

ECONOMIC ANALYSIS

Portugal: surprise increase in 3Q GDP growth to 0.8% QoQ

Myriam Montañez

The Portuguese economy grew by 0.8% QoQ in 3Q16, considerably more than expected (0.3% QoQ). In contrast with previous quarters, domestic demand contributed negatively to growth (-0.4 pp), while the external sector did so positively, by 1.3 pp, due to the strong increase in exports and an unexpected fall in imports. Initial data available for 4Q16 seem to indicate that the acceleration seen in 3Q was temporary and that growth will return to a somewhat lower rate of around 0.4% QoQ. This, together with the better-than-forecast 3Q performance, points to growth for the whole year 2016 exceeding 1.0% YoY (which is the current BBVA Research forecast) and adds a positive tilt to GDP growth in 2017 (1.3% YoY). Despite this, Portugal's economic growth continues to be constrained by the as yet incipient recovery of the external sector, domestic uncertainties and above all the weakness of investment.

Household consumption continues to recover, while private sector investment is still weak

Domestic demand contributed negatively to growth (-0.4 pp QoQ, SWDA¹), following the positive contribution of 0.6 pp in the previous quarter. Despite this, private consumption recovered pace in the third quarter, to 0.5% QoQ (compared with -0.1% QoQ in 2Q) (see Figure 1). Investment continues to be the weakest component of the economy, falling by 1% QoQ, following the weak growth already seen in the previous quarter (0.3% QoQ) and draining 0.2 pp from growth in 3Q16. The only investment heading showing slight improvement was machinery, equipment and weapon systems. This is in line with the trend in new lending to businesses, which continued to fall in 3Q16 relative to the same period of 2015 (by 8% for new corporate loans of less than €1 million and by 25% for those of more than this amount). The other component contributing negatively to growth was public consumption, which went from positive growth in 2Q (0.4% QoQ) to negative in 3Q (-0.6% QoQ), shaving 0.1 pp off quarterly GDP growth. All the same, according to budgetary execution figures, the cumulative deficit for the past 12 months based on data to October was 2.3% of GDP, representing a reduction of 0.3 pp from the deficit in 2015 (see Figures 5 and 6).

The external sector contributed to growth thanks to the good performance of exports and an unexpected fall in imports

Net external demand also contributed positively to growth (1.3 pp QoQ), following the negative contribution of the first and second quarters of the year (-0.4 pp QoQ), thanks to a recovery in exports (up by 2.5% QoQ, with a positive contribution of 1.1 pp to GDP growth) and the fall in imports (down by 0.4%, with a positive contribution of 0.2 pp to GDP growth).

The rate of job creation picked up, albeit with some caveats

The data published for 3Q16 were the best for several quarters. Specifically, after growing at an average quarterly rate of 0.1% in the first half of the year, the total number of people in employment increased by 0.8% QoQ in the third quarter to more than 4.6 million, a figure not seen since the beginning of 2012. Public

¹ Seasonally and working days adjusted (SWDA) data. All quarterly (QoQ) and monthly (MoM) changes in this document are calculated on the basis of SWDA data.

services and ICT-related services made the biggest contributions to this growth. Despite this, the monthly data show a declining trend over the course of the quarter.

4Q16: growth could return to around 0.4% QoQ

With just over 30% of the information for 4Q16 available, **the MICA-BBVA model estimates that Portugal's quarterly GDP growth could return to around 0.4%, as the combined result of the continuing dynamism of private consumption and a reduced contribution to growth from the external sector.**

This is based in part on the dynamism continuing to be shown by such consumption indicators as are available for the last quarter of the year, such as **retail sales, which grew again in October** (by 1.2% MoM). Apart from this, industry seems to be showing incipient recovery, reflected in recent trends in the **Industrial Confidence Indicator** prepared by the European Commission and in the **Industrial Production Index (IPI), which rose by 1.4% MoM in October, following the slowdown seen in the past few months.**

This ties in with the **Activity Coincident Indicator² published by Portugal's central bank, which improved again in October** (by 0.9% YoY, following average annual growth rates of 0.7% from June to September) and the **Economic Sentiment Indicator (ESI)** published by the European Commission, which showed month-on-month growth in both October and November (1.7% and 0.5% respectively).

