Prepared with information available by June 5th, 2023

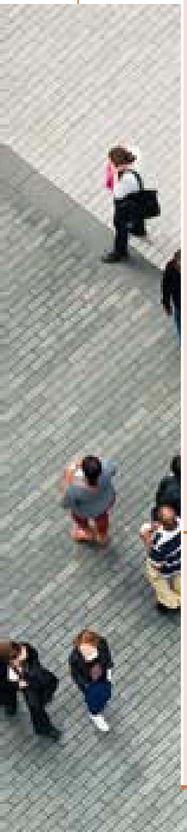
Portugal:
Macroeconomic and financial outlook

BPI *Research*

June 2023

BPI Grupo CaixaBank

Main messages



Activity

- **Strong growth in Q1 2023 was confirmed** (1,6% qoq and 2,5% yoy), pushing the Portuguese economy to 4,3% above the pre-pandemic period. Growth was driven by the external sector, namely exports of goods & services and led to an upward revision of our annual forecast to 2,5% in 2023. Early Q2 data shows mixed signs with sentiment deteriorating on the supply side, but improving among consumers; available hard indicators suggest that the economy will continue to expand, but at a slower pace. Deceleration will reflect the impact of higher financing costs and persistent inflation in families' and corporates' spending and investment decisions.
- **Inflation decelerated again in May.** The inflation rate fell to 4,0% yoy, from 5,7% and the core inflation declined to 5,5%, from 6,6% in April. 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 was downward revised to 5,0%, from 5,5%.
- **Labor market remains robust, but there are some warning signals**. The unemployment rate is above the pre-pandemic level and the average recorded in 2022 (7,2% in Q1 2023). Additionally, the jobs created in Q1 were mainly through precarious contracts: specifically temporary contracts and part-time jobs.
- **High frequency indicators related to the tourism sector confirm strong recovery.** April data reinforces the sentiment that 2023 will be the best year for national tourism in its main metrics: guests, overnight stays and revenues. Compared to the pre-pandemic period, guests increased by 17,5% (10,4% in March) and overnight stays increased by 14,3% (10,3% in March).
- **Housing market is showing signs of deceleration, but prices still show no signs of slowing down.** Our forecast for 2023 is still for an increase in housing prices (2%). This reflects not only the strong carry-over effect, but also the fact that the available data for Q1 continues to signal appreciation. We anticipate that the effect of rising interest rates and reduced transactions will have a greater effect in the second half of 2023/early 2024.
- **Public accounts are performing very well.** Up to April, the public balance registered a surplus equivalent to 1,1% of GDP (cash basis and adjusted by the transfer of the Caixa Geral de Depósitos Employees Pension Fund to Caixa Geral de Aposentações, of about EUR 3.0 billion, an one-off that will have no impact on the official final figure). At the end of the year, the budget balance is expected to remain at -0.4% of GDP in 2023 (accrual basis). Regarding debt, in a scenario of economic growth around 2% and lower inflation in the medium term, the public debt ratio is projected to fell below 100% of GDP in 2025 and a primary surplus is expected in all projected period. Nevertheless, the increase in financing costs will contribute to a worsening of the amount spent on interest; in fact, with a cautious view, the Government expects this item to reach levels close to 3% of GDP in 2025. We consider that projections included in the Stability Program are feasible and close to our own forecasts.

Banking Sector

- **Credit quality indicators improved further in Q4 2022 and we evaluate risks related with higher interest rates as contained.** Indeed, macroprudential measures continue to be relatively tight and should help to avoid major worsening of credit quality data: banks are expected to 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 labor 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 stronger position of the banking sector.

Main economic forecasts

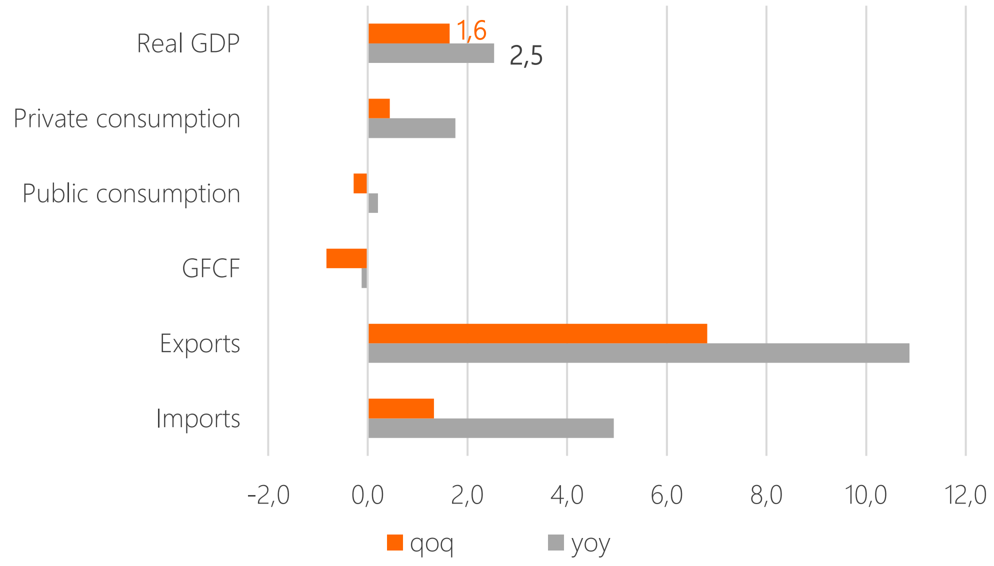
%, yoy	2016	2017	2018	2019	2020	2021	2022	Forecasts 2023	Forecasts 2024
GDP	2,0	3,5	2,8	2,7	-8,3	5,5	6,7	2,5	1,5
Private Consumption	2,6	2,1	2,6	3,3	-7,0	4,7	5,7	0,9	0,7
Public Consumption	0,8	0,2	0,6	2,1	0,4	4,6	2,4	1,0	1,0
Gross Fixed Capital Formation (GFCF)	2,5	11,5	6,2	5,4	-2,2	8,7	2,7	3,1	7,5
Exports	4,4	8,4	4,1	4,1	-18,8	13,4	16,7	7,2	6,0
Imports	5,0	8,1	5,0	4,9	-11,8	13,2	11,0	2,6	7,3
Unemployment rate	11,4	9,2	7,2	6,6	7,0	6,6	6,0	7,1	6,9
CPI (average)	0,6	1,4	1,0	0,3	0,0	1,3	7,8	5,0	2,8
External current account balance (% GDP)	1,2	1,3	0,6	0,4	-1,2	-0,8	-1,4	0,8	0,7
General Government Balance (% GDP)	-1,9	-3,0	-0,3	0,1	-5,8	-2,9	-0,4	-0,3	-0,1
General government debt (% GDP)	131,5	126,1	121,5	116,6	134,9	125,5	113,9	107,7	104,1
Risk premium (PT-Bund) (average)	307	269	138	98	89	60	98	94	102

