

Economic Watch

Portugal

Madrid, January 23, 2014
Economic Analysis

Eruope

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Stagnation at the end of 2013, although exports recover

The MICA-BBVA model predicts zero growth in 4T2013

- **In December confidence continues to improve across all sectors**

The European Commission economic sentiment indicator significantly improved again in December (Chart 3), as observed in November as well, although it remains below its historical average, pointing to a still weak pace of the recovery, somewhat below its average growth rate (around 0.3% q/q).

- **Both industry and retail bounce back in November, but we still anticipate a decline in private spending after improving in 3Q13**

The increase in industrial production in November offset the fall in October (chart 5), so that the production of this sector in the first two months of 4Q13 should have increased by 1.1% over the average of the third quarter, which suggests that the fall observed in that quarter could be temporary, associated with the reduction in orders from abroad (which also deteriorated somewhat, but have since reversed). This recent increase is mainly due to a higher production of intermediate and capital goods, probably linked to the improvement in exports, suggesting that the rebound in investment observed in the third quarter (1.5% q/q, especially in metal products and equipment and construction) is unlikely to be sustainable in the last quarter of 2013.

Despite the strong rebound in retail sales in November (3.1% m/m) (chart 6), the significant drops in the previous month are not compensated (-3.2% m/m in September and -0.7% m/m in October), so that the sales between October and November were down 0.6% on the average of 3Q13 (when it rose 1.7% q/q), which points to a slight contraction in private consumption in 4Q13 after the robust growth in the previous quarter (1.1% q/q).

- **Our MICA-BBVA model estimates zero growth in 4Q13**

With the data available so far, the MICA-BBVA model predicts zero growth in the fourth quarter (chart 2), though simpler econometric estimates indicate a 0.1% q/q. This is a clear downward bias to our baseline scenario that contemplated a forecast of 0.3% q/q. These data, after minor revisions of growth in previous quarters, imply that GDP would have contracted on average by -1.5% in 2013 (November BBVA Research forecast: -1.6%).

The coincident indicator of activity of the Bank of Portugal has continued to improve (chart 3), reaching 0.5 in October and 0.8 in November. This indicator, linked to the annual growth of the economy, would match with a slightly negative quarterly growth (about -0.1/-0.2% q/q).

- **Exports remain strong and foreign orders increase again**

Exports¹ up to November increased by 2% on the average of the third quarter (when they fell by -0.4% q/q), mainly due to an improvement in global demand, both within and outside the European Union (chart 9), while import growth would have been more modest at around 0.8% on 3Q13 (1.7% q/q) (chart 7). These figures suggest that exports will again contribute positively to growth, after draining -1.1pp in 3Q13.

Moreover, the number of tourists remains at similar levels to the third quarter (chart 10), a period in which services exports grew by about 3.2% q/q (after +4.4% in 2Q13), and suggests that at the end of the year this trend could continue.

- **Headline inflation increased slightly again in December, ending the strong moderation observed since mid-year**

Headline inflation (HICP) increased again in December by 0.1pp to 0.2% y/y, mainly due to a softer fall in energy prices and to rising prices of unprocessed food, which offset the moderation of core inflation to 0.2% y/y (chart 13). Anyway, these low inflation rates are similar to those observed earlier in the year, after the disappearance of the temporary effects observed in previous years. The slowdown in inflation in 4Q13 compared to the first quarter was around 0.4pp, due to the -0.5pp drop in the most volatile components of inflation, while core inflation increased by 0.1pp due to moderation of the fall in prices of non-energy industrial goods.

- **Unemployment and labor costs ease again**

The labor market continues to behave better than expected from an economy that has barely emerged from recession, and this suggests that there have been some positive effects from the wage moderation. The unemployment rate has fallen slightly in November to 15.5% (Chart 11), an improvement of 1.5pp if compared with the rate of a year before (17.0% in November 2012). The reduction in unemployment has been more moderate in the second half of 2013 than in the first. Without knowing yet whether this reduction is due in part to a slowdown or drop in activity rate, data up to the third quarter already marked an improvement in the unemployment rate consistent with an increase in the labor force.

Moreover, labor costs have declined slightly (-0.1% q/q) in 3Q13 after increasing in the previous quarter (1.3% q/q, mainly due to non-wage costs). Year-on-year, labor costs have been dropping for two years, especially in the wage component, although reductions in 2013 were much more moderate than in 2012 (Chart 12).

