Projections for the portuguese economy in 2016

Projections for the Portuguese economy point to a deceleration in GDP, from 1.6 per cent in 2015 to 1.1 per cent in 2016. GDP growth in 2016 is clearly below that projected by the ECB for the euro area (1.7 per cent) and points at the maintenance of idiosyncratic structural constraints on economic growth in Portugal.

Taking into account demand components net of their import content, GDP developments in 2016 should reflect the lower contribution from domestic demand, particularly investment, while the contribution of exports of goods and services should be close to that in 2015.

In intra-annual terms, underlying the projections is an acceleration in economic activity in the second half of the year, taking into account both quarter-on-quarter and year-on-year rates of change.

Deceleration in global demand

Projections for 2016 comprise information available up to the end of September and incorporate a set of assumptions on developments in the Portuguese economy consistent with the Eurosystem's projection exercise published in the September issue of the ECB *Economic Bulletin* (see the box entitled 'Projection assumptions').

On the basis of this background, and taking into account developments in economic indicators up to the middle of the third quarter, GDP is projected to grow by 1.1 per cent in 2016, after 1.6 per cent in 2015. This profile reflects lower contributions from private consumption, investment and total exports (Table 1 and Chart 1).

Table 1 • Projections of Banco de Portugal for 2016
| Annual change, in percentage

	Weights 2015	EB October 2016		EB June 2016	
		2015	2016 (p)	2015	2016 (p)
Gross domestic product	100.0	1.6	1.1	1.5	1.3
Private consumption	65.6	2.6	1.8	2.6	2.1
Public consumption	18.2	0.8	1.0	0.6	1.1
Gross fixed capital formation	15.3	4.5	-1.8	3.9	0.1
Domestic demand	99.3	2.5	1.1	2.5	1.8
Exports	40.6	6.1	3.0	5.2	1.6
Imports	39.8	8.2	3.0	7.4	2.8
Contribution to GDP growth, net of imports (in p.p.) (a)					
Domestic demand		1.1	0.5	1.1	1.0
Exports		0.5	0.6	0.4	0.3
Employment (b)		1.4	1.0	–	–
Unemployment rate		12.4	11.2	–	–
Current plus capital account (% of GDP)		1.7	1.3	1.7	1.9
Trade balance (% of GDP)		1.8	2.1	1.7	1.6
Harmonized index of consumer prices		0.5	0.7	0.5	0.7

Sources: Statistics Portugal and Banco de Portugal.

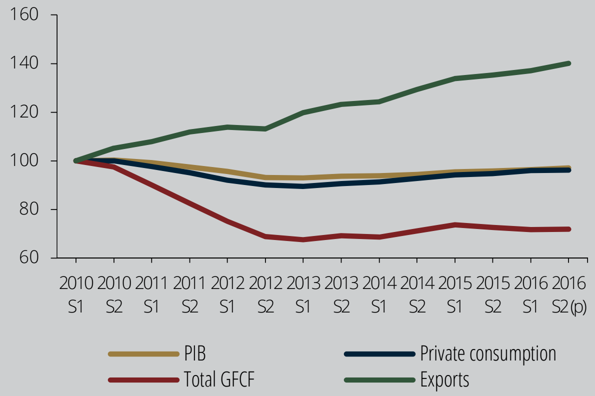
Notes: (p) – projected, (p.p.) – percentage points. For each aggregate, this table shows the projection corresponding to the most likely value, conditional on the set of assumptions considered. (a) The demand aggregates net of imports are obtained by subtracting an estimate of the imports needed to meet each component. For more information, see the Box entitled 'The role of domestic demand and exports in economic activity developments in Portugal', in the June 2014 issue of the *Economic Bulletin*. (b) Total emplyment, in number of individuals according to national accounts concept.

Private consumption is expected to decelerate from 2.6 per cent in 2015 to 1.8 per cent in 2016, although continuing to grow more than GDP. In intra-annual terms, this variable is projected to decelerate in the second half of the year, reflecting developments in the durable goods component, given that non-durable consumption should grow similarly to the first half of the year. This corresponds to a normalisation in the pace of growth in private consumption, to levels closer to trend growth in real disposable income.

In annual terms, durable goods are expected to maintain a robust growth rate, although lower than in the previous year, showing a downward profile throughout the year. This consumption component has grown markedly over the past two years, reflecting *inter alia* the implementation of spending postponed during the previous recession. The non-durable consumption component should also decelerate, although less markedly than the durable goods component.

