Economic Watch

Portugal | Growth outlook for the two-year period revised down

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After Portuguese GDP grew at an average rate of 2 .1% YoY during 2018, BBVA Research forecasts that its growth rate will moderate to around 1.5% in 2019 (3 pp less than the previous forecast). This scenario is in a context of a slowing global economy, particularly in Europe, together with the presence of still numerous risks. Even so, the recovery will continue, supported by positive momentum in domestic demand, which will enable GDP to rise by 0.3% in the first quarter of this year, as well as a gradual recovery of external demand.

The slowdown of the economy in 2018 has been confirmed

As forecast by BBVA Research[1], Portugal's economy grew by 2.1% YoY last year (7 pp less than in 2017), bringing the number of consecutive years of growth to five, but reversing the acceleration trend observed since the recovery began. **GDP growth in 2018 was once again supported by domestic demand**, in particular by the increase in household consumption and to a lesser degree by the increase in investment, both public and private, and consumption by public administrations. By contrast, external demand made a negative contribution to growth, because of the slowdown in exports of goods and services compared to imports.

Domestic demand lost momentum due to less investment

Growth in Portuguese GDP in 2018 continued to be strongly backed up by domestic demand, which contributed +2.8 percentage points to growth. Nevertheless, it was 3 pp below the contribution posted in 2017 because of lower dynamism in private investment.

Portuguese household consumption grew by 2.6% YoY in 2018 (0.2 pp more than in 2017). Performance in nondurable consumer goods remained favorable, growing 2 pp above the figure for 2017, by 2.4% YoY. However, the **slowdown in spending growth on durable goods** continued, rising by +5.0% YoY (1.1 pp less than in 2017), coming after average annual growth rates of 14.8% between 2014 and 2016. This could be a sign that domestic demand, pent up at the beginning of the economic recovery, is becoming fully absorbed.

Meanwhile, **public spending went up by 0.8% YoY** (0.6 pp more than in 2017). Linked to this, according to provisional results published by the National Statistics Institute, the central government managed to increase revenues by 5.5% in 2018, mainly by improving its current account revenues, while also succeeding in cutting total spending by 0.3%, reducing both capital and current account expenditure. So, in 2018 as a whole, **the Portuguese government succeeded in reducing its deficit to 0.5% of GDP** (2.5 pp less than in 2017 and 10.7 pp less than at its maximum in 2010), the smallest imbalance in the public accounts since 1995.

Finally, investment was the only component of domestic demand where growth weakened in 2018, recording +5.6% YoY compared to +9.2% YoY in 2017. The slowdown was generalized, except for intellectual property products and inventory variations. Performance softened over the year as a whole, with average quarterly growth rates of 1.5% QoQ in 1H18 and 0.1% QoQ in 2H18. The slowdown was particularly visible in machinery and equipment investment, as well as in transport material (around 7 pp lower growth in both compared to 2017), and to a lesser degree in construction sector investment (5 pp lower than in 2017).

1 See the previous issue of this Economic Watch, available at:
https://www.bbvaresearch.com/wp-content/uploads/2019/01/Portugal_Economic_Watch_4Q18-1.pdf

Lower growth in exports, especially services, shrank the contribution made by the external sector in 2018

Last year, exports of goods and services and imports grew by around half as much in real terms as in 2017 (+3.7% YoY and 4.9% YoY respectively in 2018). The slowdown was particularly noticeable in the exchange of services (−7 pp in the case of exports and −4 pp in imports, compared to the expansion in 2017).

Growth in sales abroad of vehicles, airplanes and other transport equipment (+24.5% YoY in nominal terms) **was not enough** to offset stagnation in exports of other important sectors such as machinery, electronic goods and textiles. By geographical destination, there was an overall reduction in the growth of sales of Portuguese goods to countries in the European Union (3 pp less than in 2017), and sales to non-European countries contracted more sharply (18 pp less than in 2017).

