUR5bn) in the annual aggregate, about two-tenths lower than that recorded the previous year, but five-tenths¹ above the target set for 2015 as a whole (government 2.7%, BBVAe: 2.6%). The deviation from the budget for 2015 is mainly due to the increase of effective revenue remaining slower than expected (+0.1% YoY against a forecast of +1.4%). The fall in non-current income (capital revenue) is draining part of the good performance of current revenues (taxes and social contributions), which are broadly in line with official forecasts (0.6% vs. 0.9% expected). Moreover, effective expenditure accumulated to July 2015 decreased more slowly than officially expected (-0.8% YoY against -1.2% YoY expected in the budget), influenced by the evolution of employee income, that decreased moderately (-0.6% vs. -4.8% expected). This trend is expected to reverse in the last months of the year, due to the base effect of the decision of the constitutional court on the partial reversal of the reduction in public wages². In all, if this trend is not reversed substantially in the second half, Portugal could continue within the excessive deficit procedure by not being able to reduce its budget deficit below the 3% threshold. Our calculations suggest that the likelihood is low of achieving the deficit target for this year, because the fiscal effort necessary to achieve it must be greater than historically recorded in the months of August to December, even if we include the possibly negative effect of the inability to reach an acceptable agreement on the sale of Novo Banco.

1: It is worth stressing that there are revenues and expenditures affecting the comparability of data accumulated up to July, caused by being made in different periods in both years. If these data are incorporated in the second half and there is no substantial improvement in the profile, the deficit could be even higher than 3.2% of GDP.

2: In 2015, the reduction in public wages partially reapplies, while in 2014 the Constitutional Court suspended its application from June.

Portugal

National account: the growth of 0.4% QoQ is maintained in 2Q15

In 2Q15, GDP registered identical growth to the previous quarter of 0.4% QoQ, mainly due to increased domestic demand. Also, net exports have made a negative contribution. Our MICA BBVA model, with very few indicators available for 3Q15, shows that the economy is likely to continue advancing at a relatively stable rate of 0.4% QoQ.

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

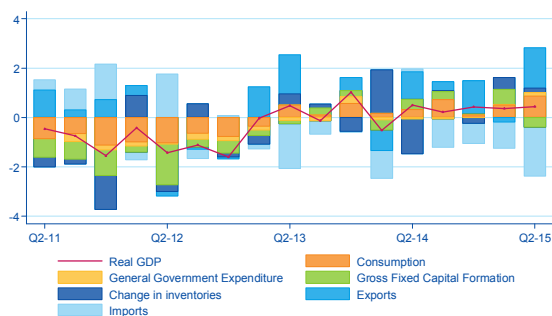
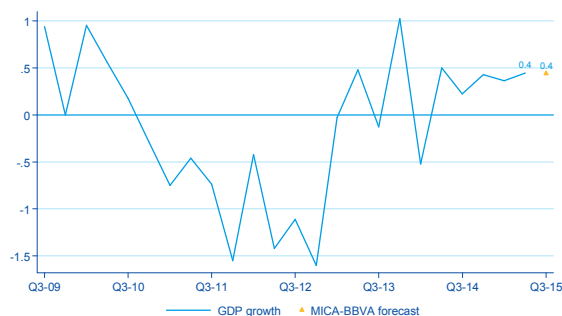


Figure 2
MICA-BBVA: GDP growth and forecasts (%QoQ)*



Confidence: the economic sentiment index softens in August

According to ESI, business confidence declined in August, but remains above its historical average. In 3Q15, the confidence of households and the service sector improves, while it moderates in manufacturing