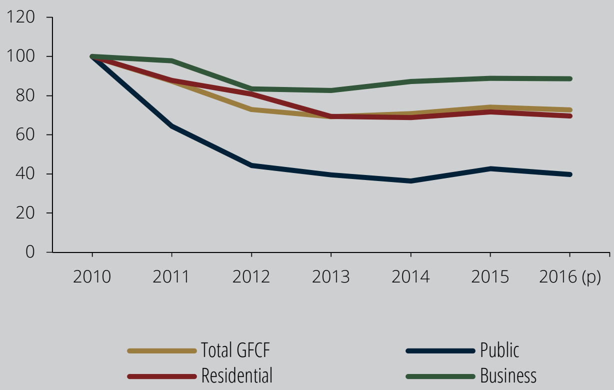
Gross fixed capital formation (GFCF) is expected to decline by 1.8 per cent in 2016, following 4.5 per cent growth in 2015. Underlying this projection are very mixed developments by type of investment and investing sector, as illustrated by an estimate of the breakdown by institutional sector (Chart 2). The public investment component presents the most negative contribution to annual changes in GFCF, with a substantial fall being projected for this year. This component has also seen the most substantial cumulative falls since 2010. However, the rate of change in public investment reflets significant base effects (see the box entitled 'Projection assumptions'). Residential investment (and, more generally, GFCF in construction) is expected to fall by around 3 per cent, after a substantial increase in 2015 (4.3 per cent). This component was affected in the first half of the year by adverse weather conditions, which were not subsequently offset, according to the information available for the third quarter. Finally, the corporate GFCF component is likely to decrease slightly in the year as a whole, after growing in 2014 and 2015, against a background of continued constraints on corporate investment,

Chart 1 • Evolution of GDP and its components | Index 1º semester 2010=100



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

Chart 2 • Breakdown of GFCF by institutional sector | Index 2010=100



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

particularly high corporate indebtedness and uncertainty at internal and external level (see Section 'Demand' in this Bulletin).

Exports of goods and services in 2016 are expected to decelerate from the previous year, with projected annual growth of 3.0 per cent (6.1 per cent in 2015). Deceleration in total exports is associated with lower external demand growth (see the box entitled 'Projection assumptions') and, in particular, is likely to continue reflecting the maintenance of unfavourable behaviour of sales to a number of extra-EU countries, most notably Angola and, to a lesser extent, China.

With regard to goods, there is a fairly different pattern for energy and other goods components. Indeed, the projected deceleration for the whole year in total goods is strongly influenced by developments in energy goods, which are expected to decelerate considerably in 2016 (particularly in the first half of the year), following close to 40 per cent growth in 2015. By contrast, exports of non-energy goods are likely to grow more in 2016 than in the previous year, despite a deceleration in external demand. These developments in non-energy goods should reflect market share gains.[1]

Exports of services are projected to decelerate over the year as a whole. In fact, the highly buoyant tourism exports are expected to coexist with a fall in exports of other services, as seen in the first half of 2016.

Imports of goods and services should decelerate markedly in 2016 (from 8.2 to 3.0 per cent), reflecting a deceleration in both domestic demand and exports. This reflects, in particular, a marked deceleration in some global demand components with high import content, such as consumption of durable goods (particularly cars) and exports of energy goods.

Chart 3 illustrates gross contributions from the various demand components to GDP growth, as well as their net contributions (an estimate of associated imports is subtracted from each demand component). The net contribution from domestic demand should decrease by around 1.1 p.p. in 2015 to 0.5 p.p. in 2016. The reduction in the net contribution from domestic demand to GDP growth in 2016 was largely due to the negative change in the contribution from investment (-0.6 p.p.) and, to a lesser extent, private consumption (-0.1 p.p.). In turn, the net contribution from exports is projected to increase by 0.1 p.p. in 2016. The very different behaviour of energy goods exports (which incorporate very high import content compared with other components) explains why the contribution from exports to GDP growth diverges so substantially when measured in gross terms or net of the import content.

Turning to the main components of global demand, adjusted for an estimate of imports needed to meet such demand (Chart 4), during the recent upturn in the Portuguese economy, exports were the most buoyant demand component, making a decisive contribution to the recovery in activity since the second half of 2013. With regard to domestic demand, public consumption showed a relative stabilisation over this period while the private consumption growth profile was close to but lower than that of GDP. Investment, in turn, decreased in the second half of 2015 and in the first half of 2016, largely reversing the growth rates seen over the previous two years. Therefore, in the first half of 2016, the level of investment (net of imports) stood at only approximately 3 per cent above that seen in the first half of 2013.

