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ECONOMIC OUTLOOK

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SUMMARY

According to the Flash Estimate of INE, Portugal's economy grew 2.7% in 2017, mainly as a result of growth in Investment and the fact that the contribution of Net External Demand was the same level as that of 2016.

There is no real reason to believe that economic growth in 2018 will be much less than that seen in 2017, based on the information that is currently available, especially regarding the expectation for greater economic growth in 2018 for both the Eurozone and the world as a whole,.

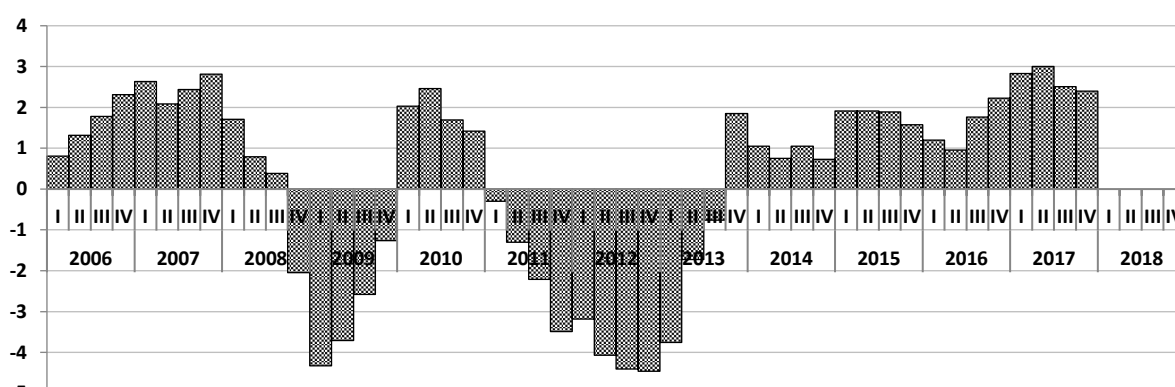
It is forecast that growth in GDP for 2018 will be between 2.4% and 2.8%, based on the expectation of reasonable levels of growth for the various components of aggregate demand in 2018, which in general will be neither greater, nor much less than those of 2017.

1. GROWTH OF GDP DURING THE 4TH QUARTER OF 2017

According to the information supplied by the National Statistics Institute (Quarterly National Accounts - Flash Estimate), GDP grew by 2.4% in volume in year-on-year terms during the 4th Quarter of 2017 (2.5% in the 3rd Quarter) and 0.7% in relation to the previous Quarter (0.5% during the 3rd Quarter).

As can be seen in the graph below, in year-on-year terms, growth this Quarter was very similar to that recorded for the previous Quarter, however its component breakdown is different, according to the preliminary information published by INE. In fact, whereas there was a strong increase in Internal Demand (ID, VH 3.4%) during the 3rd Quarter, offset by a very negative value for Net External Demand (NED, VH -0.9%), growth in ID slowed down during the 4th Quarter (just as much for Private Consumption as for Investment), although the contribution of NED returned to being positive. These variations of the contribution of NED to the year-on-year variation of GDP occur in fits and starts, differentiated by the growth in Exports and Imports of goods and services.

Graph 1.1 Year-on-year % variation of Quarterly GDP



For the whole of 2017, the growth in GDP was 2.7% (1.5% in 2016). This value clearly exceeded the forecasts for growth in 2017 made in late 2016 and early 2017 by several institutions. In reality, this pronounced acceleration in growth gave rise to some initial surprise and only started to be considered and attained after the first Quarter of 2017.

In the words of INE, annual growth was "driven by an increase in domestic demand, which mainly reflected an acceleration of Investment, as Net External Demand contributed the same as it did in 2016." However, in the context of a strong increase in ID (rising from a growth of 1.6% in 2016 to a growth estimated to be approximately 3% in 2017), together with a doubling of the growth in the volume of exports and imports of goods and services, NED only made a marginally negative contribution in comparison to 2014 and 2015. In the past, the most common pattern was that higher ID growth tended to generate more negative contributions from NED. However, it remains to be seen whether this performance of 2017 will remain sustainable during the future years.

