

# Recent developments and challenges for the Portuguese economy



BANCO DE PORTUGAL  
EUROSYSTEM

**Pedro Duarte Neves** • Banco de Portugal, Vice Governor

**Norges Bank, June 1, 2017**



- 1. The adjustment of the Portuguese economy**
- 2. Recent developments**
- 3. The macroeconomic outlook**
- 4. Challenges ahead**
- 5. Conclusions**



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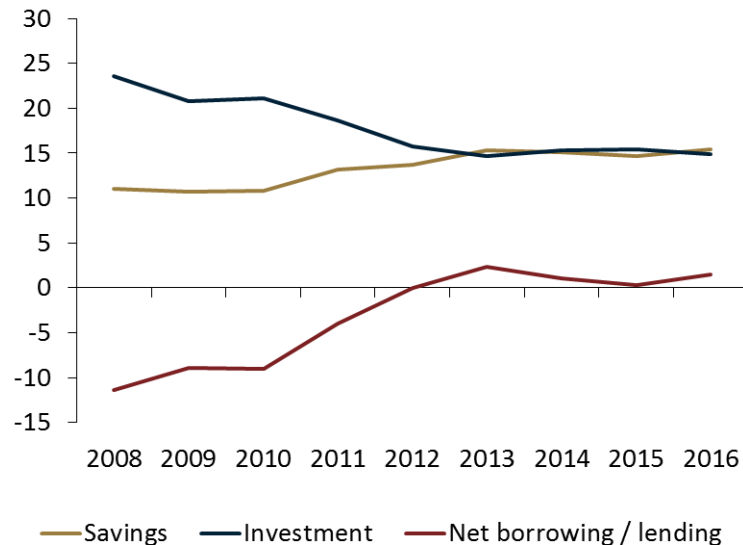


# 1. The adjustment of the economy

- **Sizeable adjustment of imbalances, in a monetary union**

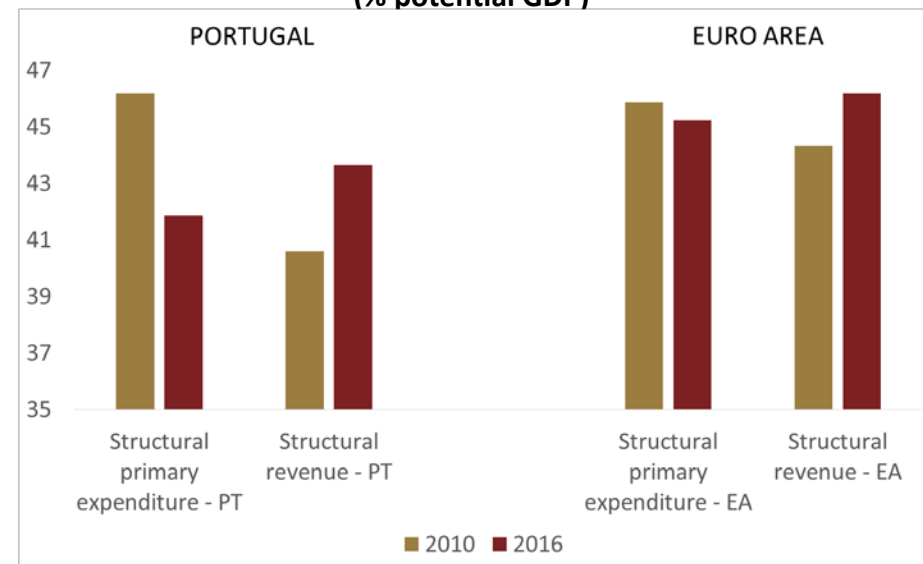
- i) The economy has remained a net lender to the rest of the world since 2013, after many years being a sizeable net borrower
- ii) Strong and unprecedented structural fiscal consolidation since 2011, both from the expenditure and revenue sides

Net borrowing / lending capacity (% GDP)



Sources: INE and Banco de Portugal

Structural fiscal developments between 2010-16  
(% potential GDP)



