Portugal:
Macroeconomic and financial outlook

BPI *Research*

May 2022

Prepared with information available by May 06th, 2022

BPI Grupo CaixaBank

Main messages

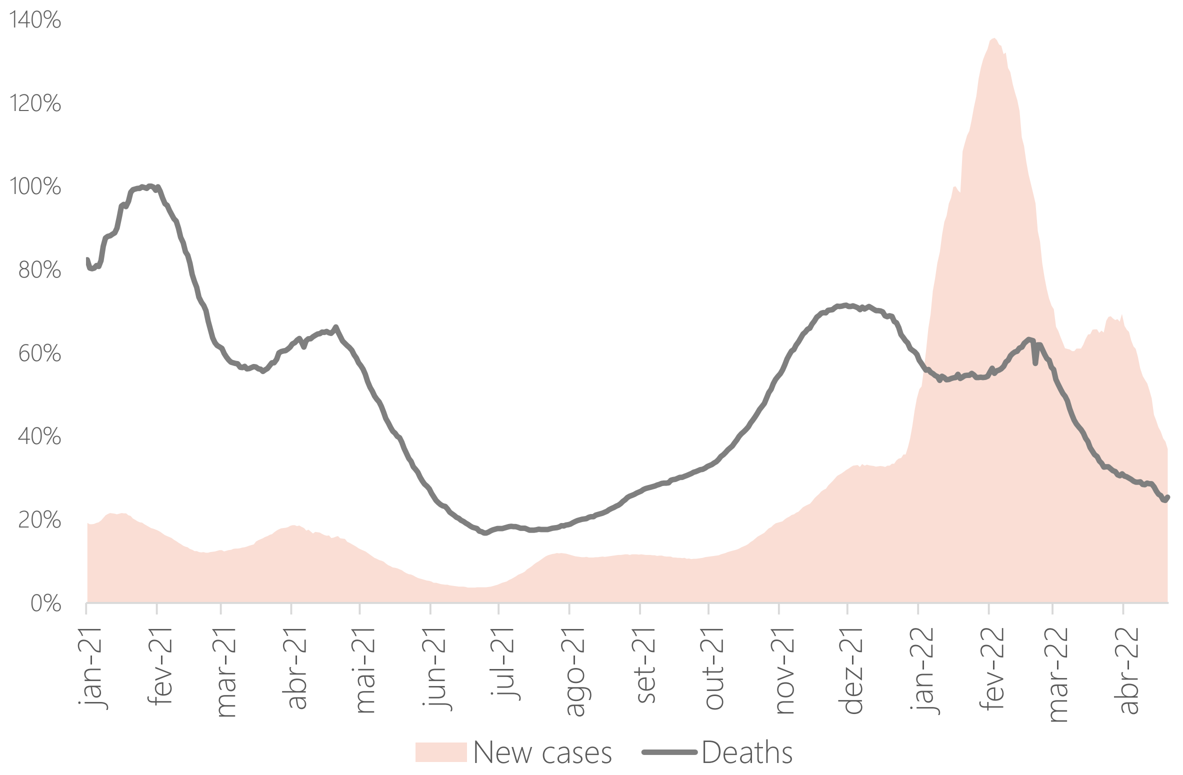
Activity	▶ **Q1 22 growth surpassed expectations, standing at +2,6% qoq and +11,9% yoy and exceeded the pre-pandemic level by 1,2%. These figures put upward pressures in our current GDP growth forecast of 4.2% in 2022. However, given the absence of signs that Ukraine's conflict will end shortly, the evidence of the cooling down of the European partners, the negative impact related with higher energy prices for households and companies and the rise in market interest rates, we prefer to adopt a more conservative stance, keeping unchanged our predictions for 2022.** ▶ Main key assumptions for the macroeconomic scenario are that the conflict does not escalate and that the largest impact is felt in 2Q22. Oil prices are assumed to average $105 per barrel in 2022 but are that they will be below $95 by year-end. ▶ **The conflict significantly increases inflationary pressures.** In April inflation stood at 7,2% and we expect a moderation during the second half of the year. **For all the year we expect an average headline inflation of 5.4%** and average core inflation of 4.7%, but risks are skewed on the upside. ▶ **With the end of the generalized compulsory wearing of masks at the end of April, COVID-19 new infections in Portugal have been increasing in the first days of May, but with much less severity.** 7 day moving average number of deaths caused by Covid are lower than the ones from previous four months. Covid related cases account for just 7% of the occupation of NHS total bed capacity and 5% of ICU bed capacity.
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 the National Parliament will facilitate the approval of the State Budget proposal for 2022, scheduled to 27th May. The government proposal continues focused in the consolidation of public accounts apparent in the expected reduction of the public deficit to 1,9% of GDP from 2,8% in 2021 (which surprised favourably, compared with -4,3% target).** ▶ **The Government adopted a set of measures to limit the impact of higher energy prices due to the war in Ukraine, equivalent to 1,6 bln euros (0,7% of GDP):** from these we highlight: €20 refund for refueling (autovaucher) until end-April; suspension of the increase of the carbon tax; reduction of tax on oil products; monthly support to most vulnerable families; credit lines to sectors 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 possible 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 20% in 2022). Still, the Treasury liquidity cushion amounts to circa €19 bln (≈9% of GDP).**

COVID-19 new cases and deaths decrease in Europe

BPI Grupo CaixaBank

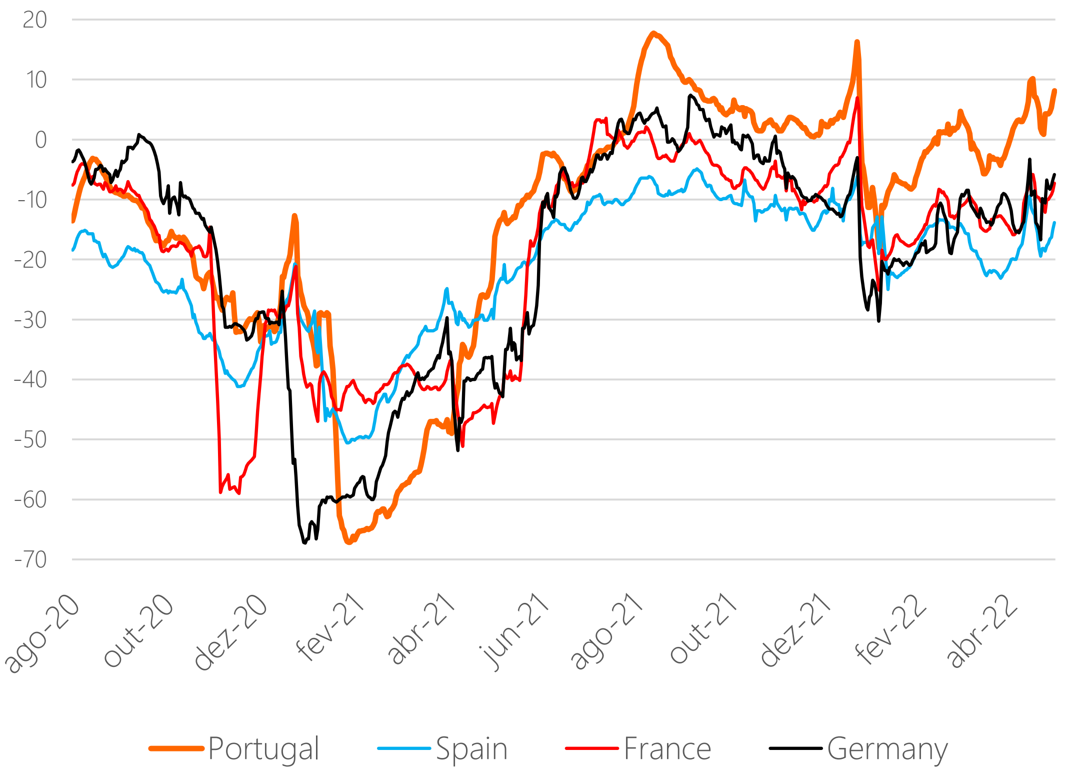
COVID-19 new cases and deaths in Europe

as a % of previous peak value



Population mobility for retail & leisure purposes

7-day moving average: deviations from baseline (%)

