MACROECONOMIC ANALYSIS

Portugal: shifting down a gear

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The negative surprise in the GDP for the third quarter and the weakening of the supports of the economy, both internal and external, lead us to revise down our growth forecast for this year and next. Domestic demand will remain the main engine of growth but deepening uncertainty may slow it down

- After growing 0.5% QoQ in each of the three previous quarters, GDP stagnated in the third quarter of 2015, well below our forecast of slight moderation (0.4% QoQ) (Figure 1). The breakdown of growth has not yet been published, but the information available suggests that the biggest surprise could come from the negative contribution of domestic demand and, in particular, the decline in investment. By contrast, the largest decline in imports relative to exports would have resulted in a positive contribution from net exports.
- During the third quarter of 2015, confidence stabilised at high levels (Figure 3), with the economic sentiment indicator of the European Commission (ESI) above pre-crisis levels. The first figures for 4Q15 show a consolidation of the trend, with particularly strong households' confidence, offset by the moderation in the services sector.
- These data have only been partly reflected in activity indicators: industrial production stagnated after the rebound in 2Q15, while retail sales grew 1.6% QoQ compared to the previous quarter, after reducing during the previous three months (Figures 5 and 6). On the external side, the fall in exports (-1% QoQ), which could have affected by the moderation in global demand was more than offset by the drop in imports (-6.6% QoQ), partly related to the contraction in investment and the slowdown in foreign sales (Figures 7 and 8).
- The unemployment rate, whose downward trend was interrupted in 1Q15 after seven quarters of decline, has again shrunk significantly in 2Q15 and 3Q15 and in September stood at 12.2%, 1.2 points less than twelve months back (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 slowed sharply (2.4% YoY in 2Q15 YoY after 4.5% in the previous quarter), especially in the wage component (2.9% YoY after 4.8% YoY), while in the public sector labour costs declined by -0.3% YoY (Figure 12).
- In October, headline inflation (HICP) has slowed by two-tenths to 0.7% YoY, due to the moderation of growth in the prices of unprocessed food as well as other less volatile components. Consequently, core inflation also registered a decrease of 0.2pp in October to 0.9% YoY (Figures 13 and 14). The low prices of raw materials, along with the expected moderation in private consumption over the next year will be the main factors responsible for the low inflation on the forecast horizon, and we expect it to average 0.5% in 2015 and 1% in 2016.
- For the fourth quarter, although information is still limited to the confidence data, our MICA-BBVA model suggests that the economy may be growing at about 0.2% QoQ (Figure 2). This stagnation in the second half of the year contrasts with our forecast three months ago of a stable pace of recovery or even some acceleration, so now the growth forecast for 2015 is revised down by about 0.5pp to 1.5%.

- In recent months, the main drivers behind the growth have remained (low commodity prices, accommodative monetary policy[1], absence of fiscal adjustment) and will continue to support it, but there has been a further deterioration of the global environment and a strong increase in political uncertainty nationwide. Therefore, despite a somewhat weaker euro, we expect a slowdown in exports, which in turn will hinder investment decisions in a context of subdued domestic demand and increased uncertainty, which practically explains our downward revision of growth in 2016 (-0.7pp to 1.3%). Low inflation and the improving labour market continue to support household consumption, although more moderately after strong growth this year, as the favourable effects of some of the positive drivers will fade. We expect fiscal policy to remain expansive. As a result, the contribution to growth in domestic demand will moderate to 1.5pp, after the forecast 2.4pp for 2015. Although we now expect further moderation in imports, they will grow more than sales abroad, so that net exports should have a negative contribution on the forecast horizon. Overall, for 2016, we continue to expect the recovery to consolidate at a moderate and relatively stable pace at around 1.6% in annualised quarterly growth but, due to the base effect of weak growth in the second half of this year, it will result in an annual average increase of about 1.3%.
- The general government deficit to September 2015 stood at around 1.8% of GDP (-EUR3.2bn) in the year-to-date, about 0.5pp less than that recorded in the previous year, and 0.9pp below the target set for 2015 as a whole[2]. This is due mainly to increased tax revenues (5.3%), combined with lower spending (-0.9%) due to the base effect of the suspension of cuts in public wages, effective from June 2014 (Figure 14). However, the historical performance of revenues and expenditures in the last months of the year jeopardises not only the official deficit forecast (government: 2.7%), but also the exit from the excessive deficit procedure, as the IMF estimated, which forecast that Portugal will record a deficit of 3.1% of GDP at the end of the year, in line with our expectations (BBVAe: 3.1%). According to our calculations, fiscal policy would have been expansionary in 2015 as the deficit reduction (about -0.6pp) would have responded to the cyclical improvement in the economy (-1.1pp), while the structural deficit would have increased around 0.5pp to 1.8% of GDP.