- **The deficit in 2013 could be even below the target set by the government and the troika**

The latest budget execution data, available until November 2013, continue to suggest that the government will meet the deficit target under the Economic and Financial Assistance Programme (EFAP) criterion (5.5%), and will even be below it (chart 17). Official estimates indicates that the deficit could finally be around 5.1% of GDP (5.5 including BANIF recapitalization), about 0.4 percentage points lower than previous estimates. Both revenue and expenses increases accumulated up to November are in line with the targets (charts 15 and 16).

1: Exports of goods seasonally adjusted with the seasonal adjustment package of HAVER Analytics

As we mentioned in our November Europe Economic Outlook², the Constitutional Court declared unconstitutional in late December last year the budget measure that tried to merge the CGA pension system (for civil servants) with the Social Security. The government with this measure hoped to cut about 10% of pensions above 600 euros and survivor pensions above 419 euros (saving 0.4% of GDP) (chart 18).

After the decision of the Constitutional Court, the government has announced measures that offset the losses of not implementing the cut in pensions. On the one hand, reapplying in 2014 the special solidarity contribution (CES) and enlarging the contribution base, which up to last year applied only to pensions above 1350 euros. On the other hand, by raising civil servants' contributions to ADSE (health system for civil servants) which were initially planned for 2014 at 2.5%, but now increase to 3.5%. These measures should be consistent with the 2014 deficit target of 4% of GDP.

² See box 4 http://www.bbvaesearch.com/KETD/fbin/mult/1311_Europeeconomicoutlook_tcm348-410556.pdf?ts=2212014

Portugal

National Accounts: GDP will remain flat in 4Q13 after two quarters of growth

GDP growth of +0.2% q/q in 3Q13 is confirmed, mainly due to growth in domestic demand offsetting the fall in external demand. Our MICA-BBVA model estimates zero growth in 4Q13.

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

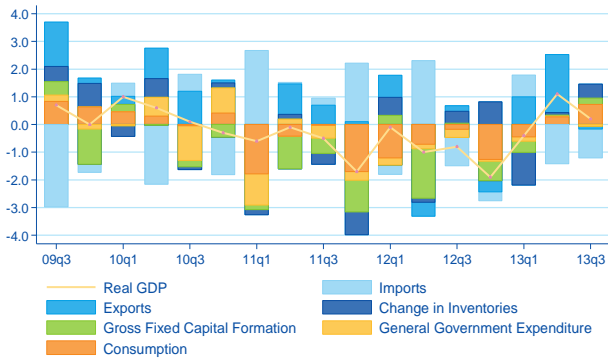
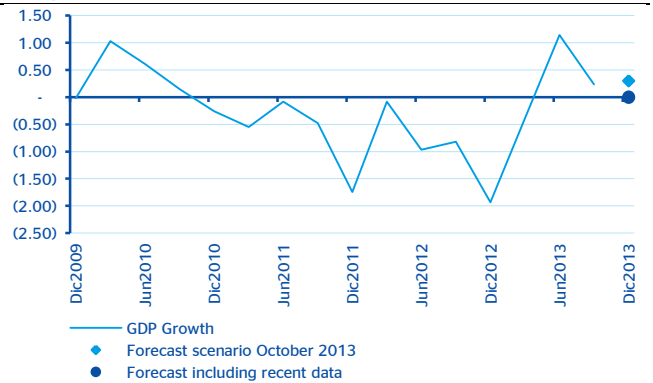


Chart 2
GDP growth estimates (%q/q) and forecasts*



Confidence: the trend started earlier this year continued in December

The confidence data published by the European Commission (ESI) continue to improve once more to its historical average, posting 97.4 points in December. The BOP coincident activity indicator suggests too that the economy could be stable at the levels reached in 3Q13.

Chart 3
Confidence (ESI), Activity Coincident Indicator and GDP growth (% y/y)*

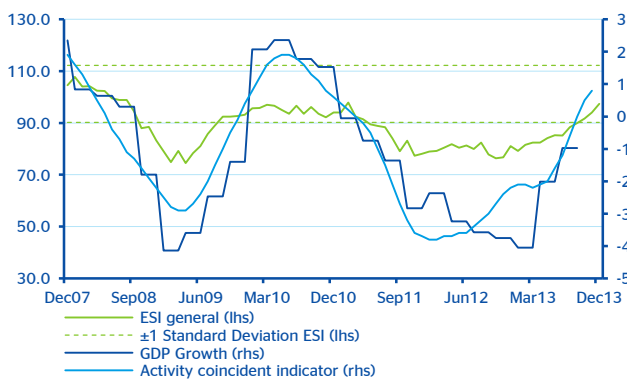
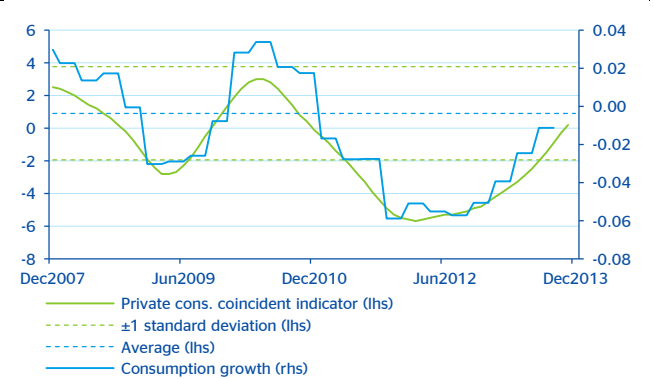