Figure 3
Confidence (ESI) and coincident activity indicator*

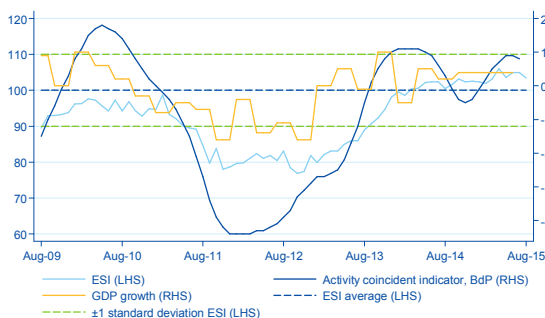
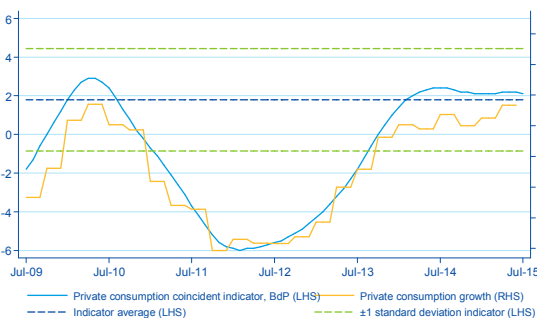


Figure 4
Coincident consumption indicator and private consumption (% YoY)*



Activity: stable industrial production and retail sales rebound

Industrial production rose 0.1% MoM in July and stays by the average of 2Q15, when it grew by 2.9% QoQ. Meanwhile, retail trade recorded an increase of 1.1% MoM in July after falling 1.5% QoQ in 2Q15.

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

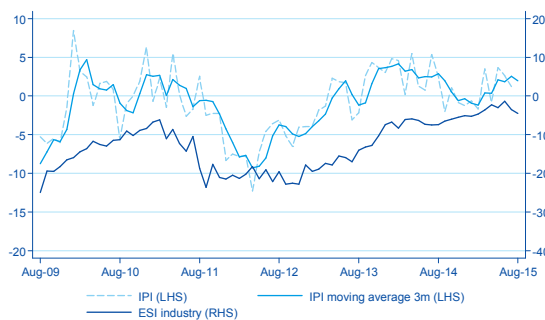
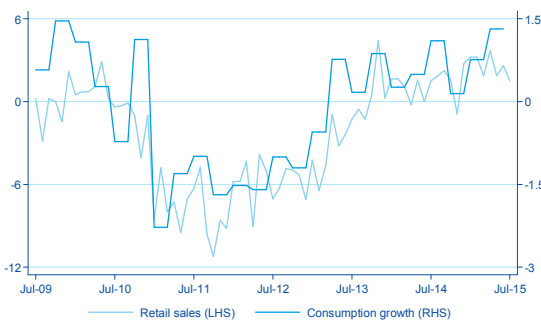


Figure 6
Retail sales (% YoY) and private consumption (%QoQ)*



* Fuente: HAVER y BBVA Research

Foreign sector: lower global demand may affect exports of goods in 3Q15

After the remarkable increase in June despite falls in April and May, exports increased (3.4% QoQ) in 2Q15 compared to 1Q15. On the other hand, imports may decrease following the significant increase in 2Q15 (9.4% QoQ).

