ECONOMIC AND FINANCIAL RESEARCH

Contacts: +351 21 310 11 86 | Fax: 21 353 56 94 | E-mail: deef@bancobpi.pt

Portugal: GDP Growth 2014

February 27th, 2015

Pedro Miguel Mendes
+351 21 10 82
pedro.miguel.mendes@bancobpi.pt

GDP EASES TO 0.7% Y/Y IN THE 4Q2014, BUT RETURNS TO GROWTH IN 2014

2014 saw the Portuguese economy return to positive growth by posting a year-long growth figure of 0.9%, this following three years of contractions, with domestic demand surging and resuming its position as the main driver of growth. Renewed confidence was visible in 2014, as both families and companies adopted a less restrained stance to their spending, taking the opportunity to fulfil some of the deferred high-value consumption needs built-up during the financial crisis. Although, unlike in the three previous years, net foreign trade failed to provide a positive contribution in 2014, this result should be taken in context of the multiple externalities that hindered export growth (mostly concentrated within the hydrocarbon sector), as well as the mentioned high levels of deferred consumption. Given this, we continue to see the export sector as a main driver of growth in 2015. While 2014 was broadly positive for the Portuguese economy, the fourth quarter result, which saw tempering domestic demand offset by growing exports, should be taken as a preview of the structure of growth that the Portuguese economy is likely to adopt in 2015.

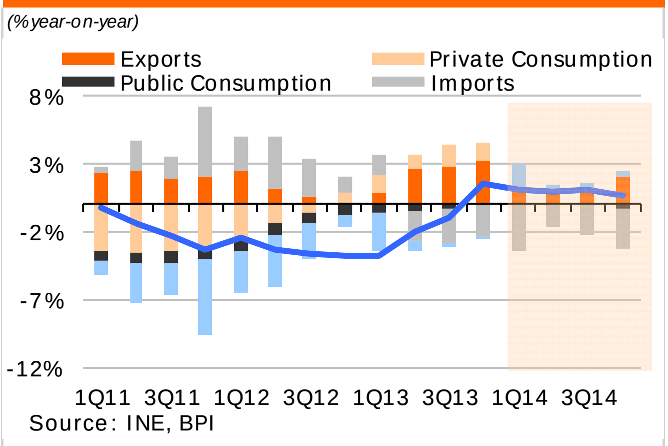
GDP growth in 2014

	1T2014	2T2014	3T2014	4T2014	2014
GDP (y/y growth rate)	1.0	0.9	1.1	0.7	**0.9**
Private Consumption	2.1	1.7	2.7	1.9	**2.1**
Public Consumption	-0.3	-0.4	-0.3	-1.6	**-0.7**
Gross Capital Formation	11.7	3.8	2.5	3.0	**5.2**
Exports	3.2	2.1	3.0	5.1	**3.4**
Imports	8.7	4.0	5.5	6.9	**6.2**
Inflation (average, %)	-0.1	-0.3	-0.6	-0.1	**-0.3**
Unemployment (end-of-period, %)	15.1	13.9	13.1	13.5	**13.9**

