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Portugal : Change in continuity?

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The outcome of 4 October legislative elections is uncertain. The latest polls show the main parties to be neck-and-neck.

The elections are occurring at a time when Portugal is back on track to growth, following structural reforms and political austerity.

Yet no radical political parties have emerged. The supremacy of the traditional parties rules out the risk of a rupture in Portugal's current policies.

On 4 October, the Portuguese will go to the polling booths to elect the 230 members of their unicameral parliament, the Assembly of the Republic. With the election just a few days away, none of the main parties seems to be in a position to win a parliamentary majority (set at 116 seats). The Socialist Party (PS) and the Alliance – comprised of the Social Democrat Party (PSD) and the Popular Party (CDS-PP), which have been in the ruling coalition since 2011 – are neck and neck in the polls. Although some of the population is unhappy with the austerity policies driven through in recent years, a radical party has not emerged. The supremacy of the traditional parties rules out the possibility of a rupture in Portugal's current policies.

An improvement in the economic environment

These elections are occurring at a time when Portugal has managed to pull out of several years of crisis since early 2013, with GDP growth of 0.9% in 2014 (vs. -1.6% in 2013).

This rebound can be attributed to a shift in the economic equilibrium in favour of exports, whose share of GDP rose from 31.8% in 2007 to 43.2% in Q2 2015. Momentum was also boosted by a decline in unit wage costs, a corollary of the decline in nominal wages (see chart 1). This enabled Portuguese companies to restore margins while at the same time, in order to offset depressed domestic demand, to more easily penetrate new international market outlets, notably in China (1.8% of merchandise exports in Q2 2015, compared to 0.5% in 2007), and until 2014, in Brazil and Angola (1.3% and 6.6%, respectively, of merchandise exports in 2014, compared to 0.7% and 4.4% in 2007). Exports rose 50% between early 2009 and Q2 2015. This momentum was partially diffused. Households continue to be heavily in debt (116.7% of gross disposable income in Q1 2014, according to the ECB). However, an upturn in job creations starting in early 2013 (nearly 233,000 jobs were created between January 2013 and July 2015), combined with renewed confidence, triggered an increase in private consumption as of Q2 2013.

Cost-competitiveness improves

2005=100 – Change in Portuguese indicators relative to those in the eurozone

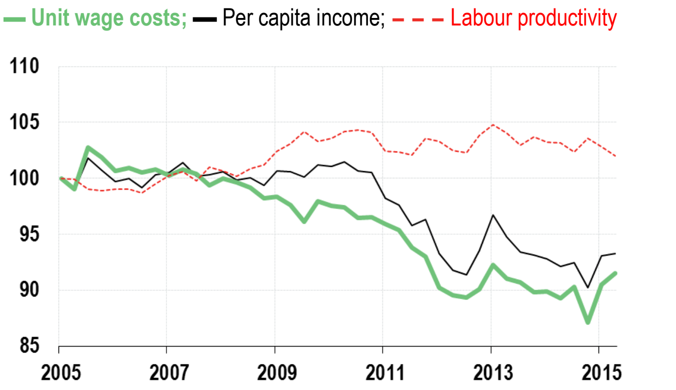

Chart 1 Source: OECD

A gradual recovery

2010=100

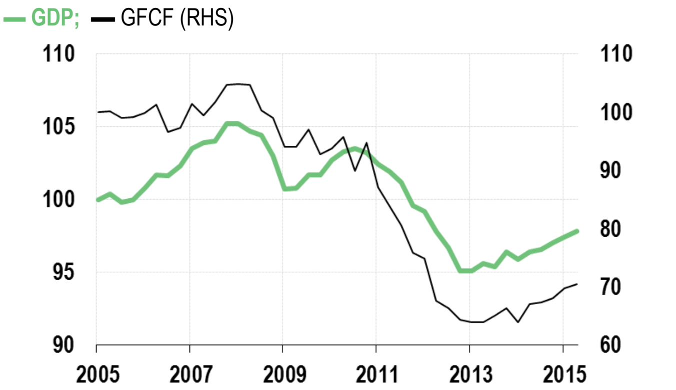

Chart 2 Source: National Statistics Institute (INE)

The country's growth prospects are still encouraging. Portugal stands to gain from a somewhat more favourable economic environment for its Eurozone partners[1], in particular in Spain (nearly 25% of merchandise exports), its main trading partner, from a persistently weak euro despite its recent appreciation, and another drop in oil prices (down 25% between May and September 2015). Indeed, this should trigger a decline in the weight of imports, which is a handicap at 45.6% of GDP in Q2 2015, as well as purchasing power gains. GDP was up 0.4% q/q in H1 and could reach 1.7% in 2015.

Mixed improvements

Yet the economy is still recovering gradually. Although companies benefit from advantageous financing conditions and have rebuilt margins, investment has barely picked up due to a particularly high debt ratio (164.2% of GDP in Q1 2014 according to the ECB) and the underutilisation of production capacity. In Q2 2015, GDP was still below 7%, the previous peak of Q1 2008, while the unemployment rate is still high, at 12.1% in July (vs. 17.5% in January 2013), nearly 4 points higher than it was in early 2008 (8.6% in Q1 2008) (see Chart 2).

Portugal still needs to lay down the framework for sustainable growth. It must notably invest in human capital. The deterioration in job market conditions in recent years goes hand in hand with an upsurge in emigration (110,000 in 2013, vs. 70,000 in 2010[2] for a population estimated at 10.4 million at end-2013). The exodus is particularly strong among youth, hard hit by high unemployment (31% in July for the 15-24 age group). The flight of labour, combined with an increase in the number of long-term unemployed[3], has eroded the country's long-term growth potential [4].

