

ECONOMIC ANALYSIS

Portugal: reduced activity and uncertainty in the first half give a downward bias to growth forecasts for 2016 and 2017

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The Portuguese economy grew by 0.2% QoQ in 1Q16 (BBVA Research: 0.3%) supported by the strong increase in consumer consumption, while investment and net external demand reduced the activity's dynamism. Data for the second quarter suggest that growth should have stabilized at around 0.2% QoQ, although composed differently from 1Q16. So while consumer indicators (retail sales) may be pointing to a correction to the strong dynamism observed in 1Q16, those indicators associated with external demand (industrial production, exports of goods) have bounced back after the poor performance of previous months.

This stable but moderate rate of recovery during 1H16 is a negative contrast to the slight trend towards acceleration that was expected for the Portuguese economy. This, coupled with increased uncertainty – partly associated with the result of the vote on the UK remaining in the European Union (“Brexit”) – introduce a negative bias to the growth forecast for both 2016 (1.4%) and 2017 (1.6%).

Main economic indicators

National accounts: growth stabilizes at around 0.2% QoQ in 1Q16 and 2Q16

GDP grew by 0.2% QoQ in the first quarter of 2016, slightly lower than expected (0.3% QoQ). In YoY terms, however, there was a slight slowdown of one tenth to 0.9% YoY. Economic activity rested entirely on the dynamism of domestic demand during the first quarter of 2016, which exceeded expectations. In return, net external demand fell more than expected. Strong consumer dynamism more than offset the decline in investment and exports. Moreover, an acceleration of public consumption was recorded in 1Q16. The MICA-BBVA model estimates GDP growth of 0.2% QoQ in 2Q16.

Figure 1
GDP (% QoQ) and input by component (p.p.)*

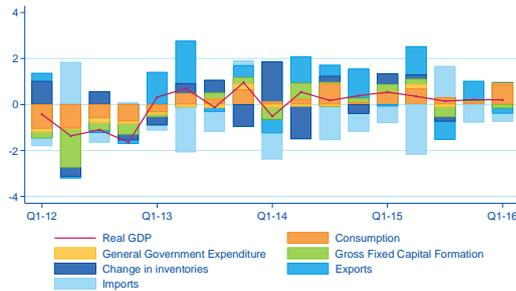


Figure 2
MICA-BBVA: Growth of GDP (% QoQ)* and forecasts¹



Activity: industrial production increases, supported by orders from abroad

According to the ESI indicator, business confidence in both service and industry remained stable in 1Q16, above its historical average. By contrast, industrial production recovered in 2H16, after declining since mid-2015, supported by improved orders from abroad and pointing to an increase in investment.

Figure 3
Confidence (ESI) and coincident indicator of activity*



Figure 4
Industrial production (% YoY) and industrial confidence*



Activity: Retail sales fell in 2Q16

Retail trade contracted in 2Q16 (according to data up to May), following the sharp increase of 1Q16, which suggests that the rebound in consumer consumption of earlier this year is not sustainable.

Figure 5
Coincident indicator of consumption & private cons. (% YoY)*

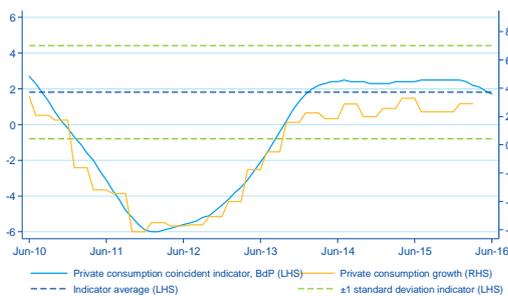
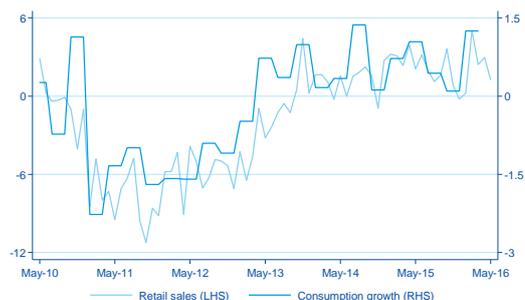


Figure 6
Retail sales (% YoY) and private consumption (% QoQ)*



* Sources: HAVER and BBVA Research

1: For more information, see Economic Outlook Europe, First Quarter 2012, available at: https://www.bbva.com/wp-content/uploads/migrados/1202_Europeeconomicoutlook_tcm348-286975.pdf

Export sector: exports of goods increase again in monthly terms

The trade balance data until May show that exports are falling more steeply year on year owing to the sharp increase in foreign sales of the previous year. However, the quarterly evolution (corrected for seasonal variations) is positive, sending optimistic signals about the recovery of the export sector. On the other hand, services exports continue to fall as a result of poor performance of passenger numbers up to May, pending the possible impact of "Brexit" or market developments on direct competitors. Overall, it is expected that the net export sector will reduce its negative contribution, which may even be neutralized.