Source: European Commission

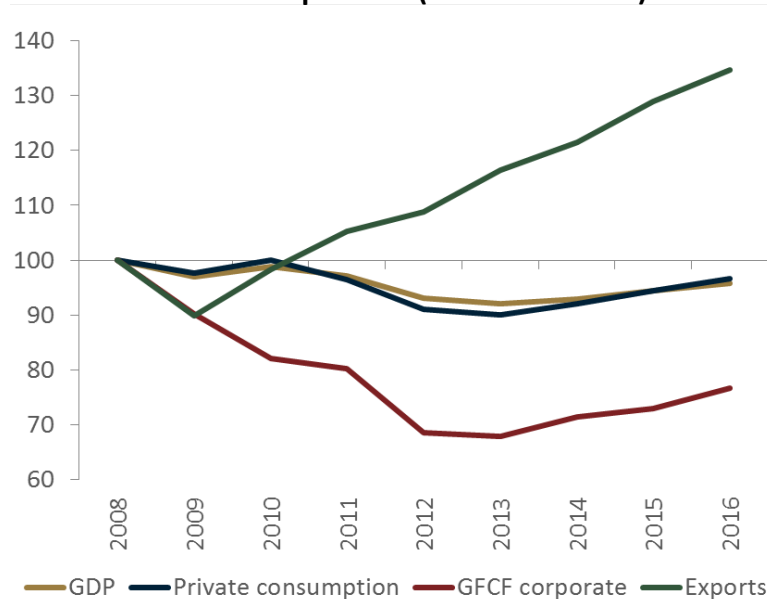


# 1. The adjustment of the economy

- **The restructuring of the economy**

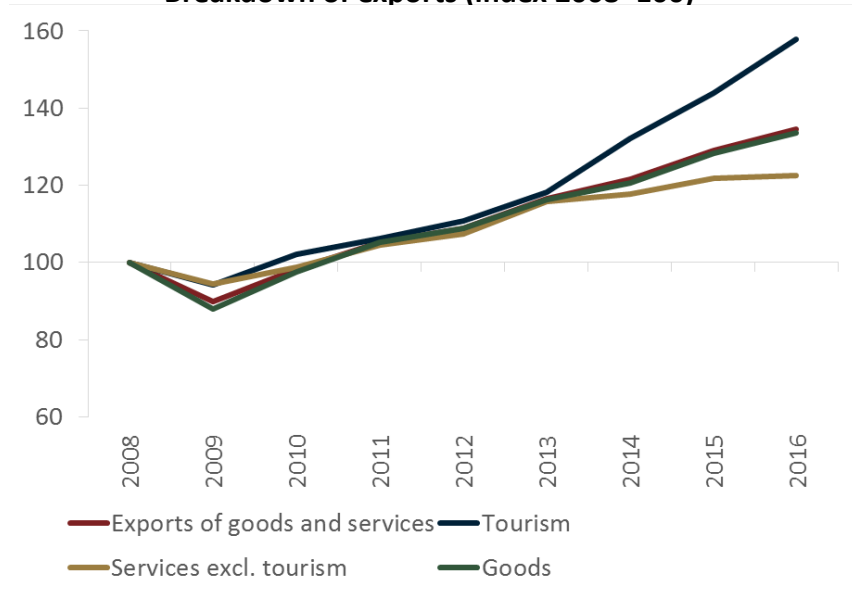
- i) Weight of exports in GDP increased 12 p.p. between 2010 and 2016
- ii) Export market share gains of around 15 p.p. in 2010-16
- iii) Reallocation of resources towards more productive firms

**GDP and components (index 2008=100)**



Sources: INE and Banco de Portugal calculations

**Breakdown of exports (index 2008=100)**



Sources: INE and Banco de Portugal calculations

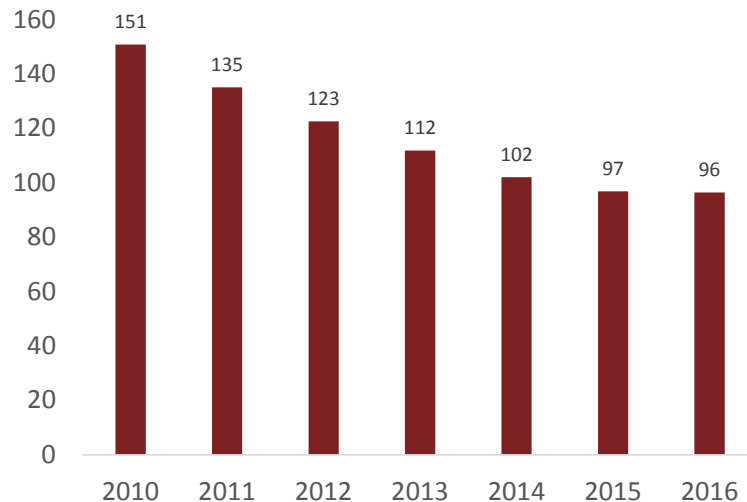


# 1. The adjustment of the economy

- **The strengthening of the financial system**

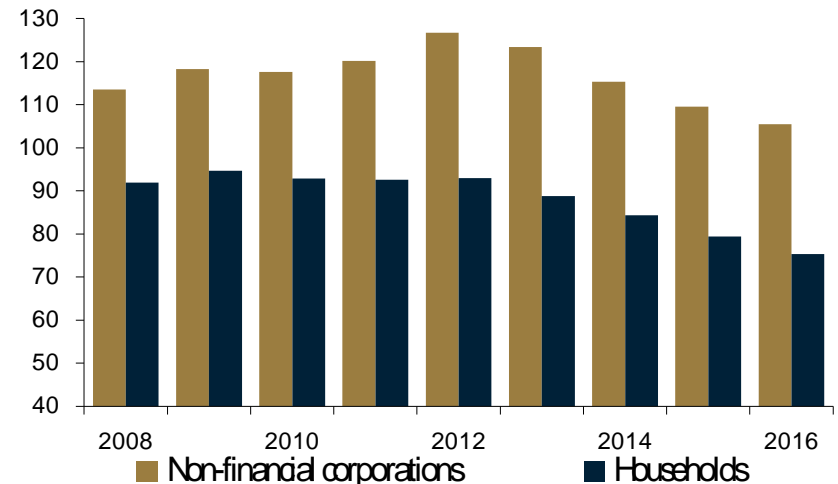
i) Significant decline in the loan-to-deposit ratio, consistent with the deleveraging process in the private sector

Loan-to-deposit ratio, in % (value at end of period)



Source: Banco de Portugal

Indebtedness of NFCs and households (as a % of GDP)



