22. PORTUGAL

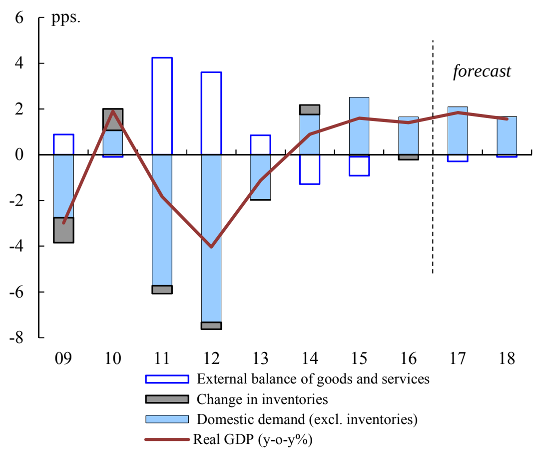
Growth momentum gains pace

Following a strong performance in the second half of 2016, Portugal's economic growth is set to rise further in 2017 before easing off in 2018. The labour market is also expected to improve with unemployment falling from 11.2% in 2016 to 9.2% in 2018. After turning out at 2.0% of GDP in 2016 the general government deficit is set to remain below 2% over the forecast horizon.

Investment rebound to support growth

Economic growth picked up in the second half of 2016 supported by private consumption and exports. Investment also improved towards the end of 2016 mainly helped by construction. Overall, GDP increased by 1.4% in 2016 and the positive carryover is expected to improve the growth rate to 1.8% in 2017 before slowing to 1.6% in 2018. The risks to the forecast remain tilted to the downside, as the banking system is still facing challenges and the economy's vulnerability to external developments is high.

Graph II.22.1: **Portugal - Real GDP growth and contributions**



The Commission's Economic Sentiment Indicator (ESI) continued to improve in the first quarter of 2017 reaching a nine-year high. However, most of the recent short-term indicators, as well as the pick-up in inflation, suggest that private consumption growth could slow down. Nevertheless, consumer spending is expected to remain strong in 2017 supported by the minimum wage increase and robust employment growth. Private consumption growth is expected to moderate afterwards, in line with weaker job creation and a gradual rebound of a historically low saving rate. There is a mixed picture as regards short-term investment indicators: cement sales continue to accelerate, while a slowdown in capital goods imports points to a weaker growth in equipment investment. Construction investment is therefore projected to rise, particularly in 2017, due to a strong recovery in public investment and a gradual increase in private property developments. Investment in machinery and equipment is also set to expand gradually, driven by an increase in capacity utilisation, improved profit margins and a modest recovery in bank lending. In spite of some positive signs in banks' capital positions, a robust recovery in lending is still not expected.

Foreign trade accelerates

Both exports and imports rose more than expected towards the end of 2016 and strengthened further at the beginning of 2017. Some slowdown is expected in the second half of the year due mostly to base effects affecting the annualised growth rates. Foreign tourism inflows surged to nearly 7% of GDP in 2016 and are projected to remain strong, although capacity constraints are likely to weaken slightly the growth rate in the peak summer season. Exports of goods are also benefiting from higher demand in main trading partners. Imports, however, are set to rise even faster than exports due to the projected investment rebound. Overall, the contribution of net exports to growth is expected to be slightly negative over the forecast horizon. The current account surplus is set to stabilise at around 0.5% of GDP, as the slight deterioration in the balance of goods and services is likely to be offset by better performance in primary and secondary income.

Labour market keeps improving

The labour market is undergoing a broad-based improvement, underpinned by sound employment growth and labour force stabilisation. Apart from tourism, job creation is also supported by the recent rebound in construction. However, job creation is projected to weaken gradually over the forecast horizon amid rising wage pressures. Accordingly, unemployment is forecast to drop from 11.2% in 2016 to 9.9% in 2017 and 9.2% in 2018 while unit labour costs are set to increase modestly and broadly in line with the trend in major trading partners.

Inflation to stabilise at around 1.5%

Consumer price inflation is forecast to reach 1.4% in 2017, mainly driven by the rebound in energy prices. The steep rise of 7.1% in house prices in 2016 is also set to exert some lagged upward pressure on rents and accommodation services. Both headline and core inflation are expected to edge up to around 1.5% in 2018 as energy price increases are assumed to slow down while wage dynamics are likely to push up the price of non-tradable goods and services.

Public finances benefitting from the recovery, one-offs and expenditure containment

The general government deficit turned out at 2.0% of GDP in 2016. Lower than budgeted revenue collection has been partially offset by additional revenues (0.25% of GDP) from the extraordinary tax debt settlement scheme PERES and overall containment of expenditure, in particular due to lower public investment. The general government deficit net of one-offs reached 2.3% of GDP and the structural balance improved by a quarter of a percentage point of GDP in 2016.

