

ECONOMIC ANALYSIS

Portugal: return to moderate growth at the end of 2015

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In the last stretch of the year, the Portuguese economy was driven more by external than domestic demand. In spite of the resilience of confidence to the global events and the uncertainty linked to the process of forming the new government, domestic demand remains weak pending the revelation of the new government's economic plan.

- Throughout the final quarter of 2015, the confidence data remained relatively stable after the deterioration registered in 3Q15 (Chart 3), in spite of the increased uncertainty, both domestic and due to global factors. The European Commission's sentiment indicator (ESI) remains above its historical average and the levels observed since the end of 2014, and is compatible with a stabilisation of GDP growth around 0.4% QoQ. By sectors, note the improvement in industrial confidence, driven by the increase in export orders, which contrasts with the deterioration in expectations in the services sector.
- The real domestic indicators for the end of 2015 were slightly disappointing, as they reflected a degree of moderation in private consumption. Industrial production showed no sign of improvement and continued to contract (Chart 5), negatively affected by the production of consumer and intermediate goods, although there were positive signals from the recovery in the manufacture of capital goods which, although they appeared to be above all driven by the improvement in export orders, also suggested a better performance by investment. Retail sales fell compared to the 3Q15 average, and point to a moderation in the growth of private consumption. The production and registration of vehicles showed positive signs, as did exports: goods exports returned to slight growth, supported by the increase in industrial orders from abroad (Charts 7 & 8), while imports fell, such that net exports could once again make a positive contribution to growth.
- Altogether, and after the stagnation of activity in the third quarter of 2015, the activity and confidence data suggest that GDP returned to growth in 4Q15, once again sustained by the contribution of net exports and a slightly better evolution of investment, which should offset a certain moderation in private consumption. With the data available to date, our short-term MICA-BBVA model estimates growth of around 0.4% QoQ in the fourth quarter (Chart 2), consistent with our forecast of 1.5% for 2015 as a whole.
- The unemployment rate (which saw its downward trend interrupted in 1Q15 after seven quarters of decline), decreased again in 2Q15 and appears to have stabilised since April, registering 12.4% in November, 1.1pp less than 12 months earlier (Chart 11). Job-creation moderated in 3Q15 (0.4% YoY vs. 1.9% YoY in 2Q15), increasing less than observed in the six previous quarters, although the data available to November indicate that it could have started to accelerate again in 4Q15 (1.3% vs. 3Q15). Meanwhile, labour costs in the private sector accelerated (2.5% YoY in 3Q15 vs. 2.3% YoY), especially the wage component (2.7% YoY, the same as in the previous quarter), while in the public sector labour costs fell 9.1% YoY (Chart 12).

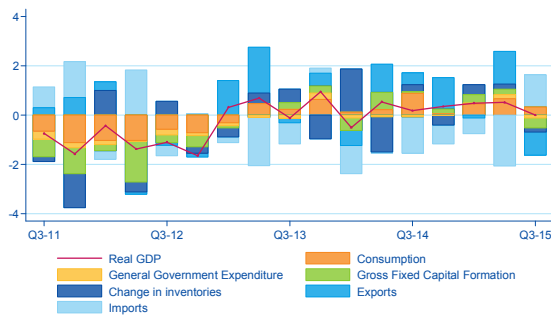
- In December, harmonised general inflation (IPCA) surprised to the downside by decelerating more than expected (by 0.3pp to 0.3% YoY), due to the moderation in the core components (0.4% YoY vs. 0.9% YoY) as a consequence of the lower transport costs (which explained -0.5pp of the reduction) and the fall in maintenance and repair prices (which explained the remaining 0.3pp). The milder decline in energy prices (-1.5% YoY vs. -3.4%) partially offset the above, although the continuing slide in these prices could be behind the fall in transport prices (Charts 13 & 14).
- The cumulative annual Public Administration deficit to November 2015 stood at around 2.7% of GDP (-EUR4.8bn), one point less than registered in the first 11 months of 2014 and in line with the official objective for 2015 as a whole. This was, above all, due to the increase in fiscal revenues (5.2%), combined with a decrease in expenditure (-1.9%) which was due to the base effect of the cuts in public-sector wages, effective since June 2014 (Chart 18). Nonetheless, the historical performance of revenues and expenditure in the month of December poses a threat not only to the official deficit forecasts (2.7% of GDP), but also to the exit from the excessive deficit procedure. According to the IMF, Portugal will register a deficit of 3.2% of GDP at year-end, in line with our October forecast (3.1%).

