Economic Watch

Portugal

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Economic Analysis

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Portugal: the recession eased in 1Q13

The improvement was supported by the upturn in exports, which are the only source of growth

- ### GDP contracts by -0.4% q/q in 1Q13, in line with expectations

  In its second estimate of GDP the INE has revised down (-0.1 pp) growth in 1Q13 to -0.4% q/q (BBVA: -0.5% q/q), thus confirming the significant moderation in the economic contractionover the previous quarter (-1.8% q/q in 4Q12). The breakdown by components indicates that the quarterly fall in GDP was mainly the result of domestic demand draining more growth than expected (-2.3 pp after -1.3 pp in 4Q12, BBVA: -1.2 pp). This was due basically to the major negative contribution of change in inventories (-1.2 pp), reflecting poor expectations of future demand, while the fall in both private consumption (-0.7% q/q after -2.4% in 4Q12) and investment (-2.8% q/q after -4.4% in 4Q12) moderated significantly, in line with our expectations.

  The positive surprise stemmed from foreign demand, as exports grew more than expected (2.6% q/q following a fall of 1.8% q/q in 4Q12, BBVA: 0.6% q/q). This has eased some doubts about their sustainability after the significant fall observed at the end of 2012. Imports also surprised with a strong fall (-2.5% q/q following a fall of -0.5% q/q in 4T12, BBVA: -1.3% q/q), reflecting and partly offsetting the major process of inventory destocking. As a result, net exports once more contributed to growth (+1.9 pp after a negative -0.5 pp in 4Q12), more than anticipated (BBVA Research: 0.7 pp).

- ### Hard and soft data suggest that the recession will moderate somewhat in 2Q13

  Hard data available for 2Q13 point that domestic demand will continue weak, while foreign demand shouldl remain the only driver of growth. Retail sales in April was practically flat (+0.4% m/m), at the same level as March when there was a strong fall; but this has not been sufficient to offset the good January and February data. Industrial output contracted in April by -3.7% m/m, draining all the growth observed in the 1Q13. Industrial orders fell in April (-3.5% y/y), due to the deterioration of domestic and foreign orders, but in particular foreign. In the external sector, Portuguese exports increased by 3.1% between February and April with respect to the three previous months, while imports fell by -2.7%.

  As mentioned above, confidence in the Portuguese economy has improved, as shown by the upturn in the European Commission's Economic Sentiment Indicator, which rose by 1.8 points to 84.2 in May (returning to the levels of mid-2011, when the economy was practically stagnant). This improvement in confidence was due to both manufacturing industry and services and retail trade, although consumer confidence and construction fell back again.

  Employment continued to show signs of weakness and increased by 0.1 pp in April after remaining at 17.7% in February and March.

- ## Our MICA-BBVA model estimates that growth will be less negative this quarter at -0.3% q/q

  Using the available data for 2Q13, mainly confidence data to May, our MICA-BBVA model estimates that economic contraction in 2Q13 will moderate further (-0.3% q/q after a fall of -0.4% in 1Q13), compared with the stabilisation we expected in our macroeconomic scenario for the quarter. However, this marginally worse than expected data will be offset by the slight positive surprise in 1Q13, so we maintain our forecast of a fall in GDP of -2.3% for the whole of 2013. Activity will grow slightly in the second half of the year supported by a positive performance from exports, which should also be reflected in a gradual recovery in investment.

- ## Budgetary execution combined with the new additional budget suggest that the deficit target will be met (now 5.5% of GDP)

  Preliminary figures for January-April 2013 indicate that the general government deficit was under the limit set by the programme (around 300 million euros below, with a deficit of 2,407 million euros, 1.45% of GDP). In addition, the central government and social security deficit was also under the limits set by the economic adjustment programme (around 530 million euros below, with a deficit of 2,469 million euros, around 1.49% of GDP).

  The government has presented the additional budget to the Assembly of the Republic, including the new deficit target (5.5% of GDP compared with the previous 4.5%), new economic growth forecasts (-2.3% compared with -1%) and new measures to offset the additional deficit generated by the decision of the Constitutional Court to rule against some cuts in the initial budget (equivalent to 0.8% of GDP). The new measures approved come from higher non-tax revenues (0.6 pp) and the rest from an additional reduction in expenditure (0.5 pp).

  To sum up, a deficit in line with plans and the introduction of the new measures mean that we maintain our core scenario of achieving the deficit target for 2013 (now set at 5.5% of GDP).