Chart 4
Private Consumption Coincident Indicator and Private consumption (%y/y)*



Activity: industrial production and retail sales recover in November

The improvement in industrial production in November (1.5% m/m) offsets the decline in October (-0.7% m/m), well above the average of the previous quarter (1.1% higher). Retail sales are below the average observed in 3Q13 (-0.6%).

Chart 5
Industrial output (% y/y) and industrial confidence (ESI)**

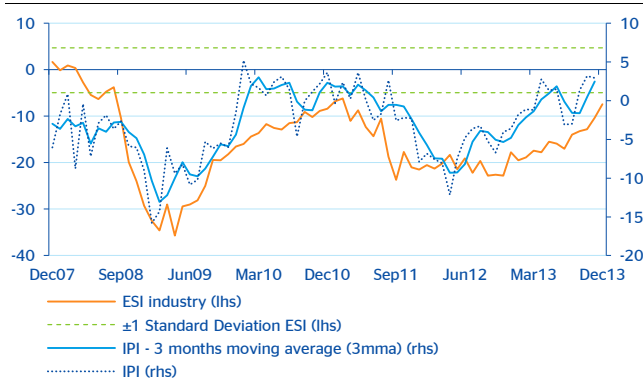
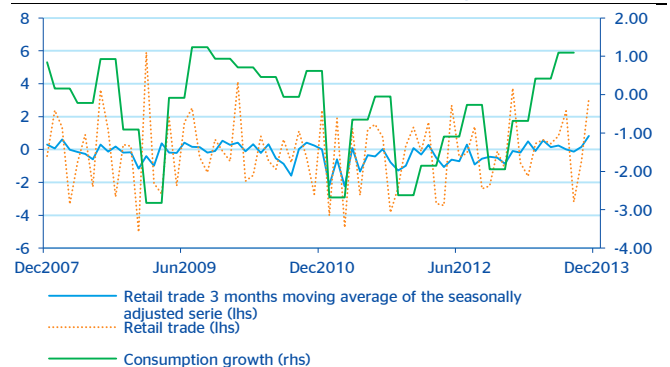


Chart 6
Retail trade (% 3m/3m) and consumption growth (% q/q)*



* Source: HAVER and BBVA Research

Foreign sector: exports continue to grow at a good pace at the beginning of 4Q13

Exports up to November increased by 2% over 3Q13 (-0.4% q/q), while imports growth has been more modest at around 0.8% over 3Q13 (1.7% q/q).

