Portugal:
Macroeconomic and financial outlook

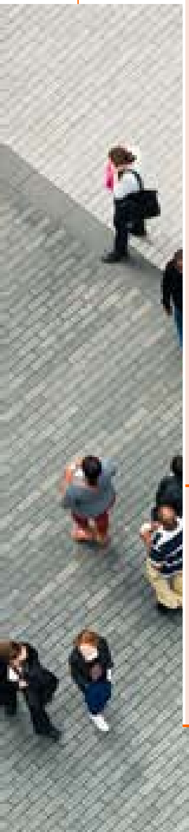
BPI *Research*

April 2023

Prepared with information available by April 11th, 2023

BPI Grupo CaixaBank

Main messages



Activity

- **Bank of Portugal updated its macroeconomic scenario.** Real GDP growth for 2023 was revised to 1,8%, +3 tenths than in December and inflation was revised in – 3 tenths to 5,5%, reflecting a more benign scenario for energy prices. Risks remain biased on the downside for growth and on the upside for inflation. In the meantime economic indicators continue to point to a small but positive growth in Q1 2023, putting upward pressures on our own prediction for GDP growth in 2023 (1%). Confidence continues to improve on a broad base; consumption has been supported by car sales but showing huge moderation in the remaining classes.
- **Inflation decelerated in March for the fiftieth month in a row,** to 7,4% yoy, -0,8 p.p. than in February; also core inflation decelerated to 7,0 from 7,2%. The predominant sentiment continues to be that the disinflationary process will be very gradual, reflecting the contagion of high energy prices to other products. Our forecast for 2023 (5,5%) is currently under watch for a possible slight downward adjustment.
- **Labor market remains robust but there are some warning signals**. Monthly data points to a maximum of employment at the beginning of 2023, in a favorable labor market which continues to attract discouraged people (inactive population is at minimums) and job vacancies remain at high levels. However, the deceleration of the economy and the high costs have started to impact labor market, with unemployment rate above pre-pandemic levels and above the average seen in 2022 (6,8% last February).
- **High frequency indicators related to the tourism sector confirm strong recovery.** January and February 2023 figures point to a good start for the year, with guests being 3% and 17% above the same period of 2020 and 2019, respectively. The same regarding overnight stays: +6% and 17% from the same period of 2020 and 2019, respectively.
- **Housing market is showing signs of deceleration,** with new mortgage loans declining at the beginning of 2023 and transactions falling by 21% yoy in Q1 (Confidencial Imobiliário data). Tighter financial conditions should undermine demand, especially in 2023, reason why we expect a small decline on prices this year and also significantly less number of transactions.
- **Fiscal deficit ended 2022 substantially below the expected by the Government (-0.4% vs -1.9%, respectively).** This behavior was especially due to high inflation and the significant economic recovery, with impact on an exceptional increase of fiscal and contributory revenues (≈14%). At the same time, expenditure increased 4.4%. In this context, **the public debt ratio reached the lowest level since 2011, decreasing to 113.9% of GDP**, -11 p.p. in comparison to 2021 and -3 p.p. in comparison to 2019.

Banking Sector

- **Credit quality indicators improved further in Q4 2022 and we evaluate risks related with higher interest rates as contained.** Indeed**,** macroprudential measures are relatively tight: banks should reduce gradually average maturity of housing loans to 30 year; institutions 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	-0.8	-1.4	-0.4	-0.2
General Government Balance (% GDP)	-1.9	-3.0	-0.3	0.1	-5.8	-2.9	-0.4	-0.9	-0.8
General government debt (% GDP)	131.5	126.1	121.5	116.6	134.9	125.5	113.9	109.7	106.2
Risk premium (PT-Bund) (average)	307	269	138	98	89	60	98	103	102

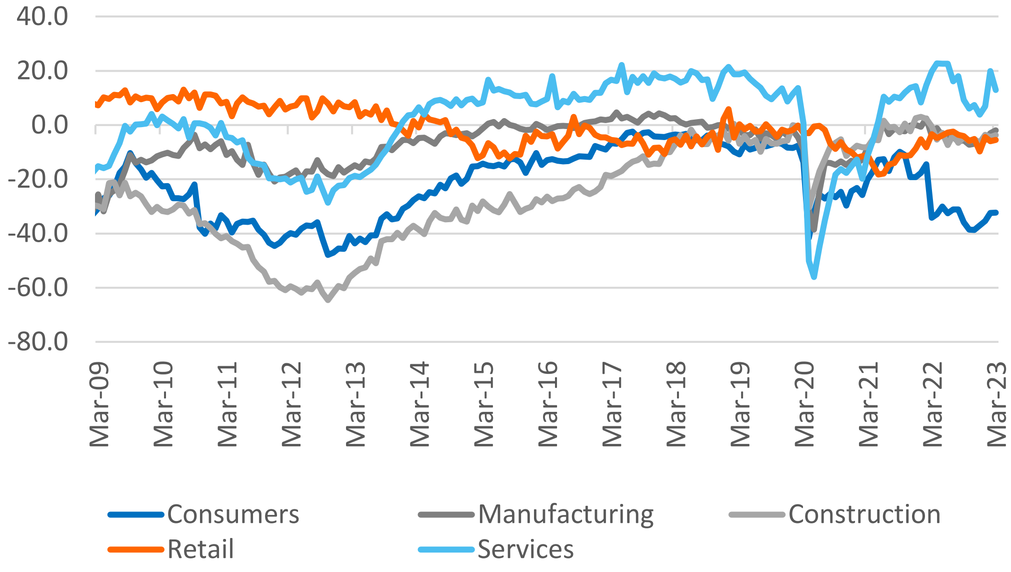
***Source**: BPI Research*

Resilience continues and downward risks to growth look now smaller than some months ago

Economic indicators *% mom, qoq*	**Q1 2023**	**Q4 2022**	**Last month**
Employment (change 1000 individuals)	28,1	-6,5	February
Unemployment (change 1000 individuals)	4,3	6,6	February
Retail sales (deflated)	0,9	-0,2	February
Car sales *(ACAP)*	13,9	6,2	March
Fights *(yoy)*	27,1	21,9	March
Overnight stays *(yoy same month 2019)*	17,3	5,7	February
ESI *(historical average ~100)*	101,0	97,6	February