- ## Tax incentives to promote investment

  In a scenario of a credit squeeze, weak domestic demand and unemployment on the rise, at the end of May the government presented its plan to reactivate investment. It should help recovery in a context of growth in exports and some improvement in activity in the euro zone as a whole:

  - **Incentives for investment through corporation tax:** companies that invest a maximum of 5 million euros between 1 June and 31 December 2013 may deduct up to 20% of the amount invested from their corporation tax, provided that the deduction does not amount to more than 70% of the total tax. This measure could in some cases reduce the tax effectively paid to 7.5% from the current 25%. In addition, if not all the credit obtained is used the excess may be used over a period of 5 years. **VAT payment:** from 1 October this year companies with turnover of not more than 500,000 euros per year may request to file their VAT returns by cash accounting. This measure is expected to improve the financial condition of around 85% of Portuguese companies.

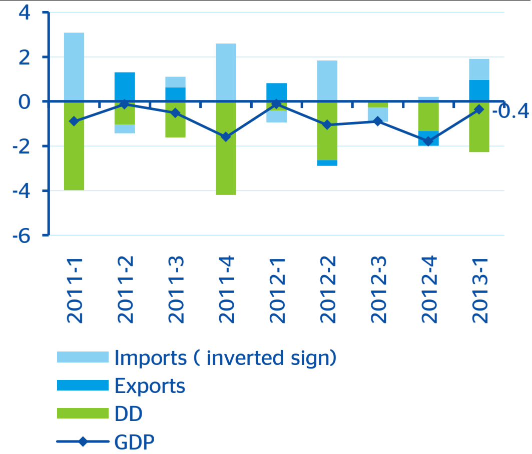
Table 1
Portugal: Quarterly GDP growth and its components (%)

	1Q12	2Q12	3Q12	4Q12	1Q13 Observed	1Q13 BBVA Research
GDP	**-0.1**	**-0.2**	**-0,1**	**-0.6**	**-0.2**	**0.1**
Private consumption	-1.8	-1.0	-0,3	-2.4	-0.7	-0.8
Public consumption	-1.1	-0.8	-1,6	-0.6	-1.1	-0.2
Investment	1.9	-10.8	0,4	-4.4	-2.8	-1.8
Inventories (1)	0.7	0.0	0,2	1.0	-1.2	-0.4
Domestic demand (1)	**-0.4**	**-2.6**	**-0,3**	**-1.3**	**-2.3**	**-1.2**
Exports	2.3	-0.7	0,0	-1.8	2.6	0.6
Imports	1.4	-4.8	1,8	-0.5	-2.5	-1.3
Foreign demand (1)	**0.3**	**1.6**	**-0,6**	**-0.5**	**1.9**	**0.7**

(1) Contribution to quarterly GDP growth
Source: INE Portugal and BBVA Research

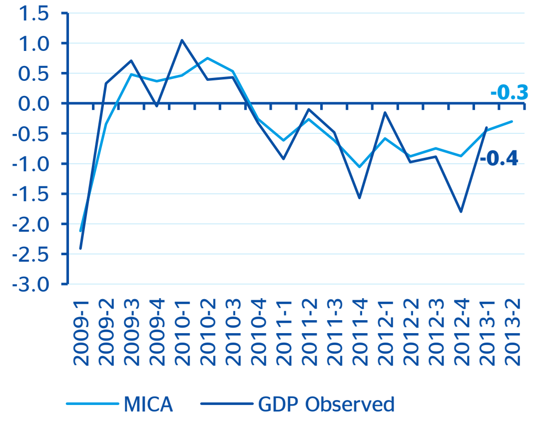
On available data we estimate that the economic contraction in the second quarter will moderate even more.

Chart 1
Portugal: GDP growth and contributions (% q/q; av.)



Source: Haver Analytics and BBVA Research

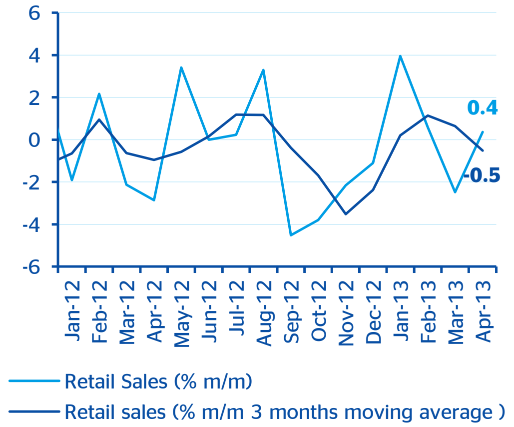
Chart 2
Portugal: MICA-BBVA and observed GDP (% q/q) the moderation will continue in 2Q13