For the Eurozone, Euro (AE19) – (EUROSTAT), the flash estimate showed a year-on-year growth during the 4th Quarter of 2017 of 2.7% (0.6% in succession), leading to an annual growth of 2.5% (1.8% in 2016). For the whole of the EU28, annual growth was similarly 2.5%. By country, in the EU19, annual growth in Germany was 2.5%, 1.9% in France, 1.5% in Italy, and 3.1% in Spain.

2. ECONOMIC CLIMATE AND CONFIDENCE INDICATORS IN JANUARY

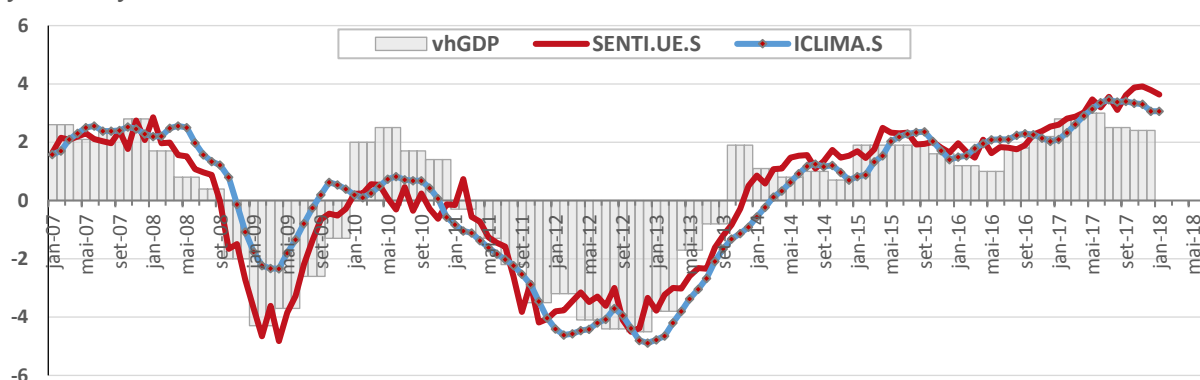
In **January**, as can be seen in Graph 2, the **Economic Sentiment Indicator** for Portugal (SENTI.UE.S¹, EUROSTAT) decreased again in relation to the peak of November. As the graph shows, this indicator, which reached the highest Quarterly average in the period analysed in the graph during the 4th Quarter of 2017, has periods of some irregularity and therefore it seems premature to conclude that there is a downward trend. In addition, this indicator continues to maintain a much higher level than that of the start of 2017.

The **Economic Climate Indicator of the National Statistics Institute** (ICLIMA.S, INE) - based on Quarterly moving averages, or in other words, the average of the values for November to January for the last value - stabilised in relation to the previous month, and although it has not decreased much, it has not increased since July. However, also referring to this case, the current level of the indicator is well above that recorded a year before.

By sector of activity – using seasonally-corrected values from EUROSTAT - the **confidence indicators** decreased in **January** for Industry, and rose for Construction, Services, and Retail, the decrease in the value of the Sentiment Indicator being explained by the additional fall in the consumer confidence indicator. The **consumer** confidence indicator of EUROSTAT decreased in January, whereas the INE confidence indicator rose for the monthly value, but decreased for the value of the average of the last three months.

In summary, the qualitative information collected in January, after having reached many maximum values during the last Quarter of 2017, remains at a level close to the recent maximums and clearly above the values recorded a year before, being mixed and somewhat inconclusive trend-wise.

Graph 2 | Economic Climate (ICLIMA.S) and Economic Sentiment (SENTIUE.S) indicators and year-on-year variation of GDP (vhGDP)