Figure 7
Exports and imports (% YoY, 3p moving average)*



Figure 8
Exports (% YoY) and export orders*

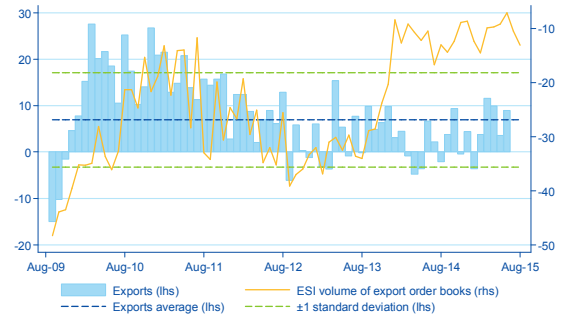


Figure 9
International trade by destination (% YoY, sa)*

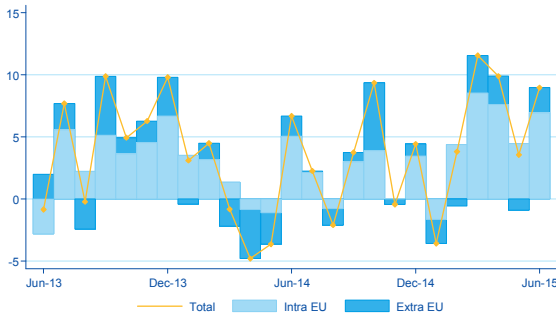
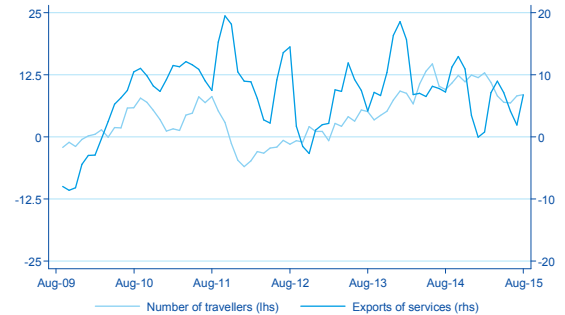


Figure 10
Tourism and services exp. (% YoY, 3p mov. av)*



Labour market: reduction in unemployment continues

After the significant decline in the unemployment rate of 2Q15 (12.5%), the rate continued to fall in July to 12.1%. Thanks to the slight acceleration in job creation (1.7% YoY after 1.5% YoY in 1Q15). On the other hand, private wages continued to rise at a slower pace in 2Q15 (0.8% YoY after 4.5% YoY in 1Q15).

Figure 11
Unemployment rate (%) and employment expectations*

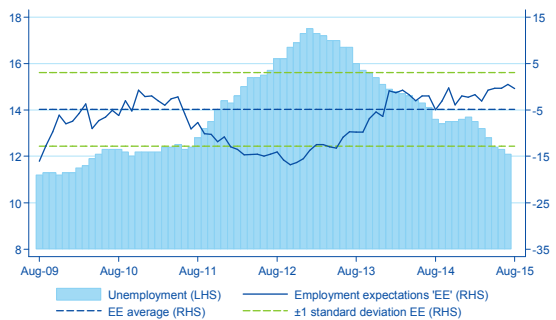
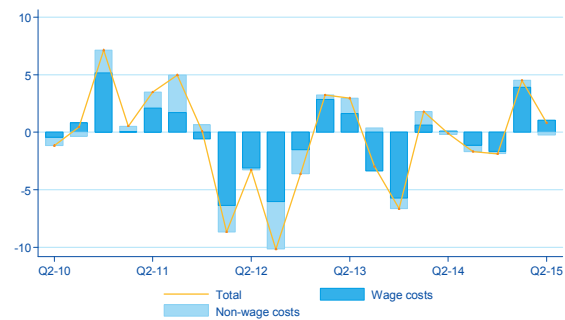


Figure 12
Labour costs in the business sector (% YoY)*



* Fuentes: HAVER y BBVA Research

Prices: headline inflation moderated in July, while core picked up

Headline inflation (HICP) moderated its pace of expansion by a tenth in July and stood at 0.7% YoY, due to a slowdown in falling prices for energy products. Meanwhile, core inflation increased by 0.1 pp to 0.7% YoY.

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

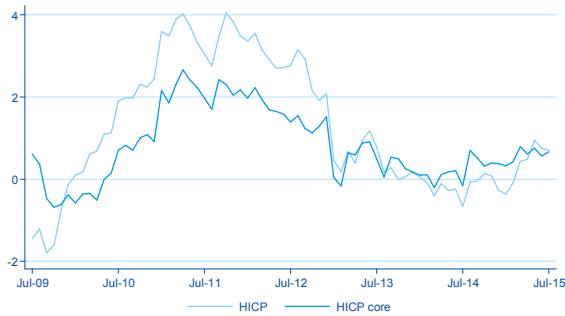
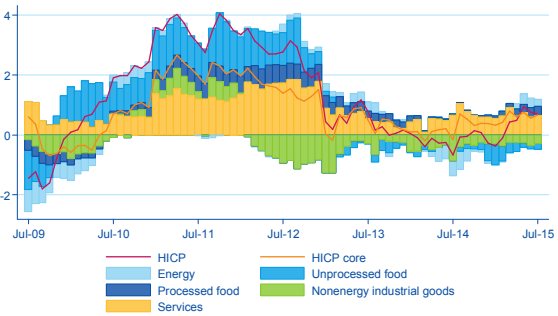


Figure 14
Inflation by component (contribution in %)*



Public sector accumulated deficit until July poses risks to compliance with the official target of 2.7%

The deviation from the budget for 2015 is mainly due to the fact that the increase in effective revenues and the reduction of compensation of employees are slower than anticipated.

