II Projections for the Portuguese economy in 2018

GDP slowdown in 2018

The projections produced by Banco de Portugal point to the continuation of the expansion of the Portuguese economy in 2018, although at a slower pace than in 2017. After real growth of 2.8% in 2017, GDP is projected to increase 2.3% in 2018 as a whole (Table 1), which is above the average of the estimates for potential output growth of the Portuguese economy. In intra-annual terms, GDP growth in the second half of the year should remain relatively stable (year-on-year rate of change of 2.2%).

Table 1 • Projections of Banco de Portugal for 2018 | Annual rate of change, in percentage (except otherwise indicated)

	Weights 2017	EB October 2018				EB June 2018	
		2017	2018 (p)	2018 H1	2018 H2 (p)	2017	2018 (p)
Gross domestic product	100.0	2.8	2.3	2.3	2.2	2.7	2.3
Private consumption	64.8	2.3	2.4	2.5	2.4	2.3	2.2
Public consumption	17.5	0.2	0.7	0.8	0.7	-0.2	0.8
Gross fixed capital formation	16.6	9.2	3.9	4.0	3.8	9.1	5.8
Domestic demand	99.2	3.0	2.4	2.6	2.2	2.8	2.5
Exports	42.7	7.8	5.0	6.0	4.0	7.8	5.5
Imports	41.9	8.1	5.1	6.4	3.8	7.9	5.7
Contribution to GDP growth, net of imports (in pp) (a)							
Domestic demand		1.3	1.2	1.2	1.2	1.2	1.1
Exports		1.5	1.1	1.1	1.1	1.5	1.2
Employment (b)		3.3	2.3			3.3	2.6
Unemployment rate		8.9	7.0			8.9	7.2
Current plus capital account (% of GDP)		1.4	1.4			1.4	1.8
Goods and services account (% of GDP)		1.8	1.3			1.8	0.9
Harmonised index of consumer prices		1.6	1.4			1.6	1.4

Sources: Banco de Portugal and Statistics Portugal. | Notes: (p) – projected, (pp) – 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 import content was based on data for 2013. For more information, see the Box entitled 'The import content of global demand in Portugal', in the December 2017 issue of the *Economic Bulletin*. (b) Total employment, in number of persons, according to the national accounts concept.

Growth projected for the Portuguese economy in 2018 stands 0.3 p.p. above the figure released by the European Central Bank (ECB) for the euro area.[1] Thus, the process of real convergence with the euro area is expected to remain very gradual.

Projections for 2018 remain unchanged *vis-à-vis* the June issue of the *Economic Bulletin*. However, there are some revisions in the components, specifically a downward revision of the growth rate of GFCF and exports and an upward revision of the growth rate of private consumption.

1. September 2018 ECB staff macroeconomic projections for the euro area, available at https://www.ecb.europa.eu/pub/pdf/other/ecb.ecbstaffprojections201809.en.pdf?8bc12010f1ed3def5cf67b26433e7f6e

The decelerating profile of the economy reflects the lower impulse from external demand

The assumptions for the Portuguese economy remain broadly favourable in 2018, but entail a moderation of growth of world trade and of the external demand for Portuguese goods and services. Amid trade tensions at global level (Section I, Chapter 2), world trade increases by 4.5% in 2018, down from 5.2% in 2017, according to the assumptions of the projection exercise.[2] Similarly, the rate of change of external demand (i.e. the growth rate of imports from the main trade partners weighted by their share in Portuguese exports) decreases from 4.4% in 2017 to 3.3% in 2018 (Table 2). These dynamics were due, in particular, to the slowdown in intra-euro area imports. According to the projections produced by the ECB Staff, euro area activity will lose some momentum, with growth declining from 2.5% in 2017 to 2.0% in 2018. Compared with the June *Economic Bulletin*, there were downward revisions to world trade and external demand growth.

Table 2 • Projection assumptions

		EB October 2018		EB June 2018	
		2017	2018	2017	2018
International environment					
World GDP	tva	3.6	3.7	3.6	3.8
World trade	tva	5.2	4.5	5.1	5.1
External demand	tva	4.4	3.3	4.5	4.3
Oil prices in dollars	vma	54.4	71.5	54.4	74.5
Oil prices in euros	vma	48.2	60.7	48.2	62.2
Monetary and financial conditions					
Short-term interest rate (3-month EURIBOR)	%	-0.3	-0.3	-0.3	-0.3
Implicit interest rate in public debt	%	3.1	3.0	3.1	3.0
Effective exchange rate index	tva	2.4	2.3	2.4	2.1
Euro-dollar exchange rate	vma	1.13	1.18	1.13	1.20

Sources: ECB (Banco de Portugal calculations). | Notes: yoy – year-on-year rate of change, % – in percentage, aav – annual average value. 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 stable 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. The implicit rate includes an assumption for the interest rate associated with new issuances.