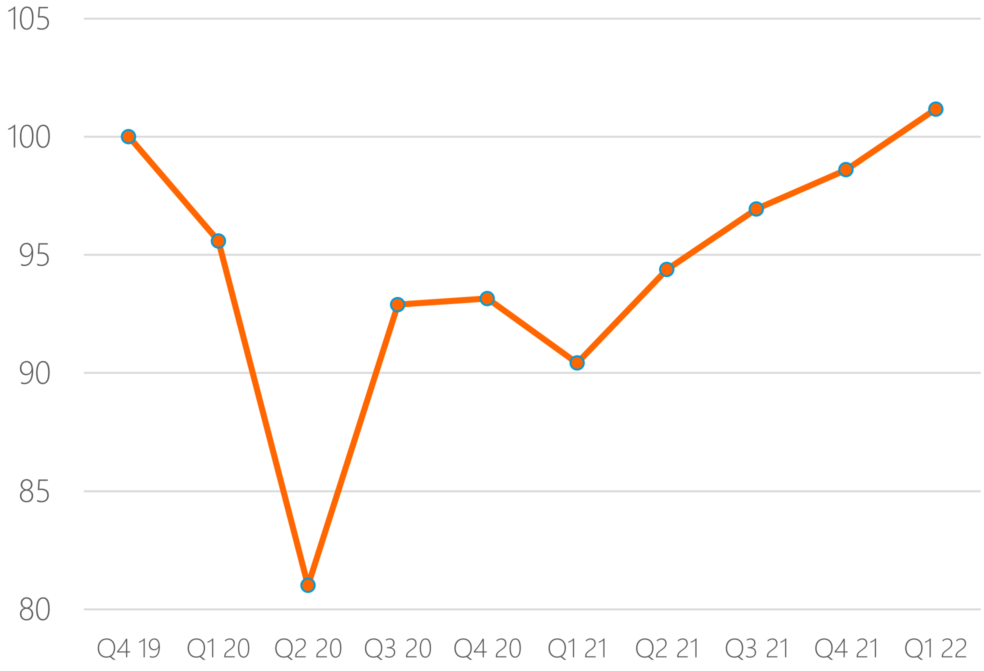


- **COVID-19 infections and deaths in Europe have been declining.** The maximum number of new infections occurred on February 3rd 2022 following the omicron variant, while the peak in deaths occurred in late January/early February 2021. The level of new cases has fallen sharply since the end of March and the level of fatalities has continued its downward trend since the end of February.
- **In Portugal, COVID-19 new infections increased in the beginning of May and are at similar levels to the third wave, but with a remarkably lower number of deaths and ICU bed occupation.** In fact, Covid related cases account for just 7% of the occupation of NHS total bed capacity and 5% of ICU bed capacity. With the lifting of most restrictions, population mobility for retail & leisure purposes continues its upward trend and already exceeds pre-pandemic levels.

GDP: strong growth in 1Q 2022 and early 2Q data keeps positive

GDP recovers pre-pandemic levels

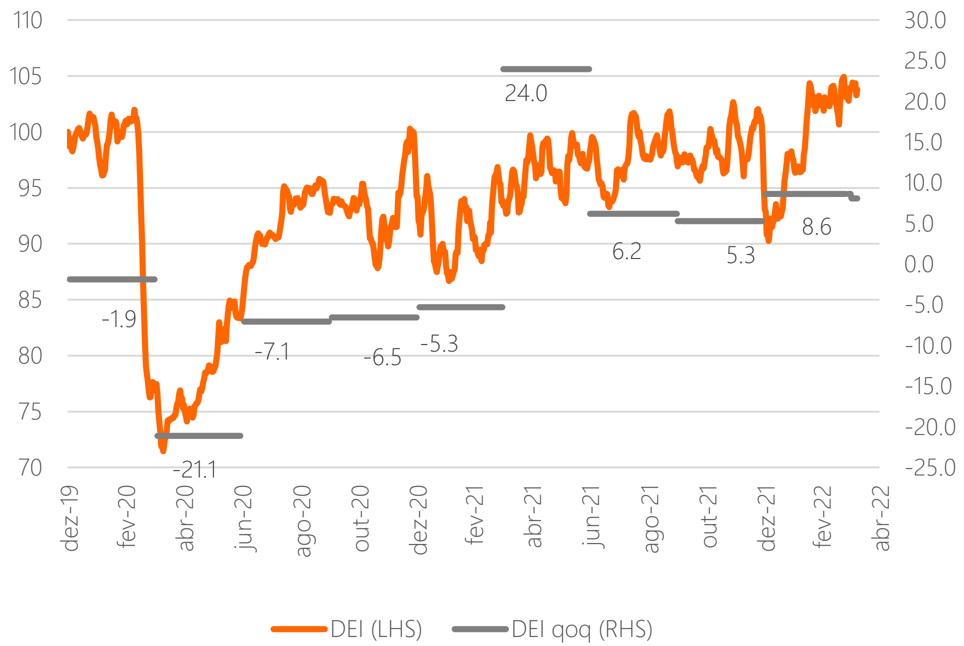
Dec 2019 = 100



Source: *BPI Research, from INE.*

Daily economic indicator

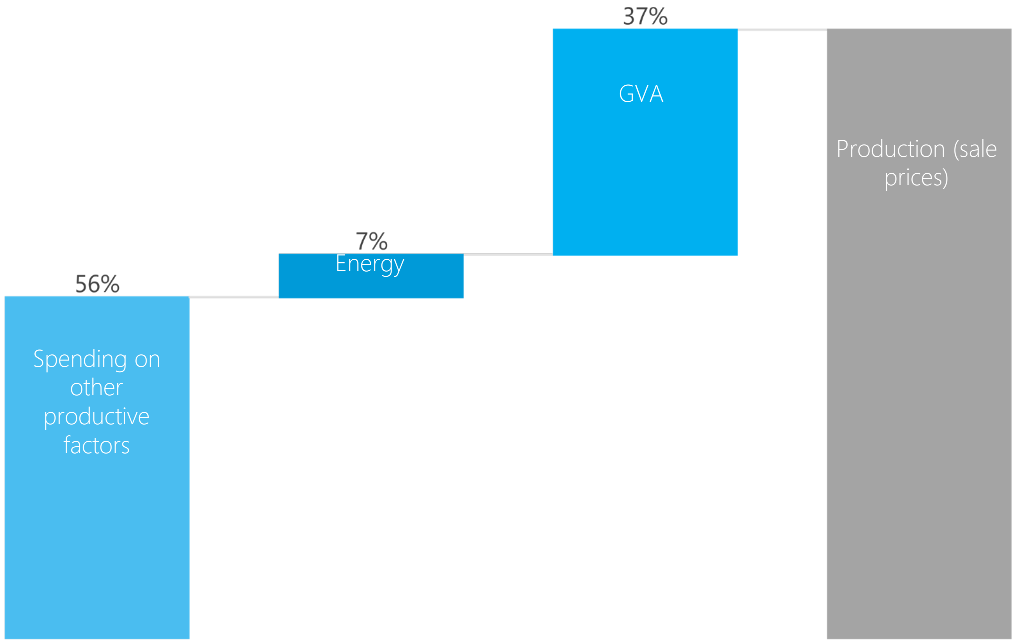
Dec 2019 = 100 *yoy*



- According to the fist release, the Portuguese economy grew 2,6% qoq and 11,9% yoy, surpassing expectations and pushing GDP to above the pre-covid levels. Consumption and tourism were the main drivers.
- In the meantime, most high frequency data suggests that activity remains strong in the beginning of the Q2.
- These signs and the better than expected performance in the 1Q, put upward risks on our current forecasts for 2022 growth (4,2%). However, given the absence of signs that Ukraine's conflict will end shortly, the evidence of the cooling of the European partners, the negative impact related with higher energy prices (whose trend began later in Portugal) and the rise in market interest rates, we prefer to adopt a wait and see approach, keeping unchanged for now our predictions for 2022.

