Portugal: Growth confirmed at 2.8% yoy in Q1

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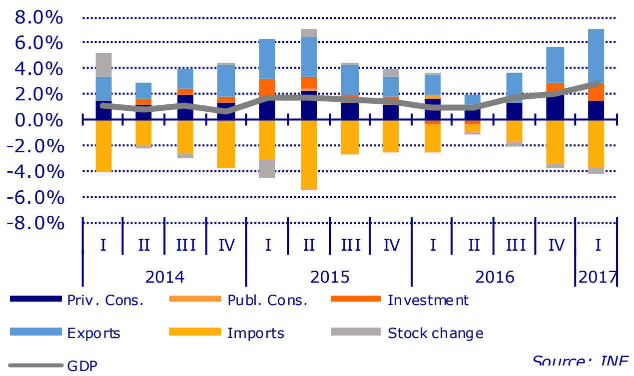
Fastest growth of investment in almost 20 years together with exports boost economic expansion

The second estimate of the GDP in Q1 confirmed an impressive growth rate of 2.8% yoy, the fastest since the end of 2007. This performance was mainly the result of a further boost in investment (particularly in construction) and of solid growth in exports, which outpaced an also significant expansion of imports (justifiable by the large imported content of domestic investment). Private consumption decelerated, in what is mostly a healthy development, as it allows for a more sustainable growth path. Risks regarding our 2.5% prediction for 2017 GDP growth are now balanced; in 2018, we expect a more moderate pace of growth.

GDP and components

(%; contributions for yoy change in p.p.)



Source: INE

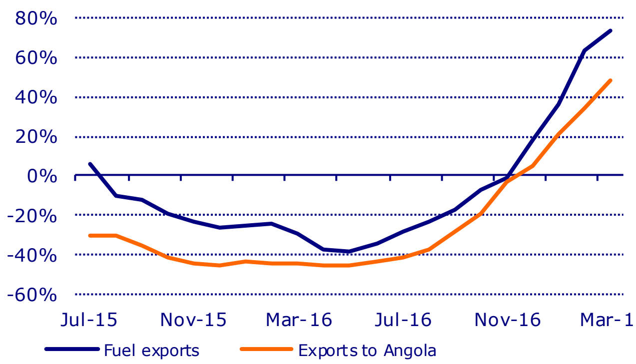
Contributions for yoy growth (p.p.)	2016 Q2	2016 Q3	2016 Q4	2017 Q1
GDP	0.9	1.7	2.0	2.8
Private consumption	1.1	1.3	2.0	1.5
Public consumption	0.1	0.0	0.0	-0.1
Investment	-0.4	-0.3	0.6	0.9
Exports	0.8	2.4	2.9	4.2
Imports	-0.7	-1.7	-3.5	-3.7

The Portuguese economy expanded 2.8% yoy, as previously estimated by the national statistics office (INE). This is the largest growth increase since the end of 2007. Quarter-on-quarter, economic activity increased 1.0% qoq, 0.3 percentage points more than in the previous three months. This is also the fastest pace of growth seen in a first quarter since 2010.

Net external demand saw its contribution become positive from negative in the previous quarter: year-on-year, it added 0.5 p.p. to the economic expansion, while adding 0.8 p.p. to quarterly growth. Exports increased 9.7% yoy, the highest rate of growth since the final quarter of 2013, with the comparison for both fuel exports and shipments to Angola benefitting from negative temporary effects felt in the Q1 2016 – the data available on goods exports show a 48.3% yoy increase in exports to Angola in Q1, and increases overall in almost all the main trading partners, with the Spanish economy contributing with 3.9 p.p. for export growth. Moreover, tourism indicators are still pointing at a large effect of these activities in services exports – total revenue increased 13.5% yoy in the Q1 2017. **Looking at current prices, exports accounted for 43.2% of the quarterly GDP, having steadily increased for the most part of the last few years from a minimum of 26.2% in Q1 2009.** The exception was a period of slight drop between the second half of 2015 and the first half of 2016, most likely due to the fall in oil prices. Exports of goods in volume increased 53.3% since Q1 2009 (60.1% in value), while exports of services rose 50.1% in volume (66.3% in value). **Imports, on the other hand also increased significantly, much due to the large share of imported content of domestic**

Exports of goods in value

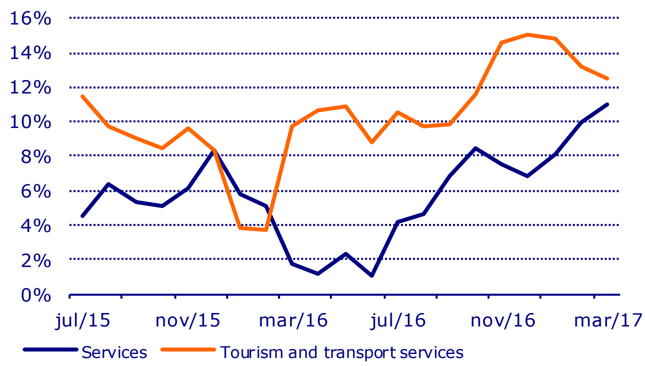
(year-on-year change on 3-month moving average)



Sources: INE, Bank of Portugal

Services exports

(year-on-year change on 3-month moving average)