***Source**: BPI Research*

GDP: strong Q1 pushes annual growth to 2,5% in 2023

GDP Growth in Q1

QoQ, YoY



Source: BPI Research, from INE

Latest economic indicators

YoY, Level

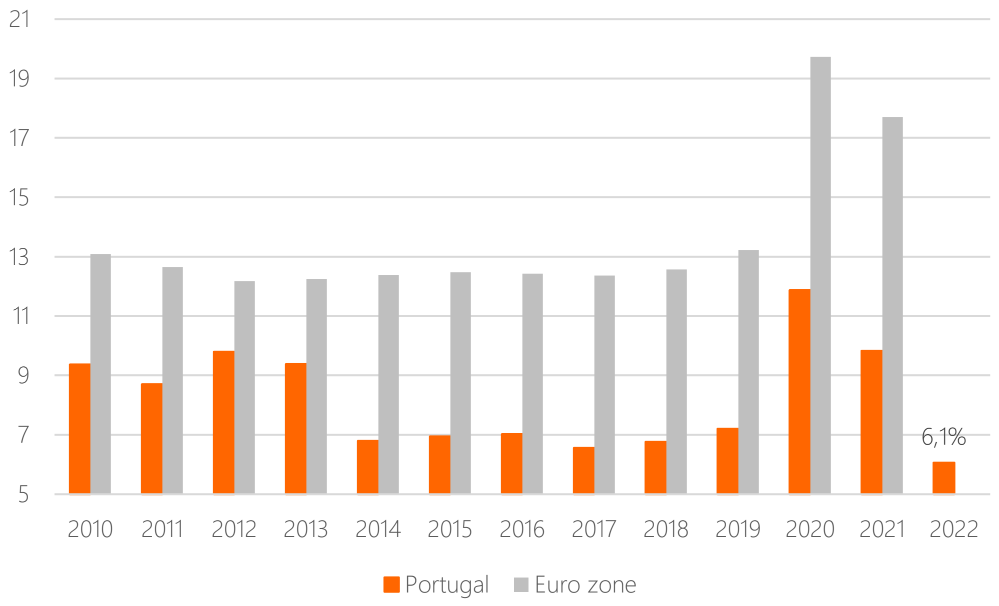
yoy, level	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Last month available
Economic climate indicator	1,7	2,1	2,1	2,3	1,6	May
Economic sentiment indicator	98,4	102,9	102,0	102,1	99,1	May
Daily economic indicator	7,2	4,2	3,5	0,8	2,7	May
Retail sales (yoy)	3,8	0,6	0,5	2,4	-	April
Retail sales excl. fuels (yoy)	-1,7	3,6	0,5	0,3	-	April
Car sales (number)	14.519	15.974	21.244	15.875	19.816	May
Car sales (yoy)	47,7	38,1	58,9	27,8	55,4	May
Imports of capital goods (accum. year)	7,7	9,3	10,2	-	-	March
Cement sales	-8,2	-12,2	-2,6	8,1	-	April
Electricity consumption	4,2	3,0	-1,1	-5,6	-2,0	May
Non-resident tourists (thousand)	769	874	1.220	1.670	-	April
Number of flights (yoy 2019)	17,5	9,6	10,3	5,0	1,8	May
Change in regist. unemployment (thousand people)	-33,8	-28,6	-20,1	-19,0	-	April
Change in employment (thousand people)	10,6	18,0	21,8	34,6	-	April

- **INE confirmed that GDP advanced 1,6% qoq in Q1 2023,** driven by strong exports. Indeed, exports of goods grew 4,8% qoq and services 10,8%. This behavior led to a significant drop in inventories, pushing the contribution of domestic demand into negative field (-0,8 p.p.). Private consumption had a more positive behavior this quarter than in Q4 2022, advancing 0.4% qoq, driven by spending on durable goods (in line with strong auto sales). This reading and expectations that the economy will continue to advance in the next quarters, albeit at a much more moderate pace, led us to revise upwards our forecast for annual growth in 2023 to 2,5%.
- For the rest of the year, we see quarterly growth decelerating, reflecting the impact of higher interest rates and inflation, but not to stagnate as activity should continue supported by tourism and consumption of durable goods (supported by increase in disposable income and strong labor market, while savings keep at comfortable levels).
- Growth should be supported by signs of deceleration of prices, higher resilience of European economies and the stimuli coming from the execution of NGEU. But the scenario continues subject to a high degree of uncertainty, due to global issues, namely related with the behavior of the energy market, the severity of the coming winter and the uncertainty regarding the conflict in Ukraine.

Households: savings are declining but also due to debt reduction

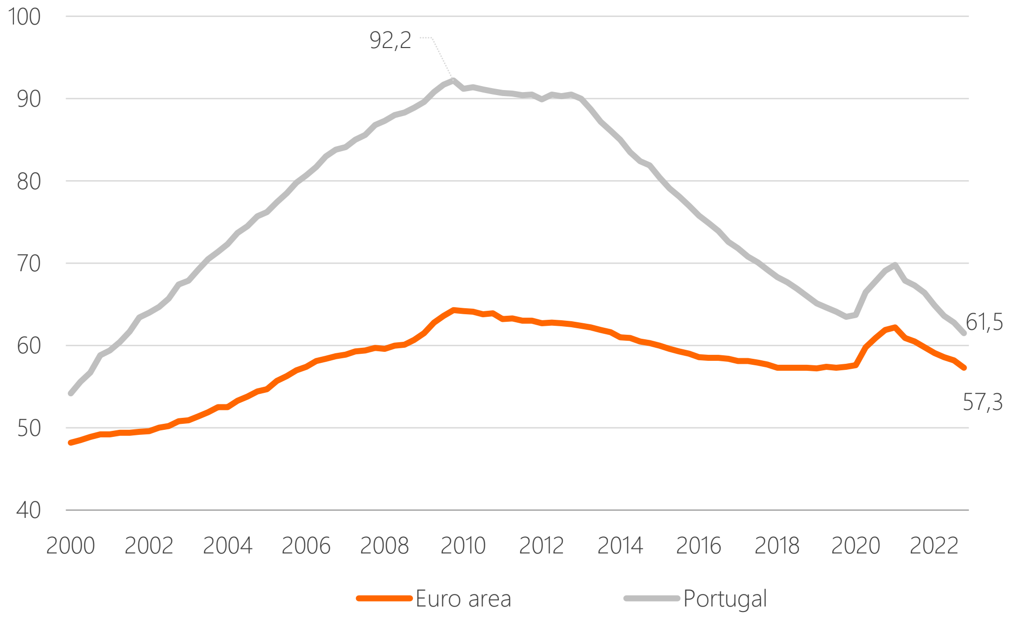
Saving rate (annual average)

% of Disposable income



Households debt

% of GDP



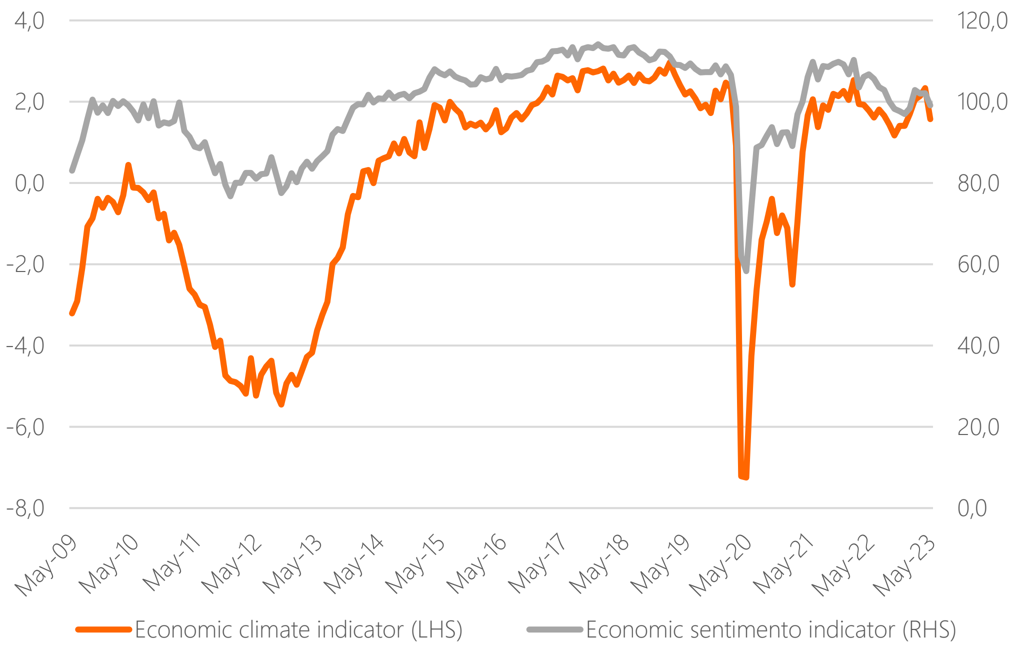
Source: BPI Research, from INE and Eurostat

- **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 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. to 61,5% of GDP. Indeed, according to the Bank of Portugal, early repayments of home loans have been increasing: in March, they represented 0,8% of the credit stock, similar to that recorded in first two months of 2023, but higher than the monthly average of 0,54% recorded in 2022.