Source: BPI Research, from BdP, INE, EC

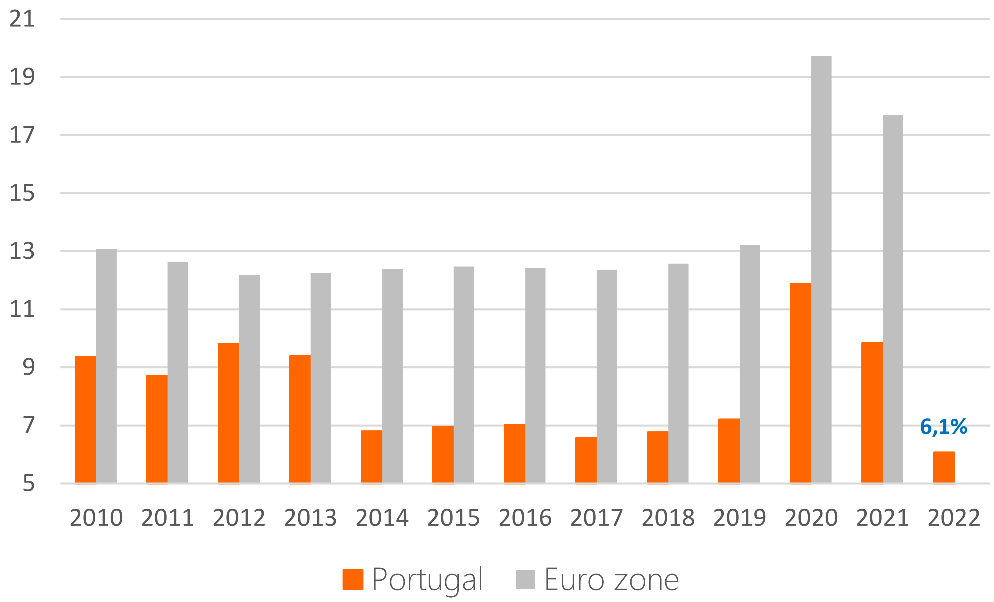
Confidence indicators
Level



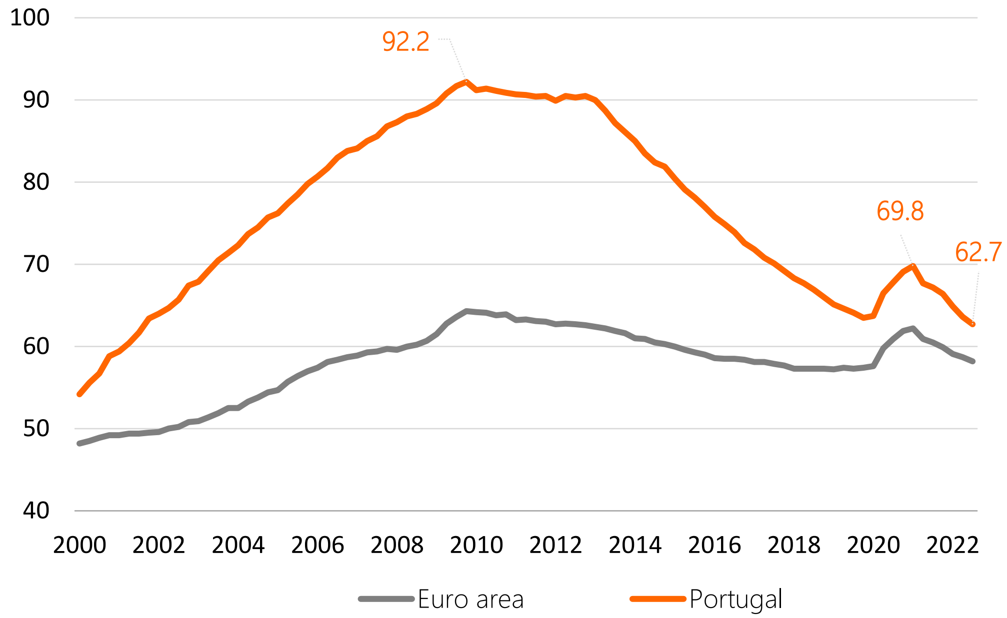
- **Consumption is being supported by an increase of durable goods expenditure, namely cars.**
- **Labour market remains strong, but first signs of weakness are appearing:** most recent data shows a deterioration in unemployment.
- **Accumulated savings during pandemic,** (~3% of GDP) will continue to partially accommodate at least some of the adverse impact of higher inflation and higher interest rates in the coming quarters. However, most of these savings are more concentrated in top-income households with lower propensity to consume.
- **Sentiment indicators**: in March the sentiment improved in industry, retail, construction and consumers.

Households: savings are declining but also due to debt reduction

Saving rate
% of Disposable income



Households debt
% of GDP



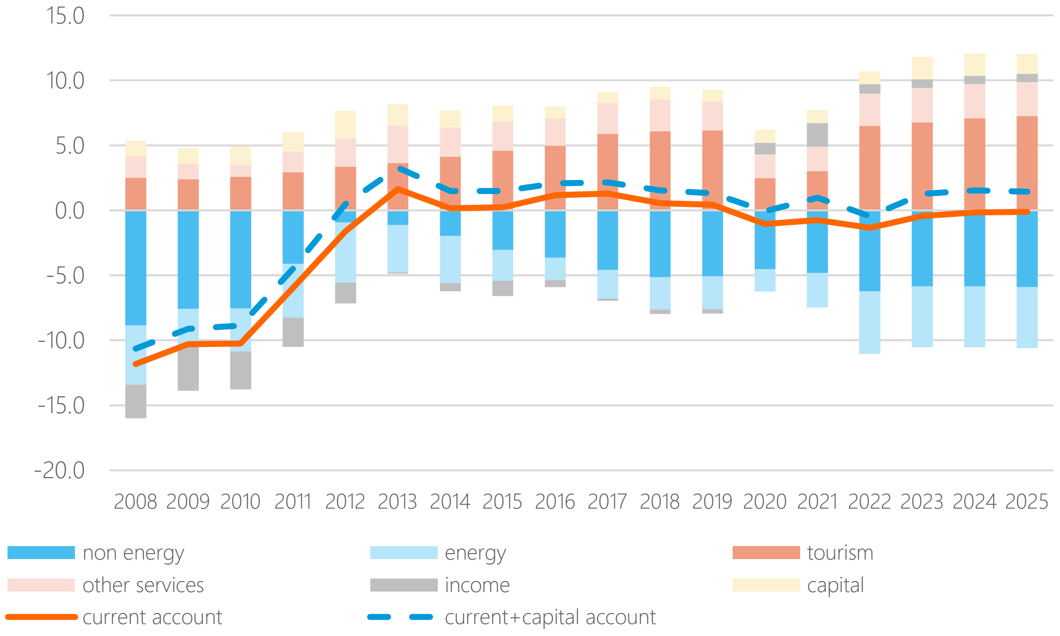
***Source**: BPI Research, from INE and Eurostat*

- **Last year, the savings rate declined markedly from the levels seen in 2020-21, and reached 6,1% of disposable income (DI), on average. However, according to our calculations, extra savings during the pandemic were not yet completely depleted, but they are now much lower and should be concentrated in higher income households: by the end of 2022, we estimate that that these extra accumulated savings still amount to circa EUR 6,6 bln, ie ~3% of GDP .**
- **Worth to mention the reduction in households debt levels since the maximums reached during the pandemic: less 7 p.p. of GDP to 62,7%. Indeed, according to the Bank of Portugal, early repayments of home loans have been increasing: in February, they represented 0,85% of the credit stock, a figure similar to that recorded in January, but higher than the monthly average of 0,54% recorded in 2022.**