The tourism sector was more sluggish in 2018 too, probably because of the slowdown in economic growth in the main source markets for tourists, as well as the improved competitiveness of some competing countries, which began to recover their visitor flows. So, the numbers of travelers entering grew by 3.8% YoY, a quarter of the growth rate in the previous four years. This performance was borne out in overnight hotel stays, which crept up by just 1.7% (+10% YoY in 2017). **The growth in hotel stays by foreign visitors, who account for around 70% of the total, was practically stagnant** (+0.1% YoY compared to +11.7% YoY in 2017), affected by the drop in tourists from the United Kingdom (-7% YoY), Germany (-2% YoY) and France (-1% YoY), three of Portugal's most important source markets. Overnight hotel stays by locals, however, grew by +5.8% YoY (against +7.1% in 2017).

The unemployment rate was 7% last year, 1.2 pp below the eurozone average

Portugal continued to create jobs during 2018, although at a more moderate rate: +2.4% YoY versus +3.3% YoY in 2017 and the unemployment rate fell again, down to 7.0%, a 2 pp reduction compared to the jobless rate in 2017, putting it at just 3 pp above the minimum reached in 2000. The services sector contributed most to job growth last year (+1.9 pp) followed by the manufacturing industrial sector (+0.7 pp). At the opposite extreme, job creation in construction contracted by −0.2% YoY, having expanded by 6.1% YoY in 2017, even though the sector looked dynamic during 2018: construction permits grew 18.6% YoY, housing sales remained buoyant, +16.6% YoY, and price index growth again accelerated, reaching double digits, at +10.3% YoY.

So, around 112 thousand new jobs were created in 2018, according to figures from the Portuguese Statistics Institute.

Looking ahead, the Portuguese economy is expected to grow, but at a more moderate rate

Based on the most recent data, BBVA Research forecasts that the Portuguese economy's average quarter on quarter growth rate in the first quarter of 2019 will be around 0.3% QoQ swda[2] (see Figure 1).

The signals given by spending and labor market indicators for 2019 suggest that private spending will expand at the same rate during 1Q19. Retail sales continued growing in January and February (by an average +4.9% YoY) after the uptick in the last quarter of 2018, even though the negative trend of the consumer confidence index accelerated and consumer credit has been falling since November 2018. Although job growth in year-on-year terms is slowing, it continued to rise in January and February (by an average of +1.4% YoY).

In terms of investment, although the machinery and equipment index recovered in January (+5.4% YoY) after year-on-year falls in November and December the previous year, in February it fell back by 0.3% YoY. So, slower momentum in manufacturing industry investment continues, compared to the average year-on-year growth rates since the beginning of the recovery (+15.2% in 2016, +16.1% in 2017 and +9.2% in 2018). In any event, doubts remain as to whether investment strength will continue, and industrial confidence has been negative since September 2018 (see Figure 4).

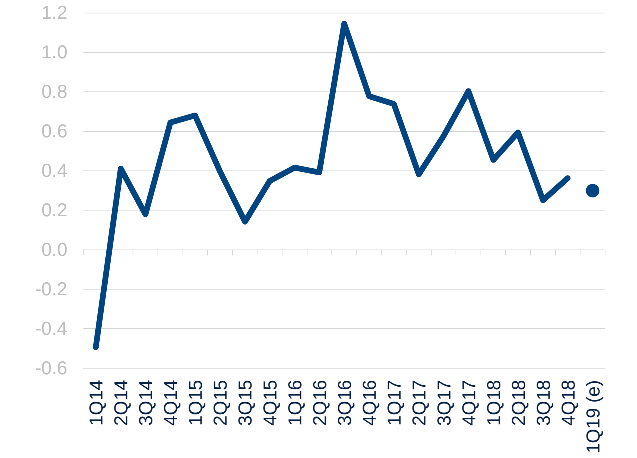
The outlook for residential investment remains optimistic. Figures for January show an increase in housing permits of +42.5% YoY, after the stagnation in December 2018, although the confidence indicator for the construction sector is not rising (see Figure 5). Consistent with the momentum in the residential market, housing mortgages grew again in January +17.8% YoY (+10.3% YoY Dec 2018). However, other credit is performing less positively. Corporate loans are slowing; especially those above the EUR 1 million mark, which fell by 41.9% YoY in January 2019 (see Figure 6).