Chart 7
Current account (% GDP)*

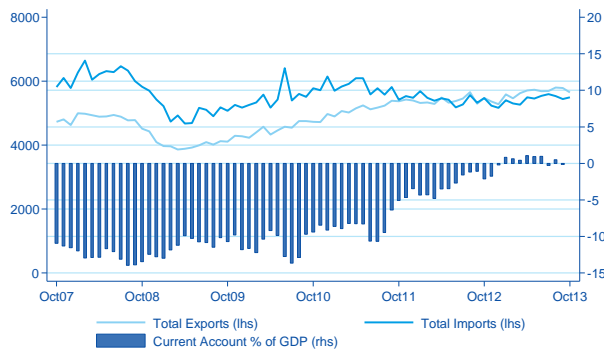


Chart 8
Exports (% y/y) and volume of export order books*

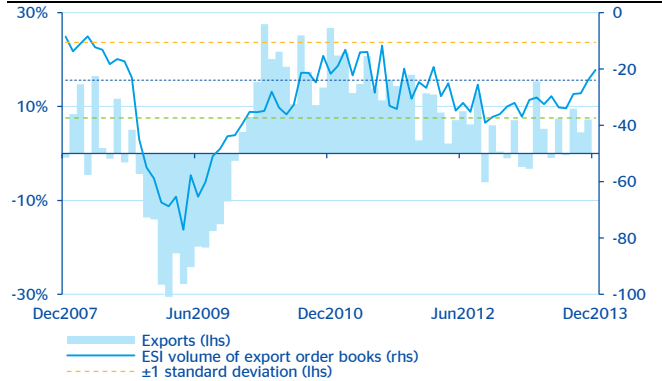


Chart 9
Exports by destination (% y/y)*

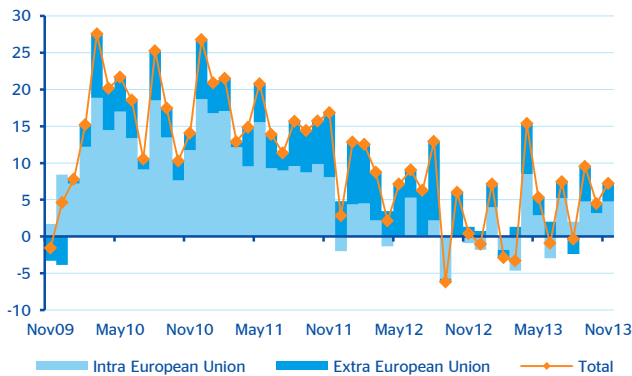
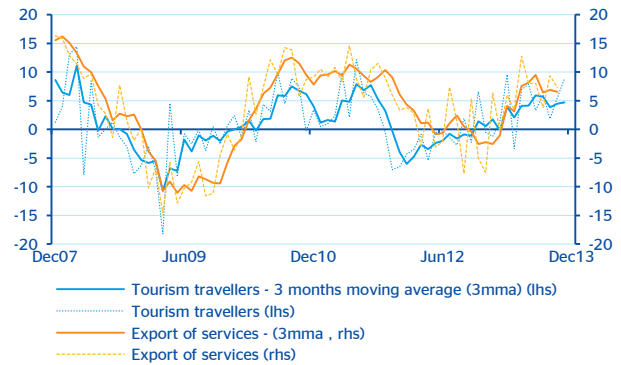


Chart 10
Tourism and service exports (% y/y)*



Labour market: unemployment and labor costs continue to decline

The unemployment rate fell slightly in November to 15.5%, an improvement of 1.5 percentage points if compared with the rate of a year ago (17.0% in November 2012). Labour costs decreased slightly (-0.1% q / q) in 3Q13 after increasing in the previous quarter.

Chart 11
Unemployment rate (%) and employment expectations*

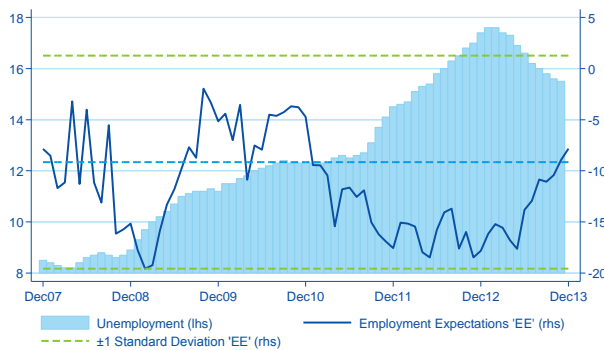
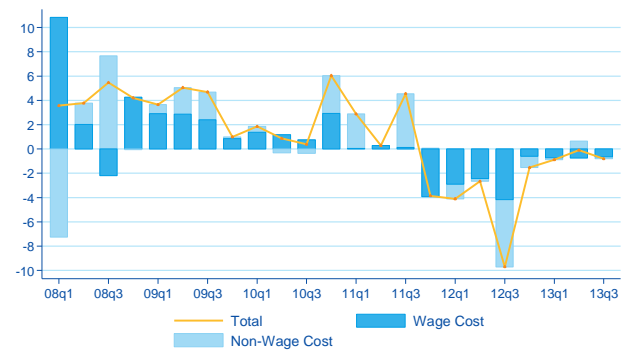


Chart 12
Labour costs in the business sector (% y/y)*



* Source: HAVER and BBVA Research

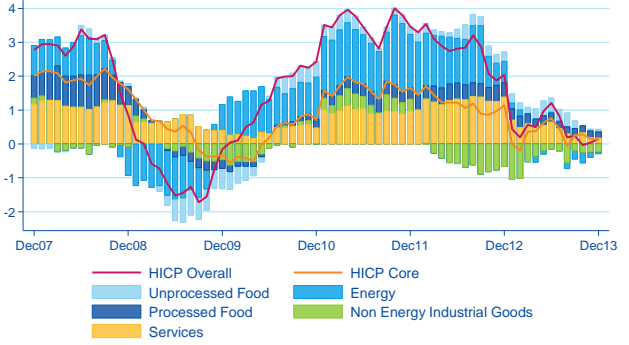
Prices: inflation rises again in December, but remains low

Headline inflation (HICP) increased again in December by 0.1pp to 0.2% y/y, while core increased by 0.2pp (for moderation in the decline in prices of non-energy industrial goods).

