Prepared with information available by March 7th, 2023

Portugal:

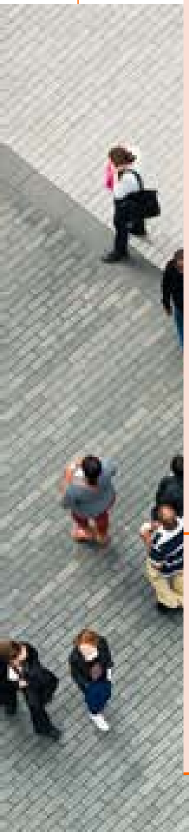
Macroeconomic and financial outlook

BPI *Research*

March 2023

BPI Grupo CaixaBank

Main messages



Activity

- **Annual GDP grew 6,7% in 2022.** Exports and consumption were the components that most contributed to this strong pace of growth that brought the Portuguese GDP to 3,3% above the 2019 level. 2023 will be a tough year due to the existence of strong headwinds coming from persistent inflation and interest rates, but a recession should be avoided as Portugal is less vulnerable than central and northern Europe to high energy prices: the proportion of renewables in the primary energy mix is higher; dependence on Russian gas is low (2021: total energy imports from Russia represented 8% of total energy imports); and also due to the capacity to receive LNG (port of Sines) and due to the existence of long term contracts with different gas providers. Comparatively less heavy energy intensive industrial sector is also a plus in the current scenario. First data for 2023 seems to confirm a more resilient activity than predicted some months ago.
- **Inflation decelerated in February for the fourth month in a row,** to 8,3% yoy, -0,1 p.p. than in January; but the core inflation rose to 7,2% from 7% in January, confirming the sentiment that the disinflationary process will be very gradual, reflecting the contagion of high energy prices to other products. We predict that inflation may stay around 5% in 2023.
- **High frequency indicators related to the tourism sector confirm strong recovery.** Recovery from pre-pandemic levels is still not complete: in 2022, guests were still 2.3% and overnight stays 0.9% below 2019 levels – but in 2023, these numbers are expected to be surpassed.
- **Housing market is showing signs of deceleration,** with new mortgage loans declining at the beginning of 2023 and professional's confidence being more prudent about sales and prices. Tighter financial conditions should undermine demand, especially in 2023, reason why we expect a small decline on prices this year and a reduced number of transactions.
- **Public accounts are having a very good performance, one of the factors behind recent improvements of sovereign debt risk evaluations (rating improved by one notch, by S&P's and Fitch to BBB+, DBRS to A).** On a cash basis, public balance registered a deficit of 1,5% of GDP in 2022, which compares to -4,0% and -0,3% in 2021 and 2019, respectively.
- **In 2023, public deficit is expected to decline to 0,9% of GDP** from 1,9% in 2022 (we estimate that it will probably be lower). The prudent fiscal stance was already apparent in the performance of public debt in 2022, that fell to 113,8% of GDP, trend that is expected to continue in 2023. According to the IMF in a scenario of unchanged policies, public debt is seen to fell below 100% in the medium term. At last, the public administration liquidity cushion (which includes the Treasury cash buffer) amounts to circa €17 bln (≈8% of GDP), the same amount as registered in 2019.

Banking Sector

- **Credit quality indicators improved further in Q3 2022 and we evaluate risks related with higher interest rates as contained.** Indeed**,** macroprudential measures are relatively tight. Recently, additional measures were taken in order to reduce the maturity of housing loans; also, before granting a loan, banks have to communicate the impact on the debt service of an hypothetical increase of interest rates by 300 basis points on mortgages loans. Additionally, the strong position of the labour market, expected to worsen only moderately, and the improved position of households and firms in terms of leverage, also suggest that the interest rate impact on credit quality might be moderate, in a context of a strong position of the banking sector.

Main economic forecasts

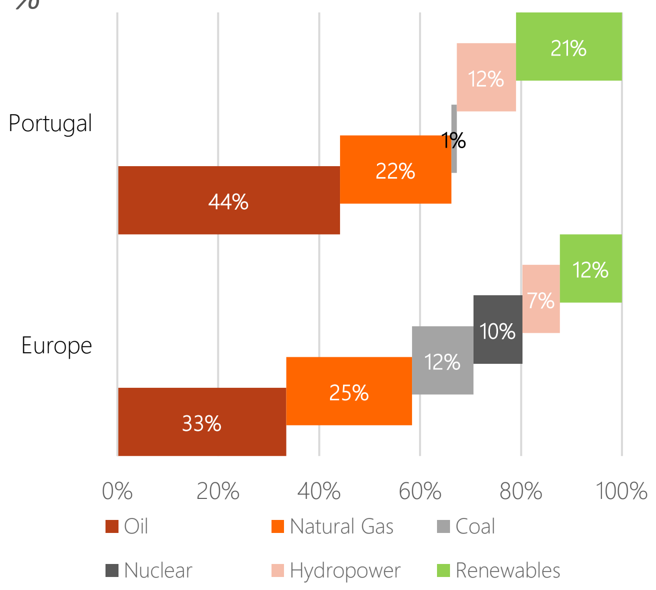
%, yoy	2016	2017	2018	2019	2020	2021	2022	Forecasts 2023	Forecasts 2024
GDP	2.0	3.5	2.8	2.7	-8.3	5.5	6.7	1.0	2.1
Private Consumption	2.6	2.1	2.6	3.3	-7.0	4.7	5.7	0.4	0.9
Public Consumption	0.8	0.2	0.6	2.1	0.4	4.6	2.4	1.0	1.0
Gross Fixed Capital Formation (GFCF)	2.5	11.5	6.2	5.4	-2.2	8.7	2.7	4.4	8.2
Exports	4.4	8.4	4.1	4.1	-18.8	13.4	16.7	4.3	6.1
Imports	5.0	8.1	5.0	4.9	-11.8	13.2	11.0	4.7	6.3
Unemployment rate	11.4	9.2	7.2	6.6	7.0	6.6	6.0	6.4	6.1
CPI (average)	0.6	1.4	1.0	0.3	0.0	1.3	7.8	5.5	2.8
External current account balance (% GDP)	1.2	1.3	0.6	0.4	-1.2	-1.2	-1.4	-0.6	-0.4
General Government Balance (% GDP)	-1.9	-3.0	-0.3	0.1	-5.8	-2.9	-1.1	-0.9	-0.8
General government debt (% GDP)	131.5	126.1	121.5	116.6	134.9	125.5	113.8	109.7	106.2
Risk premium (PT-Bund) (average)	307	269	138	98	89	60	98	103	102

