22. PORTUGAL

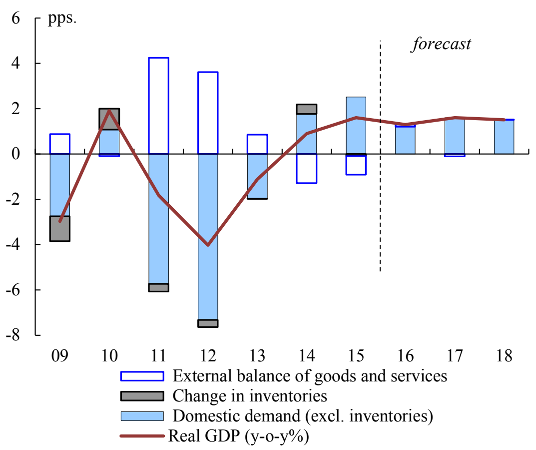
Strong tourist sector supports growth

The strong economic performance in the second half of 2016, particularly from tourism, has improved the outlook of the Portuguese economy. Weak investment has weighed negatively on growth but is set to rebound. The general government deficit is expected to turn out at 2.3% of GDP in 2016, helped by one-off revenues, and is set to remain below 2.5% over the forecast horizon. The structural balance is projected to be broadly stable in 2016 and 2017 but to deteriorate slightly in 2018.

Economic outlook improves

Economic growth picked up to 1.6% (y-o-y) in the third quarter of 2016 from 0.9% (y-o-y) over the first half of the year, driven by a solid rebound in private consumption and exports. However, investment continued to decline due to the switchover to the new programming period of EU investment co-financing and because of a further contraction in corporate credit. Portugal's economy likely grew by an estimated 1.3% in 2016 and real GDP growth is forecast to reach 1.6% in 2017 and 1.5% in 2018. The risks to the forecast are tilted to the downside, as unsolved problems in the banking sector could dampen the expected recovery in investment.

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



The Commission's Economic Sentiment Indicator (ESI) improved substantially towards the end of 2016, providing support to the short-term economic outlook. Most of the recent soft indicators suggest that private consumption should remain robust. In addition, consumer spending is enjoying support from the increase in the minimum wage and the labour market, which continues to improve vigorously. Private consumption is expected to develop more moderately this year and next, in line with more stable wage dynamics, sustained deleveraging pressures and rising prices. Despite some improvement in confidence, most construction investment indicators remain weak while equipment investment indicators, including manufacturing confidence and capacity utilisation, continue to signal expansion. Construction investment is therefore set to improve only marginally, driven by some recovery in public investment, whereas machinery and equipment investment is expected to continue its positive trend. Overall, investment is expected to gather pace in 2018 as more projects are implemented under the new programming period of EU funding and credit conditions improve gradually.

Exports outpace market demand

Estimates for 2016 suggest that Portugal's export sector likely grew significantly faster than external markets, helped by the very strong performance of the tourist sector. The country thus expanded its export market share in 2016 despite the estimated increase in unit labour costs. Carryover effects are projected to keep the country's market share on the rise in 2017 before stabilising in 2018. Imports are meanwhile expected to accelerate along with the projected rebound in investment, resulting in a slight contraction in the external trade surplus. The net contribution of the external sector to growth is therefore also set to deteriorate marginally. Nevertheless, the current-account surplus is expected to improve due to positive developments in primary income and current transfers reflecting lower interest costs and the cycle of EU funding.

Job creation to slow down

The strong tourist season supported the labour market as both job creation and wages improved. Employment growth, however, is expected to gradually slow down from 1.3% in 2016 to 0.6% in 2018, as the recent rebound in wages can be expected to dampen labour demand and labour supply restraints linked to the decrease in the working age population are starting to take effect. Unemployment is projected to drop accordingly to around 10% in 2017 and 9.4% in 2018.

Inflation is picking up

Annual HICP inflation edged up to 0.6% in 2016, largely driven by the service sector. Core inflation reached 1% in the same period while housing prices rose by 7.6% (y-o-y) in the third quarter of the year. Rising labour incomes, as well as the recent rebound in consumer lending, are expected to maintain continuous upward pressure on service prices. Energy prices are projected to add to inflation in 2017 but their impact over 2018 should flatten. All in all, consumer prices are forecast to increase by 1.3% in 2017 and 1.4% in 2018.