Turning to the foreign sector, nominal exports of goods continued to grow in year-on-year terms during the first two months of the year at +4.4% YoY on average, while the growth of imports accelerated, at an average of +14.7% YoY (see Figure 7). In SWDA month-on-month terms, however, sales abroad have stagnated. By territory, there was a recovery in the sale of goods within the European Union, particularly after the fall at the end of 2018, whereas the stagnation in sales to other destinations continued. The positive performance of the tourism sector at the end of 2018, meanwhile, continued. Entries by tourists increased by 7.1% YoY in January, and overnight hotel stays by 4.7% YoY.

2: Seasonally and working-day adjusted data (SWDA).

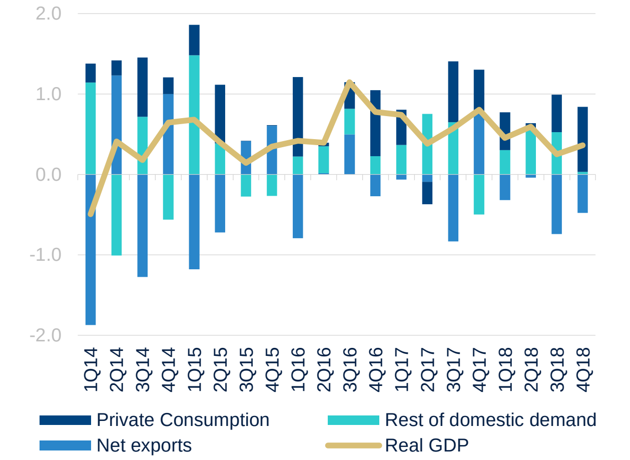
Key activity indicators

Figure 1 MICA-BBVA: GDP growth (% QoQ) and forecasts



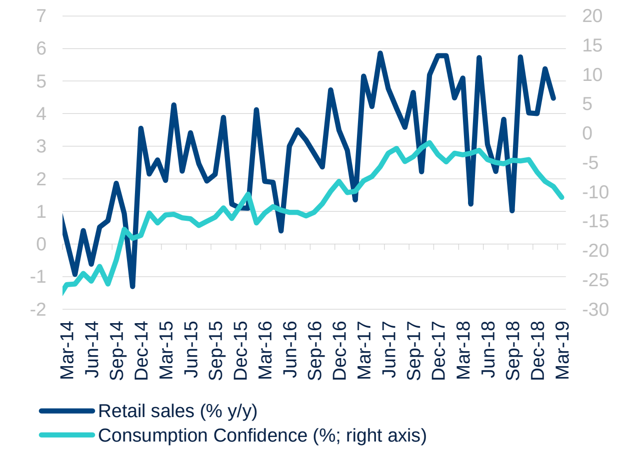
Source: BBVA Research, based on the National Statistics Institute (INE)

Figure 2 GDP (% QoQ) and contribution by components (pp)



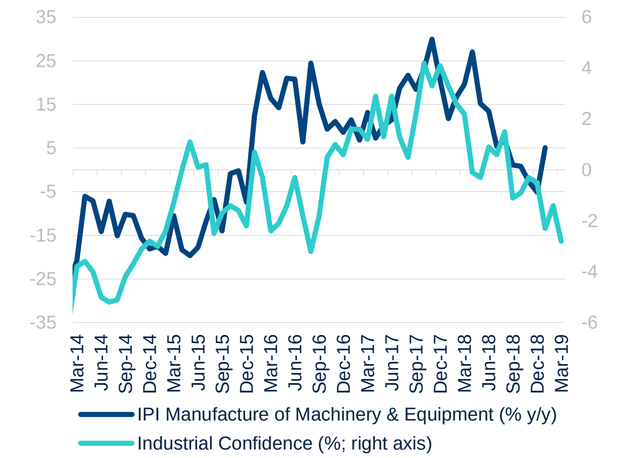
Source: BBVA Research, based on the National Statistics Institute (INE)