Source: *BPI Research*

Energy mix with more renewables provides a buffer against volatile environment

Primary energy source

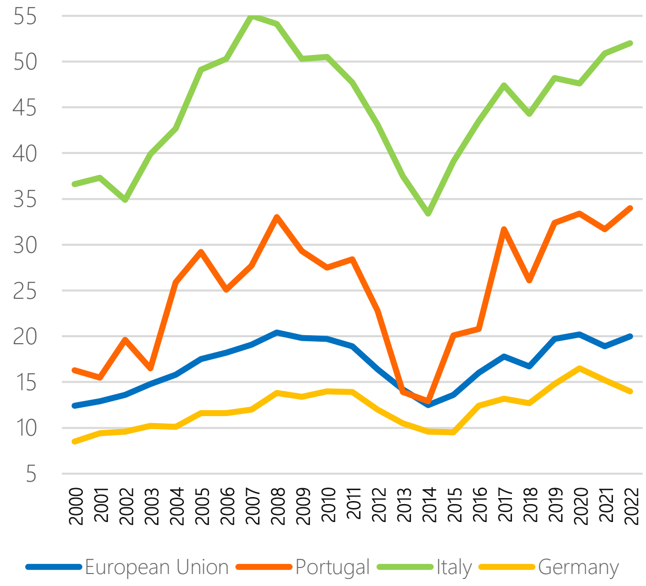
%



Source: BPI Research, using data from Our World in Data,

Share of electricity generated by gas

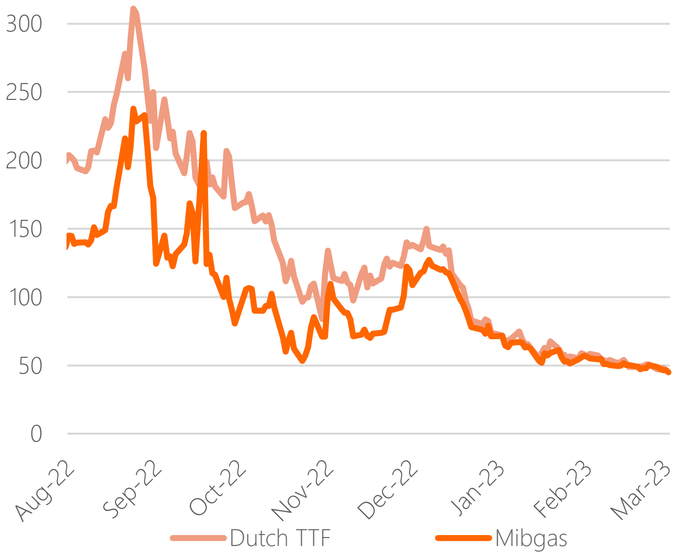
%



Source: BPI Research, using data from Our World in Data and Eurostat,

Natural gas price: Dutch TTF *versus* Mibgas

Eur/MWh



Source: BPI Research, using data from Bloomberg,

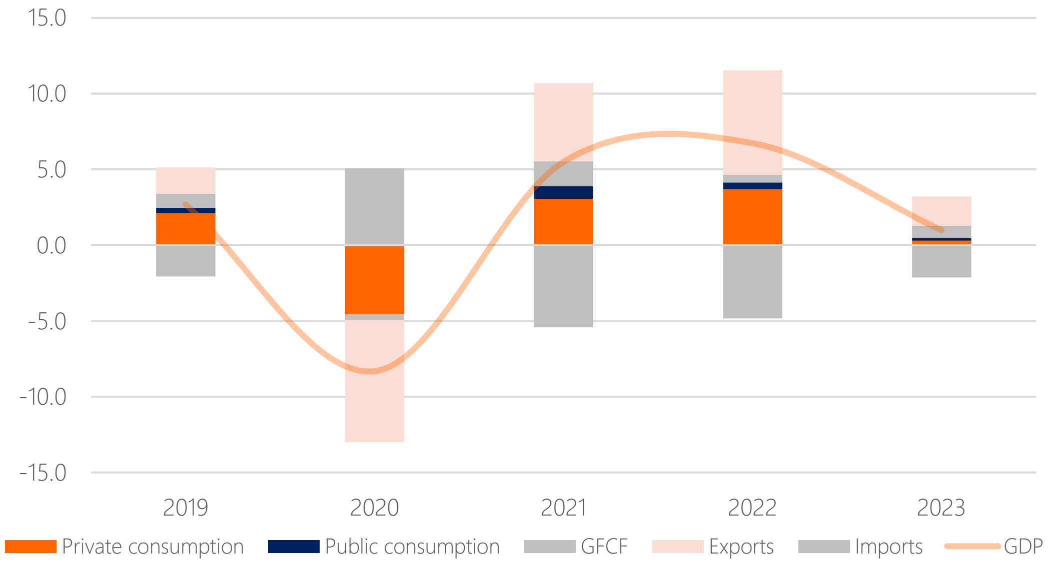
- **Compared to the rest of Europe, Portugal is more dependent on oil as a primary energy source (44%).** On the other hand, the energy component via renewable energies is also substantially higher.
- **In 2022, natural gas was the source of 34% of the electricity produced (increasing from 31% in 2021)**, in part this was because electricity production using hydropower fell by 45% in 2022 as a result of the drought in the country. This means that the country is also exposed to the price of gas, which has experienced a sharp increase on international markets in the context of geopolitical tension with Russia and war with Ukraine. It is now trading at around 50 eur/MWh, due to the warm winter so far, energy saving measures at EU level and coordinated policy and diversification of providers.
- **The gap between the reference gas price in the European market (Dutch TTF) and the reference price in the Iberian gas market (Mibgas) is narrowing.** The difference registered during 2022 was justified by the fact that the closure of gas pipelines in Russia has turned the European gas market into a market with a preponderance of LNG (liquefied natural gas). Unlike the Iberian Peninsula, which has ample capacity to receive LNG, the rest of Europe still does not have sufficient infrastructure to receive and gasify the gas it needs.

GDP: after exceptional growth in 2022, the economy will decelerate in 2023, but the year is starting with positive signals…

Grupo CaixaBank

GDP Growth and contribution by components

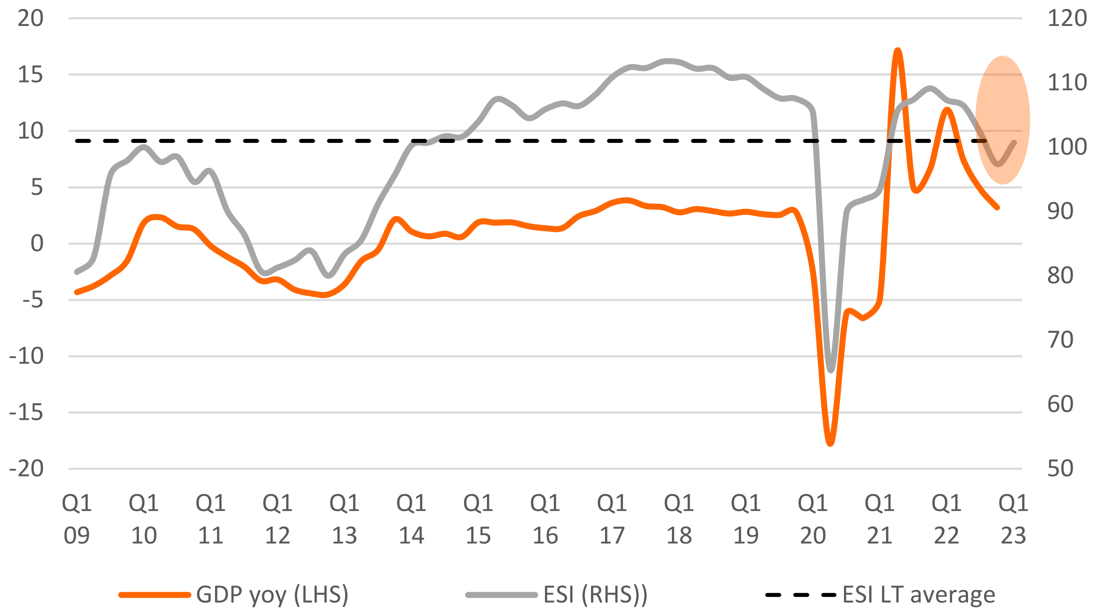
Yoy, p.p.



