# Economic Bulletin

December 2018

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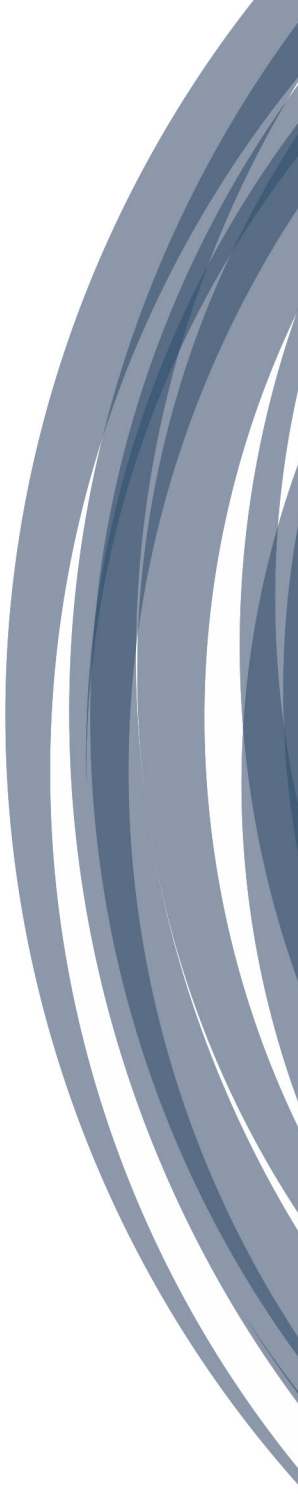
# Contents



# I Projections for the Portuguese economy: 2018-2021

# 1 Introduction

Over the 2018-21 horizon, according to the projections published in this Bulletin, the Portuguese economy is expected to maintain a growth trajectory, albeit with some deceleration (Table I.1.1). The projected profile corresponds to a maturing phase of the economic cycle, in which the output gap, following a value close to zero in 2017, will be positive in subsequent years, and growth is expected to converge gradually to its potential rate (Box 1). Projections for GDP growth in Portugal are broadly in line with those published for the euro area as a whole by the European Central Bank (ECB), within the scope of the Eurosystem's projection exercise for December 2018. Against this background, the degree of cyclical synchronisation in the euro area remains high (Chart I.1.1).

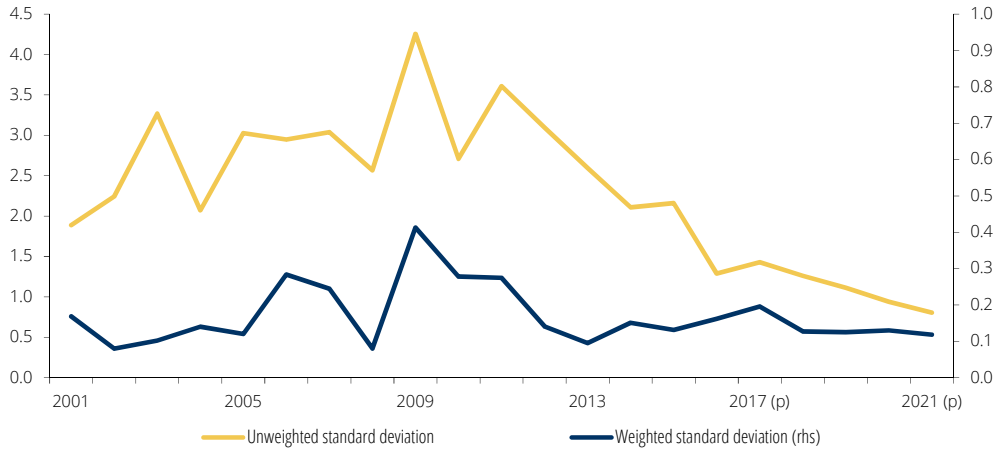
**Table I.1.1 • Projections of Banco de Portugal for 2018-2021 | Annual rate of change, in percentage**

| | Weights 2017 | EB December 2018 | | | | | EB October 2018 | EB June 2018 | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2017 | 2018 (p) | 2019 (p) | 2020 (p) | 2021 (p) | 2018 (p) | 2018 (p) | 2019 (p) | 2020 (p) |
| Gross domestic product | 100 | 2.8 | 2.1 | 1.8 | 1.7 | 1.6 | 2.3 | 2.3 | 1.9 | 1.7 |
| Private consumption | 65 | 2.3 | 2.3 | 2.0 | 1.8 | 1.6 | 2.4 | 2.2 | 1.9 | 1.7 |
| Public consumption | 18 | 0.2 | 0.7 | 0.1 | 0.0 | 0.2 | 0.7 | 0.8 | 0.1 | 0.2 |
| Gross fixed capital formation | 17 | 9.2 | 3.9 | 6.6 | 5.9 | 4.9 | 3.9 | 5.8 | 5.5 | 5.4 |
| Domestic demand | 99 | 3.0 | 2.4 | 2.4 | 2.2 | 2.0 | 2.4 | 2.5 | 2.2 | 2.1 |
| Exports | 43 | 7.8 | 3.6 | 3.7 | 4.0 | 3.6 | 5.0 | 5.5 | 4.6 | 4.3 |
| Imports | 42 | 8.1 | 4.1 | 4.7 | 4.9 | 4.2 | 5.1 | 5.7 | 5.0 | 5.0 |
| Contribution to GDP growth, net of imports (in p.p.) (a) | | | | | | | | | | |
| Domestic demand | | 1.3 | 1.2 | 1.2 | 1.0 | 1.0 | 1.2 | 1.1 | 1.0 | 0.9 |
| Exports | | 1.5 | 0.9 | 0.7 | 0.7 | 0.6 | 1.1 | 1.2 | 0.9 | 0.8 |
| Employment (b) | | 3.3 | 2.2 | 1.2 | 0.9 | 0.4 | 2.3 | 2.6 | 1.2 | 0.9 |
| Unemployment rate | | 8.9 | 7.0 | 6.2 | 5.5 | 5.3 | 7.0 | 7.2 | 6.2 | 5.6 |
| Current plus capital account (% of GDP) | | 1.4 | 1.3 | 1.3 | 1.3 | 1.6 | 1.4 | 1.8 | 1.8 | 1.8 |
| Trade balance (% of GDP) | | 1.8 | 1.5 | 1.1 | 0.9 | 0.7 | 1.3 | 0.9 | 1.0 | 0.9 |
| Harmonized index of consumer prices | | 1.6 | 1.4 | 1.4 | 1.5 | 1.6 | 1.4 | 1.4 | 1.5 | 1.4 |

Sources: Statistics Portugal and Banco de Portugal. | Notes: (p) – projected, (p.p.) – percentage points. For each aggregate, this table shows the projection corresponding to the most likely value, conditional on the set of assumptions considered. (a) The demand aggregates net of imports are obtained by subtracting an estimate of the imports needed to meet each component. The calculation of the import content was based on information available for the year 2013. For more details, see Box "The import content of global demand in Portugal", *Economic Bulletin*, December 2017. (b) Total employment, in number of persons according to the national accounts concept.

After growing significantly more than activity in 2017 and 2018, international trade is expected to move more closely to world GDP over the projection horizon, implying a stable growth rate of the external demand for Portuguese goods and services in 2019-21. The remaining main variables of the external environment are also expected to present relatively favourable developments in 2018-21, notwithstanding the expected beginning of the normalisation of monetary policy in the euro area, which will yet remain accommodative over the projection horizon (Chapter 2). However, despite this benign central scenario, the external environment is the source of the main risks surrounding the current projections (Chapter 6).

**Chart I.1.1** • GDP growth dispersion in euro area countries

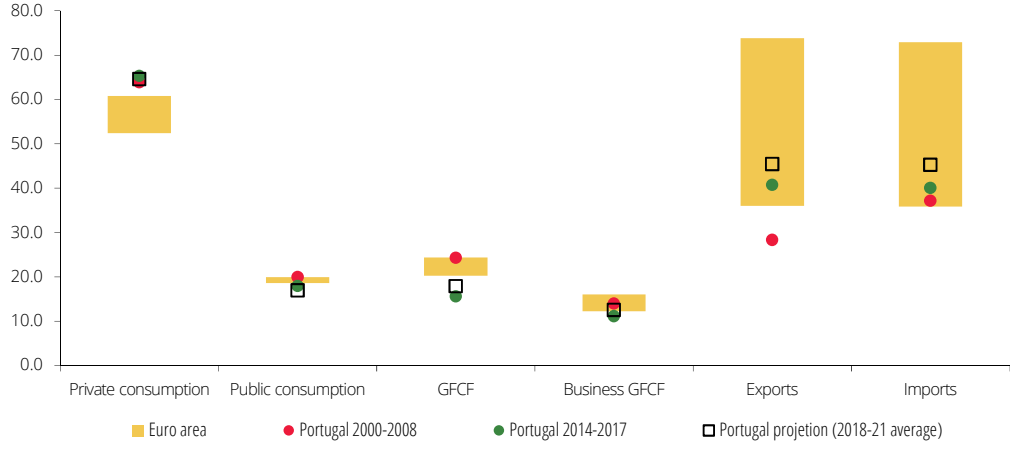



Sources: ECB, Statistics Portugal and Banco de Portugal. | Notes: (p) – projected. The chart refers to the 19 euro area countries excluinding Ireland, whose 25% GDP growth in 2015 constitutes an outlier.

The recovery period subsequent to 2013 was characterised by the continued increase in the weight of exports in GDP (Chart I.1.2), a trend that extends to all components, with emphasis on tourism, which presented the greatest cumulative growth. Corporate GFCF accelerated significantly during this period, and is expected to reach at the end of the horizon a level 8% higher than that observed in 2008 (Chart I.1.3). In contrast, public and housing investment remain below the average observed prior to the international financial crisis. The weight of private consumption in GDP remained relatively unchanged during this period. The current projections prolong these trends, which are consistent with a more sustainable growth profile for the Portuguese economy.

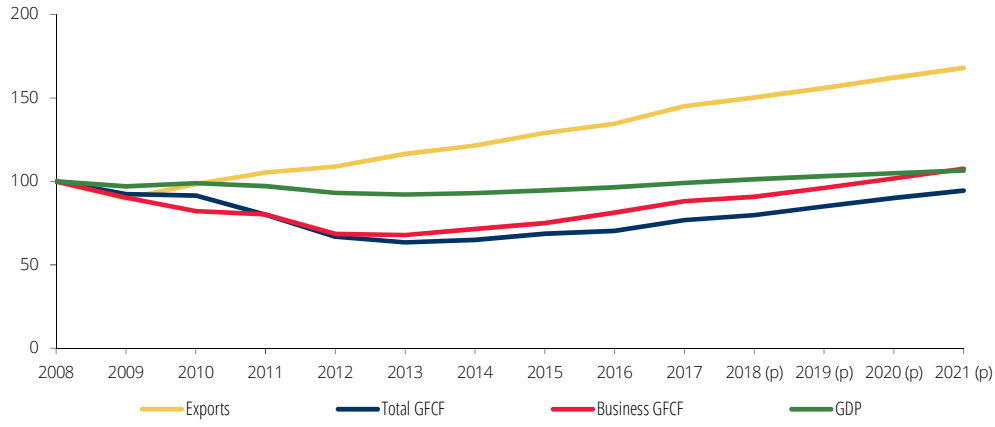
Net of import content, the profile projected for GDP reflects a progressively lower contribution of exports in 2018-21 (Chart I.1.4). The contribution made by domestic demand net of import content to GDP growth is also projected to decrease slightly over the projection horizon.

**Chart I.1.2** • Weight of expenditure components on GDP in Portugal and the euro area
| In percentage of nominal GDP



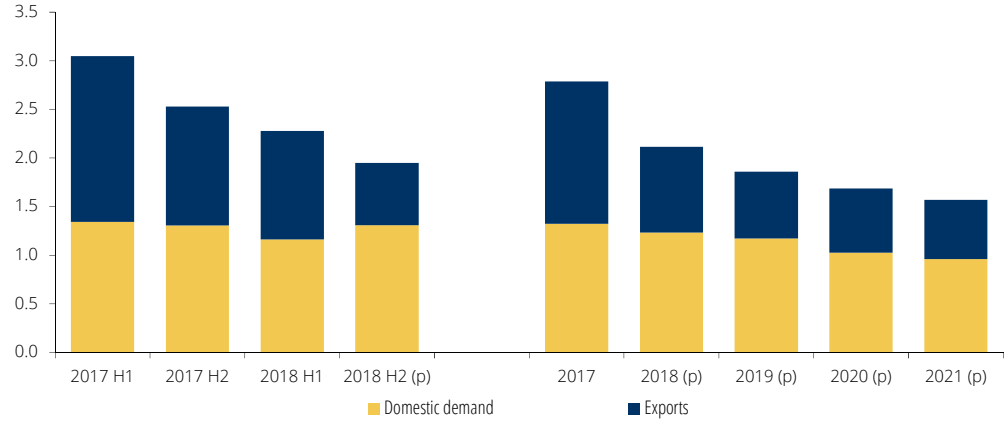

Sources: ECB, Statistics Portugal and Banco de Portugal. | Note: The shaded area defines the 25 to 75 percentile interval for the 2000-2017 average of euro area countries.

**Chart I.1.3** • Developments in GDP, GFCF and exports | Index 2008=100




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

**Chart I.1.4** • Net contributions to the year-on-year rate of change of GDP | In percentage points




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

Over the projection horizon, the Portuguese economy is expected to maintain a net lending position towards the rest of the world, as observed since 2012. The combined current and capital account balance is expected to stand at 1.3% of GDP on average in 2018-20, relatively unchanged from 2017, increasing to 1.6% at the end of the horizon. However, a change in composition is anticipated given that a decrease in the goods and services balance is projected to be offset by developments in the primary income and capital accounts. The reduction in the primary income account deficit reflects the profile anticipated for public debt interest, while the increase in the capital account balance in 2018-20 largely reflects the expected developments in inflows of Community funds within the scope of the Portugal 2020 Programme, and in 2021, a one-off transfer from the European Financial Stability Facility.

Following very dynamic growth in 2017, employment is expected to return to growth rates that are, on average, more in line with its historical relationship with activity over the projection horizon, which implies that the unemployment rate will continue to fall, although more slowly than in recent

years. Total and working age population developments remain a structural supply constraint of the economy.

Despite the projected deceleration trend, employment is expected to remain the main factor contributing to growth of GDP *per capita* on average over the projection horizon. Physical capital and total factor productivity are also expected to make positive contributions to economic growth, in contrast to developments in the 2014-17 period. In this context, the contribution of human capital is significant and is expected to remain an important growth factor in the long term.

Inflation, measured by the Harmonised Index of Consumer Prices (HICP) is expected to remain at relatively moderate levels, lower than those projected for the euro area. Inflation excluding energy will present an upward path, reflecting inflationary pressures stemming from wage costs. This is expected to be partially offset by slower growth in energy goods prices in 2019-21, in line with the technical assumptions relating to oil prices in euro.

The current projections indicate slightly lower GDP growth in 2018 and 2019 compared with the figures published in the previous two issues of the *Economic Bulletin*, chiefly due to a downward revision of export growth. This reflects a revision of the assumptions relating to developments in external demand and the incorporation of the most recent information. Inflation projections remain relatively unchanged in comparison with those published previously.

# 2 External environment and technical assumptions of the projections

The external environment of the Portuguese economy has been generally favourable in 2018. The global economy has continued to expand at a solid pace against a background of continuing favourable financial and labour market conditions and relatively high levels of confidence of economic agents in the major advanced economies. However, certain previously anticipated downward risks have materialised during the year, namely an increase in trade protectionism and episodes of financial turmoil in certain more vulnerable emerging economies, in a context of monetary policy normalisation in the USA and lower risk appetite by international investors. Against this background, global GDP growth in 2018 was less synchronized across countries.

Along the projection horizon, the global economic expansion is expected to proceed at a more moderate pace reflecting the maturing economic cycle and the gradual reduction in monetary and budgetary policy stimuli in the major advanced economies, especially the USA, as well as the gradual deceleration of the Chinese economy. In turn, a recovery in activity is expected in those emerging economies most affected by the recent episodes of financial turmoil. According to the Eurosystem's projection exercise, global GDP will maintain a growth rate of 3.6% in 2018 and decelerate to around 3.3% in the period 2019-21 (Table I.2.1).[1] In the euro area, activity is expected

1. The projections for global activity and trade, as well as for euro area GDP as referred to in this Bulletin are the result of the Eurosystem projection exercise published on 13 December by the ECB (see 'Eurosystem staff macroeconomic projections for the euro area', December 2018, available at https://www.ecb.europa.eu/pub/pdf/other/ecb.projections201812_eurosystemstaff.en.pdf?41e4003141ddb316da9155918404c4cf). The external environment of the euro area and technical assumptions on oil prices, interest rates and exchange rates incorporate the data available up to 21 November.

to register a more pronounced slowdown in 2018 (from 2.5% to 1.9%), reflecting developments in the four largest economies in the area. A more gradual deceleration is projected subsequently, to 1.5% in 2021, with emphasis on the significant contribution of the Spanish economy for this slowdown.