Portugal

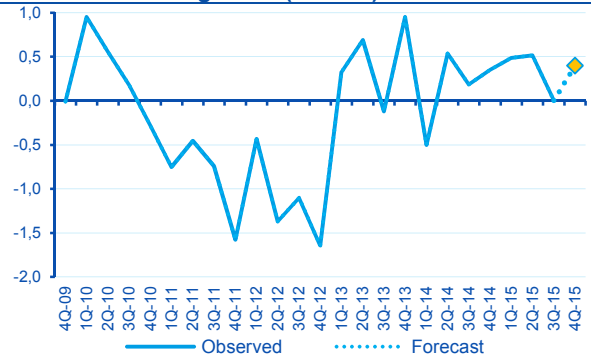
National accounts: stagnant activity in 3Q15

In 3Q15, GDP posted flat growth after the 0.5% QoQ of 2Q15, which was principally due to the decline in domestic demand, while net exports made a positive contribution. Our MICA-BBVA model indicates that the economy expanded by around 0.4% QoQ in 4Q15.

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



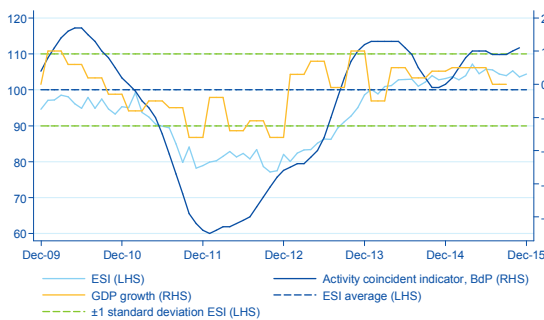
**Chart 2
MICA-BBVA: GDP growth (% QoQ) and forecasts ***



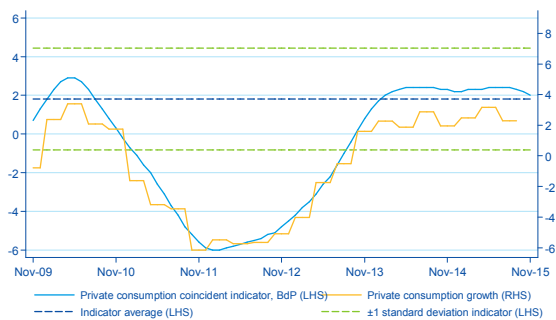
Confidence: the economic sentiment indicator stable in 4Q15

According to the ESI, business confidence remained practically stable and above its historical average in 4Q15. By components, manufacturing confidence improved, while consumer and services confidence both deteriorated.

**Chart 3
Confidence (ESI) and coincident activity indicator ***



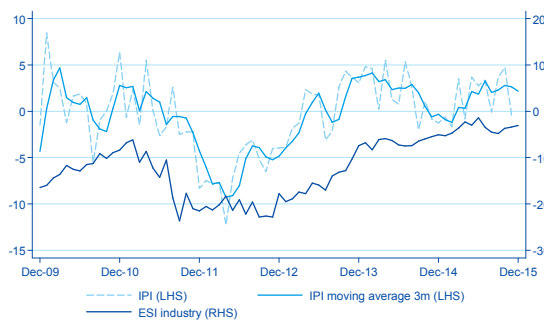
**Chart 4
Coincident consumption indicator and private consumption (% YoY)***



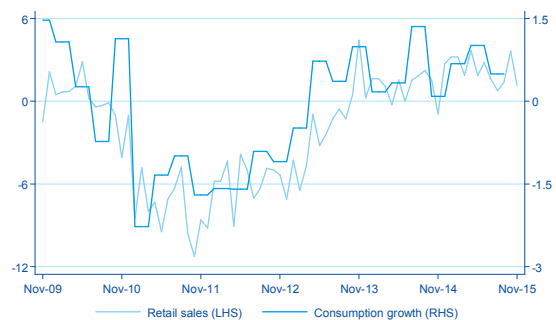
Activity: industrial production moderates and retail sales contract

Industrial activity declined sharply in November, and remains below the 3Q15 average, when it fell 0.2% QoQ. Meanwhile, retail trade decreased by 1.4% MoM in November and by 0.8% vs. the 3Q15 average.

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



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



* Source: HAVER and BBVA Research

External sector: exports rising again in 4Q15 to date

The deceleration in global demand resulted in a fall in exports in 3Q15, but to November the trend in sales abroad could have reversed, registering an increase of 0.5% vs. the previous quarter. Imports fell.

