Portugal:
Macroeconomic and financial outlook

BPI *Research*

April 2022

Prepared with information available by April 11th, 2022

BPI Grupo CaixaBank

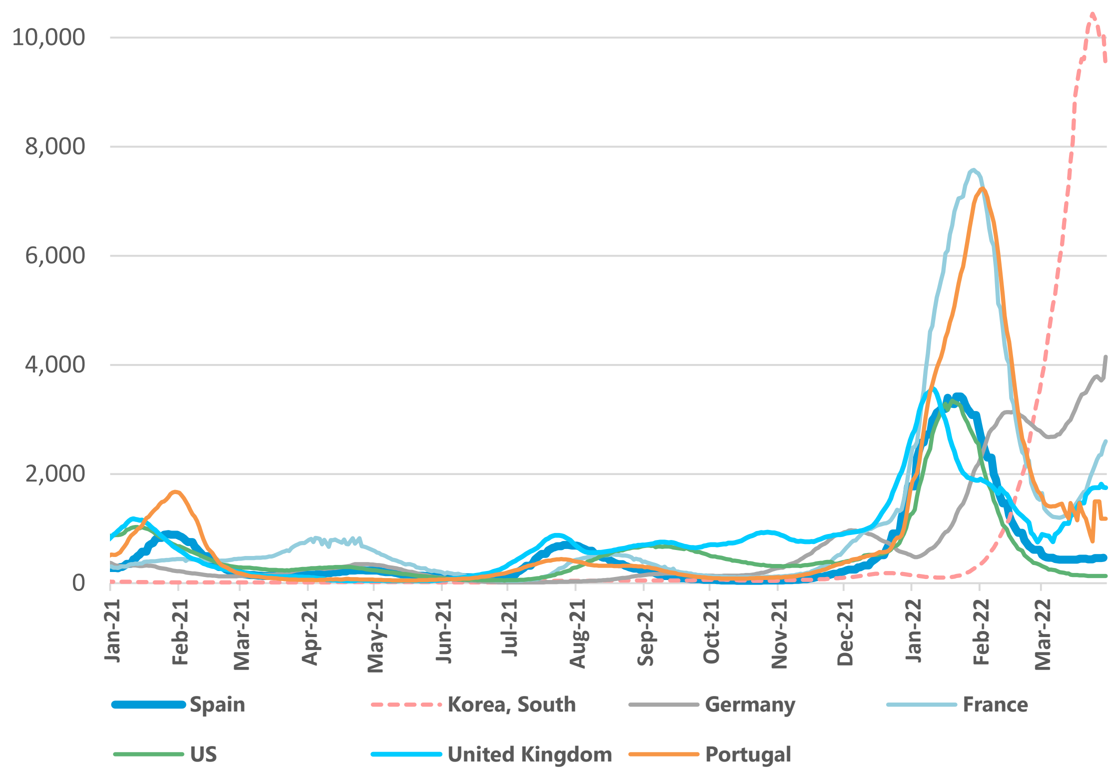
Main messages

Activity	▶ **Annual GDP growth is forecast at 4.2% in 2022, 0,7 pp below the pre-invasion scenario.** Key assumptions are that the conflict does not escalate and that the largest impact is felt in March and 2Q22. Oil prices are assumed to average \$105 per barrel in 2022 but are below \$95 by year-end. The downward revision of GDP growth is mainly attributed to higher energy prices, which reduces growth by 1,1 pp, partially compensated by the positive impact of a better than expected pace of growth in Q4 2021, which adds 1 p.p. to growth in 2022. The remainder can be attributed to other channels like higher uncertainty, trade, tourism, or further disruption in global value chains. ▶ **The conflict significantly increases our inflation forecasts for 2022.** We now expect an average headline inflation of 5.4% (previously 2.2%) and average core inflation of 4.7% (previously 1.6%). ▶ **COVID-19 new infections are at similar levels to the third wave (January/February 2021), but with a remarkably lower number of deaths.** The booster dose campaign has reached 60% of total population, and more than 90% of the high-risk population (65 years old or higher), but progress has stagnated. Covid related cases account for only 6% of NHS ICU bed occupation.
Banking sector	▶ **Despite the end of moratoria last September, the Portuguese banking system maintains a strong financial position**. NPLs continue to decline and banks built reserves to face future losses, with NPL coverage ratios at ≈52% by end 2021. Liquidity and solvency ratios continue also to improve. Healthy balance sheets will be key to accommodate a possible increase in bad loans due to the end of moratoria and also due to maturity of credit lines from mid-2022. Moreover, the possibility of restructuring debt under moratoria, with state guarantee, a measure aimed at the most vulnerable sectors, will probably reduce the impact.
Policy	▶ **The majority obtained by the Socialist Party in March general elections will facilitate the approval of the State Budget proposal for 2022, that probably will not differ much from the main measures announced in the last proposal rejected in November 2021.** General elections results will also ease the approval of reforms and measures needed to receive NGEU funds. Main risk is related to the scarcity of resources and the increasing costs. ▶ **The Government adopted a set of measures to limit the impact of higher energy prices due to the war in Ukraine, equivalent to 1,3 bln euros (0,6% of GDP):** from these we highlight: €20 refund for refueling (autovaucher) in March; suspension of the increase of the carbon tax up to the end of June; reduction of tax on oil products; monthly support to most vulnerable families; credit lines to sectors more most affected by rising energy costs. ▶ **Despite the strong support to the economy, the fiscal deficit and public debt are declining.** In 2021, fiscal deficit stood at 2,8% of GDP (5,8% in 2020) and public debt declined to 127,4%, -7,8 p.p. than in 2020. This positive trend is expected to continue, but more moderate, as public accounts will face several challenges in the near future, some of them related with the new measures to fight negative impacts of the war in Ukraine for households and companies (possible execution of guarantees related to Covid-credit lines, eventual additional financing needs of some SOE and the impact of new measures to contain the impact of increasing energy costs). Nevertheless, there is room to accommodate potential fiscal slippage as the economy is showing strong dynamics and as public debt increased comparatively less in 2020 than in other European peers. ▶ **The Government public funding needs will be less covered by ECB purchases in 2022 than in 2020-21, but ECB acquisitions will continue to be an important support, (expected to cover around 40% in 2022). Still, the Treasury liquidity cushion amounts to circa €19 bln (≈9% of GDP).**

COVID-19 hits Asia and starts increasing again in northern Europe

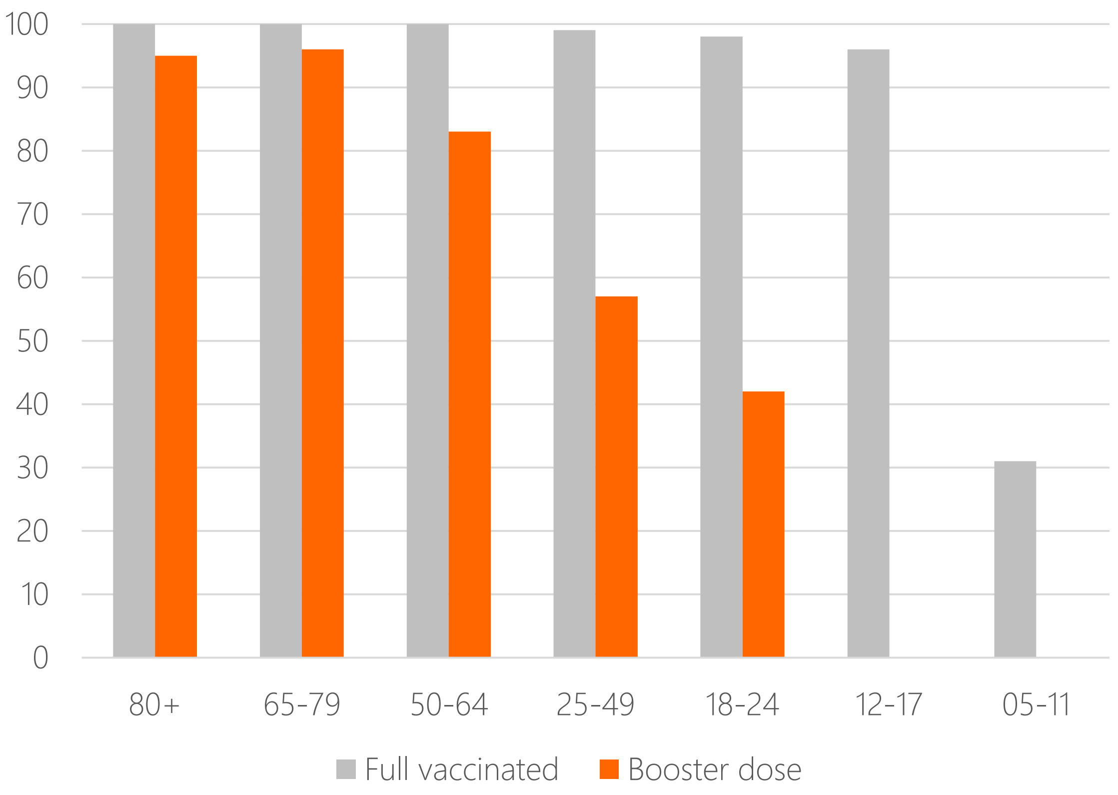
COVID-19 incidence

Infections per 100k inhabitants accumulated in 14-day



Population vaccinated and with a booster dose by age group in Portugal

% of each age group



- **COVID-19 infections in Asia boomed in March.** South Korea and Hong Kong data show a huge spike in daily contagions and point to a heavy outbreak in the region. China has imposed lockdowns in major cities to control the outbreak. On the other hand, COVID-19 infections in **Europe remain partially stable but are beginning to pick up pace in some northern countries.** The new omicron lineage (BA2) is behind these new waves, as it is a more contagious strain of omicron but not a more virulent one.
- **In Portugal, COVID-19 new infections are at similar levels to the third wave (January/February 2021), but with a remarkably lower number of deaths.** The booster dose campaign has reached 60% of total population, and more than 90% of the high-risk population (65 years old or higher), but progress has stagnated. Covid related cases account for only 6% of NHS ICU bed occupation.

