# 22. PORTUGAL

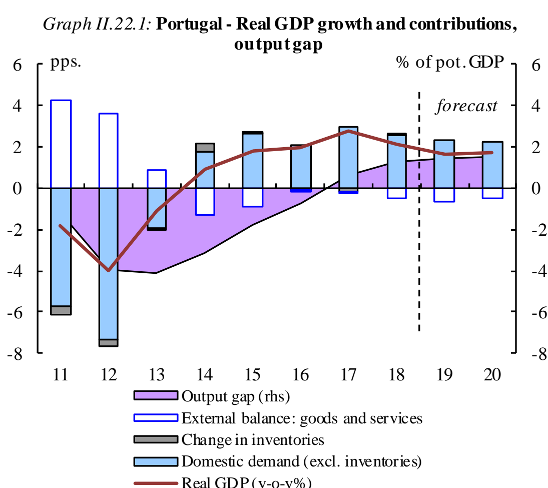
## Robust domestic demand supports growth

*The economic expansion is expected to continue at a moderate pace despite a weaker contribution from net exports, thanks to the strength of private consumption and investment. Unemployment should continue to fall but at a slower pace. The general government headline balance and debt-to-GDP ratio are expected to benefit from growth and favourable financing conditions, while the structural balance is forecast to remain broadly unchanged.*

### Economy continues moderate expansion

Real GDP growth in Portugal eased to 2.1% in 2018 from a peak of 2.8% in 2017. The slowdown was driven by the negative impact of net exports, which came from an abrupt slowdown in exports. Nonetheless, domestic demand remained solid, particularly private consumption, while investment growth slowed after an exceptional performance in 2017. Investment and private consumption are set to continue supporting growth, offsetting most of the negative impact from external trade.

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




Recent high frequency indicators are somewhat less favourable. While readings remain above their long-term averages, the Commission's Economic Sentiment Indicator (ESI) eased in the first quarter of 2019, reflecting a decrease in confidence among consumers and most business sectors. Private consumption growth is forecast to slow somewhat, in line with the softening in labour market conditions. Meanwhile, investment is set to rise gradually over the forecast horizon, following the expected strengthening in external demand and absorption of EU funds. However, net external trade is set to weigh on economic activity. Overall, GDP growth is projected at 1.7% in both 2019 and 2020. Risks to this scenario appear on the downside due to the persistent uncertainty surrounding the external environment.

### Current account moves back to deficit

Portugal's current account deteriorated to a deficit of 0.9% of GDP in 2018 after a surplus of 0.2% in the previous year. This is largely due to the increased deficit in the trade of goods. The primary income balance also worsened due to a substantial increase in dividend outflows outweighing the positive impact from lower interest rates paid to foreign creditors. The balance of services continued to improve, though at a lower pace than in the last two years, as growth in the tourism sector slowed down. The external balance is projected to worsen further in the short run, driven by robust domestic demand and weaker prospects in global trade. However, larger EU fund inflows and a further decline in interest payments are set to offset a large part of the negative trade impact.

### Labour market continues to improve

Unemployment dropped from 9.0% in 2017 to 7.0% in 2018, supported by strong employment growth. The unemployment rate stood at its lowest in over 16 years, with the employment rate at its highest over the same period. Slack in the labour market declined accordingly and wage growth picked up somewhat, thanks in part to the unfreezing of career progressions in the public sector. For the second year in a row, employment grew faster than GDP, triggering a slight drop in productivity and higher unit labour costs. However, employment growth slowed towards the end of 2018 and in early 2019. The slowdown is expected to continue over the forecast period. Unemployment is also set to fall at a slower pace to 6.2% in 2019 and 5.7% in 2020 amid a broadly stable labour force.

### Inflation remains low despite rising wages

Inflation dropped from 1.2% in 2018 to 0.8% (y-o-y) in the first quarter of 2019. Core inflation picked up only marginally above the headline rate in early 2019 despite rising domestic demand and wages. Core inflation has been reined in by the

continuous decline in prices of industrial goods and a moderation in accommodation prices. At the same time, energy prices declined at the beginning of 2019 due to a downward impact from regulatory components in some items, particularly electricity and petrol. Inflation is expected to remain low at 1.1% in 2019 and to rise to 1.6% in 2020 when demand factors are expected to have a more pronounced impact on core inflation.

### Public finances benefit from domestic demand and favourable financing conditions

The general government headline deficit turned out at 0.5% of GDP in 2018, helped by buoyant cyclical revenue, decreasing interest expenditure and lower-than-budgeted public investment. It was however negatively impacted by the activation of the Novo Banco contingent capital mechanism (0.4% of GDP). Excluding this and other one-offs, the headline balance would have reached a surplus of 0.2% of potential GDP. As a result, the structural balance is estimated to have improved by about ¾% of GDP in 2018 and the structural primary balance by ½%.