External accounts: structural improvements support return to surplus

Current & capital account by components

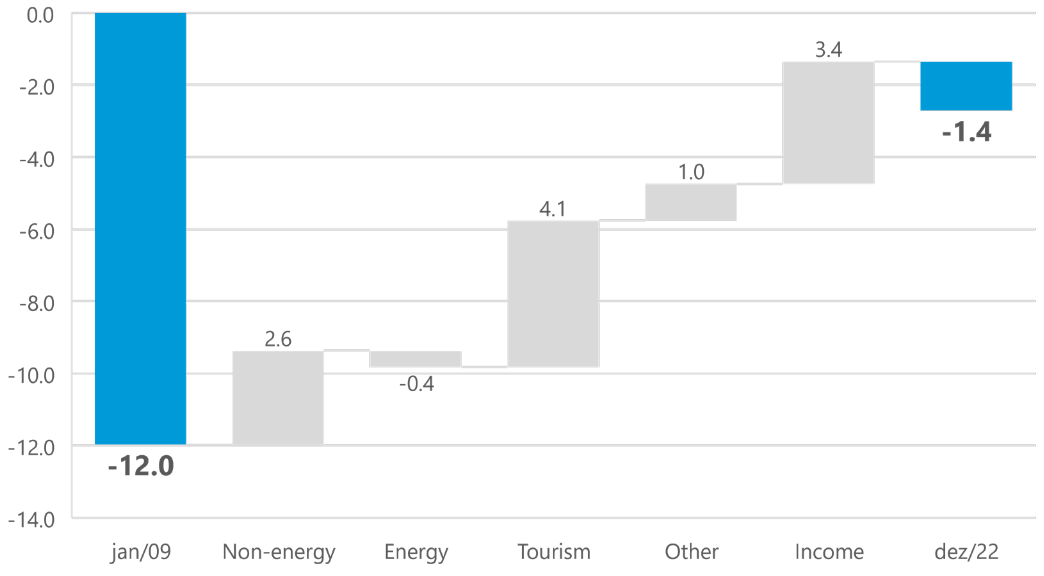
% of GDP



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

Current account since the years of the last international financial crisis

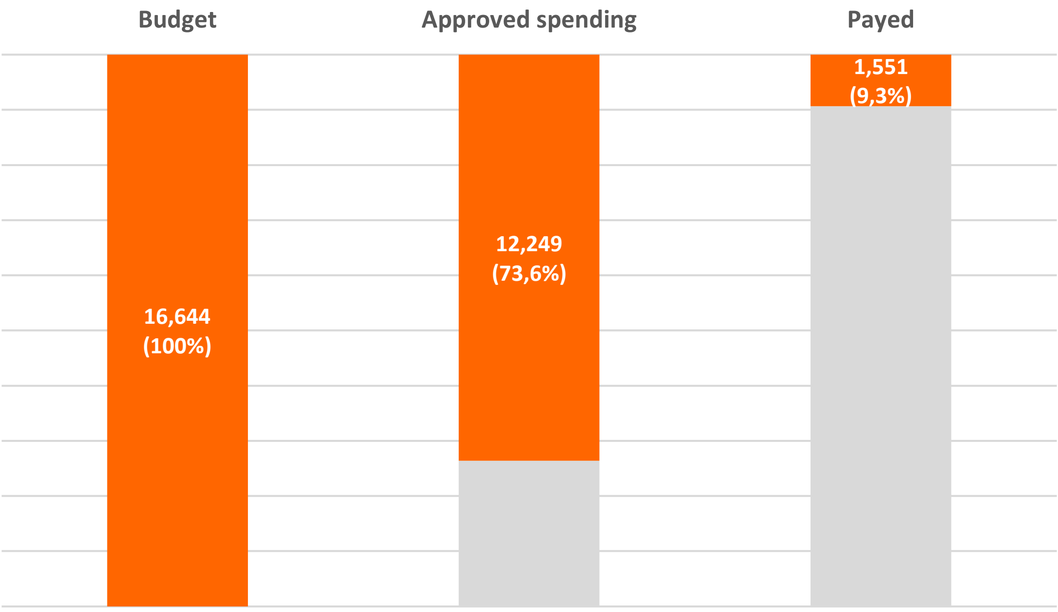
% of GDP, p.p



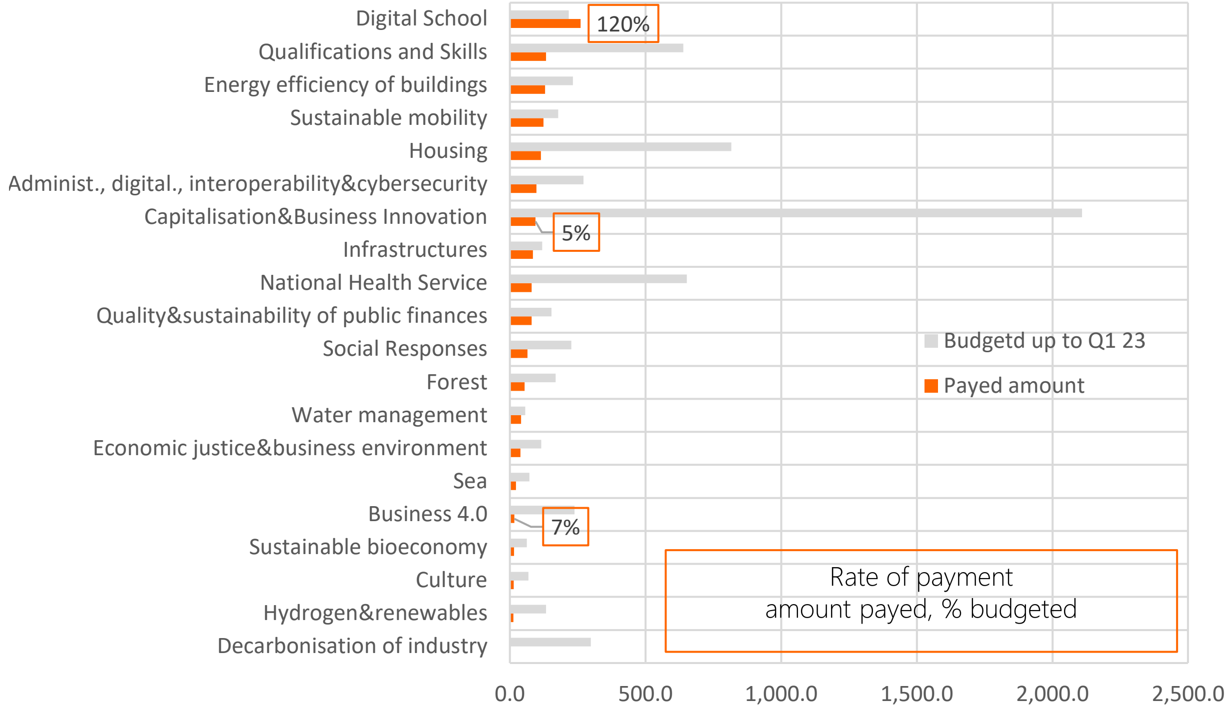
- **In 2022, the current account balance deficit widened to -1,4% of GDP** from -0,8% of GDP in 2021. This movement reflects the impact of the pandemic and also of the Ukraine war on global value chain imbalances and in particular, energy markets. The balance of goods – both non energy and energy – were the aggregates more impacted by the strong increase in international prices, specially those of food and energy.
- On the other hand, with the end of Covid related restrictions, tourism recovered and the respective external surplus (6,5% of GDP) surpassed levels seen in 2018-19. However, this improvement was not enough to compensate the worsening in the Goods Balance. The deterioration of the current account was the main reason why Portugal registered external funding needs in 2022 for the first time since the beginning of the century.
- **However, this is expected to be corrected in the years ahead**, first with the gradual normalization between global supply and demand; then because we believe the domestic productive structure has become more competitive, driving export growth. On a long term perspective, this is apparent in the improvement of the non-energy balance between 2008 and 2022, despite the strong rise on import prices; in 2022 the energy deficit stood at 4,9% of GDP, an historical high, compared to circa -4,3% back in 2008, when the current account deficit registered exceptional high levels: 12% of GDP.

NGEU: a lot of projects in the pipeline

Q1 23: NGEU Funds)
EUR million



Amounts budgeted and implemented (up to Q1 23)
EUR million



Source: BPI Research, from Recuperar Portugal

- **Investments have been fully contracted since April 2022. And the investments already approved amount to 12,249 million, equivalent to an approval rate of 74%, which looks promising for the use of the funds Portugal will receive until 2026.**
- **The rate of payment of the amounts budgeted up to Q1 amounts to 22%; and are centered in investment related with improvements in residential efficiency and the digital transition of schools.**

Despite the challenges ahead, forecasts have been improving for the short run

Macroeconomic scenarios for Portugal

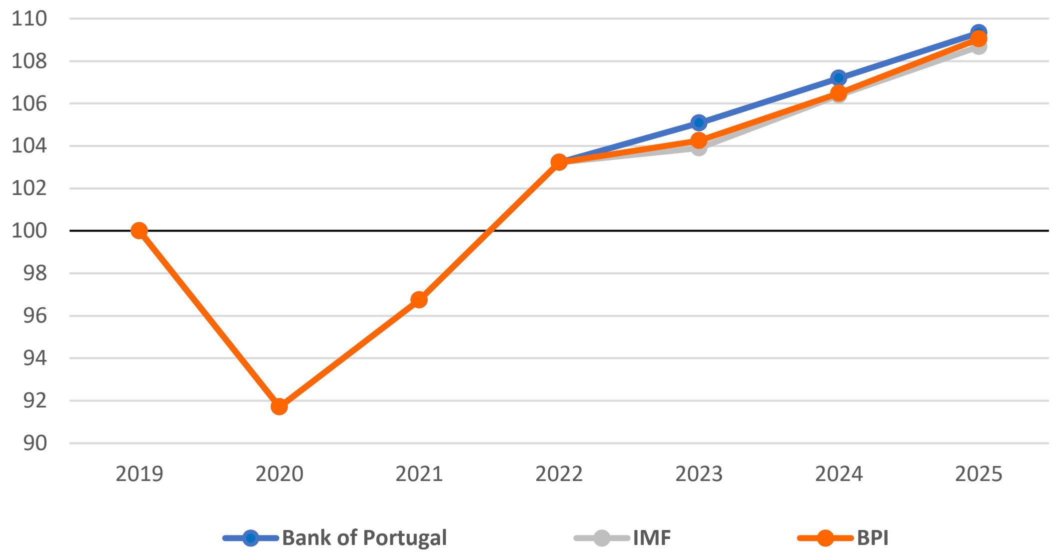
%

Portugal		2022	2023	2024	2025	Accum. 23-25
GDP	BdP Mar-23	6,7	1,8	2,0	2,0	5,9
(annual, %)	FMI Abr 23		1,0	1,7	2,2	4,9
	BPI Abr-23		***1,0***	***2,1***	***2,4***	***5,6***
Unemployment rate	BdP Mar-23	6,0	7,0	6,9	6,7	0,7
(annual average, %)	FMI Abr 23		6,6	6,5	6,3	0,3
	BPI Abr-23		***6,4***	***6,1***	***5,9***	***-0,1***
Inflation rate[1]	BdP Mar-23	8,1	5,5	3,2	2,1	11,2
(annual average, %)	FMI Abr 23		5,7	3,1	2,5	11,7
	BPI Abr-23		***5,5***	***2,8***	***1,8***	***10,5***
Housing prices	EBA - Mar 23	12,6	2,5	3,0	2,7	8,5
(annual average, %)	***BPI Abr-23***		***-0,2***	***0,1***	***2,4***	***2,3***