**Table I.2.1** • Projection assumptions: 2018-2021

| | | EB December 2018 | | | | | Revisions from EB June 2018 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2017 | 2018 (p) | 2019 (p) | 2020 (p) | 2021 (p) | 2017 | 2018 | 2019 | 2020 |
| International environment | | | | | | | | | | |
| World GDP | arc | 3.6 | 3.6 | 3.3 | 3.4 | 3.3 | 0.0 | -0.2 | -0.3 | 0.0 |
| Euro area GDP | arc | 2.5 | 1.9 | 1.7 | 1.7 | 1.5 | 0.0 | -0.2 | -0.2 | 0.0 |
| World trade | arc | 5.2 | 4.7 | 3.7 | 3.7 | 3.9 | 0.1 | -0.4 | -0.8 | -0.3 |
| External demand | arc | 4.6 | 3.4 | 3.6 | 3.8 | 3.4 | 0.1 | -0.9 | -0.8 | -0.1 |
| Oil prices in dollars | aav | 54.4 | 71.8 | 67.5 | 66.8 | 65.9 | 0.0 | -2.7 | -6.0 | -1.9 |
| Oil prices in euros | aav | 48.2 | 60.9 | 59.5 | 58.8 | 58.1 | 0.0 | -1.3 | -2.6 | 0.9 |
| Monetary and financial assumptions | | | | | | | | | | |
| Short-term interest rate (3-month EURIBOR) | % | -0.3 | -0.3 | -0.3 | 0.0 | 0.3 | 0.0 | 0.0 | -0.1 | -0.2 |
| Implicit interest rate in public debt | % | 3.1 | 2.9 | 2.8 | 2.8 | 2.7 | 0.0 | -0.1 | -0.1 | -0.1 |
| Effective exchange rate index | arc | 2.3 | 2.4 | -0.7 | 0.0 | 0.0 | 0.0 | 0.3 | -0.2 | 0.0 |
| Euro-dollar exchange rate | aav | 1.13 | 1.18 | 1.14 | 1.14 | 1.14 | 0.0 | 0.0 | 0.0 | 0.0 |

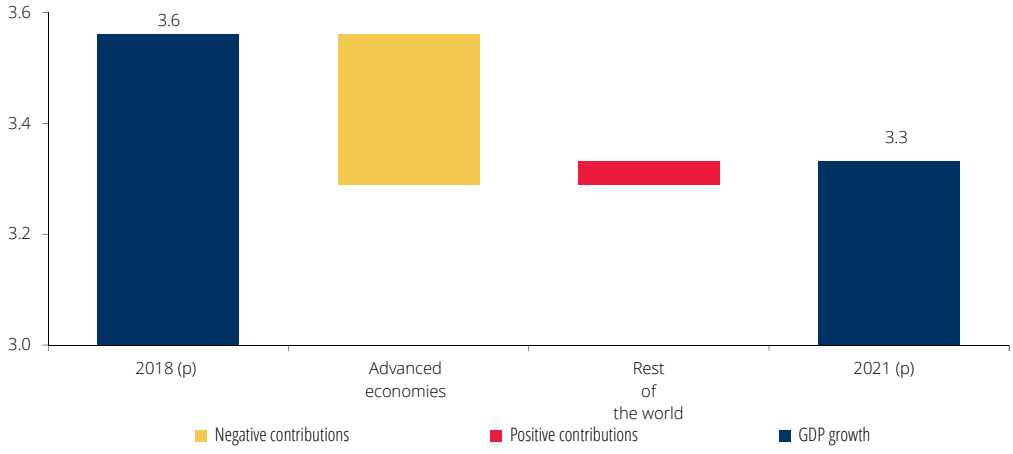
Source: Eurosystem (Banco de Portugal calculations). | Notes: aav – annual average value. arc – annual rate of change. An increase in the exchange rate corresponds to an appreciation of the euro. The technical assumption for bilateral exchange rates assumes that the average levels observed in the two weeks prior to the cut-off date will remain unchanged over the projection horizon. The technical assumption for oil prices is based on futures markets. Developments in the three-month Euribor rate are based on expectations implied in futures contracts. The implicit interest rate on public debt is computed as the ratio of interest expenditure for the year to the simple average of the stock of debt at the end of the same year and at the end of the preceding year. Assumptions for the long-term interest rate on portuguese public debt are based on an assumption for the implicit rate, which includes an assumption for the interest rate associated with new issuances.

Global trade decelerated faster than economic activity, but is expected to maintain a relatively strong growth rate in 2018. This development is consistent with the position in the economic cycle of the advanced economies, which translates into a moderation of economic activity and especially of investment and exports. The USA's increase in import tariffs, in particular those from China, and respective retaliatory measures, are negatively affecting trade flows between these two countries. Note that the measures implemented only cover a small proportion of world trade and the effects on economic agents' confidence were contained. Notwithstanding, the uncertainty regarding the future world trade environment, associated with a potential increase in protectionism as well as the United Kingdom's departure from the EU, may translate into a postponement of investment decisions with further implications on trade given the close relationship between these two flows[2]. In this context, forecasts for world trade suggest a reduction in trade growth to a pace closer to that projected for expansion of activity (Chart I.2.1). Therefore, external demand for Portuguese

2. For further details on the potential impact of these factors, see Box "Macroeconomic impact of a rise in global protectionist tensions" in the June 2018 issue of the *Economic Bulletin*.

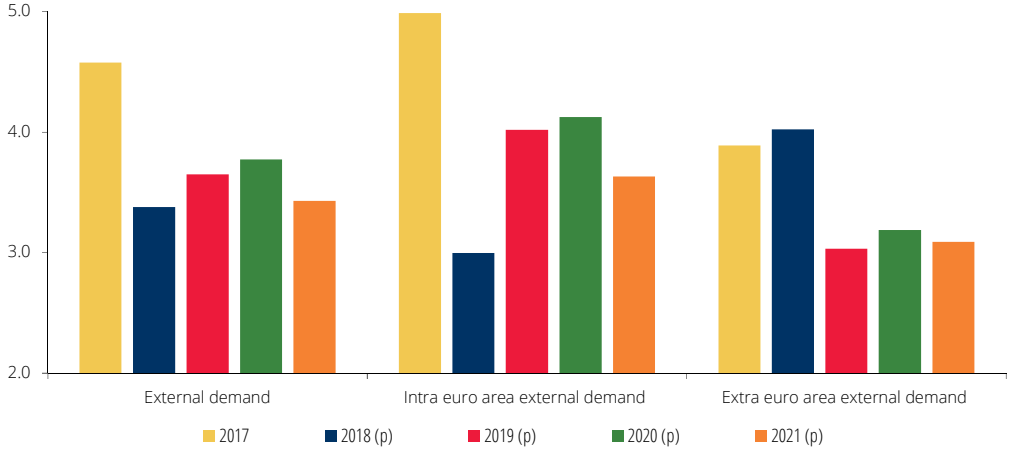
goods and services is expected to decelerate sharply in 2018 (from 4.6% to 3.4%), reflecting the marked slowdown in intra-euro area imports, but recover subsequently to a rate close to that projected for world trade (Chart I.2.2).

**Chart I.2.1** • World GDP growth and contributions | In percentage and percentage points




Source: Eurosystem (Banco de Portugal calculations). | Note: (p) – projected.

**Chart I.2.2** • External demand for Portuguese goods and services | Annual rate of change, in percentage.

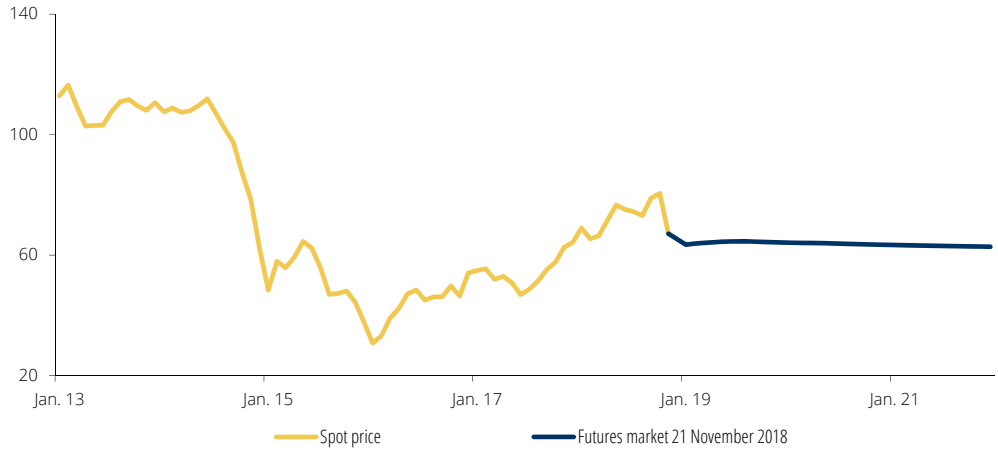



Source: Eurosystem. | Note: (p) – projected.

Oil prices have been somewhat volatile throughout 2018. In the first nine months of the year the Brent crude oil price was on an upward trend, reaching USD 86 per barrel at the beginning of October (Chart I.2.3). These developments occurred against a background of continued growth in demand and some supply side constraints, such as the collapse of production in Venezuela and expectations of a fall in exports from Iran as a result of the reintroduction of sanctions against the country. More recently, the continued and very significant increase in production in the

USA, the greater level of stocks and the downward revision of the growth outlook for the global economy, have translated into a fall of over 20% in oil prices during October, to a level closer to that observed at the beginning of the year (approximately USD 67/barrel). The expectations implicit in the futures markets point to a stabilisation of oil prices over the projection horizon. In annual average terms, oil prices are expected to decline very gradually, to about USD 66 per barrel at the end of the projection horizon, following a very significant increase in 2018.

**Chart I.2.3** • Brent price | USD/barrel

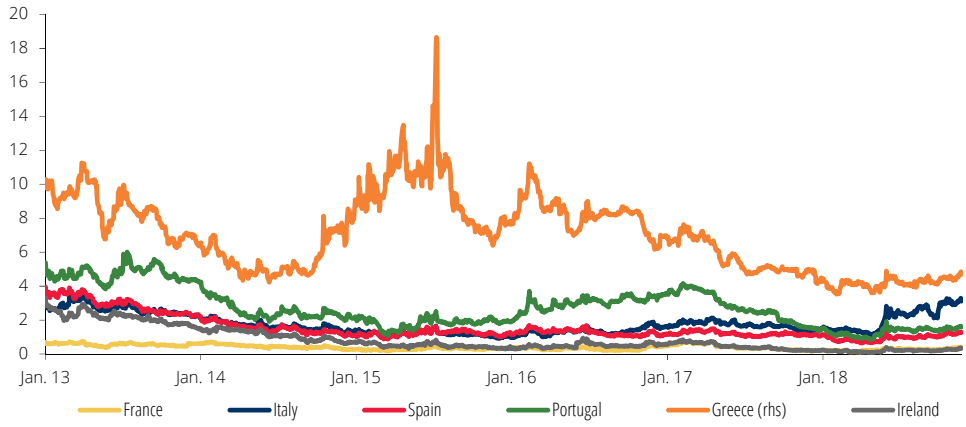



Source: Thomson Reuters.

Monetary and financial conditions in the euro area remained accommodative, despite a slight tightening during the year. At global level, financial markets registered various peaks of volatility, associated with the announcement and implementation of protectionist measures by the USA, to the revision of the world growth outlook and the cycle of US monetary policy normalisation. In bond markets, there was an increase in public debt yield rates in the USA and United Kingdom, associated with expectations of an increase in monetary policy interest rates in the near future. In the euro area, government bond interest rates experienced periods of volatility, essentially associated with political uncertainty in Italy. The sovereign debt yield differential of Italy against Germany increased significantly, contributing also to a widening in other euro area countries, albeit in a limited way (Chart I.2.4). In terms of bank lending, financing conditions for non-financial corporations and households remained favourable throughout 2018.

The ECB reiterated its intention to end net purchases under the expanded asset purchase programme at the end of 2018 and to reinvest the capital from the programme's maturing securities for a prolonged period. Furthermore, the key monetary policy rates are expected to remain at current levels, at least until the summer of 2019, and in any case until deemed necessary to ensure developments in inflation remain in line with current expectations of a sustained adjustment to the price stability objective. Based on market expectations, the short-term interest rate will remain at historically low levels over the horizon (increasing very gradually from -0.3% in 2018 to 0.3% in 2021). In turn, the implied interest rate on Portuguese public debt remains slightly below 3%. These assumptions were revised marginally downwards for 2019-20 in comparison to the June issue.

**Chart I.2.4** • Ten-year government bond yields spread versus Germany | In percentage points




Source: Thomson Reuters.

Developments in euro exchange rates in 2018 were essentially marked by an appreciation trend of the currencies of advanced economies, especially the US dollar, and the depreciation of emerging market currencies, with the exception of the Chinese renminbi. The assumption of constant exchange rate levels over the projection horizon translates into an appreciation of the euro in nominal effective terms of 2.4% in 2018 and a depreciation of 0.7% in 2019. Note that, by design, changes in the effective exchange rate converge to zero over the projection horizon.

# 3 Expenditure and external accounts

According to current projections, GDP is expected to slow down gradually over the projection horizon, from 2.1% in 2018 to 1.8% in 2019, 1.7% in 2020 and 1.6% in 2021, approaching the average of available estimates for potential output growth (Box 1).

In intra-annual terms, after a slowdown in the first half of 2018 (in year-on-year terms) reflecting the behaviour of GFCF and exports, GDP is expected to maintain a deceleration profile in the second half of the year, largely owing to a further slowdown of exports (Chart I.1.4). In particular, in the third quarter of 2018, according to the flash estimate released by Statistics Portugal,[3] GDP recorded a 2.1% change from the same period last year, which translated into a deceleration of activity from the previous quarter and from the whole of the first half of the year. Developments in the last quarter of 2018 are expected to have followed a similar pattern in year on year terms. In quarter-on-quarter terms, GDP also decelerated in the third quarter of 2018, to 0.3%, partly due to temporary factors that had an impact on export growth. The fading away of these factors likely induced some recovery in the quarter-on-quarter rate of change of activity in the last quarter of the year.

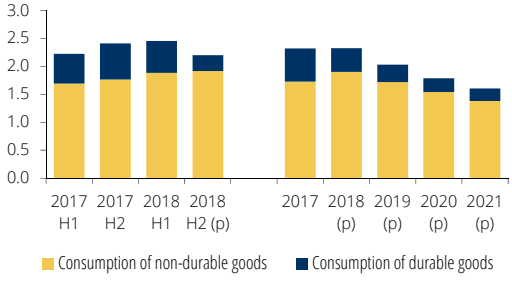
3. This Bulletin's cut-off date for data is 28 November, therefore projections for the second half of the year reflect the short-term data available up to that point and the GDP flash estimate for the third quarter of 2018, as well as the qualitative information on the composition of expenditure disclosed in Statistics Portugal's press release.

## Moderate slowdown of private consumption and maintenance of buoyant GFCF growth over the projection horizon

According to the qualitative information provided in the National Accounts flash estimate release by Statistics Portugal, private consumption contributed to the year-on-year slowdown in activity in the third quarter of 2018, after recording relatively stable growth in the first half of the year. This information is supported by a large set of short-term indicators for current consumption in the national territory[4] and also by qualitative information on consumer confidence. A slight moderation in the year-on-year growth of private consumption is estimated for the fourth quarter.

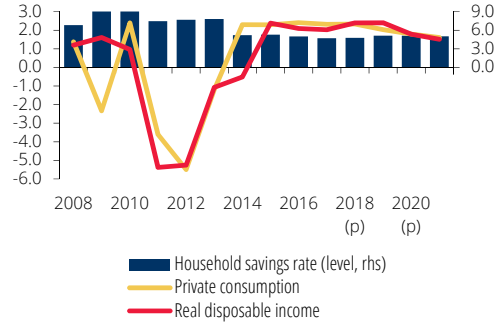
In 2018 as a whole private consumption is expected to have grown by 2.3%. This is expected to be followed by a projected deceleration over the horizon, to 1.6% in 2021 (Chart I.3.1). This deceleration profile extends to the durable and non-durable components of consumption. In the case of durable goods consumption, the slowdown is sharper reflecting the unwinding of the pent-up demand effect that followed the recession period. Nevertheless, this component is expected to maintain growth rates higher than those of total consumption and activity, within a framework of favourable financing conditions.

**Chart I.3.1** • Contributions to the year-on-year rate of change of private consumption | In percentage points




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

**Chart I.3.2** • Private consumption, disposable income and savings rate | Annual growth rate and level in percentage




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

After a slight acceleration in 2018, the non-durable component of consumption is expected to slow down throughout the projection horizon in line with changes in real disposable income (Chart I.3.2). The evolution of real disposable income in 2018 was largely determined by the acceleration in wages, to which the minimum wage increase also contributed, and by the dynamic growth in employment. From 2019 to 2021 the progressive slowdown in employment is expected to be to a large extent offset by an acceleration in compensation per employee, leading to a very slight deceleration in

4. The relevant concept for private consumption under national accounts refers to expenditure by residents in Portugal. However, private consumption indicators in general (turnover indices of retail trade and services, funds transferred in ATMs and Point-of-Sale Terminals) refer to expenditure in Portuguese territory, being therefore affected by spending by tourists, which are accounted for under exports in the national accounts.

the wage bill. The public finance assumptions[5] have a favourable impact on disposable income in 2018-19. Besides the measures approved in previous years (such as the gradual reversal of general government wage freezes or the change in wage brackets in the personal income tax), the measures announced in the 2019 State Budget were also incorporated. The expressive increase in government expenditure for social purposes is worth mentioning, in particular, the widening of scope of the social benefit for inclusion.

The fading impact of these measures as well as some increase in inflation by the end of the projection horizon heightened the slowdown projected for real disposable income in 2020-21. Against this background, after a slight increase in 2018-19, the saving rate is expected to remain relatively stable at historically low levels throughout the remainder of the projection horizon (Chart I.3.2).

The current estimate for real growth of public consumption in 2018 stands at 0.7%. Underlying this estimate is the assumption of an increase in the number of civil servants in line with that recorded in the first half of the year. In addition, it also reflects the one-off impact on intermediate consumption from expenses related to the wildfires of the preceding year. The reversal of this impact in 2019, together with the assumption of lower public employment growth, leads to a deceleration in public consumption in real terms. Over the remaining projection horizon, real public consumption is expected to stay relatively stable, within a context of gradual stabilisation of public employment.

After very significant growth in 2017 (9.2%), GFCF is expected to slow down to 3.9% in 2018 (Chart I.3.3). In the first half of 2018, despite being broad-based across institutional sectors and types of product, this slowdown resulted primarily from the construction segment, reflecting *inter alia* a base effect associated to the very strong growth in investment in public works in 2017. Besides, uncertainty regarding developments in international trade in a context of protectionist tensions may be having an impact on corporate investment decisions. The information available for the third and fourth quarters of 2018 – relating to cement sales in the domestic market and to an indicator of nominal machinery imports – points to a slowdown in GFCF in year-on-year terms. However, this information is offset by the recovery of the indicator for GFCF in transport equipment in the third quarter of 2018, suggesting some stabilisation in GFCF growth year-on-year in the second half of the year. Over the rest of the projection horizon, GFCF growth is expected to keep an elasticity versus GDP growth above the historical average, decelerating from 6.6% in 2019 to 4.9% in 2021.

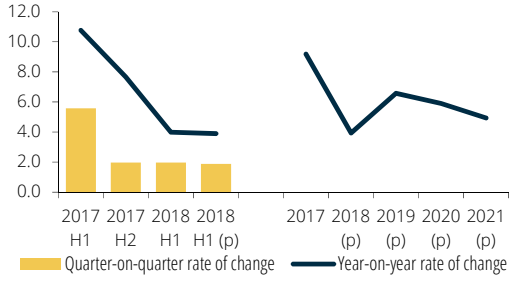
This very dynamic growth largely reflects the profile projected for corporate investment, which is expected, unlike GFCF of the other institutional sectors, to surpass the level recorded at the onset of the financial crisis in 2008 by the end of the horizon (Chart I.3.4). Due to this momentum the weight of this component in GDP is expected to stand at a historically high level by 2021 (14.3%). This segment is expected to benefit from the construction of some large scale infrastructure projects and, from a broader point of view, from the ongoing favourable prospects for demand, as well as from the maintenance of favourable financing conditions. Investment constraints due to financial conditions have eased, though they are still higher in Portugal than the European average, and are considered by corporations to be less important in comparison with the constraints created by the regulatory framework and by uncertainty in general (Box 2).