Sources: INE and Banco de Portugal

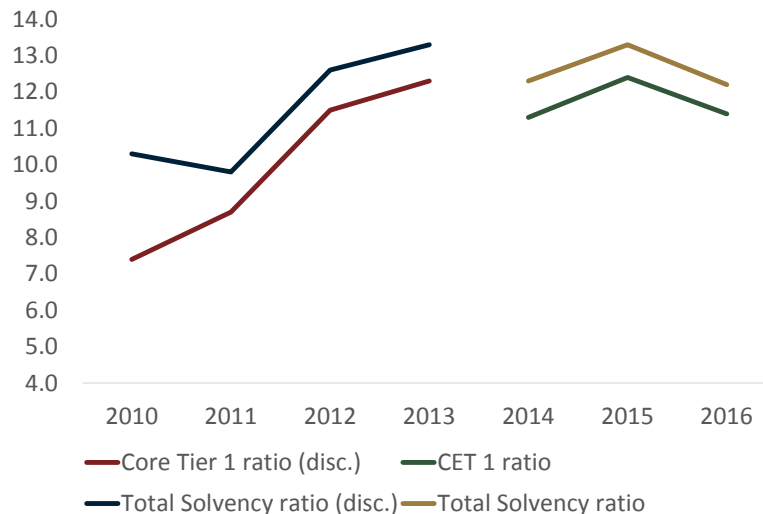


# 1. The adjustment of the economy

## • The strengthening of the financial system

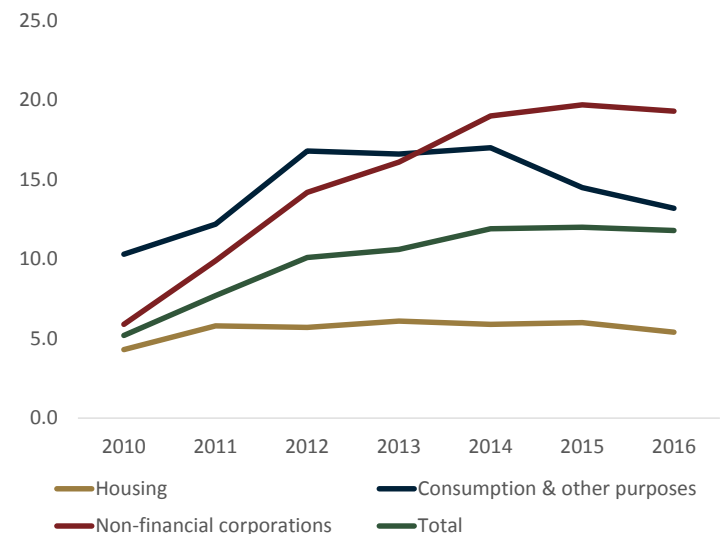
- i) Significant decline in the loan-to-deposit ratio, consistent with the deleveraging process in the private sector
- ii) Improved solvency and liquidity position of banks, furthered in 2017
- iii) The high level of NPLs in the banking sector remains a challenge

Own funds ratios, in % (value at end of period)



Source: Banco de Portugal

Credit at risk ratio, in % (values at end-period)



Source: Banco de Portugal



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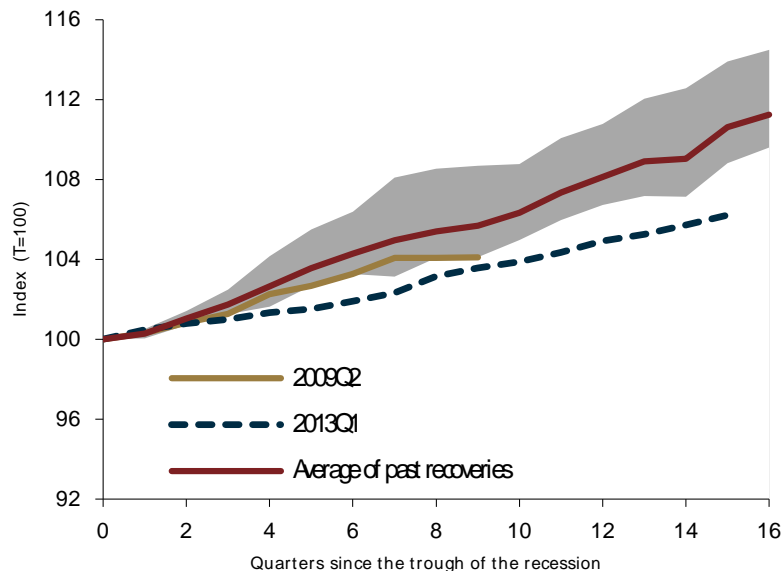




## 2. Recent developments

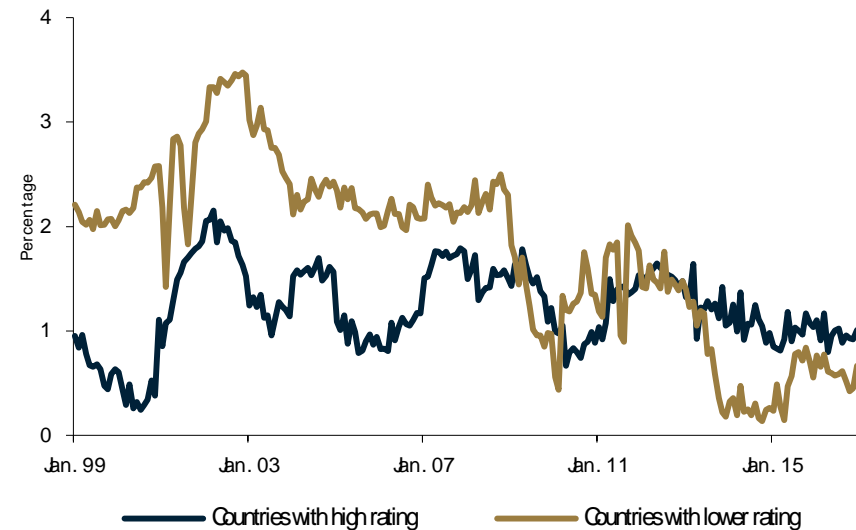
- **The international environment is improving, but downside risks are still prevalent in the medium term**
  - i) The recovery in the euro area is becoming more broad-based
  - ii) Sustained adjustment of inflation is still a challenge for the ECB