Update of macroeconomic scenario following the invasion of Ukraine

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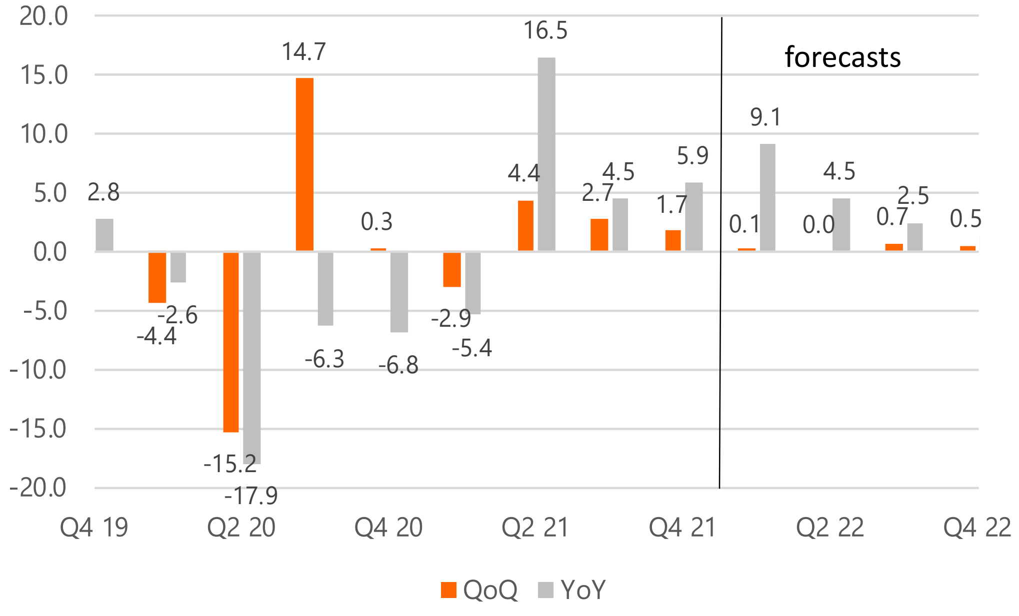
GDP growth
Percentage change (%)



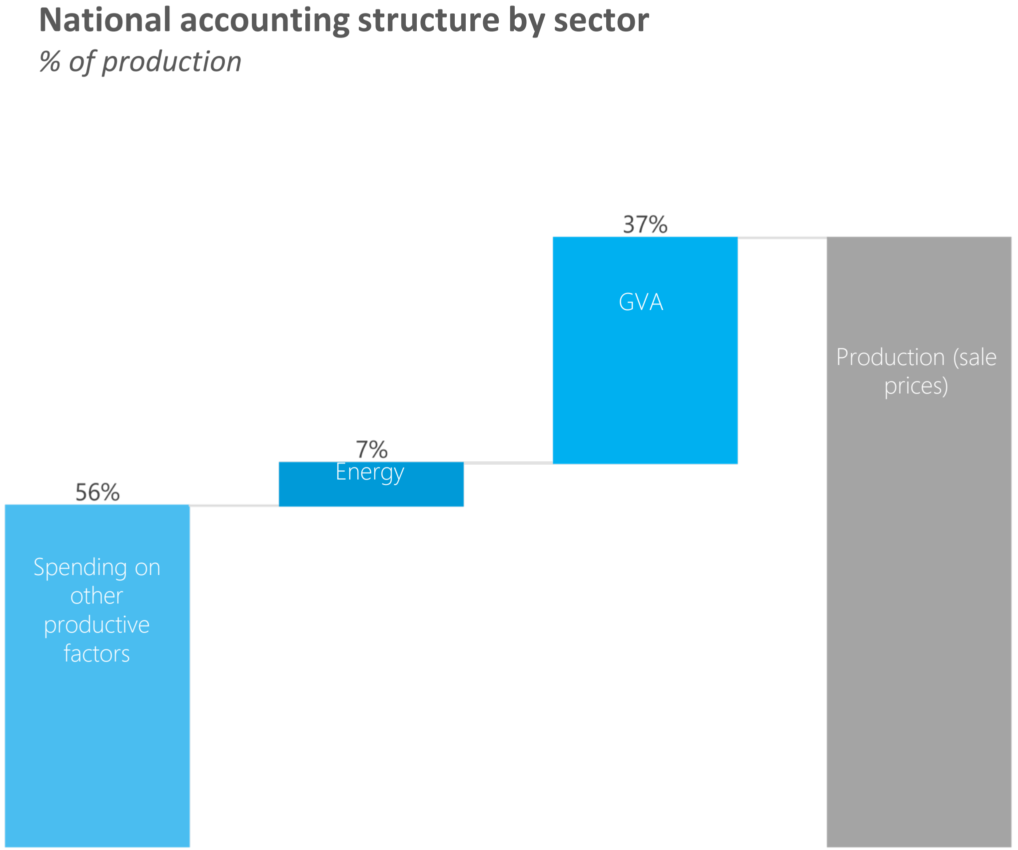
Source: *BPI Research, from INE.*

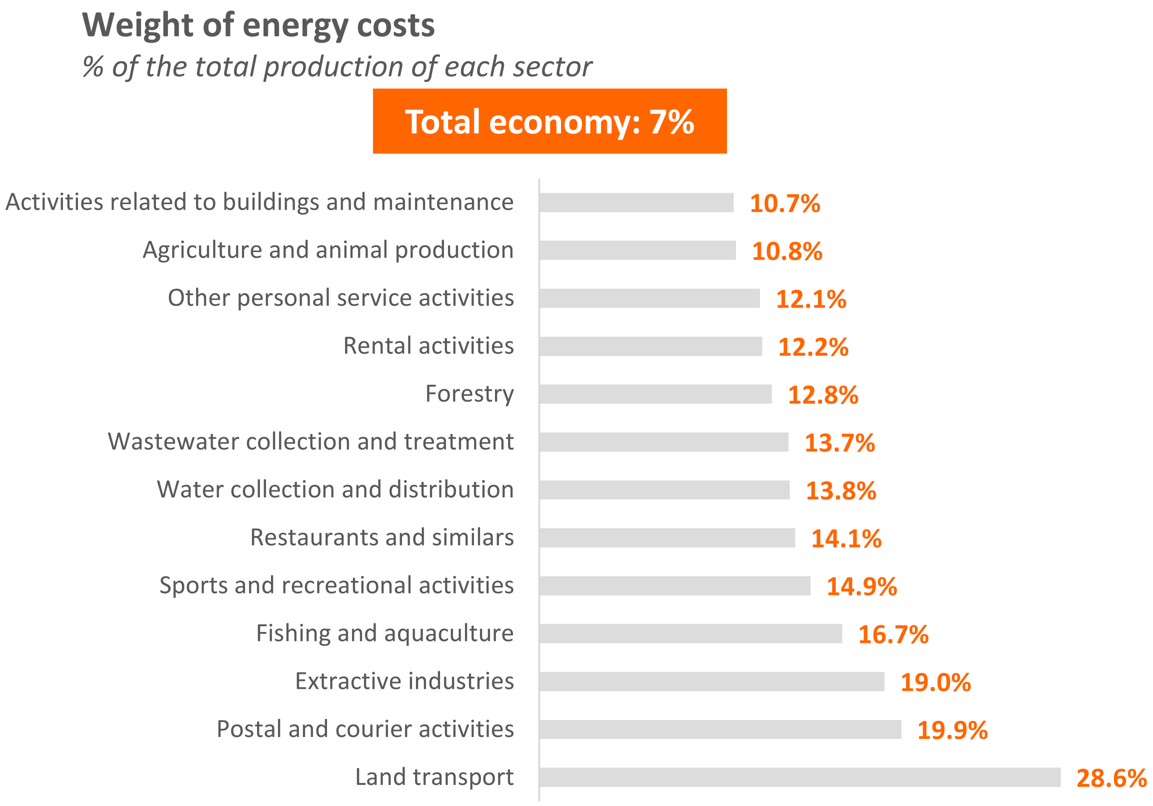
Macroeconomic projections
Annual change (%)

	2021	2022	2023	2024	Acum. 22-24
GDP	**4,9**	**4,2**	**2,8**	**2,0**	**9,3**
Pre-invasion	*4,9*	*4,9*	*2,6*	*1,9*	*9,7*
Unemployment rate	**6,6**	**6,7**	**6,5**	**6,2**	**-0,4**
Pre-invasion	*6,6*	*6,1*	*5,9*	*5,8*	*-0,8*
Inflation	**1,3**	**5,4**	**1,8**	**1,9**	**9,4**
Pre-invasión	*1,3*	*2,2*	*1,7*	*1,7*	*5,7*
House prices	**9,4**	**7,1**	**2,2**	**2,8**	**12,4**
Pre-invasion	*9,4*	*5,1*	*2,8*	*2,8*	*11,1*

- The new scenario assumes that tensions related with the Russia-Ukraine conflict decrease from the beginning of the second half of 2022, onwards. As a result, the main impact of the crisis will take place between March and Q2-2022. The scenario does not envisage meaningful disruptions to energy supply to Europe.
- The conflict triggers a substantial increase in energy prices. Brent oil price is forecast to average 105$/barrel in 2022 (+15$ relative to pre-invasion scenario) and gas prices are forecast to average 125€/MWh (+50€ relative to pre-invasion scenario).
- Activity is forecast to stagnate during the first half of 2022 and the subsequent rebound is moderate. Annual GDP growth is forecast at 4.2% in 2022, 0,7 pp below the pre-invasion scenario. 1,1 pp can be attributed to higher energy prices, while the rest can be attributed to other channels, such as diminished confidence, trade, tourism, or further disruption in global value chains. This negative impact is partially offset by the stronger than expected growth in Q4 2021, which added 1 pp to growth in 2022.
- The unemployment rate will continue to decline, albeit at a slower pace than previously expected. House prices will continue to grow, as the sector carries a strong momentum from 2021 and reflecting the increase in construction prices.