Financing conditions are expected to continue to support housing investment, though in a progressively more mitigated way over the projection horizon. The labour market rebound and the

5. In line with Eurosystem rules, the projection includes only the policy measures that have already been approved (or are highly likely to be approved) and that are sufficiently specified.

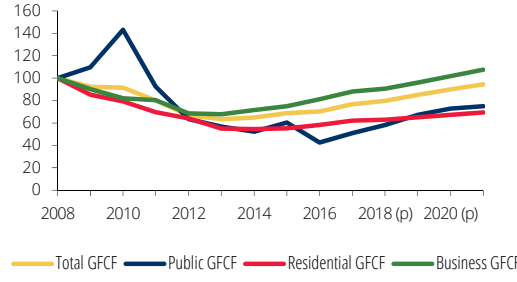
incentives created by the sharp rise in house prices, affected among other factors by the indirect impact of the buoyancy of tourism, also contribute to support the expansion trajectory expected for this sector. Housing investment will, however, record a smaller growth rate than that of the other institutional sectors over the projection horizon.

**Chart I.3.3** • Developments in GFCF | Rate of change, in percentage




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

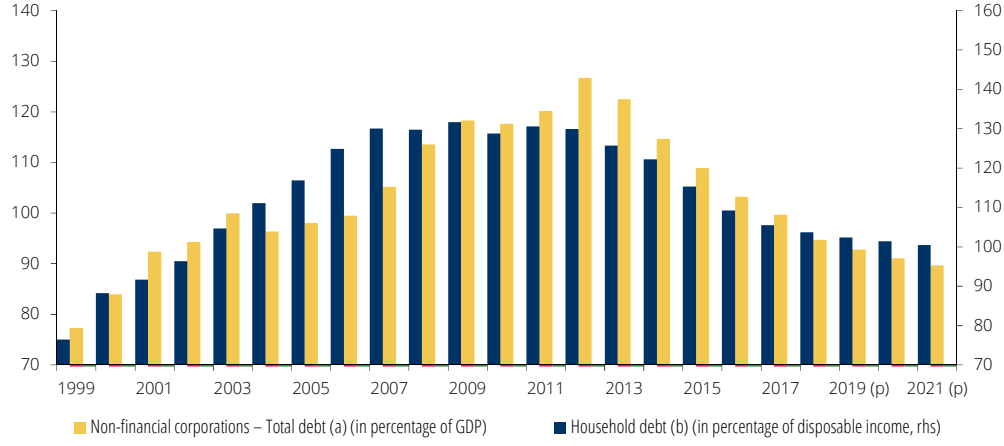
**Chart I.3.4** • GFCF breakdown by institutional sector | Index 2008=100




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

Projected developments for credit aggregates are compatible with the maintenance of the declining trend of indebtedness ratios of households and non-financial corporations (NFCs) over the projection horizon, measured as percentage of disposable income and of GDP respectively, though at a progressively slower pace (Chart I.3.5).

**Chart I.3.5** • Debt of the non-financial private sector in Portugal | End of period figures in percentage of GDP and disposable income




Sources: Banco de Portugal and Statistics Portugal. | Notes: (p) – projected. Consolidated values. (a) It includes loans granted to non-financial corporations by other institutional sectors; commercial paper and bonds issued by non-financial corporations held by other sectors and trade credits received from other sectors. (b) The debt of households corresponds to loans and debt securities issued by the sector and trade credit and advances.

Public investment in 2018 and 2019 is expected to evolve in line with the projections in the State Budget for 2019. In the following years of the projection horizon, this aggregate is projected to decelerate gradually. This implies an increase in the average weight of public investment in total

GFCF over the projection horizon, but to levels significantly lower than those recorded prior to the sovereign debt crisis in 2011 (12.8% on average in the 2018-21 period, from 18.9% on average between 1996 and 2010).

## Relative stable export growth, though at lower rates than in 2017

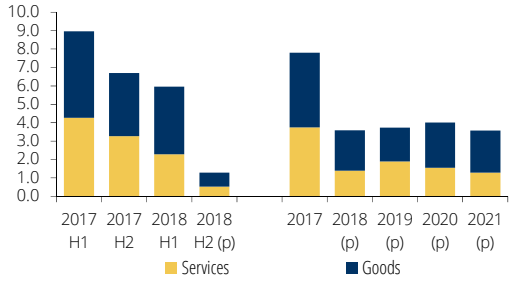
Exports of goods and services were the component of overall demand that contributed the most to the recovery of the Portuguese economy that began in 2013. This feature is expected to continue in the 2018-21 period and at the end of the horizon real exports are expected to show growth of around 70% against the level observed prior to the international financial crisis. The weight of this aggregate in GDP should be close to 50% by 2021. In the next few years, exports are expected to record annual average growth between 3.5% and 4%, which translates into a deceleration from the very sharp growth pace recorded in 2017 (7.8%) (Chart I.3.6).

The deceleration in exports in the first half of 2018 was also observed in the euro area within a context of deceleration in global activity and of trade tensions associated with the announcement of protectionist policies. Yet, while in the euro area this slowdown extended to goods and services, in Portugal it concentrated on services, largely due to the positive impact on goods exports of the rise in the productive capacity of an industrial unit in the motor vehicle sector. This sector and that of energy goods were the source of some temporary effects with negative impact on export growth, year-on-year, in the second half of 2018 (Chart I.3.6).[6] Services exports are expected to have decelerated again in the second half of this year, with this component accounting for the largest contribution to the slowdown in total exports in 2018, in spite of its high growth rate. This reflects, on one hand, the smaller growth of tourism throughout the year – similarly to developments seen in other southern European countries, such as Spain and Italy, and may partly reflect the recovery of some competitor destinations (see the Special issue 'Tourism exports: recent developments and future prospects') – and, on the other hand, some temporary effects. Developments in tourism also contribute indirectly to a slowdown in exports of other services, for instance through the transportation component.

Export developments in the period 2019-21 are expected to be in line with the assumptions for external demand for Portuguese goods and services, which will present relatively stable growth (Chapter 2). Thus, over the projection horizon, the export market share is expected to show only marginal gains (Chart I.3.7). These gains are associated with tourism exports, which are expected to keep growing above external demand figures – in line with this sector's recent buoyancy and with its margin for further growth (see the Special issue in this Bulletin) – but with a deceleration profile. Tourism's progressively smaller growth largely explains the smaller contribution of exports net of import content to GDP growth over the projection horizon, since they weigh more on this aggregate than on gross exports.

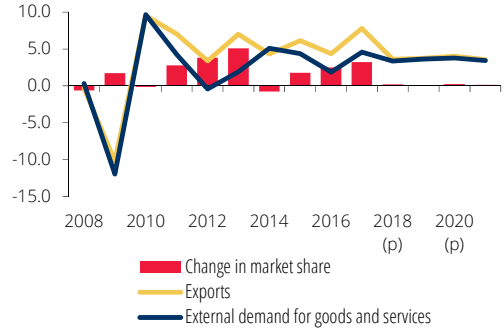
6. An important vehicle production unitwas closed in August 2018, which was not the case in 2017, leading to a negative base effect in goods exports. In addition, in September 2018, car exports experienced some turmoil due to the entry into force of the new worldwide harmonised light vehicles test procedure (WLTP) for certifying emissions and fuel or energy consumption. Energy goods exports were affected by several planned production stops at refineries throughout the year.

**Chart I.3.6** • Contributions to the year-on-year rate of change of private consumption | In percentage points




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) –projected.

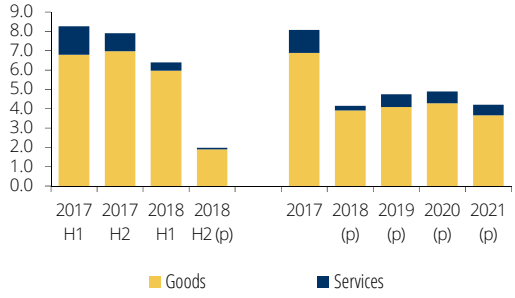
**Chart I.3.7** • Exports and external demand | Annual rate of change, in percentage




Sources: ECB, Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

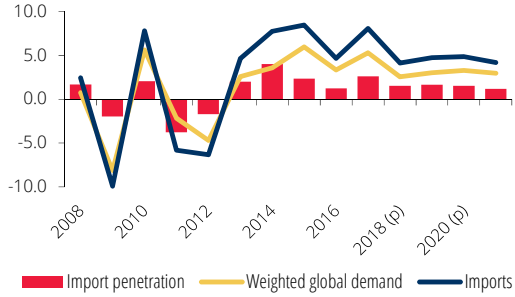
After a pronounced slowdown in 2018 to 4.1%, imports are expected to progressively accelerate to a 5% growth rate by 2020, returning at the end of the horizon to the growth pace projected for this year (Chart I.3.8). Overall, this is in line with the average historic elasticity versus overall demand weighted by import content. Such elasticity is greater than unity in the short term, which implies additional increases in the penetration of imports (Chart I.3.9). Unlike GDP, overall demand weighted by import content is not expected to slow down in 2019-20, with its growth being reduced only by the end of the horizon, which reflects the recovery of exports of energy goods over that period, an item that has a high import content.

**Chart I.3.8** • Contributions to the year-on-year rate of change of imports | In percentage points




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

**Chart I.3.9** • Imports and import-content weighted global demand | In percentage



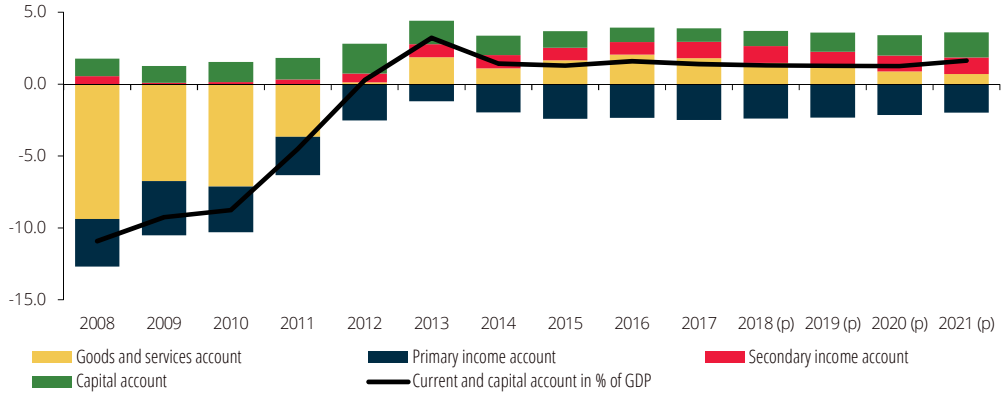

Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

## Maintenance of the net lending capacity of the Portuguese economy

Current forecasts suggest that the Portuguese economy will maintain its positive external net lending capacity over the projection horizon, as measured by the combined current and capital account balance. This balance is expected to stand close to 1.3% of GDP in the period 2018-20 and to increase to 1.6% in 2021 (Chart I.3.10). Compared with 2017, the projection presumes a shift in

the composition of the current and capital accounts, with a reduction in the goods and services account surplus largely offset by an increase in the capital account balance and by a reduction of the primary income deficit.

**Chart I.3.10** • Current plus capital account | In percentage of GDP




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

In regard to the goods and services account, its surplus is projected to fall gradually throughout the projection horizon. This profile reflects the projected behaviour for the goods account, since the services account surplus is expected to increase further. In 2018, the increase in the goods account deficit was largely associated to the energy component, reflecting the impact of the strong rise in oil prices. In the following years, the profile of this balance is expected to mainly reflect real growth of imports above that of exports.

The primary income account deficit as a percentage of GDP is expected to fall gradually over the projection horizon, benefiting from the expected path of public debt interest. In 2019-20, the capital account balance as a percentage of GDP is expected to increase mainly owing to an increase in European Union transfers under the ongoing European funding programme. In 2021, this account balance is expected to improve via a significant increase in capital revenue, reflecting the refund by the European Financial Stability Facility (EFSF) of amounts previously paid by Portugal under the Economic and Financial Assistance Programme.

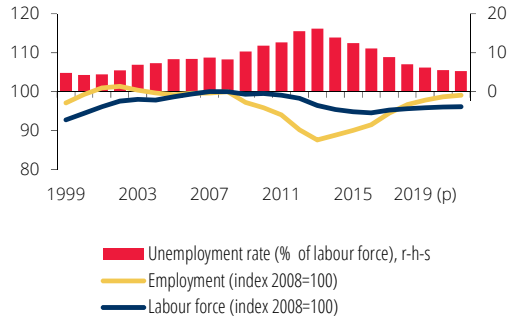
# 4 Labour market

## Labour market improvement to continue

Employment is expected to continue to grow over the projection horizon, albeit at a progressively slower pace than in previous years. Following an estimated increase of 2.2% in 2018, employment is projected to decelerate gradually, reaching 0.4% in 2021, with an annual average growth rate of 0.8% in the period 2019-21. Employment growth essentially reflects developments in the private sector while public sector employment is anticipated to gradually decelerate, stabilising in 2020-21. At the end of the projection horizon, employment levels are expected to be close to but

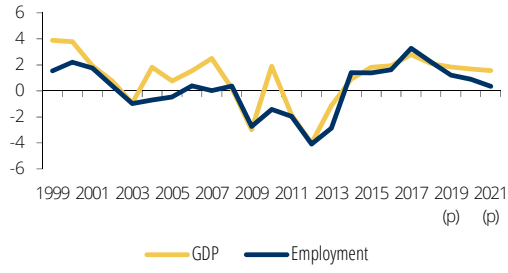
slightly below those observed in the period immediately prior to the 2008 international financial crisis (Chart I.4.1). The unemployment rate will fall at a more moderate pace than that observed during the past three years, reaching 5.3% in 2021.

**Chart I.4.1** • Employment, unemployment and labour force | Index 2008=100 and percentage




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected. Employment in number of individuals according to the national accounts concept.

**Chart I.4.2** • GDP and employment | Annual rate of change, in percentage




Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected. Employment in number of individuals according to the national accounts concept.

The labour force is expected to increase slightly over the projection horizon, following growth observed in 2017 and in the first quarters of 2018 (0.8% in 2017 and 0.3% cumulatively in the first three quarters of 2018). This increase in the labour force, against a background of a falling and ageing total population, reflects the increase in the participation rate, which can be attributed to the return to the labour market of discouraged workers, the gradual increase in the retirement age and the continued increase in female participation in the workforce.

The increase in productivity is the crucial factor to increase the growth rates of the Portuguese economy. Projected developments in GDP and employment are expected to translate into moderate labour productivity growth in the period 2019-21, following a change close to zero in 2018 and negative changes in the period 2014-17 (Chart I.4.2). Output per worker in Portugal continues to be low when compared with the euro area, which is associated, *inter alia*, with relatively low levels of education and capital *per worker*.

# 5 Prices and wages

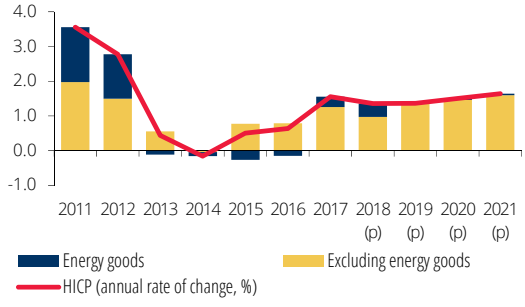
## Moderate inflation developments over the projection horizon, with a gradual rise in the non-energy component

Inflation, as measured by the rate of change in the HICP, is expected to rise slightly, standing on average at approximately 1.5% over the projection horizon. Prices of the energy component, following an estimated increase of some 5% in 2018, are expected to record minor changes in the projection period, in line with the assumptions for oil prices. In 2019-21, the contribution of energy goods prices to inflation is projected to be close to zero.

Inflation of the non-energy component is expected to follow a slightly upward path between 2019 and 2021 (Chart I.5.1). Projections for an inflation measure that excludes the most volatile components (food and energy goods) also point to a slightly upward trend in prices in Portugal over the next three years. By comparison with the projections for the euro area published by the ECB on 13 December, the profile of inflation excluding food and energy in Portugal is close to that projected for the euro area. Regarding headline HICP, a slightly negative differential (-0.2 percentage points) is expected (Chart I.5.2).

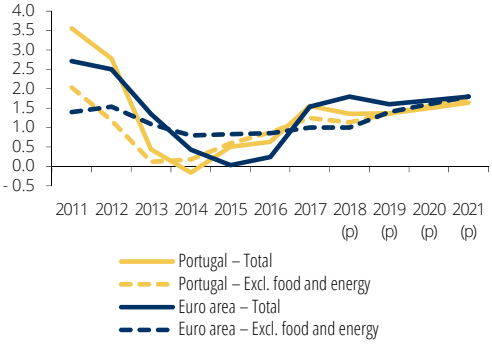
The moderately rising profile expected for inflation excluding energy over the period 2018-21 essentially reflects an increase in domestic inflationary pressures, in particular the transmission to prices of the increase in wage costs and in profit margins, against a background of continued economic growth and increase in inflation expectations. A gradual acceleration in nominal wages per employee over the projection period is projected, extending to the private and public sectors (Chart I.5.3). In the case of private sector wages, signs of greater buoyancy have been observed in the most recent period. The profile for this variable in 2018 and 2019 is also influenced by the 4.1% increase in the minimum wage in 2018, the effects of which will dissipate in 2019.[7] A continuation of the recent acceleration trend in wages is projected for 2020-21. In the case of the public sector, the gradual reversal of general government wage freezes that began in 2018 will be reflected in wage increases until 2020. Furthermore, in 2020 and 2021, projections take into account an assumption of wage updates in the general government, in line with price development expectations. These assumptions imply a positive change of the public consumption deflator over the projection horizon.

**Chart I.5.1** • Harmonised index of consumer prices | Contributions to the annual rate of change, in percentage points




Sources: Eurostat and Banco de Portugal. | Notes: (p) – projected.

