Portugal: Debt reduction and sustainable growth feasible

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Consistence is the name of the game

The Bank of Portugal upgraded its forecasts on the performance of the Portuguese economy, underpinned by a stronger domestic behavior since the turn of the year, together with a broadly more favourable international environment. This latest revision, combined with other factors related with public finances and external equilibrium, is a signal of a more sustained optimism regarding Portugal. If this trend consolidates, and if some risks are overcome – mostly political – in the European context, our forecasts will most likely also confirm this upward trend. In the meantime, we are keeping with our prediction of 1.5% growth in 2017, with a strong possibility of an upward revision.

In 2017, according to the Portuguese central bank, growth is expected to accelerate towards 1.8%, which would be the fastest pace of growth since 2010 (+1.9%). The earlier prediction, updated in December last year, expected a GDP increase of 1.4%. The outlook for 2018 and 2019 was also upgraded, respectively, by 0.1 and 0.2 percentage points, to 1.7% and 1.6%. Private consumption will increase at a similar rate as the GDP, rising 2.1% in 2017, and 1.4% in both 2018 and 2019. Exports will continue to be, for the most part, the engine of the Portuguese economy, having a larger contribution for growth (net of imported content[1]) than other components of the GDP. Sales of goods and services to other economies are expected to increase 6.0% in 2017, 4.8% in 2018 and 4.5% in 2019. Various factors will influence this acceleration: on the one side, tourism related exports will again perform significantly well, in part supported by important international events in Portugal this year; moreover, exports of goods will surely recover, as some negative factors wane (diminished external demand from Angola, oil refinery stops in 2016, transition issues in the Autoeuropa car factory). Finally, a decrease of internal uncertainty (mostly political) and the full implementation of the European Funds Programme will allow for a considerable recovery of investment, expected to surge 6.8% in 2017.

Portugal - Macroeconomic scenario

	BPI*			IMF Feb 17		EC Feb 17		EIU - Mar 17		BoP Mar 17		Gov - SB 2017		OECD Jun 2016	
	2016F	2017F	2018F	2017P	2018P	2017F	2018F	2017P	2018P	2017P	2018P	2016P	2017P	2016P	2017P
Real GDP	**1.4**	**1.5**	**1.5**	**1.3**	**1.2**	**1.6**	**1.5**	**1.6**	**1.5**	**1.8**	**1.7**	**1.2**	**1.5**	**1.2**	**1.2**
Private Consumption	2.3	2.0	1.4	1.3	1.2	1.6	1.2	1.8	1.6	2.1	1.4	2.0	2.5	2.0	1.2
Public Consumption	0.8	0.6	0.5	0.6	0.3	0.4	0.5	0.5	0.8	0.2	0.5	0.6	-1.2	1.1	0.2
Investment	-0.9	3.9	3.3	2.8	2.4	3.8	4.2	1.3	2.1	6.8	5.0	-0.7	3.1	-2.0	0.7
Exports	4.4	4.0	2.5	3.6	3.9	4.1	4.2	3.5	2.8	6.0	4.8	3.1	4.2	3.3	3.7
Imports	4.4	5.0	2.5	3.5	3.9	4.3	4.3	3.1	2.9	7.3	4.8	3.2	3.6	3.6	3.6
Domestic demand	1.5	2.0	1.5	1.4	1.2	1.8	1.6	1.5	0.0	0.7	0.7	1.2	1.8	1.2	1.0
Foreign demand	-0.1	-0.5	0.0	-0.1	-0.1	-0.2	-0.1	0.1	0.0	1.1	1.0	0.0	-0.3	0.0	0.2
Inflation rate (annual average)	0.6	1.2	1.5	1.1	1.4	1.3	1.4	1.2	1.6	1.6	1.5	0.8	1.5	0.7	1.1
Unemployment rate	11.1	10.1	9.5	10.6	10.1	10.1	9.4	10.3	9.4	9.9	9.0	11.2	10.3	11.0	10.1
Budget balance (% GDP)	-2.1	-1.9	-1.7	-2.1	-2.3	-2.0	-2.2	-2.1	-2.2	-	-	-2.4	-1.6	-2.5	-2.1
Public debt (% GDP)	130.4	128.5	126.4	129.8	128.7	128.9	127.1	130.6	129.0	-	-	129.7	128.3	130.2	129.5
Current+Capital account (% GDP)	1.7	1.7	1.2	-0.1	0.4	1.3	1.5	1.3	1.2	0.9	0.9	1.7	2.2	1.6	1.6