1: For more information, see Europe Economic Outlook 4Q15
2: It is worth noting that there are revenue and expenditure figures that affect data comparability accumulated by September, as they were produced in different periods in both years.

Portugal

National accounts: activity stagnates in 3Q15

In 3Q15, GDP recorded zero growth, after 0.5% QoQ in 2Q15, mainly due to falling domestic demand, while net exports contributed positively. Our MICA-BBVA model, with very few indicators available for 4Q15, suggests that the economy would advance only marginally (0.2% QoQ).

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

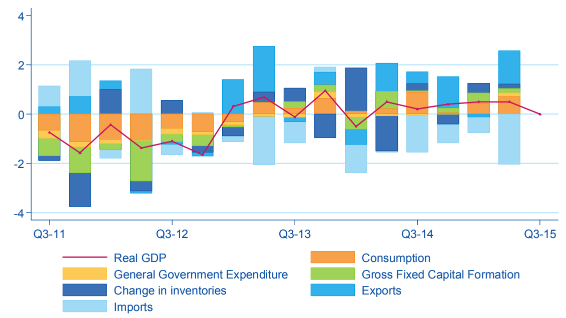
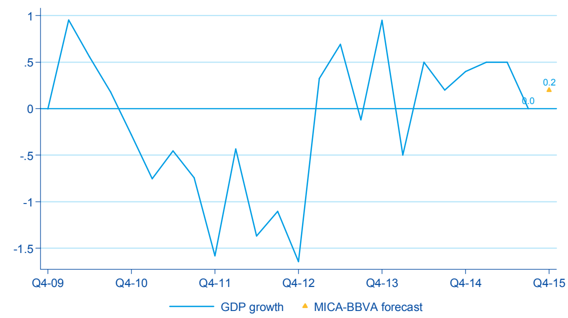


Figure 2
MICA-BBVA: GDP growth and forecasts (%QoQ)*



Confidence: economic sentiment index improved in October

According to ESI, business confidence increased in October after two months of decline, and remains above its historical average. Regarding 3Q15, household and manufacturing confidence improve, while it moderates in the service sector

Figure 3
Confidence (ESI) and coincident activity indicator *

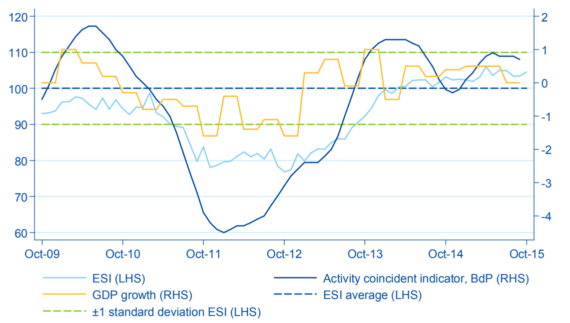
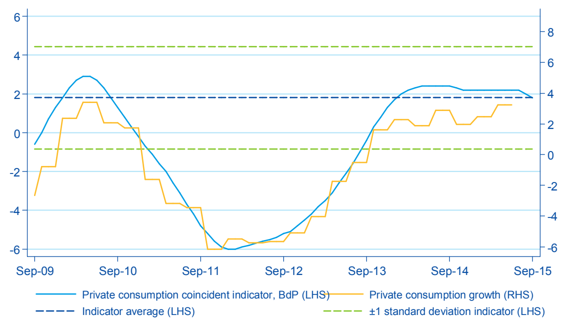


Figure 4
Coincident consumption indicator and private consumption (%YoY)*



Activity: stable industrial production while retail sales rebounded

Industrial production did not increase vs. the average of 2Q15, when it increased by 3% QoQ. Meanwhile, retail trade recorded an increase of 1.6% throughout the third quarter.

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

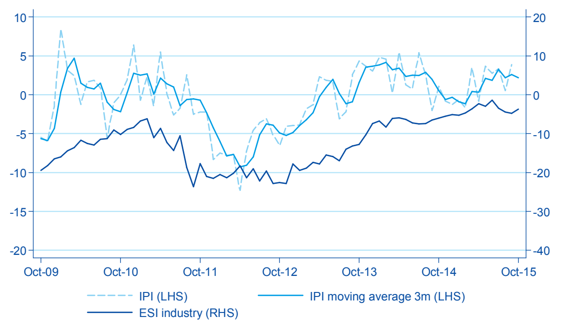
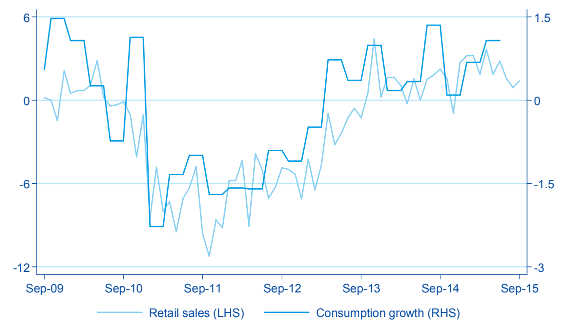


Figure 6
Retail sales (% YoY) and private consumption (%QoQ)*



* Source: HAVER and BBVA Research

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

Despite the improvement in September, exports fell 1% QoQ in 3Q15. On the other hand, imports plummeted (-6%), following the significant increase in 2Q15 (9.3% QoQ).