The headline deficit is set to decline slightly to 0.4% of GDP in 2019 while the headline balance net of one-offs (mainly a further deficit-increasing impact of 0.6% of GDP from the Novo Banco contingent capital mechanism) is set to remain unchanged at a surplus of 0.2% of GDP. As the combined impact of discretionary fiscal policy measures, decreases in interest expenditure and higher non-tax revenue is expected to be broadly neutral in 2019, the structural balance is projected to remain broadly stable. Under a no-policy-change assumption, the headline balance is set to improve to a deficit of 0.1% of GDP in 2020 while the structural balance is set to remain broadly unchanged. The structural primary balance is forecast to worsen by about ½% of GDP over the forecast horizon. Risks are tilted to the downside, linked to uncertainties surrounding the macroeconomic outlook and the potential further impact of banking support measures.

After falling by 3.3 pps. to 121.5% in 2018, the gross public debt-to-GDP ratio is forecast to further decline to 119.5% in 2019 and 116.6% in 2020, mainly due to primary budget surpluses and the favourable growth - interest rate differential.

*Table II.22.1:*

**Main features of country forecast - PORTUGAL**

| | 2017 | | | Annual percentage change | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| bn EUR | Curr. prices | % GDP | 99-14 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| GDP | 194.6 | 100.0 | 0.5 | 1.8 | 1.9 | 2.8 | **2.1** | **1.7** | **1.7** |
| Private Consumption | 126.2 | 64.8 | 0.7 | 2.3 | 2.4 | 2.3 | **2.5** | **2.3** | **1.9** |
| Public Consumption | 34.0 | 17.5 | 0.8 | 1.3 | 0.8 | 0.2 | **0.8** | **0.8** | **0.5** |
| Gross fixed capital formation | 32.3 | 16.6 | -2.5 | 5.8 | 2.3 | 9.2 | **4.4** | **4.6** | **5.0** |
| of which: equipment | 11.1 | 5.7 | -0.9 | 10.4 | 7.5 | 13.5 | **6.1** | **6.3** | **8.5** |
| Exports (goods and services) | 83.1 | 42.7 | 4.0 | 6.1 | 4.4 | 7.8 | **3.6** | **3.2** | **3.5** |
| Imports (goods and services) | 81.5 | 41.9 | 2.3 | 8.5 | 4.7 | 8.1 | **4.9** | **4.9** | **4.6** |
| GNI (GDP deflator) | 190.4 | 97.8 | 0.5 | 0.7 | 2.4 | 2.9 | **1.8** | **2.1** | **2.0** |
| Contribution to GDP growth: Domestic demand | | | 0.2 | 2.6 | 2.1 | 3.1 | **2.6** | **2.4** | **2.2** |
| Inventories | | | 0.0 | 0.1 | -0.1 | -0.2 | **0.1** | **0.0** | **0.0** |
| Net exports | | | 0.4 | -0.9 | -0.1 | 0.0 | **-0.5** | **-0.7** | **-0.5** |
| Employment | | | -0.5 | 1.4 | 1.6 | 3.3 | **2.3** | **1.1** | **0.8** |
| Unemployment rate (a) | | | 9.7 | 12.6 | 11.2 | 9.0 | **7.0** | **6.2** | **5.7** |
| Compensation of employees / head | | | 2.4 | 0.4 | 1.7 | 1.6 | **2.0** | **2.2** | **2.3** |
| Unit labour costs whole economy | | | 1.4 | 0.0 | 1.4 | 2.1 | **2.2** | **1.6** | **1.4** |
| Real unit labour cost | | | -0.8 | -2.0 | -0.3 | 0.5 | **0.8** | **0.3** | **-0.2** |
| Saving rate of households (b) | | | 8.9 | 5.3 | 5.0 | 4.7 | **4.6** | **4.6** | **4.8** |
| GDP deflator | | | 2.2 | 2.0 | 1.8 | 1.5 | **1.4** | **1.4** | **1.6** |
| Harmonised index of consumer prices | | | 2.3 | 0.5 | 0.6 | 1.6 | **1.2** | **1.1** | **1.6** |
| Terms of trade goods | | | 0.0 | 2.7 | 1.0 | -0.9 | **-0.6** | **0.2** | **0.2** |
| Trade balance (goods) (c) | | | -9.7 | -4.5 | -4.3 | -5.4 | **-6.2** | **-7.0** | **-7.5** |
| Current-account balance (c) | | | -7.9 | -0.9 | 0.1 | 0.2 | **-0.9** | **-1.0** | **-1.1** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | -6.3 | 0.3 | 1.0 | 1.1 | **0.2** | **0.0** | **0.1** |
| General government balance (c) | | | -5.5 | -4.4 | -2.0 | -3.0 | **-0.5** | **-0.4** | **-0.1** |
| Cyclically-adjusted budget balance (d) | | | -5.2 | -3.4 | -1.6 | -3.3 | **-1.1** | **-1.1** | **-0.8** |
| Structural budget balance (d) | | | - | -2.2 | -2.0 | -1.3 | **-0.4** | **-0.5** | **-0.5** |
| General government gross debt (c) | | | 80.3 | 128.8 | 129.2 | 124.8 | **121.5** | **119.5** | **116.6** |

(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.