Source: Bank Portugal, Ministry of Finance, European Commission, BPI, OECD.
*Under revision

Despite the fact that this scenario update does not change the broad outlook for the Portuguese economy, which will likely continue to grow at a moderate pace below 2% (as compared to the Spanish economic recovery, around 3%), **these forecasts signal a renewed improvement in the prospects for the Portuguese economy, and are, together with other signals, a token of sustainability of the economic recovery process.**

Firstly, this review confirms a scenario of consistent economic growth and external equilibrium, two issues still much in question not long ago. The possibility of an economic stagnation was only definitely discarded on the second half of 2016, when data for that period revealed an acceleration in economic activity. On the other hand, the relative sustainability of a positive trade balance (in goods and services) was confirmed, along with a similar trend for the current and capital account balance. Once again, one should notice that the intuition (and the forecast) of various institutions was that this equilibrium achieved during the crisis would rapidly be reverted by an increase in imports at the time of the recovery. Furthermore, this is still the prediction of the

[1] According to the Bank of Portugal, the aggregate demand components net of imported content are calculated by estimating the necessary imports for each component – this estimation was originally done using 2005 data.

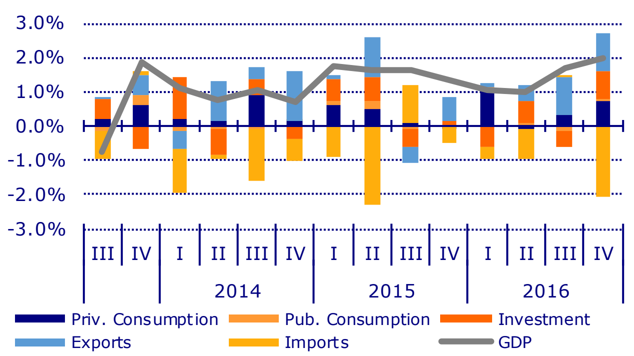
IMF, for the time being. This consistency, which prevailed alongside with an uncommon political context, will provide confidence and optimism to economic agents.

Secondly, there is less uncertainty as to the solidity of such growth, in the sense that it is proving to be compatible with a process of external debt reduction, for the whole of the economy. While there was a reasonable argument for doubt in the path of Portuguese external debt in the 2011-14 period, this seems not to be the case in the current moment. Private debt of firms and families is being reduced at a considerable rate, while allowing for a modest rate of economic growth, together with improvements on the labour market. Despite the fact that the debt level will continue to limit savings by the part of families, and investment plans by firms, a medium-term scenario of continued debt reduction, growth, and general improvement of economic conditions is now in sight – in fact it is what is happening right now. **The same consolidation process is taking place in the public administration, although in a far more complex fashion. The budget deficit was reduced by a considerable amount since 2011, and public debt reduction will ensue, provided that fiscal policy remains prudent.** In particular, the likely exit of the Excessive Deficit Procedure will prove to be a very positive confidence factor for the economy in the near term.

In conclusion, we want to stress that, going forward, consistence is the name of the game. Yes, economic growth, unemployment reduction, income increase and debt reduction are possible to achieve at the same time. Still, this hinges on persistent fiscal prudence, on the one hand, and on public policies that grasp what has been the fundamental trait of the Portuguese economic recovery: an economy with a positive external surplus, exporting more than it imports, and where competitiveness is a key factor, namely in the more competition-exposed sector of exporting companies. There are risks to this scenario, namely the decrease of ECB support: as a matter of fact, this process will likely entail larger financing costs for the State, but also for firms, while bringing a renewed environment of uncertainty, where key investments might be postponed of reevaluated. For this reason, it is advisable to maintain a fiscal policy with a considerable buffer, while also ensuring the stability of economic policy. **This is a reliable path to maintain a robust economic path and the credibility linked to that process. In time, this could progressively bring about more investment, foreign and national, which in turn could sustain a faster, more "Spanish", pace of growth, one that we still lack.**

GDP and components

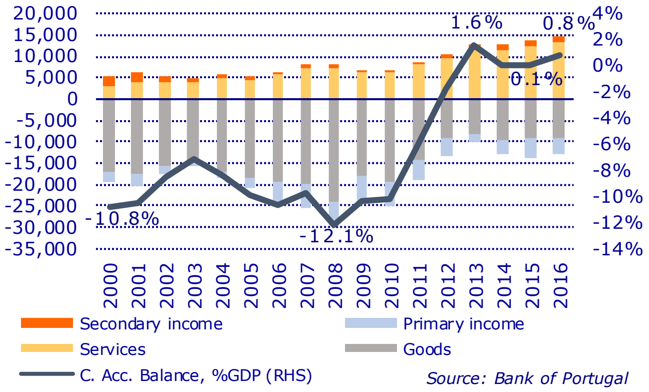
(%; contributions for yoy growth in p.p.)