BoP forecasts are for the HCPI; BPI forecasts for the CPI; for unemployment, the cumulative 22-25 is computed as the difference between unemployment in 2025 vs unemployment in 2021

GDP Growth

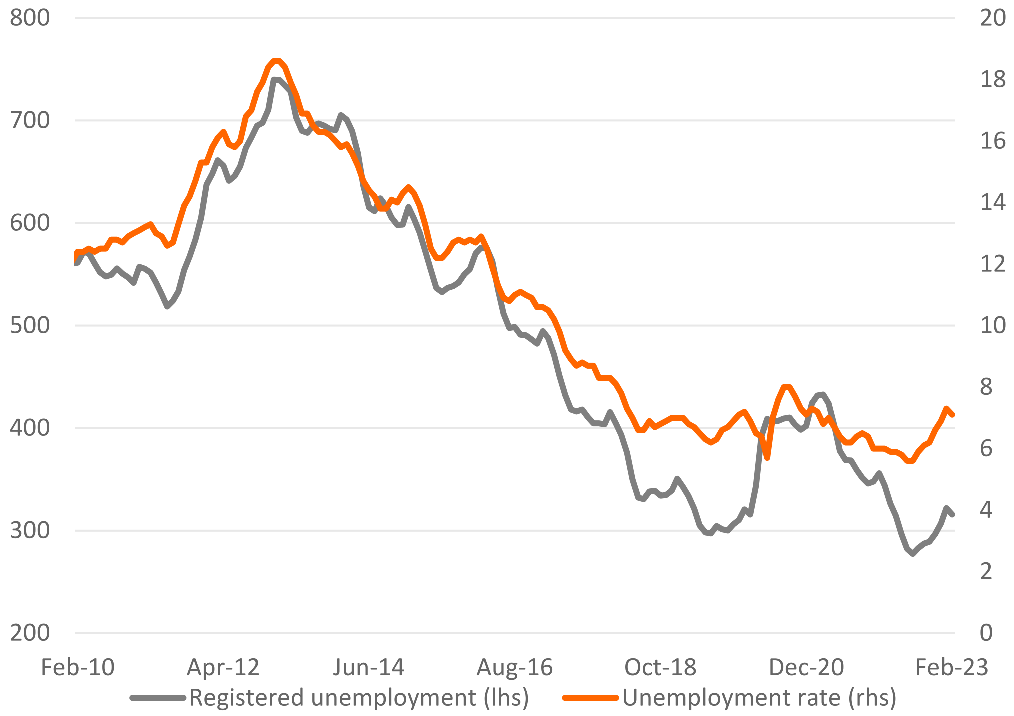
Level, 2019=100



- **First data for 2023 suggests that deceleration may be more moderate than previously predicted.** Risks to our scenario continue to be biased on the upside.
- **According to the Bank of Portugal scenario:**
  - GDP will advance 1,8% in 2023 (+0,3 percentage point than forecasted in December). Risks for this scenario are biased on the downside and are related with a higher than expected impact due to a possible stronger deterioration of financing costs for families and corporates than implicit on this scenario. Geopolitical issues continues to be a downside risk.
  - 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. Risks for the scenario designed for inflation are on the upside.
  - Labour market is predicted to remain resilient, despite the strong deceleration of growth, reflecting difficulties in hiring.
- IMF more cautious about growth and inflation.

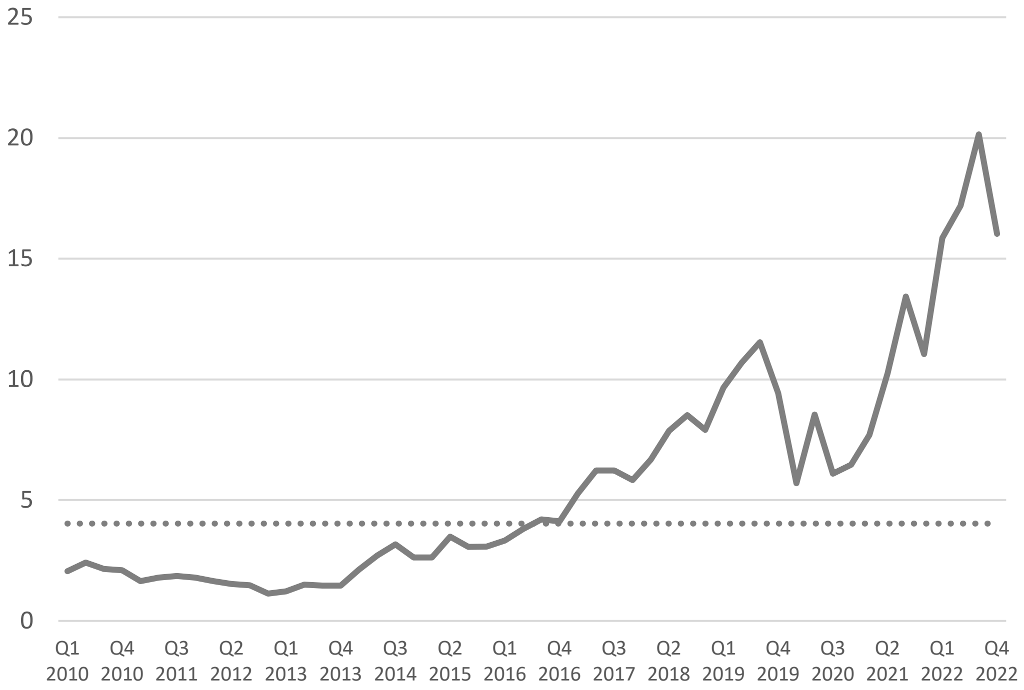
Labor market remains robust but there are some warning signals

Registered unemployment and unemployment rate*
Thousand people *(%)*



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

Job vacancies by unemployed person
Ratio



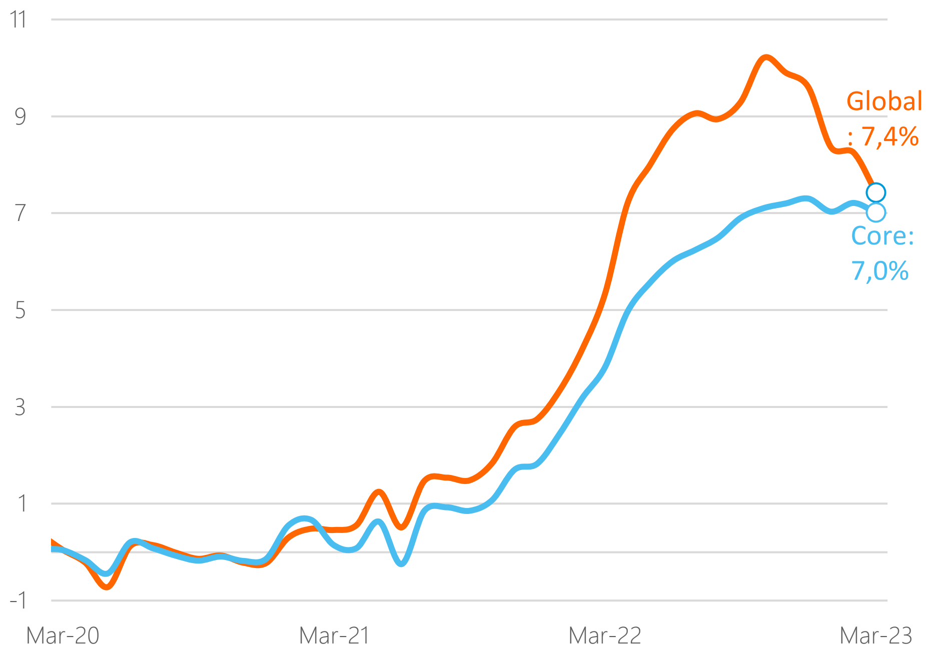
***Source**: BPI Research, from Eurostat.*

- **Labor market remains robust and attracting the discouraged people.** Employed population is at maximum levels (considering the monthly data) and the ratio of job vacancies to unemployed person is considerably above the average recorded between 2010-2019. This should be an important buffer in a context of lower hiring intentions (at least initially) and the expected economic deceleration. Additionally, the labor market continues attracting the discouraged people: the inactive population reached a new minimum in February since the start of the series (1998).
- **However, there are some warning signals and we should look to the labor market indicators with prudence.** The unemployment rate is above the pre-pandemic level and the average recorded in 2022, and the registered unemployment has started to increase since end-2022, even though both indicators revealed an improvement in February in comparison to the previous month.