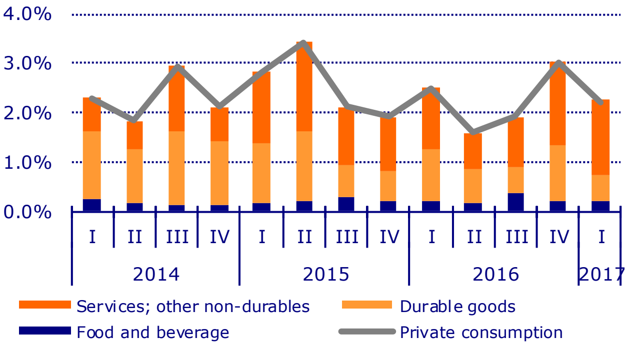
Sources: INE, Bank of Portugal

investment, rising 8.0% yoy (7.7% in the previous quarter). These figures translate into a balance of goods and services of 1.2% of the GDP, and a 4-quarter average of 1.1%, slightly below the previous 4-quarter period (1.2%).

Domestic demand contributed with 2.3 p.p. for economic growth in yearly terms (2.6 p.p. in Q4 2016). Consumption decelerated to 2.2% yoy, from 3.0% - quarter-on-quarter, private consumption showed a similar performance, increasing 0.8% (1.1% in the previous quarter). The evolution of the different components implied a rather healthy composition of the growth profile, as consumption of durable goods increased 5.4% yoy (12.5% in Q4 2016), contributing with 0.52 p.p. to the expansion of private consumption, well below the average in the last few years (average contribution of 0.94 p.p. since H2 2013); consumption of food and beverages and the consumption of other goods and services are still growing at a moderate pace (respectively, at 1.1% and 2.1% year-on-year), thus not raising issues of sustainability for consumption spending. **What is more, it could allow for an improvement in the savings rate, still at historically low levels.**

Private consumption and components

(%; contributions for yoy change in p.p.)

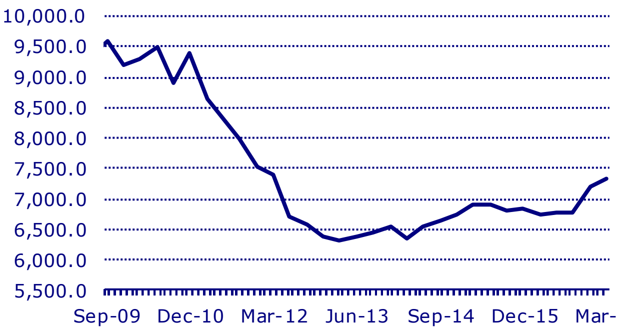


Source: INE

Most importantly, investment accelerated to 8.9% yoy (the fastest rate of expansion since the final quarter of 1998), thus confirming its improvement trajectory begun in the final quarter of 2016, as shown by various higher frequency indicators. Investment in machines and equipment grew 15.0% yoy (largest rate since Q3 2014), while construction saw also its largest pace in 15 years. While there could be some fear over a recovery of investment supported only on another construction boom, it is worth to notice that investment in construction plunged after the financial crisis, and is still short of EUR 4 billion per quarter after this increase, when these were well above EUR 6 billion before 2008. Finally, there was a quarterly decrease of stocks, which shaved 0.7 p.p. off quarterly growth, a good omen for investment growth in the following quarter.

Investment

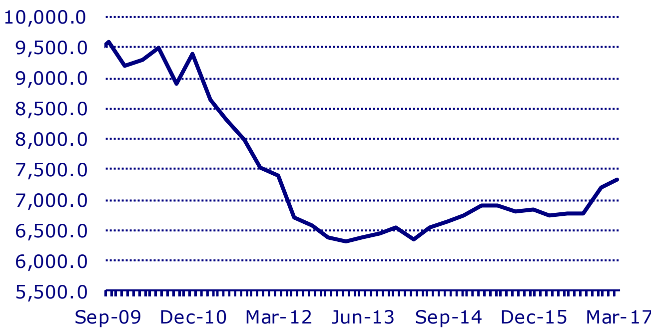
(EUR million)



Source: INE

Investment

(EUR million)



Source: INE

In 2017, we expect growth to stay surely above 2%, benefitting, in part from very favorable base effects in various components of the aggregate demand. Moreover, while a positive cycle is showing its better phase, it is our view that there are also structural effects supporting part of this more solid dynamic. In 2018, however, we remain slightly more cautious in our forecast: the conditions for a consistent pace of expansion above 2% do not seem yet to be in place, given such factors as the high indebtedness of the economy in general, and more specifically, of the State, families and firms (which is particularly negative for corporate investment, essential for a more sustained recovery); moreover, the tapering process by the ECB should bring some bumps to the road, even if public financing and deficit reduction are not at stake at a more fundamental level.

BPI - Forecast for the Portuguese economy

	2017	2018
GDP	**2.5**	**1.8**
Private Consumption	2.1	1.6
Public Consumption	0.2	0.5
GFCF	4.0	4.4
Exports	7.8	3.1
Imports	6.3	3.2
Inflation Rate (HICP)	1.7	1.6
Public Deficit	1.6	1.8
Unemployment	9.5	8.7

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