Source: INE

Current account balance

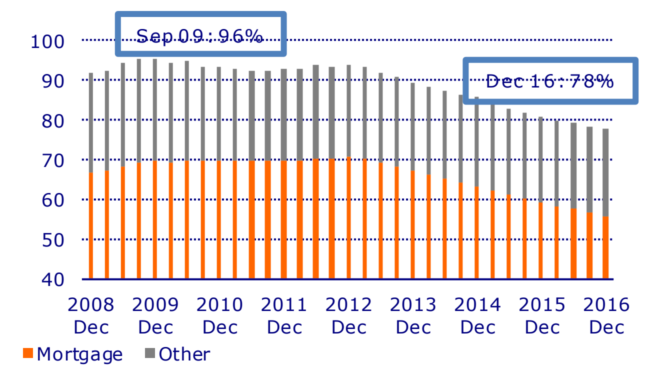
(EUR millions, % of GDP)



Source: Bank of Portugal

Household debt

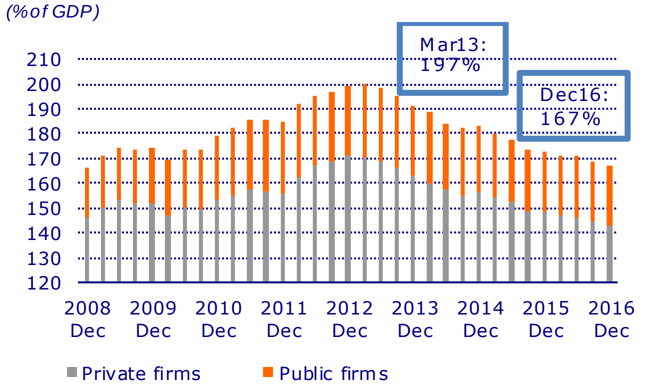
(% of GDP)



Source: Bank of Portugal

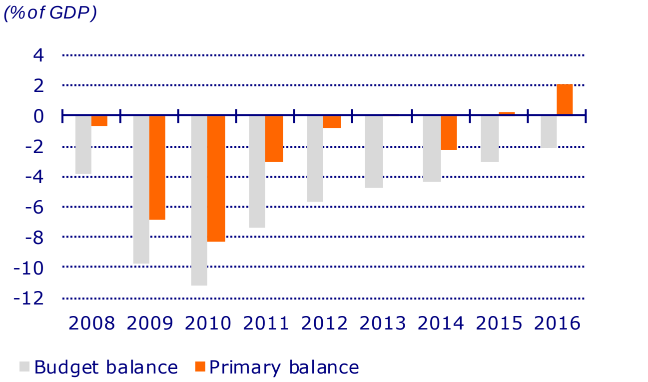
NFC debt

(% of GDP)



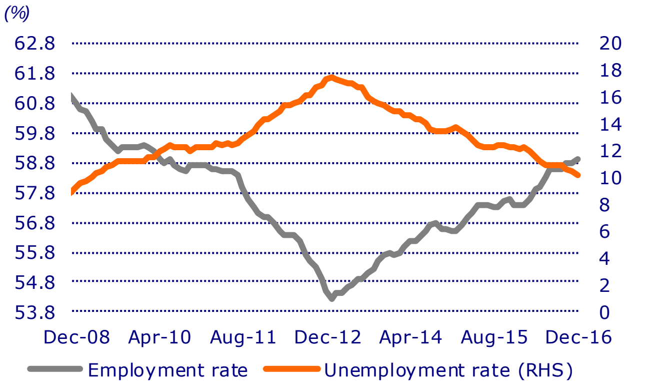
Source: Bank of Portugal

Budget balance



Sources: Ameco, INE, IMF, IGCP, DGO

Labour market



Source: INE

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