Source: BBVA Research

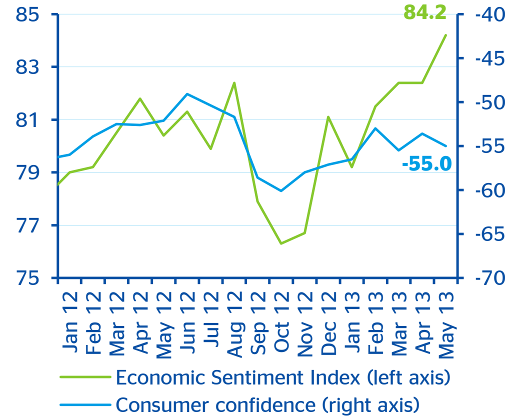
The figures for retail sales and consumer confidence suggest that private consumption could again contract in the second quarter.

Chart 3
Retail trade



Source: Haver Analytics and BBVA Research

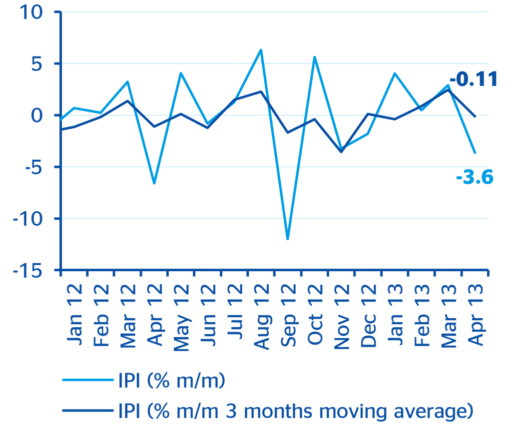
Chart 4
Portugal: economic sentiment



Source: Haver Analytics and BBVA Research

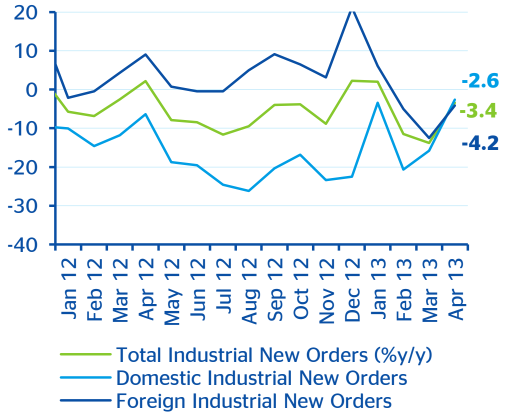
The deterioration in industrial output and weak industrial orders suggest that investment will continue to contract in 2Q.

Chart 5
Portugal: industrial output



Source: Haver Analytics and BBVA Research

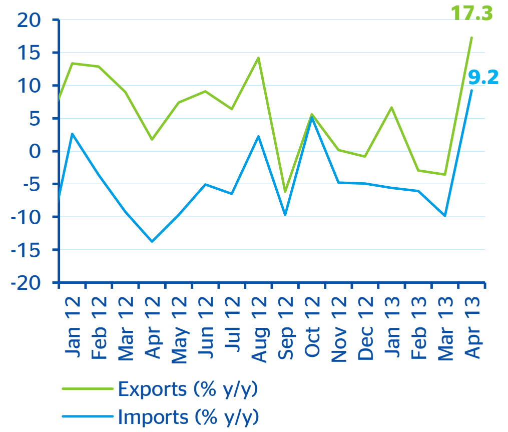
Chart 6
Portugal: industrial orders



Source: Haver Analytics and BBVA Research

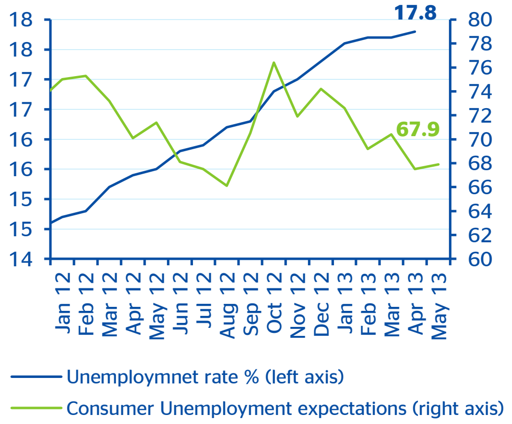
Data available at the closing date of this report appear to indicate that the external sector will continue to be the only source of growth in 2Q.

Chart 5
Portugal: external sector (not seasonally adjusted)



Source: Haver Analytics and BBVA Research

Chart 6
Portugal: unemployment



Source: Haver Analytics and BBVA Research

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