Figure 15
Fiscal expenditure (compared to previous year)*

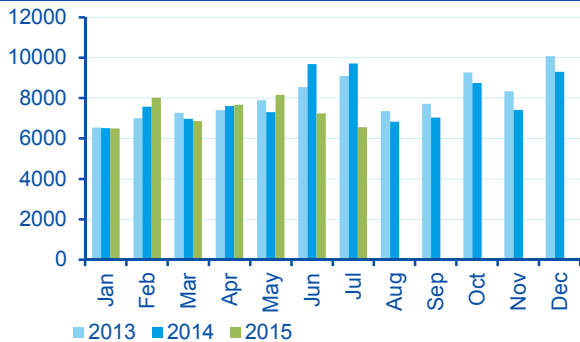


Figure 16
Fiscal revenues (compared to previous year)*

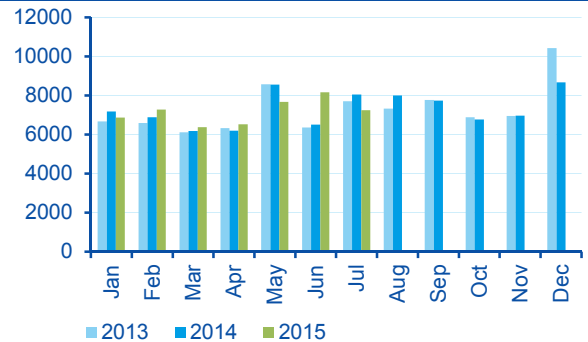


Figure 17
Public and private debt (% of GDP)

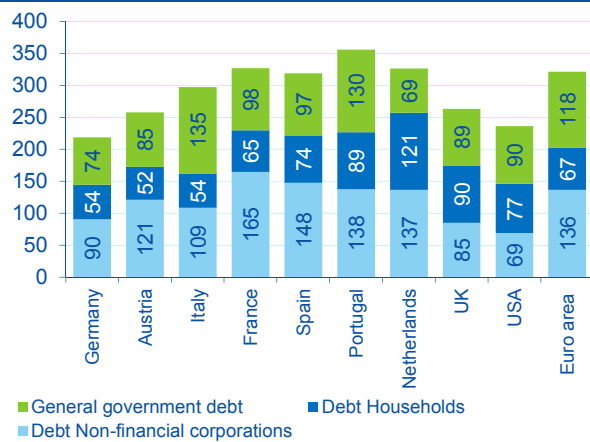
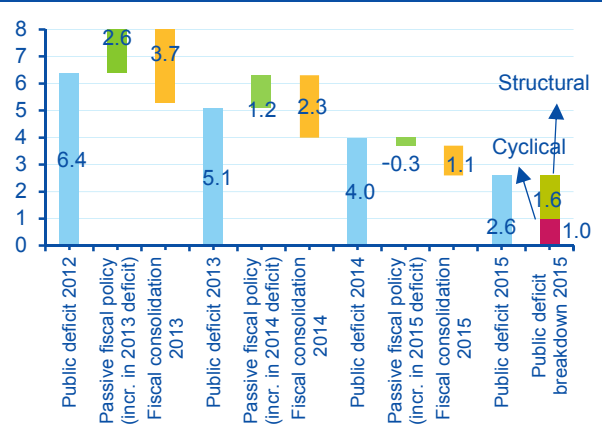


Figure 18
Decomposition of fiscal deficit (cyclical and structural)*



* Fuentes: HAVER y BBVA Research

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