Oil prices in US dollars increases by around 26% in annual average terms in 2018, to around USD 71 per barrel, according to the assumptions of the projection exercise. This level is slightly lower than that considered in the June *Economic Bulletin*. The effective exchange rate appreciation (*vis-à-vis* 19 trading partners) in 2018 is similar to that recorded in 2017. The monetary and financial environment remains benign – with no revisions from June – reflecting the maintenance of the accommodative stance of monetary policy in the euro area (Section I, Box 2) and the favourable financing conditions of economic agents.

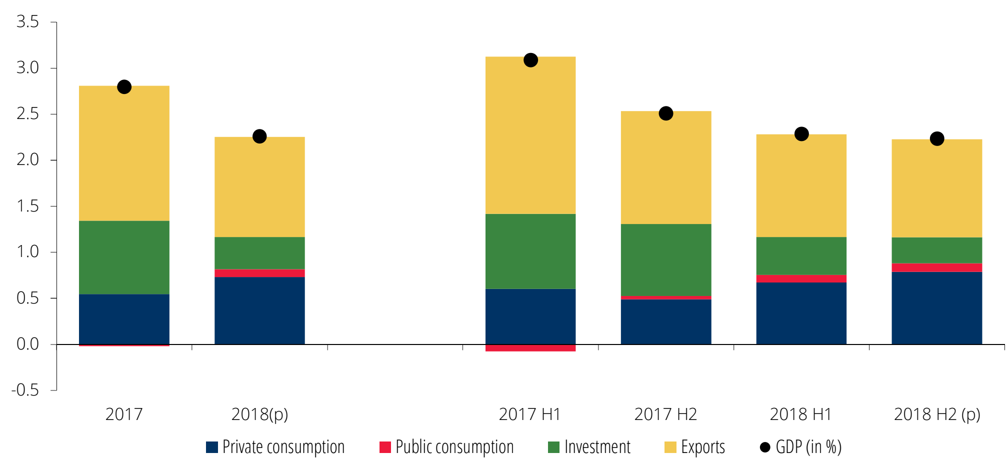
2. The current projection is based on data available up to 21 September and on the set of technical assumptions consistent with the ECB projection exercise released on 13 September. The cut-off date for the assumptions was 21 August.

Deceleration of exports and investment and acceleration of private consumption in 2018

The slowdown projected for GDP in 2018 results from the deceleration of exports and GFCF. In turn, private consumption growth is slightly higher than in 2017. The contribution (net of the respective import content) of exports to GDP growth declines from 1.5 p.p. in 2017 to 1.1 p.p. in 2018 (Chart 1). The contribution of domestic demand decreases slightly from 1.3 p.p. in 2017 to 1.2 p.p. in 2018. Projections point to a reduction of the contribution of investment and an increase in the contributions of private and public consumption.

For 2018 as a whole, private consumption is projected to increase by 2.4%, amid strong growth of real disposable income associated with buoyant job creation and a recovery in real wages (Section I, Chapter 6). The households' saving rate is projected to remain stable at historically low levels. The growth rate of current consumption is expected to increase slightly, while consumption of durable goods is expected to decelerate somewhat, while maintaining a growth pace above that of total private consumption. In intra-annual terms, private consumption growth is expected to decline slightly in the second half of the year.

Chart 1 • Net contributions to real GDP growth | In percentage points



Sources: Banco de Portugal and Statistics Portugal. | Notes: (p) – projected. The demand aggregates net of imports are obtained by subtracting an estimate of the imports needed to meet each component. The calculation of import content was based on data for 2013. For more information, see the Box entitled 'The import content of global demand in Portugal', in the december 2017 issue of the *Economic Bulletin*.

Turning to assumptions regarding public finances, public consumption should grow 0.7% in real terms in 2018. These developments assume the maintenance of the upward trend in public employment observed in the past few years.[3] In addition, expenditure in the acquisition of goods and services is expected to accelerate in 2018, reflecting to a large extent a temporary effect related to the 2017 wildfires. The assumption for public investment points to the maintenance of a significant growth pace in 2018, albeit lower than that considered in the official budgetary documents.

3. The public finances variables incorporate the measures specified with sufficient detail in official documents, following the rules used within the Eurosystem exercises. In addition to these measures, information available until the cut-off date for data on the budget execution and on developments in the number of civil servants has also been considered.