Inflation: Global and Core CPI down in March

Portugal CPI: Global & Core

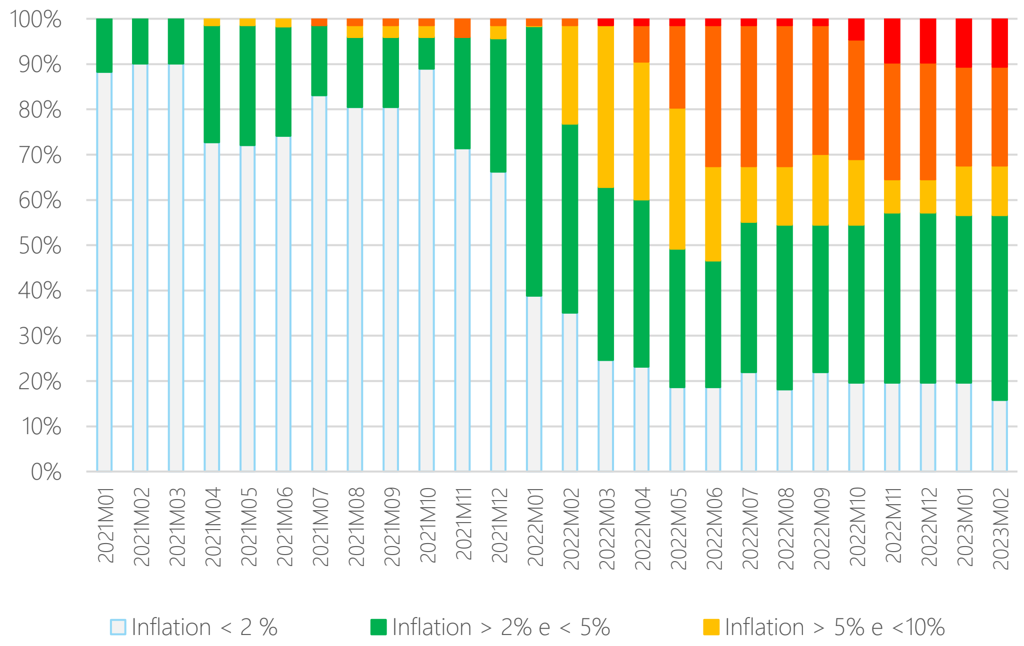
Year-on-year (%)



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

Core inflation traffic light

% of Core inflation basket



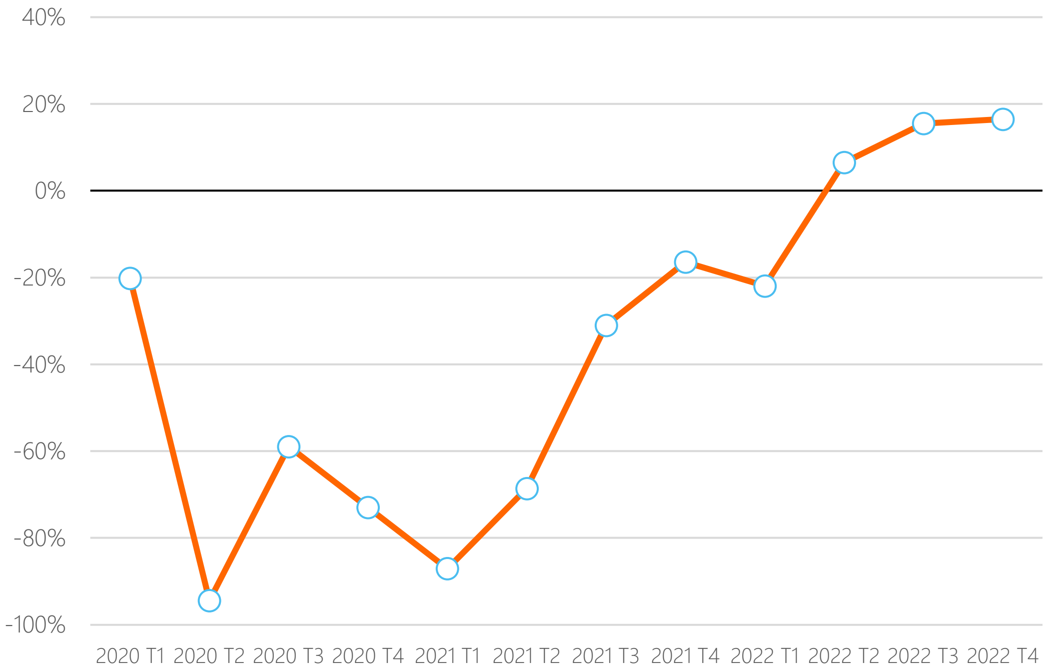
***Source**: BPI Research, using data from INE.*

- **The yoy rate of change of the Consumer Price Index (CPI) slowed down to 7,4% in March from 8,2% in February.** Contrary to what happened in February, the deceleration in overall inflation occurred simultaneously with a reduction in the core inflation rate. That is, excluding the most volatile products - unprocessed food and energy - prices increased by 7,0% (7,2% in February).
- **Energy prices continued to decelerate significantly (-4.4% year-on-year, down from 1.9% in February).** Unprocessed food prices also decelerated to 19.3%, 0.8 p.p. less than in February. This movement in the energy index explains about half of the 0.8 p.p. decline in the year-on-year Global CPI rate compared to February.
- **Sticky core inflation.** Since May 2022, without interruption and until February, the core inflation basket has recorded inflation rates above 5% in over 40% of its composition. In the March CPI flash estimate, despite the slight decline in core inflation (from 7,2% to 7,0%), it remains at very high levels.

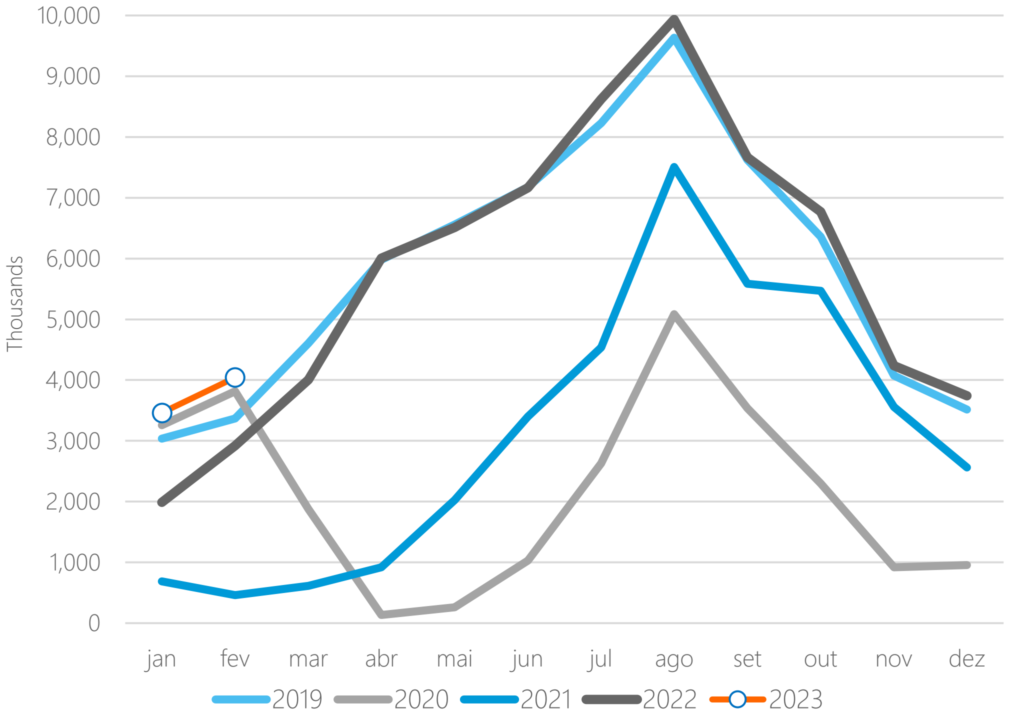
Tourism: good start in 2023

Revenue from Tourist Accommodation VS 2019 (in real terms)