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

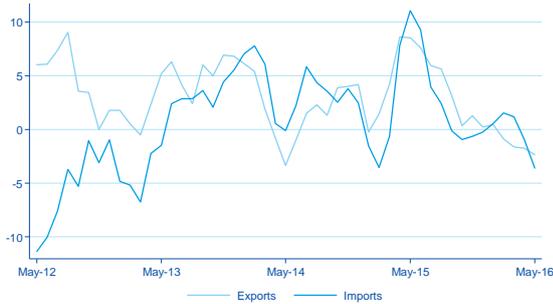


Figure 8
Exports (% YoY) and export orders*

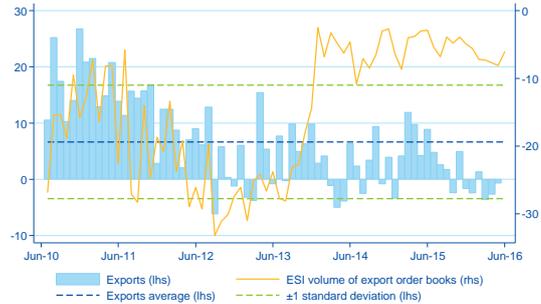


Figure 9
International trade by destination (% YoY, sa)*

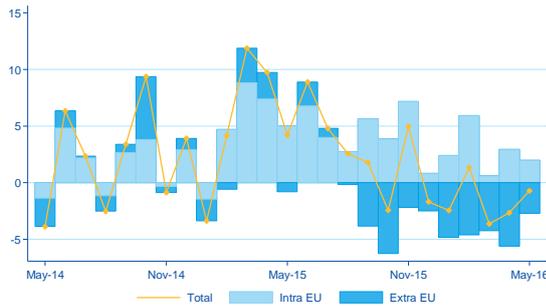
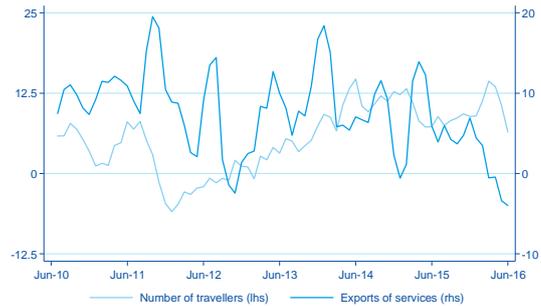


Figure 10
Tourism and export of services (% YoY, MM3p)*



Labour market: weak job creation slows the pace of improvement

The unemployment rate fell by 0.1 percentage points in 1Q16 to 12.1%. Behind this slight decrease it can be observed that the working population has decreased more than employment. Moreover, employment expectations continued to decrease their pace and virtually stagnated in June. As a result of the evolution of employment, in 1Q16 labour costs fell for first time in 5 quarters, generating gains in competitiveness that may extend to the second quarter.

Figure 11
Unemployment rate (%) and employment expectations*

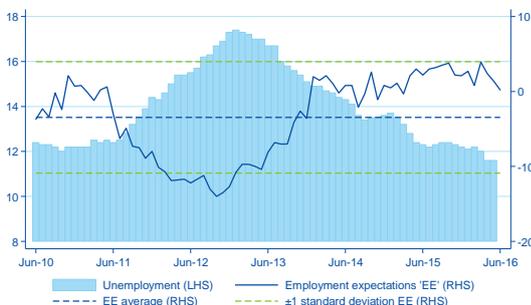


Figure 12
Labour costs in the business sector (% YoY)*



* Sources: HAVER and BBVA Research

Prices: general and core inflation increased in 2Q16, although it remains at very low levels

Harmonized consumer inflation (HICP) continued to grow in the second quarter of 2016 to 0.7% in June, owing to higher growth of the core component, which stood at 1.0%. Behind the growth is the increase in service sector prices, which more than offset the fall in unprocessed food.

