# Portugal:
## Macroeconomic and financial outlook

**BPI** *Research*

October 2023


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BPI Grupo CaixaBank

# Main messages

## Activity

- **GDP growth in 2023 revised downwards by two tenths to 2,4%.** After the stagnation seen in Q2, Q3 data is pointing to a more modest evolution of GDP compared to the first half of the year. This moderation and the expected full impact of higher interest rates (internally and also on the activity of the main trading partners of Portugal) in the last part of the year, were the main drivers for this revision. For 2024 we kept unchanged our forecast of an annual growth of 1,8%, with risks slightly biased on the negative side.
- **Inflation in September resumed the downward trend, declining to 3,6%,** minus 1 tenth than in August; the disinflationary trend is being confirmed by the fall of the core inflation, that in September fell 4 tenths to 4,1%. The dominant sentiment continues to be that the disinflationary process will be very gradual but consistent, taking into account the relief in the energy component and the negative year-on-year changes in the Industrial Production Price Index. Also the extension of the zero VAT in some food items will help to consolidate the downward path in 2H23. For 2023 as a whole we see inflation at 4,6%, minus 1 tenth than previously expected. Main risk associated to this forecast are related with the recent less benign performance in the oil market.
- **Labor market remains robust**. The unemployment rate fell to 6.2% in August and the employed population reached a new high (+0.1% mom; 1.3% yoy). Even if there are signs that employment is close to its peak, there seems to be no significant risks to our projection for an unemployment rate of 6,6% in 2023.
- **Tourism continue to perform well.** Compared to the pre-pandemic period, overnight stays in the first seven months of the year increased circa 10%.
- **In housing market, prices surprised on the upside in Q2, rising 3,1% qoq; however, the number of transactions kept declining.** The narrowing gap between houses on the market and houses sold  and non residents acquisitions continues to support the appreciation of the market.
- **Fitch upgraded the Portuguese sovereign rating to A- from BBB+.** Strong commitment with fiscal consolidation, an expected surplus in the fiscal balance between 2023-25, the return of the external accounts to surpluses, reduction of indebtedness levels were the main factors supporting this decision.
- **Up to August, the fiscal balance registered a surplus equivalent to 1,5% 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), supporting the Fitch view of a surplus equivalent to 0,5% of GDP for this year. Nevertheless, the impact on the interest expenditure related with the increase in financing costs and the deceleration on activity expected for the H2 2023 may have a negative impact on public accounts in the last months of the year. But despite the risks, public balance should stay close to equilibrium, with a comfortable primary surplus.

## Banking Sector

- **NPLs ratio stable in Q2 2023.** 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 years; institutions have to apply a shock (depending on the maturity, it can reach 150 bp) to assess the impact on the debt service of an hypothetical increase of interest rates 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 contained, in a context of a stronger position of the banking sector.