The headline deficit is projected to decrease to 1.8% of GDP in 2017, mainly due to a one-off operation (the recovery of a guarantee to BPP bank worth 0.25% of GDP), the continued economic recovery and the accommodative monetary policy. Due to the limited volume of fiscal consolidation measures, the structural balance is expected to slightly deteriorate by 0.2% of GDP in 2017. Under a no-policy change assumption, the headline deficit is set to deteriorate slightly to 1.9% of GDP in 2018. In the absence of sufficiently specified consolidation measures, the structural balance is expected to continue to slightly deteriorate. Risks to the fiscal outlook are tilted to the downside, linked to the uncertainties surrounding the macroeconomic outlook and the potential deficit-increasing impact of banking support measures.

Portugal's gross public debt-to-GDP ratio rose slightly to 130.4% in 2016, mainly due to higher issuance of government debt for the ongoing recapitalisation of the state-owned bank CGD. The ratio is forecast to decline to 128.5% in 2017 and to 126.2% in 2018, due to primary budget surpluses and continued economic growth.

Table II.22.1:

Main features of country forecast - PORTUGAL

		2015		Annual percentage change						
	bn EUR	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP		179.5	100.0	1.1	-1.1	0.9	1.6	**1.4**	**1.8**	**1.6**
Private Consumption		117.8	65.6	1.2	-1.2	2.3	2.6	**2.3**	**1.9**	**1.3**
Public Consumption		32.6	18.2	1.6	-2.0	-0.5	0.7	**0.5**	**0.4**	**0.5**
Gross fixed capital formation		27.4	15.3	-0.8	-5.1	2.3	4.5	**-0.1**	**5.4**	**4.7**
of which: equipment		8.9	5.0	0.1	8.1	13.3	9.7	**3.7**	**6.0**	**7.7**
Exports (goods and services)		72.8	40.6	4.3	7.0	4.3	6.1	**4.4**	**4.4**	**4.2**
Imports (goods and services)		71.5	39.8	3.0	4.7	7.8	8.2	**4.4**	**5.2**	**4.5**
GNI (GDP deflator)		174.4	97.1	1.0	0.0	0.5	0.4	**2.2**	**2.2**	**1.7**
Contribution to GDP growth:		Domestic demand		1.0	-2.0	1.7	2.6	**1.6**	**2.1**	**1.7**
		Inventories		0.0	0.0	0.4	-0.1	**-0.2**	**0.0**	**0.0**
		Net exports		0.1	0.9	-1.3	-0.8	**0.0**	**-0.3**	**-0.1**
Employment				0.0	-2.9	1.4	1.4	**1.6**	**1.4**	**0.9**
Unemployment rate (a)				8.6	16.4	14.1	12.6	**11.2**	**9.9**	**9.2**
Compensation of employees / head				3.0	3.6	-1.8	-0.3	**1.4**	**1.5**	**1.5**
Unit labour costs whole economy				1.8	1.8	-1.3	-0.5	**1.6**	**1.0**	**0.9**
Real unit labour cost				-0.6	-0.5	-2.0	-2.5	**0.0**	**-0.3**	**-0.6**
Saving rate of households (b)				9.5	7.8	5.2	4.5	**4.4**	**4.2**	**4.6**
GDP deflator				2.5	2.3	0.8	2.1	**1.6**	**1.4**	**1.4**
Harmonised index of consumer prices				2.5	0.4	-0.2	0.5	**0.6**	**1.4**	**1.5**
Terms of trade goods				0.0	1.7	1.2	3.2	**0.6**	**-0.3**	**0.0**
Trade balance (goods) (c)				-10.4	-4.0	-4.7	-4.3	**-4.0**	**-4.5**	**-4.7**
Current-account balance (c)				-8.8	0.7	-0.3	-0.8	**0.5**	**0.5**	**0.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-7.1	2.3	1.0	0.3	**1.5**	**1.4**	**1.5**
General government balance (c)				-5.3	-4.8	-7.2	-4.4	**-2.0**	**-1.8**	**-1.9**
Cyclically-adjusted budget balance (d)				-5.3	-2.6	-5.6	-3.5	**-1.7**	**-2.0**	**-2.4**
Structural budget balance (d)				-	-2.9	-1.7	-2.3	**-2.0**	**-2.2**	**-2.4**
General government gross debt (c)				70.8	129.0	130.6	129.0	**130.4**	**128.5**	**126.2**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.