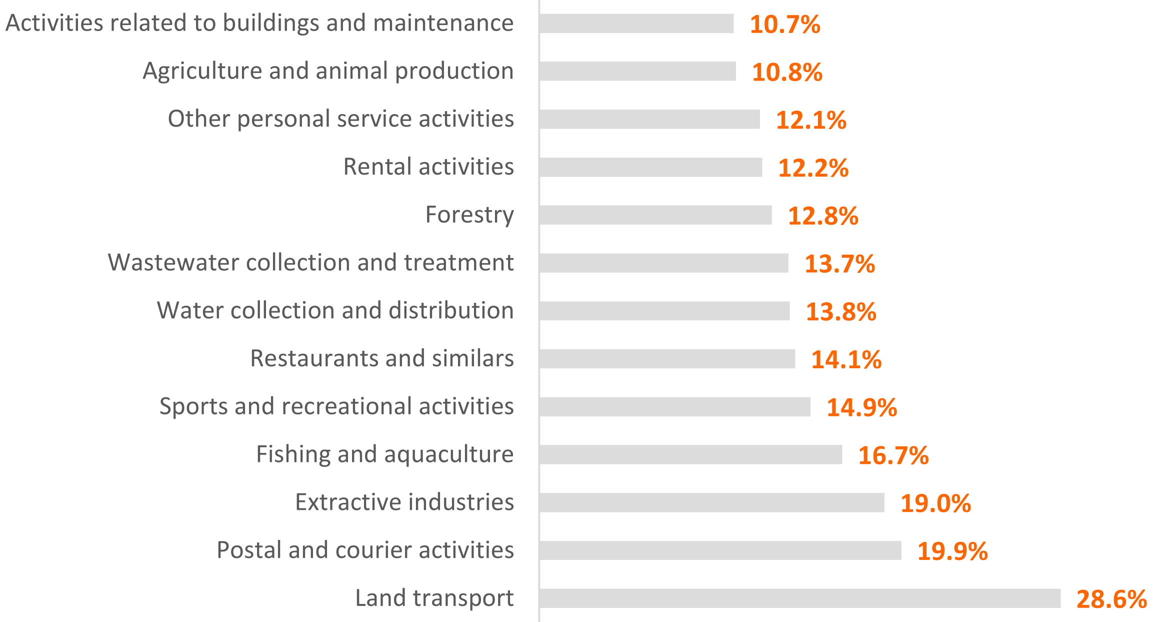
The impact of higher energy prices is heterogeneous among sectors

National accounting structure by sector
% of production



Weight of energy costs
% of the total production of each sector

Total economy: 7%

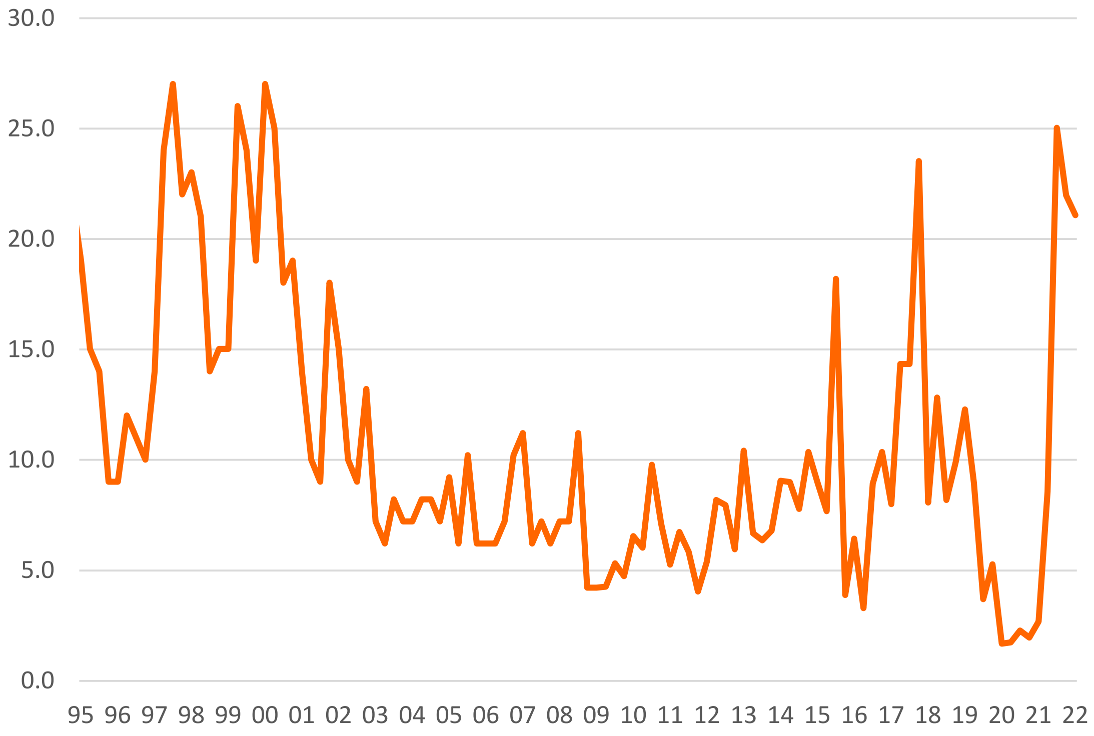


***Source**: Caixabank Research, from INE.*

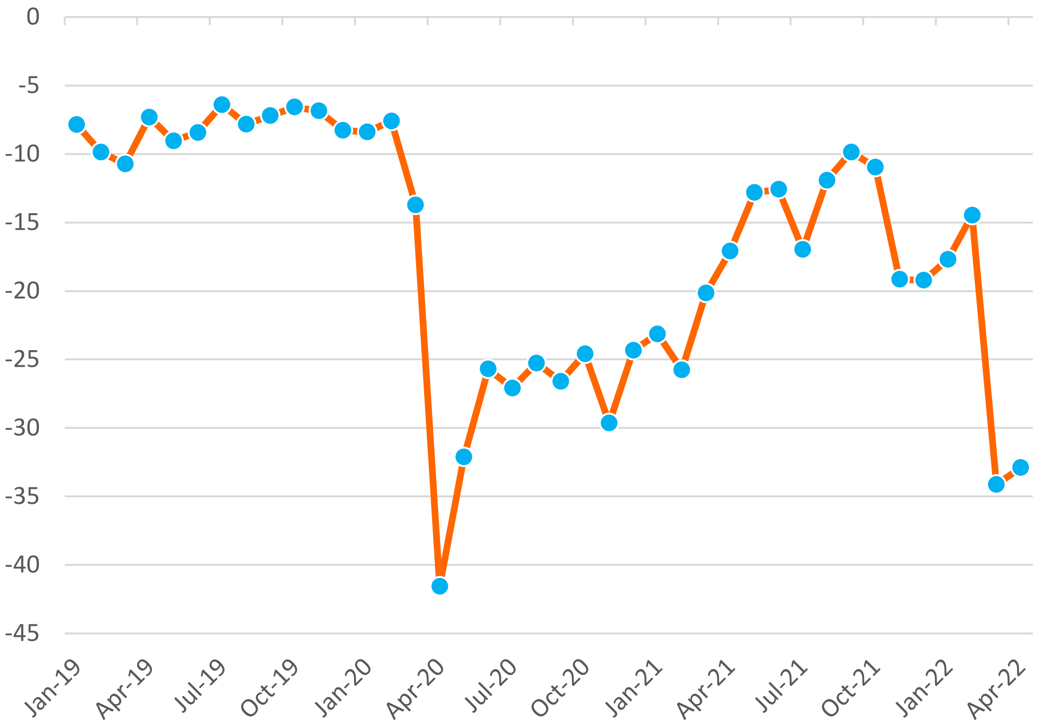
- **The war has caused a shock in energy prices, but also in the prices of other raw materials such as industrial metals (Russia is a key producer on a global scale) and agricultural products (Ukraine is one of the main exporters of cereals in Europe). The exposure of the Portuguese economy to price 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 sectors is very diverse.**