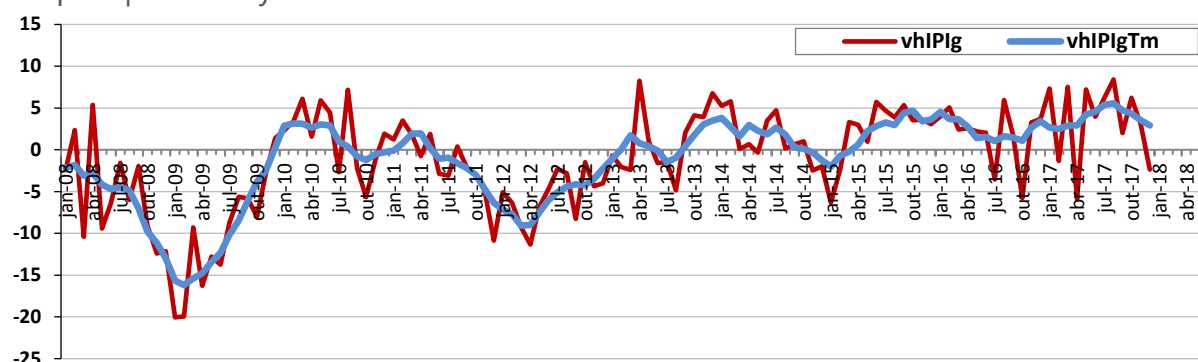
For the **Eurozone**, the **Economic Sentiment Indicator** (EUROSTAT) also decreased slightly in January, after having attained maximum values in December and also during the last Quarter of 2017. By country, in January this indicator increased in Germany and Spain, and decreased in France and in Italy. The **Consumer Confidence Indicator** (Eurozone) rose in January, especially in Germany and Spain.

¹ The original values of the indicators were adjusted for the average and for the standard deviation of the year-on-year variations of GDP (vhGDP) during the period under analysis.

3. INDUSTRIAL PRODUCTION

In **December**, with two less working days, the **Industrial Production Index** registered a year-on-year variation of -2.3% (gross values, **vhIPIg** series in Graph 3). The variation in manufacturing was -1.3%. During the 4th Quarter of 2017, the year-on-year change in the gross index was 2.4%. Annual growth was 3.5%, doubling that recorded in 2016. Corrected for seasonal and calendar effects, the year-on-year variation of estimated trend (**vhIPIgTm**, see graph) de-accelerated ever since August, to a value close to 3% at the end of the previous year. In contrast to the de-acceleration of the global Industrial Production index, car manufacturing increased nearly 75% during the 4th Quarter of 2017, and 100% in **January** of this year (ACAP).

Graph 3 | Year-on-year variation of Industrial Production

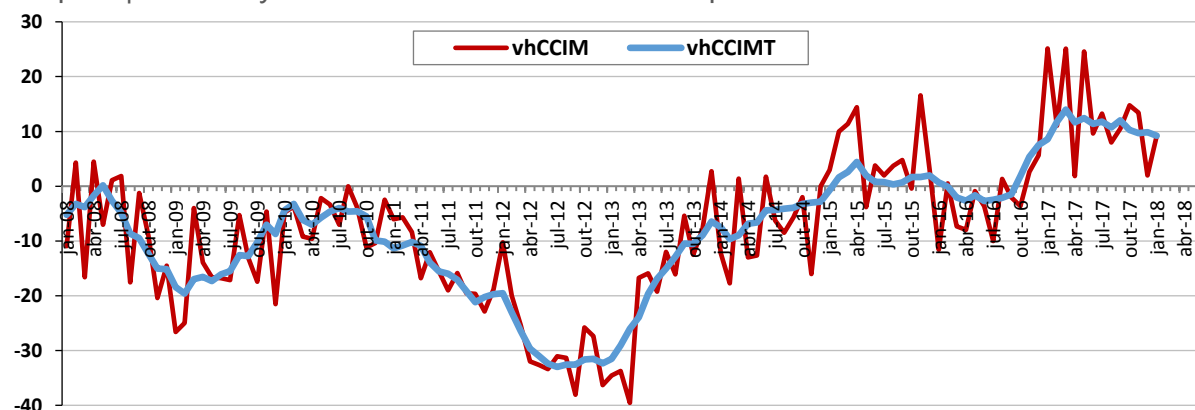


For the same month, the (nominal) **Industry Turnover Index** showed a year-on-year variation of 3.6%, with 3.7% for the national market, and 3.4% for the external market. This growth incorporates a variation of 1.3% in industrial production prices. During all of 2017, this index grew 8.7% (with an increase of prices in industrial production of 3.1%).

4. CEMENT CONSUMPTION AND CONSTRUCTION/PUBLIC WORKS

In **January**, the consumption of cement increased by about 9% in year-on-year terms. After adjustment for seasonal, calendar and precipitation effects, the year-on-year variations of estimated trend – **vhCCIMT**, in Graph 4 – are of the same magnitude. Taking into account the evolution of demand prospects for this sector, the growth of construction and public works during the current year could be similar to that of the previous year.