Source: BPI *Research, from INE*

GDP & EC Sentiment indicator

Yoy, level



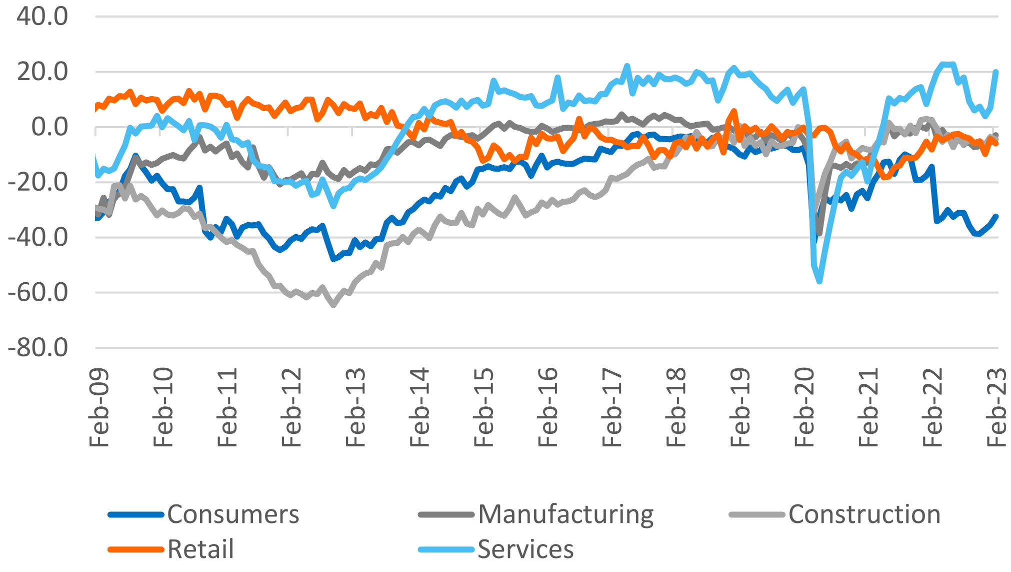
- **Confirmed growth of 6.7% in 2022.** Exports and consumption were the components that most contributed to this result, reflecting the strong increase in tourism activity and the recovery in the consumption of durable goods, namely in the automobile component within the apparent reduction of global supply chain constraints related with the pandemia; expenditure on non-food goods and services also evolved positively, while expenditure on food goods contracted 2.3%. In 2022, GDP reached 3,3% above 2019 levels.
- **Meanwhile, indicators published regarding the first months of 2023 suggest that the economy continues resilient.** Deflated retail sales rose 3.7% year-on-year in January; car sales, in February rose 38% year-on-year, after having advanced 47.7% in January. On the supply side, the indicators are also positive, with industrial production growing 4.5% year-on-year in January (1.7% excluding the energy component). Finally, sentiment indicators recovered again in February, with the economic climate indicator advancing 2.2% year-on-year and consumer confidence recovering to levels closer to the summer months of 2022 (Feb-23: -32.5; Jan-23: -35.4; Aug-22: -31.1).
- First data for 2023 puts some upside risks to our forecasts of 1% growth in 2023.

… and risks of contraction look lower now than some months ago

Economic indicators *% mom, qoq*	**Q1 2023**	**Q4 2022**	**Last month**
Employment (change 1000 individuals)	-19,2	-8,3	January
Unemployment (change 1000 individuals)	24,5	15,1	January
Retail sales (deflated)	-1,7	0,2	January
Car sales *(ACAP)*	7,6	5,4	February
Fights *(yoy)*	20,3	22,3	February
Overnight stays *(yoy same month 2019)*	14,4	5,7	January
ESI *(historical average ~100)*	100,7	97,7	February

Source: BPI Research, from BdP, INE, EC

Confidence indicators
Level



- **Consumption is being supported by an increase of durable goods consumption, namely cars.**
- **Labour market remains strong, but first signs of weakness are appearing:** most recent data shows a deterioration in unemployment.
- **Accumulated savings during pandemic,** (~2% of GDP) will continue to partially accommodate at least some of the adverse impact of higher inflation and higher interest rates in the coming quarters. However, it should be recalled that most of these savings are probably more concentrated in top-income households with lower propensity to consume. Even if that is the case, this should provide at least a buffer to the evolution of private consumption going forward.
- **Sentiment indicators**: in February, the sentiment improved in all sectors: industry, retail, construction, services and consumers.

Despite the challenges ahead, GDP is more than 3% above pre-Covid

Bank of Portugal December economic scenario vs BPI scenario

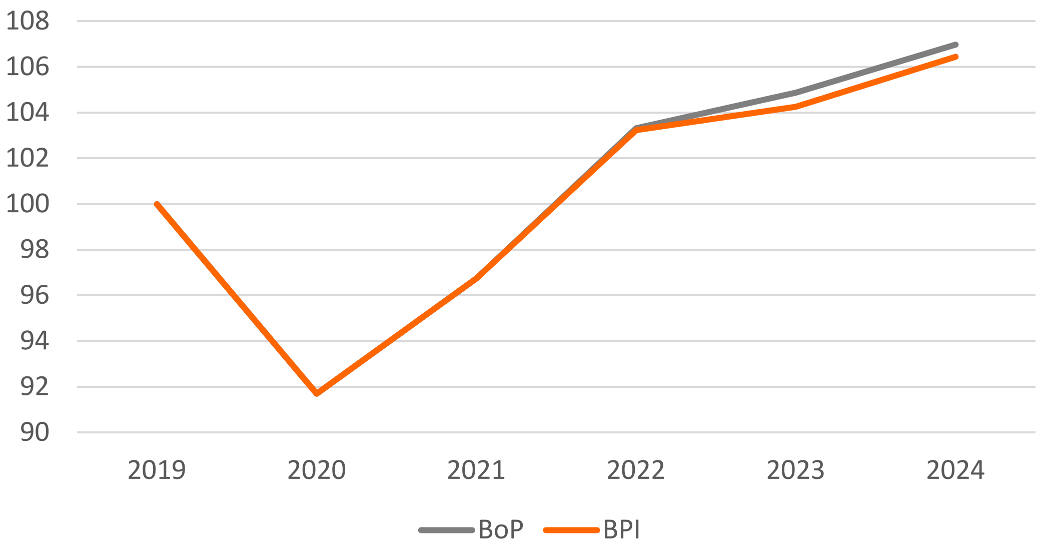
%

Portugal		2021	2022	2023	2024	Accum. 22-24
GDP	BoP Dec-22	5.5	6.8	1.5	2.0	10.6
(annual, %)	*BoP Dec-22 (adverse)*		*6.8*	*-0.4*	*0.3*	*6.7*
	BPI Jan-23		***6.7***	***1.0***	***2.1***	***10.0***
Unemployment rate	BoP Dec-22	6.6	5.9	5.9	5.9	-0.7
(annual average, %)	*BoP Dec-22 (adverse)*		*5.9*	*7.1*	*7.9*	*1.3*
	BPI Jan-23		***6.0***	***6.4***	***6.1***	***-0.5***
Inflation rate[1]	BoP Dec-22	1.3	8.1	5.8	3.3	18.1
(annual average, %)	*BoP Dec-22 (adverse)*			*8.0*	*5.1*	*22.7*
	BPI Jan-23		***7.8***	***5.5***	***2.8***	***16.9***

BoP forecasts are for the HCPI; BPI forecasts for the CPI; for unemployment, the cumulative 22-24 is computed as the difference between unemployment in 2024 vs unemployment in 2021

GDP Growth

Level, 2019=100



- **BPI continues more conservative for growth in 2023; first data for 2023 suggests that deceleration may be more moderate than previously predicted.** Risks to our scenario seem balanced for now.
- **According to the Bank of Portugal scenario:**
  - GDP will advance 1,5% in 2023 (-1,1 percentage point than forecasted in June). High level of global uncertainty, loss of purchasing power, higher financing costs and weaker external demand are the factors behind the strong deceleration estimated for 2023, affecting mainly private consumption.
  - Inflation will stay higher for longer; return to 2% postponed to 2025. The accumulation of global shocks and spillover effects from energy and food prices to most components of the basket will translate to higher levels of inflation during more time.
  - Unemployment rate is predicted to remain stable, despite the strong deceleration of growth, reflecting difficulties in hiring.
  - **Uncertainty is very high and risks are negatively biased for growth and upward biased for prices.** Materialization of risks (adverse scenario) – total cut in gas and oil supplies from Russia to Europe, slower substitution by other energy sources, and a colder than usual winter – may led to the contraction of growth in 2023 and to higher levels of inflation.