# Main economic forecasts

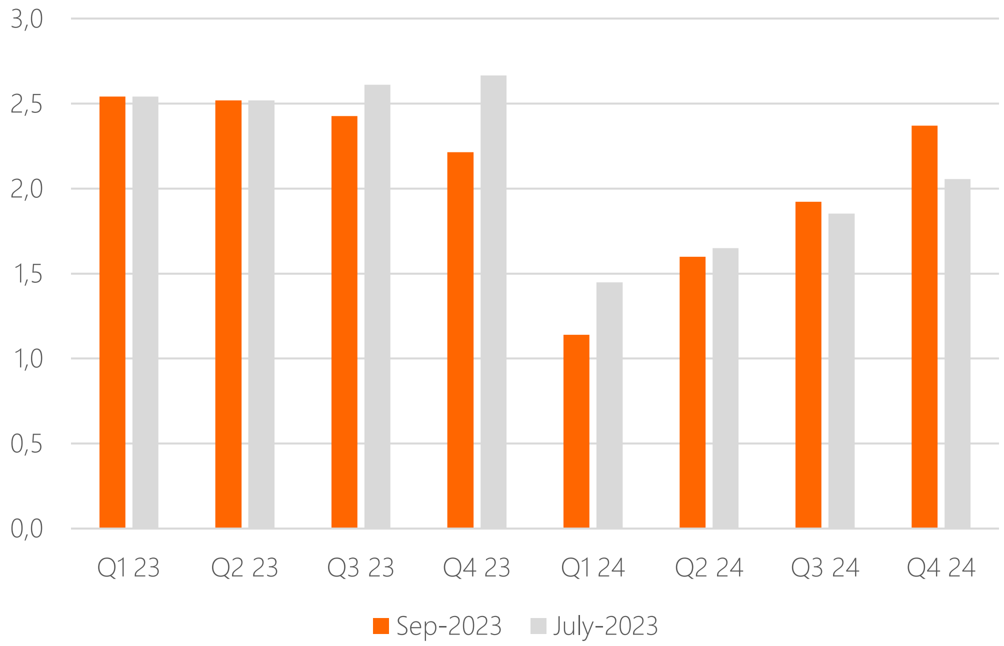
| %, yoy | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Forecasts 2023 | Forecasts 2024 |
|---|---|---|---|---|---|---|---|---|---|
| **GDP** | 2.0 | 3.5 | 2.8 | 2.7 | -8.3 | 5.7 | 6.8 | 2.4 | 1.8 |
| **Private Consumption** | 2.6 | 2.1 | 2.6 | 3.3 | -7.0 | 4.7 | 5.6 | 0.9 | 0.7 |
| **Public Consumption** | 0.8 | 0.2 | 0.6 | 2.1 | 0.4 | 4.5 | 1.4 | 1.2 | 1.3 |
| **Gross Fixed Capital Formation (GFCF)** | 2.5 | 11.5 | 6.2 | 5.4 | -2.2 | 8.1 | 3.0 | 1.3 | 5.0 |
| **Exports** | 4.4 | 8.4 | 4.1 | 4.1 | -18.8 | 12.3 | 17.4 | 5.5 | 2.7 |
| **Imports** | 5.0 | 8.1 | 5.0 | 4.9 | -11.8 | 12.3 | 11.1 | 1.6 | 2.5 |
| **Unemployment rate** | 11.4 | 9.2 | 7.2 | 6.6 | 7.0 | 6.6 | 6.0 | 6.6 | 6.5 |
| **CPI (average)** | 0.6 | 1.4 | 1.0 | 0.3 | 0.0 | 1.3 | 7.8 | 4.6 | 2.4 |
| **External current account balance (% GDP)** | 1.2 | 1.3 | 0.6 | 0.4 | -1.2 | -0.8 | -1.4 | 1.2 | 1.2 |
| **General Government Balance (% GDP)** | -1.9 | -3.0 | -0.3 | 0.1 | -5.8 | -2.9 | -0.3 | -0.1 | -0.1 |
| **General government debt (% GDP)** | 131.5 | 126.1 | 121.5 | 116.6 | 134.9 | 125.5 | 112.4 | 106.0 | 102.7 |
| **Risk premium (PT-Bund) (average)** | 307 | 269 | 138 | 98 | 89 | 60 | 97 | 83 | 87 |

***Source****: BPI Research*

# GDP: downward revision of growth in 2023

## GDP: revision of the growth path

*% yoy*




## Forecasts for the Portuguese economy

*% annual growth*

| | 2022 | 2023 | 2024 | 2025 | Accum. 23-25 |
|---|---|---|---|---|---|
| BPI Set23 | 6,8 | 2,4 | 1,8 | 2,4 | 6,8 |
| BPI Jul23 | | 2,6 | 1,8 | 2,4 | 6,9 |
| BoP Oct23 | | 2,1 | 1,5 | 2,1 | 5,9 |
| IMF Oct 23 | | 2,3 | 1,5 | 2,2 | 6,1 |

*Source: BPI Research, from Bank of Portugal, EC, IMF*

- **We revised downwards by 2 tenths our forecast for annual growth in 2023 to 2,4% (2024-2026 forecasts remain unchanged):** Indicators available for Q3, point to a more modest evolution of activity compared to the first half of the year or even compared to 2022. Risks to our forecasts are slightly negative due also to uncertainty related with the impact of higher interest rates in households consumption and due to worse prospects for external demand.
- **Bank of Portugal significantly revised it growth scenario**, reducing predicted growth in 2023 to 2,1% from 2,7 in June and in 2024 to 1,5% from 2,4%. According to BdP, this revision reflects a stronger impact than previously expected coming from the weaker momentum of the main trading partners and the cumulative impact of inflation and higher interest rates.