Conflict in Ukraine affects confidence and pressures inflation

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



Consumer confidence
Level



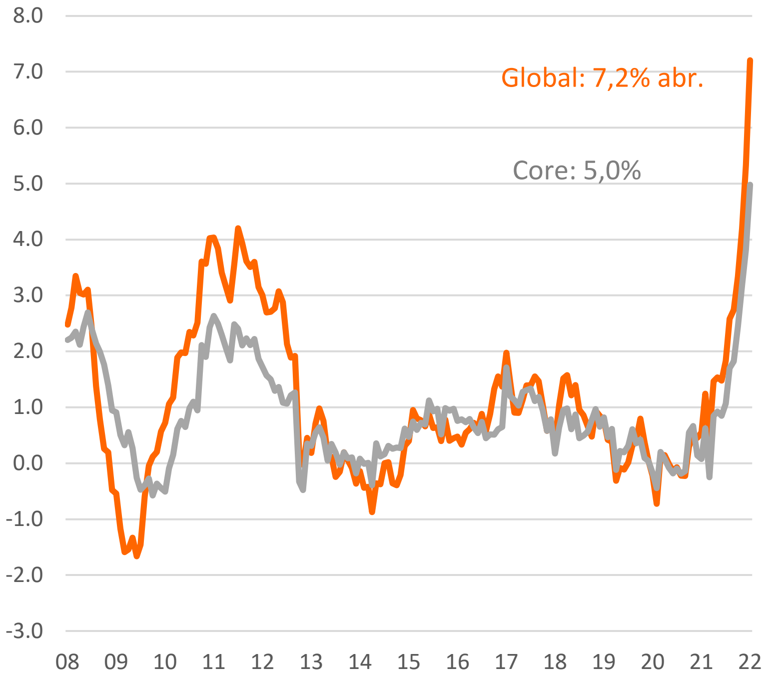
***Source**: BPI Research, from INE.*

- **Shortage of raw materials continue to be referred as an important obstacle to activity,** raising risks for the supply side activity of the economy**.** Manufacturers continues to report the lack of inputs as one of the main constrains to production.
- **Consumer confidence slumped in March and remain at low levels,** reflecting the impact of higher inflation and concerns about labor market performance in the next months.

Inflation accelerates to 7,2% in April, a maximum since 1993

The global and core inflation

Year-on-year (%)



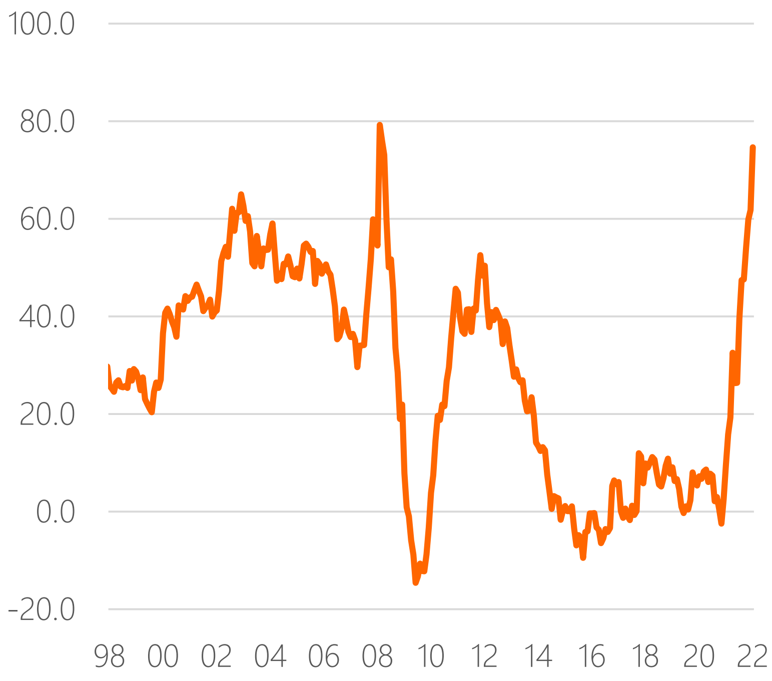
Contributions for global inflation

Year-on-year (%); percentage points

	CPI	Contribution
Core	5,0%	4,0 p.p
Unprocessed food	9,5%	1,1 p.p
Energy	26,7%	2,2 p.p
Global inflation	7,2%	

Consumer confidence, price component

points



Source*: BPI Research, from INE.*

- **Inflation accelerated again in April** to 7,2% (5,2% in Mar.), driven by higher prices on energy component (detail still not available). Additionally, high energy prices 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 5,0%, from 4,3% in March. **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 €1,6bn euros (0.7% of GDP), includes €0,5bn in credit lines

To cushion the impact on households

- **Most vulnerable families:** support of €60 in order to mitigate increase of prices of basic necessities + support of 10€/month to acquisition of bottled gas. Estimated tax cost: €55 mln.
- AutoVoucher - 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% and fiscal neutrality. Estimated tax cost: €287 mln/month.
- Temporary suspension of the carbon tax. Cost: €360 mln.
- Reduction in tariffs for access to electricity networks

Sector related measures

- **Agriculture and livestock**: reduction or exemption of oil tax on agriculture oil; support to mitigate increased costs with animal feed and fertilizers. Total €65 mln. Lines of credit: for the swine and milk sectors: €9 mln; for dry support: €50 mln.
- **Transport sector**: support to mitigate impact of higher fuel prices (30 cents/lt). Cost: € 75mln. Support to public transports.
- **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.