Figure 13
Headline and core inflation (% YoY)

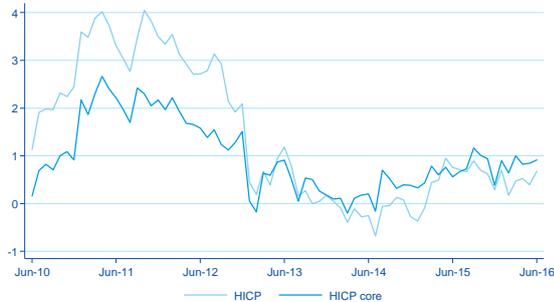
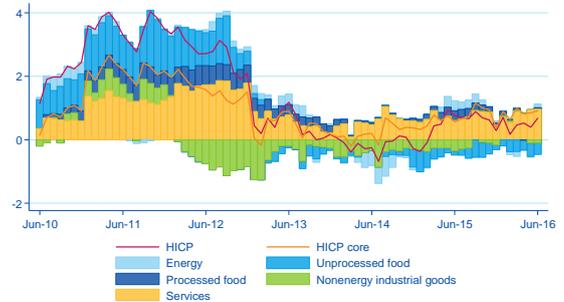


Figure 14
Inflation by components (inputs in %)*



Public sector: default risk increased because of a lower-than-expected cyclical upturn

The Stability Programme includes a fiscal adjustment plan which, combined with the cyclical improvement in the economy and the one-off effects for this year (estimated at 0.2 percentage points of GDP) would place the deficit at 2.3% of GDP in 2016. However, both the forecasts of the European Commission (-2.8%²) and BBVA Research (-2.8%) are somewhat more pessimistic because they foresee a somewhat weaker recovery in revenue.

Figure 15
Tax expenditures (comparison previous year)*

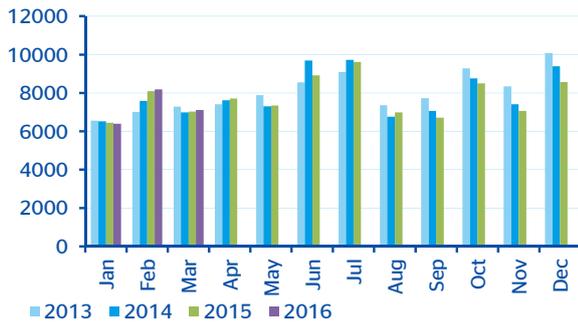


Figure 16
Tax revenue (comparison previous year)*

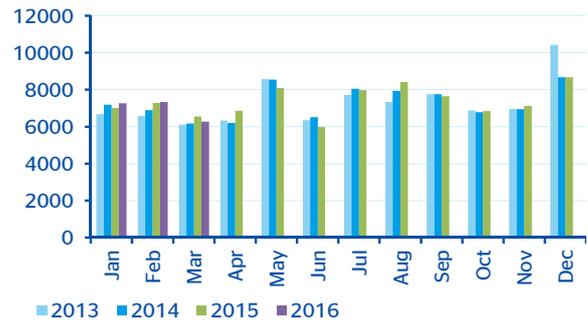


Figure 17
Public and private debt (% of GDP)*

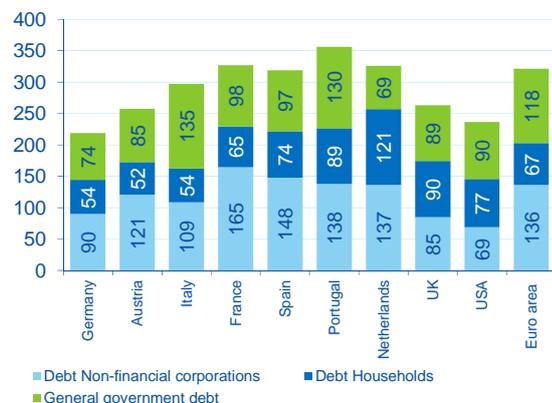
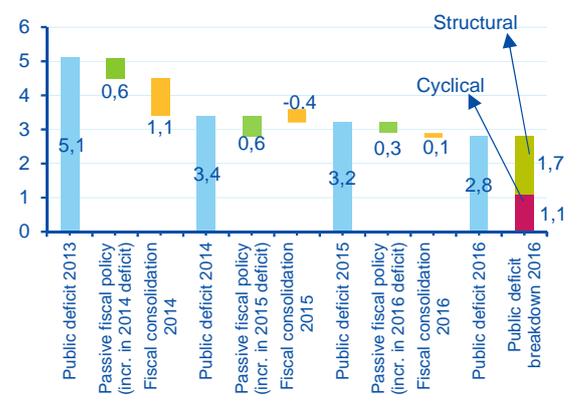


Figure 18
Breakdown of fiscal deficit (cyclical and structural)**



* Sources: HAVER and BBVA Research

2: For more information see http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2016/22_pt_scp_en.pdf

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