Source: INE

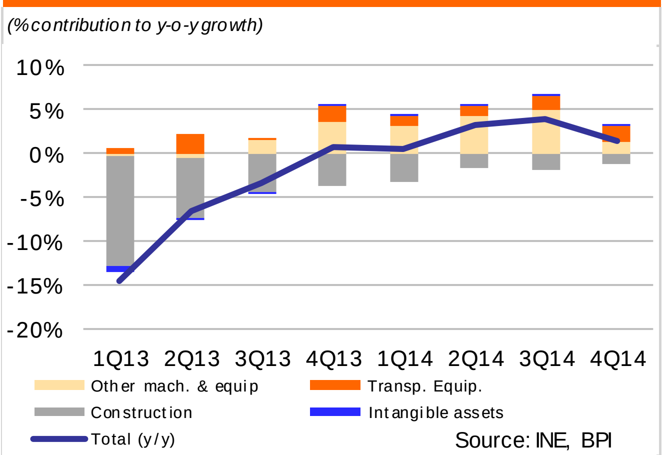
After three consecutive years of contraction, the Portuguese economy resumed y-o-y growth in 2014, with the year-long growth figure standing at 0.9%, up from the -1.4% recorded in the preceding year. The year was marked by the trajectory of Domestic Demand, a negative contributor to growth over the past three years, which surged 4.3 p.p. in 2014 to post a 2.0% increase (contribution of +2.0 p.p.) and becoming the main contributor to growth in 2014. This result is primarily explained by the performance of private consumption, which expanded from a 1.4% contraction in 2013 to gain 2.1% in 2014, resulting from the recovery of consumption in non-durable goods and services to 1.1% as well as a large surge in the purchase of durable goods, which grew 14.8% amid strong sales in the automotive market (partially explained by a sizable build up belated consumption). Although public consumption continued to contract on a year-on-year basis, at -0.7%, its contribution to growth was less negative than in 2013 (-1.9%).

GDP Growth Rate



Gross Capital Formation was the second contributor to growth in 2014, surging from a 6.5% contraction in 2013 to grow 5.2% in 2014. Companies felt more inclined to resume investment amid increasing business activity and growing confidence in the economic recovery process, and this was observed in the figures for Investment, which expanded from -6.3% in 2013 to 2.3% in the current year, a figure which denotes strong increases in machinery and equipment investment, as well as in transportation equipment, while GCF in the construction sector, one of

Investment decelerates in the 4th quarter

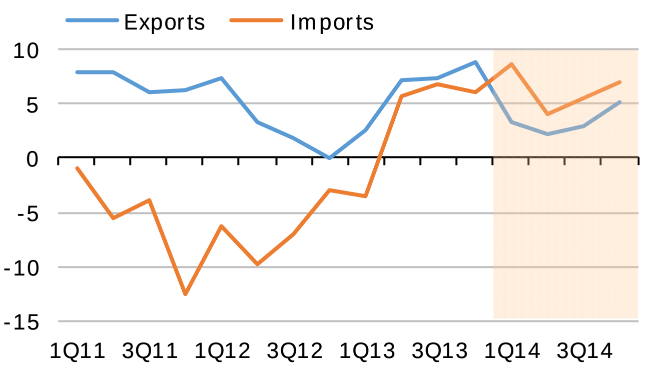


the most beleaguered sectors during the financial crisis, decreased at a milder pace of -4.3% (-14.1% in 2013). In 2014, inventories change has also added to GFC growth, with these contribution more than 50% to the aggregate. This result can is partially explained by the oil refinery shutdown in early 2014, as well as the movement of strategic oil reserves into the country.

External Trade, which over the past three years has been the largest factor offsetting the negative growth of the Portuguese economy, failed to provide a positive contribution to growth (-1.1p.p., down from 1.0p.p. in the preceding year). Export activity expanded 3.4% in 2014, down 3.0 p.p. from the 2013 figure, a figure that denotes decreases in both goods and services exports (although it is worth noting that tourism revenue recorded significant gains, being offset by losses in other activities). Compounding this, import activity accelerated in 2014, with the 6.2% increase expanding on the 3.6% growth rate recorded in 2013. These results should, nevertheless, be contextualized with the large influence of temporary and externality-related effects such as, on the export side, the effects of the Sines oil refinery shutdown on refined oil exports, as well as a recorded surge in high-value durable imports throughout the year (mainly transportation vehicles and machinery). Given the temporary nature of these effects -oil refining operations have since resumed, while the still-high levels of indebtedness among both families and companies make it unlikely that the surge in durable goods consumption can be sustained over the long term- it is our expectation that external trade will resume its positive contribution to growth in 2015.