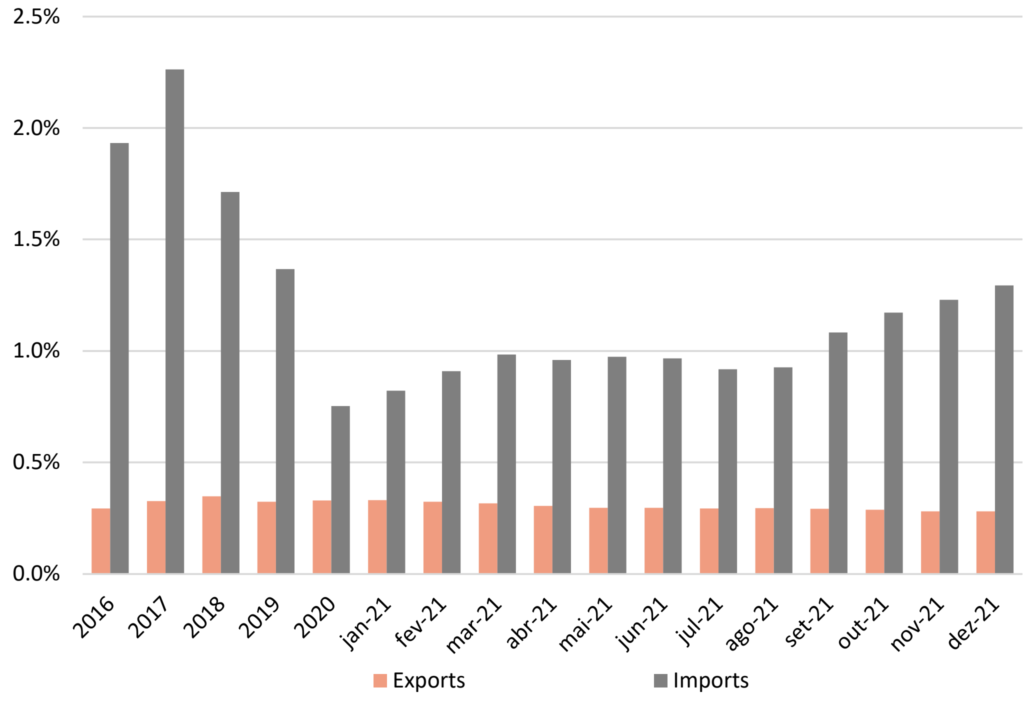
Others

- 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

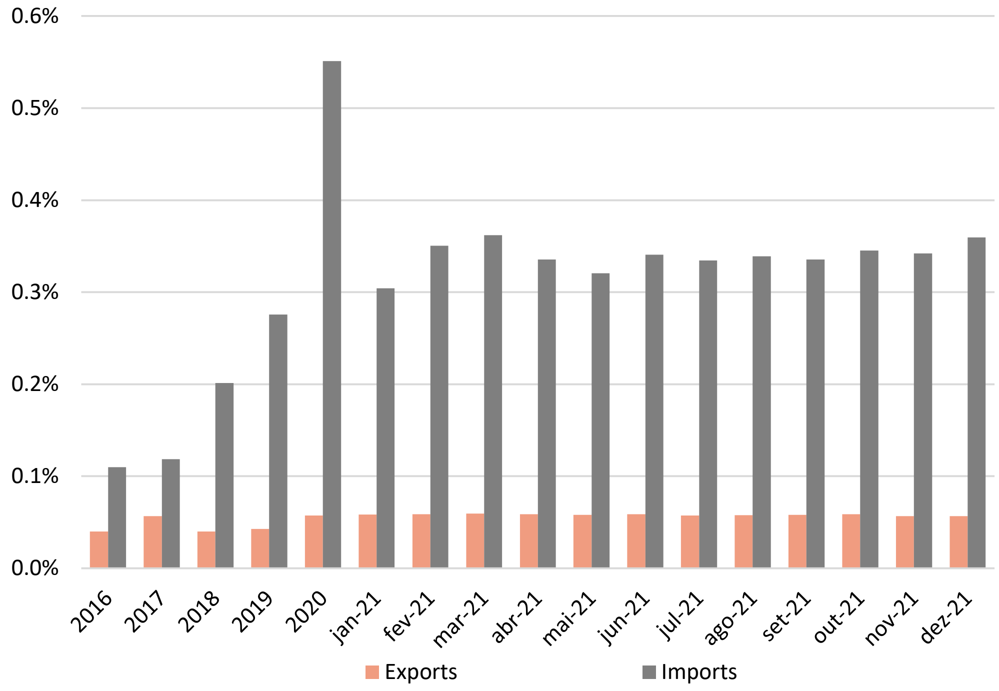
Trade balance with Russia

Weight in total exports and imports (accumulated 12 months)



Trade balance with Ukraine

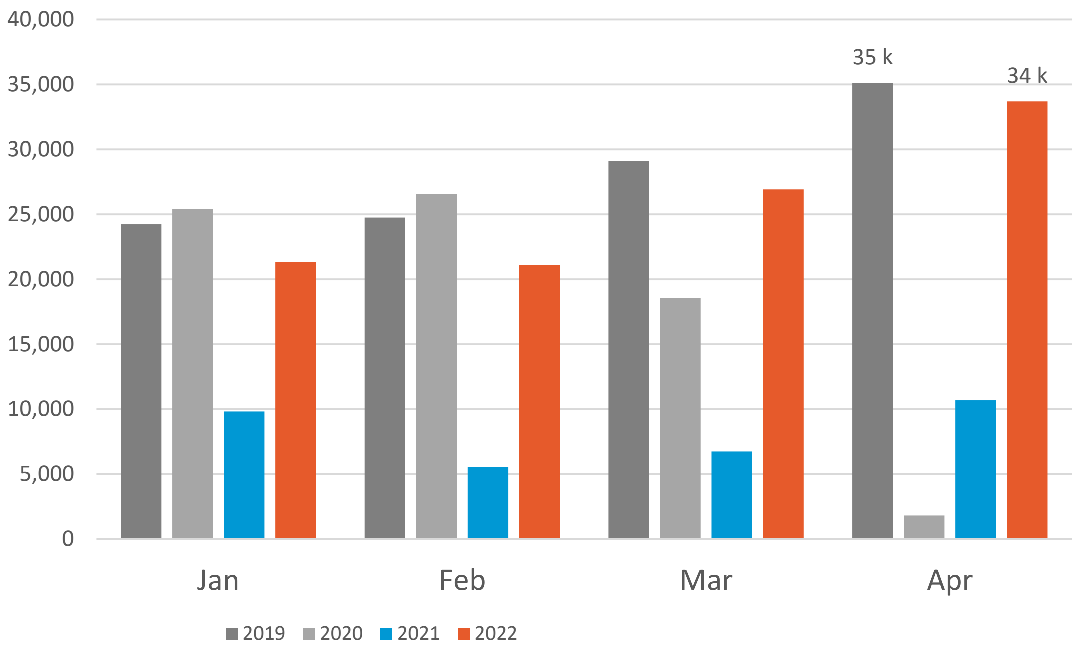
Weight in total exports and imports (accumulated 12 months)



- 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.

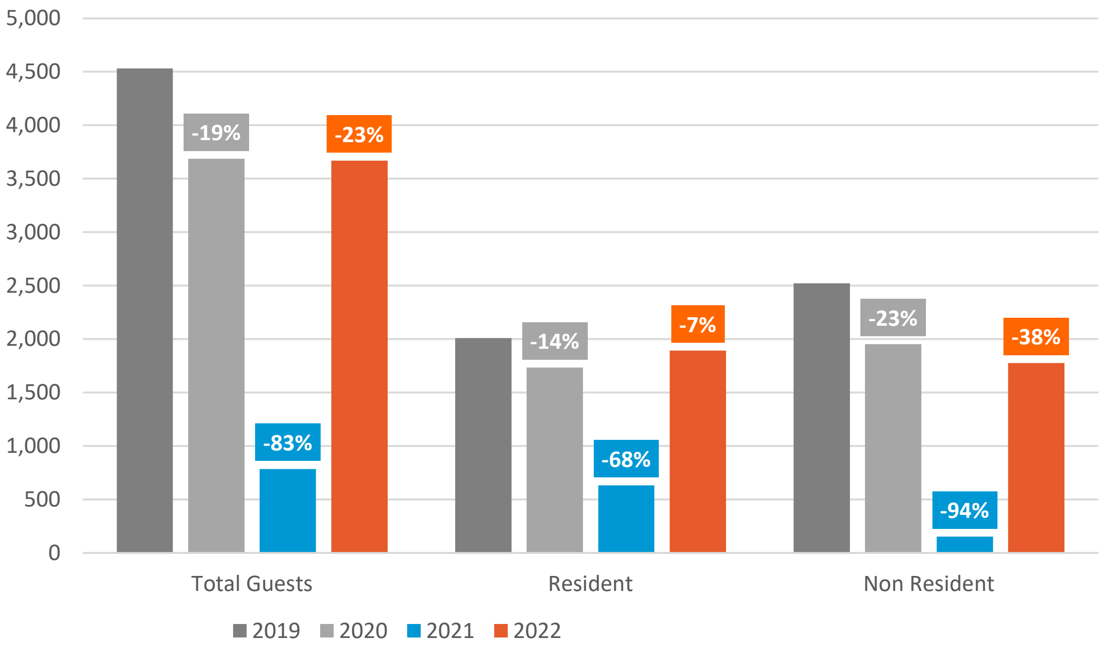
Tourism should recover as vaccines demonstrate their effectiveness

