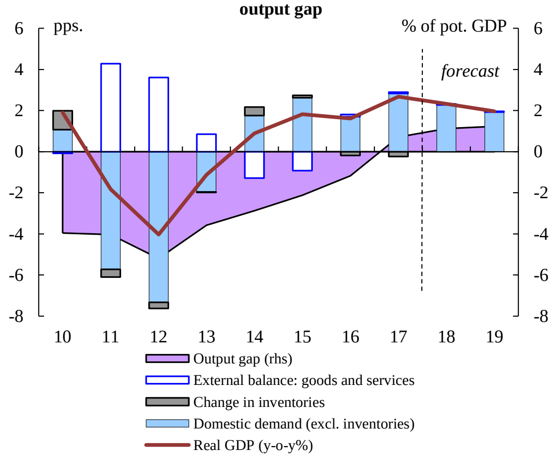
22. PORTUGAL
Growth remains robust after strong upswing in 2017

GDP and employment increased significantly in 2017, driven by buoyant domestic demand and exports. Growth is expected to ease slightly but should remain strong in 2018 and 2019 as exports and employment continue to expand. The general government deficit is set to remain below 1.0% in 2018 and 2019 while the structural balance should remain broadly stable. The gross public debt-to-GDP ratio is projected to decrease by around three percentage points per year.

Outlook remains favourable despite moderate slowdown

Economic growth picked up to 2.7% in 2017, driven by both domestic demand and exports. Private consumption grew by a solid 2.3% supported by job creation, wage growth and favourable financing conditions. Investment growth rose to 9.1% reflecting a sharp upturn in construction and equipment. Net external demand had a slightly positive contribution to annual growth, reflecting the strength of net services exports.

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



The Commission's Economic Sentiment Indicator (ESI) eased in the first quarter of 2018, reflecting a broad-based decrease across its sectoral components. By contrast, consumer confidence remained resilient, suggesting that private consumption growth was slightly stronger than expected. Nevertheless, private consumption growth is expected to cool somewhat while household savings are set to increase, although they should remain at a relatively low level over the medium term. Investment is expected to rise faster than GDP but at a weaker pace than in 2017. This reflects a negative base effect in equipment investment after the large capacity upgrade in the automotive industry in 2017 and some slowdown in construction investment after a steep rebound in 2017. Overall, GDP growth is expected to slow to 2.3% in 2018 and 2.0% in 2019. Risks to the outlook are slightly tilted to the downside, mainly due to uncertainties in the external environment.

External balance still benefiting from tourism

Exports and imports are forecast to grow at a similar pace in 2018 and 2019, keeping the current account relatively stable in the range of 0.5-0.6% of GDP. Despite some slowdown, tourism is set to remain a major driver supporting the country's external balance. The recent capacity expansion in the automotive sector is projected to further influence trade dynamics in 2018, contributing to sizeable gains in export market shares. The external position is also supported by the projected increase in absorption of EU structural funds and lower interest cost for domestic borrowers.

Labour market slack declines substantially

Following a substantial improvement in 2017, labour market indicators are expected to maintain positive momentum albeit at a slowing pace. Unemployment is forecast to decline from 9.0% in 2017 to 7.7% in 2018 and 6.8% in 2019 amid further employment growth and a higher activity rate. Unemployment is already lower than it was just before the global financial crisis in 2008 but is still above the historical low of 5.1% in 2000. The employment rate for the age group of 15-74 is meanwhile approaching its historical high of 62.7% reached in 2001. Therefore, the slack in the labour market is rapidly declining and wages are projected to gradually grow over the forecast period along with the unfreezing of career progressions in the public sector. Yet the increase in the economy-wide average wage is likely to be partly offset by strong job creation in sectors with lower-than-average wages.

Inflation faces temporary dip

Inflation is projected to slow to 1.2% in 2018 reflecting the impact of the recent euro's appreciation and a large base effect in accommodation prices. In 2019, inflation is set to rebound to 1.6% as wage developments are expected to gradually push up service prices while energy prices are expected to have a disinflationary impact. Core inflation is forecast to move slightly above the headline rate in 2019 after a temporary dip in 2018. House price rises are set to gradually slow down over the forecast horizon after a large increase of 9.2% in 2017.

