PORTUGAL

GDP growth is projected to remain broadly stable at around 2% per year in 2019 and 2020. Domestic demand and further export gains will support economic activity. In particular, consumption growth will remain solid as the unemployment rate falls further. Rising labour costs will prompt an increase in inflation.

The fiscal deficit is expected to disappear by 2020 and the debt-to-GDP ratio is on a firmly declining path, which is appropriate owing to long-term fiscal sustainability issues. In case growth surprises on the upside, all windfall revenues should be used to reduce the debt ratio faster. The greening of the economy can be further improved by increasing environmental taxes so that the prices of different energy sources adequately reflect their environmental impact.

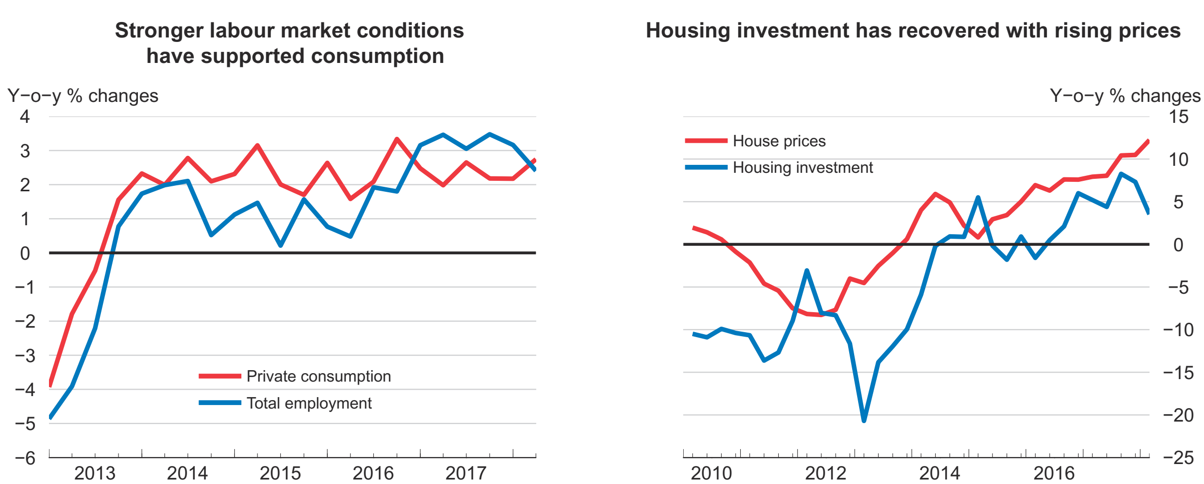
Economic activity remains steady

Business and consumer confidence have eased over the past few months, but both remain at comparatively high levels. Private investment growth is being underpinned by spending on machinery and equipment, with the vehicle manufacturing sector showing notable signs of increased capacity utilisation. Housing investment is rising strongly, responding to strong growth in prices of both new and existing dwellings. Labour market conditions continue to improve, with the unemployment rate having now fallen below 7%.

Policy measures will need to continue buttressing the public finances

After being slightly expansionary in 2018, the fiscal stance is projected to be broadly neutral in 2019 and 2020. The authorities must continue to balance the objectives of improving the fiscal position and sustaining the economic recovery. In this context, the government plans to reach a balanced budget by 2020 are appropriate. Any windfall revenues should be used to reduce the public debt-to-GDP ratio further, which is still extremely high at above 120% of GDP.

Portugal



Source: OECD Economic Outlook 104 database; and Statistics Portugal.

StatLink http://dx.doi.org/10.1787/888933877145

Portugal: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2011 prices)				
GDP at market prices	179.8	1.9	2.8	2.2	2.1	1.9
Private consumption	117.7	2.4	2.3	2.2	1.8	2.0
Government consumption	32.6	0.8	0.2	1.0	0.2	-0.3
Gross fixed capital formation	27.8	2.3	9.2	4.6	6.0	5.0
Final domestic demand	178.2	2.1	3.0	2.4	2.2	2.1
Stockbuilding[1]	0.6	-0.1	0.0	0.0	0.0	0.0
Total domestic demand	178.8	2.0	3.0	2.4	2.2	2.1
Exports of goods and services	72.6	4.4	7.8	5.8	4.3	4.0
Imports of goods and services	71.6	4.7	8.1	6.2	4.8	4.5
Net exports[1]	1.0	-0.1	0.0	-0.1	-0.2	-0.2
Memorandum items						
GDP deflator	_	1.8	1.5	1.4	1.4	1.4
Harmonised index of consumer prices	_	0.6	1.6	1.3	1.5	1.4
Harmonised index of core inflation[2]	_	0.9	1.2	1.1	1.4	1.4
Unemployment rate (% of labour force)	_	11.1	8.9	7.1	6.4	5.7
Household saving ratio, net (% of disposable income)	_	-3.7	-4.1	-5.2	-5.8	-6.0
General government financial balance[3] (% of GDP)	_	-2.0	-3.0	-0.7	-0.2	0.1
General government gross debt (% of GDP)	_	146.7	147.0	144.0	140.6	137.2
General government debt, Maastricht definition (% of GDP)	_	129.2	124.8	121.7	118.4	115.0
Current account balance (% of GDP)	_	0.6	0.5	-0.9	-0.4	-0.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Based on national accounts definition.
Source: OECD Economic Outlook 104 database.

StatLink http://dx.doi.org/10.1787/888933878076

There is potential for changes in both the tax mix and improvements in the efficiency of government spending that would benefit both the public finances and the economy. For instance, there is scope to raise environmental taxation so that energy pricing properly reflects environmental costs. At the same time, innovation activities of young firms that are often making losses could be better encouraged through allowing unused R&D tax credits to be carried forward indefinitely or refunded in cash.

EU structural funds are expected to contribute positively to investment growth in 2019 and 2020 and the banking sector is now in a better position to fund investment projects. A recent sovereign credit upgrade by Moody's should also lower the cost of investment financing.

Growth is projected to remain stable

The pace of economic activity is projected to be broadly unchanged in 2019 and 2020, at around 2% each year. Employment gains and rising real wages will underpin consumption growth and a slight increase in inflation over the coming years. The projected slowdown in the pace of activity in Portugal's major trading partners will be a headwind to future growth.

Risks to the outlook include a tightening of financial conditions. In particular, an increase in the interest rate paid on government bonds could lead to financial stress given the heightened fragilities that exist from high public debt and an elevated stock of non-performing loans in the banking system. Further increases in oil prices may also weigh on growth given that Portugal is a large net oil importer. On the upside, steps to complete the banking union in the euro area could boost confidence and investment activity in Portugal.