The impact of higher energy prices is heterogeneous among sectors



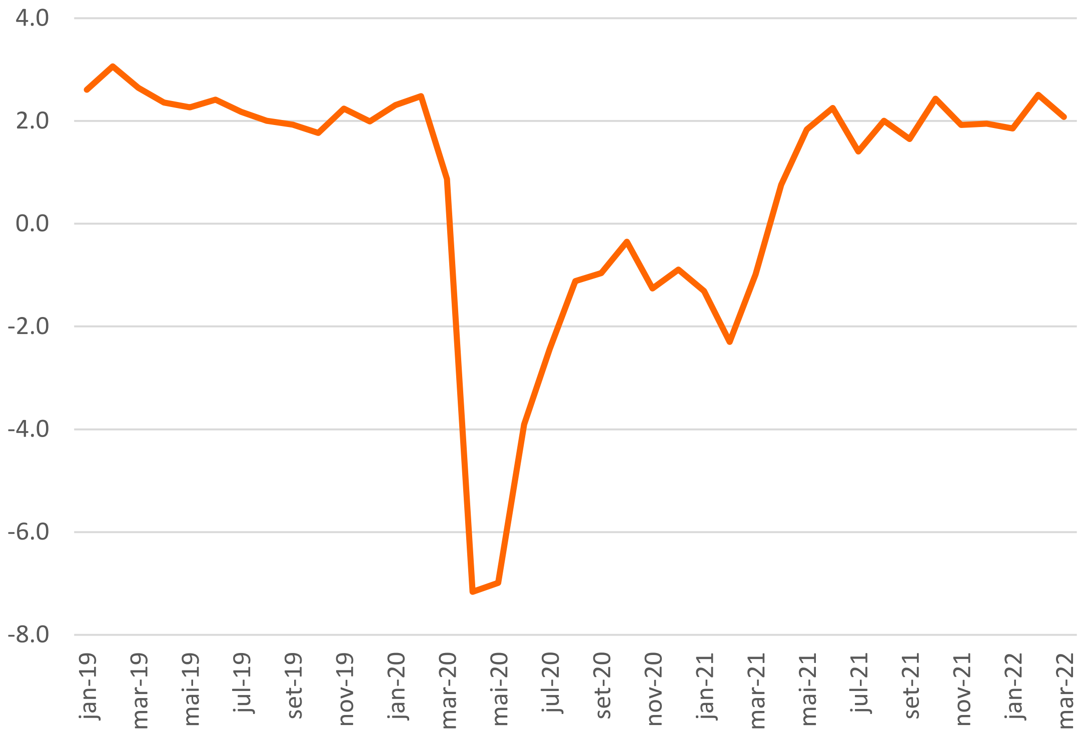


Source: *BPI Research, from INE.*

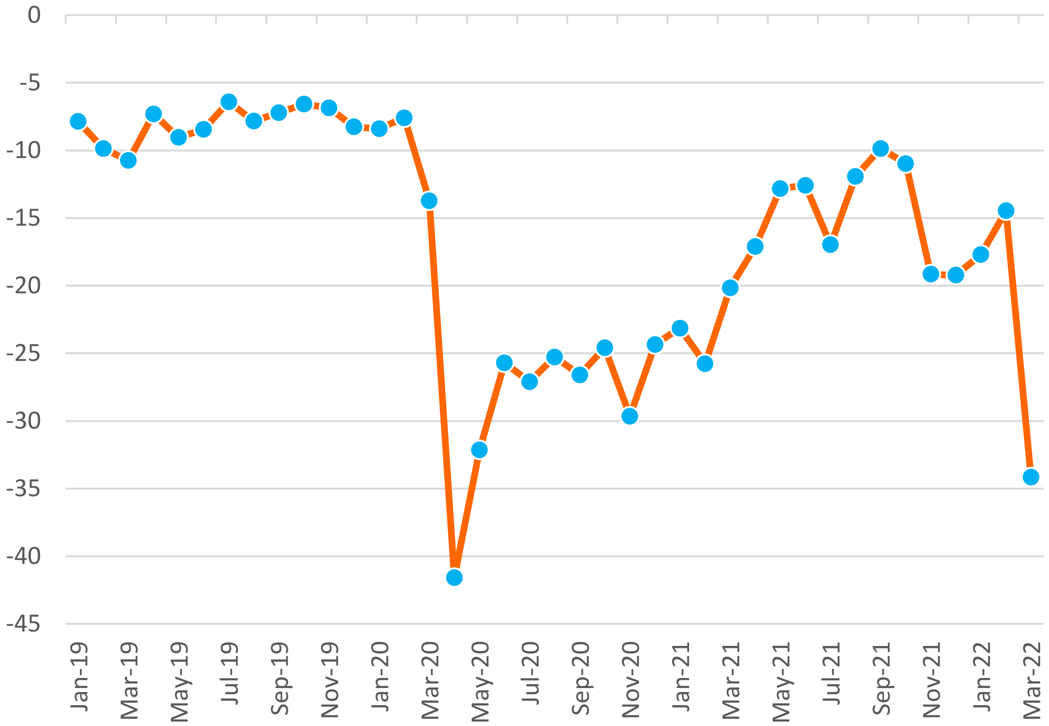
- **The war has caused a shock in energy prices, but also in the prices of other raw materials such as industrial metals (Russia is a key producer on a global scale) and agricultural products (Ukraine is one of the main exporters of cereals in Europe). The exposure of the Portuguese economy to price increases in these products is highly heterogeneous across sectors.**
- **On average, costs with energy correspond to 7% production, however the impact of higher prices in energy among sector is very diverse.**

Conflict in Ukraine affects confidence and pressures inflation

Confidence surveys: obstacles to the activity - shortage of raw materials
Level



Consumer confidence
Level

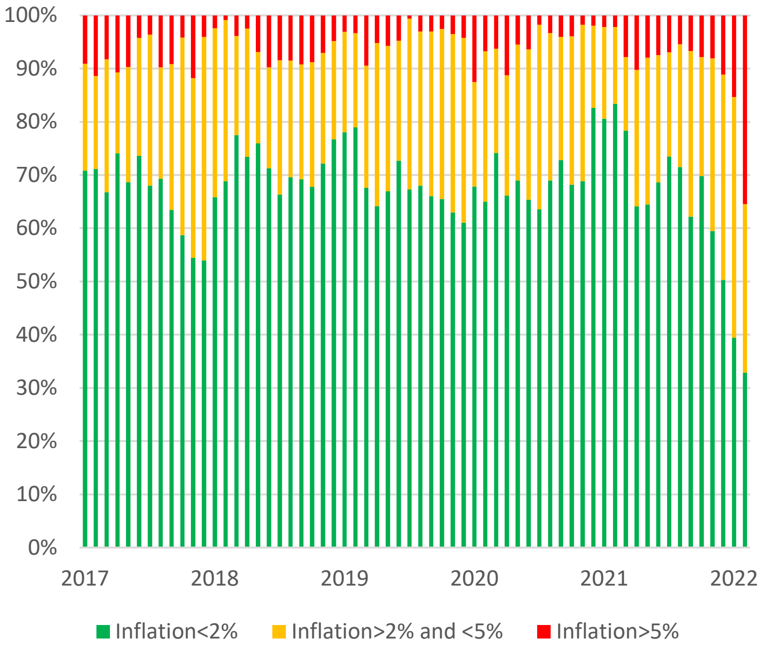


Source: BPI *Research, from INE.*

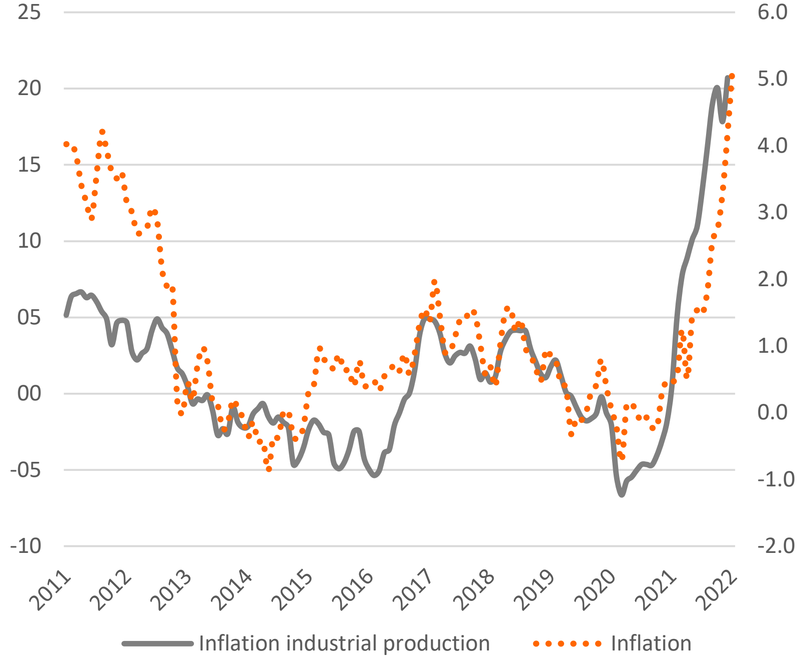
- **Confidence deteriorated in March,** reflecting the impact of the war on demand**.** Manufacturers and construction reported already lower demand in March; services are expecting declines in the months ahead. Higher energy prices, disruptions in supply chains and deterioration regarding the economic outlook will continue to impact negatively on confidence. **Shortage of raw materials continue to be referred as an important obstacle to activity and is showing signs of deterioration.**
- **Consumer confidence slumped in March,** reflecting the impact of higher inflation and concerns about labor market performance in the next months.