Number of flights, by month
Number



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

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



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

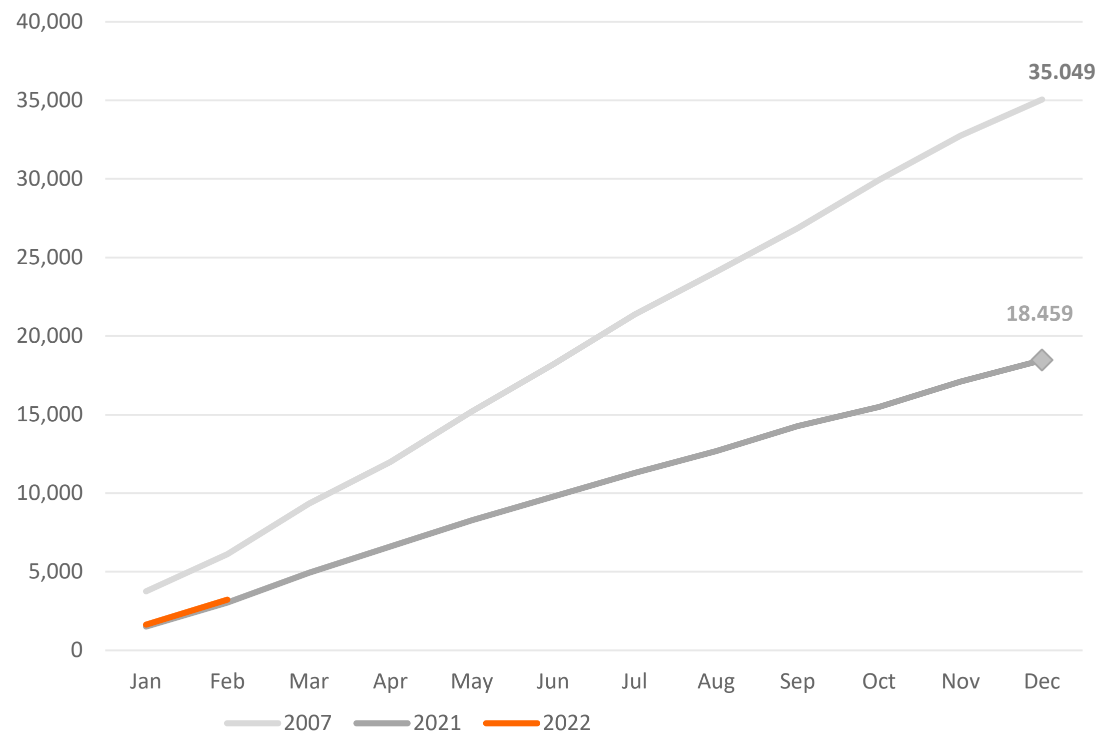
- **Tourism has been the sector hardest hit by the pandemic:** in 2021, the number of tourists reached 14.5 million, 39% more than in 2020, but still 46% below 2019. In the last months, the number of international tourists visiting Portugal has been increasing at a strong pace, reducing the gap between Q1 2022 and Q1 2019 to 23%. Domestic tourism (40% of total tourism demand in pre-covid era) remains 7% 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

BPI Grupo CaixaBank

Licenses to build new dwellings

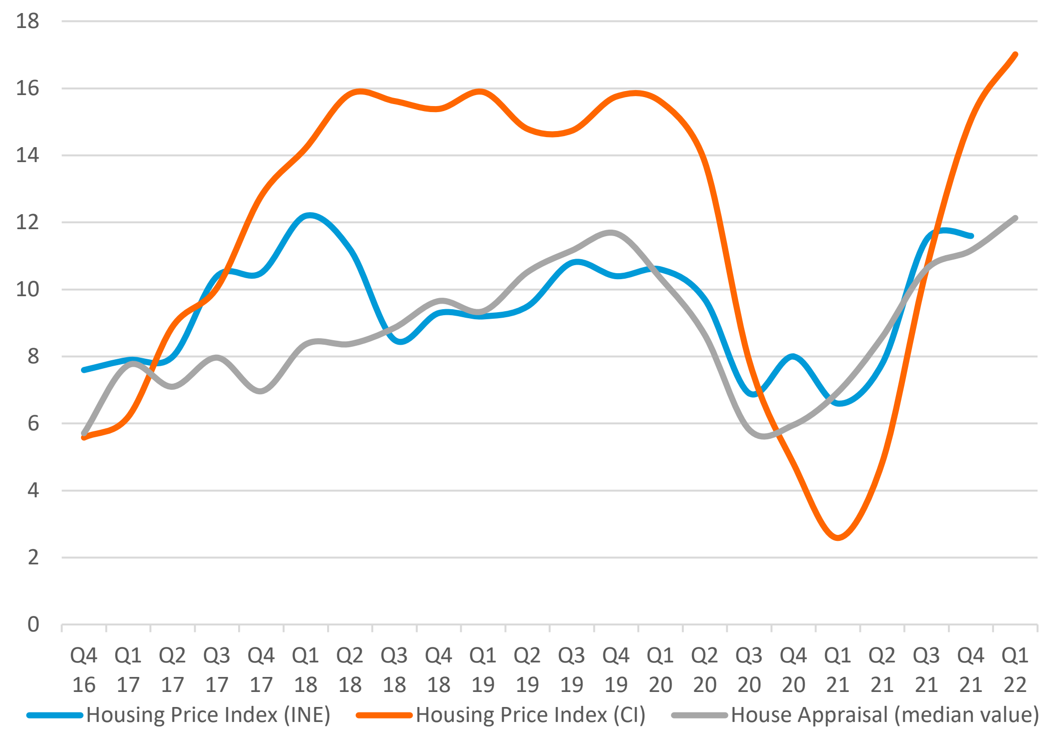
Units accumulated in the year



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. First data for 2022 suggests strong dynamics persisted in 1st quarter, with a visible moderation in most trends in March and April. However, demand continues supported and the main concern is the lack of supply, especially in major cities and Algarve.
- Going forward, **the market should continue resilient as there are no signals of oversupply. On the other hand, prices are expected to moderate in the future**, 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.

The Government Budget Plan 2022: focused on consolidation

Government's draft budgetary plan 2022

Key elements	% GDP 2019	% GDP 2021	% GDP 2022	2019-2022 change (EUR millions)	2019-2022 growth rate (%)
Total revenue	**42.6**	**45.3**	**44.7**	**10,224**	**11**
Indirect taxes (VAT,...)	15.0	15.3	15.2	2,369	7
Taxes on income and wealth	9.7	9.7	9.6	941	5
Social contributions	11.8	12.8	12.5	3,040	12
Total spending	**42.5**	**48.1**	**46.6**	**14,874**	**16**
Worker salaries	10.8	11.8	11.4	2,635	11
Social transfers	18.1	19.6	18.9	4,178	11
Interest payments	3.0	2.4	2.2	-1,324	-21
Balance	**0.1**	**-2.8**	**-1.9**	**-4,650**	

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

Government reinforces the commitment to consolidate public accounts; after the positive surprise recorded in 2021 (with the public deficit declining to 2.8% vs. 4.3% expected), the Government forecasts a deficit of 1.9% of GDP in 2022.

Revenue

- Government expects to reach 44.7% of GDP in 2021, more 2.1 p.p. than in 2019.
- Social contributions are forecasted to reach 12.5% of GDP (11.8% in 2019), reflecting goods prospects for labor market.
- Excluding revenues related with NG EU funds, revenues weights 43,4% on GDP.