Labor market remains robust but there are some signals of reversal

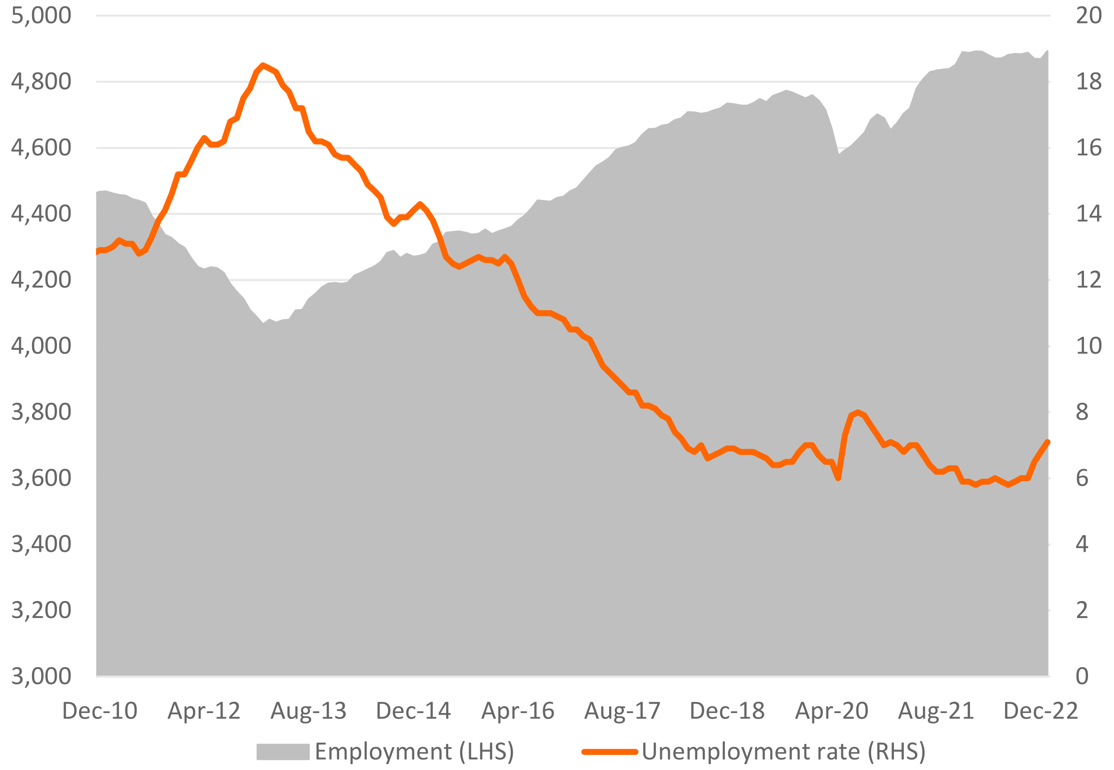
Registered unemployment*

Thousand people

***Note (*):** not seasonally adjusted.*
***Source**: BPI Research, from IEFP.*

Employment population and unemployment rate

Thousand people *(%)*



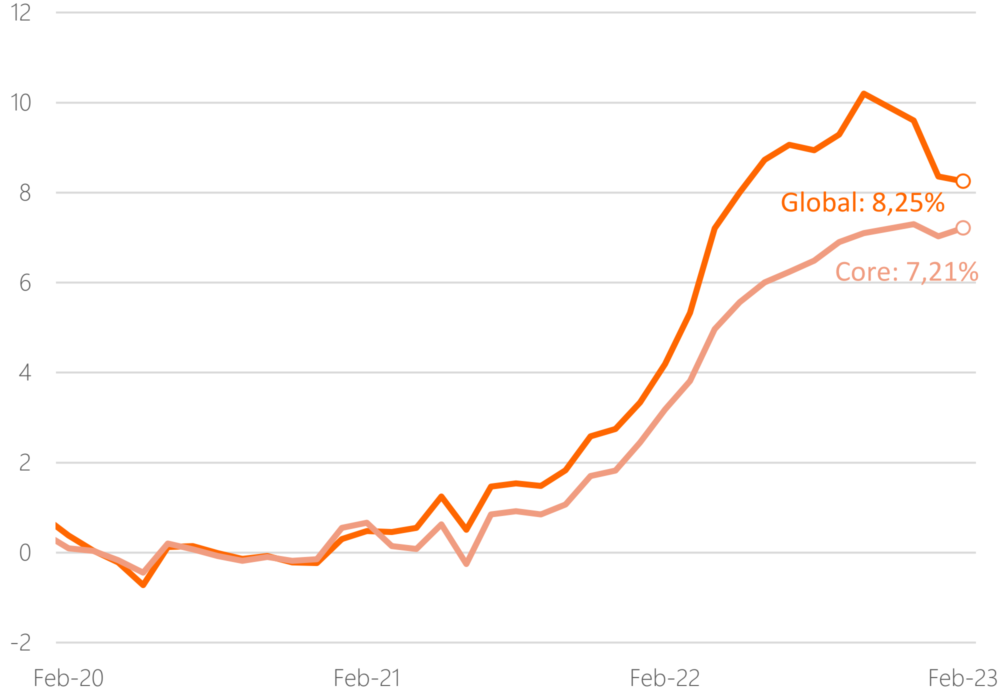
***Note:** Seasonally adjusted.*
***Source**: BPI Research, from INE.*

- **Registered unemployment maintained the upward trajectory at the beginning of 2023**, although it remains at low levels in comparison to the past. **Some sectors have shown more alarming dynamics**, such as construction and accommodation & catering. At the same time, **unemployment rate increased for the third consecutive month**, to 7,1% in January.
- However, **employment continues at maximum levels** (considering the monthly data)**, confirming the tight labor market**. Additionally, **the inactive population recorded the minimum level in January**, which means that labor market continues to attract the discouraged people.

Inflation: Global CPI down again in February but this is the only good news

Portugal CPI: Global & Core

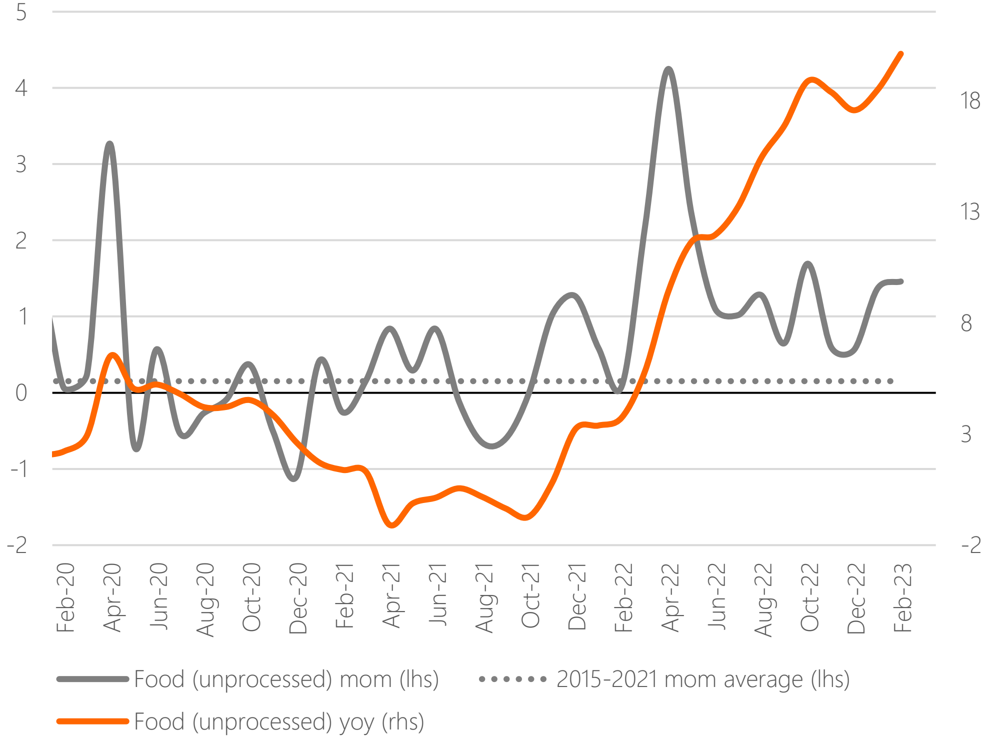
Year-on-year (%)