Inflation accelerates to 5,2% in March, a maximum since 1994

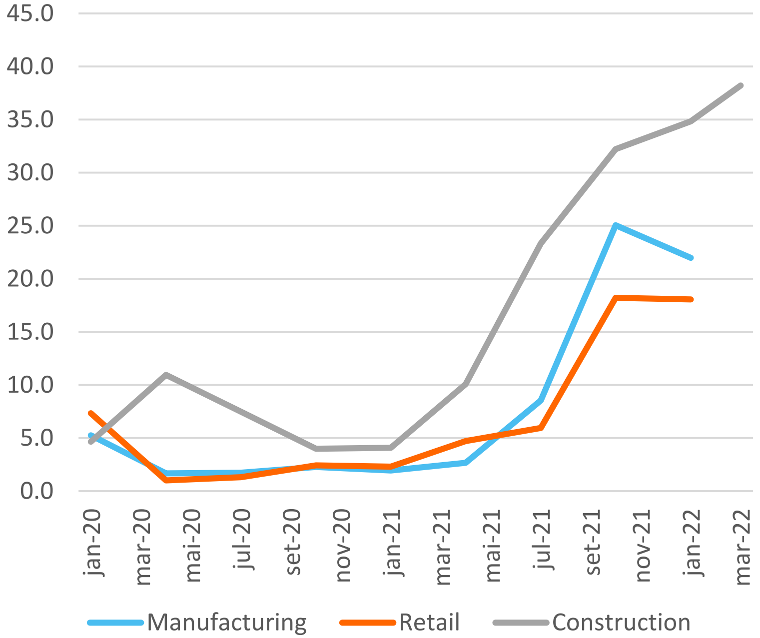
The inflation traffic light: monitoring CPI's 105 components
% of the consumer basket



Inflation in industrial production and overall inflation rate
Year-on-year (%)



Obstacles to production in Portugal
Report of insufficiency of materials in the manufacturing industry (%)



***Source**: BPI Research, from INE.*

- **Inflation accelerated in March** to 5,2% (4,2% in Feb.), driven by higher prices on energy component (detail still not available). Additionally, high energy prices have started to spread to other components (food for example), driven by the impact of scarcity of inputs in a period of higher demand. Core inflation accelerated to 4,3%, from 3,2% in February. **Inflation should remain high in the first half of the year and moderate in the second half**: drop in energy prices and supply bottlenecks should ease during the last part of the year. However, there is strong uncertainty regarding the pace of moderation in consumer prices.
- **Central scenario**: our main scenario sees annual inflation reaching 5,4% in 2022 (a considerable upward revision from the pre invasion scenario of 2,2%), decelerating to 1,8% in 2023, as second round effects (expectations and wages) will remain contained. **Risks are tilted to the upside**.

The government unveils a fiscal package to cushion the impact of the war

The fiscal package will have a direct cost of €1,3bn euros (0.6% of GDP), includes €0,5bn in credit lines

To cushion the impact on households

- **Most vulnerable families:** support of €60/month in order to mitigate increase of prices of basic necessities + support of 10€/month to acquisition of bottled gas. Estimated tax cost: €50 mln.
- Reimbursement of 40 cents/lt of fuel, up to €20/month (march and April). Estimated tax cost: €133 mln.
- Reduction of tax on oil products equivalent to a cut of VAT to 13%). Estimated tax cost: €80 mln/month.
- Temporary suspension of the carbon tax. Cost: €180 mln.
- Reduction in tariffs for access to electricity networks

Sector related measures

- **Agriculture and livestock**: Lines of credit: for the swine and milk sectors: €8,5 mln; for dry support: €50 mln; reduction or exemption of oil tax on agriculture oil: €2,7 mln; Support to mitigate increased costs with animal feed and fertilizers: €18,2 mln. Total €79,4 mln.
- **Transport sector**: support to mitigate impact of higher fuel prices (30 cents/lt); support to public transports: €25 mln. Deferral of tax obligations to be fulfilled in 1H 2022.
- **Gas intensive industries**: grants to support companies' rising gas costs; non-refundable support covering 30% of the difference between costs incurred in 2021 and those incurred in 2022 (max €400 mil/company): € 160 mln
- Flexibility of tax payments and SS contributions to the most vulnerable sectors: agriculture, fisheries, transport, textiles, pulp manufacturing, ceramics and glass industry, steel, cement production and the chemical industry.

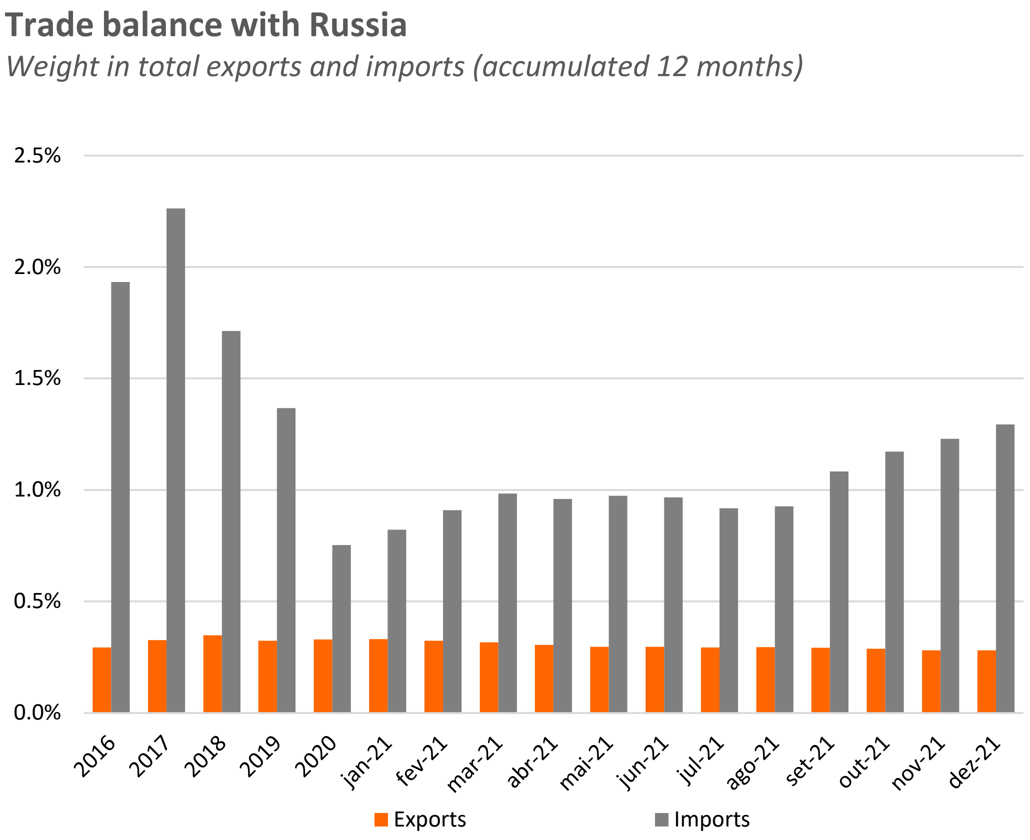
Sector related measures

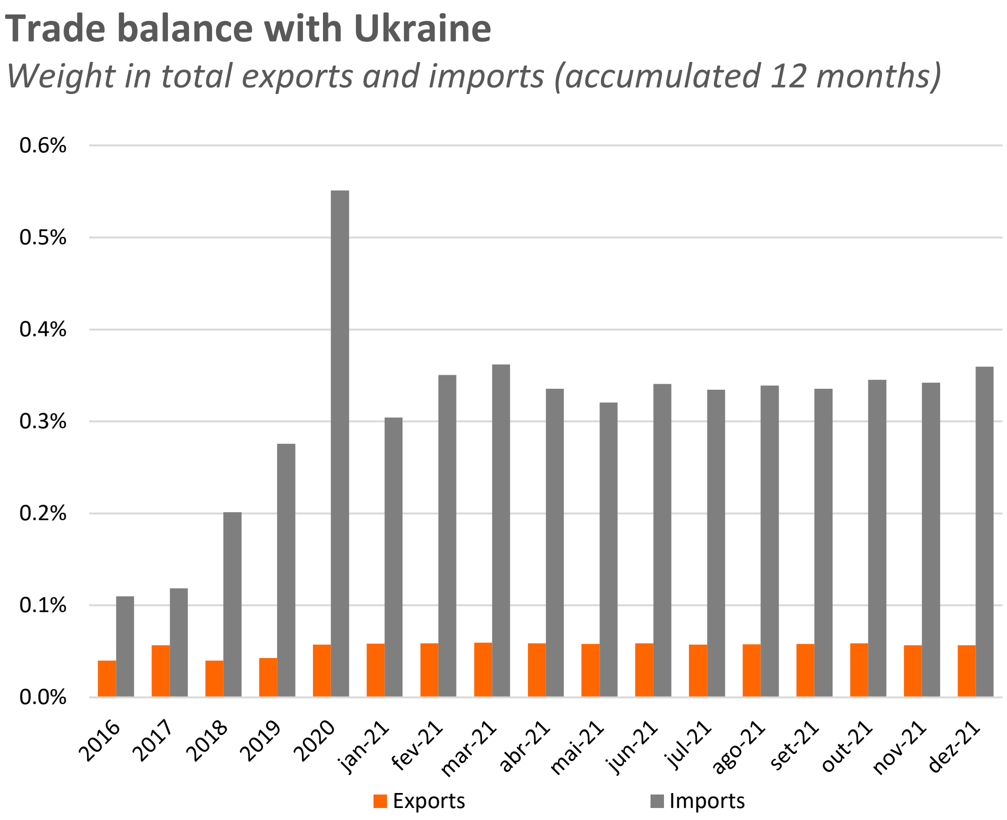
- **'Apoio à Produção' credit line for manufacturing and transport industries**: covering 70% of the credit, within a period of up to 8 years; 12-month grace period for capital. Requirements: weight >= 20% of energy costs in production costs; Increase in the cost of goods sold and consumed >= 20%; Drop in operational invoicing >= 15% due to reduction in orders related to scarcity or difficulty in obtaining raw materials, components or intermediate goods. €400 mln.