**Chart I.5.2** • Inflation – total and excluding food and energy | Annual rate of change, in percentage



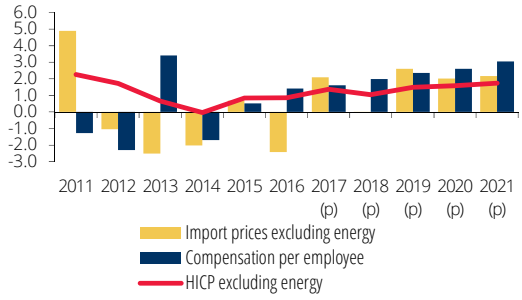

Sources: ECB, Eurostat and Banco de Portugal. | Notes: (p) – projected.

Given that, along with wage increases, some recovery in productivity is projected, growth in unit labour costs will be relatively moderate during the forecast period. Gross operating surplus per unit of output is expected to recover in the period 2019-21 following the estimated declines in 2017 and 2018. Reflecting the positive contributions of unit labour costs and profit margins,

7. In accordance with Eurosystem rules, the possibility of an additional increase in the minimum wage in 2019 is not included in the central projection scenario as it is not a measure specified in sufficient detail. However, this question is dealt with in Chapter 6, "Uncertainty and Risks".

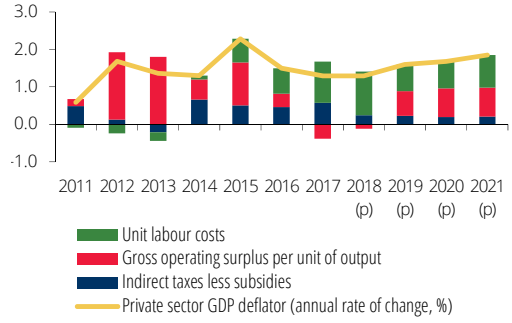
the GDP deflator is expected to present a rising profile over the projection horizon, with a more pronounced acceleration than that projected for the HICP (Chart I.5.4).

**Chart I.5.3** • Evolution of HICP excluding energy | Annual rate of change, in percentage




Sources: Statistics Portugal and Banco de Portugal. | Notes: (p) – projected.

**Chart I.5.4** • Decomposition of private sector GDP deflator | Contributions to the annual rate of change, in percentage points




Sources: Statistics Portugal and Banco de Portugal. | Notes: (p) – projected.

In terms of external inflationary pressures, import prices excluding energy goods, after a nil change in 2018 – implying a deceleration against 2017, explained mainly by the appreciation of the euro – are expected to accelerate in 2019, reaching a growth rate of around 2% in 2020-21, in line with the assumptions for export price developments of Portugal's main trading partners. The terms of trade, after recording changes close to zero in 2018-19, are expected to show marginal gains in 2020-21, reflecting in part the slight fall anticipated for oil prices.

# 6 Uncertainty and risks

The projections presented in this Bulletin represent the most likely scenario, based on the assumptions set out in Table I.2.1. This central scenario may be affected by a set of risks and uncertainties due to either the assumptions not materialising, or the possibility of events occurring that have not been considered in the projections. The quantified analysis of the risks and uncertainty surrounding the projections is presented below.

## Downside risks to activity and slight upside risks to inflation

The main risk factors to activity identified result from the possibility of a less favourable international environment than that considered in the projections. This deterioration in the international environment, with negative effects on world trade, could result from an intensification of protectionist policies and from a tightening of financial conditions, as well as the possibility of an increase in geopolitical tensions and political uncertainty at a global level. At European level, a sudden adjustment in euro area sovereign debt markets may cause tensions in financial markets, with a negative impact on financing conditions. The possibility of a more adverse impact from the exit of

the United Kingdom from the European Union (Brexit) was also considered. The materialisation of these risks would have an adverse impact on overall demand.

At the domestic level, an upward risk to inflation was considered stemming from the likelihood of an increase in the minimum wage in 2019. Inflation may also be higher as a result of the impact of higher trade tariffs on import prices. These upward risks might be partially offset by the possibility of a position in the economic cycle less favourable than that suggested by the available estimates for the output gap, which would limit inflationary pressures.

The set of risks identified translates into the probability of developments in external demand being less favourable than those considered in the projection, principally in 2020 (Table I.6.1). In terms of long-term interest rates, an upside risk was identified for 2019. For investment, downside risks were included for 2019 and 2020, whilst private consumption includes a slight downside risk for 2019, linked to potential negative effects on confidence levels and financing conditions associated with the aforementioned risk factors. Finally, an upside risk for wages was included for 2019, with a 55% probability of occurring. No significant risk factors have been identified for 2021.[8]

The combination of the risk factors described above implies downside risks to real GDP growth over the whole projection horizon and a slight upside risk to inflation, especially in 2019 (Table I.6.2, charts I.6.1 and I.6.2).

**Table I.6.1** • Risk factors – Probability of an outcome below the implicit in the projections | In percentage

| | 2019 | 2020 | 2021 |
|---|---|---|---|
| Projection assumptions | | | |
| External demand | 53 | 55 | 51 |
| Long-term interest rate | 44 | 46 | 50 |
| Endogenous variables | | | |
| Private consumption | 53 | 50 | 50 |
| GFCF | 57 | 55 | 50 |
| IHCP | 48 | 49 | 50 |
| Wages | 45 | 50 | 50 |

Source: Banco de Portugal.

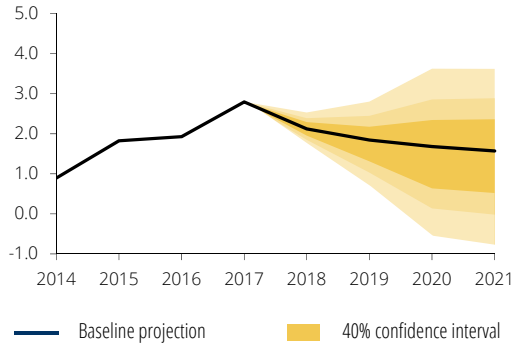
**Table I.6.2** • Macroeconomic scenario – probability of an outcome below the implicit in the projections | In percentage

| | Weights in 2017 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| Gross domestic product | 100 | 55 | 55 | 53 |
| Private consumption | 65 | 55 | 53 | 51 |
| GFCF | 17 | 60 | 57 | 50 |
| Exports | 43 | 52 | 56 | 53 |
| Imports | 42 | 56 | 58 | 52 |
| IHCP | | 44 | 47 | 49 |

Source: Banco de Portugal.

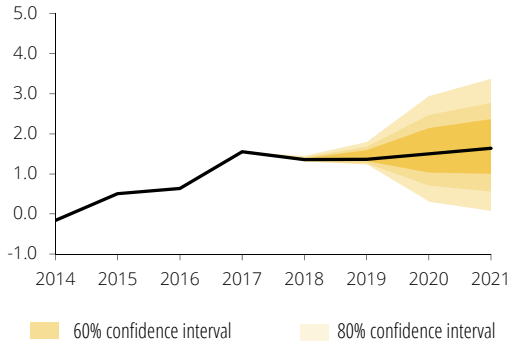
8. Given the proximity of the end of the year, no specific risk factors were considered for 2018. However, a margin of uncertainty surrounding the central scenario was considered, in line with the figures for previous projection errors.

**Chart I.6.1** • Gross domestic product | Rate of change, in percentage




Source: Banco de Portugal and Statistics Portugal.

**Chart I.6.2** • Harmonized index of consumer prices | Rate of change, in percentage




Source: Banco de Portugal and Statistics Portugal.

# 7 Conclusions

Over the projection horizon under consideration, the Portuguese economy will be characterized by a progressive convergence of activity growth to its potential rate.

During the recovery period beginning in 2013, the Portuguese economy showed features that allow to currently expect a more sustained growth in economic activity. Productive private investment grew at a much greater pace than that of activity, while simultaneously driving a reduction in the levels of indebtedness of non-financial corporations, developments that are expected to continue over the projection horizon. The degree of openness of the economy increased substantially, benefiting from export behaviour, with emphasis on the increase in the relevance of tourism (see the Special issue of this Bulletin). This structural change in the economy heightened its exposure to international developments, particularly in the euro area. In fact, the projected deceleration of economic activity in Portugal partly results from expected developments in exports, reflecting the maturing economic cycle also in the euro area and advanced economies in general, accompanied by a progressive reduction of monetary policy stimulus. The high levels of cyclical synchronisation between Portugal and the euro area are expected to persist in 2018-21, translating into modest progress in the convergence growth process of the Portuguese economy in *per capita* terms.

In this context, some of the main challenges facing the Portuguese economy over the coming years are also those of the euro area and European Union. The deepening of Economic and Monetary Union, especially regarding the mechanisms that allow a more effective macroeconomic coordination, a more efficient risk sharing and a greater resilience to unfavourable shocks, is essential to ensure macroeconomic stability and the conditions for future economic growth.[9]

9. For an assessment of the European integration process and the challenges remaining, see Amador, J., Valle e Azevedo, J. and Braz, C. "The deepening of the Economic and Monetary Union", *Banco de Portugal Occasional Paper 1/2018* (forthcoming, Portuguese version already available).

The Portuguese economy continues to face specific constraints to growth in the medium to long term. Despite the progress made over the past few years in the functioning of markets and the deleveraging in the various sectors of the economy, these factors should continue to impact on investment and productivity developments. The reallocation of resources to sectors more exposed to international competition, which are typically more open to innovation, should be further pursued, thereby enhancing composition effects that improve total factor productivity. Finally, population ageing constrains the contribution of labour input to growth, although developments in migration flows may counterbalance this negative trend. Against this background, investment in human capital remains key to promote long-term growth.

## Box 1 • Growth factors

The potential output of an economy can be defined as the level of output corresponding to a sustainable use of the resources available in the economy. As it is not observable, potential output may be estimated on the basis of observable variables, which allow an assessment of potential economic growth and the so-called output gap, defined as the difference between actual output and potential output.

Chart B1.1 shows a set of estimates for real growth in potential GDP in Portugal. Despite the high degree of uncertainty, these estimates suggest that projections for GDP growth gradually converge to potential GDP rates over the projection horizon. During the recent recovery period, GDP grew above potential GDP rates, leading to a reduction in the output gap to levels close to zero after a long period of negative figures. This suggests a gradual depletion of the margin of productive resources that are not used in the Portuguese economy. Over the projection horizon, the output gap is expected to stand at slightly positive levels (Chart B1.2).

**Chart B1.1** • GDP and potential GDP growth rate | In percentage

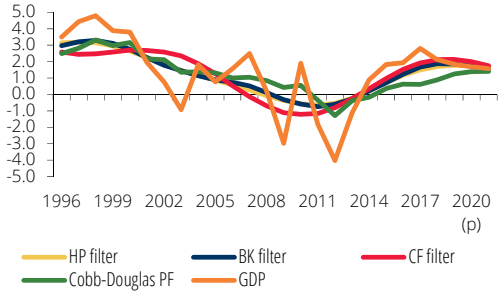
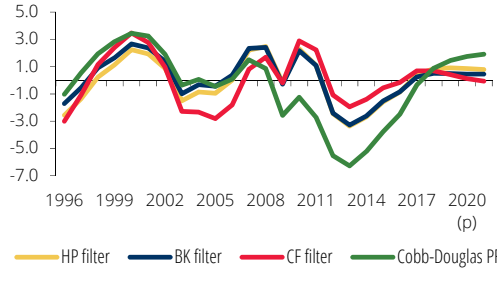



**Chart B1.2** • Output gap estimates for Portugal | In percentage of potential output




Sources: Statistics Portugal and Banco de Portugal. | Notes: (p) projected. The output gap corresponds to the difference between GDP and four estimates for potential output: Hodrick-Prescott (HP) filter, Baxter e King (BK) filter, Christiano e Fitzgerald (CF) filter and calculations based on a Cobb-Douglas production functions (Cobb Douglas PF). For a more detailed analysis see the Special issue 'Potential output: challenges and uncertainties', *Economic Bulletin*, December 2017.

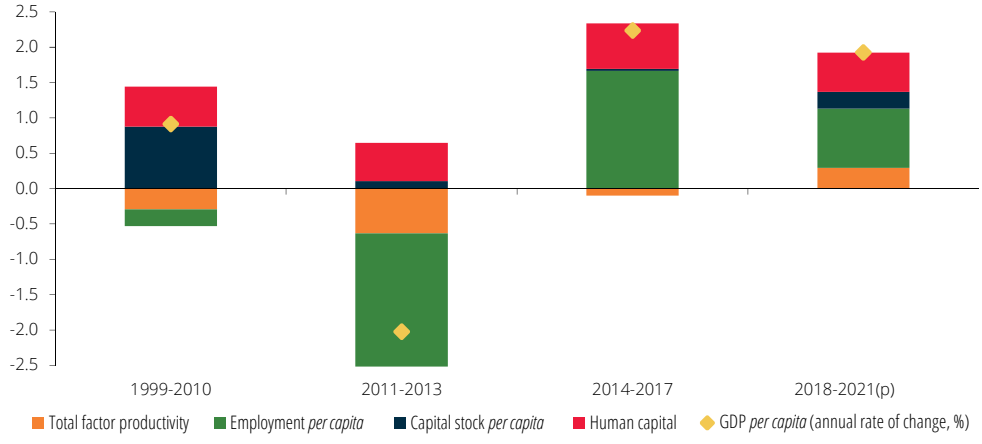
Chart B1.3 shows a breakdown of actual and projected growth of GDP *per capita* in Portugal in terms of the contributions of the main inputs and total factor productivity since the start of the euro area, on the basis of a growth accounting exercise which uses a Cobb-Douglas aggregate production function. Although lower than in the period 2014-17, the contribution of the labour factor is projected to remain positive in the period 2018-21. Developments in this contribution drive the deceleration of GDP. Future developments in the contribution of this factor are limited by the considerable decrease in the underutilisation in the labour market observed in the last few years, as well as the very subdued growth outlook for the labour force, against a backdrop of a declining and ageing total population. Nevertheless, projections for a continued – albeit less marked – decline in the unemployment rate and an increase in the participation rate over the next three years imply that the labour input will continue to contribute positively to *per capita* GDP growth. In addition, human capital is expected to maintain a positive contribution to economic growth, as observed since the start of the euro area, associated with the upward trend in the average qualification levels of the labour force (measured indirectly by the gradual increase in

average education levels). Over the projection horizon, the average contribution of this input to growth is expected to be close to that of the period 2014-17.

As regards the capital factor, a positive – but small – contribution is expected in the next few years, following levels close to zero in the period 2014-17. The positive contribution of the capital factor over the projection horizon results from recent investment dynamics and projections, especially business investment, which is a key to raise economic growth. In the recent past, developments and shifts in investment have translated into an increase in the depreciation rates of the capital stock. Consequently, stronger investment growth is currently necessary to enable not only the replacement or substitution of depreciated capital, but also an expansion of the capital stock.

Implicit total factor productivity (obtained as a residual in this exercise against estimated contributions of labour and capital factors) is expected to make a relatively low positive contribution to GDP growth over the projection horizon, following a virtually nil contribution in the 2014-17 period. Positive developments in total factor productivity reflect an improvement in the economy's resource allocation, associated, in particular, with the reallocation of production to more productive activities as well as more exposed to international competition, the ongoing financial deleveraging process and the reforms adopted over the current decade in labour and product markets, as well as in the judicial system.[10]

**Chart B1.3** • Breakdown of the growth in real GDP *per capita* | Contributions in percentage points




Sources: Barro, R.J. and Lee, J.W. (2013), Quadros de Pessoal, Statistics Portugal and Banco de Portugal. | Notes: (p) – projected. The growth accounting exercise of GDP *per capita* is based on a Cobb-Douglas production function. The measures of human capital were constructed from the data of Barro and Lee (2013) 'A new data set of educational attainment in the world, 1950-2010', *Journal of Development Economics 104*, pp. 184-198. For Portugal, these series were annualized and extended using the profile of the average years of education of employment of Quadros de Pessoal (until 2012), the Labour Force Survey of INE (from 2013 to 2015) and the projections available in http://www.barrolee.com/.

10. For a discussion on recent developments in total factor productivity in Portugal, see the Special issue entitled "Reallocation of resources and total factor productivity in Portugal", *Economic Bulletin*, October 2018.

## Box 2 • Are foreign-owned firms better positioned to invest?

Investment plays a decisive role in economic growth. In the short term, investment is part of domestic demand, thus contributing to GDP. In the long term productive investment (net of depreciation) boosts capital stock and helps to determine the economy's potential output. The Portuguese economy is currently characterised by relatively low domestic savings, while the need to reduce its indebtedness levels still persists. In this context, investment dynamics depends to a higher degree on the behaviour of foreign-owned firms. The purpose of this box is to analyse the role of foreign-owned firms as a source of investment in the Portuguese economy.

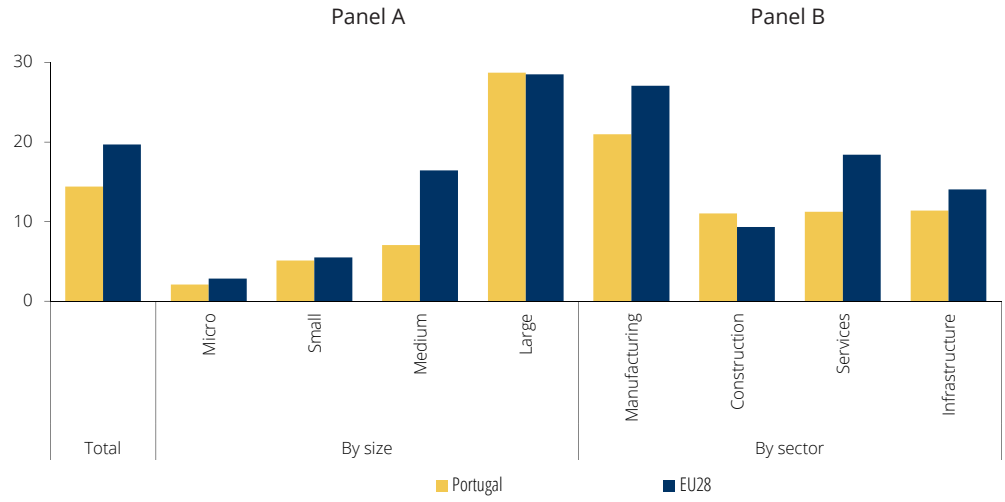
This analysis is based on data from the European Investment Bank Investment Survey (EIBIS) and it compares investment decisions and finance constraints of the Portuguese firms with those of EU28 firms, broken down into Portuguese and foreign-owned firms. EIBIS is a unique annual survey at EU28 level covering 12,300 business and collecting data on their characteristics and performance, past investment and future planning, financing sources and problems, as well other challenges faced by the firms. The survey uses a stratified sampling method, therefore it is representative in all 28 Member States, as well as in terms of firm size classes (from micro to large) and in terms of main sectors (manufacturing, construction, services and infrastructure). The survey is designed to enable the creation of a panel of observations that supports time series analysis and that can be supplemented by information on the balance sheet and profitability. In the case of Portugal, the survey covered a total of 480, 525 and 535 non-financial corporations in 2016, 2017 and 2018 respectively. The results presented in this box are based only on EIBIS and they do not necessarily match those from other statistical sources.