The sentiment continues strong, but with slowing signs

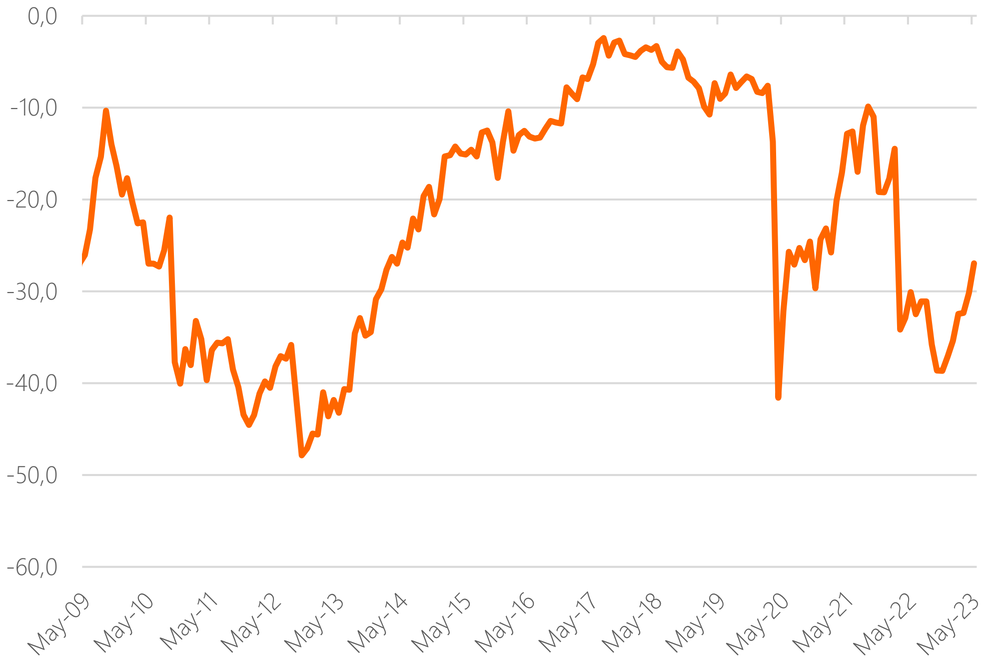
Grupo CaixaBank

Synthetic sectoral sentiment indicators
% yoy, level



Source: BPI Research, from INE, EC

Consumer confidence
Level



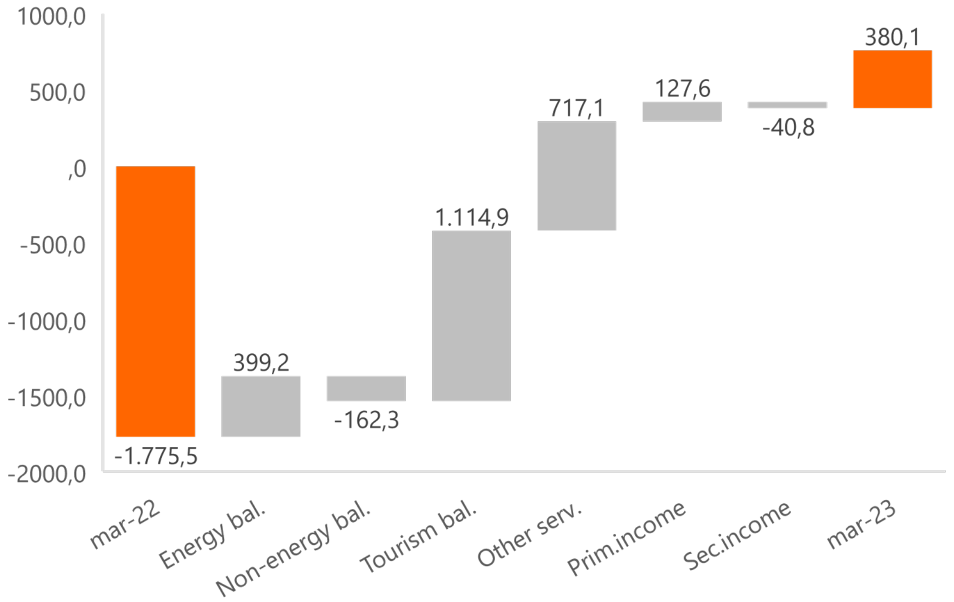
- **INE's economic climate and EC economic sentiment indicators deteriorated in May, due to a more cautious evaluation in all sectors.** However, they continue strong comparing with the pre-covid levels**.** The former decelerated to 1,6%, from 2,3%, and the latter to 99,1 points from 102,1.
- **Between consumers, confidence continues to recover**, reflecting a better outlook for price developments and positive evaluation of the labor market.

External accounts return to surplus due to reduced energy prices, tourism dynamism and also structural improvements

Grupo CaixaBank

Current account evolution in Q1 2023

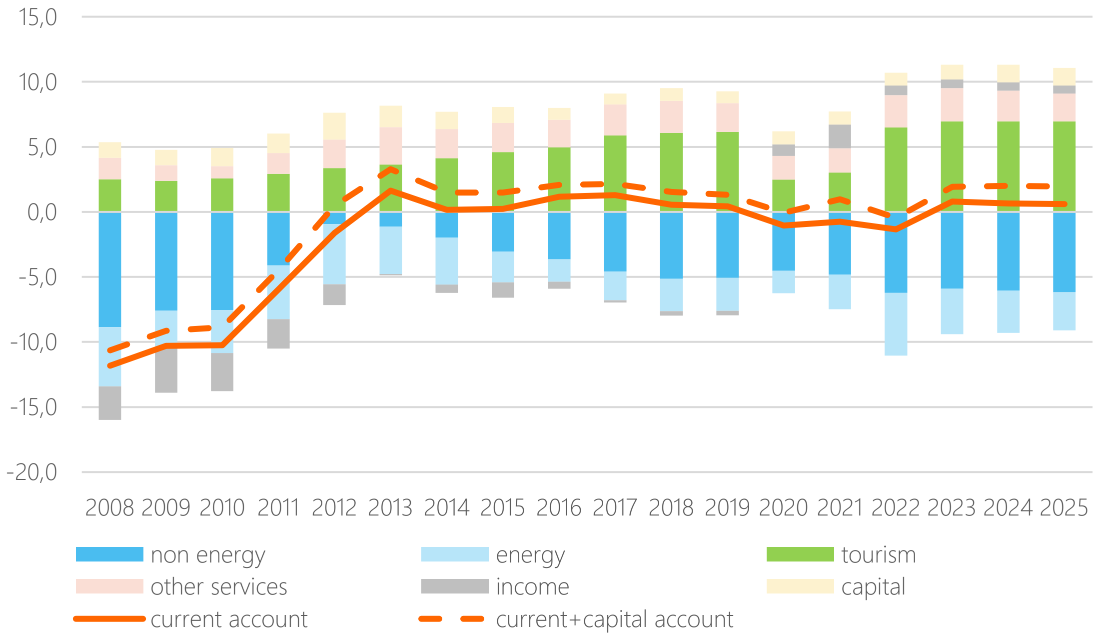
EUR Million



Source: *BPI Research, from INE*

Current & capital account by components

% of GDP

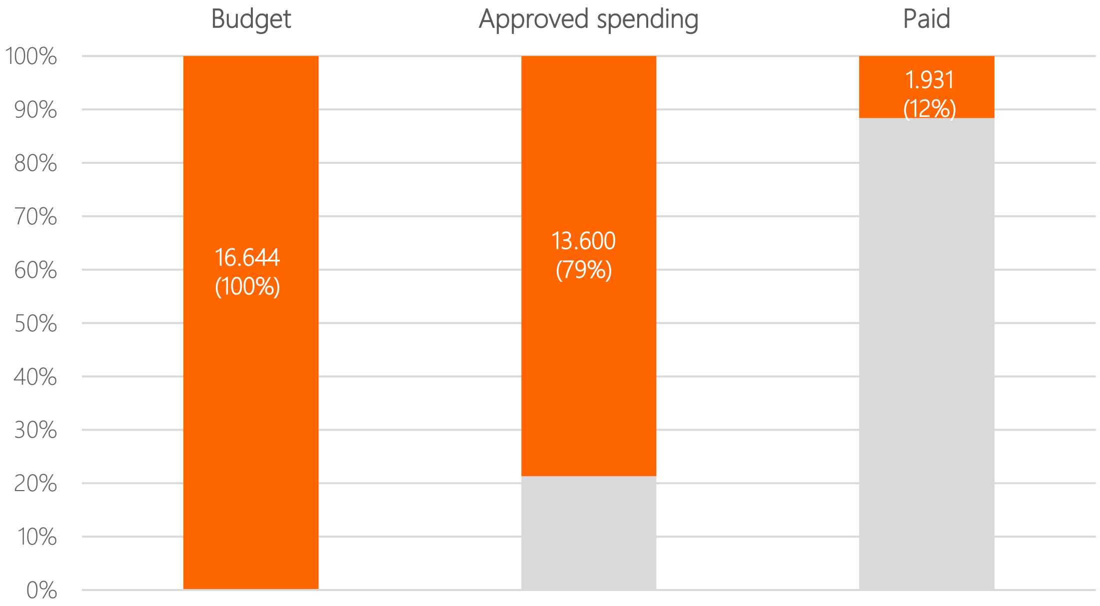


- **The current account posted a surplus in the Q1 2023, for the first time since 2018 (with the exception of a tinny surplus in 2021).** Compared to the same period a year ago, the main contributions to this improvement came from the services account (surplus of 5.2 billion, up 1.8 million from a year ago), particularly tourism (surplus of 3.3 million, +1.1 million), and the energy account (deficit of 2.1 billion, down 400 million from March 2022), reflecting the reduction in energy prices, which a year ago were at historically high levels.
- **Worth to mention the increase in the market share of services, with particular emphasis to tourism. The data now published and the dynamics expected for global and domestic activity suggest the possibility that the current account balance will again record a surplus at the end of 2023, equivalent to 0,8% of GDP.**