Others

- Support for refugees: €50 mln
- Support for installation of photovoltaic panels in agro-industry, farms and hydro-agricultural developments: €46 mln
- Simplification of procedures related to the decarbonization of the solar panel industry in agro-industry, agricultural exploitation and hydro-agricultural developments and reinforcement of support funds: €97 mln.
- Reduction to the minimum rate of VAT on all electrical equipment that allows families to be less dependent on gas.

Reduced direct exposure to Russia and Ukraine

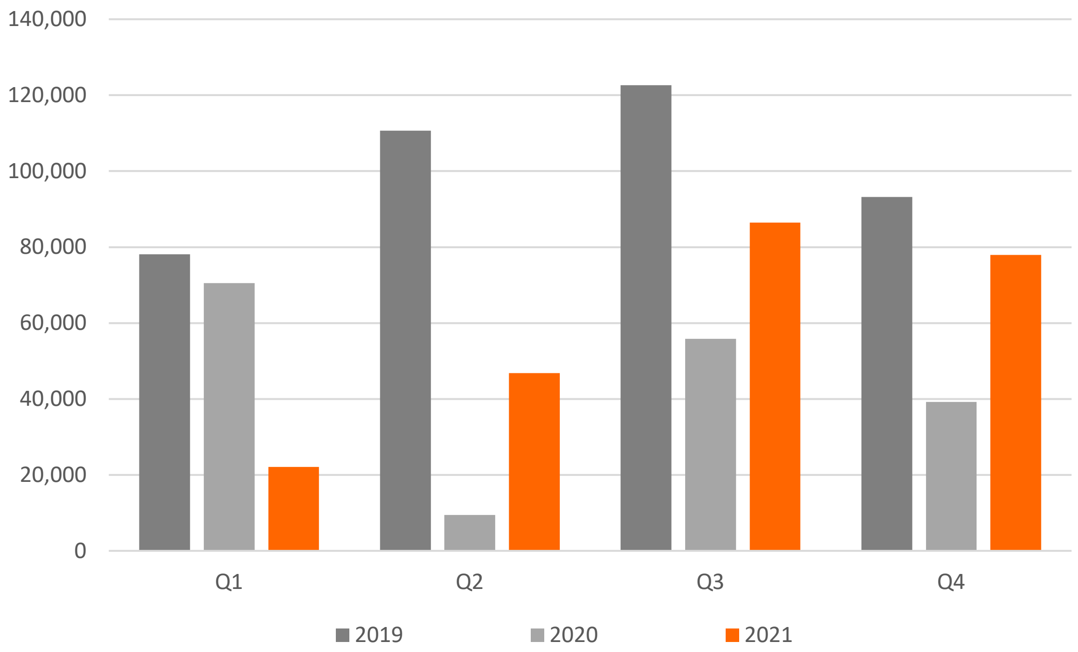




- Portugal's direct exposure to Russia (0.3% of exports) or Ukraine (<0.1%) is of little relevance**, so the expected effects on the Portuguese economy will essentially be indirectly.**
- **The most obvious indirect effect will be through the increase in energy costs:** we estimate that an increase of 10$ per barrel annual average increase of oil prices and a 20€/MWh increase in gas prices will reduce GDP growth by 0,8pp.

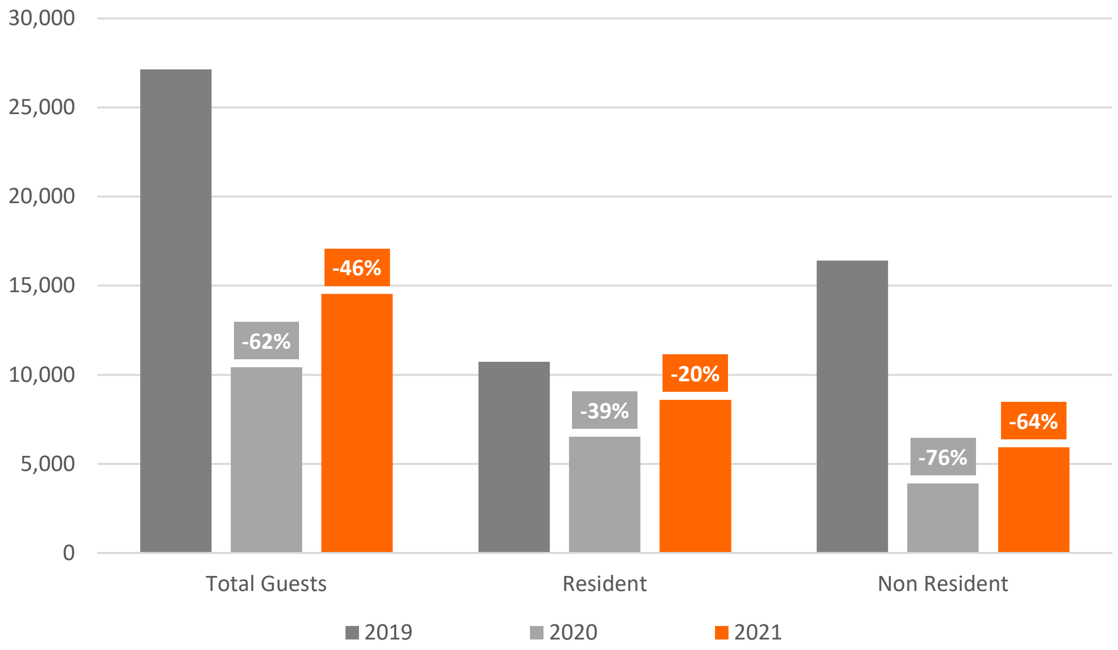
Tourism should recover as vaccines demonstrate their effectiveness

Number of flights, by quarter
Number



***Source**: BPI Research, based on EUROCONTROL data.*

Number of guests (foreign and national)
Accumulated in the year (Thousand)

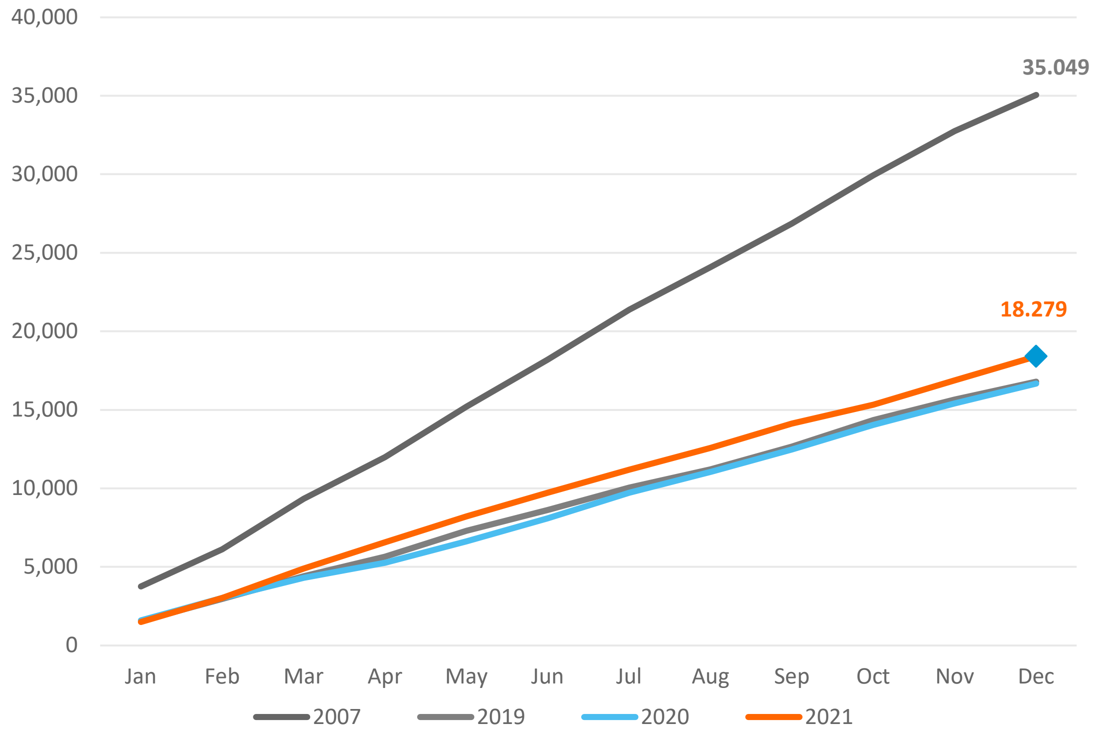


***Source**: BPI Research, based on INE data.*

- **Tourism has been the sector hardest hit by the pandemic:** in 2021, the number of tourists reached 14.5 million, 39% more than in 2020, but still 46% below 2019. In the last months, the number of international tourists visiting Portugal has been increasing at a strong pace, but the total number of foreign guests is still 64% below the 2019 level. Domestic tourism (40% of total tourism demand in pre-covid era) remains 20% below the accumulated level of 2019.
- **Fundamentals remain strong and are complemented by the well succeeded vaccination process.** The Portuguese tourism industry is the 12th most competitive in the world and "safety & security" is viewed as one of its biggest assets. Hence, recovery should be supported by the successful vaccination process with circa 90% of the population already fully vaccinated and the effectiveness of vaccines to minimize the pressure on health sector. However, **the revival is subject to uncertainty** as confidence is one of the main constraints and also some headwinds can arise associated with a slower than expected recovery of the European airline business and the recent war in Ukraine.