Increase in employment and reduction in the unemployment rate

From this issue of the *Economic Bulletin* onwards, Banco de Portugal will release projections for developments in employment and the unemployment rate within projection articles, in line with Eurosystem practice. For 2016, the unemployment rate is projected to decrease from

12.4 per cent to 11.2 per cent, in annual average terms. Employment is expected to increase by around 1.0 per cent in 2016 (1.4 per cent in 2015), and its rate of change, in the second half of the year, is projected to edge close to that seen in the first half.

Maintenance of positive external balance

Current projections point to the maintenance of net lending of the Portuguese economy in 2016, measured by the combined current and capital account balance as a percentage of GDP. Nevertheless, the external surplus is expected to decline in 2016 (from 1.7 to 1.3 per cent of GDP), chiefly as a result of more adverse developments in the income account (primary and secondary income accounts), similarly to the first half of the year. The goods and services account should improve somewhat, despite less buoyant exports, reflecting a positive terms of trade effect associated with the fall in oil prices in 2016 (see the box entitled 'Projection assumptions').

In the case of the capital account, its balance as a percentage of GDP is projected to stabilise in 2016 as a whole. Underlying this projection is a recovery in the transfer of EU funds to final beneficiaries, following a fall in the first half of the year, which should be associated with the transition between EU framework programmes (see Section 'Balance of payments' in this Bulletin).

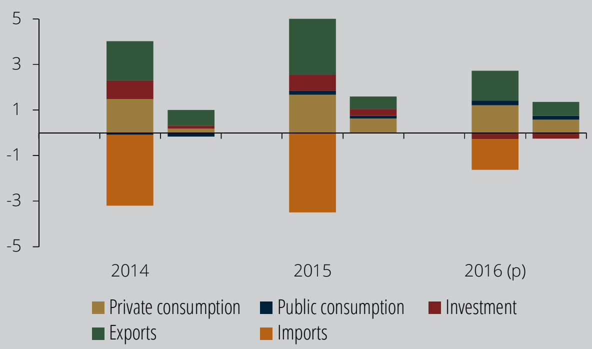
Slight increase in inflation

Inflation, measured by the Harmonised Index of Consumer Prices, is expected to increase slightly in 2016, although remaining at relatively low levels (0.7 per cent, after 0.5 per cent in 2015).

The acceleration in prices in 2016 is likely to reflect a smaller decrease in energy goods prices (from -3.7 per cent in 2015 to -2.5 per cent in 2016) and an acceleration in prices of the non-energy component compared with the previous year (from 0.8 to 1.0 per cent).

The inflation differential between Portugal and the euro area is likely to remain positive and close to that seen in the previous year (around

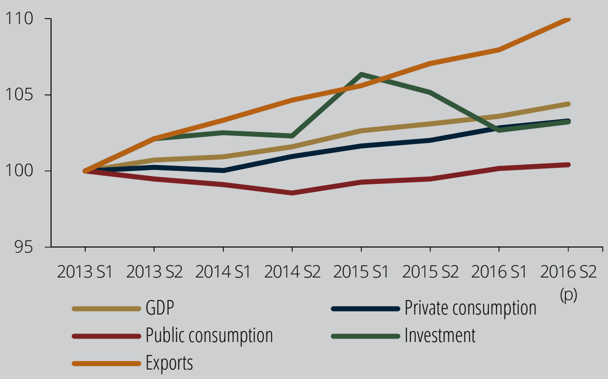
Chart 3 • Gross and net contributions to GDP growth | In percentage points



Sources: Statistics Portugal and Banco de Portugal.

Notes (p) projected; For each year, the left-hand bar refers to gross contributions from each GDP component and the right-hand bar to the corresponding net contributions.

Chart 4 • Evolution of GDP and its components net of imports



Sources: Statistics Portugal and Banco de Portugal calculations.

Notes: (p) – projected, (p.p.) – percentage points. The demand aggregates net of imports are obtained by subtracting an estimate of the imports needed to meet each component. See note (a) of table 1.

0.5 p.p.), based on projections released by the ECB in September. Similarly to 2015, this positive differential largely reflects a fall in energy goods prices more marked in the euro area than in Portugal. In the case of Portugal, the fall in oil prices in 2016 will not be fully reflected in developments in consumer fuel prices, given that it was counterbalanced by an increase in the tax on oil products in February 2016 (see Section 'Prices' in this Bulletin).

The acceleration in the non-energy component should reflect an acceleration in services prices. These more buoyant services prices may reflect the onset of an upward trend, albeit subdued, in a number of factors with greater impact on this sector's prices, particularly an improvement in the labour market situation, the increase in unit labour costs and high buoyancy in a number of specific services segments, such as those related to tourism. To the acceleration in the non-energy component should also contribute an interruption in non-energy industrial goods prices.