Spending

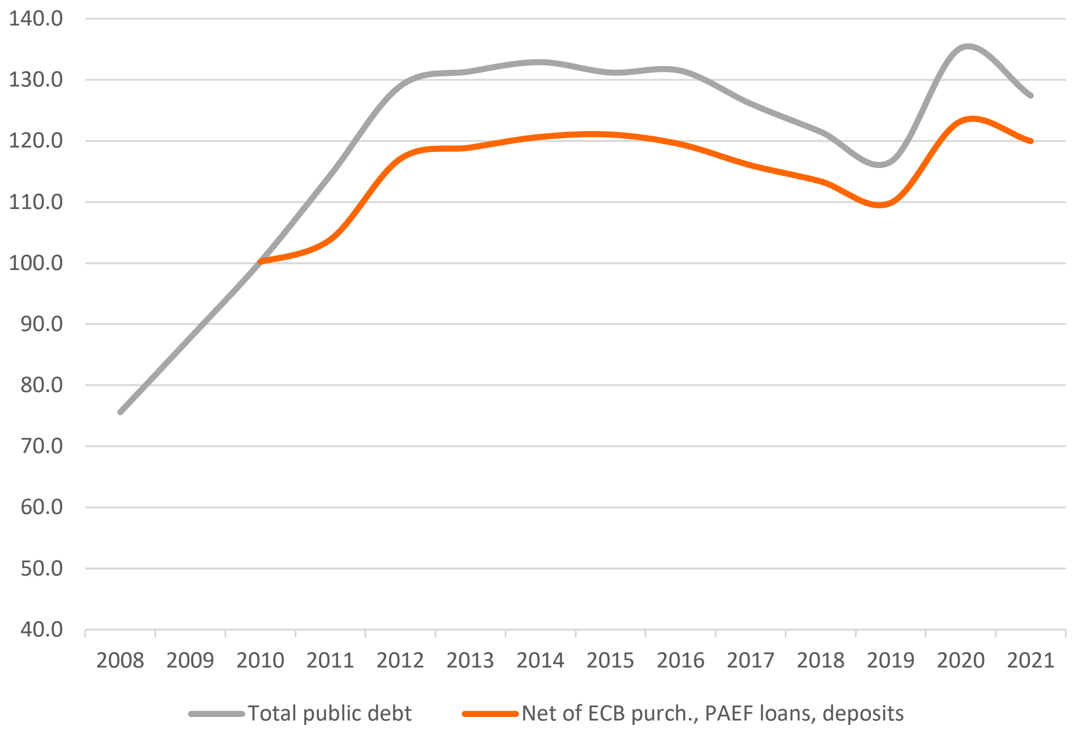
- Increase expected due to social benefits (which includes an extraordinary update of pensions), personnel expenses (update of public administration salaries by 0.9%) and public investment (with the implementation of the PRR). Expenditure exceeds 2019 levels by 4.2 p.p., but also includes the impact of the pandemic (albeit to a lesser extent) and measures to mitigate the impacts of the war, namely price and cost pressures for households and companies.

Budgetary policy bias

- Restrictive according to the Government (structural balance corrects from -1.4% of GDP in 2021 to -1.2% in 2022).

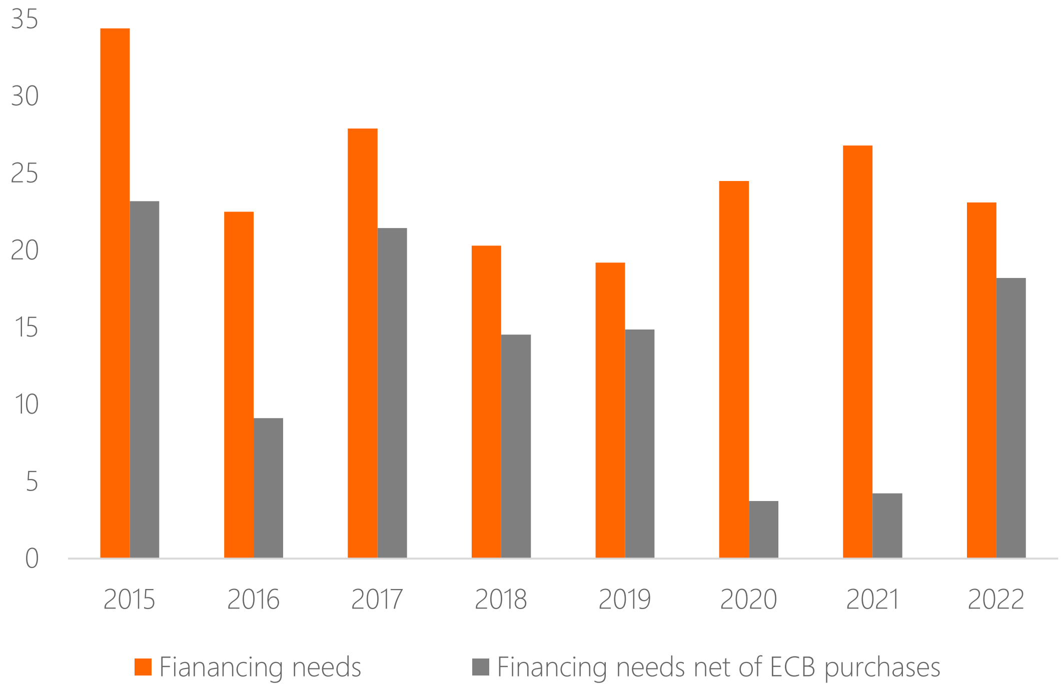
Prudent fiscal stance, the liquidity cushion and ECB reinvestments provide comfort in an uncertain environment

Public debt
(% GDP)



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

Portugal: Funding needs
(Billion euros)



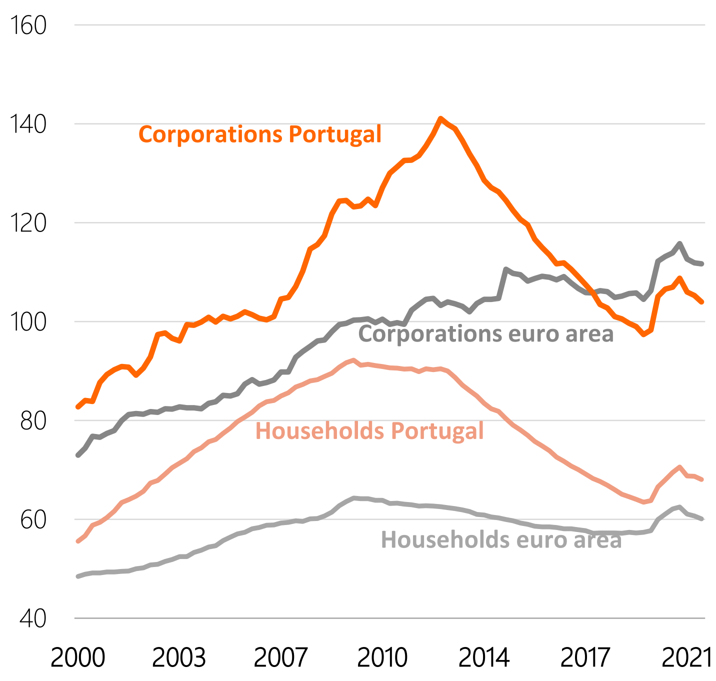
***Note (*):** Budget execution according to cash basis.*
***Source**: BPI Research based on DGO.*

- **Public debt (% of GDP) decreased by 7,7 p.p. to 127,4% in 2021,** and is forecasted to decline to 123,5% of GDP in 2022, reflecting the expected narrowing of the fiscal balance and strong nominal GDP growth. We expect fiscal deficit to reduce to 2,1% of GDP in 2022 from 2,8% in 2021 (Government is forecasting public deficit to reach 1,9% of GDP in the end of 2022), assuming BPI Research more conservative macro scenario.
- **Financing needs for 2022 amount to 23 MM€, minus 4 MM€ than in 2021. Assuming the end of the APP program in July (PEPP ended in March), ECB's net acquisition of Portuguese debt may decline to around 5 MM€, circa 20% of financing needs in 2022, pushing net financing needs not covered by the ECB to pre pandemic levels . Still, the current liquidity cushion amounts to around 19 MM€ (c. 9% of GDP) and the Treasury is forecasting its maintenance up to the end of 2022**