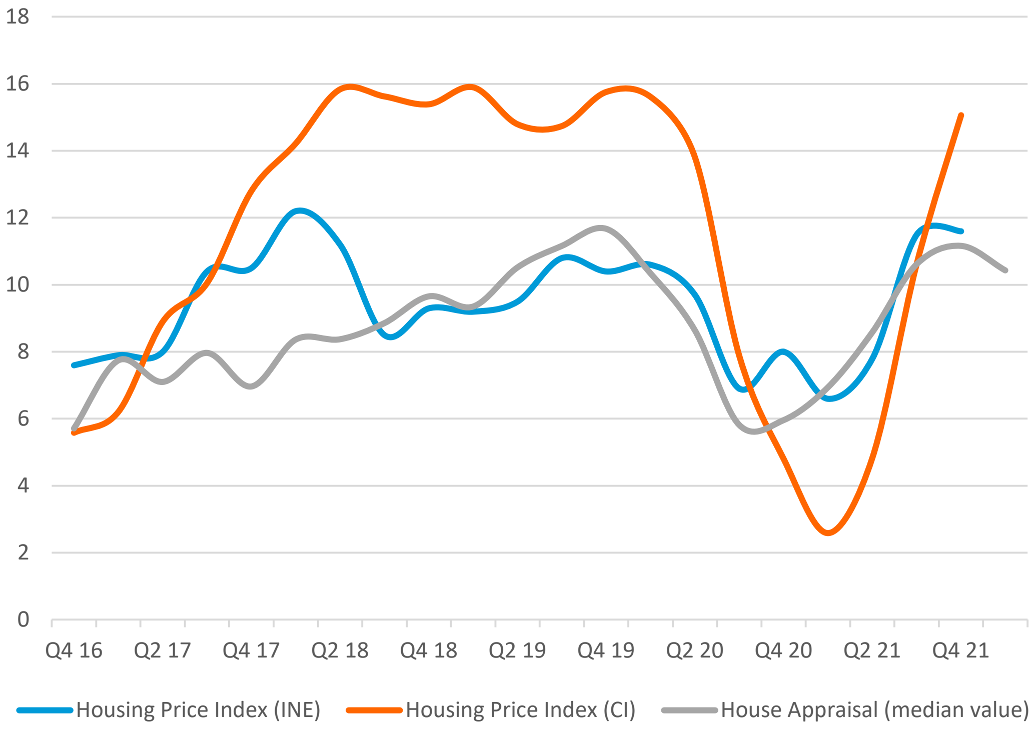
The real estate sector: resilience and solid fundamentals

Licenses to build new dwellings
Units accumulated in the year



Source: *BPI Research, based on INE data.*

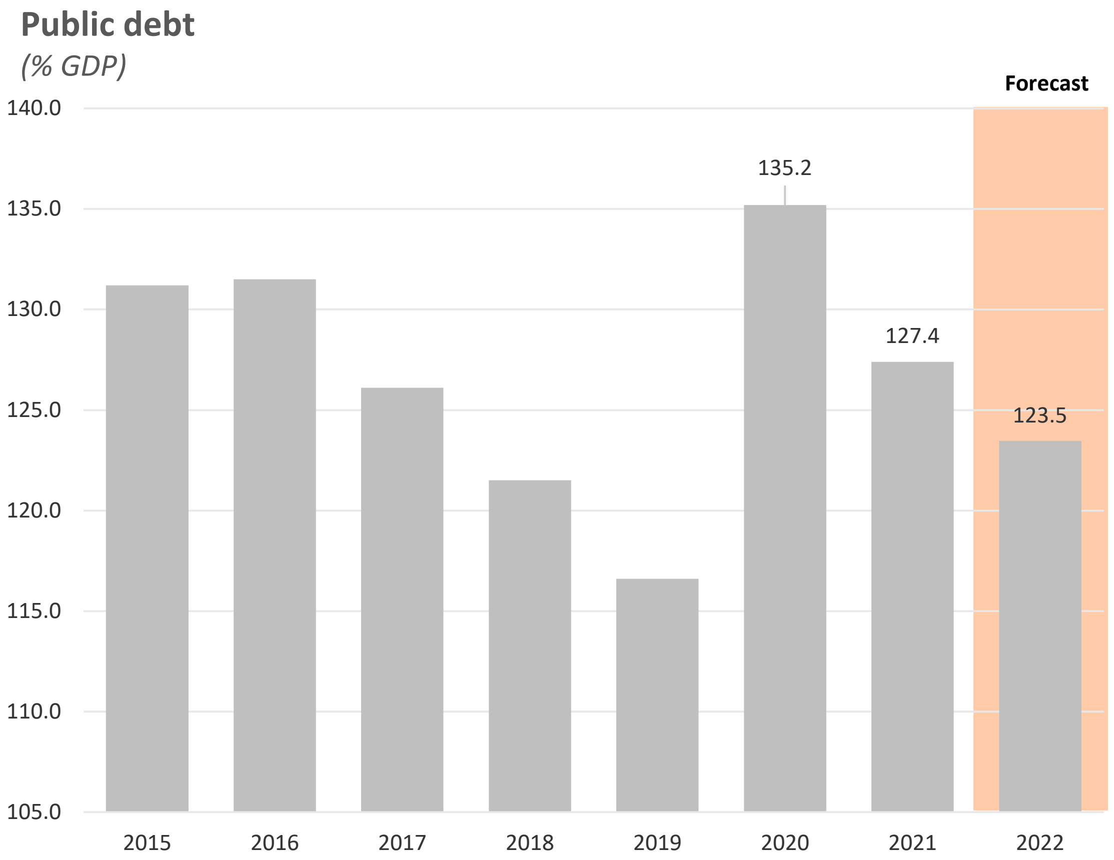
Housing prices
Year on year (%)



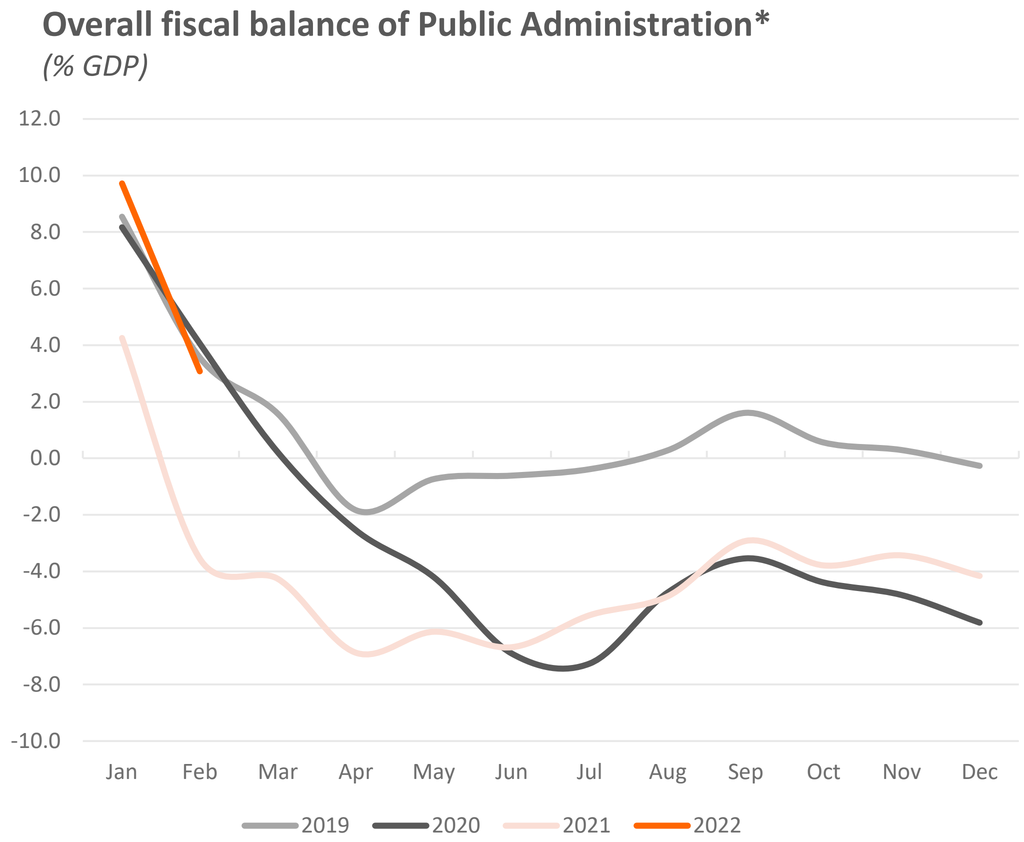
Source: *BPI Research, based on INE and Confidencial Imobiliário data.*

- Both **new licenses and new construction are expanding, but they are still well below 2007 level**, suggesting a moderate pace of new homes entering the market, continuing to support prices. Additionally, prices continued to increase in last months of 2021 and confidence keeps strong in the sector.
- Going forward, **the market should continue resilient: no signals of oversupply, but the prices should decelerate in the coming years**, in line with the end of Vistos Gold in main cities as well as some cooling down expected from domestic buyers due to the end of some Covid-related supporting measures (namely moratoriums) and also due to the upward trend in interest rates. Housing prices increased 9,4% in 2021 and should decelerate to around 7,0% in 2022.