Downward revision of activity and unchanged projections for inflation

Compared with previous projections released in the June issue of the *Economic Bulletin*, GDP growth for 2016 was revised downwards by 0.2 p.p. This lower GDP growth resulted from the downward revision of domestic demand, particularly GFCF and private consumption. In turn, exports for 2016 were revised upwards, chiefly due to greater than expected growth in exports of goods and tourism in the first half of the year. In this context, the goods and services account balance was revised upwards.

Projections for inflation in 2016 were not revised compared with the figures published in the June issue of the *Economic Bulletin*. However, the current projection points to a more marked fall in energy goods prices (in line with the downward revision of assumptions for the oil price) and more substantial growth in services prices.

Box 1 | Projection assumptions

Table 2 presents the main assumptions of the projection exercise for the Portuguese economy, which are consistent with information underlying the ECB's projection exercise, published on 8 September.

Turning to the international framework, according to current assumptions, external demand is expected to decelerate (from 4.2 per cent in 2015 to 2.8 per cent in 2016). This profile reflects a deceleration in demand among euro area countries, while extra-euro area demand is projected to grow moderately, close to that seen in the previous year. Demand from euro area countries is expected to grow more than that from other economies. Compared with the projections released in the June issue of the Economic Bulletin, external demand for 2016 was revised downwards, in line with a downward revision of world trade.

Based on information on futures markets, oil prices in both USD and euros are projected to fall in the year as a whole (by approximately 20 per cent). Oil prices in euros are expected to be very close to those considered in the June projections.

The technical assumption for 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. After a considerable depreciation in 2015, the euro is expected to see an annual average appreciation in 2016, both in nominal terms and against the US dollar, somewhat similarly to that considered in the June projections.

Developments in the three-month Euribor rate are based on expectations implied in futures contracts. These contracts point to a negative interest rate in 2016, following a zero rate in 2015, with no changes from the levels projected in the June issue of the Economic Bulletin. Assumptions for the long-term interest rate on Portuguese public debt are based on an assumption for the implied rate, which includes an assumption for the interest rate associated with new issuances. This rate is expected to decrease slightly in 2016 from 2015.

Table 1 • Projection assumptions

		EB October 2016		EB June 2016
		2015	2016	2016
International environment				
World GDP	yoy	3.0	2.9	2.9
World trade	yoy	1.9	1.8	2.5
External demand	yoy	4.2	2.8	3.7
Oil prices in dollars	aav	52.4	42.8	43.4
Oil prices in euros	aav	47.2	38.4	38.3
Monetary and financial conditions				
Short-term interest rate (3-month EURIBOR)	%	0.0	-0.3	-0.3
Implicit interest rate in public debt	%	3.6	3.5	3.5
Effective exchange rate index	yoy	-9.3	2.5	2.9
Euro-dollar exchange rate	aav	1.11	1.11	1.13

Sources: Bloomberg, ECB, Thomson Reuters and Banco de Portugal calculations.

Notes: yoy – year-on-year rate of change, aav – annual average value. An increase in the exchange rate corresponds to an appreciation. The implicit interest rate on public debt is computed as the ratio between interest expenditure for the year and the simple average of the stock of debt at the end of the same year and at the end of the preceding year.

Turning to public finance variables, projections for 2016 incorporate most measures included in the State Budget for 2016, as well as the latest data on budgetary execution, in accordance with the rules applicable to the Eurosystem's projection exercises.

In turn, public consumption is projected to grow by 1 per cent in real terms in 2016. Underlying this projection is an increase in expenditure in goods and services, associated with a rise in expenditure in intermediate consumption, which is partly due to increased expenditure with public-private partnerships of the road sector. Underlying the current forecast for public consumption is an upward revision of the number of general government employees. By contrast and subject to significant uncertainty, a preliminary estimate of the impact of the reduction in the normal working hours of public employees in the second half of 2016 was taken into account. Developments in the public consumption deflator are expected to be positive and significant, as a result of the impact of the reversal in wage cuts in the general government employees.

Turning to public investment, the current estimate for 2016 points to a marked fall in real terms resulting from the base effect associated with the acquisition of real estate by Oitante registered in 2015, and to the sale of military equipment to Romania. Excluding these effects, this item is likely to stabilise.

Note

1. This market share gain is obtained taking into account the external demand indicator adjusted by the relative importance of external trade with Angola. The external demand indicator for Portugal mentioned in Box 1 and used in the scope of Eurosystem's projections does not specifically include Angola's external demand.