22. PORTUGAL

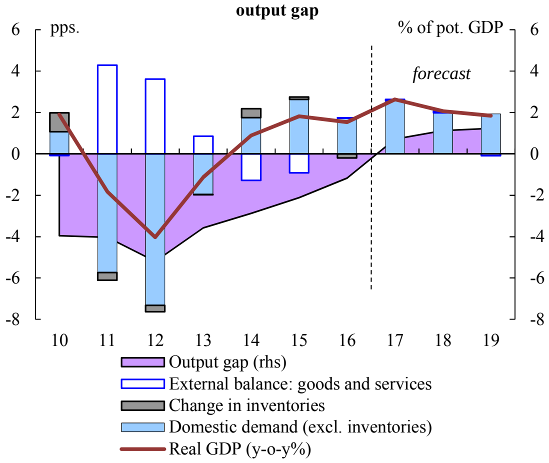
Growth and employment to perform strongly

GDP and employment are set to increase significantly in 2017 driven by exports and investment. Despite some slowdown, economic performance is expected to remain strong in 2018 and 2019 amid further export growth and lower unemployment. The general government deficit is set to remain below 1.5% over the forecast horizon while the structural balance is projected to remain broadly unchanged.

Investment and exports push up growth

Economic growth picked up to 2.9% in the first half of 2017, mainly driven by investment and exports, while private consumption growth continued to slow. Investment rose to 10% (y-o-y) in the first half of the year, supported by both construction and equipment. Net external demand made a slightly positive contribution to annual growth, reflecting the strength of net service exports, particularly tourism. Overall, GDP is forecast to increase by 2.6% in 2017, before decelerating to 2.1% in 2018 and 1.8% in 2019. Risks to the outlook remain slightly tilted to the downside, mainly due to the country's vulnerability to external shocks.

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



The Commission's Economic Sentiment Indicator for Portugal moderated in the third quarter of 2017 but remained significantly above its long-term average. In parallel, consumer confidence deteriorated and retail trade slowed down, suggesting that private consumption growth may also flatten out along with a small increase in the household saving rate. Investment in construction is not expected to reach pre-crisis levels any time soon and its growth is set to weaken somewhat after its rebound this year. Following a big jump in 2017, equipment investment is expected to ease somewhat before picking up again in 2019. These fluctuations are largely due to the base effect from a large boost to investment this year that came from a capacity upgrade in the country's biggest automotive company that is set to fade away in 2018.

External flows remain balanced

Exports of goods and services increased substantially in the first half of 2017, supported by external demand. The ongoing expansion in the automotive industry and the continuous positive cycle in tourism are expected to keep exports growing well above demand from main trading partners in both 2017 and 2018. In 2019, export growth is expected to be more in line with external demand, as the impact of car manufacturing and tourism is set to weaken. Imports are projected to grow at a similar rate to exports over the forecast horizon, reflecting a rebound in equipment investment and the high import content of car manufacturing. As a result, the current account is set to retain a small surplus, also supported by an improvement in net interest transfers.

Job creation outpaces GDP growth

Employment grew faster than GDP in the first half of 2017, particularly in labour-intensive services related to tourism and in construction. Wage growth remained subdued at the aggregate level, as most of the job openings were in sectors with low-skill profiles and lower-than-average salaries. The job-rich recovery reduced substantially both the headline and long-term unemployment rates and supported economic activity as the labour force increased despite a drop in the working age population. Accordingly, the unemployment rate is set to drop from 11.2% in 2016 to 9.2% in 2017, the lowest level since 2008, and further to 7.6% in 2019 amid some slowdown in job creation and a moderate increase in wages.

Inflation moderates despite one-off triggers

After a one-off rebound in the spring triggered by energy prices and the Easter calendar effect, consumer price inflation moderated in the summer months. HICP inflation is projected to remain relatively stable at 1.5% in 2017, 1.4% in 2018 and 1.5% in 2019. Core inflation is expected to be only marginally higher, reflecting the impact of tourism on accommodation services and moderate wage dynamics. House price inflation rose from 7.1% in 2016 to 8% y-o-y in the second quarter of 2017, along with a significant increase in property transactions. Demand for real estate is expected to remain strong but the impact on prices is likely to be at least partly offset by growing supply from new construction.