Figure 3 Consumer indicators



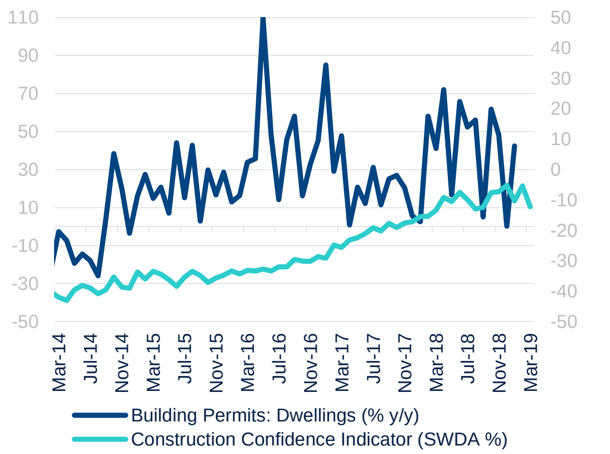
Source: BBVA Research, based on the National Statistics Institute (INE)

Figure 4 Industry indicators



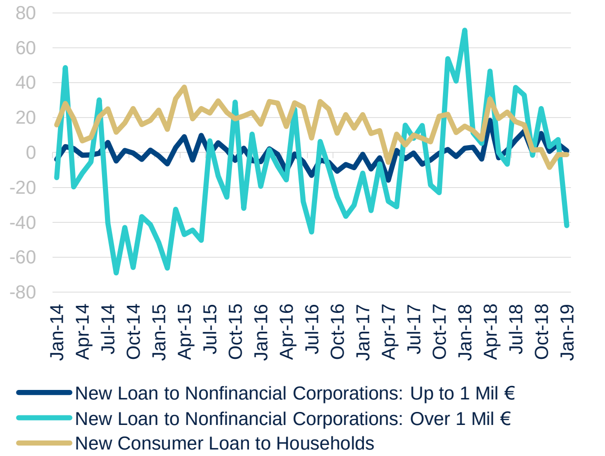
Source: BBVA Research, based on the National Statistics Institute (INE)

Figure 5 Construction sector indicators



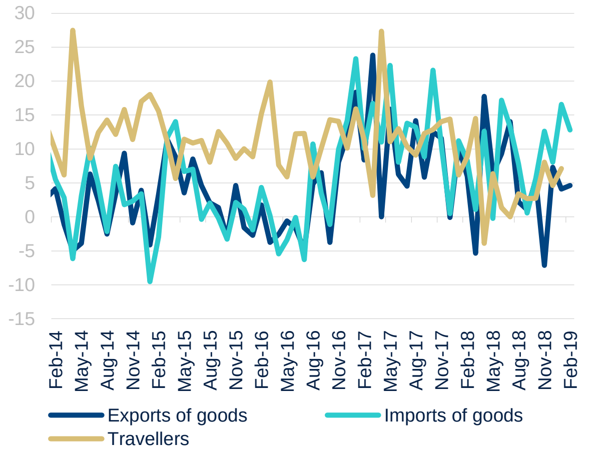
Source: BBVA Research, based on the National Statistics Institute (INE)

Figure 6 New credit to businesses and households (% YoY)



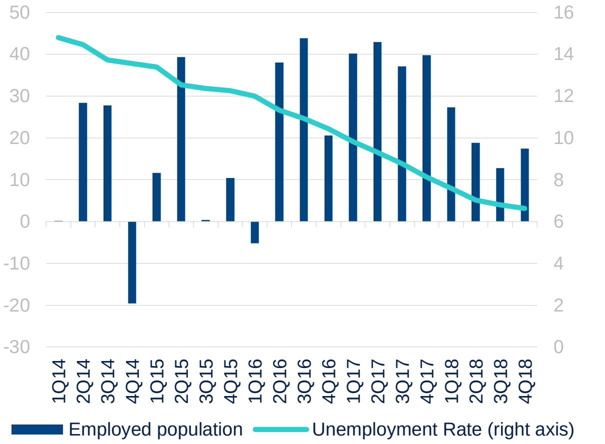
Source: BBVA Research, based on the National Statistics Institute (INE)

Figure 7 Foreign sector indicators (% YoY)



Source: BBVA Research, based on the National Statistics Institute (INE)

Figure 8 Employed population (quarterly variation in ‘000s of persons) and unemployment rate (%)



Source: BBVA Research, based on the National Statistics Institute (INE)

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