Public finances are also in a delicate situation. Portugal has significantly reduced its budget deficit since 2010 (from 11.2% of GDP in 2010 to 4.5% in 2014). In 2014, it also managed to exit the bailout programme[5] set up in 2011 by the Troïka (IMF, European Union and the European Central Bank) in exchange for structural reforms and fiscal austerity. As a result, it managed to return to the financial markets in early 2014 and to benefit from more advantageous financing conditions. These policies, combined with an improved economic situation, should enable Portugal to bring the deficit below the 3% limit this year (to 2.9% of GDP according to our estimates, from 4.5% in 2014). Yet Portugal is still vulnerable to any new shocks given its high public debt ratio (130.2% of GDP in 2014).

Traditional parties are still popular

Pedro Passos Coelho, the current prime minister of the coalition government, points out the improvement in the economic situation to justify the policies implemented in recent years. The Socialist Party (PS) and its leader, Antonio Costa, defend their programme by highlighting instead the negative impact of certain structural measures and austerity policies (cutbacks in public service jobs and wages, etc.) on growth and the job market. They promise to improve job quality and to boost the purchasing power of Portuguese households, notably by reducing social welfare charges. The PS would also like to allocate additional resources to healthcare and education.

Although some of Portugal's population is unhappy about austerity policies, neither the PS nor the other left-wing parties has managed to rise above the others. The weight of the Communist Party, which traditionally wins the support of far left voters, has not evolved much, and unlike what can be seen in the other countries hard hit by the crisis and by austerity policies, no new radical parties have emerged – like Podemos in Spain and Syriza in Greece – to win the support of a major fringe of the population. There are several reasons for this. No charismatic leaders have come forward, and the proportional, 1-round voting system[6] favours the big parties, namely the PS and the PSD, which have dominated the Portuguese political landscape since the Carnation Revolution of 1974.

Since early September, the PS and the PSD/CDS-PP alliance have been credited with 35-37% and 35-40% of voting intentions[7], respectively, largely ahead of the CDU (Democratic Unity Coalition) comprised of the Portuguese Communist Party (PCP), the "Green" ecologists (PEV) and the Democratic Intervention (ID), as well as the radical Left Block (BE)[8] (see Chart 3).

The next government's uncertain profile

The ability of the main parties in the running to mobilise Portuguese voters -- who are not very inclined to vote[9] -- could influence the outcome of the election. However if none of the main parties manages to win a majority of seats in Parliament, few options are open to them. We are unlikely to see the formation of a coalition other than the one between the PSD and CDS-PP. It is hard to imagine the PS joining forces with the Communist Party, which is more euro-sceptical and advocates public debt restructuring. A grand coalition bringing together the existing PSD/CDS-PP alliance and the PS is also unlikely due to the inherent difficulties of defining a joint platform between the three parties. As it has in the past, the PS could from a minority government, which by definition is a source of instability.

Despite the uncertain outcome of the election, however, the supremacy of the traditional parties rules out the possibility of a

1 The eurozone accounts for nearly 60% of Portugal's merchandise exports.

2 Data taken from the "Portuguese Emigration Factbook 2014", published by the Emigration Observatory (Observatório da Emigração), CIES-IUL

3 There were nearly 200,000 more long-term unemployed (out of work more than 12 months) in Q2 2015 than in Q2 2008.

4 Potential GDP corresponds to a country's economic growth if all its productive resources were being used.

5 The programme called for EUR78bn in financial assistance. At year-end 2014, Portugal had received EUR24.3bn from the European Stability Mechanism (ESM), EUR26bn from the European Financial Stability Fund (EFSF) and EUR26.5bn from the IMF.

6 The number of seats is determined by the number of votes obtained in each district.

7 According to projections, the PS and the PSD/CDS-PP alliance would each obtain about 100 seat.

8 According to recent polls, these parties would receive about 8% and 5% of the vote.

9 During previous legislative elections in 2011, the participation rate was only 58.1% (vs. 59.7% in 2009). During the previous European elections in 2014, the participation rate was only 33.7% (vs. an average of 42.6% in the European Union).

rupture with Portugal's current policies. Although the PS would like to loosen the grip of austerity policies, it has approved the deficit targets set by the European Union.

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An uncertain election

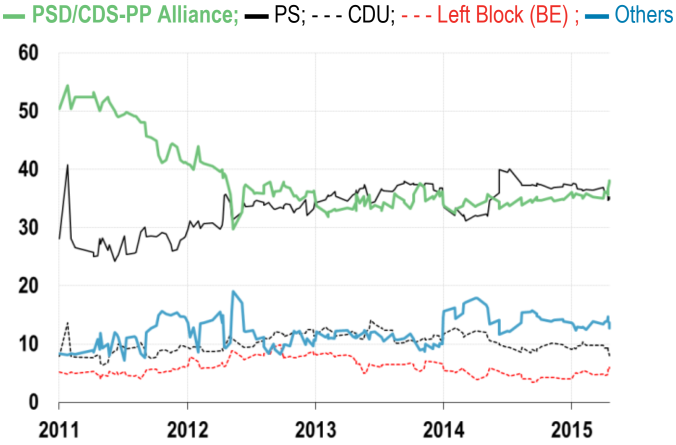

Chart 3 Source: BNP Paribas

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