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

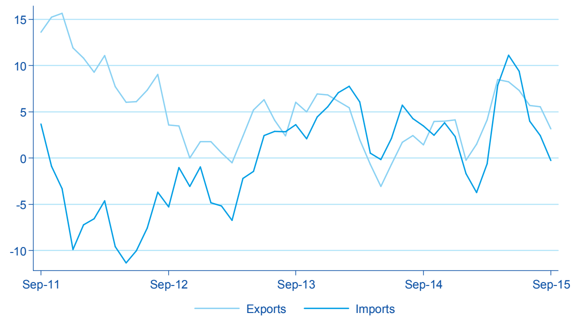


Figure 8
Exports (% YoY) and export orders*

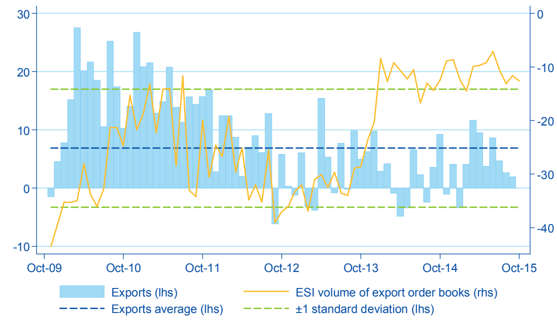


Figure 9
International trade by destination (% YoY, sa)*

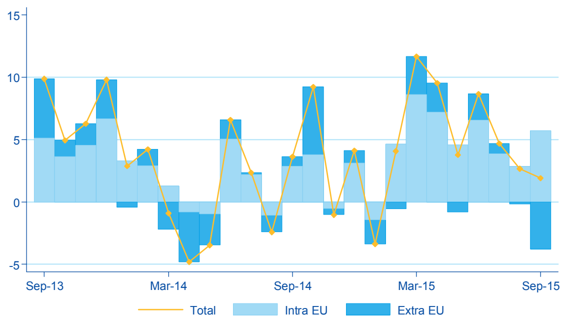
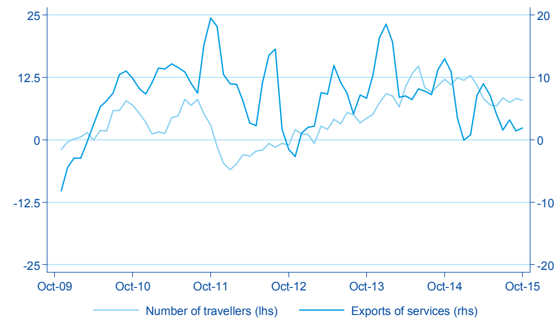


Figure 10
Tourism and services exp. (% YoY, 3p mov. avg.)*



Labour market: reducing unemployment continues

The unemployment rate continued to decline in 3Q15, registering 12.2% in September, thanks to the slight acceleration in job creation (1.7% YoY after 1.5% YoY in 1T15). On the other hand, private wages continued to rise at a slower pace in 2Q15 (2.4% YoY after 4.5% YoY in 1T15).

Figure 11
Unemployment rate (%) and employment expectations*

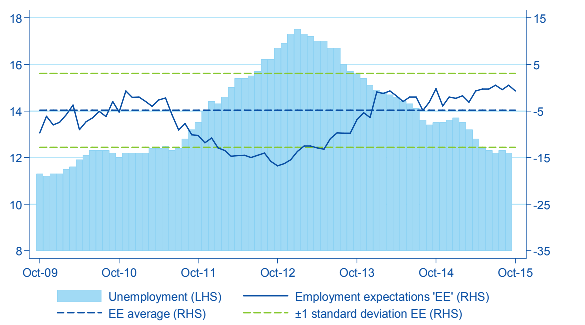
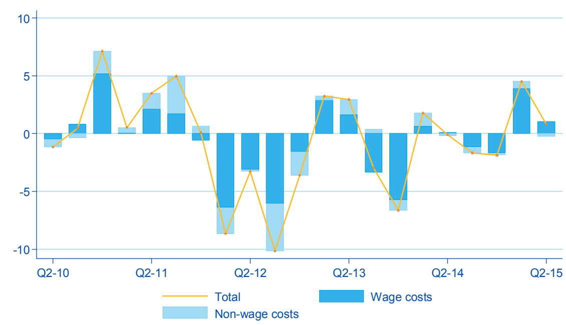