Chart 7
Exports and imports (% YoY, MM3p)*



Chart 8
Exports (% YoY) and export orders*

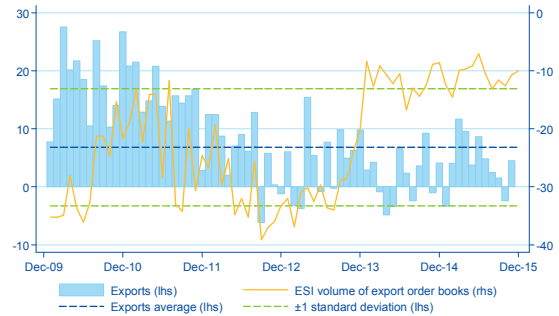


Chart 9
International trade by destination (% YoY, sa)*

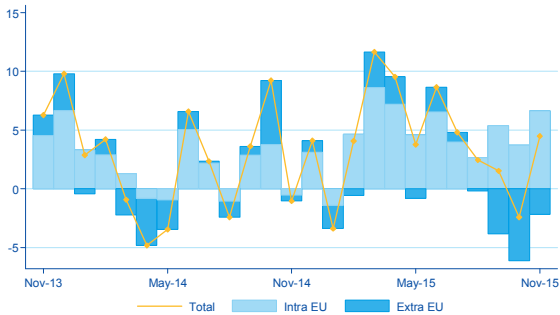
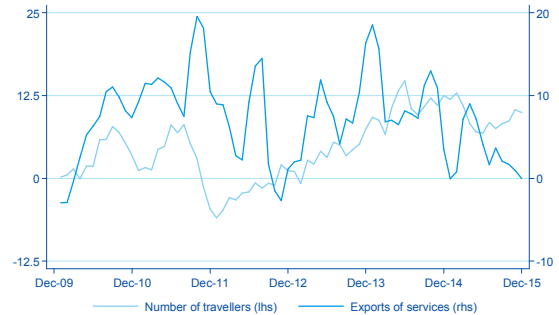


Chart 10
Tourism and services exports (% YoY, MM3p)*



Labour market: the unemployment rate remained stable at the end of the year

After the notable drop in unemployment at the beginning of 2015, unemployment remained stable at 12.4% in November. Job-creation moderated (0.4% YoY in 3Q15, 1.9% YoY) and private-sector wages increased at a steady rate (2.7% YoY in 3Q15).

Chart 11
Unemployment rate (%) and employment expectations*

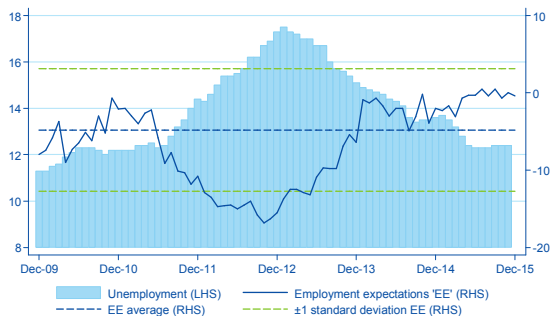
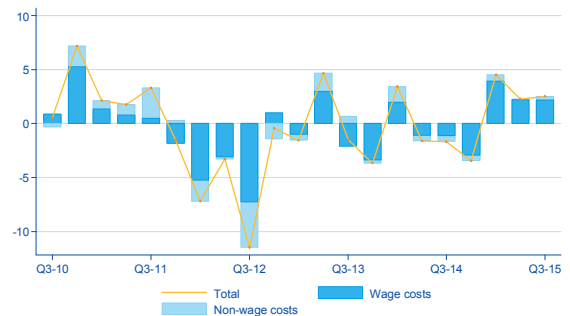


Chart 12
Labour costs in the business sector (% YoY)*



* Sources: HAVER and BBVA Research

Prices: general and core inflation fell in December

Headline inflation decelerated by 0.3pp in December to 0.3% YoY, principally due to the moderation in services prices. Core inflation moderated by 0.5pp to 0.4% YoY.