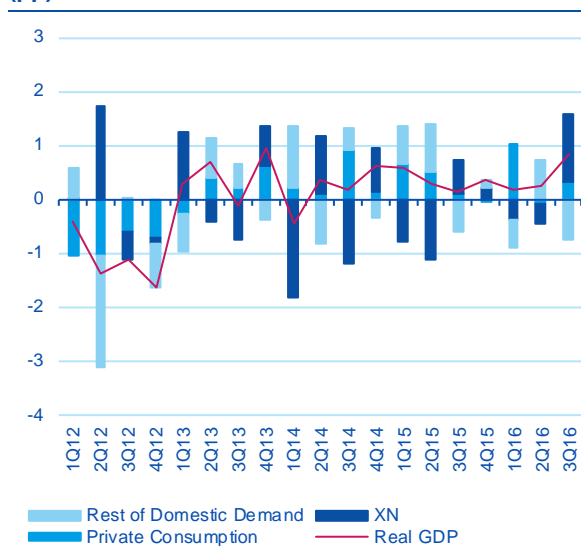
As for external trade, following the strong growth observed in 3Q, available data for October point to a **slower rate of growth in exports** (in fact, in October nominal exports of goods fell by 2.7% MoM, following the average increase of 1.2% MoM from July to September). **Nominal imports of goods have continued to fall and in October they have again shown a reduction of 0.2% MoM (-0.2% MoM on average in the third quarter).**

Lastly, **despite the positive quarterly growth rate in employment in 3Q, the monthly data show that since July the total number of people in employment has barely changed** (see Figure 8). This trend continued in October, when the number of people in employment increase by barely 2,000 (0.0% MoM).

² Indicator published by Banco de Portugal, summarising the most significant information on the country's economic activity.

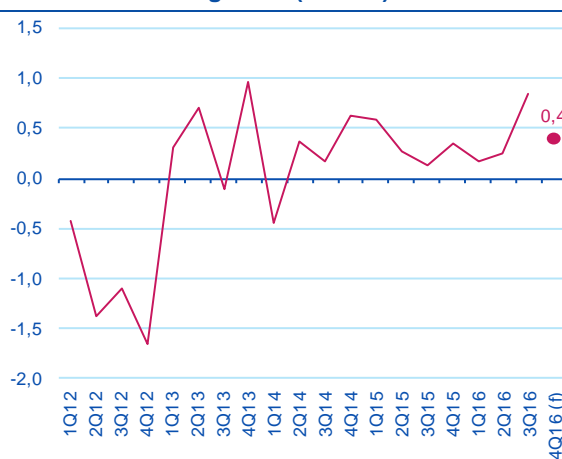
Main indicators of activity

Figure 1
GDP (% QoQ) and contributions by component (pp)



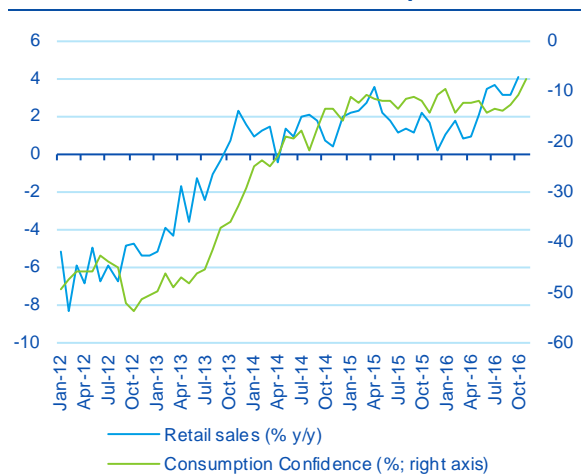
Source: BBVA Research based on INE and BdP.