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

Food (unprocessed) CPI

Mont-on-month and Year-on year (%)

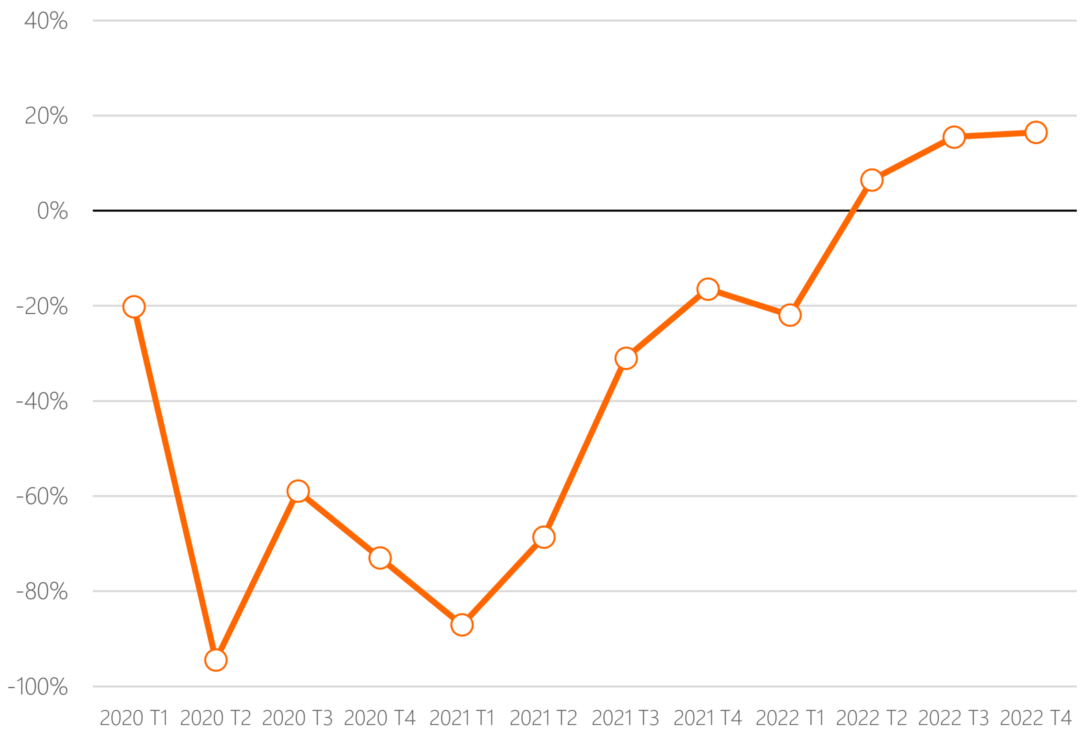


- **In contrast to what happened in some of the Euro Zone major countries (Germany, Spain and France, for instance), the Consumer Price Index for February 2023 decelerated for the fourth consecutive month, to 8.25% year-on-year, 0.11 p.p. less than in January.** This decrease was again supported by the energy component that fell by 2.2% in monthly terms.
- **Core inflation picked up again to 7.2% after the January halt.** This component had risen for 15 consecutive months up to January. The progress in core inflation (both at a national and euro area level), underlines the inertia of inflation at high levels and continues to justify ECB action.
- **Food prices keep a strong upward trajectory (20.1% year-on-year, compared to 18.5% in January)**. The pace of the price increase in this component was strong in February (+1.46%) and well above the 2015-2021 monthly average (0.15%).

Tourism: good start in 2023

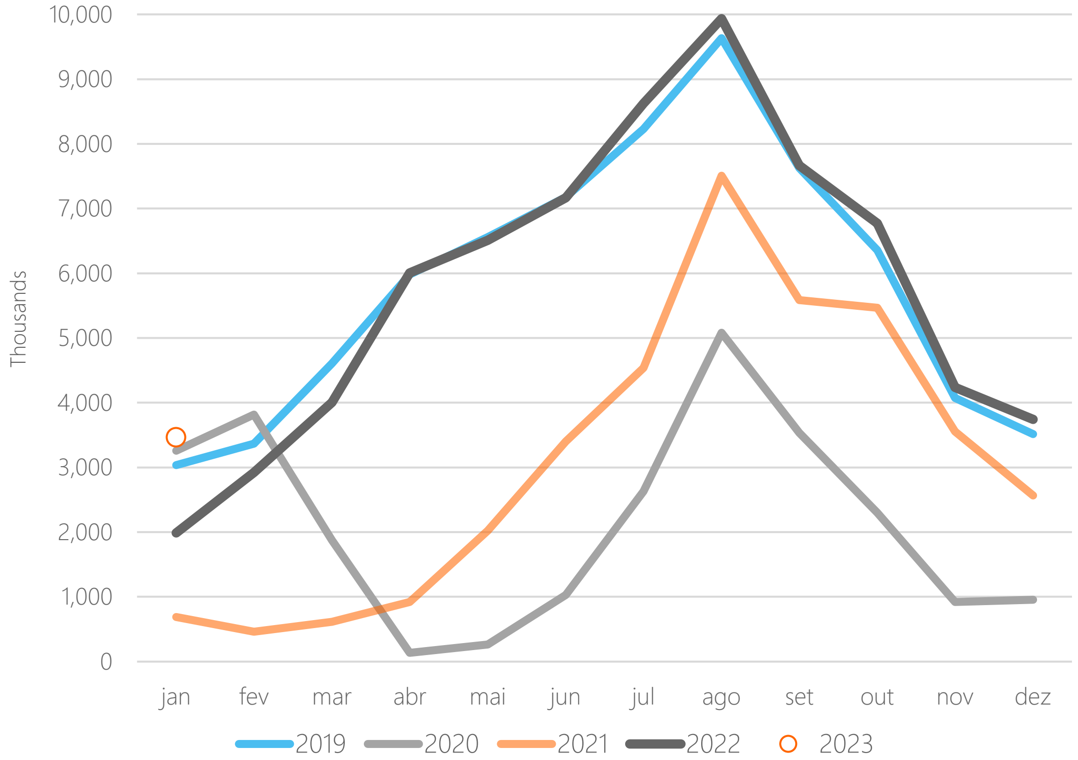
Revenue from Tourist Accommodation VS 2019 (in real terms)

% change versus same month of 2019



Source: BPI Research, using data from INE.