Panel A of the chart B2.1 shows the share of foreign-owned firms (defined as the firms with foreign ownership above 50%) in Portugal and in the EU28, disaggregated in terms of size classes and economic sectors. The share of foreign-owned firms in Portugal is lower than the EU28 average (14% and 20% respectively). The comparison in terms of size classes indicates a lower prevalence of foreign investment in medium-sized firms, which are an important part of the productive structure, especially in Portugal. In terms of distribution across sectors (Panel B of chart B2.1), the manufacturing sector shows the highest share of foreign-owned firms in Portugal and in the EU28 (21% and 27% respectively). Furthermore, the prevalence of foreign-owned firms in Portugal is higher than that of the EU28 only in the construction sector.

Although national and foreign-owned firms diverge significantly at various levels, they all face the same business environment of the country in which they operate. For that reason, it is important to compare how they assess barriers to investment. First of all, a comparison was made in terms of the assessment of the different types of barriers to long-term investment in Portugal and in the EU, measured as the share of firms indicating each one of them. Chart B2.2 suggests that, in Portugal, in most cases barriers to investment are considered to be higher than in the EU28, although they are less relevant in terms of the digital and transport infrastructures, availability of skilled staff and demand. No significant differences were observed when the analysis is based on the sectors or size of the firms.

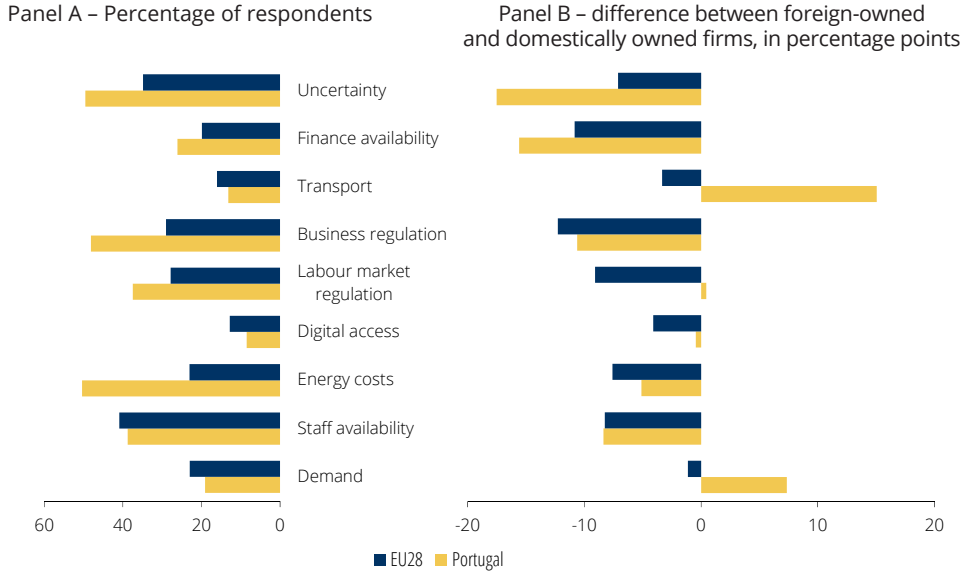
When focusing on Portugal and comparing the main barriers reported by Portuguese and foreign-owned firms (Chart B2.2, Panel B), there are significant differences. In most aspects, foreign-owned firms operating in Portugal report lower barriers than Portuguese firms. This difference is especially relevant in terms of 'uncertainty about the future' and 'availability of finance'. In this latter aspect, the share of foreign-owned firms reporting a significant barrier is 16 p.p. lower than that of Portuguese firms.

**Chart B2.1** • Foreign owned firms in Portugal and the EU: breakdown for each size (Panel A, in percentage) and for each sector (Panel B, in percentage)




Sources: EIBIS16, 17 and 18 and ORBIS.

**Chart B2.2** • Long-term obstacles to investment in Portugal and in the EU28: level and difference between foreign-owned and domestically owned firms



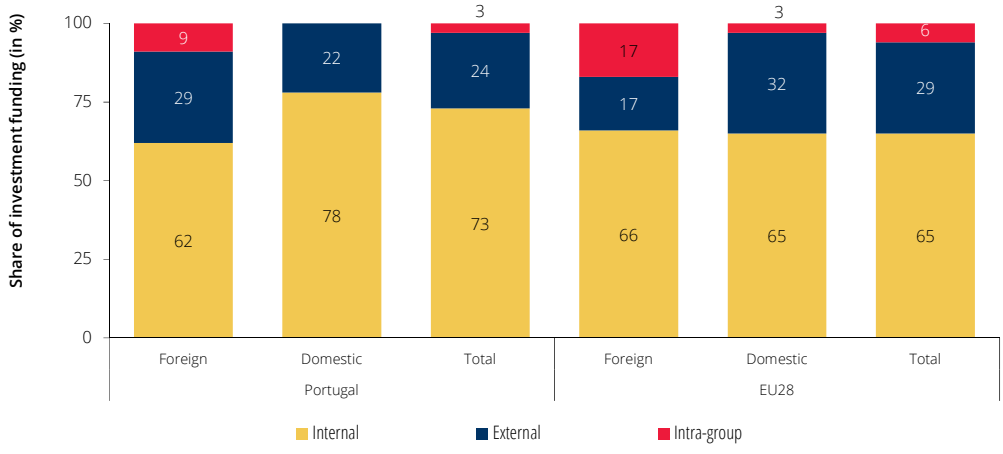

Sources: EIBIS16, 17 and 18 and ORBIS.

The availability of finance is related to the firms' funding structure for investment purposes.[11] According to EIBIS results, in Portugal this structure differs significantly between Portuguese and foreign-owned firms. As expected, foreign-owned firms present a higher share of intra-group funding than Portuguese firms. In Portugal, intra-group funding represents 9% of foreign investment, while

11. For a more detailed analysis of the firms integrated in groups operating in Portugal, see the study entitled 'Análise das empresas integradas em grupos' (Analysis of firms integrated in groups), Banco de Portugal, *Central Balance Sheet Studies No 32, May 2018.*

this is not a relevant option for Portuguese firms (Chart B2.3). The proportion to the EU28 is 17% and 3% respectively. In addition, in Portugal the proportion of external finance in foreign-owned firms is higher than in Portuguese firms. This outcome is explained not by the lower domestic investment of foreign-owned firms operating in Portugal (given the similarity of the EU28 share), but mainly by the high proportion of internal finance of Portuguese firms. This figure is 78%, compared with the EU28 average of 65%, and it may result from the ongoing deleveraging effort of Portuguese firms.

**Chart B2.3** • Structure of investment funding

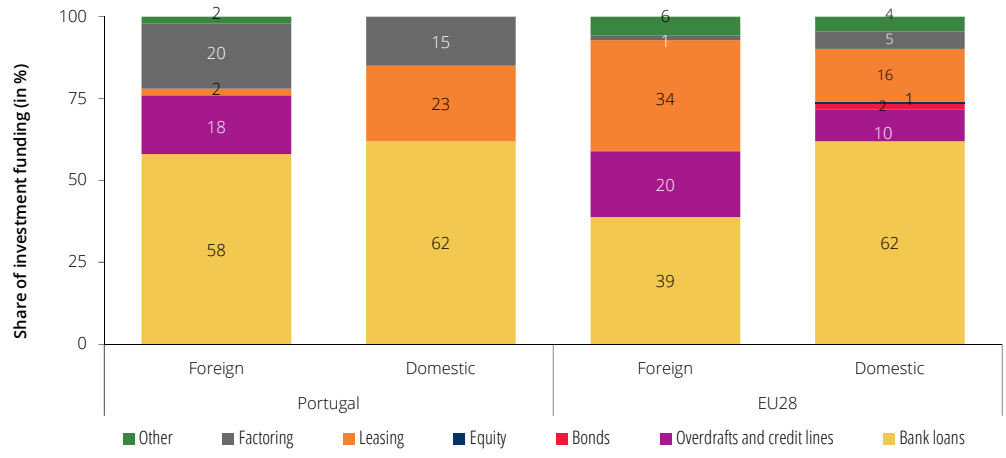



Sources: EIBIS16, 17 and 18 and ORBIS.

Interestingly, when analysing the structure of external finance for investment purposes, in Portugal foreign-owned firms use bank loans to a somewhat lesser extent than Portuguese firms. Those firms have an important component of overdraft facilities and credit lines (18%) which is offset by the larger leasing component of Portuguese firms (Chart B2.4). This indicates the possibility of a greater diversification of the sources of financing for Portuguese firms, including in terms of equity, e.g. through the development of capital markets targeting smaller firms. However, in the period under review, equity funding did not account for a significant share of external finance for foreign-owned firms in Portugal or in the EU28.

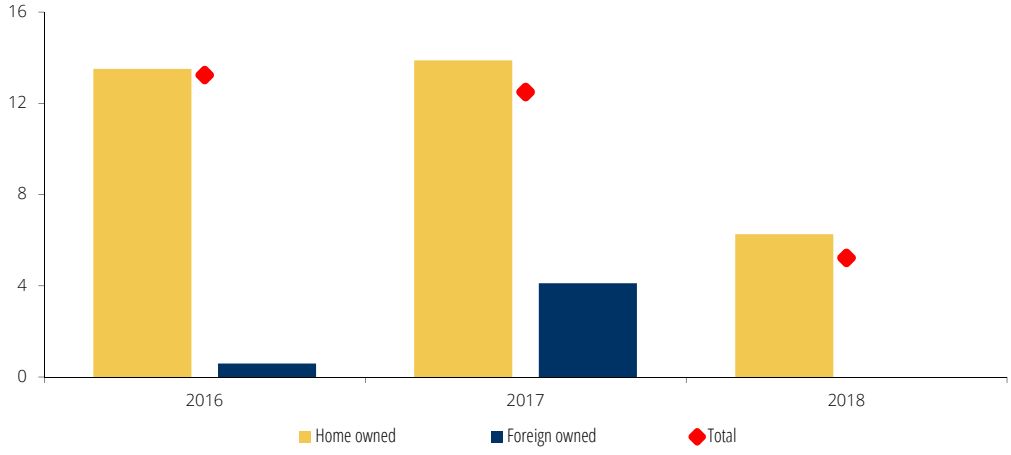
The differences in the investment's financing structure tend to relate to the differences in finance constraints for investment decision-making purposes, as perceived by the firms. Chart B2.5 shows that, according to EIBIS results, in Portugal the proportion of Portuguese firms with finance constraints was higher than that of foreign-owned firms in 2016, 2017 and 2018 (respectively 13, 12 and 6 p.p.). However, it is worth noting that the proportion of firms with finance constraints decreased significantly for Portuguese and foreign-owned firms over the period and very sharply in 2018. This decrease reflects the improvement in financing conditions for Portuguese firms over the last three years. In fact, in 2018 the share of firms with finance constraints in Portugal is almost the same as in the EU, standing at around 5%. During the previous two years, this difference was substantially higher, with a 13% share of Portuguese firms with finance constraints in 2016 and 2017. During the same period, the share of firms with finance constraints in the EU28 was 6% in 2016 and 7% in 2017.

**Chart B2.4** • Structure of external financing for investment purposes




Sources: EIBIS16, 17 and 18 and ORBIS.

**Chart B2.5** • Share of Portuguese firms with financial constraints




Sources: EIBIS16, 17 and 18 and ORBIS.

As mentioned above, investment plays a decisive role in economic growth, both from a cyclical perspective and a long-term perspective, thus affecting the potential output of the Portuguese economy. EIBIS findings show that foreign-owned firms are better positioned to invest than Portuguese firms. Therefore, enhancing the conditions to attract FDI and diversifying the sources of external finance for Portuguese firms would help improve the investment outlook for the Portuguese economy.

# II Special issue

## Tourism exports: recent developments and future prospects

# Tourism exports: recent developments and future prospects

## Introduction

Nominal tourism exports doubled between 2010 and 2017. For the most part, tourism growth outpaced growth in demand of the main countries of origin of visitors, resulting in share gains in international tourism markets.[1] The increasing importance of tourism exports for the Portuguese economy calls for an evaluation of recent developments and future prospects.

This Special issue is organised as follows. The first part illustrates the increased relevance of tourism sector exports in terms of their contribution to the external accounts, economic activity and employment. In the second part the behaviour of the tourism indicators in Portugal is contextualised and compared to developments worldwide and in competitor economies. The third part shows that tourism exports' performance is not explained by the usual drivers of this type of international trade flows (external demand and price competitiveness), which suggests a significant role for non-price-competitiveness factors, including a relative increase in the perception of Portugal as a safe destination and an improvement in the quality of the services offered. The following section looks at the sector's structural changes, shown in the indicators of non-resident tourism and in the data relating to supply capacity in terms of accommodation and air transport. The Special issue ends with a discussion of the outlook and challenges for the sector.

## Macroeconomic importance

Portuguese tourism exports have shown strong growth in recent years. Tourism exports as a share of GDP in nominal terms – which fluctuated around 4% between 1999 and 2009 – increased sharply from 2010, reaching 7.8% in 2017 (Chart 1). From 2018 to 2021, tourism exports' growth is projected to continue to outpace overall economic growth (see the main text of this *Economic Bulletin*), resulting in an increased weight in GDP, to 9.3% at the end of the projection horizon.[2]

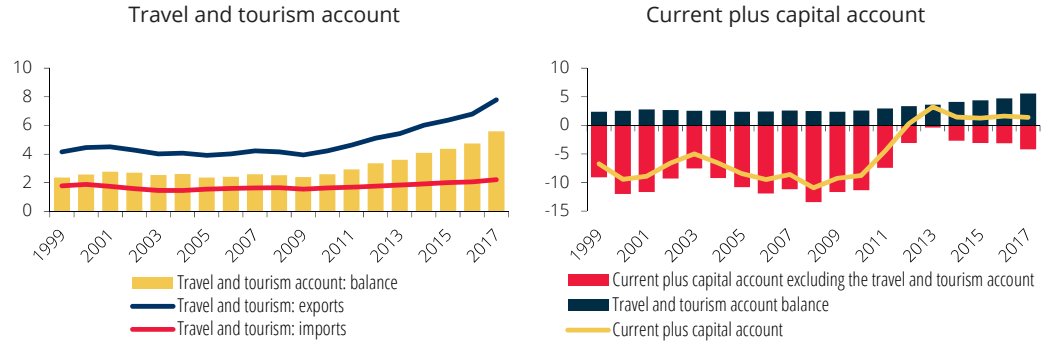
Tourism exports' growth has largely surpassed growth of tourism imports, resulting in a widening of the travel and tourism account surplus. This surplus more than doubled as a percentage of GDP from 2010 to 2017, from 2.6% to 5.6% (Chart 2). Developments in the tourism account have been making a significant contribution to the maintenance of the Portuguese economy's net lending capacity in recent years, in a context of some deterioration in the other accounts (Chart 2).

1. See Box 2 "Recent developments in the market share of Portuguese exports", *Economic Bulletin*, June 2018.
2. Tourism exports as a share of total goods and services exports also increased from 2013 onwards (from around 13.5% on average in the 2006-2013 period to 18% in 2017), despite the buoyancy of exports of goods and of other services. Over the projection horizon, this share is expected to increase further, but less markedly, reaching 19.5% in 2021.

**Chart 1** • Portuguese tourism exports | EUR million and percentage of GDP


Sources: Statistics Portugal and Banco de Portugal. | Note: (p) – projected.

**Chart 2** • Travel and tourism account and current plus capital account | In percentage of GDP




Sources: Banco de Portugal and Statistics Portugal.

The tourism sector has gained in importance both in GDP and in employment. According to the Tourism Satellite Account (TSA) released by Statistics Portugal, tourism spending in Portugal increased from 9.2% to 12.2% as a percentage of GDP from 2008 to 2015 (Table 1).[3] This was largely the result of non-resident tourism expenditure, whose share of GDP increased from 5.1% to 7.5%. GVA generated by tourism grew faster than the economy as a whole, implying an increase in its relative importance over this period. Also, in terms of the labour market, there was an increase in the share of employment in tourism-related activities in total employment. The available indicators suggest that the relevance of the tourism sector in the various macroeconomic aggregates increased further between 2015 and 2017.

The contribution made by tourism to the recovery in economy activity and in employment since 2013 is visible chiefly in the behaviour of the accommodation and food services sector.[4] Developments

3. 2015 is the most recent year for which the detailed TSA is available. The TSA is an integrated information system with the primary objective of presenting indicators illustrating the importance of tourism for the Portuguese economic structure, in a quantified, complete and relatively detailed way.
4. According to the latest data from Statistics Portugal's TSA, non-resident tourists spent chiefly on accommodation, food and drink (around 50% of spending on average over 2014-2015).

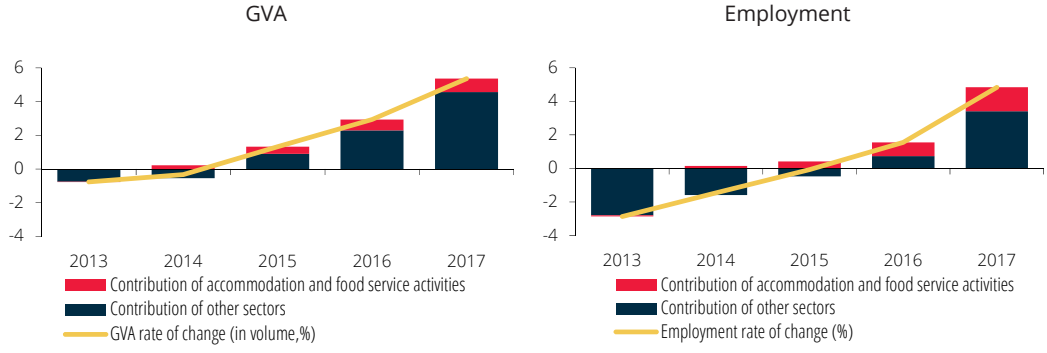
in GVA and employment in this sector greatly exceeded the growth of the corresponding aggregates for the economy as a whole. The sector was responsible for around 15% of cumulative GVA growth between 2013 and 2017 and for around 30% of the cumulative change in employment (Chart 3). The accommodation and food services sector increased its share in GVA and of total employment from 5.0% and 5.9% respectively in 2013 to 6.0 and 6.9% in 2017.