Export activity rebounded in the 4Q2014

(% y-o-y growth rate)



Source: INE, BPI

While 2014 was a broadly positive year for the Portuguese economic recovery, we nevertheless expect that while growth is slated to continue to expand in 2015 (our forecast calls for a growth rate of 1.5%), the composition of the drivers of growth is likely to once again change over the current year. Indeed, economic growth in the fourth quarter of 2014, recorded at 0.7% y/y, already points to a changing trajectory for the main contributors of growth. Domestic demand decelerated from 2.1% y/y in the third quarter to 1.4% y/y in the fourth quarter, a variation mainly explained by milder private consumption growth in both durable and non-durable goods. Likewise, although GCF growth edged up from 2.5% y/y to 3% y/y in the fourth quarter, this result was fully driven by Inventory Formation, with Gross Fixed Capital Formation investment receding from 4.0% y/y in the third quarter to 1.5% y/y in the last reported period, a figure grossly driven by uncategorized machinery and equipment, since GFCF in transportation equipment remained high (albeit slightly lower in comparison to the preceding quarter) while the decrease in Construction-sector GFCF continued to thin out (-2.6% y/y in the 4Q2014, up from -3.9% y/y in the preceding quarter). More positively, export activity expanded 5.1%, the largest y-o-y increase in 2014, which saw growth in the exports of goods offset a milder results in services. Import activity also expanded in the final quarter of 2014, from 5.5% y/y in the third quarter to 6.9% y/y in the following three months.

In conclusion, 2014 can indeed be taken as the year where the Portuguese economy successfully turned the page on the three-year recession it experienced over the 2011-2013 period. The surge in domestic demand points to increasing levels of confidence among both families and companies, which are likely to continue to be spurred both by the remarkably low interest rates currently in place, the expectations of stronger growth both domestically and within the Eurozone as well as the devaluation of the currency amid the subdued oil prices in the international markets. Nevertheless, given the effects of deferred demand in 2014 and the strong possibility that these won't be sustained, we nevertheless expect that both private consumption and investment in GFCF will again decelerate in 2015, its contribution to growth being once again overtaken by net foreign trade, which should experience a steadier performance overall, now that the particularly volatile oil sector (in 2014) is likely to experience less externality-related effects. On the same note, it will be important to pay close attention to whether Investment in construction can maintain the less negative trajectory observed in 2014, as well as the trajectory for investment in machinery

BPI Forecasts for the Portuguese economy

	2011F	2012F	2013F	2014F	2015F	2016F
GDP (annual growth rate)	-1.8	-3.3	0.9	1.5	1.7	1.7
Private Consumption	-3.6	-5.2	2.1	1.2	1.0	1.0
Public Consumption	-3.8	-4.3	-0.7	-0.1	0.3	0.3
Gross Capital Formation	-14.0	-14.2	5.2	1.5	3.0	3.0
Exports	7.0	3.1	3.4	4.3	4.0	4.0
Imports	-5.8	-6.6	6.2	3.0	2.8	2.8
Inflation (average, %)	3.7	2.8	-0.3	0.1	1.5	1.5
Unemployment (%)	12.7	15.7	13.9	13.8	13.5	13.5
Budget Balance (%GDP)	-4.3	-6.4	-4.9	-4.2	-2.7	-2.5
Public Debt (% GDP)	108.2	124.1	128.0	128.7	127.7	125.9
Current Account + Capital Account (%GDP)	-4.6	0.1	2.3	2.1	2.2	2.2

Source: BPI

and equipment. As always, some existing factors of uncertainty cannot be disregarded, particularly those related to Ukraine and the multiple issues involving the Greek government, and these are the sole factors holding back a possible upwards review of our +1.5% growth forecast for the Portuguese economy in 2015.

BANCO BPI S.A.

Rua Tenente Valadim, 284 4100 – 476 PORTO
Telef.: (351) 22 207 50 00   Telefax: (351) 22 207 58 88

Largo Jean Monnet, 1 – 9º 1269-067 LISBOA
Telef.: (351) 21 724 17 00   Telefax: (351) 21 353 56 94