Chart 13
Inflation: general and core (% YoY)*

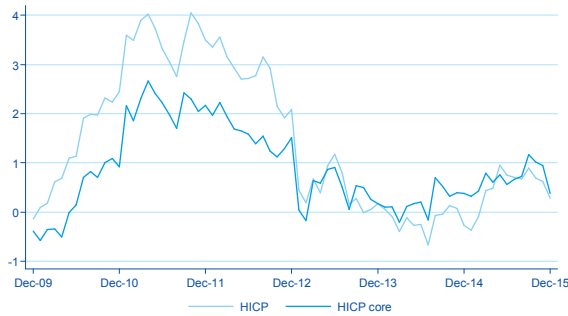
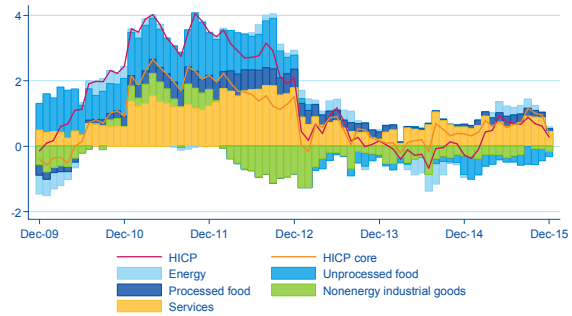


Chart 14
Inflation by components (contribution in %)



Public sector: the cumulative deficit to November puts meeting the target at risk

Between January and November, the reduction in taxes and the increase in revenues were fairly in line with the budget figures, such that in December, historically a higher expenditure month, the 2.7% of GDP target was under threat.

Chart 15
Fiscal expenditure (comparison with previous year)*

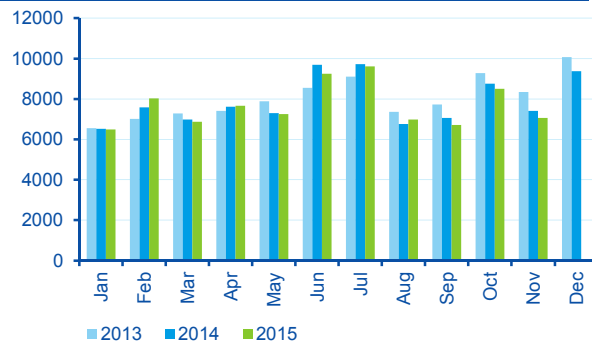


Chart 16
Fiscal revenues (comparison with previous year)*

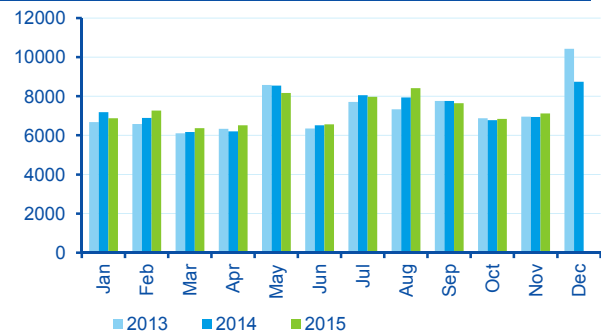


Chart 17
Public and private debt (% of GDP)*

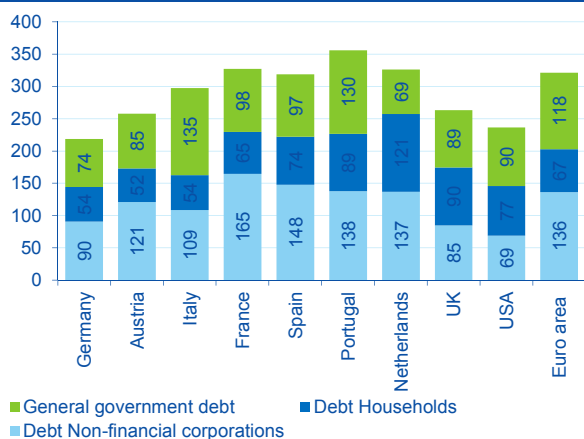
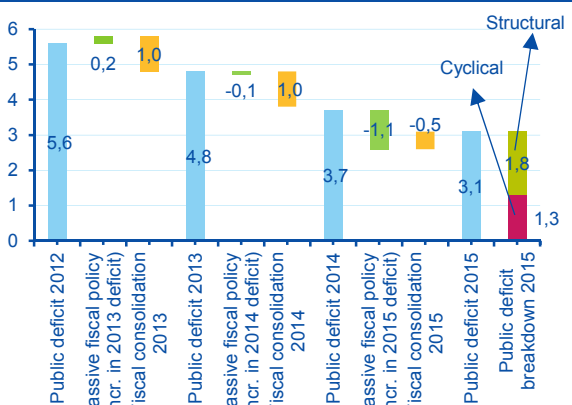


Chart 18
Breakdown of fiscal deficit (cyclical and structural)*



* Sources: HAVER and BBVA Research

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