# Economic data points to slower pace of growth in H2

## Latest economic indicators

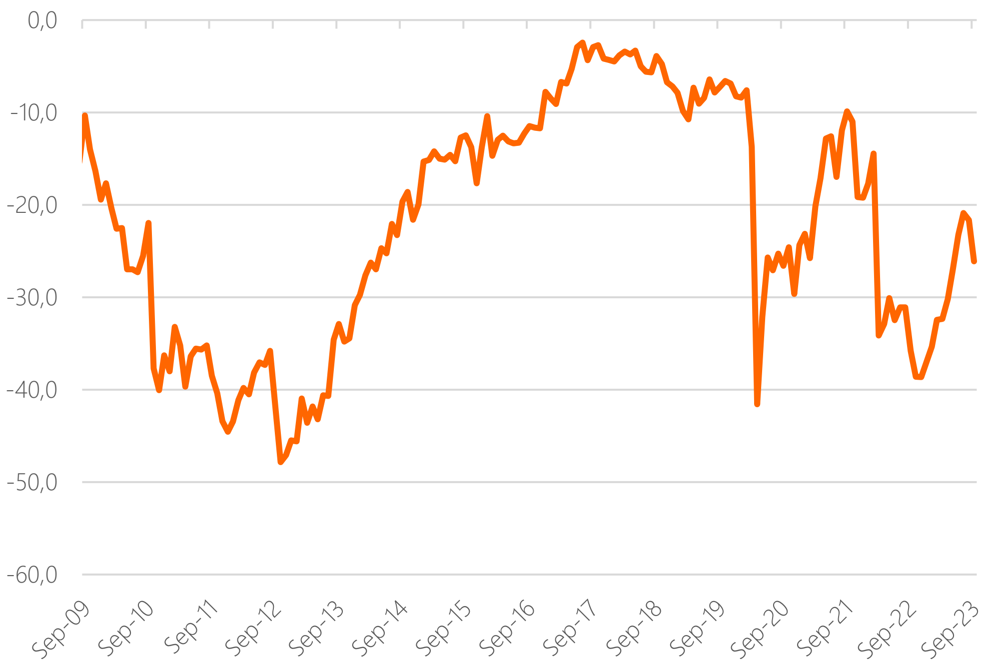
*YoY, Level*

| yoy, level | | Q2 2023 | Q3 2023 | Last month available |
|---|---|---|---|---|
| Synthetic indicators | Economic climate indicator | 1,8 | 1,3 | September |
| | Economic sentiment indicator | 100,1 | 97,6 | September |
| | Daily economic indicator | 1,6 | 1,4 | September |
| Consumption | Retail sales (yoy) | 3,0 | -48,2 | August |
| | Retail sales excl. fuels (yoy) | 2,5 | -48,4 | August |
| | Car sales (yoy) | 41,4 | 12,2 | September |
| Investment | GFCF indicator | 1,9 | 4,7 | July |
| | Imports of capital goods (accum. year) | 8,5 | 8,1 | July |
| Suply | Cement sales | 4,2 | 8,8 | August |
| | Industrial production | -5,0 | -51,6 | August |
| Demand | Electricity consumption | -2,2 | -1,3 | September |
| | Non-resident tourists (yoy 2019) | 10,0 | 9,0 | July |
| | Number of flights (yoy 2019) | 5,6 | 6,6 | September |
| Labour market | Change in regist. unemployment (thousand people) | -11,4 | 9,7 | August |
| | Change in employment (thousand people) | 62,4 | 63,9 | August |