Private sector credit: deleveraging trend returns

Gross private debt

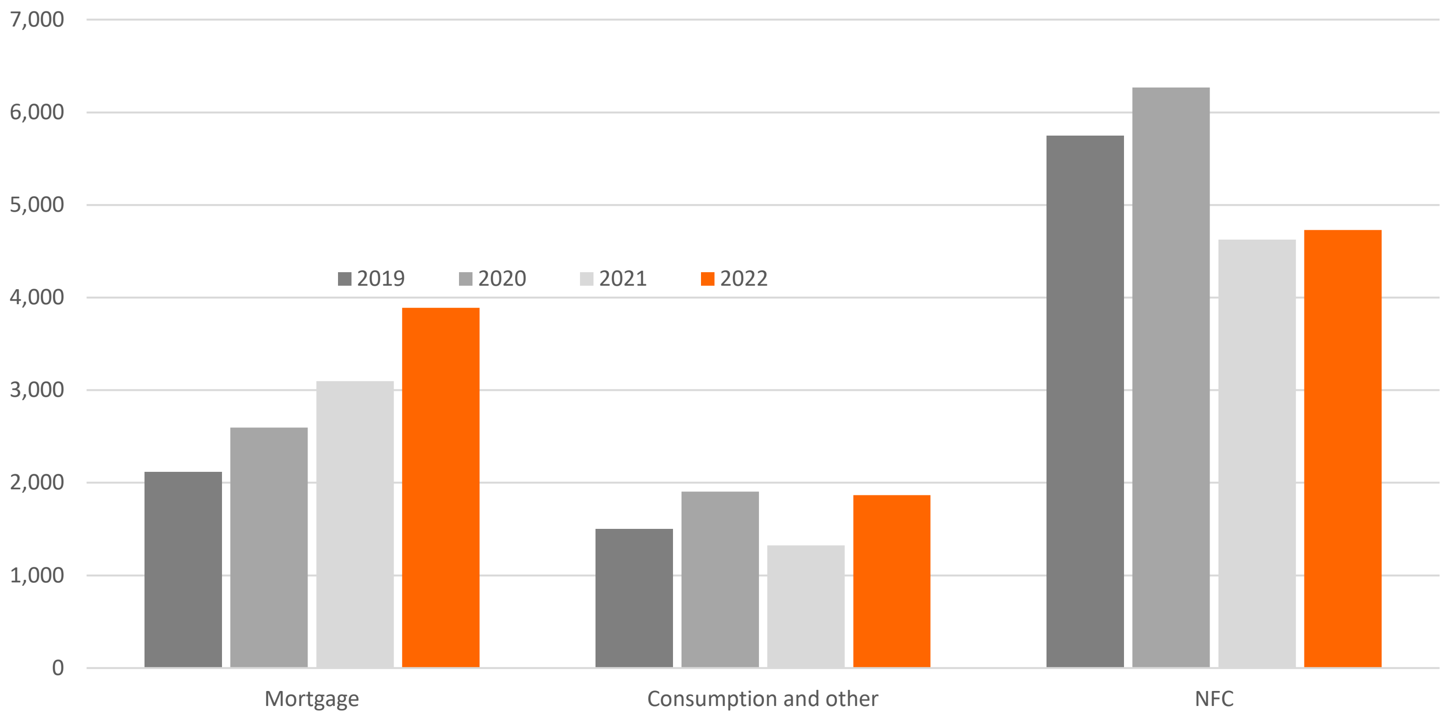
% of GDP, non consolidated debt.



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

New lending activity in March by segments

(Million euros)

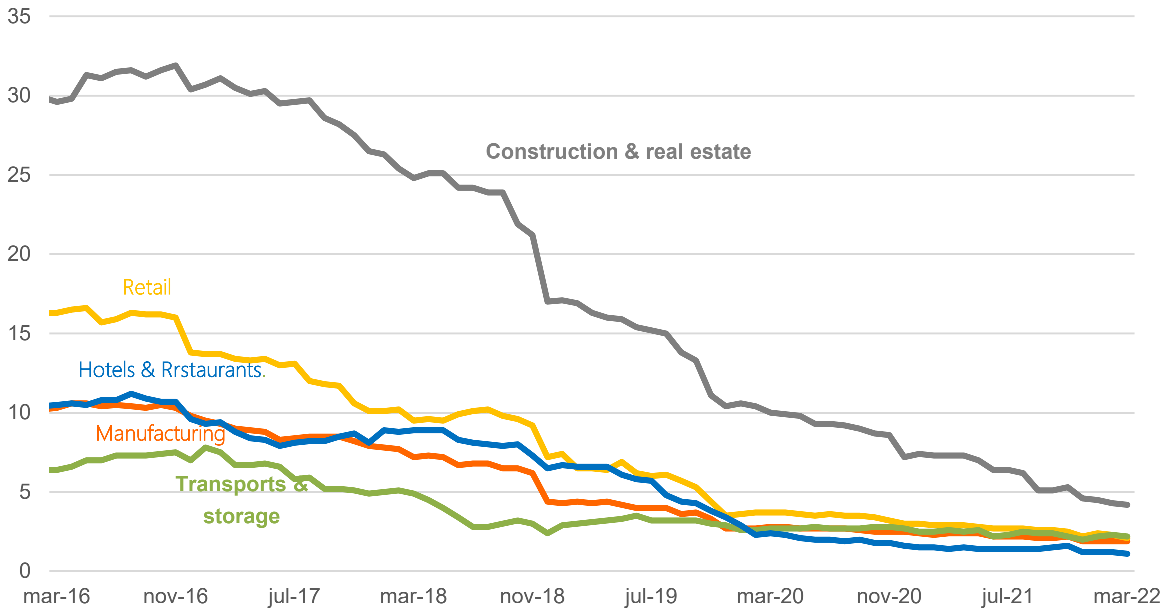


***Note:** excluding renegotiations.*
***Source**: BPI Research, based on BoP data.*

- **The end of moratorium 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). 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). New operations for **households showed a strong performance, especially on mortgage operations** (increasing housing prices, financing conditions, employment-supporting measures).
- **For Q1 2022, new operations showed a positive trend**: new credit for NFC and households increased 2,3% and 30,2%, respectively. The dynamics was especially positive in March for both mortgage credit and NFC. However, the interest rate on new mortgage credit have started to increase, reflecting the market expectations for the monetary policy normalization. This increase, as well as the setback in confidence after the Ukraine war, could cool down the new mortgage credit.

The Portuguese banking system: resilient and supporting the economy

Non financial private sector: Overdue loans
(%)



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

Private domestic credit
Year on year (%)

	Mar 2021 % yoy	Mar-2022 % yoy	2022 (For.) % yoy
Credit to the non-financial private sector	**5.1%**	**2.8%**	**-0.9%**
Households	**1.8%**	**3.7%**	**0.7%**
Housing mortgages	**2.7%**	**3.0%**	**1.3%**
Other purposes	**-1.2%**	**6.4%**	**-1.7%**
Consumer lending	**-1.5%**	**5.9%**	**0.9%**
Non-financial corporations	**11.0%**	**1.2%**	**-3.6%**

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

- **Moratorium was an important supporting measure for both households and firms in the COVID context.** Specifically in the case of companies, **credit under moratorium reached a maximum of 34,1% of total NFC credit between August and October 2020. 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	2.4	2.0	2.6	2.1	2.6	3.3	-7.1	4.5	4.1	2.5
Public Consumption	-0.6	0.8	0.8	0.2	0.6	2.1	0.4	4.1	1.8	0.2
Gross Fixed Capital Formation (GFCF)	2.3	5.9	2.5	11.5	6.2	5.4	-2.7	6.4	4.7	6.6
Exports	4.3	6.3	4.4	8.4	4.1	4.1	-18.6	13.1	11.4	12.5
Imports	7.9	8.0	5.0	8.1	5.0	4.9	-12.1	12.9	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	-2.1	-0.9
General government debt (% GDP)	132.9	131.2	131.5	126.1	121.5	116.6	135.2	127.4	121.0	117.5
Risk premium (PT-Bund) (average)	252	189	307	269	138	98	89	60	94	105

Source: *BPI Research.*

BPI

Grupo CaixaBank