Public finances benefitting from the recovery, lower interest and contained primary spending

The general government headline deficit turned out at 3.0% of GDP in 2017 including the fiscal impact of the recapitalisation of public bank Caixa Geral de Depósitos, which was worth 2.0% of GDP. Excluding this and other one-off operations, the 2017 headline deficit ratio would have been reduced to 0.9% thanks to lower interest expenditure, contained primary expenditure growth and higher cyclical-related revenue. As a result, the structural balance is estimated to have improved by about 1% of GDP in 2017 and the structural primary balance by ½% of GDP.

The headline deficit is forecast to be 0.9% of GDP in 2018, impacted by further banking support operations, in particular the activation of the Novo Banco contingent capital mechanism (0.4% of GDP), while the deficit net of one-offs is set to improve to 0.5% 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 to 0.6% of GDP in 2019 while the structural balance is set to slightly deteriorate. The structural primary balance is forecast to worsen 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 further deficit-increasing impact of banking support measures.

After falling by 4.2 pps. to 125.7% in 2017, gross public debt-to-GDP is forecast to further decline to 122.5% in 2018 and 119.5% in 2019, mainly due to primary budget surpluses and high 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		185.5	100.0	0.8	0.9	1.8	1.6	**2.7**	**2.3**	**2.0**
Private Consumption		121.3	65.4	0.9	2.3	2.3	2.1	**2.3**	**2.0**	**1.8**
Public Consumption		33.4	18.0	1.3	-0.5	1.3	0.6	**-0.2**	**0.7**	**0.3**
Gross fixed capital formation		28.3	15.3	-2.0	2.3	5.8	1.5	**9.1**	**5.7**	**5.3**
of which: equipment		9.4	5.1	-0.5	13.3	10.4	5.2	**13.3**	**7.7**	**8.5**
Exports (goods and services)		74.4	40.1	4.2	4.3	6.1	4.4	**7.8**	**6.8**	**5.5**
Imports (goods and services)		72.4	39.0	2.6	7.8	8.5	4.2	**7.9**	**6.9**	**5.6**
GNI (GDP deflator)		181.0	97.6	0.7	0.5	0.7	2.0	**2.9**	**2.4**	**2.1**
Contribution to GDP growth:	Domestic demand			0.5	1.7	2.6	1.8	**2.8**	**2.3**	**2.1**
	Inventories			0.0	0.4	0.1	-0.2	**-0.2**	**0.0**	**0.0**
	Net exports			0.3	-1.3	-0.9	0.1	**0.1**	**0.0**	**0.0**
Employment				-0.4	1.4	1.4	1.6	**3.3**	**2.1**	**1.3**
Unemployment rate (a)				9.2	14.1	12.6	11.2	**9.0**	**7.7**	**6.8**
Compensation of employees / head				2.9	-1.8	0.4	2.1	**1.1**	**1.8**	**2.0**
Unit labour costs whole economy				1.7	-1.3	0.0	2.1	**1.7**	**1.5**	**1.2**
Real unit labour cost				-0.7	-2.0	-2.0	0.6	**0.3**	**0.2**	**-0.1**
Saving rate of households (b)				9.3	5.2	5.3	5.9	**5.4**	**6.1**	**6.3**
GDP deflator				2.4	0.8	2.0	1.5	**1.4**	**1.3**	**1.4**
Harmonised index of consumer prices				2.4	-0.2	0.5	0.6	**1.6**	**1.2**	**1.6**
Terms of trade goods				0.1	1.2	2.7	0.3	**-0.6**	**0.0**	**0.0**
Trade balance (goods) (c)				-10.1	-4.7	-4.5	-4.3	**-5.2**	**-5.5**	**-5.8**
Current-account balance (c)				-8.3	-0.3	-0.9	0.1	**0.5**	**0.6**	**0.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-6.8	1.0	0.3	1.0	**1.4**	**1.5**	**1.5**
General government balance (c)				-5.3	-7.2	-4.4	-2.0	**-3.0**	**-0.9**	**-0.6**
Cyclically-adjusted budget balance (d)				-5.2	-5.6	-3.6	-1.5	**-3.1**	**-1.4**	**-1.3**
Structural budget balance (d)				-	-1.8	-2.3	-2.0	**-1.1**	**-1.1**	**-1.1**
General government gross debt (c)				75.4	130.6	128.8	129.9	**125.7**	**122.5**	**119.5**

(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.