% change versus same month of 2019



Number of guests



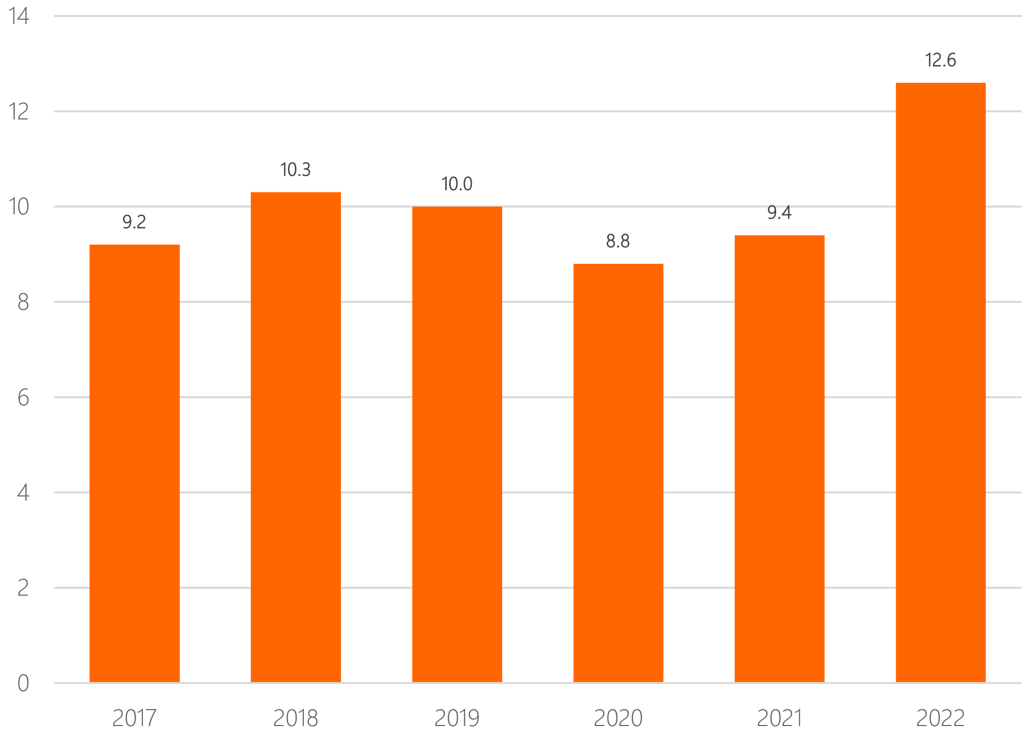
Source: BPI Research, using data from INE.

- **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% y/y. 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 and February 2023 figures point to a good start:** guests are 3% and 17% above the same period of 2020 and 2019, respectively. The same regarding overnight stays: +6% and 17% from the same period of 2020 and 2019, respectively.

Housing market: strong 2022, but slowing down

House Price Index

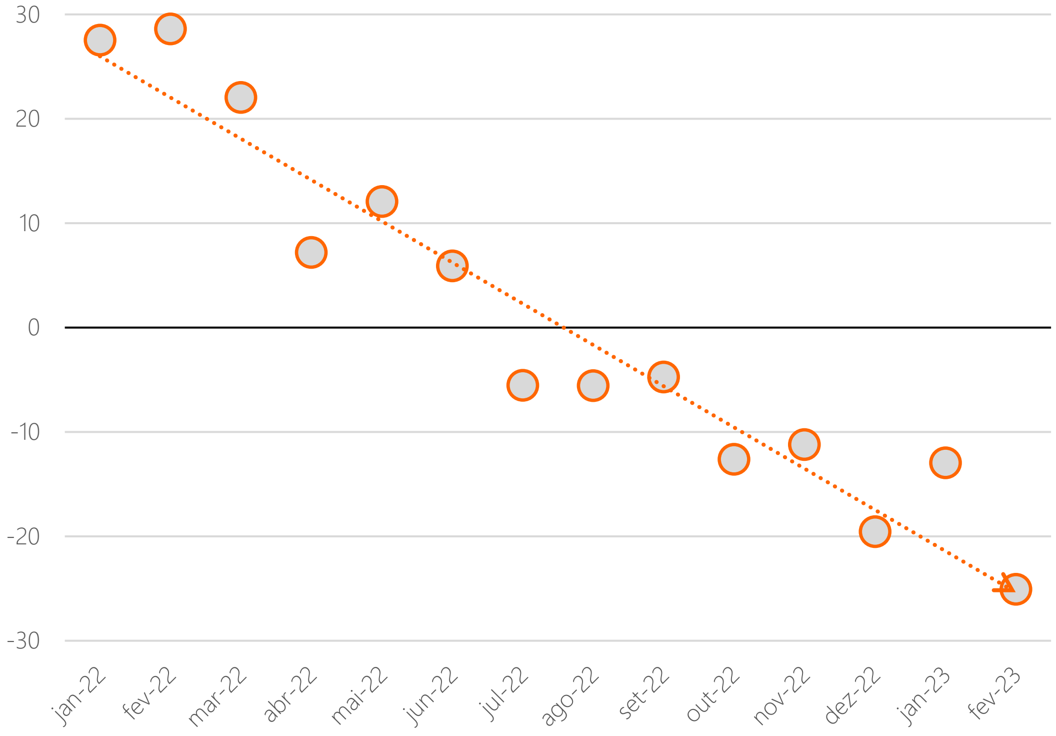
Average annual growth rate (%)



Source: BPI Research, using data from INE.

New loans for house purchase

Yoy change of the monthly amount (%)



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

- **House Price Index (HPI) grew 12,6% in 2022.** Also, the number of property transactions reached 167.900, +1,3% compared to 2021. Nonetheless, quarter-on-quarter movements on prices (+1,1% in Q4 2022) and transactions (-8,8% in Q4 2022) are loosing momentum.
- **The slowdown in the housing market is clear when we look at the values of new mortgage loans:** -25% yoy in February 2023. Other data also confirms this view: the number of house appraisals decreased in February 2023 for the ninth consecutive month, standing at about 20.000. This represents 29% less compared to February 2022. Also, transactions in the last three months up to February (data from Confidencial Imobiliário), fell 21% compared to Q1 2022.
- **Despite the market's loss of steam, we see 2023 as a year of soft landing in housing market,** since perceived demand level keeps strong despite loosing some momentum (in similar patterns as the ones of 2018 and 2019).

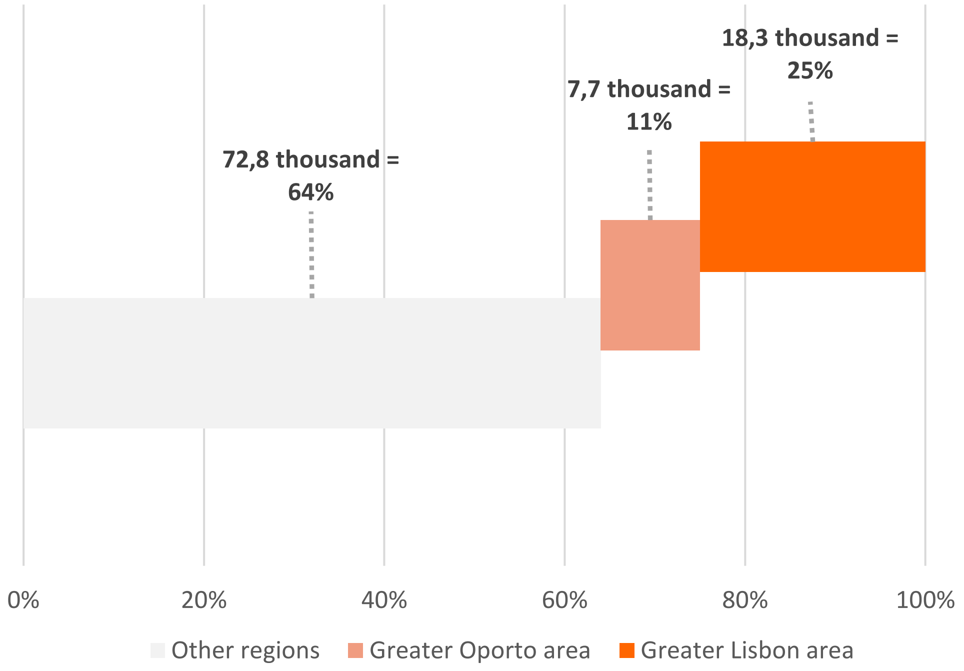
Housing market: The “Mais Habitação” program

The “Mais Habitação” program main measures

- Possibility of automatically changing the use of commercial or service properties into residential properties.
- Architectural and specialty projects will now be approved based on the terms of responsibility of the authors of the projects.
- The State rents available houses from private owners at market prices for a period of five years, as long as it can sublet them. The sublease will be made for the value corresponding to 35% of the tenant's effort rate.
- Incentive to return to the housing market to dwellings that are currently dedicated to "Alojamento local": "zero" taxation on property income until 2030 for owners.
- Current “Alojamento local” licenses in force until 2030. In 2030, the municipalities will decide whether or not to renew the licenses.
- Coercive lease. Only applies to flats that have been vacant for more than two years and does not apply to low density territories.
- The tax rate on income from property will fall from the current 28% to 25%, and will be lower in contracts of longer duration.
- New appliances to Golden Visa licenses will end and those that exist will have a limited renewal. The renewal of visas already granted, every two years, will only occur if the property is allocated to the owner's own residence or that of their children; or if it is rented as a permanent dwelling for no less than 5 years.