**GDP evolution in the euro area  
(index; T = 100 in the trough of the recession)**



Sources: EUROSTAT, CEPR and Banco de Portugal calculations

**HICP in the euro area  
(y-o-y rate of change)**



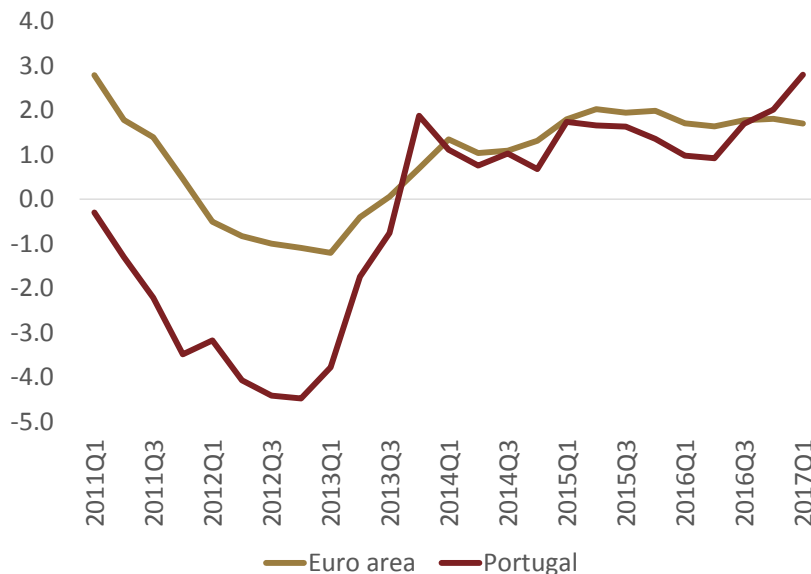
Source: ECB, EUROSTAT and calculations by Banco de Portugal  
Note: Countries with high rating: DE, FR, NL, BEL, AT, FIN;  
Countries with lower rating: IT, ES, GRE, PT, IRL, CYP



## 2. Recent developments

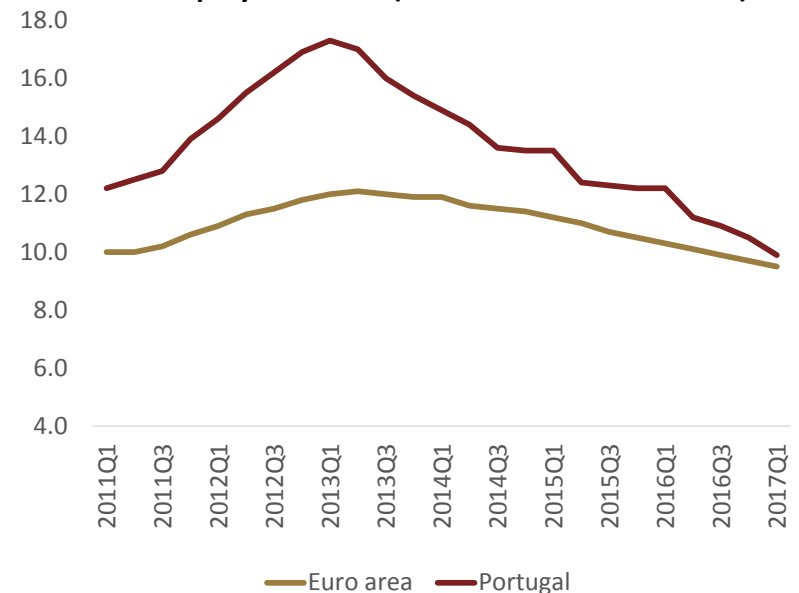
- **A gradual but strengthening recovery in the Portuguese economy**
  - i) Y-o-y GDP growth close to the euro area by end-2016 and significantly above in 2017Q1
  - ii) Improvements in the labour market, albeit long-term and structural unemployment remain high

Year-on-year rate of change of GDP (per cent)



Source: EUROSTAT and INE

Unemployment rate (as a % of the labour force)

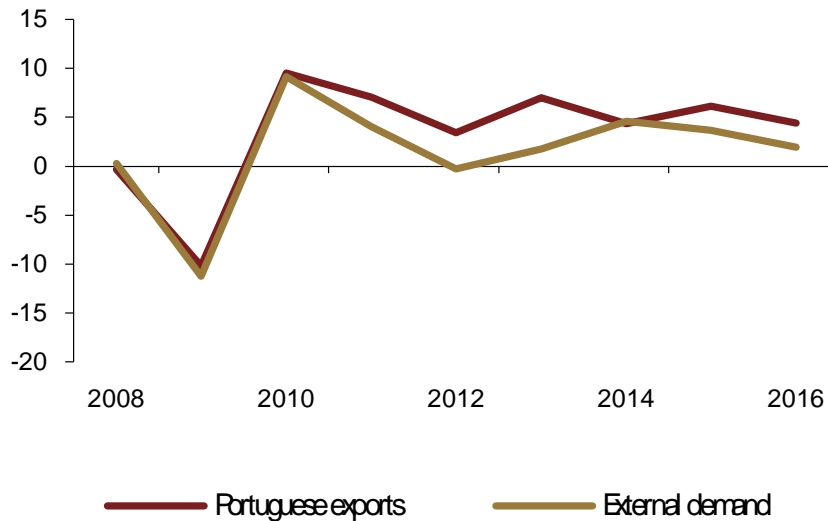


Source: EUROSTAT and INE



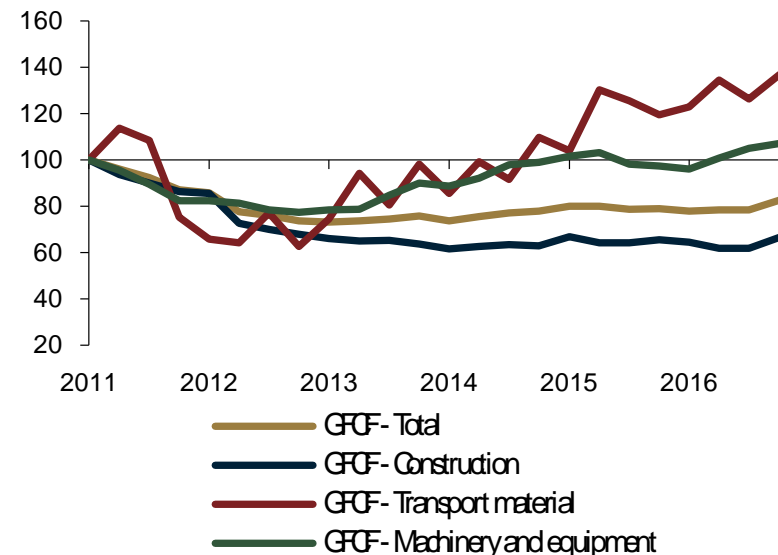
- **The recovery is rooted in the dynamism of exports**
  - i) Robust export growth across a broad set of sectors and destinations, with market share gains after 2010
  - ii) Investment dynamics has accelerated since 2016, notably in the corporate sector