**Table 1** • Impact of tourism in the economy

| | | 2008 [a] | 2015 [a] |
|---|---|---|---|
| Tourism consumption in the economic territory | Million euros | 15,776 | 21,902 |
| | % GDP | 9.2 | 12.2 |
| Inbound tourism expenditure (expenditure by non-residents in the the economic territory) | Million euros | 8,847 | 13,543 |
| | % GDP | 5.1 | 7.5 |
| | % Tourism consumption | 56.1 | 61.8 |
| Domestic tourism expenditure + other components [b] | Million euros | 6,929 | 8,359 |
| | % GDP | 4.0 | 4.6 |
| | % Tourism consumption | 43.9 | 38.2 |
| GVA generated by tourism | Million euros | 6,076 | 10,458 |
| | % Total GVA | 4.1 | 6.7 |
| Employment in tourism characteristic activities | FTE [c] | 416,076 | 397,619 |
| | % Total employment | 8.3 | 9.2 |

Sources: Statistics Portugal – Tourism Satellite Account (Banco de Portugal calculations). | Notes: (a) The 2008 Tourism Satellite Account (TSA) was compiled on the basis of the 2006 National Accounts data while the TSA data for 2015 are compatible with the 2011 base series. (b) Domestic tourism is the expenditure incurred by residents in the course of a trip within the country, provided that it is outside their normal environment. The 'other components' include the 'non-monetary' components of tourism, in particular the valuation of housing services of secondary homes on own account used for tourism and the tourist components (individual consumption) of the general government and non-profit institutions serving households. (c) FTE: employment measured in full-time equivalents.

**Chart 3** • Contribution of accommodation and food service activities to the cumulative change in total GVA and employment since 2013 | In percentage points and percentage



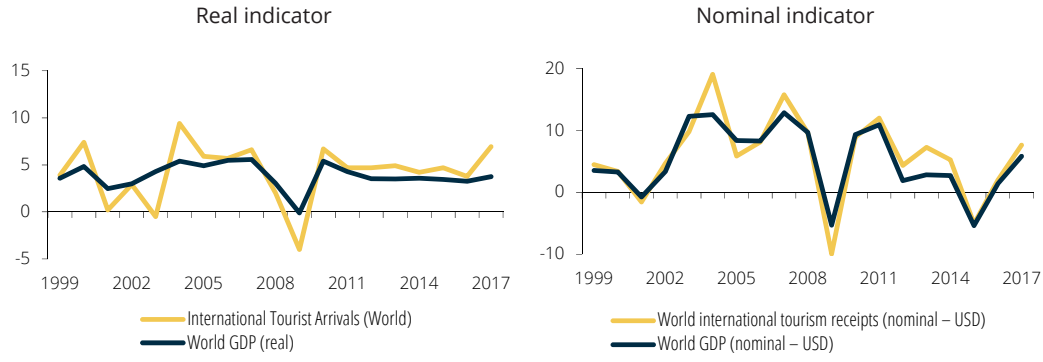

Source: Statistics Portugal (Banco de Portugal calculations).

# International environment and comparison

The developments in Portuguese tourism exports should be seen within the international context of strong growth of these kinds of transactions at the world level. International tourist arrivals have grown faster than global GDP in real terms. These arrivals grew on average annual terms by 5.1% in

the period from 2010 to 2017, which compares to real growth of world GDP of 3.8% on average for the same period (Chart 4). International tourism receipts have also surpassed nominal growth of world GDP.

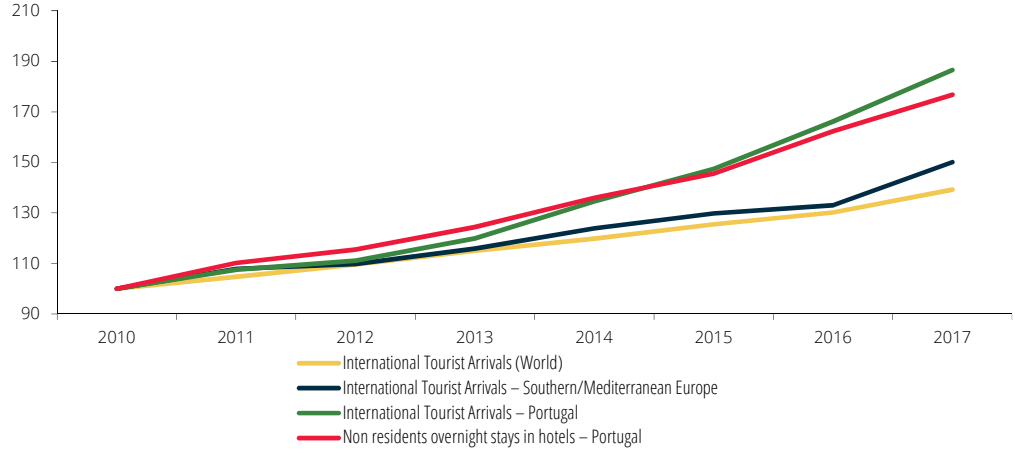
**Chart 4** • Indicators of worlwide tourism and GDP | Rate of change, in percentage




Sources: IMF, UNWTO and World Bank (Banco de Portugal calculations).

Estimates for tourist arrivals in Portugal indicate average annual growth far above the world total (8.8% versus 5.1% respectively in the 2010-2017 period) (Chart 5). The robust growth of tourism in Portugal was also reflected in a sharp increase in demand for accommodation services. Non-resident overnight stays in Portuguese hotels increased 7.6% a year on average from 2010 to 2017. The cumulative growth of these indicators in Portugal far outpaced that of Southern and Mediterranean Europe[5] over this period (Chart 5).

**Chart 5** • Tourism indicators in Portugal and worldwide | Index 2010=100



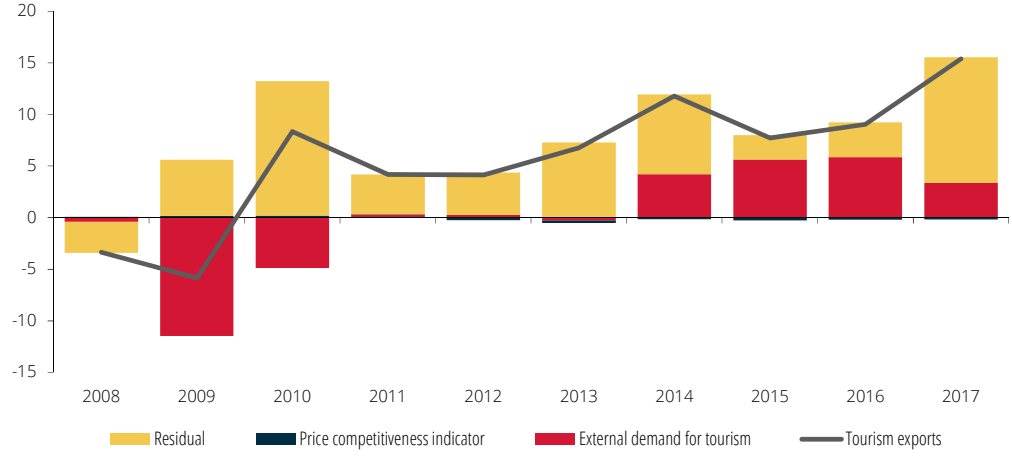

Sources: World Bank, Statistics Portugal and UNWTO (Banco de Portugal calculations).

5. The concept of Southern and Mediterranean Europe referred to throughout the text is that used by the United Nations World Tourism Organization (UNWTO) and includes the following countries: Albania, Andorra, Bosnia and Herzegovina, Croatia, Cyprus, Greece, Israel, Italy, Macedonia, Malta, Montenegro, Portugal, San Marino, Serbia, Slovenia, Spain and Turkey.

# Drivers of tourism exports

The behaviour of Portugal's real tourism exports may be evaluated using a simple econometric equation – commonly used in Banco de Portugal's projection exercises – which has as explanatory variables an indicator of external demand for tourism and a measure of price competitiveness specific to the tourism sector. The indicator of external demand for tourism takes into account developments in tourism imports of the main origin countries of tourists visiting Portugal, weighted by their shares in total Portuguese tourism exports. Price competitiveness is given by the relative behaviour of consumer prices of services in Portugal versus a group of competitor countries. This indicator aims to measure the cost of services that a foreign tourist faces in Portugal relative to the cost of the same basket of services in competitor tourism destinations. The estimation explains only around 20% of the growth in tourism exports in the period from 2010 to 2017, which implies that the remainder must have been driven by variables not explicitly included in the model, in particular, non-price-competitiveness factors (Chart 6).[6]

**Chart 6** • Real tourism exports and main drivers | Rate of change in percentage and contributions in percentage points

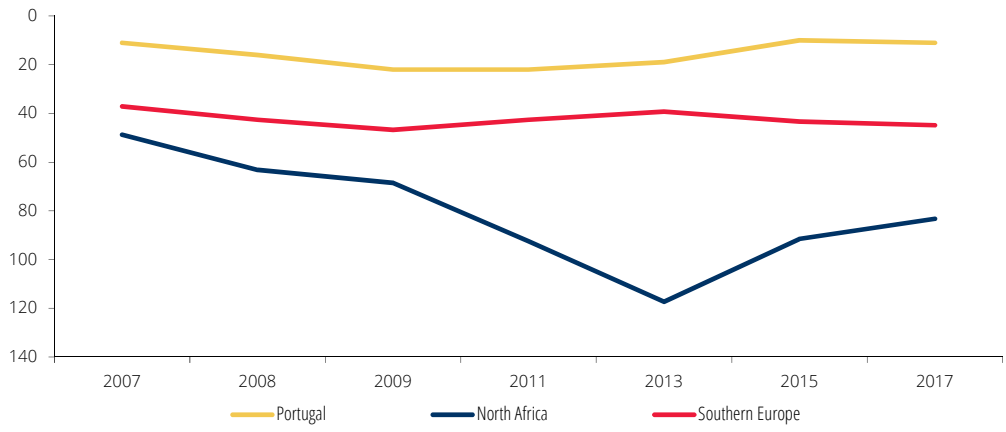



Sources: Statistics Portugal, Eurostat and Banco de Portugal. | Note: The results presented are based on an error correction mechanism equation for real tourism exports estimated on the basis of quarterly data for the period 1996 Q1-2016 Q2. External demand for tourism is an indicator that reflects the growth of tourism imports from the main markets of origin of tourists visiting Portugal. The variable competitiveness measures the evolution of relative prices of Portugal in relation to client and competitor countries.

Part of these effects is likely linked to the increase in geopolitical instability and insecurity in competitor destinations in North Africa (starting in 2011 with the Arab Spring). This factor is likely to have caused a redirection of tourism flows, with Portugal being one of the beneficiaries.[7] Portugal's appeal as a safe tourism destination is confirmed by the World Economic Forum's competitiveness indicators for tourism (described in detail below) for 2017, which placed Portugal 11th out of 136 countries in the safety and security category, above all the southern European countries, and significantly above most of the countries of North Africa (Chart 7).

6. The contribution of the price competitiveness indicator is very small and does not help to explain the recent positive trend in tourism. This could be due to limitations arising from the sample of competitor countries used to calculate the price competitiveness indicator, restricted to the Southern and Mediterranean Europe countries belonging to the euro area.
7. Spain was another beneficiary (see Box 7 "Dynamism of non-resident tourism in 2016 and its determinants" – *Bank of Spain Economic Bulletin*, 1/2017).

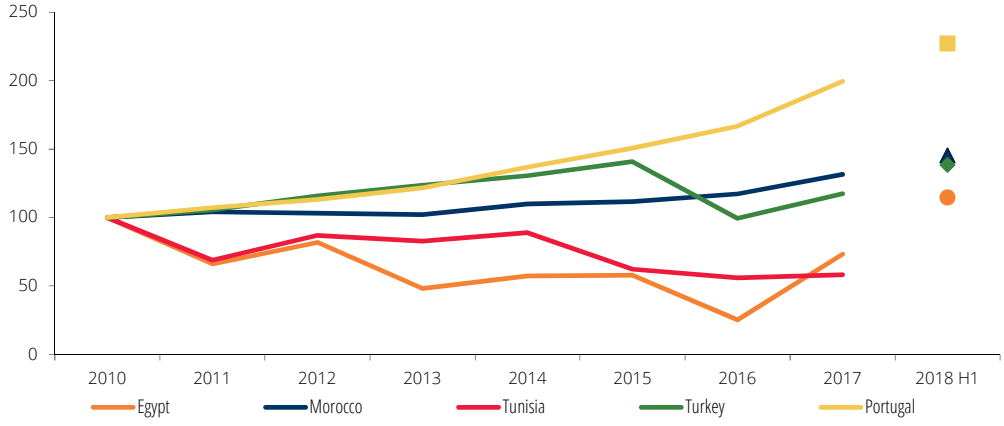
**Chart 7** • Travel and Tourism Competitiveness Index – assessment of safety and security | Ranking




Source: WEF (Banco de Portugal calculations). | Notes: Only the safety and security ranking was considered. In the WEF publication, North Africa includes Morocco, Egypt, Tunisia and Algeria whereas Southern Europe includes Spain, Italy, Portugal, Greece, Croatia, Malta, Turkey and Cyprus. The ranking of the regions of Southern Europe and North Africa was obtained as a simple average of the rankings of the countries considered.

Tourism exports from the countries most affected by the insecurity and political instability showed relatively weak developments from 2010, in particular Egypt, Tunisia and more recently Turkey (Chart 8). By contrast, developments were very positive over the same period in most of the countries of Southern and Mediterranean Europe (Chart 9). However the most recent data points to a strong rebound in tourism exports in Egypt and Turkey in 2017 and the start of 2018, in a context of a decline in the perception of geopolitical risks. This rebound can partly explain the deceleration of indicators of non-resident tourism in Portugal and other Southern and Mediterranean Europe countries in the first half of 2018.

**Chart 8** • Nominal tourism exports (in EUR) | Index 2010=100

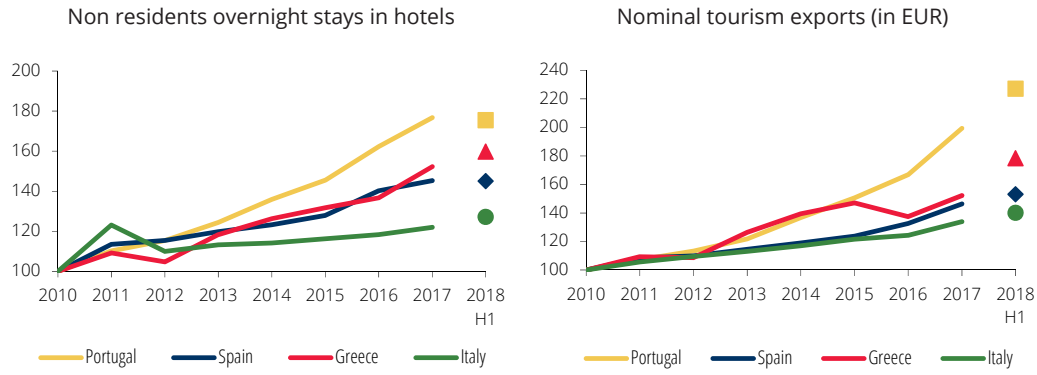



Sources: Banco de Portugal and IMF.

Compared to Southern and Mediterranean Europe – where countries have similar tourism attractions to Portugal – the Portuguese economy clearly stands out due to the more positive behaviour of the nominal tourism exports or overnight stays by non-residents over the 2010-2017

period (Chart 9). This suggests that part of the buoyancy unexplained by the usual drivers is likely associated with other factors aside from the impact of the insecurity in competitor markets.

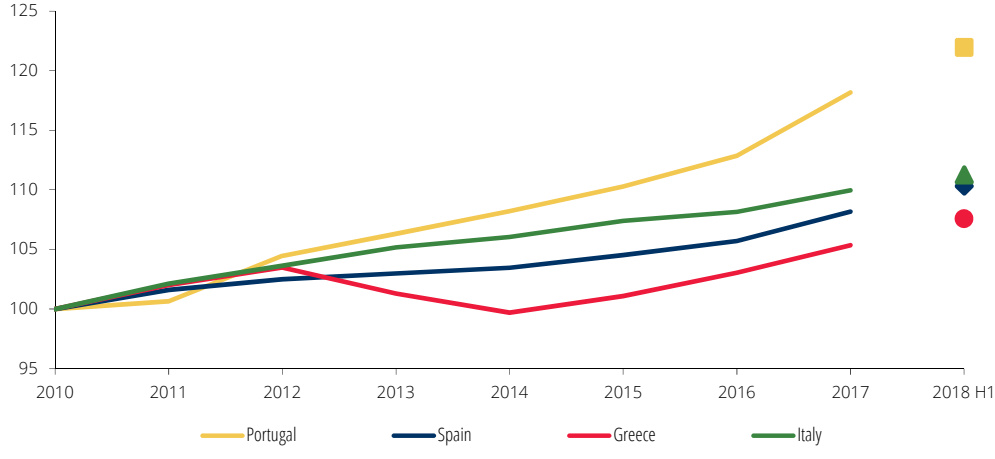
**Chart 9** • Tourism indicators – comparison of Portugal with Southern/Mediterranean Europe countries | Index 2010=100




Sources: Eurostat, Statistics Portugal and Banco de Portugal. | Note: International tourists overnight stays in hotels consider only hotel and similar establishments.

As already mentioned (Chart 6), developments in price competitiveness do not help explain why Portuguese tourism exports grew faster than that of other countries of Southern and Mediterranean Europe in the 2010-2017 period. Indeed, comparing the HICP of tourism-related services – namely restaurants and hotels – in Portugal and in the three main competitor countries belonging to the euro area (Spain, Italy and Greece), it can be seen that prices in Portugal have grown more sharply, in particular in the most recent period (Chart 10).