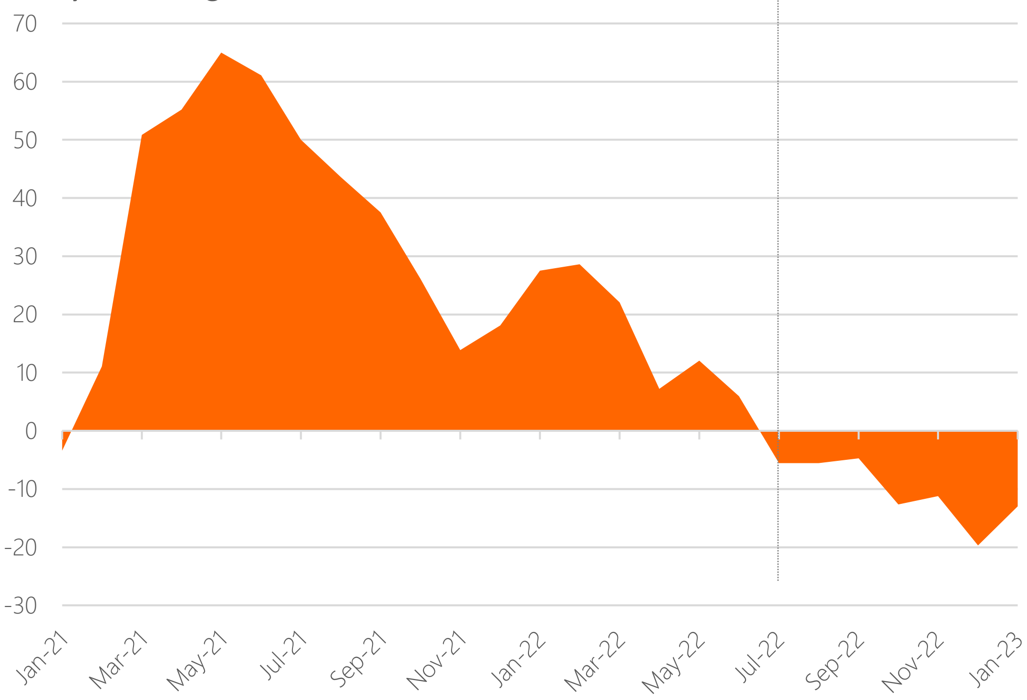
Number of guests



- **In the whole of 2022, tourist accommodation establishments recorded 26.5 million guests and 69.5 million overnight stays**, translating into increases of 83.3% and 86.3%. Compared to 2019, guests declined by 2.3% and overnight stays by 0.9%. However, behaviour was different between residents and non-residents: +8.6% for residents and -5.0% for non-residents.
- **In terms of sector revenues (in real terms) the 2019 figures were exceeded from the second quarter of 2022 onwards**.
- **We believe that 2023 will mark the surpassing of the pre-pandemic figures both globally and also with regard to non-residents. January 2023 figures point to a good start:** guests are above January 2020 (a month still unaffected by the pandemic) levels by +3%. The same regarding overnight stays with +10% (residents) and +4.8% (non-residents).

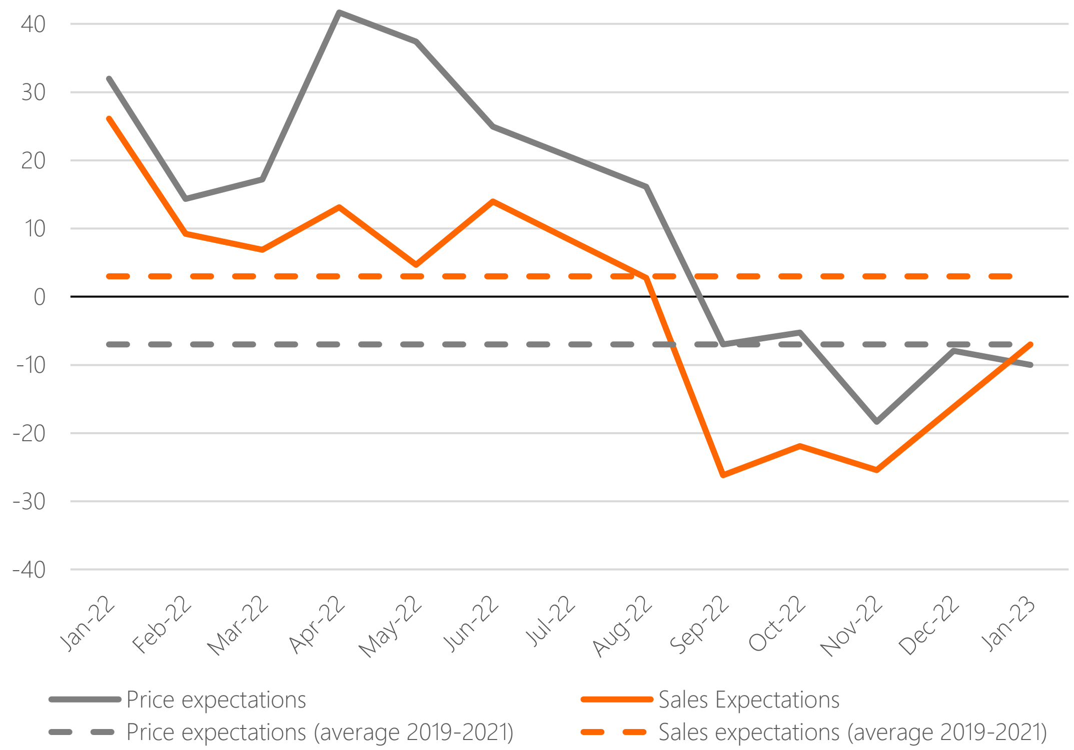
Housing market: More pessimistic mood among market players

New mortgage loan amounts
Yoy % change



Source: BPI Research, using data from Banco de Portugal and Confidencial Imobiliário .

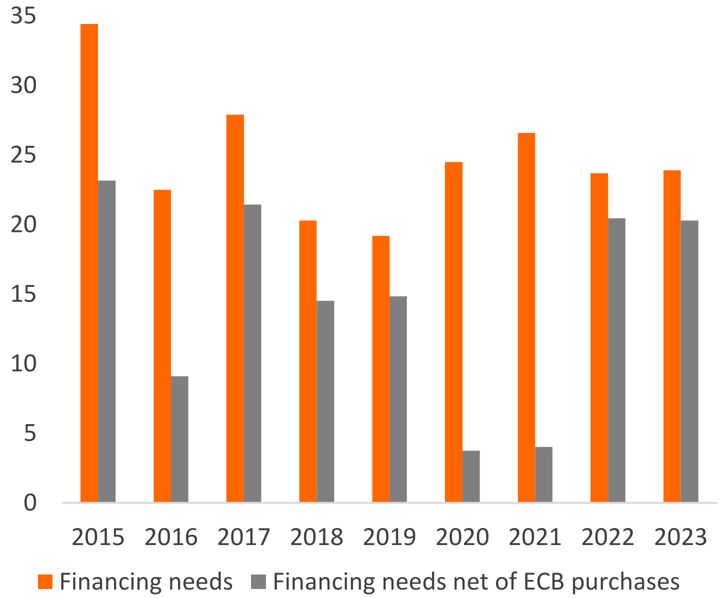
Portuguese housing market survey
Balance of surveyors (%)



- **The slowdown in the housing market market is clearly apparent in the amounts of new mortgage loans:** with the beginning of the monetary tightening cycle (July 2022) the year-on-year changes in new housing loans volumes have been increasingly negative (-13% yoy in January 2023).
- **The mood among real estate agents and developers regarding future sales and prices is in negative ground and bellow recent years average.** Still, we should note that expectations about prices are very close to 2019-2021 average level and sales expectations is increasing since November. This means that market players expect the market to cool down but with greater price inertia. Supporting this idea is a fairly resilient labour market and the shortage of housing supply in the market.