“Alojamento Local” by region (2021)

Number / %



Note: “Alojamento Local" refers to short-term rental houses for tourism purposes.
Source: BPI Research, using data from INE.

- **The “Mais Habitação” program:** The Government approved a set of measures that aim to achieve the goal of having a housing stock capable of guaranteeing decent housing for the entire population through a balance between a structural reform, based on the promotion of new public housing and on the qualification of existing ones, and a cyclical response that allows more immediate answers to deal with the urgency of ensuring access to decent housing and adequate to the income and size of different family units.
- In our view the measures linked to licensing can speed up the business cycle of construction activity and ultimately reduce the time between project start and completion, lowering construction costs. On the other hand, measures regarding “Alojamento local” (short-term rental service) may also have the side effect of reducing the number of overnight stays by tourists if there is no hotel supply to compensate for the withdrawal of installed capacity. It may also result in a greater number of unused houses or short-term rentals moving to the informal economy.
- The measures regarding Coercive lease can still raise legal disputes due to property law issues. The Plan is still under discussion/approval, so it is possible that it will suffer some adjustments until plein implementation.

Fiscal balance surprised again on the upside in 2022

Budget execution: main items (accrual basis)

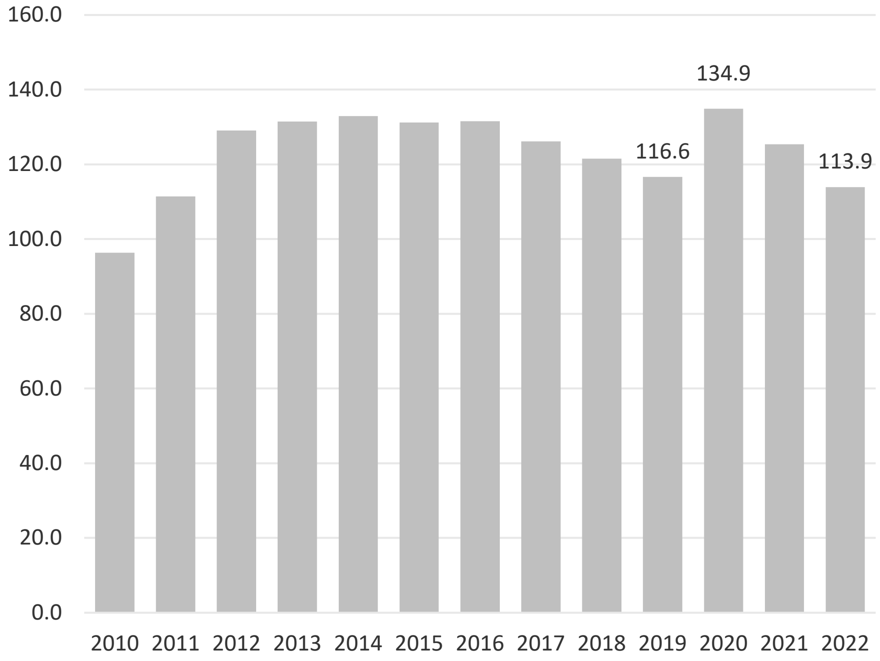
(Million euros)

(% GDP)	**2018**	**2019**	**2020**	**2021**	**2022**	**Change 2022 vs 2019** (million euros)	**Change 2022 vs 2021** (million euros)
Fiscal revenues	25.2	24.7	24.6	24.7	25.9	8,879	8,825
Indirect Taxes	15.1	15.0	14.5	15.1	15.1	4,062	3,831
Direct Taxes	10.1	9.7	10.0	9.6	10.7	4,817	4,993
Social Contributions	11.6	11.8	12.8	12.7	12.4	4,238	2,331
Total Revenue	**42.9**	**42.6**	**43.4**	**44.9**	**44.4**	**14,888**	**9,818**
Intermediate consumption	5.3	5.1	5.5	5.8	5.7	2,510	1,101
Staff expenditure	10.7	10.8	11.9	11.6	10.8	2,694	866
Social Transfers	18.2	18.1	20.0	19.4	18.7	5,868	3,085
Interests	3.4	3.0	2.9	2.4	2.0	-1,638	-484
Investment	1.9	1.8	2.4	2.6	2.5	2,044	417
Total Expenditure	**43.2**	**42.5**	**49.2**	**47.7**	**44.8**	**16,079**	**4,547**
Current primary expenditure	**36.8**	**36.7**	**41.9**	**41.5**	**38.8**	**14,326**	**3,796**
Overall fiscal balance	**-0.3**	**0.1**	**-5.8**	**-2.9**	**-0.4**	**-1,192**	**5,271**
Primary fiscal balance	**3.0**	**3.1**	**-2.9**	**-0.5**	**1.6**	**-2,829**	**4,787**

Source: *BPI Research, based on INE.*

Public debt ratio

(% of GDP)



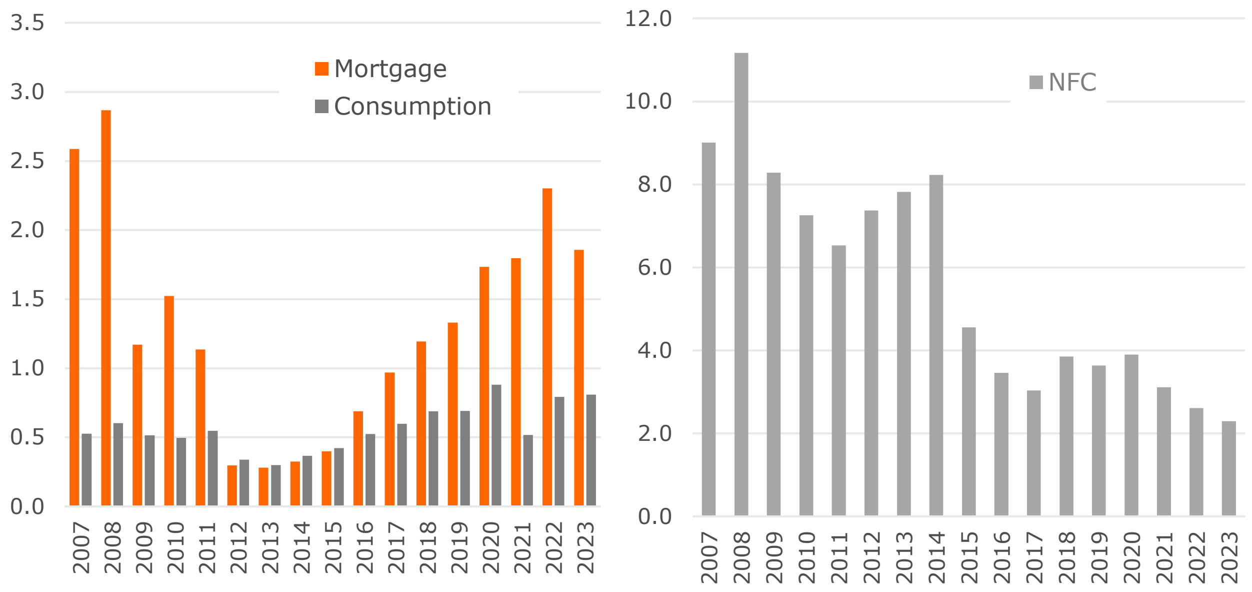
Source: *BPI Research, based on state budget 2023 and INE.*

- **Fiscal deficit ended 2022 substantially below levels expected by the Government** (-0.4% of GDP vs -1.9%, respectively). This behavior was especially due to high inflation and the significant economic recovery, with impact on an exceptional increase of fiscal and contributory revenues (≈14%). At the same time, expenditure increased 4.4%, with the lower impact of COVID measures offset by the measures taken at the end of year to help households, firms and retired people to deal with high inflation rate and the substantial increase of energy.
- In this context**, the public debt ratio decreased to levels below the pre-pandemic period**. In fact, decreased to 113.9% of GDP, -11 p.p. in comparison to 2021 and -3 p.p. in comparison to 2019. Public debt reached the lowest level since 2011.
- Given the commitment of the Portuguese Government with the consolidation of public accounts, we are expecting that fiscal deficit and public debt ratio will continue on the radar of Portuguese authorities and new measures to deal with inflation will be targeted to mostly needed households, hence having contained impact on the deficit.