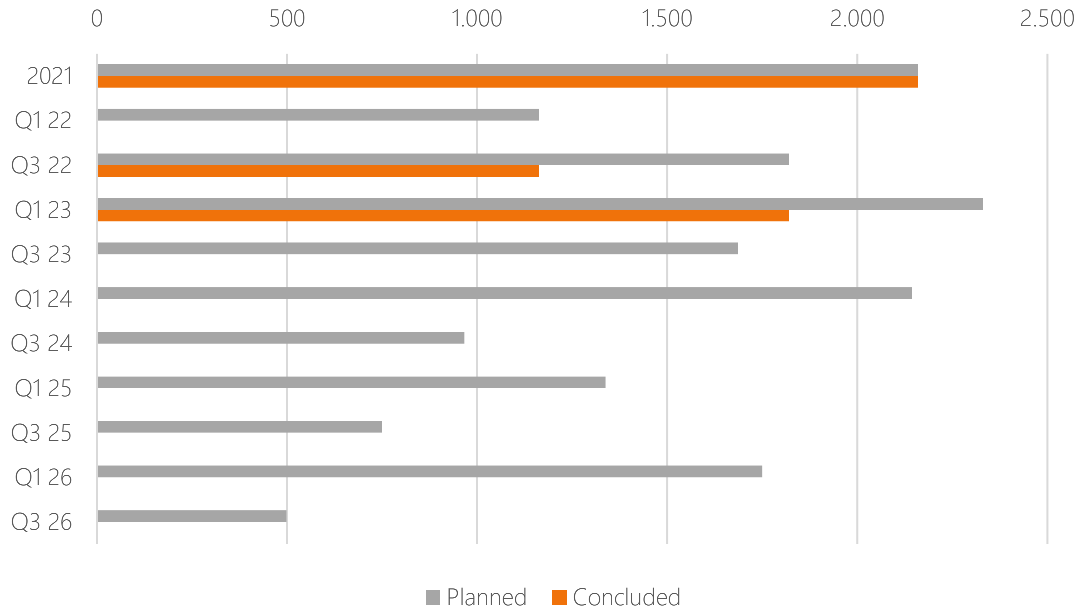
NGEU: a lot of projects in the pipeline

Grupo CaixaBank

NGEU Funds up to May 2023
EUR million



Expected disbursements along the program
EUR million



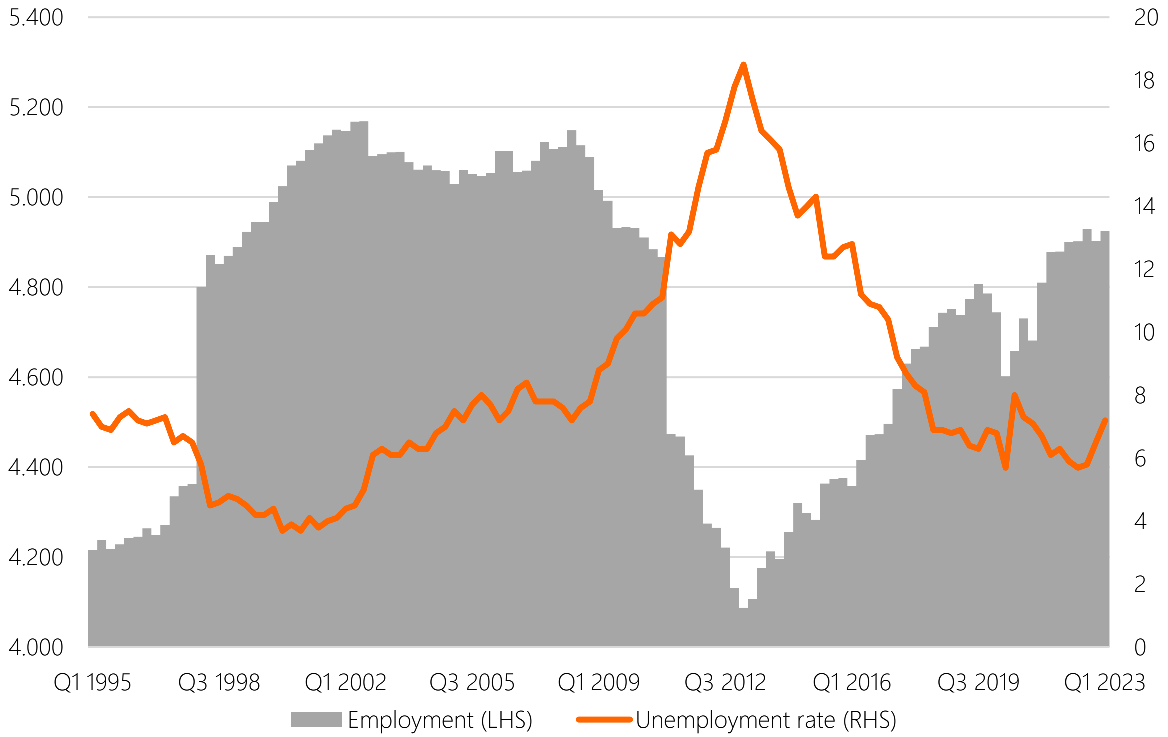
Source: BPI Research, from Recuperar Portugal

- **Up to the end of May, the approval rate was of 79%, which looks promising for the use of the funds that Portugal will receive until 2026.**
- The Regulation of the Resilience and Recovery Mechanism foresees adjustments in the distribution of NGEU funds among the various countries according to the accumulated growth of real GDP in 2020-21, which **in the case of Portugal led to an increase of the funds to be received from 16,6 billion euros to 22,2 billion euros (2,4 billion grants and 3,2 billion loans).** Some priorities for these additional of grants and loans are the increase of the amounts available for companies, for the STEAM program (intended to strengthen labor force skills) and for the reinforcement of social equipment's. **The Portuguese authorities estimate that the impact of the funds currently available for the implementation of the RRP will led to an increase of 4,1% in potential GDP over the next 10 years.**

Labor market remains robust but the trend is rolling back

Employment and unemployment rate*

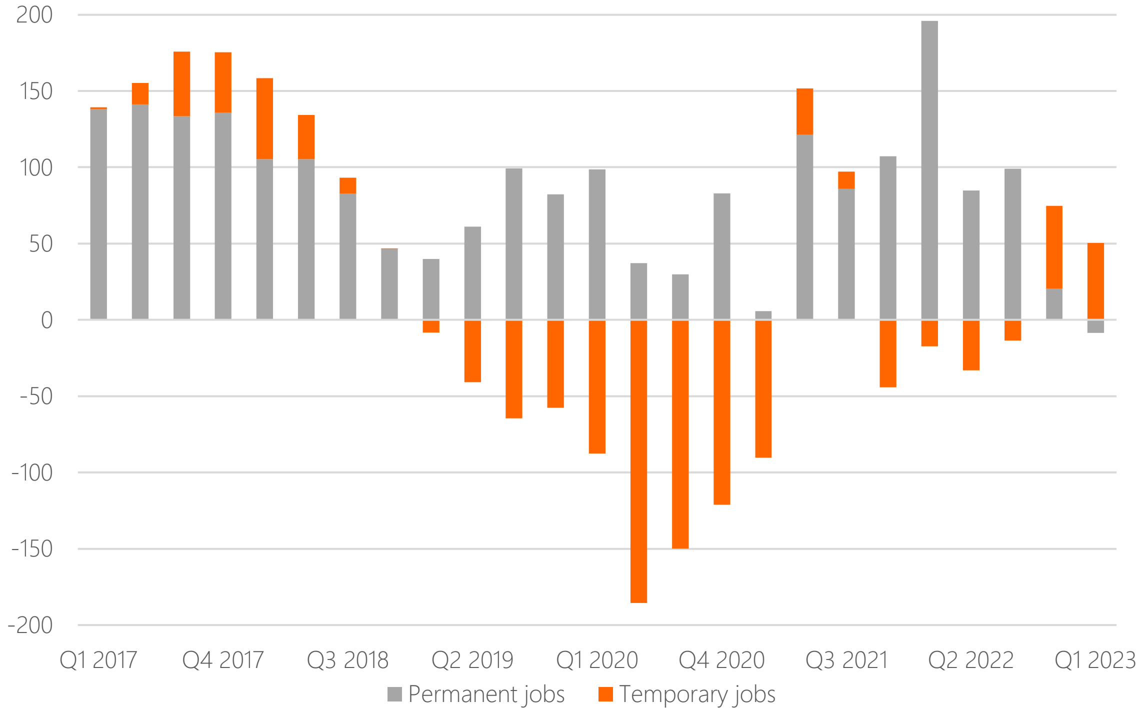
Thousand people *(%)*



Notes: (*) not seasonally adjusted.
Source: BPI Research, from INE.