*Source: BPI Research, from INE, EC*

## Consumer confidence

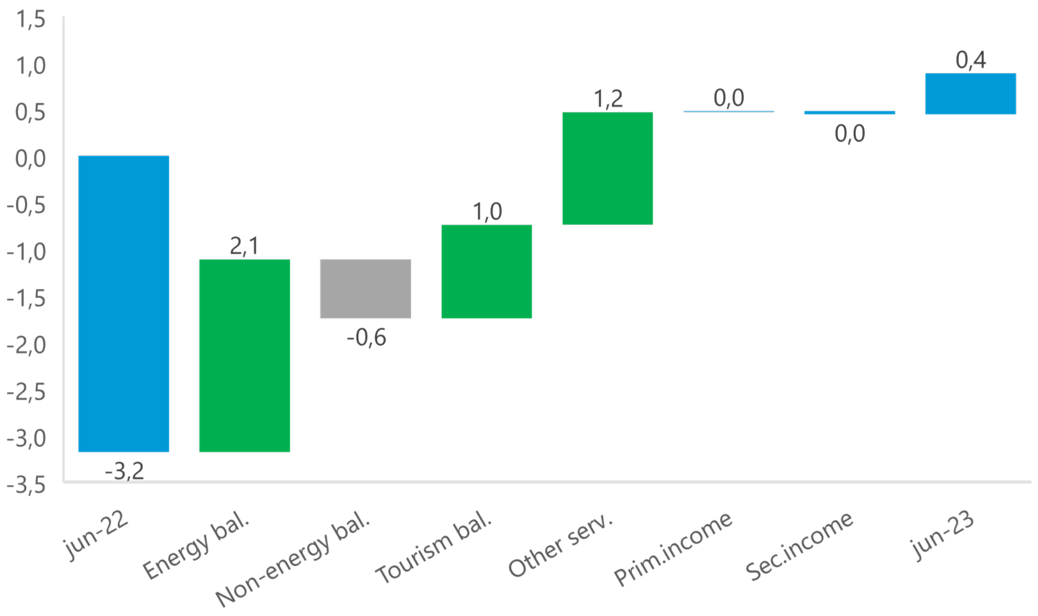
*Level*



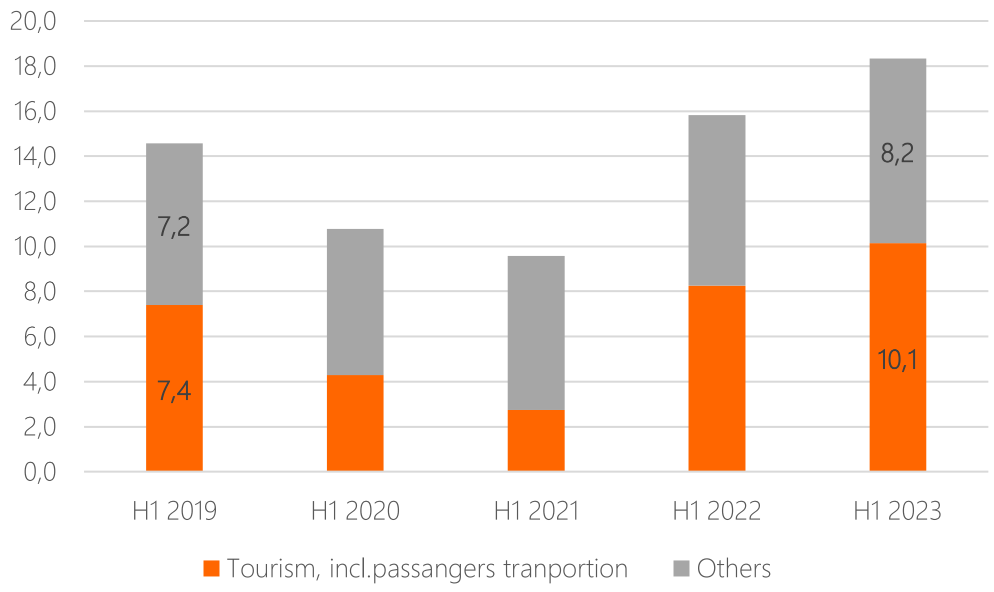

- **Indicators for Q3 point to deceleration:** those related with consumption continue to perform well, supported by resilience of the labour market, but its pace is slowing; construction shows some favorable signs (cement sales increased 8,8% up to August); and the number of flights in Q3 exceeded the 2019 level by around 7%. Meanwhile, confidence indicators deteriorated a bit in September in services, retail and among consumers. The manufacturing sector remains cautions, but recovered a bit.
- **In the coming quarters, growth should be supported by signs of deceleration of prices, competitive gains (seen in tourism and other items) and the stimuli coming from the execution of NGEU and other European funds. The expected absence of disruptions in the energy market, will support a gradual deceleration of inflation, helping households to improve its disposable income.**