After the high growth rate observed in 2017, GFCF is expected to slow down in 2018. For the year as a whole, projections point to a 3.9% growth (9.2% in 2017). These developments extend to the several types of investment. The deceleration projected for investment in construction in 2018, after strong growth in 2017 (8.3%), reflects in part the impact of the postponement of works in some large infrastructures. According to the projection, the growth rate of investment in machinery, equipment and transport material should remain significant, but lower than in 2017, amid expectations of more moderate growth of overall demand and higher uncertainty at a global level (Section I, Chapter 2). In intra-annual terms, total GFCF growth in the second half of the year is projected to be close to that registered in the first half.

According to the projection, exports decelerate in 2018 to 5.0% (7.8% in 2017). The dynamism of this aggregate continues to be higher than that of the external demand for Portuguese goods and services, translating into further market share gains in external markets. However, these gains are expected to be lower than in 2017 and more concentrated on some export markets, namely tourism and passenger cars. The slowdown in exports reflects developments in both goods and services; however, the tourism component is still projected to remain considerably buoyant. In terms of the intra-annual pattern, the deceleration seen in the first half of the year is projected to continue in the second half, reflecting the slowdown in tourism and other services and a sharp reduction in fuel exports, resulting from scheduled halts in major refineries.

The labour market situation continues to improve

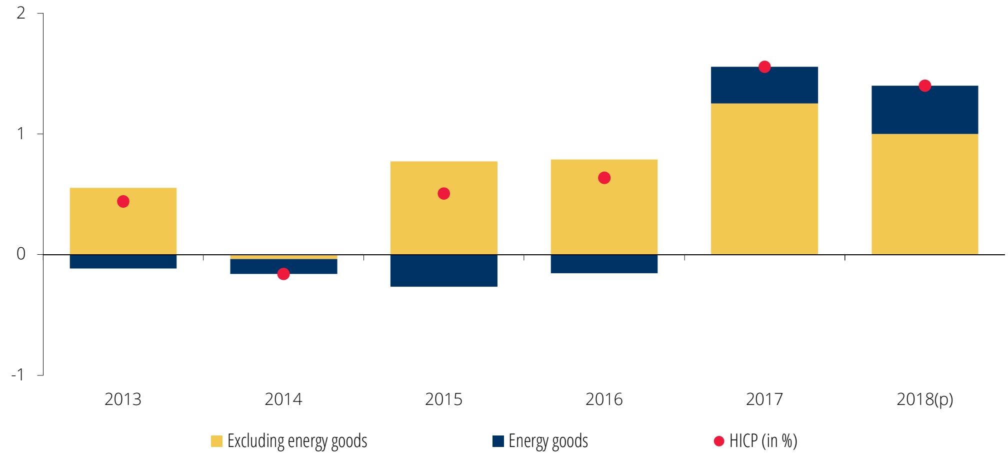
Developments projected for the labour market in 2018 are characterised by a rise in employment of 2.3%, 1.0 p.p. lower than in 2017. The unemployment rate is expected to continue on a downward trajectory, standing at 7.0% in 2018 as a whole (-1.9 p.p. compared with 2017). Wages are projected to accelerate, pressed by the declining unemployment rate, by the impact of the rise in the national minimum wage, and by the gradual unfreezing of career progressions in the general government.

Compared with the June *Economic Bulletin*, there was a downward revision in employment and in the unemployment rate, in the context of a downward revision of the participation rate.

Slight reduction of inflation in 2018

According to the projections, inflation, as measured by the rate of change in the HICP, should decline to 1.4% in 2018, 0.2 p.p. lower than in 2017. This figure is similar to that projected in the June issue of the *Economic Bulletin*. The deceleration in the pace of increase in prices reflects lower external inflationary pressures resulting from developments in import prices of goods excluding energy, despite an acceleration in oil prices. Higher domestic inflationary pressures resulting from the acceleration of wages are expected to be mitigated by developments in some volatile components related to tourism, as well as, by the evolution of profit margins (Section I, Chapter 7). Projections point to a rise in the contribution of the energy component and a decline in the contribution of the non-energy component to inflation in 2018 (Chart 2). The growth of prices projected for Portugal is 0.3 p.p. lower than the latest projections released by the ECB for the euro area.

Chart 2 • Harmonised index of consumer prices | Contributions to the annual rate of change, in percentage points



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

Maintenance of the Portuguese economy's net lending

Finally, current projections point to the maintenance of the Portuguese economy's net lending, as measured by the current and capital account surplus, equivalent to 1.4% of GDP in 2018, similar to the figure for 2017. On the one hand, the goods and services account is projected to deteriorate. On the other hand, a rise in inflows of Community funds is projected – with a rebound expected in the second half of the year – while public debt interest payments are expected to decline. The current projection for the current and capital account is lower than that considered in the June *Economic Bulletin*, incorporating an upward revision of the goods and services surplus and a downward revision of the remaining accounts.