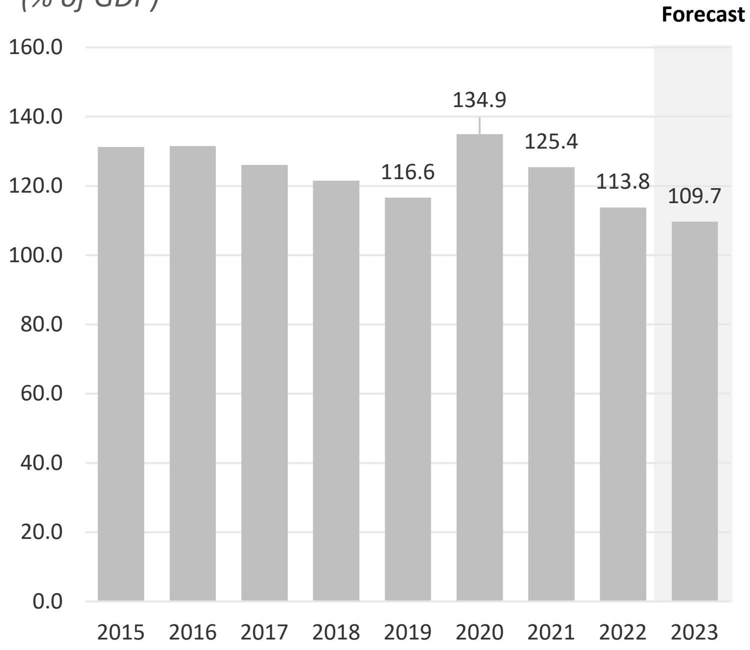
Prudent fiscal stance, the liquidity cushion and ECB reinvestments provide comfort in an uncertain environment

Funding needs
(Billion euros)



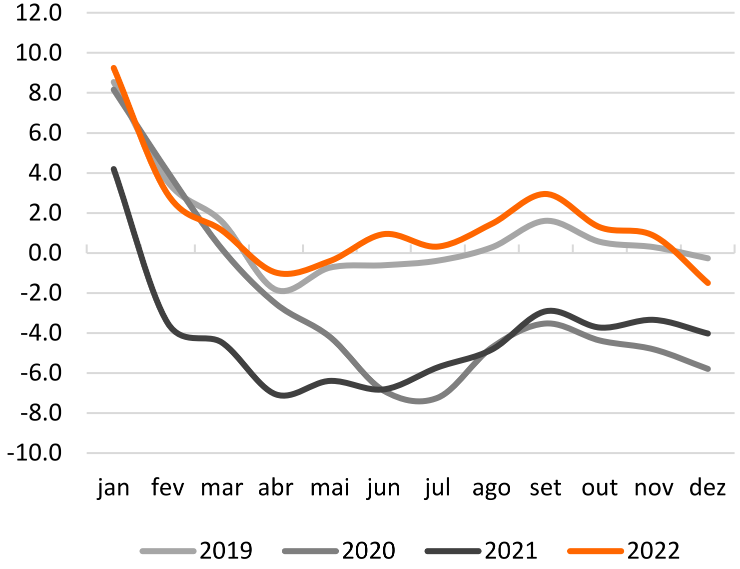
Source: *BPI Research, based on DGO and state budget 2023.*

Public debt ratio
(% of GDP)



Source: *BPI Research, based on state budget 2023 and INE.*

Overall fiscal balance*
(% of GDP)



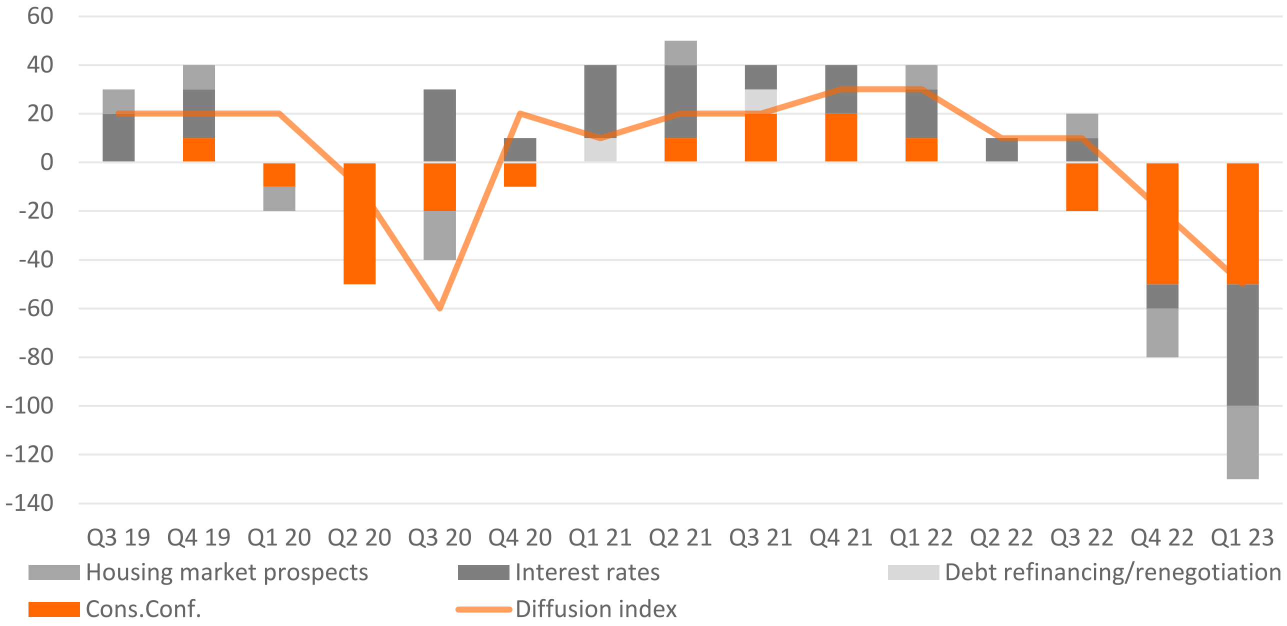
Note (*)*: cash basis.*
Source: *BPI Research, from DGO data.*

- **Financing needs for 2023 amount to €24 bn.** In 2023 Q2, ECB will start the quantitative tightening through reduction of reinvestments of debt purchased under the APP; debt that matures under the PEPP continues to be reinvested. Despite this change in the ECB's policy (a more restrictive stance), ECB is expected to purchase debt equivalent to circa 15% of financing needs in 2023, a similar amount than in 2022. The muted reaction of the sovereign spread to the reduction of ECB purchases already in 2022 demonstrate the more positive evaluation of the Portuguese sovereign risk by international investors, in part due to a very cautious fiscal stance and positive growth dynamics. Still, the current liquidity cushion (public administration deposits, including the Treasury cash buffer) amounts to around €17 bn (c. 8% of GDP), comfortable according to historical standards.
- The sovereign risk premium has increased following the end of net asset purchases, but we expect it to remain within reasonable bounds supported by the ECB new anti-fragmentation tool, Government's commitment to fiscal consolidation and the positive evaluation from the several rating agencies.