**Chart 10** • HICP for restaurants and hotels | Index 2010=100

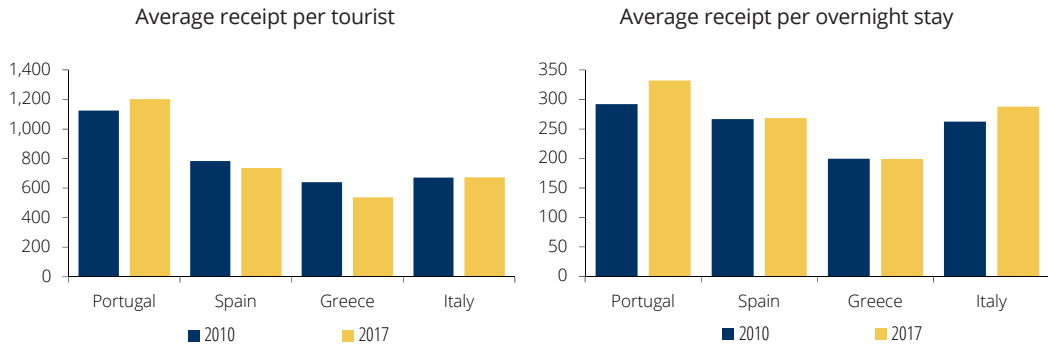



Sources: Eurostat and Statistics Portugal (Banco de Portugal calculations).

The sustained buoyancy of the real indicators of non-resident tourism in Portugal – implying significant market share gains – in a context of prices rising faster than those observed in competitor destinations signals an increase in the perception of the quality and value-added of the services

offered by Portuguese tourism operators. This is confirmed by developments in the average export receipt per tourist, and in particular, per overnight stay by non-residents (increases of 7.7% and 13.7% respectively between 2010 and 2017) (Chart 11). Both indicators developed more favourably in Portugal than in the competitor countries of Southern and Mediterranean Europe, and their levels are higher than the ones observed in those countries.

**Chart 11** • Average receipt per tourist and overnight stay (non residents) | EUR




Sources: Eurostat, Statistics Portugal, UNWTO and Banco de Portugal. | Note: The average receipt per tourist is obtained by dividing nominal tourism exports by the number of tourist arrivals. The average receipt per overynight stay is obtained by dividing nominal tourism exports by the number of nights spent by non residents in tourism accommodation.

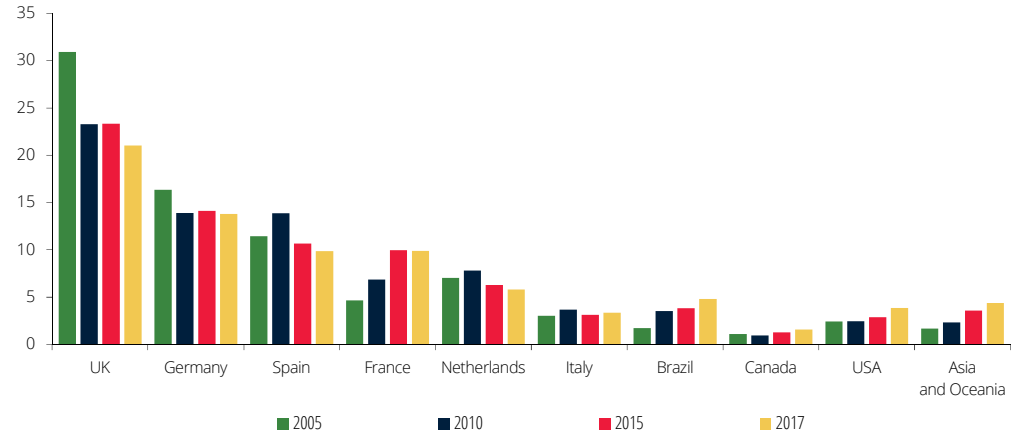
## Structural changes in the sector

There is evidence of structural changes in the tourism sector in Portugal which likely contributed to the buoyancy seen in exports of these kinds of services and which may also foster strong growth over the projection horizon. In terms of non-resident tourism indicators, there are notable diversification trends, namely in terms of the nationalities visiting and their geographical distribution around Portugal. There was also a change in the tourists' profile in regard to the type of accommodation favoured. Furthermore, there are signs of lower seasonality in non-resident tourism indicators.

Portugal has been registering a diversification of the origin markets of foreign tourists. The share of non-resident overnight stays in tourism accommodation from the main five origin markets – the United Kingdom, Germany, Spain, France and the Netherlands – is still high, accounting for around 60% in 2017, but has been gradually falling (by around 5 p.p. against 2010 and 10 p.p. against 2005) (Chart 12).[8] The share decline extended to most of the EU markets, with the notable exception of the French market. By contrast, the share of tourists originating from the US, Brazil and Canada has been increasing, as a result of annual average growth rates of overnight stays of 15% or more in the 2010-2017 period. The annual average growth rate of overnight stays by tourists originating in Asia and Oceania was even more significant (19%), implying a doubling of its share between 2010 and 2017.

8. Data for nominal tourism exports by country also show a loss of share of the five main tourism origin markets in 2010-2017, but less marked than that of overnight stays (from 65% to 62%).

**Chart 12** • Non residents overnight stays in tourism accommodation, by nationality | Weight in total, in percentage



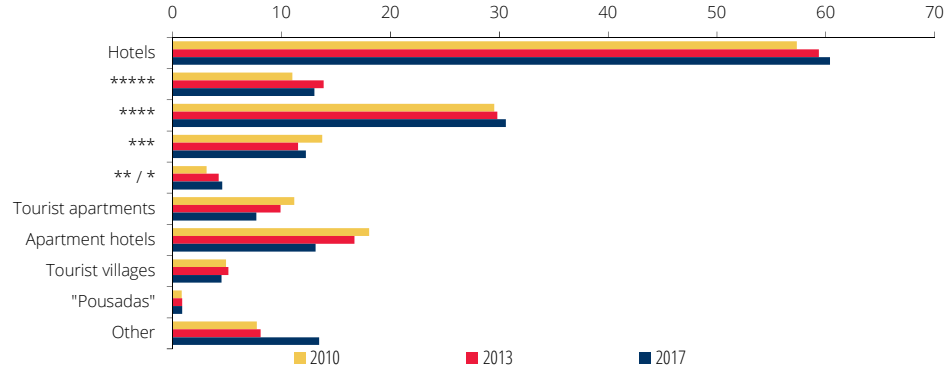

Source: Statistics Portugal (Banco de Portugal calculations).

The type of establishment favoured by non-resident tourists changed, with an increase in the share of accommodation at the upper and lower ends of the average cost distribution. On the one hand, the percentage of tourists staying in more expensive accommodation increased. Hotels, with a higher average daily revenue per available room, gained share in terms of total overnight stays (from 57% in 2010 to 59% in 2013 and 60% in 2017), in particular the higher category hotels (Charts 13 and 14). On the other hand, there was also an increase, more marked, in the percentage of tourists that stay in cheaper establishments (grouped under 'other' in Charts 13 and 14, where local accommodation predominates). It is estimated that these changes have resulted in a slightly negative composition effect in the 2013-2017 period,[9] i.e. a lower increase in average daily revenue per-tourist than would be the case if overnight stays' accommodation structure had remained unchanged from the base year. However, there was a significant increase in average daily revenue per available room across all types of accommodation in the 2013-2017 period, which resulted in a cumulative growth of average revenue of around 60% for total accommodation. These developments suggest an improvement in the quality of the service provided (Chart 14).

Statistics also show that the geographical distribution of non-resident tourists broadened across the territory, with the proportion of tourists staying the night in the main tourism region (the Algarve) having fallen from around 40% in 2010 to 36% in 2017 (Chart 15). The Região Autónoma (R. A.) da Madeira also lost share over the period. The share of all the other regions increased, especially the Área Metropolitana (A. M.) de Lisboa and the Norte region.[10]

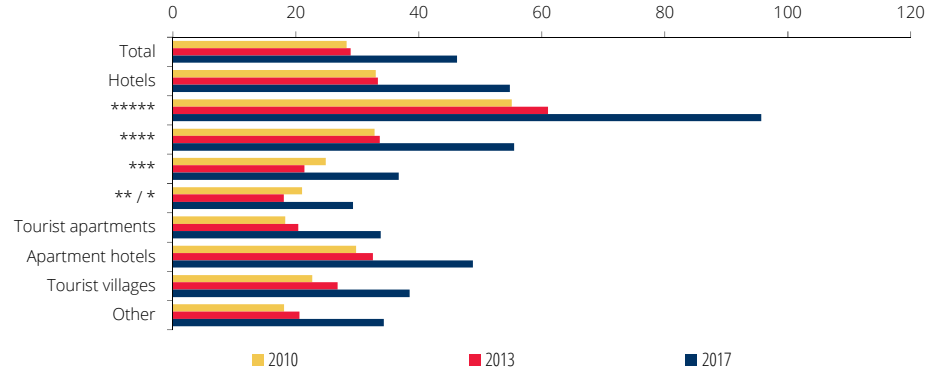
9. There was a change to the scope of the overnight stay statistics in tourism establishments in 2013, affecting comparison with the data of previous years.
10. Foreign card transaction data in ATMs and payment terminals in Portugal (sources: SIBS and Banco de Portugal) may be used as a proxy for total expenditure by non-residents in each region of the country. According to these data, the region in 2017 with the greatest share of spending by non-residents was the A. M. Lisboa with 37%, followed by the Algarve and the Norte regions (both with 22%). When comparing to data for overnight stays, it should be noted that these card transaction data also account for expenses of non-resident tourists that do not stay in tourism establishments but in housing, either rented or belonging to family or friends. In terms of change from 2014 to 2017, the A. M. Lisboa and Norte increased their respective shares of total foreign card transactions in ATMs and payment terminals.

**Chart 13** • Non residents overnight stays in tourism accommodation, by accommodation type | Weight in total, in percentage



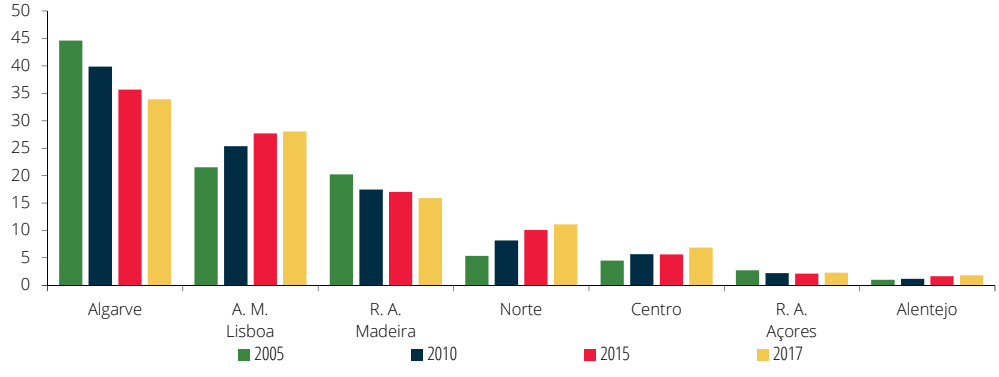

Source: Statistics Portugal(Banco de Portugal calculations). | Note: The 'other' aggregate is not directly comparable between 2010 and 2013/2017. It includes motels, boarding houses and inns in 2010 and 'Quintas da Madeira', rural tourism, guest houses and local accommodation (with more than 10 beds) in 2013 and 2017.

**Chart 14** • Average daily revenue per available room, by accomodation type | EUR




Source: Statistics Portugal (Banco de Portugal calculations). | Note: The 'other' aggregate is not directly comparable between 2010 and 2013/2017. It includes motels, boarding houses and inns in 2010 and 'Quintas da Madeira', rural tourism, guest houses and local accommodation (with more than 10 beds) in 2013 and 2017.

**Chart 15** • Non residents overnight stays in tourism accommodation by region | Weight in total, in percentage



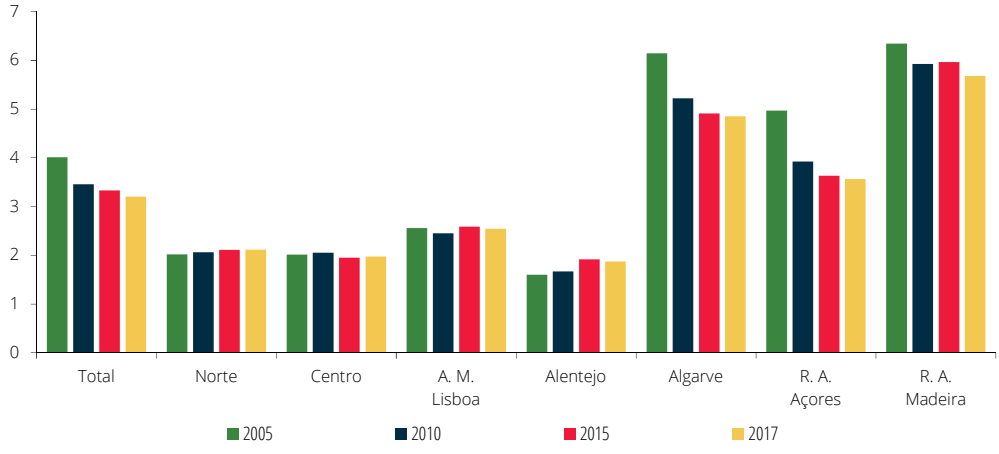

Source: Statistics Portugal (Banco de Portugal calculations).

The regions with the largest share gains over the period have an average length of stay below the national average (Chart 16). This contributed, in part, to a slight reduction in the average length of stay in tourism establishments by non-residents over the 2010-2017 period.

The developments in the regional distribution of non-residents' overnight stays are likely linked to changes in the type of tourism coming to Portugal, with a relative reduction in 'beach' tourism and an increase in city break and business tourism.

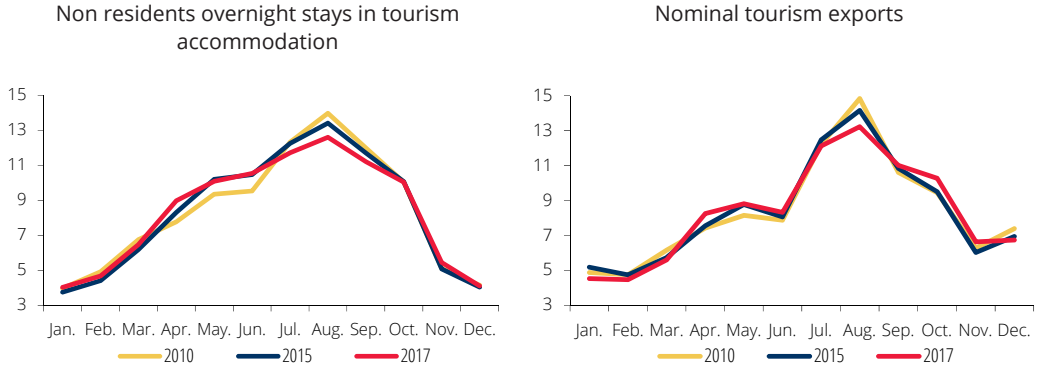
These changes might also explain the lower seasonality evident in tourism export indicators (Chart 17). In particular, there was a decline in the share of overnight stays and tourism export revenues in the months of July and August, offset by an increase in the share of nearby months. The reduction in seasonality is visible in terms of overnight stays in most regions (Chart 18). However, this indicator continues to show high seasonality in the Algarve and other regions (R. A. Açores, Alentejo, Centro), and lower seasonality in the R. A. Madeira, the A. M. Lisboa and also, to a lesser extent, the Norte region. The share gains in the latter two regions contributed to reduce the seasonality of overnight stays at national level.

**Chart 16** • Average lenght of stay of non residents overnight stays in tourism accommodation, by region | Number of days



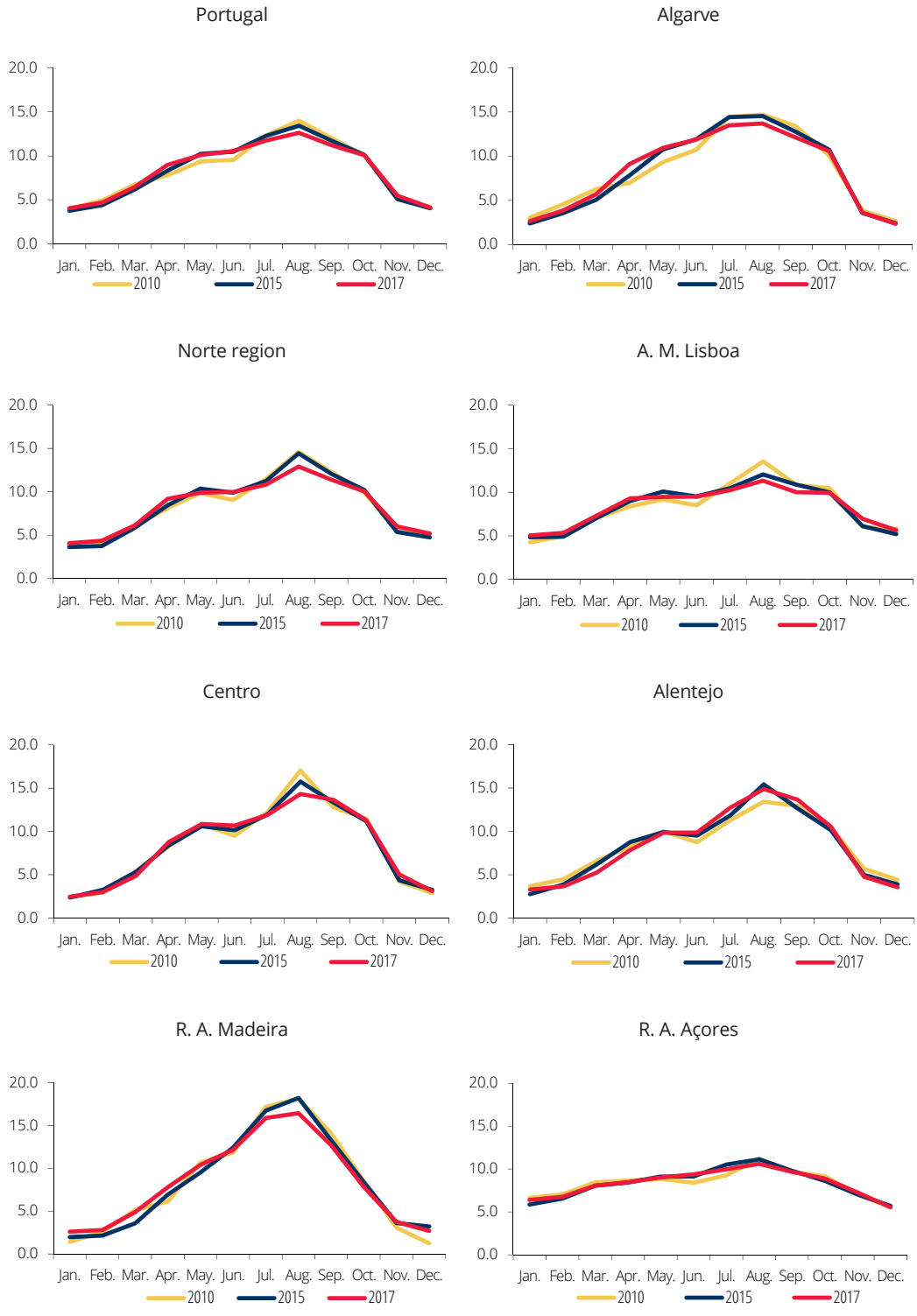

Source: Statistics Portugal (Banco de Portugal calculations).