Exports of goods and services and external demand  
(y-o-y rate, in percentage)



Sources: INE, IMF, ECB and calculations by Banco de Portugal

Evolution of GFCF in Portugal, by type of investment  
(index 2011Q1=100)

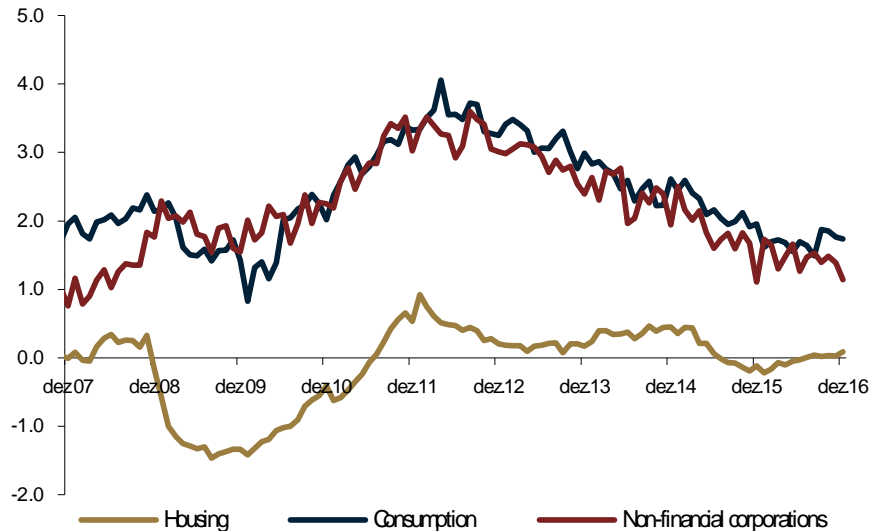


Source: INE and calculations by Banco de Portugal



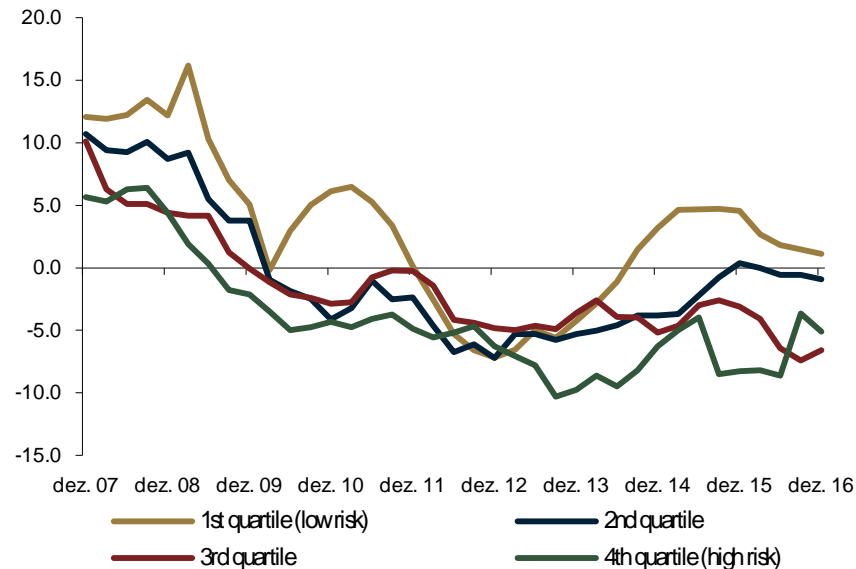
- **Credit developments have supported the recovery**
  - i) Improvement in credit market conditions since 2013
  - ii) Credit flows have been channeled to the most dynamic and productive firms, notably exporting firms in the private sector

Interest rate differentials vis-à-vis the euro area (in p.p.)



Sources: Consensus Economics, Thomson Reuters and Banco de Portugal

Credit growth to private firms, by risk profile (per cent)



Note: Low (high) risk corresponds to the low (high) z-score deciles  
Source: Banco de Portugal

