Portugal: growth beats expectations as inflation shock intensifies

The Portuguese economy performed much better than expected in the third quarter, growing 0.4% while the labour market remained very tight. However, the inflation shock has deepened, reaching double digits in October for the first time

Source: istock

Growth accelerates in 3Q

Portuguese GDP grew 0.4% quarter-on-quarter in the third quarter, an improvement on the 0.1% growth in the second quarter. Despite high inflation, private consumption increased, allowing domestic demand to make a positive contribution to the growth figures. Tourism, which represented about 15% of GDP before the pandemic, also remained a powerful growth driver. Overnight stays were 2.9% above pre-pandemic levels in 3Q, thanks to a strong rebound in domestic tourism (+10.8% from 3Q19). This offset the slightly lower number of stays booked by international tourists (-0.8% compared to 3Q19).

High inflation continues to trigger concern for both businesses and consumers, which will cause the economy to cool considerably towards the end of the year. The latest indicators are already pointing to a deterioration in the economic outlook, likely pushing the economy into a mild

recession from the fourth quarter onwards. Consumer confidence declined further in October and is now at its lowest level since the start of the pandemic. Business confidence also fell once again across almost all sectors. In addition, funds from the EU's Recovery and Resilience Facility (RRF) will now be lower than initially anticipated, although support measures announced by the government are expected to soften the blow. In early September, the Portuguese government announced a support package to help households cope with rising inflation.
Together with measures taken previously, this is estimated to amount to around 1.5% of GDP.

Inflation hits double digits in October

The inflation shock is getting worse, which is likely to put pressure on household consumption. Inflation rose sharply again in October to 10.2% year-on-year from 9.3% in the previous month, reaching the highest level since May 1992. In the space of just one month, prices rose 1.3% (up from 1.2% in September). The main drivers were the energy and food components within the inflation basket.

However, the sharp rise in core inflation from 6.9% to 7.1% shows that energy and food are not the only drivers and that inflation is increasingly spreading throughout the Portuguese economy. This is likely to increase further over the coming months as the spillover effect of high energy and food prices on other sectors persists. Price expectations in industry and trade rebounded significantly in September and October, although they had fallen slightly from their peak levels before summer. This shows that, despite the recent fall in gas prices, inflationary pressures will remain high and it will probably take until early next year for Portuguese inflation to fall below 10%.

Jobless figure slightly up in September

In September, unemployment stood at 6.1%, 0.1 percentage points higher than in August. Despite the slight increase in the overall unemployment rate, the labour market remains very tight. In particular, employers in the tourism and construction sectors are struggling to fill vacancies. Hiring intentions also remain intact for now, with a recent survey by Manpower reporting historically high figures for expectations from Portuguese companies for the fourth quarter. Despite a slight decrease from the previous quarter, the overall health of the labour market remains strong. If growth stalls further during the winter months, unemployment is likely to rise, but any increase is expected to be modest.

All in all, we still expect a year-on-year growth rate of 6.6% in Portugal thanks to a strong start to the year and a solid contribution from tourism, which has now seen a full recovery from the pandemic. High inflation and economic uncertainty will likely dampen investment and consumption over the winter months, but government support is expected to cushion the impact.

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