**Chart 17** • Seasonal pattern of tourism | Weight of each month in total, in percentage




Sources: Banco de Portugal and Statistics Portugal.

**Chart 18** • Seasonal pattern of non residents overnight stays, by region | Weight of each month in total, in percentage




Source: Statistics Portugal (Banco de Portugal calculations).

Tourism's strong seasonality is linked to the fact that leisure and holiday travel, which tends to be more concentrated in the summer months, represents around 70% of international tourism

in Portugal,[11] compared to a share of around 55% worldwide.[12] A strategy to reduce seasonality is the promotion of business tourism – which accounted for around 8% of total tourism in 2016 (compared to a worldwide average of 15%) – given that these kinds of events (congresses, fairs, meetings, etc.) tend to fall in the spring and autumn months. An additional advantage is that the average daily spending of this type of tourism tends to be higher.[13]

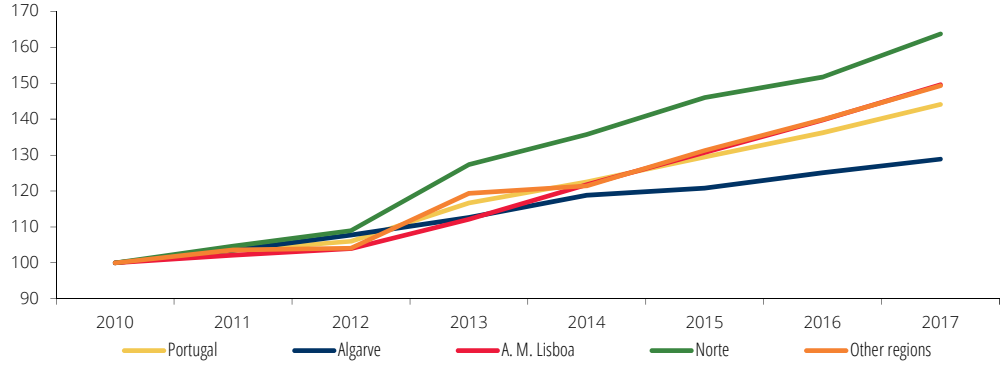
Tourism exports' buoyancy went hand-in-hand with a strong growth in the supply of tourism accommodation, particularly in recent years (Table 2). Over the 2013-2017 period, the number of beds in establishments with 10 or more beds (based on data from Statistics Portugal) grew around 23% in cumulative terms, while the increase in the number of establishments was considerably higher (75%). The main driver of the growth in the number of beds came from local accommodation, where the number of beds increased by 62% between 2013 and 2017 (local accommodation establishments increased in number by 163%). Taking into account the number of beds, the regions contributing the most to the increase in capacity were the A. M. Lisboa, the Algarve and the Norte region (Chart 19).

**Table 2** • Number of available bed places in tourism accommodation | In thousands and in percentage

| | Level (in thousands) | | | | | Change (in thousands) | | | | Rate of change (%) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2014 | 2015 | 2016 | 2017 | 2014 | 2015 | 2016 | 2017 |
| Total (10 or more bed places) | 326 | 342 | 362 | 381 | 403 | 16 | 20 | 19 | 22 | 5.0 | 5.7 | 5.2 | 5.8 |
| Hotels | 174 | 185 | 190 | 202 | 211 | 11 | 5 | 11 | 9 | 6.4 | 2.8 | 6.0 | 4.7 |
| Apartment hotels | 42 | 43 | 43 | 44 | 44 | 1 | 0 | 2 | -1 | 1.7 | -0.6 | 3.9 | -1.2 |
| Tourist apartments | 35 | 36 | 37 | 34 | 35 | 1 | 1 | -4 | 1 | 2.3 | 2.5 | -9.6 | 3.5 |
| Tourist villages | 17 | 17 | 17 | 19 | 19 | 0 | 0 | 2 | 0 | 1.4 | -1.8 | 13.2 | 2.1 |
| Other | 58 | 61 | 75 | 82 | 94 | 4 | 14 | 7 | 12 | 6.1 | 22.7 | 9.3 | 14.0 |
| of which: | | | | | | | | | | | | | |
| 'Pousadas' | 3 | 3 | 3 | 3 | 3 | 0 | 0 | 0 | 0 | -3.8 | 9.8 | -2.6 | -5.8 |
| Local accommodation | 41 | 44 | 49 | 56 | 67 | 3 | 6 | 6 | 11 | 6.3 | 12.8 | 12.8 | 19.4 |
| Total (less than 10 bed places) [(a)] | | | | 36 | 94 | | | 36 | 59 | | | | 164.6 |

Sources: Registo Nacional de Alojamento Local and Statistics Portugal (Banco de Portugal calculations). | Note: (a) The level corresponds to the cumulative variation of the available years.

**Chart 19** • Number of available bed places in tourist accommodation, by region | Index 2010=100



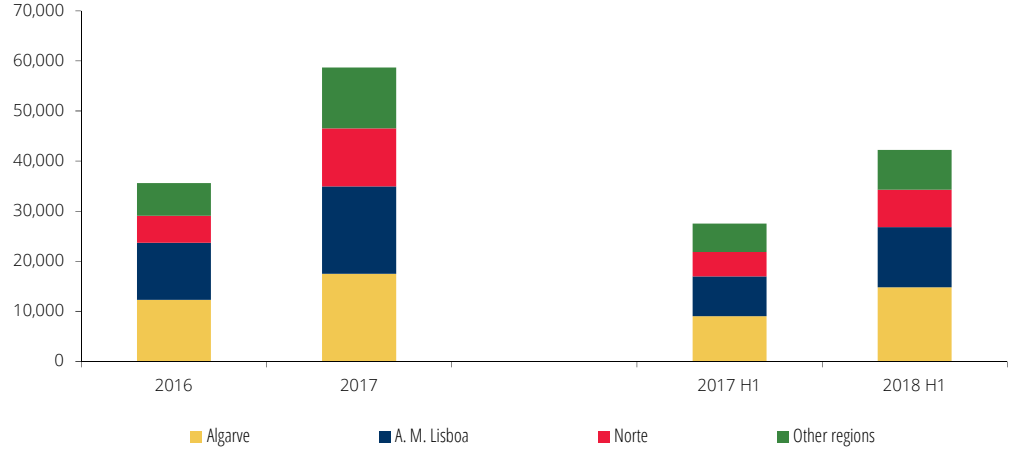

Source: Statistics Portugal (Banco de Portugal calculations). | Note: Tourism accommodation includes local accommodation with more than 10 bed places.

11. See Statistics Portugal, Tourism Statistics, 2016. According to the International Tourism Survey for the period from July 2015 to June 2016, most foreign tourists visited Portugal for leisure, recreation or holidays (69.3%). Tourism to visit family or friends accounted for 20.3% of the tourists while professional or business reasons accounted for 8.0%.
12. Source: *Tourism Towards 2030*, UNWTO.
13. Source: Eurostat (survey on trips of EU residents).

Local accommodation with fewer than 10 beds has gained relevance in the tourism supply in Portugal. According to data from Registo Nacional de Alojamento Local, there were around 18,000 registrations of local accommodation with fewer than 10 beds in 2017, implying an increase of 59,000 beds from 2016 (in 2016, there was an increase of 36,000 beds) (Table 2). This trend has continued into the first half of 2018, with a year-on-year increase of 56% in the number of local accommodation establishments with fewer than 10 beds (equivalent to 42,000 beds). In terms of overall capacity, the registrations of local accommodation with fewer than 10 beds in 2016 and 2017 represented 23% of the stock of beds in supply in all accommodation reported by Statistics Portugal in the Tourism Statistics for 2017. While striking, this statistic should be taken with a degree of caution, because the registrations only capture the inflow into the local accommodation stock, not the outflow. The creation of this kind of accommodation is concentrated in the Algarve, the A. M. Lisboa, and to a lesser degree, the Norte region. These three regions accounted for around 80% of new local accommodation with fewer than 10 beds in 2017 (Chart 20).

The other factor contributing to the buoyancy of tourism exports was the growth of low-cost airlines operating in the Portuguese market. The number of these companies operating in Portugal increased from 3 in 2001 to over 15 currently. According to data from the Portuguese Civil Aviation Authority (ANAC), there was a very sharp growth in the number of passengers carried[14] by these operators between 2003 and 2006, with their market share in the domestic market increasing from 6% to 22%.[15] The number of passengers carried by these operators continued to grow faster than the total over the following years, bringing additional share gains, reaching 37% in 2011 and over 40% in 2017 (Chart 21).

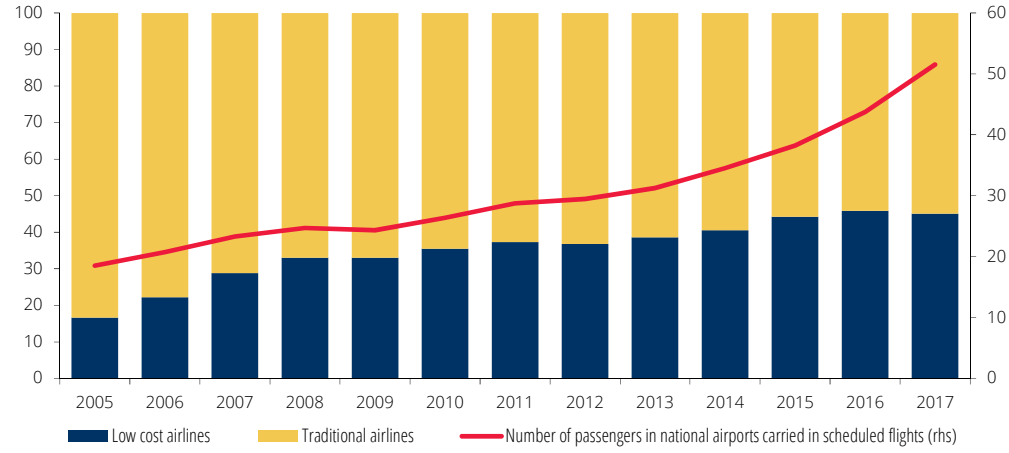
**Chart 20** • Change in the number of bed places in tourism accommodation with less than 10 bed places




Source: Registo Nacional de Alojamento Local (Banco de Portugal calculations).

14. The universe of passengers carried relates to routes originating or terminating in Portuguese airports, as well as routes in which these airports are intermediate stops on multi-leg journeys.
15. Source: ANAC, *O impacto das transportadoras de baixo custo no transporte aéreo nacional (1995-2011)* (In portuguese only).

**Chart 21** • Number of passengers in national airports carried in scheduled flights and market share of traditional and low cost airlines | In millions and percentage




Source: Portugal Civil Aviation Authority (ANAC) (Banco de Portugal calculations).

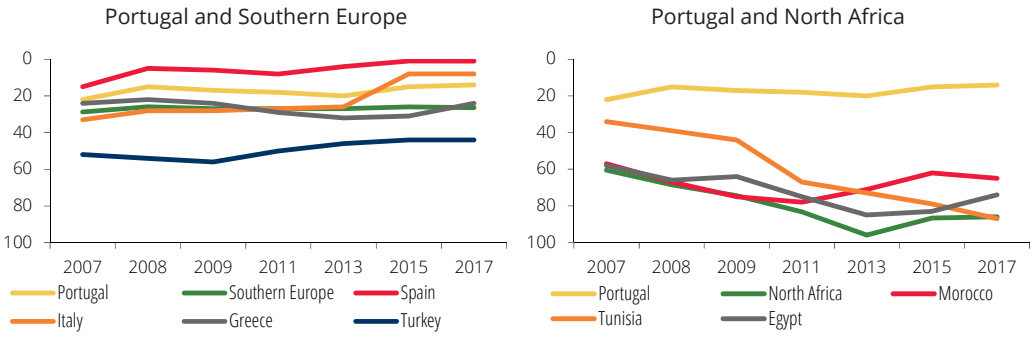
# Outlook and challenges for the sector

The projections of this *Economic Bulletin* point to the maintenance of relatively strong growth in tourism exports over the next few years – at a faster rate than that projected for total goods and services exports and for GDP – but at rates lower than those registered in 2017. At the world level, the available projections point to growth of the number of international tourist arrivals that is essentially in line with that of activity. The outlook for Portuguese tourism exports is anchored in the comparative advantage of the Portuguese economy in this sector and in the existing margin for growth. This positive outlook is subject, however, to uncertainty and risks. On the one hand, tourism activity is highly sensitive to the global economic cycle, meaning that a deterioration in the growth outlook worldwide will have an impact on this sector. On the other hand, the recovery in tourism activity in competitor destinations, which essentially compete at price level, could also have a negative effect on Portuguese tourism exports.

According to data from the WEF, Portugal has a relatively competitive tourism sector. In the WEF ranking of tourism competitiveness indexes calculated by this organism for around 140 countries – which summarise developments in different determinants of the country´s capacity of competing in the global tourism markets – Portugal improved its position between 2009 and 2017, rising from 17$^{th}$ to 14$^{th}$ most competitive destination (Chart 22). Portugal's position is slightly above the average for the southern European countries – only below Spain and Italy but above Greece and, in particular, Turkey – and is well above the average for North African countries. Against the latter group, Portugal scores lower only for price competitiveness.

In terms of tourism intensity (number of international tourist arrivals as a percentage of the population) and the macroeconomic importance of this sector (inbound tourism expenditures in percentage of GDP), Portugal stands slightly below the average for Southern and Mediterranean Europe (Chart 23). The higher relative position of some countries of Southern and Mediterranean Europe suggests that there is margin for tourism activity in Portugal to grow faster than the total economy.

**Chart 22** • Travel and Tourism Competitiveness Index – global rank | Ranking



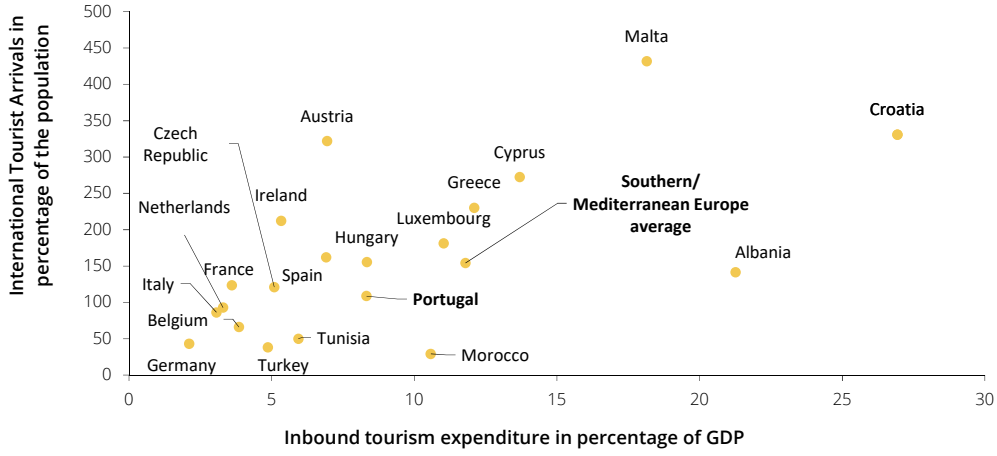

Source: WEF (Banco de Portugal calculations). | Notes: The global rank takes into account four areas that make the country attractive for developing projects in the travel and tourism sector, which reflect a set of indicators. The first area of action is the enabling environment, based on indicators of business environment, safety and security, health and hygiene, human resources and labour market and ICT readiness. The second area covers tourism policy and enabling conditions, including indicators related to the prioritization of tourism, international openness, price competitiveness and environmental sustainability. The third area of analysis is related to transport and tourism service infrastructures. Finally, the fourth area takes into account natural and cultural resources. In the WEF publication, North Africa includes Morocco, Egypt, Tunisia and Algeria whereas southern Europe includes Spain, Italy, Portugal, Greece, Croatia, Malta, Turkey and Cyprus. The ranking of the regions of Southern Europe and North Africa was obtained as a simple average of the rankings of the countries considered.

However, this positive outlook for tourism activity in Portugal involves significant challenges. The high competition characterizing this market requires investment in tourism attractiveness factors that do not centre on price competitiveness, such as increasing the quality and value-added of the services offered, which could help to increase repeat visits from tourists and increase average return per tourist. This strategy may allow the maintenance of high growth of tourism exports in parallel with the development of segments with room for growth, such as business tourism. On the other hand, the relatively new accommodation types, particularly small-scale local accommodation, have greatly contributed to increase the country's overall supply to foreign visitors, thereby sustaining an important part of the sector's buoyancy.

The foreseeable increase in tourism intensity brings clear advantages for the economy but also poses some challenges, namely risks of hostility from local residents, the deterioration of the tourism experience and the degradation of natural, cultural and historical assets.[16] In this setting, further efforts are needed to distribute non-resident tourism more evenly throughout the year and across the country. Progress made in these areas must be continued to avoid potential congestion during high season or underuse of infrastructures during low season, as well as the negative impact of seasonality on the labour market, contributing to increase temporary and unstable employment. Aside from this effort of seasonality reduction, investment into transport infrastructure and other tourism facilities must not be neglected in order to avoid bottlenecks. Lastly, the sector's regulatory framework should provide for the orderly development of new business models, in particular those linked to new technologies.

16. Assessing this issue is complex, as it is based on the subjective experience of residents and tourists. Research by the World Travel & Tourism Council (WTTC) on 68 cities worldwide, based on a combination of objective and subjective tourism intensity indicators, placed Lisbon in the group of 20% of cities with the highest risk of congestion in regard to the seasonality indicator for tourist arrivals (Coping with success – Managing overcrowding in tourism destinations, December 2017). The seasonality indicator used in this research is the difference in the number of places on flight arrivals between the months of highest and lowest affluence.

**Chart 23** • Aggregate indicators of tourism – international comparison




Sources: UNWTO and World Bank. | Notes: Data refers to the year 2016. Inbound tourism expenditure covers the total expenditure of foreign tourists in the reference economy. This is a broader concept than tourism exports in National Accounts, which do not include, for example, international transport expenditure (included in exports of other services). The (simple) average of Southern/Mediterranean Europe excludes Andorra and San Marino due to data unavailability.