Public finances benefitting from the recovery and lower interest expenditure

The headline deficit is projected to decrease to 1.4% of GDP in 2017, mainly due to the accelerated economic recovery, decreasing interest expenditure and lower-than-budgeted public investment. The general government deficit net of one-offs is expected to reach 1.6% of GDP. As the improvement in the headline deficit is mostly cyclical in nature and not accompanied by discretionary fiscal consolidation measures, the structural balance is expected to improve only slightly in 2017. The headline deficit is forecast to remain stable at 1.4% of GDP in 2018 due to a more negative impact of one-off operations while the deficit net of one-offs is set to improve to 1.2% of GDP. As the impact of discretionary measures and savings in interest expenditure in 2018 is expected to be broadly neutral, the structural balance is projected to remain broadly stable. Under a no-policy-change assumption, the headline deficit is set to improve slightly in 2019 to 1.2% while the structural balance is set to remain broadly unchanged. The structural primary balance is forecast to deteriorate by about ½% of GDP over the forecast horizon. Risks to the fiscal outlook are tilted to the downside, linked to uncertainties surrounding the macroeconomic outlook and the potential deficit-increasing impact of banking support measures in 2017.

After reaching 130.1% at the end of 2016, Portugal's gross public debt-to-GDP ratio is forecast to decline to 126.4% in 2017, 124.1% in 2018 and 121.1% in 2019, due to primary budget surpluses and higher nominal GDP growth.

Table II.22.1:

Main features of country forecast - PORTUGAL

	2016		Annual percentage change						
	bn EUR Curr. prices	% GDP	98-13	2014	2015	2016	2017	2018	2019
GDP	185.2	100.0	0.8	0.9	1.8	1.5	**2.6**	**2.1**	**1.8**
Private Consumption	121.3	65.5	0.9	2.3	2.3	2.1	**1.9**	**1.6**	**1.6**
Public Consumption	33.4	18.0	1.3	-0.5	1.3	0.6	**0.4**	**0.5**	**0.5**
Gross fixed capital formation	28.3	15.3	-2.0	2.3	5.8	1.6	**8.1**	**5.3**	**4.9**
of which: equipment	9.4	5.1	-0.5	13.3	10.4	5.2	**12.5**	**7.7**	**9.0**
Exports (goods and services)	74.0	39.9	4.2	4.3	6.1	4.1	**8.0**	**7.3**	**4.9**
Imports (goods and services)	72.2	39.0	2.6	7.8	8.5	4.1	**8.0**	**7.2**	**5.2**
GNI (GDP deflator)	181.2	97.8	0.7	0.5	0.7	2.1	**2.7**	**2.1**	**1.9**
Contribution to GDP growth: Domestic demand			0.5	1.7	2.6	1.8	**2.6**	**2.0**	**1.9**
Inventories			0.0	0.4	0.1	-0.2	**0.0**	**0.0**	**0.0**
Net exports			0.3	-1.3	-0.9	0.0	**0.1**	**0.1**	**-0.1**
Employment			-0.4	1.4	1.4	1.6	**2.9**	**1.2**	**0.9**
Unemployment rate (a)			9.2	14.1	12.6	11.2	**9.2**	**8.3**	**7.6**
Compensation of employees / head			2.9	-1.8	0.4	2.1	**1.6**	**1.7**	**1.8**
Unit labour costs whole economy			1.7	-1.3	0.0	2.2	**1.9**	**0.8**	**0.9**
Real unit labour cost			-0.7	-2.0	-2.0	0.7	**0.6**	**-0.6**	**-0.5**
Saving rate of households (b)			9.3	5.2	5.3	5.8	**6.2**	**6.2**	**6.3**
GDP deflator			2.4	0.8	2.0	1.4	**1.3**	**1.4**	**1.4**
Harmonised index of consumer prices			2.4	-0.2	0.5	0.6	**1.5**	**1.4**	**1.5**
Terms of trade goods			0.1	1.2	2.7	0.3	**-0.3**	**0.0**	**0.0**
Trade balance (goods) (c)			-10.1	-4.7	-4.5	-4.4	**-5.0**	**-5.1**	**-5.4**
Current-account balance (c)			-8.3	-0.3	-0.9	0.1	**0.1**	**0.2**	**0.2**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-6.8	1.0	0.3	1.0	**1.0**	**1.1**	**1.1**
General government balance (c)			-5.3	-7.2	-4.4	-2.0	**-1.4**	**-1.4**	**-1.2**
Cyclically-adjusted budget balance (d)			-5.2	-5.5	-3.5	-1.5	**-1.7**	**-2.0**	**-1.9**
Structural budget balance (d)			-	-1.7	-2.3	-2.0	**-1.8**	**-1.8**	**-1.9**
General government gross debt (c)			75.4	130.6	128.8	130.1	**126.4**	**124.1**	**121.1**

(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.