Chart 13
Headline and core inflation rate (% y/y)*



Chart 14
Inflation by component (contribution in %)*



Public sector: the government seems to be meeting the deficit target

The latest budget execution data suggest that the government will meet the deficit target of 5.5% of GDP, with expenditure and income above 2013 figures.

Chart 15
Government expenditure (comparison with the previous year)*

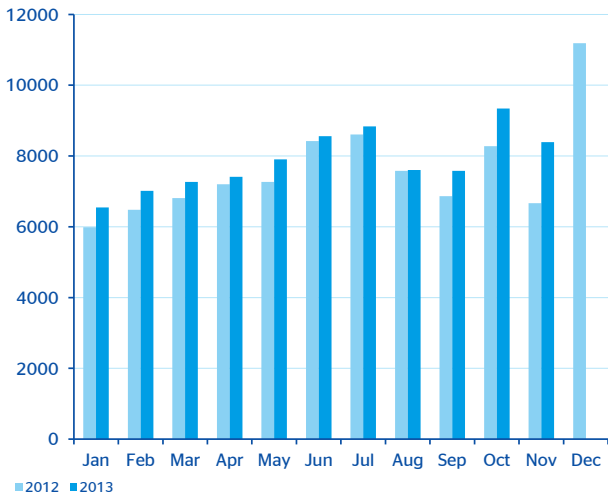


Chart 16
Government revenue (comparison with the previous year)*

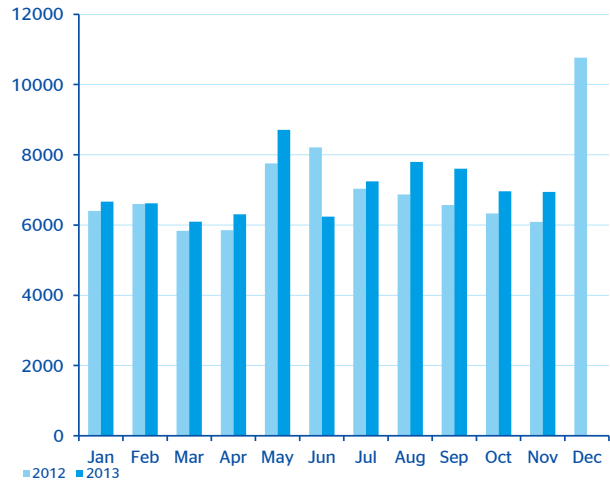


Chart 17
Fiscal deficit target*

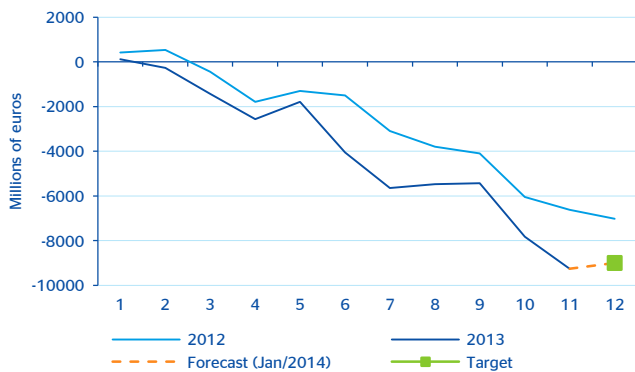
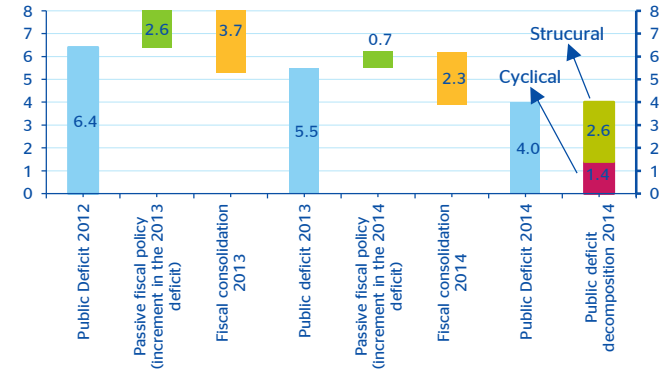


Chart 18
Breakdown of fiscal deficit (cyclical and structural)*



* Source: HAVER and BBVA Research

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