Number of jobs created, by type of contract*

Thousand



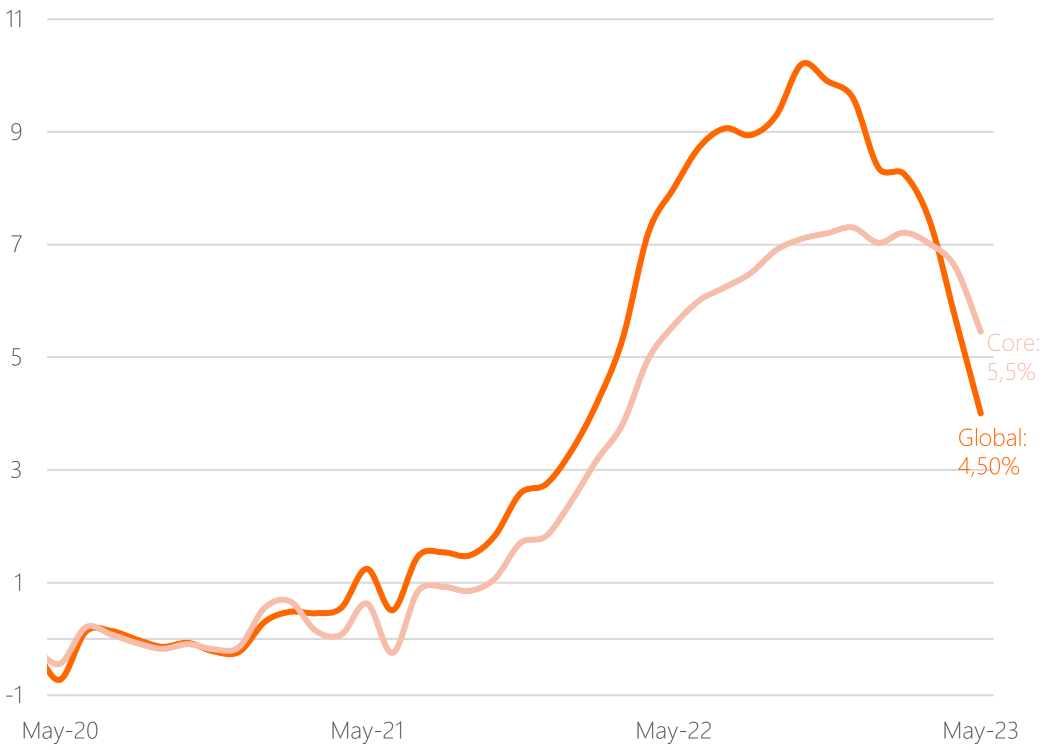
Source: BPI Research, from INE.

- **Labor market remains robust and attracting discouraged people.** Employed population keeps improving, but in the Q1 unemployment has also increased. This is due to the decrease of the inactive population: people who has previously no interest entering in the labor market but now they are trying to find a job. Additionally, it is possible that the significant increase in the active population is also justified by immigration. In this context, unemployment rate increased to 7,2% in Q1, the highest level since Q1 2018 (excluding pandemic).
- **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. Additionally, the jobs created in Q1 were mainly through precarious contracts: only by temporary contracts and part-time jobs.

Inflation: all CPI major components down in May

Portugal CPI: Global & Core

Year-on-year (%)



Source: BPI Research, using data from INE.

CPI: Global and major components

Month-on-month (%)

	2022		2023				
	Nov	Dec	Jan	Feb	Mar	Apr	May
CPI Global	0,3	-0,3	-0,9	0,3	1,7	0,6	-0,7
CPI Core	0,4	0,1	-0,3	0,3	2,0	1,0	-0,3
Energy	-1,5	-4,3	-8,9	-2,2	-0,4	-3,2	-1,8
Non processed food	0,6	0,6	1,4	1,5	1,5	-0,3	-2,4
Processed food	2,6	0,4	2,3	0,6	1,1	0,2	-2,9

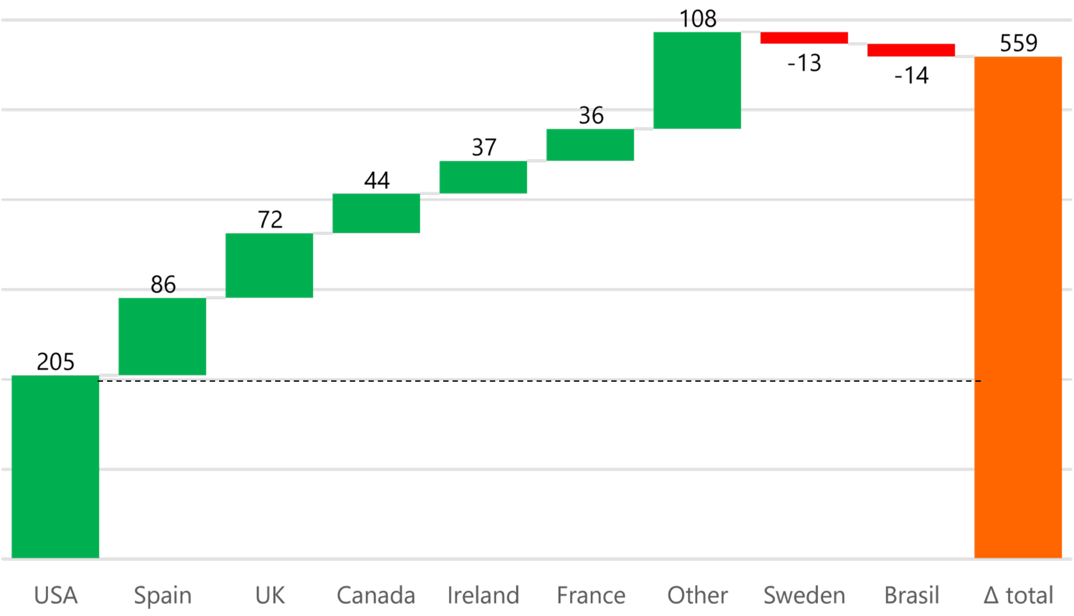
***Source**: BPI Research, using data from INE.*

- **The inflation rate falls for the seventh consecutive month.** The yoy rate of change of the Consumer Price Index (CPI) slowed down to 4,0% in May, from 5,7% in April. The core inflation rate decelerated too, and kept above the global inflation: 5,5% (6,6% in April). Energy prices declined at a strong pace (-12,7% yoy, down from -4,4% in March). Unprocessed food prices also decelerated to 14,1%, 5,2 p.p. less than in March.
- **In May, the "zero VAT" measure was reflected in prices (the price of unprocessed food products fell -2,4% in monthly terms and processed food products -2,9%), which will also have had some effect on the core component of the index (it fell -0,3% in monthly terms).** The energy component continued to support the decline in inflation as it had been doing in previous months (-15,4% yoy, compared to -12,7% in April).