Fiscal deficit in 2021: positive surprise, at 2,8%



Source: BPI Research, based on Bank of Portugal; forecasts by BPI Research.



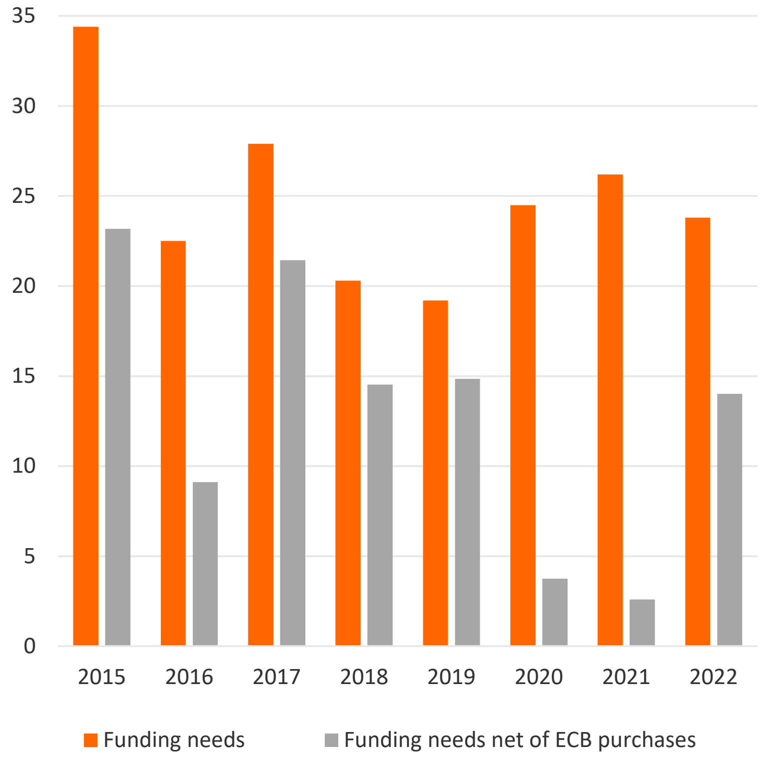
Note (*): *Budget execution according to cash basis.*
Source*: BPI Research based on DGO.*

- **Public debt (% of GDP) increased by 18,6 p.p. in 2020,** reflecting the supportive measures to companies, households and the health system due to the Covid-19 pandemic. Despite large, this increase was smaller than the evolution seen in other European countries (such as France, Spain, Italy), where supporting measures were larger. **In 2021, the public debt ratio decreased by 7,7 p.p. to 127,4% of GDP and should reach 2019 levels only in 2025** (Government's estimates)**. Going forward, keeping a sustained pace of economic growth, a moderate fiscal stance and low financing costs will be key for the achievement of these goals.**
- In 2021 **the fiscal deficit in 2021 fell to 2,8% of GDP**, explained by the substantial increase in revenues (fiscal and contributory revenues, as well as Europeans funds) and is expected to remain quite unchanged in 2022, driven by the implementation of some measures of support to limit the negative impact of higher inflation.

Funding needs are well covered, despite ECB reduced support

Portugal: Funding needs

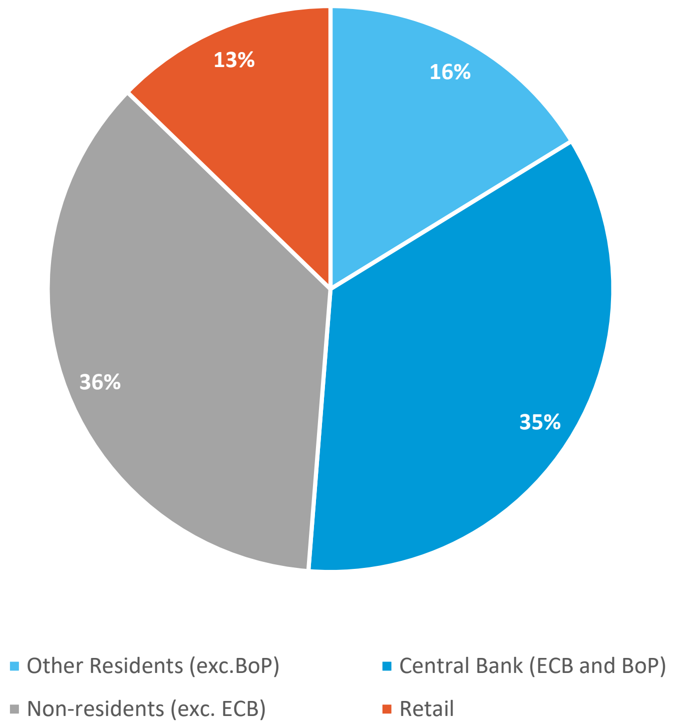
(Billion euros)



Source: *BPI Research, based on IGCP, BoP.*

Government debt by holders (exc. non-tradable debt)

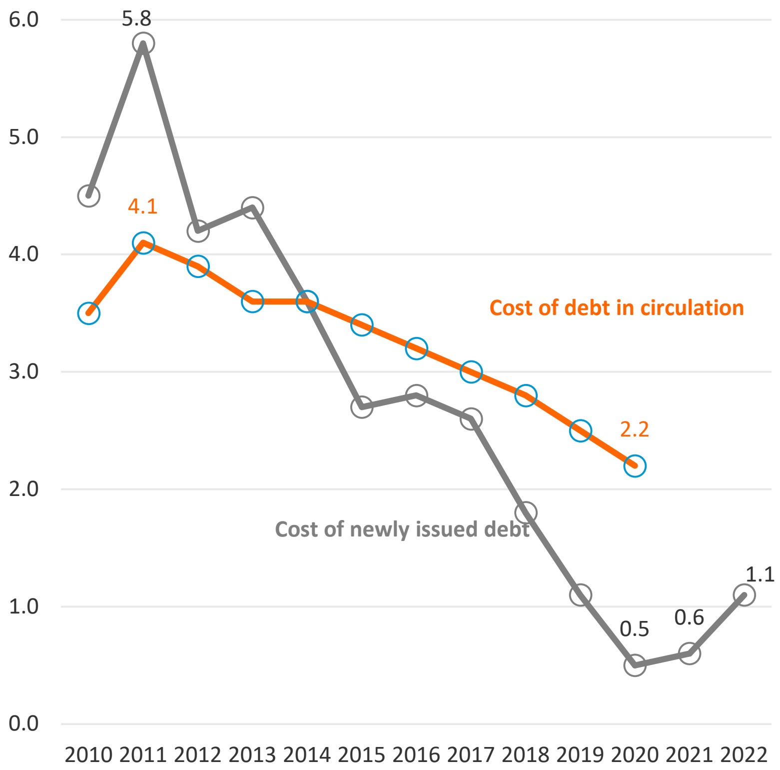
(% of total; up to February)



Source: *BPI Research, based on IGCP.*

Cost of debt

(%)



Source: *BPI Research, based on IGCP.*

- Funding needs not covered by the ECB in 2022 will be above those of 2020 and 2021, but slightly below the levels seen in 2018 and 2019.
- **However, public funding needs continue well covered, helped by ECB purchases** (expected to cover around 40% in 2022), a strong retail base of investors (with ~13% of total debt outstanding) and abundant liquidity, while interest rates will be increasing but will continue comparatively low by historical standards (some OT's that will reach maturity have comparatively high coupon rates). Furthermore, 18% of total debt are EU loans linked to the Economic and Financial Assistance Program (PAEF). **Currently, the Treasury liquidity cushion amounts to €20 bln (≈9% of GDP).**

Private sector credit: deleveraging trend returns

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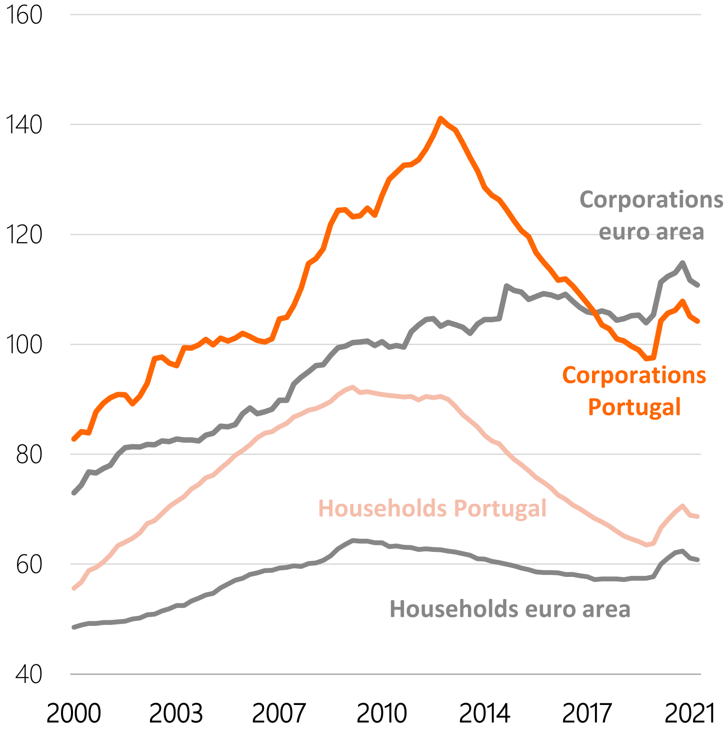
Gross private debt