Graph 4 | Year-on-year variation of Cement Consumption

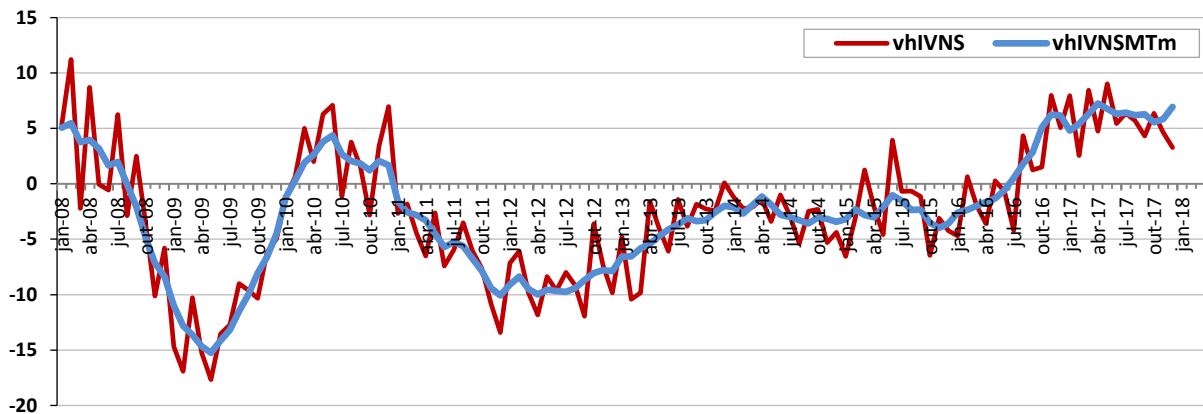


5. TURNOVER IN THE SERVICES SECTOR

In **December**, with two less working days, the (nominal) **Services Turnover Index** showed a year-on-year variation of 3.3% (vhIVNS series, Graph 5, gross values). At the end of the year, the year-on-year variations in estimated trend (vhIVNSMTm, adjusted for seasonal and calendar effects, Graph 5) returned to recording growth.

For the tourism sector, the nominal indicator for **Hotel Turnover** (Tourism Activity, INE) registered a year-on-year variation of 18.1% in December and a total growth of 16.6% in 2017.

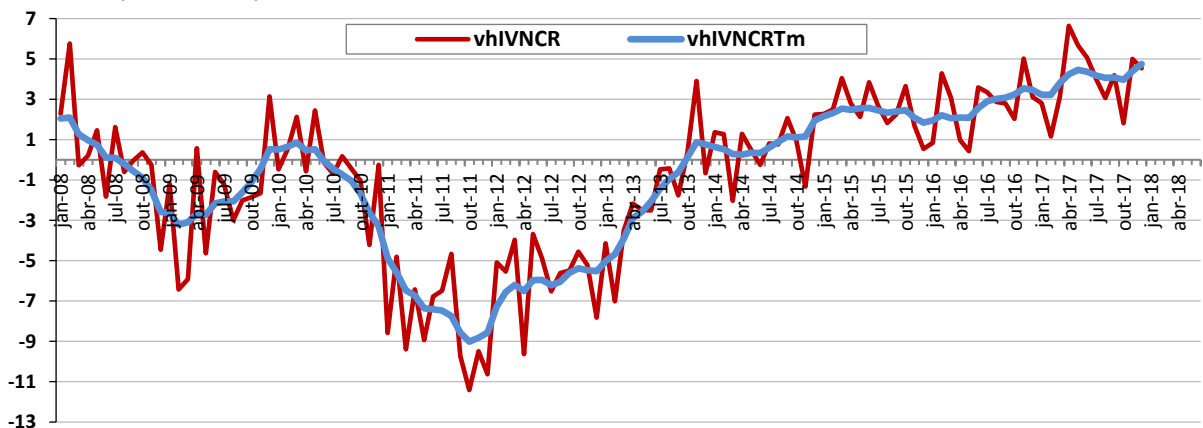
Graph 5 | Year-on-year variation for the Services Sector



6. RETAIL TRADE TURNOVER

In **December**, the **Retail Trade Turnover Index** registered a year-on-year variation of 4.5% (Graph 6, **deflated** gross values). As can be seen in the graph below, trend-wise (vhIVNCRTm), the rate of growth of this indicator rose again to about 4%. The year-on-year variation of the 4th Quarter of 2017 was 3.8%, with the annual variation being 3.9% (2.7% in 2016). Trend-wise, the rate of year-on-year variation (vhIVNCRTm) increased at the end of 2017. The growth in this indicator in 2017 ranged from a growth of 2.5% for the *food products* grouping and 5.1% for the *non-food products* grouping (in contrast to a growth of 3.8% and 1.8% respectively in 2016).