Public finances benefitting from the continued recovery and one-off revenues

The general government deficit is estimated to have reached 2.3% 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 is estimated to have reached 2.6% of GDP and the structural balance is expected to have remained broadly unchanged in 2016.

The headline deficit is projected to decrease to 2.0% 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 moderate economic recovery and the accommodative monetary policy. As the impact of discretionary measures is expected to be broadly neutral, the structural balance is projected to remain broadly unchanged. Under a no-policy change assumption, both the headline deficit and the structural balance are set to deteriorate slightly in 2018. 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.

After reaching 129.0% at the end of 2015, Portugal's gross public debt-to-GDP ratio is estimated to have risen to 130.5% 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 128.9% in 2017 and to 127.1% 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	**1.3**	**1.6**	**1.5**
Private Consumption	117.8	65.6	1.2	-1.2	2.3	2.6	**2.1**	**1.6**	**1.2**
Public Consumption	32.7	18.2	1.6	-2.0	-0.5	0.8	**0.6**	**0.4**	**0.5**
Gross fixed capital formation	27.4	15.3	-0.8	-5.1	2.3	4.5	**-1.5**	**3.8**	**4.2**
of which: equipment	8.9	5.0	0.1	8.1	13.3	9.7	**2.6**	**7.9**	**7.8**
Exports (goods and services)	72.8	40.6	4.3	7.0	4.3	6.1	**3.9**	**4.1**	**4.2**
Imports (goods and services)	71.5	39.8	3.0	4.7	7.8	8.2	**3.9**	**4.3**	**4.3**
GNI (GDP deflator)	175.3	97.6	1.0	0.0	0.5	0.9	**1.4**	**2.0**	**1.7**
Contribution to GDP growth: Domestic demand			1.0	-2.0	1.7	2.6	**1.3**	**1.7**	**1.5**
Inventories			0.0	0.0	0.4	-0.1	**0.0**	**0.0**	**0.0**
Net exports			0.1	0.9	-1.3	-0.8	**0.0**	**-0.1**	**0.0**
Employment			0.0	-2.9	1.4	1.4	**1.3**	**0.8**	**0.6**
Unemployment rate (a)			8.6	16.4	14.1	12.6	**11.2**	**10.1**	**9.4**
Compensation of employees / head			3.0	3.6	-1.8	-0.3	**1.4**	**1.2**	**1.2**
Unit labour costs whole economy			1.8	1.8	-1.3	-0.5	**1.3**	**0.4**	**0.3**
Real unit labour cost			-0.6	-0.5	-2.0	-2.5	**-0.2**	**-0.9**	**-1.1**
Saving rate of households (b)			9.5	7.8	5.2	4.4	**4.1**	**3.7**	**3.6**
GDP deflator			2.5	2.3	0.8	2.1	**1.5**	**1.4**	**1.4**
Harmonised index of consumer prices			2.5	0.4	-0.2	0.5	**0.6**	**1.3**	**1.4**
Terms of trade goods			0.0	1.7	1.2	3.2	**0.5**	**-0.2**	**0.1**
Trade balance (goods) (c)			-10.4	-4.0	-4.7	-4.3	**-4.1**	**-4.5**	**-4.6**
Current-account balance (c)			-8.8	0.7	-0.3	-0.3	**0.3**	**0.4**	**0.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-7.1	2.3	1.0	0.8	**1.3**	**1.5**	**1.7**
General government balance (c)			-5.3	-4.8	-7.2	-4.4	**-2.3**	**-2.0**	**-2.2**
Cyclically-adjusted budget balance (d)			-5.3	-2.7	-5.6	-3.5	**-1.9**	**-2.1**	**-2.6**
Structural budget balance (d)			-	-2.9	-1.7	-2.2	**-2.2**	**-2.3**	**-2.6**
General government gross debt (c)			70.8	129.0	130.6	129.0	**130.5**	**128.9**	**127.1**

(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.