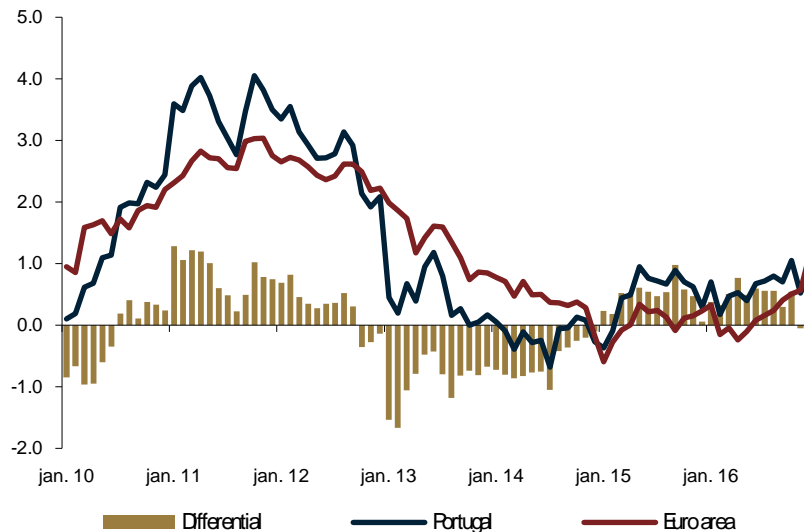


## 2. Recent developments

- **Inflation close to the euro area average**

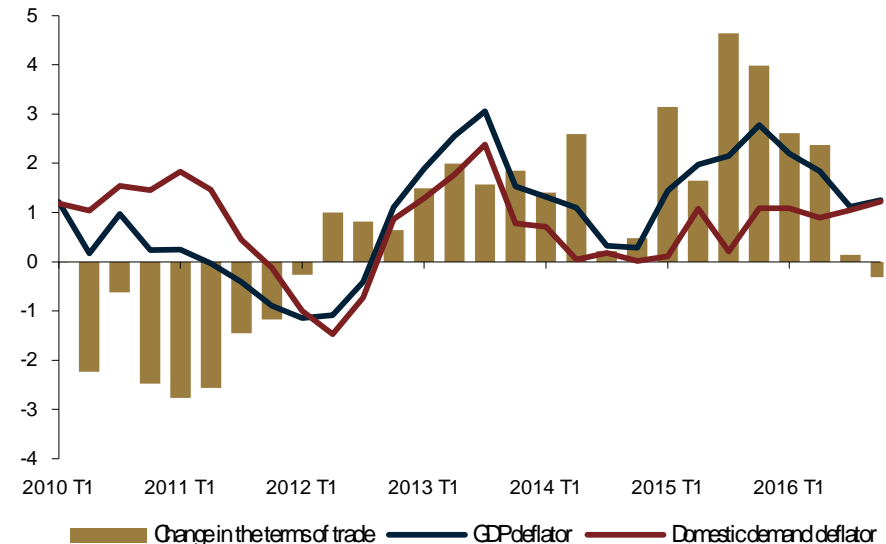
- i) Increase in inflation during 2016 due to the recovery in energy prices
- ii) The increase in oil prices implied a negative change in the terms of trade in the last quarter of 2016

**HICP – Portugal and euro area**  
(y-o-y rate of change, in percentage and p.p.)



Source: INE and EUROSTAT

**GDP deflator, domestic demand deflator and terms of trade**  
(in percentage)



Source: INE



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### 3. The macroeconomic outlook

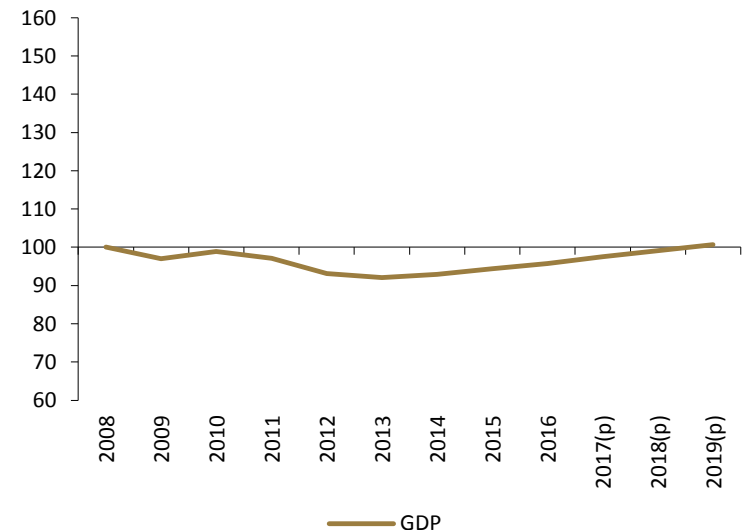
- **The latest macroeconomic projections by Banco de Portugal**
  - i) GDP growth close to the euro area average in the projection horizon

**Projection March 2016**  
(annual rate of change, per cent, except where indicated)

	2016	2017 <sup>(p)</sup>	2018 <sup>(p)</sup>	2019 <sup>(p)</sup>
Gross domestic product	1.4	1.8	1.7	1.6
Private consumption	2.3	2.1	1.4	1.4
Public consumption	0.8	0.2	0.5	0.2
Gross fixed capital formation	-0.3	6.8	5.0	4.8
Exports	4.4	6.0	4.8	4.5
Imports	4.4	7.3	4.8	4.7
Current plus capital account (% of GDP)	1.7	1.0	1.1	1.2
HICP	0.6	1.6	1.5	1.5

Sources: INE e Banco de Portugal.

**Evolution of GDP composition (index, 2008=100)**



Sources: INE and Banco de Portugal

Note: (p) - projected



## 3. The macroeconomic outlook

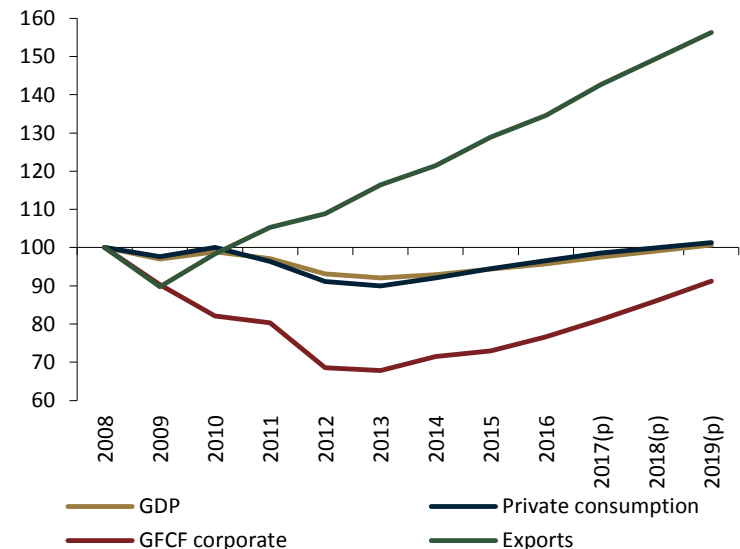
- **The latest macroeconomic projections by Banco de Portugal**
  - i) GDP growth close to the euro area average in the projection horizon
  - ii) Strong exports dynamics and recovery of domestic demand, notably investment

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## 3. The macroeconomic outlook