Tourism: on the way to a record-breaking year

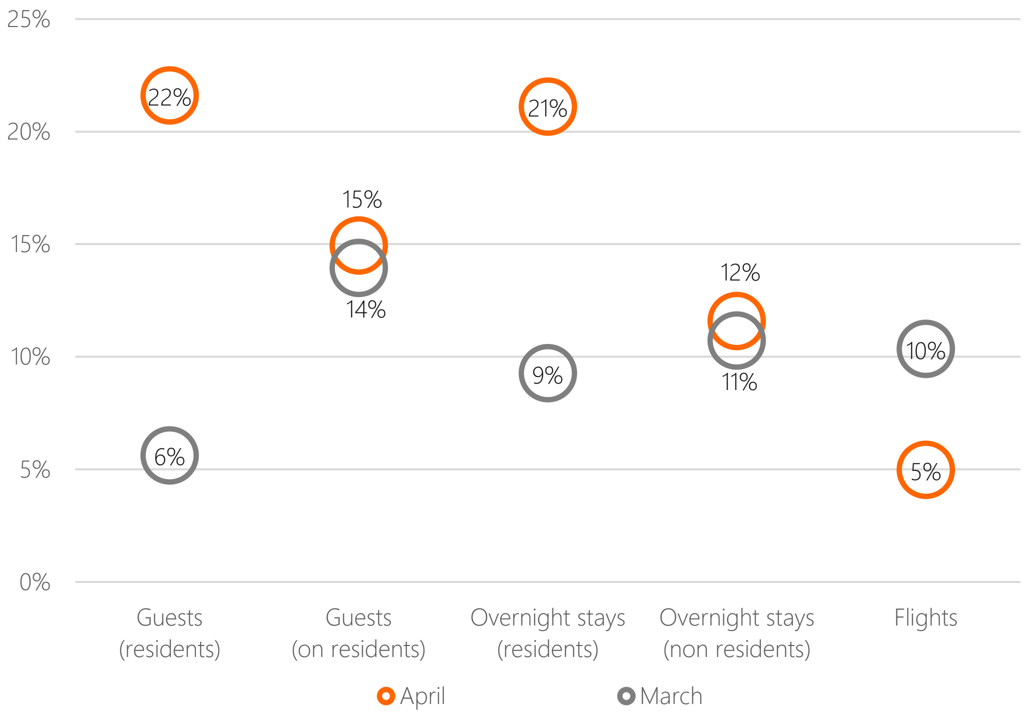
Grupo CaixaBank

Jan-Apr 2023 *vs* Jan-Apr 2019: change in non resident guests
thousands



Source: BPI Research, using data from INE.

Tourism: changes versus same month of 2019

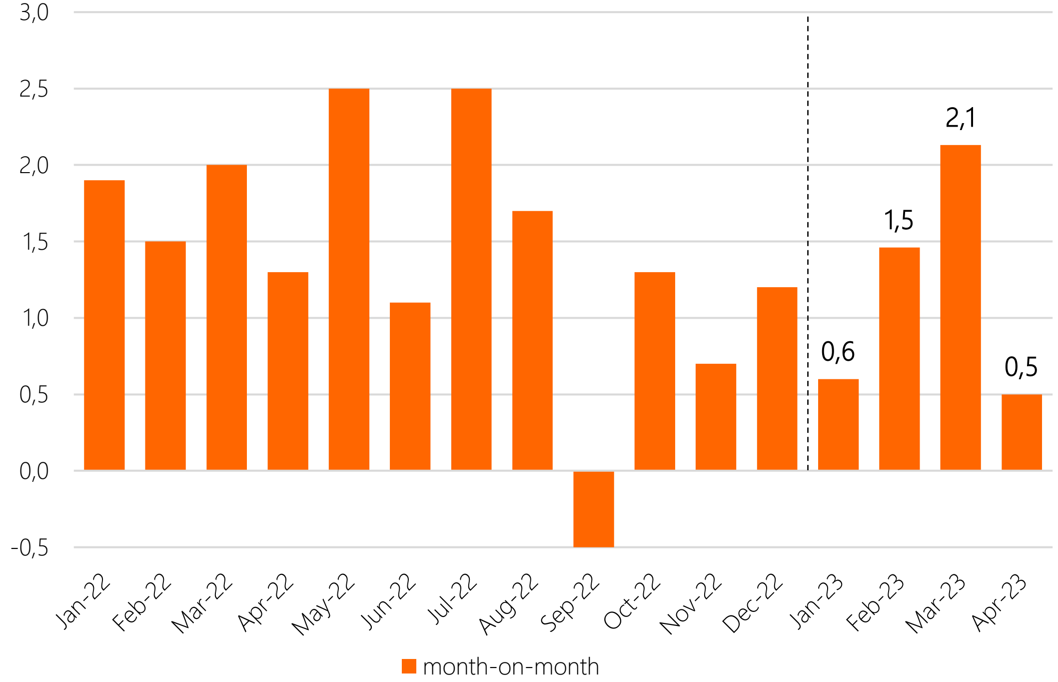


Source: BPI Research, using data from INE.

- **April Tourism data reinforces our belief that this will be the best year for national tourism in its main metrics: guests, overnight stays and revenues.** In fact, in April, and compared to the pre-pandemic, guests increased by 17,5% (10,4% in March) and overnight stays increased by 14,3% (10,3% in March). Progressively, the sector returned to the mix that was observed in the pre-pandemic with 60% of guests and 70% of overnight stays being by non-residents.
- **The increase in tourists from the USA continues the 2022 trend and should be highlighted, as they account for 37% of the net increase in non-resident tourists in the first four months of the year,** which amounted to 559 thousand. Other long-haul tourists also show good performance, such as Canada.

Housing market: positive price movements and a healthier loan portfolio

House Price Index (Confidencial Imobiliário)
Month-on-month (%)



Source: BPI Research, using data from Confidencial Imobiliário.

Stock of mortgage loans by LSTI class and income quintile
(%)

		Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
LSTI class	≤ 20%	6,9	20,2	40,5	59,4	82,7
	> 20% ; ≤ 30%	18,3	35,1	35,2	28,1	12,9
	> 30% ; ≤ 40%	23,7	23,7	16	8,9	3,2
	> 40% ; ≤ 50%	17,7	11,2	5,2	2,3	0,7
	> 50%	33,3	9,8	3,1	1,4	0,5
Average debt in mortgage loan (€)		72.064	79.381	87.869	97.566	124.514
Weight in the stock of mortgage porfolio		9,4%	15,7%	18,9%	19,5%	36,5%

Source: BPI Research, with data from Banco de Portugal. LSTI (Loan service-to-income) corresponds to the ratio between the home loan instalment and the borrowers' average monthly income (annual income divided by 12 months). .

- **In the first months of 2023, the HPI from Confidencial Imobiliário shows positive month-on-month price movements (in average = 1,18%).** Our forecast for 2023 is still for an increase in housing prices (2%). This reflects not only the strong carry-over effect, but also the fact that in the Q1 the available data continues to signal appreciation. We anticipate that the effect of rising interest rates and reduced transactions will have a greater effect in the second half of 2023/early 2024.
- **Total mortgage loans in 1st income quintile borrowers constitutes only 9,4% of the total stock of the mortgage portfolio of Portuguese banks**. In fact, for housing loans granted in the most recent years (2019-2023), there is a lower weight of households/borrowers in the lowest income quintile (only 6%). Borrowers in the fourth and fifth income quintile make up 53% of the number of these contracts.

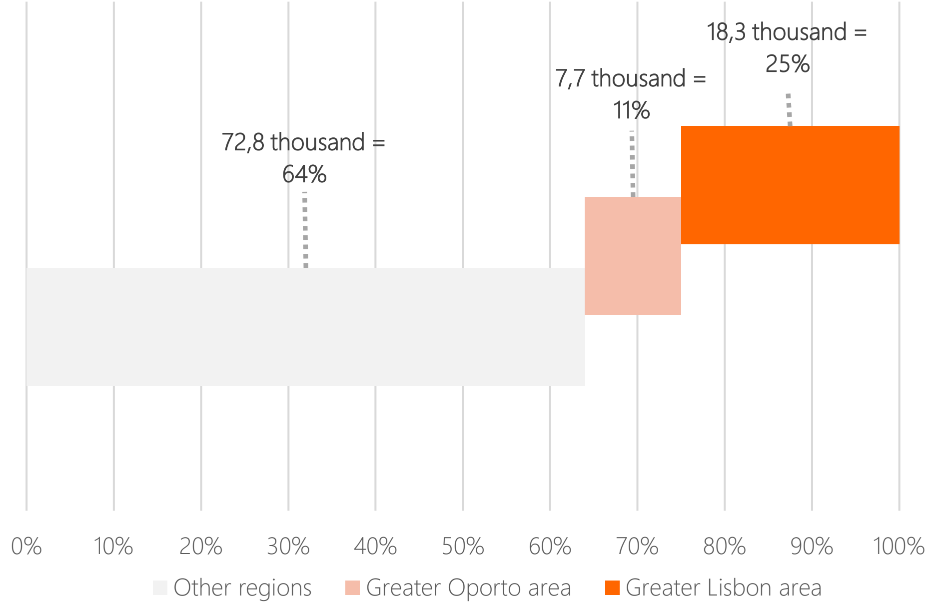
Housing market: The "Mais Habitação" program