Graph 6 | Year-on-year variation in Retail Trade turnover

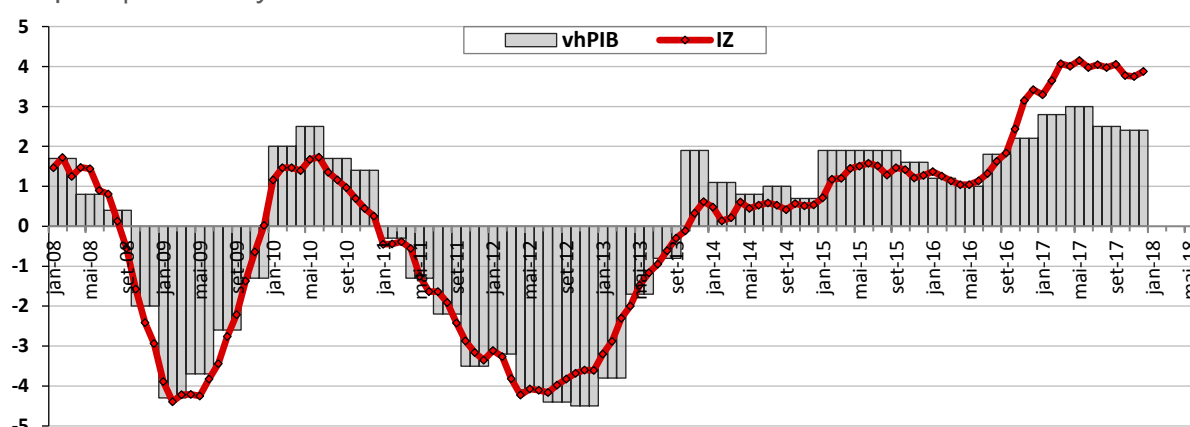


7. EVOLUTION OF THE Z TREND INDICATOR

As can be seen in Graph 7, the **global activity trend indicator (IZ)** – which summarises the year-on-year evolution of the quantitative indicators analysed above – presents an average level for the 4th Quarter of 2017 which is slightly lower than that of the previous two Quarters (but not than that of the 1st Quarter of 2017). At the end of the year, this indicator² remained at a level close to that of the most recent peaks, without indication of acceleration, neither de-acceleration.

Given the scarcity of qualitative and quantitative information currently available for the current year, it would be a mistake to identify trends where they cannot be detected. However, in general, the external environment for the Portuguese economy does not seem unfavourable, and has indeed been improving in terms of the level attained (in 2017) and forecasts (for 2018). Despite this, the latest forecasts by the European Commission continue to maintain that growth in the Eurozone in 2018 will be less (albeit only slightly so) than that recorded in 2017, in particular in Portugal, even though this is not substantiated by the current indicators and forecasts.

Graph 7 | Year-on-year variation in GDP and the Z trend indicator



Therefore, it is expected that growth in GDP during 2018 will be between 2.4% and 2.8%, based on what appear to be acceptable levels of growth for the different components of aggregate demand in 2018, which are no greater than those manifested in 2017 – namely zero growth for Public Consumption and levels of growth of about 2.3% for Private Consumption, 7.5% for Investment, 7% for Exports, and 7.3% for Imports.

Compiled with information available as of the 22nd of February.

² As has been stated in previous reports, the highest level of this IZ indicator for growth in GDP – even after being normalized by growth in GDP, which therefore suggests that growth in GDP could have been somewhat greater – has its origins in the use of some of the nominal series (which, in 2017, were positively influenced by the rise in oil prices), in a certain dependence on indicators related to domestic demand and in not reflecting the contribution of Net External Demand for growth in GDP.