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

New lending activity by sector

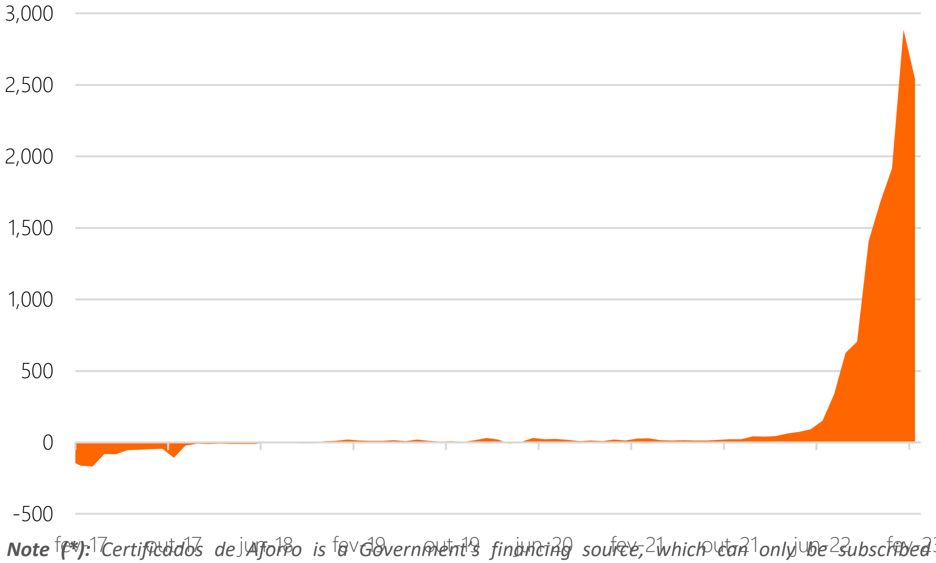
Accumulated in the year until February, million euros



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

Net CA subscriptions*

Accumulated in the year until February, million euros

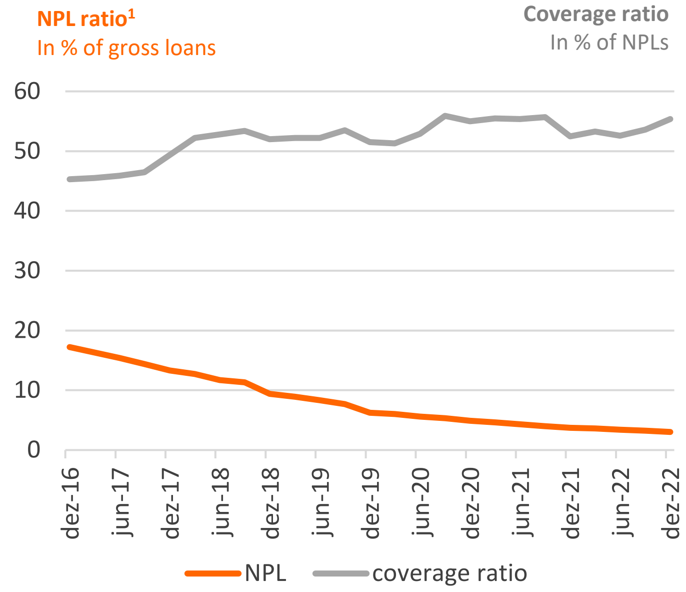


***Note (*)**: Certificados de Aforro is a Government's financing source, which can only be subscribed by households. The interest rate is calculated as Euribor 3M+1%, with a cap at 3,5%; to this return, CAs can have a holding premium of 0.5% from the 2nd to the 5th year or 1% from the 6th to 10th year (ending). The interests are capitalized. The maximum amount that Government can issue for these retail instruments (CA and CT) is 7bnEur in 2023. **Source**: BPI Research, base on data from Bank of Portugal.*

- **The stock of credit is declining since mid 2022.**
  - **Mortgage credit:** significant deceleration (2.1% yoy in February, vs 2.6% in January), in line with the drop in new operations (-19.3% yoy accumulated in the first two months of 2023). High levels of interest rates, inflation and increasing housing prices explained this decline and this context should constrain this segment during next months. However, the absolute amount of mortgage new operations remains high by historical standards, above the one recorded in February 2020.
  - **NFC**: the stock has been declining since mid-2022, due to the redemptions of credit lines related with COVID. Additionally, new operations for the first two months of 2023 were the lowest value since the beginning of the series (2003).
- Since December, **deposits have been declining** (-7.8bnEur since December), **moving to alternative applications, especially in the case of households, which can subscribe Certificados de Aforro**. However, despite the significant deceleration, deposits continue to increase (+2.9% yoy for non-financial private sector) and the interest rate of new deposits is increasing (in February, household's deposit interest rate reached 0.65%, in comparison to 0.04% in February 2022), a trajectory which can limit the recent movements to retail instruments.

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

NPLs and coverage ratios



Cost of risk[1]
0.5% in 2019
0.3% in Q4 2022

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

Banks' profitability

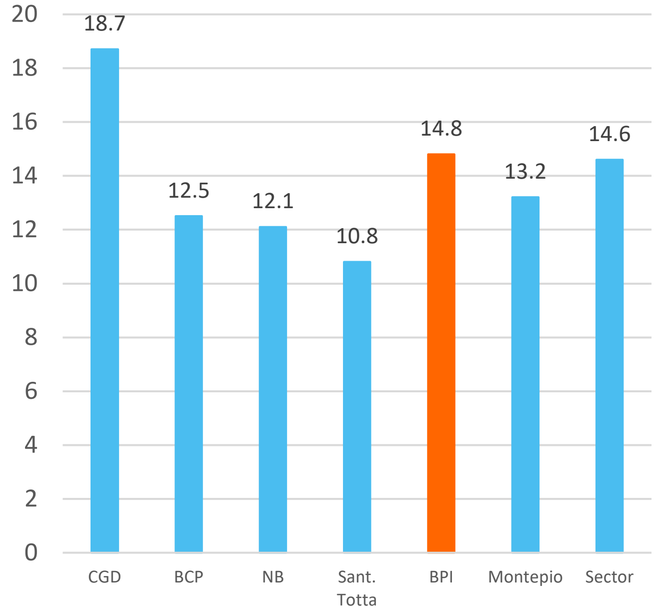
In % of average total assets (Q4 22; trailing 12M)

	BPI	BCP	San Totta	CGD	NB*	Montepio
Net interest income	**1.3%**	**1.4%**	**1.3%**	**1.0%**	**1.4%**	**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%	0.1%	0.1%
Other net profits	-0.1%	-0.1%	0.0%	0.0%	0.3%	-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%	-1.0%	-1.3%
Operational result	**0.9%**	**1.4%**	**1.4%**	**0.8%**	**1.4%**	**0.6%**
Impairement losses, taxes and others	-0.2%	-0.6%	0.0%	0.2%	-0.2%	-0.2%
Profit	**0.6%**	**0.5%**	**1.0%**	**0.7%**	**1.2%**	**0.2%**
ROTE[1]	8.0%	4.0%	12.3%	9.8%	ver nota	nd

***Notes**: 1) the values for BCP and CGD refer to ROE; calculation methodologies differ between banks. * NB reports only 14.4% annualized pre-tax ROTE.*

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 total NPL ratio declined by 2 tenths to 3.0% in Q4 2022. The decrease is widespread to all segments, with especial focus on NFC (-0.7 p.p. to 6.5%). In relation to housing, the NPL ratio decreased by 0.1 p.p. to 1.1%. Nonetheless, it is possible that these ratios will gradually increase in the coming months, due to the increasing interest rates.
- **Profitability remains well above the pre-pandemic period,** in Q4 it improved 5 tenths to 8,8% (ROE). 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 and the impact of high interest rates on NPL's.** The CET1 ratios remain above the regulatory minimum.

BPI

Grupo CaixaBank