Banking system: a solid position to face the economic slowdown (1)

Diffusion index – demand for mortgage credit

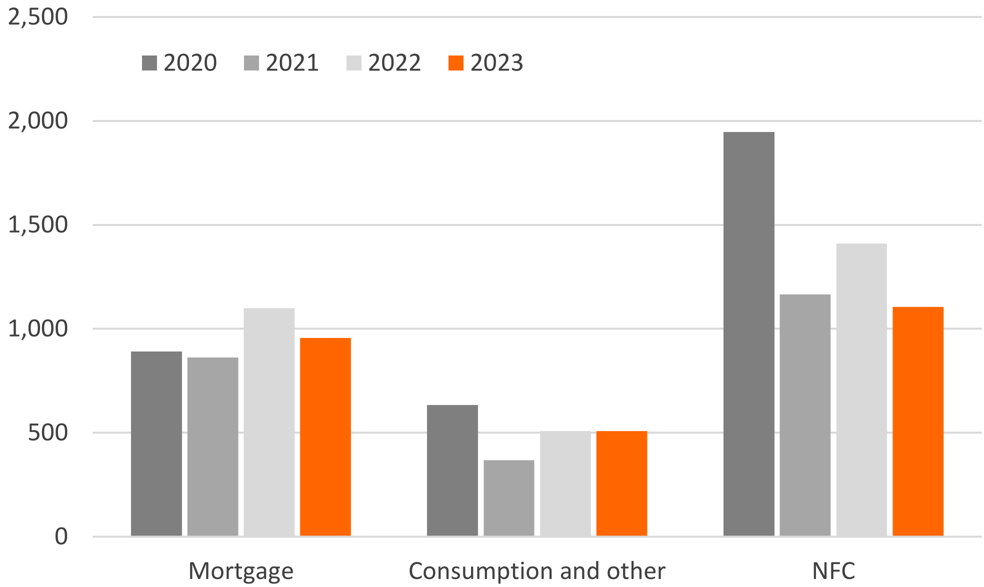
Index



Source: *BPI Research, base on data from Bank of Portugal.*

New lending activity by sector

Accumulated in the year, million euros

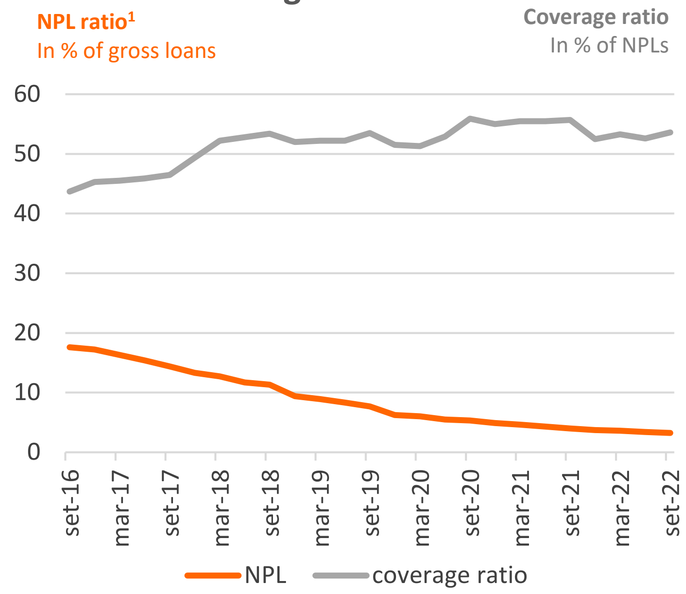


Source: *BPI Research, base on data from Bank of Portugal and ECB.*

- **The stock of credit is declining since mid 2022.** The main reason behind this was the fall in the stock of credit to NFC, due to an in increase of redemptions of credit lines related with COVID. In January, circa 60% of the fall of 1 bn € in the stock of credit was explained by the decline in the stock of mortgages.
- **New credit started to decelerate.** In 2022, new financing for NFC and households increased (11.3% and 6.6%, respectively), but started to show signs of deceleration, especially mortgage credit. In the second part of 2022, housing credit decreased ≈10% yoy, despite continuing at higher levels than the average seen in 2019 (+49%); and in January fell 13%; new operations with NFC declined by 21,6% yoy in the first month of 2023.
- **Banks are anticipating lower demand for credit in Q1**. Increasing interest rates, higher inflation rate, lower confidence and housing prices at significant values should cool down new mortgage credit operations going forward. Regarding NFC, credit outstanding will decline due to the progressive maturity of Covid-credit lines and also due to moderate demand of new credit, as companies' budgets are constrained by high inflation and increasing interest rates, and investment projects are postponed.

Banking system: a solid position to face the economic slowdown (2)

NPLs and coverage ratios



Cost of risk[1]
0.5% in 2019
0.2% in Q3 2022

***Note** (1): flow of impairments to credit as a percentage of total gross.*
***Source**: Bank of Portugal*

Banks' profitability

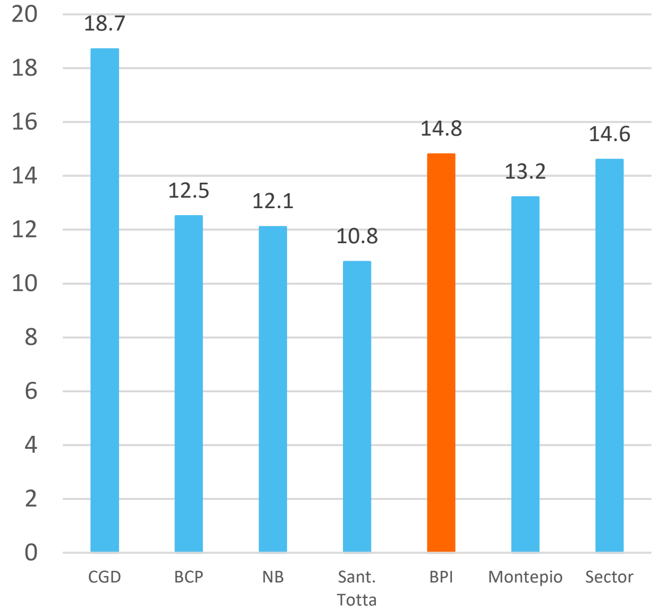
In % of average total assets (Q3 22; trailing 12M)

	BPI	BCP	San Totta	CGD	NB*	Montepio
Net interest income	**1.3%**	**1.4%**	**1.3%**	**1.0%**	**1.2%**	**1.3%**
Net fees	0.7%	0.8%	0.8%	0.5%	0.6%	0.6%
Gains on financial assets	0.1%	0.1%	0.1%	0.2%	0.2%	0.1%
Other net profits	-0.1%	-0.1%	0.0%	0.0%	0.4%	-0.1%
Gross income	**2.1%**	**2.3%**	**2.2%**	**1.8%**	**2.4%**	**1.9%**
Operating expenses	-1.1%	-0.9%	-0.8%	-1.0%	-0.9%	-1.3%
Operational result	**0.9%**	**1.4%**	**1.4%**	**0.8%**	**1.5%**	**0.6%**
Impairment losses, taxes and others	-0.2%	-0.6%	0.0%	0.2%	-0.1%	-0.2%
Profit	**0.6%**	**0.5%**	**1.0%**	**0.7%**	**1.3%**	**0.2%**
ROTE[1]	8.0%	4.0%	12.3%	9.8%	nd	nd

***Notes**: 1) the values for BCP and CGD refer to ROE; calculation methodologies differ between banks. * data for Q3 2022, trailing 12M*

Banks' solvency and liquidity position

*In % (Q4 22)**



***Source**: Banks publications, BoP*
**Q3 for Novo Banco and Sector*

- **NPLs continue to decline, despite the fact that debt moratoria have already expired.** The sector NPL ratio declined by 2 tenths to 3.2% in Q3 2022.
- **Profitability remains well above the pre-pandemic period,** but decelerated 6 tenths in Q3 (ROE fell 8.3% in Q3 2022 from 8.9% in Q2). Even so, profitability is expected to benefit from higher interest rates.
- **The capital position of Portuguese banks provides buffers against the risks that could arise due to the conflict in Ukraine.** The CET1 ratios remain above the regulatory minimum.

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