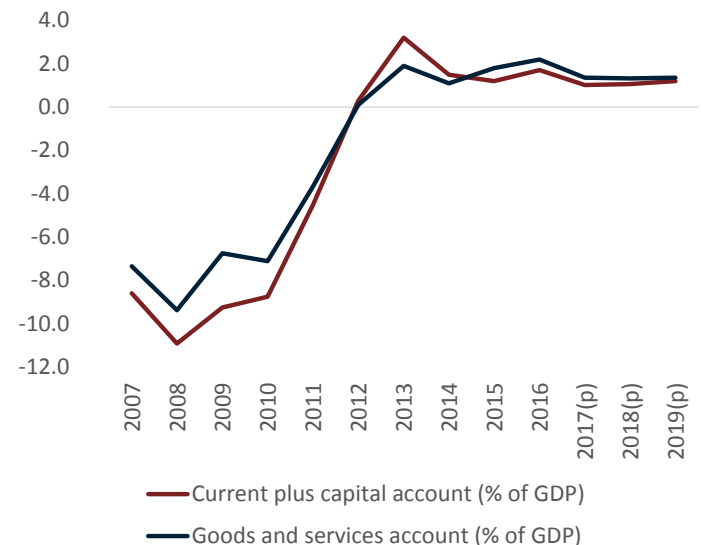
- **The latest macroeconomic projections by Banco de Portugal**
  - i) GDP growth close to the euro area average in the projection horizon
  - ii) Strong exports dynamics and recovery of domestic demand, notably investment
  - iii) Sustained correction of macroeconomic imbalances

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Sources: INE e Banco de Portugal.

Current and capital account (% of GDP)



Sources: INE and Banco de Portugal

Note: (p) - projected



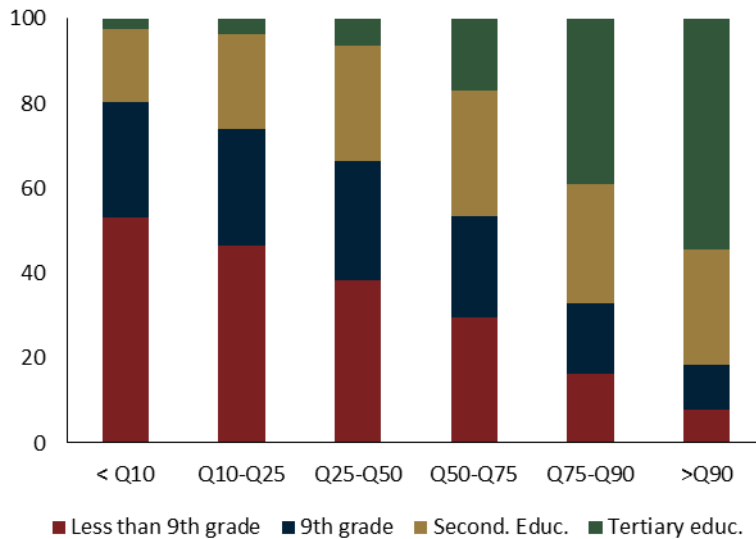
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## 4. Challenges to the Portuguese economy

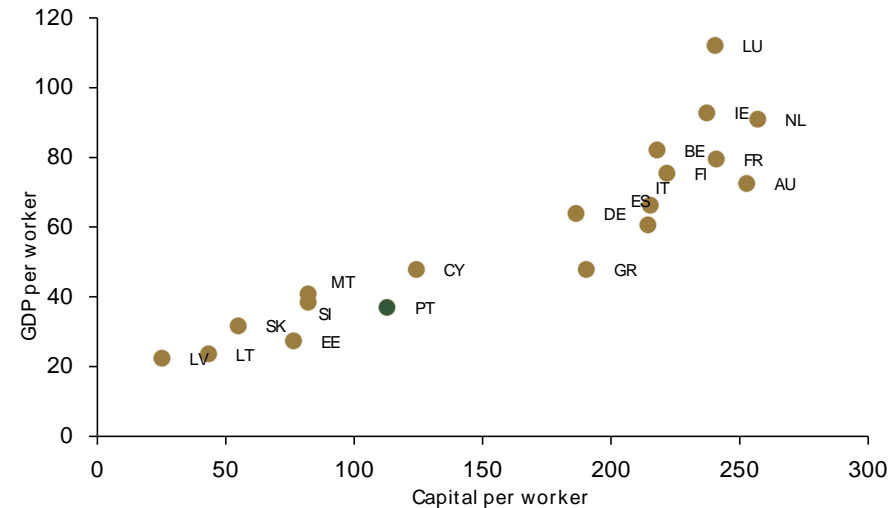
- **Investments in human and physical capital are key**
  - i) High level of education inequality in Portugal; the qualification of the younger cohorts is already at the EU average
  - ii) The returns on physical investment depend on their allocation

Educational composition of the wage distribution (2013)



Source: Campos and Reis (2017), "Revisiting the returns to schooling in the Portuguese economy", Banco de Portugal Economic Studies Vol. 3(2)