Figure 12
Labour costs in the business sector (% YoY)*



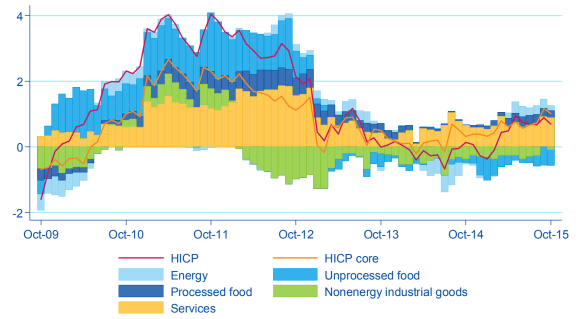
* Sources: HAVER and BBVA Research

Prices: headline and core inflation moderated in October

Headline (HICP) and core inflation slowed their pace of expansion by 0.2pp in October and stood at 0.7% YoY and 0.9% YoY, respectively, due to a moderation in the growth of both unprocessed food prices and other less volatile components.

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

Figure 14
Inflation by component (contribution in %)*



Public sector: deficit could be higher than the government forecast of 2.7%

The expenditure reduced through September and tax revenue increased, but the historical performance of both components at the end of the year jeopardises not only the official forecast (government: 2.7%), but also the exit from the excessive deficit procedure.

Figure 15
Fiscal expenditure (compared to previous year)*

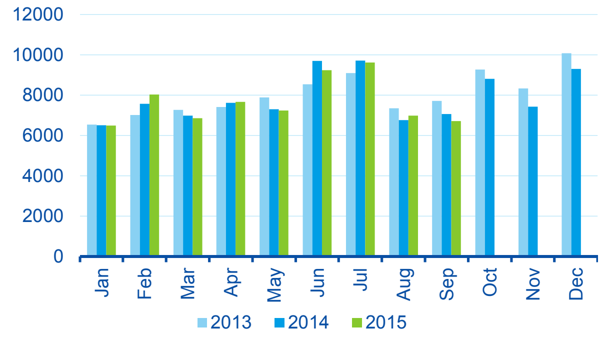


Figure 16
Fiscal revenues (compared to previous year)*

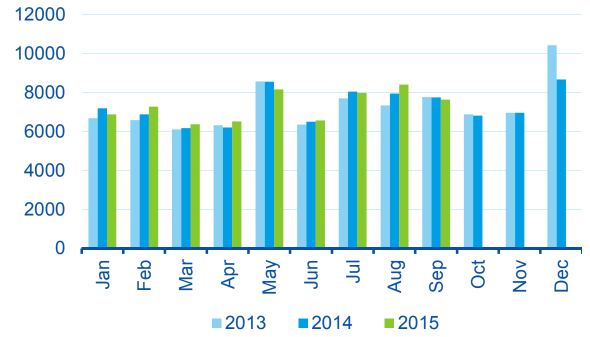


Figure 17
Public and private debt (% of GDP)*

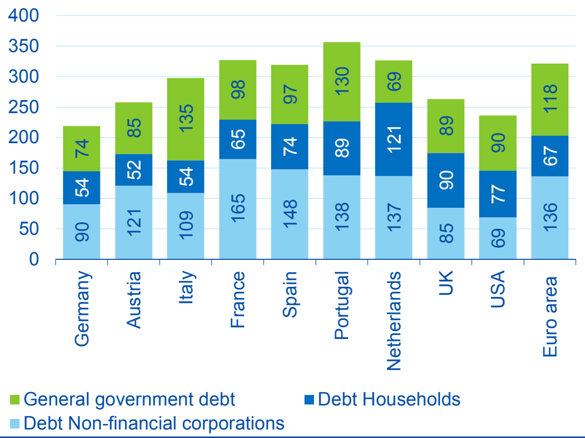
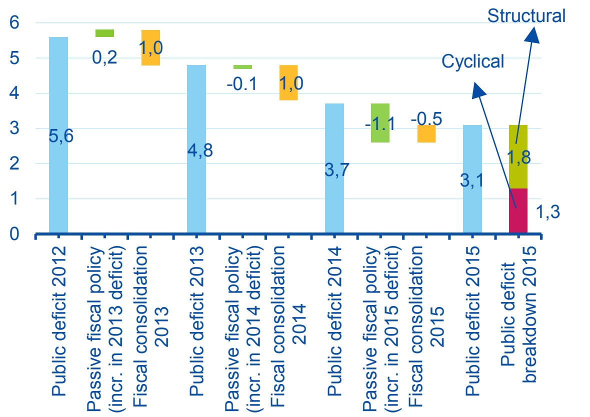


Figure 18
Decomposition of fiscal deficit (cyclical and structural)**



* Sources: HAVER and BBVA Research

** Sources: HAVER, IMF and BBVA Research

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