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 of 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 / %



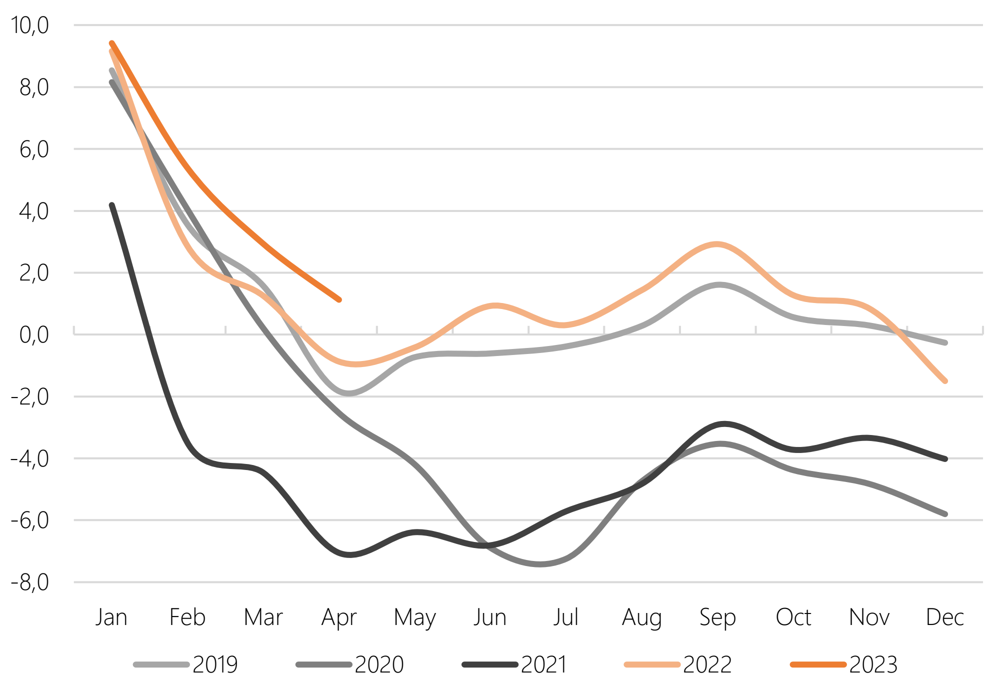
Source: BPI Research, using data from INE. Note: "Alojamento Local" refers to short-term rental houses for tourism purposes.

- **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.

Committed with fiscal consolidation

Overall fiscal balance*

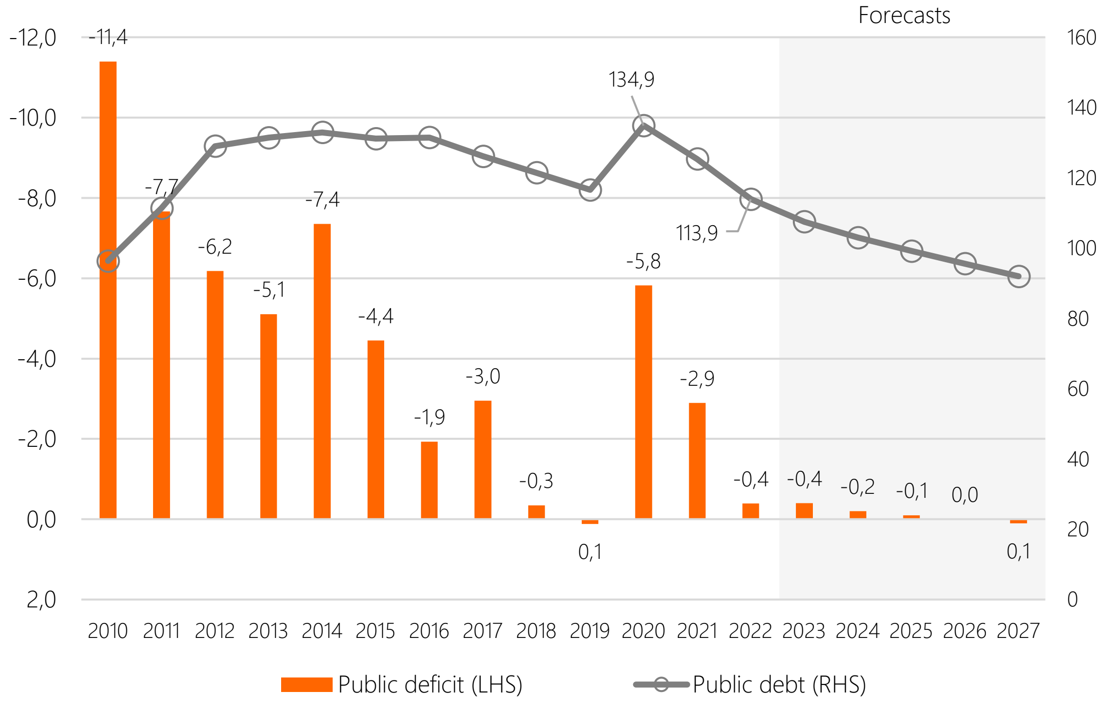
(% GDP)



Note (*): cash basis. Source: BPI Research, based on INE.

Public deficit and public debt ratio

(% of GDP)



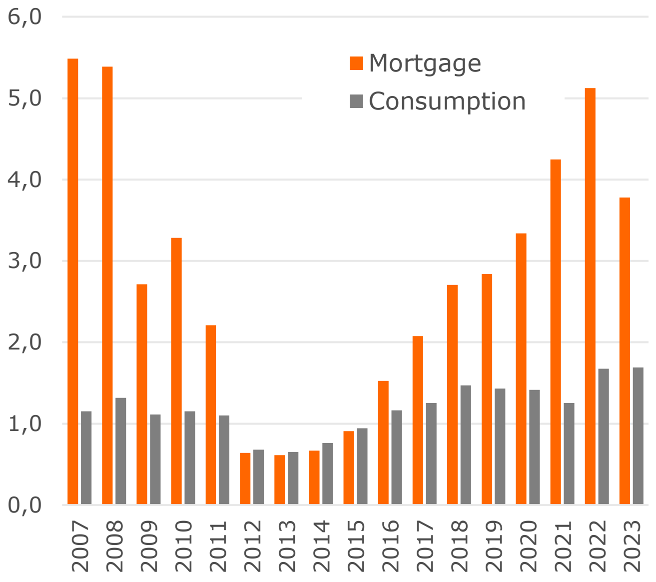
Source: BPI Research, based on INE and Stability Program 2023-2027.

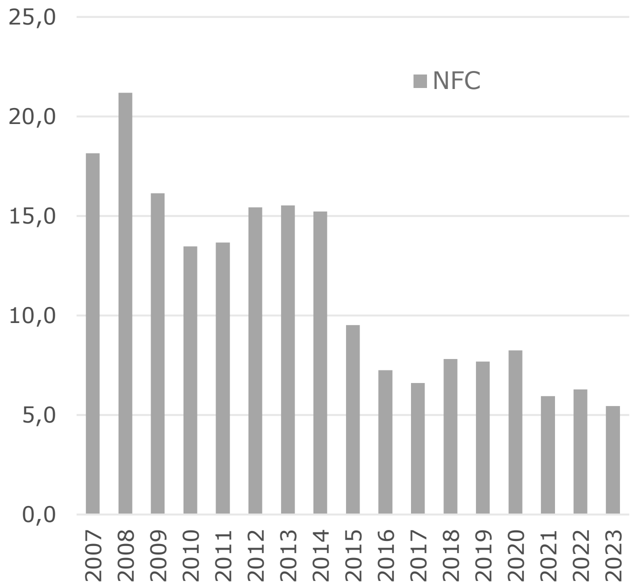
- **Balanced public accounts is the medium term target.** The budget balance is expected to remain at -0,4% of GDP in 2023, suggesting moderate support to economic activity (Government estimates the reduction of the structural balance from -0,5% to -0,4%). In the medium term, without the impact of the measures implemented to help families and companies to deal with higher inflation, the Government expects a slight surplus in 2027 (0,1% of GDP). This includes a projected adjustment to household taxes (income-related taxes) and an upward revision to pensions.
- In a scenario of economic growth around 2% and lower inflation, the public debt ratio is projected to fell below 100% of GDP in 2025 and a primary surplus is expected in all projected period. Nevertheless, the increase in financing costs will contribute to a worsening of the amount spent on interest; in fact, with a cautious view, the Government expects this item to reach levels close to 3% of GDP in 2025.
- Given the evolution of the public debt since 2019, in comparison with European peers, **Portugal (113,9%) is one of the countries that registers debt levels already below 2019**, whereas the distance from Spain and France has been reduced (as both countries registered debt to GDP ratios above 100% by end-2022).

