# Portugal: expansion, with issues to resolve

La Voz de Galicia (Spain)
Miguel Cardoso
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The prospects for the Portuguese economy are positive, although the country still has significant imbalances that could slow the pace of recovery if the reforming zeal shown in the past few years is not maintained.

In particular, activity shows strong momentum, with growth rates averaging between 2.5 and 3% YoY over the last three quarters of 2017. Behind this is the consolidation of household spending, which has been showing the positive effects of various tailwinds since the beginning of 2016. Furthermore, exports of goods have performed particularly well, thanks to growth in demand from Spain and the good performance of sectors such as machinery and equipment and the production of motor vehicles. Similarly invisible exports are gaining in importance, thanks to the positive performance of tourism. In particular, factors such as the fall in prices and the perception of competing alternative destinations as unsafe have led to overnight stays showing a rising trend and for now with few signs of saturation. This has also been one of the reasons for the recovery in investment in construction observed in the past few quarters, given the support deriving from the increase in foreign demand in the housing sector. All this is against a backdrop in which the public sector has had to continue its efforts to reduce the imbalance in its accounts, mainly by limiting increases in spending.

Looking ahead, expectations are positive, underpinned by a favourable international environment and the improvement in the external perception of domestic prospects. In particular, we expect the global recovery to continue and to be more synchronised. Also, the European Central Bank's monetary policy will hold interest rates at historically low levels, at least until the second half of 2019, when it will start a process of gradual normalisation. Additionally, Portugal's risk premium is benefiting from the improved growth prospects for the next few years, the reforms implemented, the reduced uncertainty about economic policy and an environment of abundant liquidity and the search for yield. Thus, the Portuguese Treasury's cost of financing fell by more than 200 bps over the course of last year. This should lead to an improvement in competitiveness, given the reduction in financing costs.

Nonetheless, certain risks remain. For example, the sustainability of the growth in household spending, given that their savings rate is at an all-time low. Additionally, it is necessary to make even more progress on strengthening the balance sheet of part of the financial system so that the reduction in financing costs is transferred to the private sector. Apart from this, labour productivity has remained practically stagnant since 2013, and this could weigh on competitiveness. Finally, the high level of public debt will require the implementation of additional measures to reduce it. In the short term, these risks will not be such as to prevent the recovery from continuing, but it is crucial that the reform efforts be maintained in order for a virtuous reduction of the persistent imbalances to come about.