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



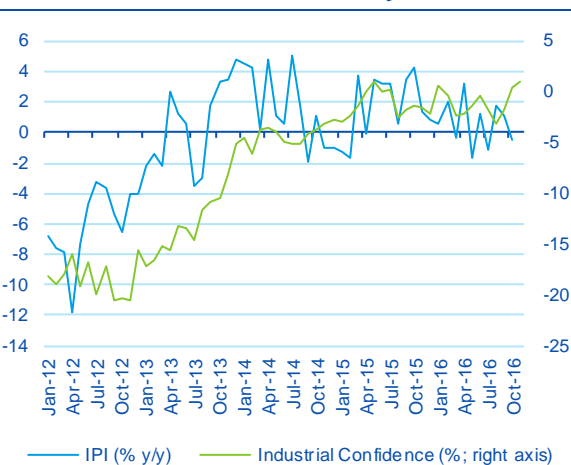
Source: BBVA Research based on INE and BdP.

Figure 3
Indicators associated with consumption



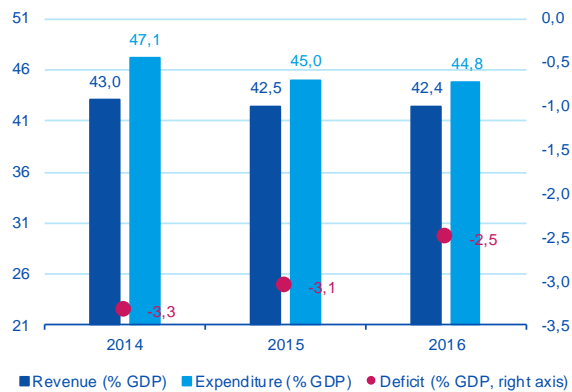
Source: BBVA Research based on INE and BdP.

Figure 4
Indicators associated with industry



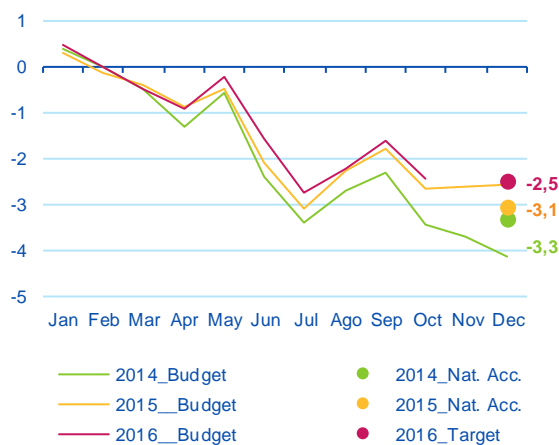
Source: BBVA Research based on INE and BdP.

Figure 5
Budgetary Execution (2016: accumulated 12 months with data to October). Not including injections to the financial sector.



Source: BBVA Research based on INE and BdP.

Figure 6
Fiscal Deficit: Budgetary execution and National Accounts (% GDP, Not including injections to the financial sector.)



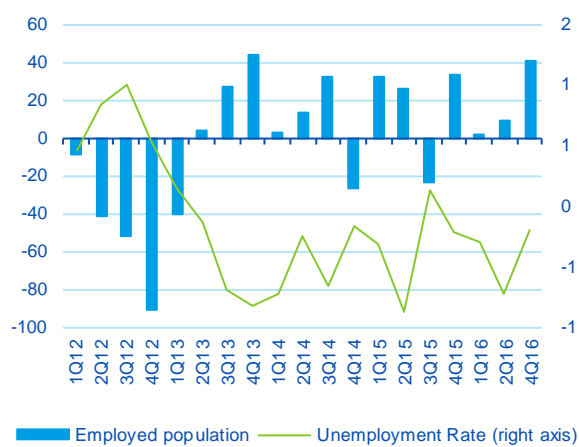
Source: BBVA Research based on INE and BdP.

Figure 7
Indicators associated with the external sector (% YoY)



Source: BBVA Research based on INE and BdP.

Figure 8
Population employed (quarterly change in thousands of persons) and unemployment rate (%)



Source: BBVA Research based on INE and BdP.

DISCLAIMER

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.