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

New lending activity by sector

Accumulated in the year until April, billion euros

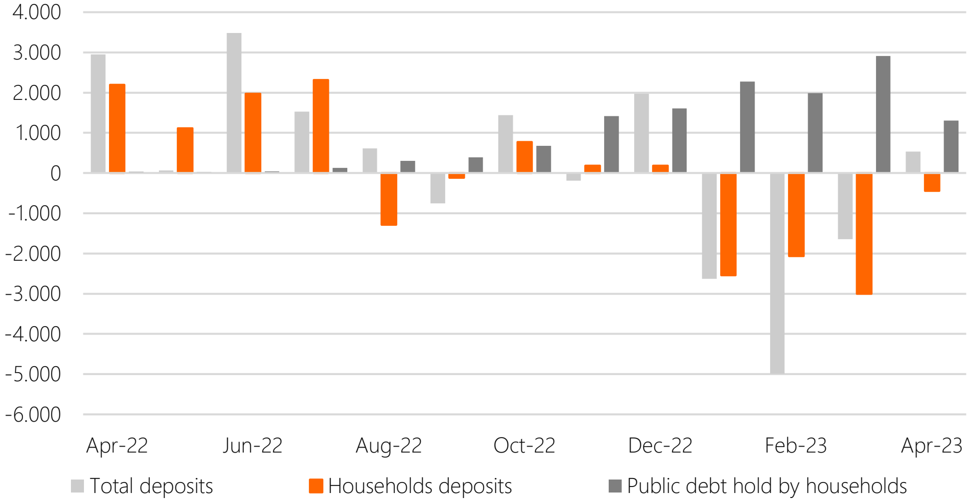




Source: BPI Research, base on data from Bank of Portugal and ECB.

Deposits and public debt hold by families*

Monthly variation (M€)

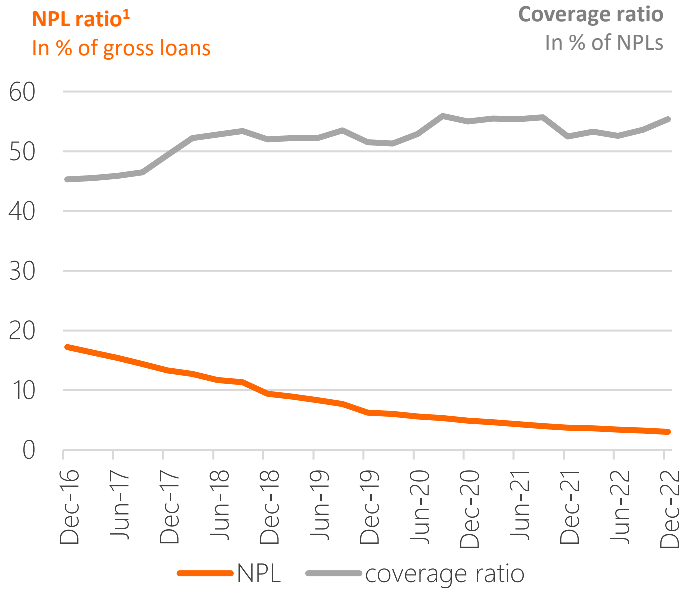


*Notes: (*) **Public debt by households includes** Certificados de Aforro and Certificados do Tesouro, which can only be subscribed by resident households. The maximum amount that Government can issue for these retail instruments (CA and CT) is 16.5 bn Eur in 2023.*
Source: BPI Research, base on data from Bank of Portugal.

- **The stock of credit is decelerating since mid 2022:**
  - **Mortgage credit:** significant deceleration (1,1% yoy in April vs 2,7% in January), in line with the drop in new operations (-26,4% yoy accumulated in the first four months of 2023) and the amount of early redemptions. High levels of interest rates, inflation and housing prices explain this decline, which should continue next months. However, the absolute amount of new mortgage operations remains high by historical standards.
  - **NFC**: the stock has been declining since mid-2022, due to the redemptions of COVID-credit lines and the worst start of the year for new credit operations (the lowest value since the beginning of the series, 2003).
- Since December, **deposits in the banking system have been declining** (-9,9bnEur ytd). The pursuit for alternative applications (especially in the case of households, which can subscribe Treasury products directed to the retail segment - Certificados de Aforro (CA's) and Certificados do Tesouro, for instance), the early repayment of debt or higher expenditure needs (due to the high inflation and interest rates) are some of the reasons behind this evolution. However, the aggregate amount of households' deposits and Treasury products is stable.
- Deposits of the private sector decreased in April (-0,8% yoy) for the first time since the end of 2013, especially due to households' deposits (-1,6% yoy). Meanwhile, interest rates for new deposits have been increasing (last April, household's deposit interest rate reached 1,03%, the highest rate since February 2015). Together with the recent change in CA's new subscription conditions (maximum interest rate of 2,5%) , this may probably limit the recent outflows 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

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

Banks' profitability

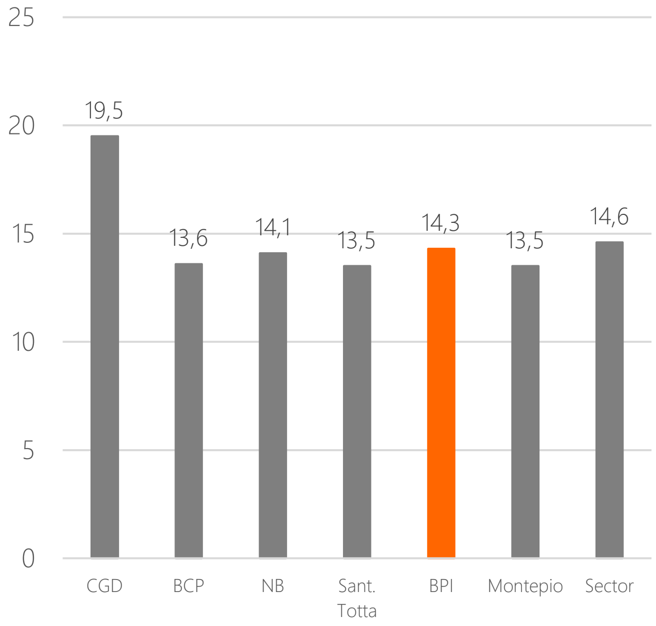
In % of average total assets (Q1 23; trailing 12M)

	BPI	BCP	San Totta	CGD	NB	Montepio
Net interest income	**2,0%**	**2,0%**	**1,8%**	**2,1%**	**2,2%**	**1,9%**
Net fees	0,7%	0,8%	0,8%	0,6%	0,6%	0,7%
Gains on financial assets	0,1%	0,1%	0,1%	0,4%	0,2%	0,0%
Other net profits	-0,3%	0,0%	0,0%	-0,2%	-0,4%	-0,2%
Gross income	**2,6%**	**3,0%**	**2,7%**	**2,8%**	**2,5%**	**2,3%**
Operating expenses	-1,2%	-0,9%	-0,8%	-0,9%	-1,0%	-1,4%
Operational result	**1,4%**	**2,1%**	**1,9%**	**1,9%**	**1,6%**	**1,0%**
Impairement losses, taxes and others	-0,2%	-0,6%	-0,1%	-0,2%	-0,2%	0,2%
Profit	**0,7%**	**1,0%**	**1,2%**	**1,0%**	**1,3%**	**0,7%**
ROTE[1]	9,5%	17,7%	19,7%	13,1%	-	9,3%

Notes: 1) the values for BCP and CGD refer to ROE; calculation methodologies differ between banks.

Banks' solvency and liquidity position

*In % (Q1 23)**



Source: Banks publications, BoP
*Note: *Q4 for the whole sector*

- **NPLs continue to decline, despite the fact that debt moratoria has 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 increase slightly in the coming months, reflecting the impact of increasing interest rates and prolonged inflation in households and firms consumption and costs.
- **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