

GDP

Portuguese 2Q05 GDP up 0.5%

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- According to the National Statistics Institute (INE), the Portuguese economy grew by 0.5% YoY in 2Q05, above our estimates of a minor contraction. GDP was up 1.0% QoQ. The better-than-expected performance reflects stronger domestic demand and a lower-than-expected negative effect from net exports. The numbers were also positively affected by some changes in methodology related to the rebasing of national accounts to the year 2000 and reconfiguration in the calculation of some components.
- The calculations for private consumption (in terms of deflators and consumption by resident households) and external trade (both for exports and imports) have been reconfigured. However, the reconfiguration of the financial intermediate services component will not be implemented until 3Q05, and this could provide room for further improvement in the GDP numbers in that quarter.
- In the 2Q05 data, we highlight the resilience of private consumption, which was largely due to an increase in the number of cars bought ahead of the July 1 VAT increase. This effect accounted for 0.6pp of the 1.0% QoQ increase in GDP. The other components of private consumption (food and non-food current expenditure) contributed 0.2pp to the QoQ growth rate.
- In July, some incentives for car sales were maintained, with dealerships absorbing the higher VAT rate. However, car sales fell 12% YoY in August (following an increase of 1.1% in July) and the trend is likely to continue in September. So, the consumption of durables may end up having a negative effect on 3Q05 GDP.
- Net exports made a strong quarterly contribution, adding 0.6pp QoQ to GDP. However, exports fell 0.1% YoY, mainly due to a difficult comparison with 2Q04, which was boosted by the Euro2004 Football Championships. This resulted in a 4.2% YoY drop in exports of services in 2Q05, which more than offset the +1.0% YoY in the export of goods. Imports rose just 1.2% YoY, mainly on stronger imports of services.
- Exports may also have benefited from stronger external demand (Spain, which is Portugal's main trading partner, grew 3.4% in 2Q05) and from a weaker euro. We were surprised by the small size of the increase in imports, as it is at odds with the strength in private consumption (particularly in light of the strong car imports) and the new highs in oil prices. Given that inventories contributed negatively to GDP and their residual nature, there may be some room for revision of external demand data.

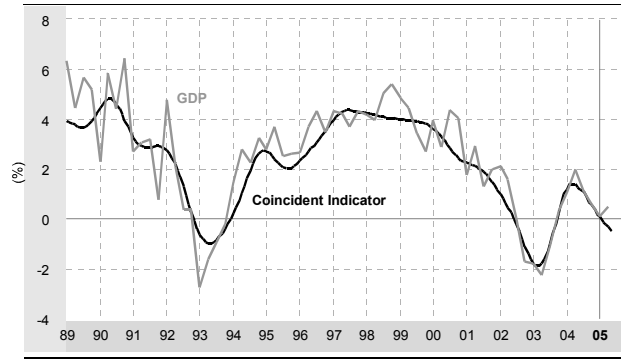
Portugal – GDP Growth (YoY)

(% YoY)	1Q03	2Q03	3Q03	4Q03	FY03	1Q04	2Q04	3Q04	4Q04	FY04	1Q05	2Q05	2005E
GDP	-1.8	-2.2	-1.1	0.3	-1.2	1.1	2.0	1.1	0.6	1.2	0.1	0.5	0.5
Private consumption	-1.1	-0.9	-0.6	1.1	-0.4	2.0	2.7	2.5	2.7	2.5	2.9	3.0	1.7
Public expenditure	0.3	0.0	0.2	0.8	0.3	1.8	2.5	2.7	2.4	2.4	1.7	0.9	0.9
Investment	-12.7	-12.9	-8.6	-4.8	-9.9	0.2	3.1	1.6	1.4	1.5	-1.3	-4.5	-1.0
Exports	5.9	1.4	5.0	5.6	4.5	5.0	8.5	3.0	1.9	4.6	-0.9	-0.1	3.7
Imports	-1.6	-3.5	-0.1	2.5	-0.7	5.4	9.2	5.8	6.3	6.7	3.5	1.2	4.2

Source: INE and BSNP estimates.

- Investment fell 4.5% YoY and the construction component continued to lag, despite the higher activity on the back of local elections due on October 9, 2005. The main drag on this component may come from residential building, which is still adjusting to the downturn after the boom of the late 1990s. Falling confidence in the building sector continues to point to weak activity ahead. Investment in machinery and equipment remained fairly flat in 2Q05 on a YoY basis.
- These numbers were much better than our expectations, implying an upside risk to our 0.5% estimate for FY2005E. However, other available data point to weaker growth given the higher oil prices and falling confidence. For instance, the Bank of Portugal's monthly coincident indicator fell again in July to its lowest level since October 2003.
- Therefore, for the time being, we are sticking to our forecast of 0.5% for GDP growth in 2005E.

Portugal – GDP Growth (YoY) vs Coincident Indicator



Source: INE and the Bank of Portugal

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Key to Investment Codes¹

Buy	Upside of more than 15%.
Hold	Upside of 10%-15%.
Underweight	Upside of less than 10%.

(1) Target prices set from January to June are for December 31 of the current year. Target prices set from July to December are for December 31 of the following year.

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