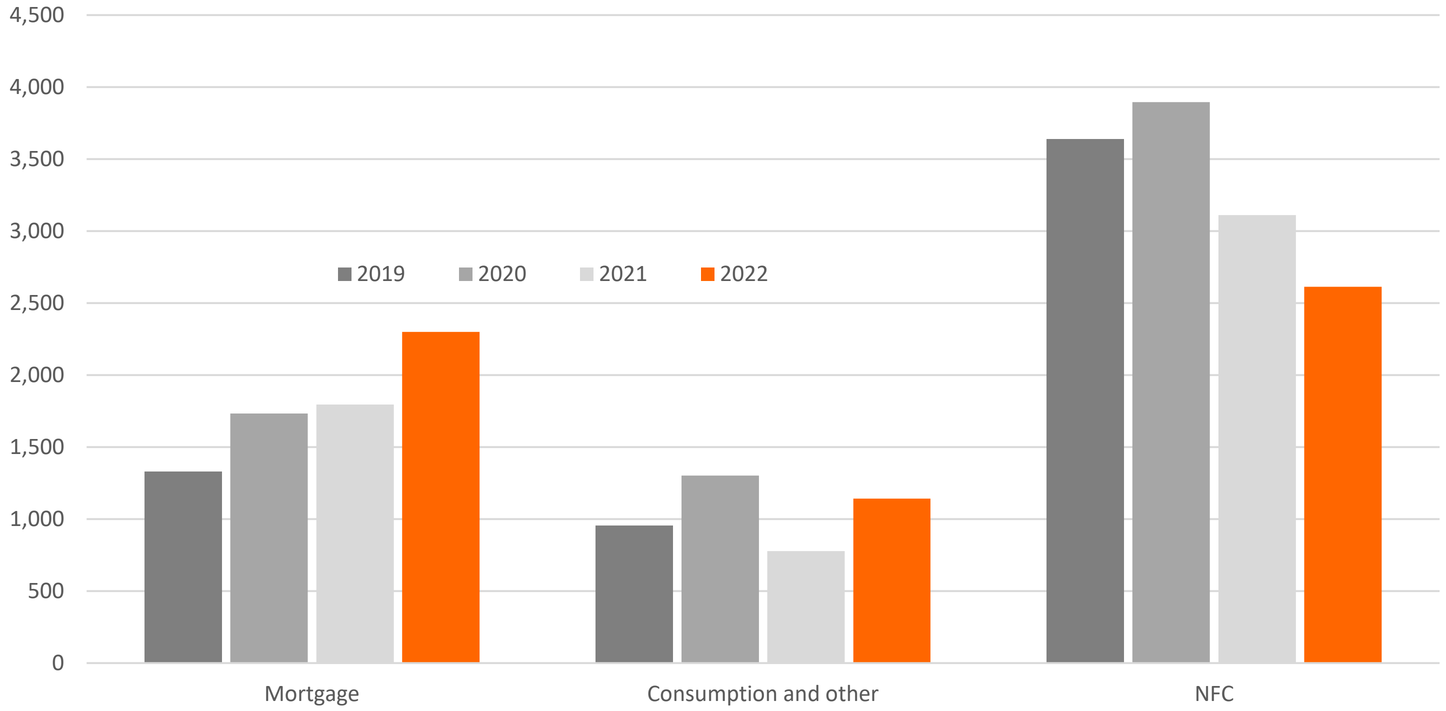
% of GDP, non consolidated debt.



Source: *BPI Research, based on Eurostat data.*

New lending activity in February by segments

(Million euros)



Note: *excluding renegotiations.*
Source: *BPI Research, based on BoP data.*

- **The end of moratorium (September 21) for households and companies justifies the return of the deleveraging trend in the private sector. Corporate debt levels** remain below euro area average despite the recent pick-up in credit outstanding (mostly due to state guaranteed credit lines, issued back in 2020). **Household debt** shows more gradual reduction, reflecting expanding mortgage lending.
- **In 2021, new lending for the non-financial private sector contracted 11,4% yoy**, reflecting the fall of new credit to NFC (-33,5%). However, when excluding Covid-related credit lines, credit to companies decreased less (-9,9% yoy). **On the contrary, data for households shows a strong performance: new lending in 2021 increased 24,5%, due to the rise of 34% on mortgage operations**. The strength seen on the housing market, favorable financing conditions, the employment-supporting measures and the past households' balance-sheet improvements (deleveraging) explain this performance, although new mortgage credit (in volume) is still below the highs of the years 2006-07. Despite the strong evolution of new credit to households until February, for the whole 2022 we expect a moderation of this trend due to the setback in confidence after the Ukraine war and also reflecting higher expectations for interest rates.

The Portuguese banking system: resilient and supporting the economy

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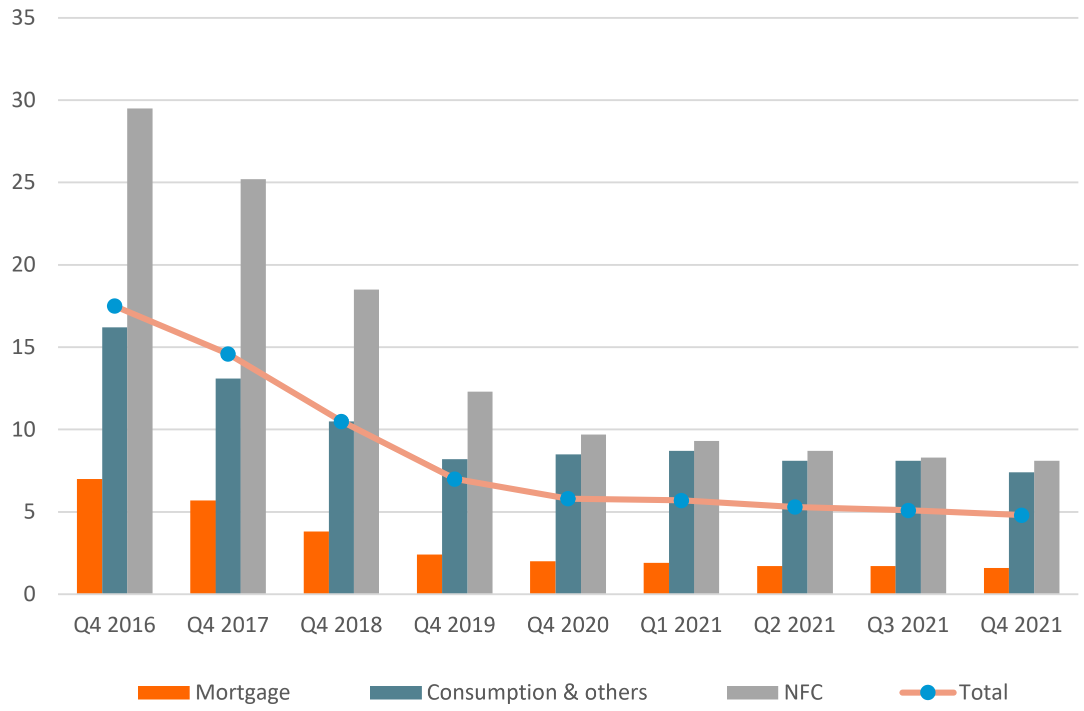
Non financial private sector: Non-performing loans

(%)



Private domestic credit

Year on year (%)

	Feb 2021 % yoy	Feb-2022 % yoy	2022 (For.) % yoy
Credit to the non-financial private sector	**5.0%**	**2.7%**	**3.4%**
Households	1.3%	3.3%	3.5%
Housing mortgages	2.3%	2.9%	3.3%
Other purposes	-2.1%	4.7%	4.1%
Consumer lending	-2.0%	3.7%	0.7%
Non-financial corporations	11.8%	1.6%	3.4%

***Source**: BPI Research, based on BoP data.*

- **Moratorium was an important supporting measure for both households and firms in the COVID context.** This measure was especially important to firms: **between August and October 2020, credit under moratorium reached a maximum of 34,1% of total credit for NFC. Moratorium ended at the end of 2021** for those who applied until March 2021.
- Considering the importance of this measure and the potentially negative impacts on the firms' solvency after its end, the Government decided to give a public guarantee (maximum of 25% of credit) directed towards the most affected sectors (with revenue drop of at least 15% in 2020 in comparison to 2019; firms that did not achieve the 2019 revenues level yet) and those who previously renegotiate with banks their credits (extending the grace period – without capital reimbursements - and enlarging the maturity). **Given the ample cushions in the banking system and the healthy balance sheet of households and companies compared with past situations, we don't expect a significant deterioration in NPL's due to the end of moratoria**.

Main economic forecasts

%, yoy	2014	2015	2016	2017	2018	2019	2020	2021	Forecasts 2022	Forecasts 2023
GDP	0.8	1.8	2.0	3.5	2.8	2.7	-8.4	4.9	4.2	2.8
Private Consumption	2.5	1.9	2.6	2.1	2.6	3.4	-7.3	4.5	4.1	2.5
Public Consumption	-0.5	0.8	0.8	0.2	0.6	2.1	0.4	5.0	1.8	0.2
Gross Fixed Capital Formation (GFCF)	5.0	6.5	2.5	11.9	7.9	3.2	-5.7	7.2	4.7	6.6
Exports	4.3	6.2	4.4	8.4	4.1	4.1	-18.6	13.0	11.4	12.5
Imports	8.1	8.1	5.0	8.1	5.0	4.9	-12.1	12.8	9.7	12.0
Unemployment rate	14.5	13.0	11.4	9.2	7.2	6.6	7.0	6.6	6.7	6.5
CPI (average)	-0.3	0.5	0.6	1.4	1.0	0.3	0.0	1.3	5.4	1.8
External current account balance (% GDP)	0.2	0.2	1.2	1.3	0.6	0.4	-1.2	-1.1	-2.2	-1.6
General Government Balance (% GDP)	-7.4	-4.4	-1.9	-3.0	-0.3	0.1	-5.8	-2.8	-2.9	-1.5
General government debt (% GDP)	132.9	131.2	131.5	126.1	121.5	116.6	135.2	127.4	123.5	120.5
Risk premium (PT-Bund) (average)	252	189	307	269	138	98	89	60	68	73

***Source**: BPI Research.*

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