Capital and GDP per worker (average 2007-16) – thousands of euros



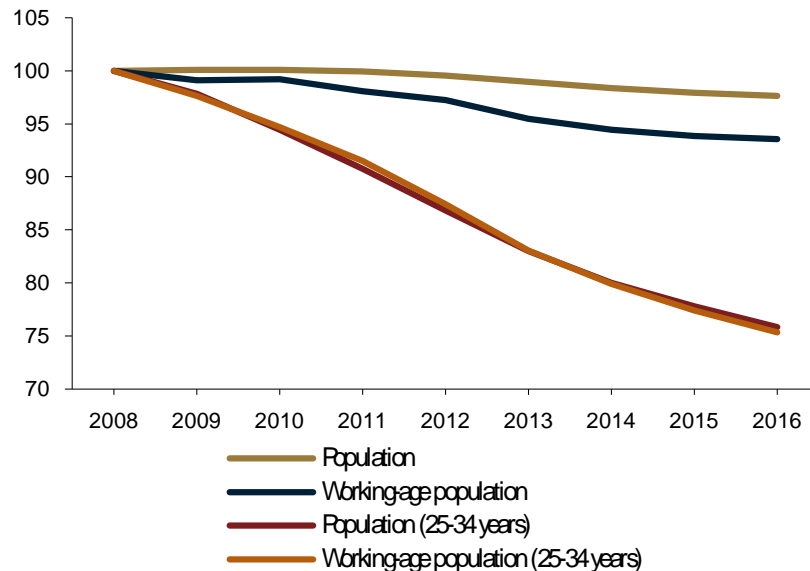
Source: EUROSTAT



## 4. Challenges to the Portuguese economy

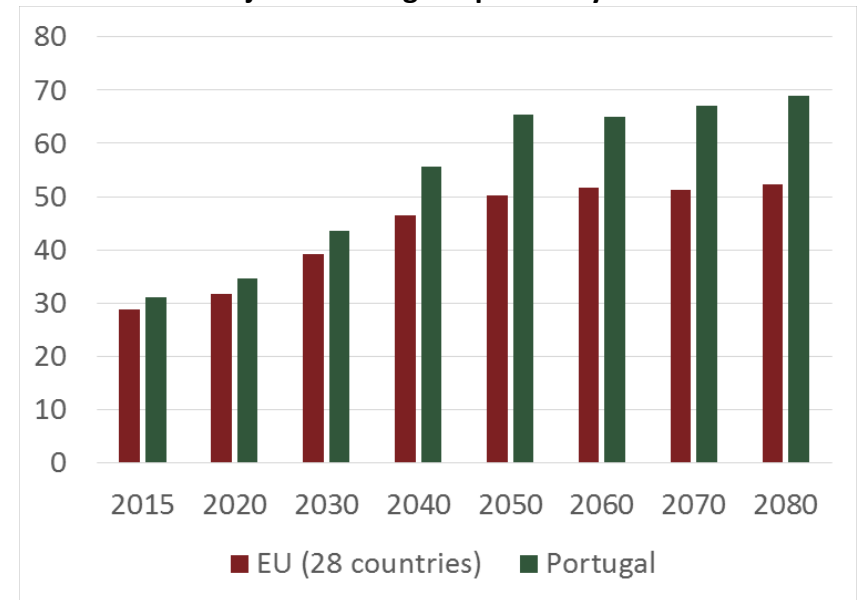
- **The ageing society is an important issue in Portugal**
  - i) Total population and working-age population are declining
  - ii) The projected old-age dependency ratio is one of the highest in Europe

Population and working-age population (index 2008=100)



Source: Employment Survey

Projected old-age dependency ratio



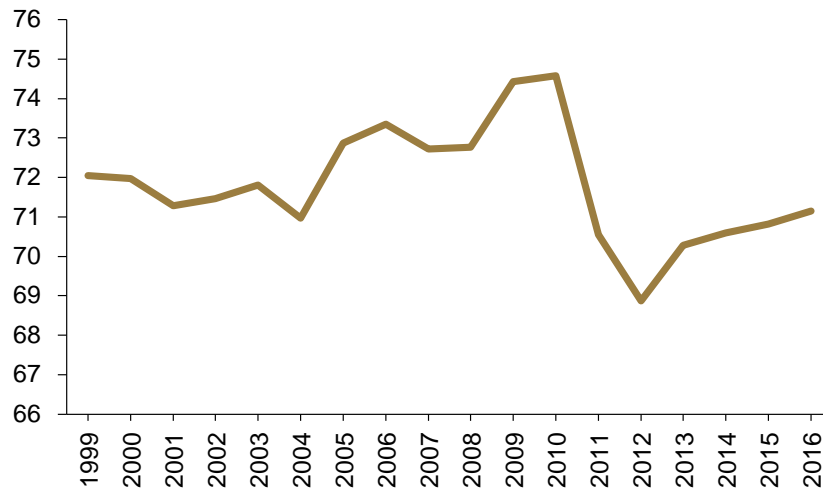
Note: Ratio between the projected number of persons aged over 64 and the projected number of persons aged between 15 and 64  
Source: EUROSTAT



## 4. Challenges to the Portuguese economy

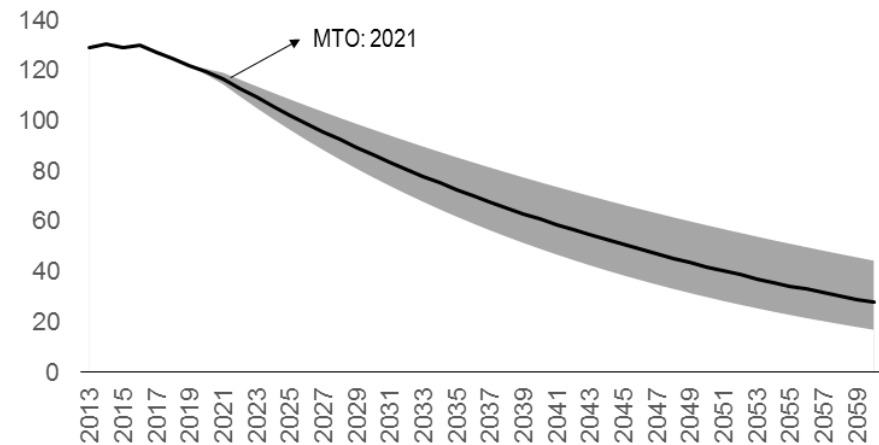
- **Improving long-run growth and anchoring the downward path of public debt are of the essence**
  - i) There is a need to sustain the reform momentum
  - ii) Fulfilling the Fiscal Compact – including further structural fiscal consolidation – ensures debt sustainability

GDP per capita at PPP (as a % of GDP in EU15)



Source: European Commission (AMECO)

Public debt ratio (% of GDP): fulfillment of the European commitments (+/- 1% nominal GDP growth)



Source: EUROSTAT and Banco de Portugal calculations



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- The Portuguese economy has improved its underlying fundamentals in the recent past, notably rooted in an outstanding performance of exports of goods and services
- The Portuguese economy continues to face several important challenges, *inter alia* related to the high indebtedness levels of both the public and the private sectors
- Sustaining the ongoing macroeconomic adjustment requires a stable macroeconomic framework and long-term commitments which anchor agents' incentives
- Further institutional deepening on a European level – notably the completion of the Banking Union – is essential to foster macroeconomic stability and enhance potential growth