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

**Current account evolution in H1 2023**
% of GDP and p.p. changes




**Balance of services**
*% of GDP*

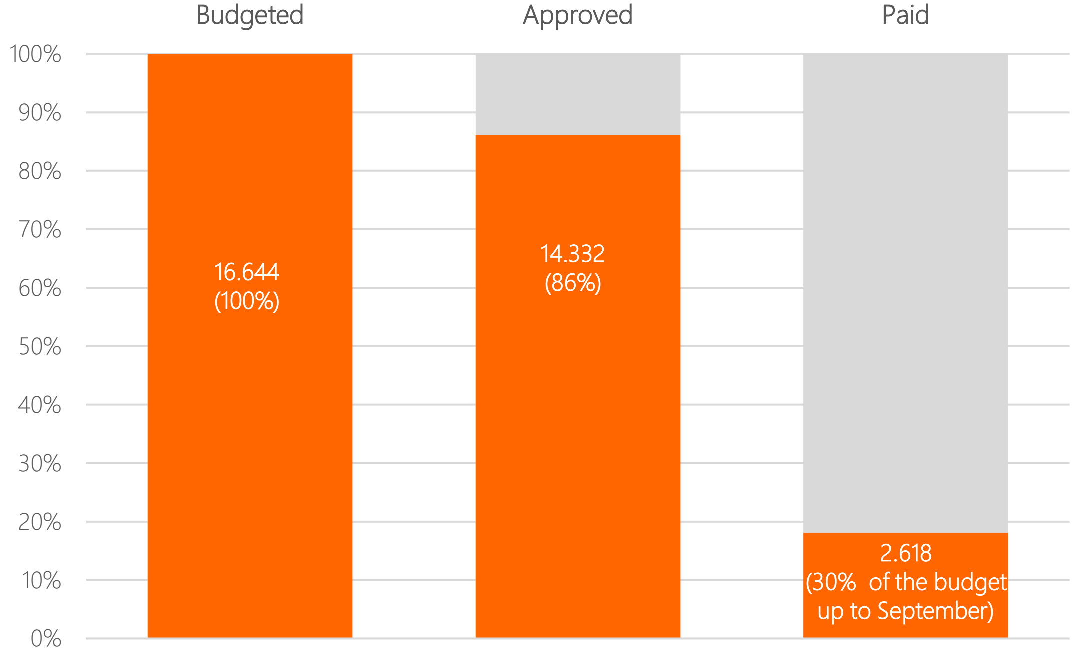



*Source*: BPI Research*, from INE*

- **The current account posted a surplus in the H1 2023 equivalent to 0,4% of GDP.** Compared to the same period a year ago, the main contributions for this improvement came from the energetic balance and balance of services, both tourism and other services.
- **Worth to mention the increase in the market share of services. Tourism continue to be the main contributor to growth of exports of services, but other services are gaining importance.** In 2019 the latter weighed 7,2% in GDP and in 2023 increased to 8,2%. Annual growth of other services between 2019 and 2023 was 13% (9% in tourism). TIC and exports of services of R&D are among those with better performance, with annual growth since 2019 of 20% and 14%, respectively.

# NGEU: 30% paid up to September

### NGEU Funds up to August 2023
EUR million




*Source: BPI Research, from Recuperar PortugalPI*

### Approvals and payments to direct and final beneficiaries

| *(Up to 27 September)* | Approved (EUR million) | Paid (EUR million) | Paid rate |
|---|---|---|---|
| Families | 181 | 148 | 81,8 |
| Social and solidarity economy institutions | 353 | 47 | 13,3 |
| Firms | 4.529 | 763 | 16,8 |
| Institutions of the scientific and technological system | 330 | 47 | 14,2 |
| Higher Education Institutions | 624 | 137 | 22,0 |
| Schools | 369 | 234 | 63,4 |
| Municipalities and metropolitan areas | 1.442 | 175 | 12,1 |
| Public entities | 4.260 | 729 | 17,1 |
| Public firms | 2.244 | 338 | 15,1 |
| **Total (million euros)** | **14.332** | **2.618** | **18,3** |
| ***(% total RRP)*** | ***86,1%*** | ***15,7%*** | |

- **Up to the end of September the approval rate stood at 86%, which looks promising for the use of the funds that Portugal will receive until 2026.** The payment rate remains below the approvement rate but is recovering. Since August we underline the acceleration on the payment rates to firms, institutions of the scientific and technological system, higher education institutions and schools.
- 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 continues robust but it's worth to keep monitoring

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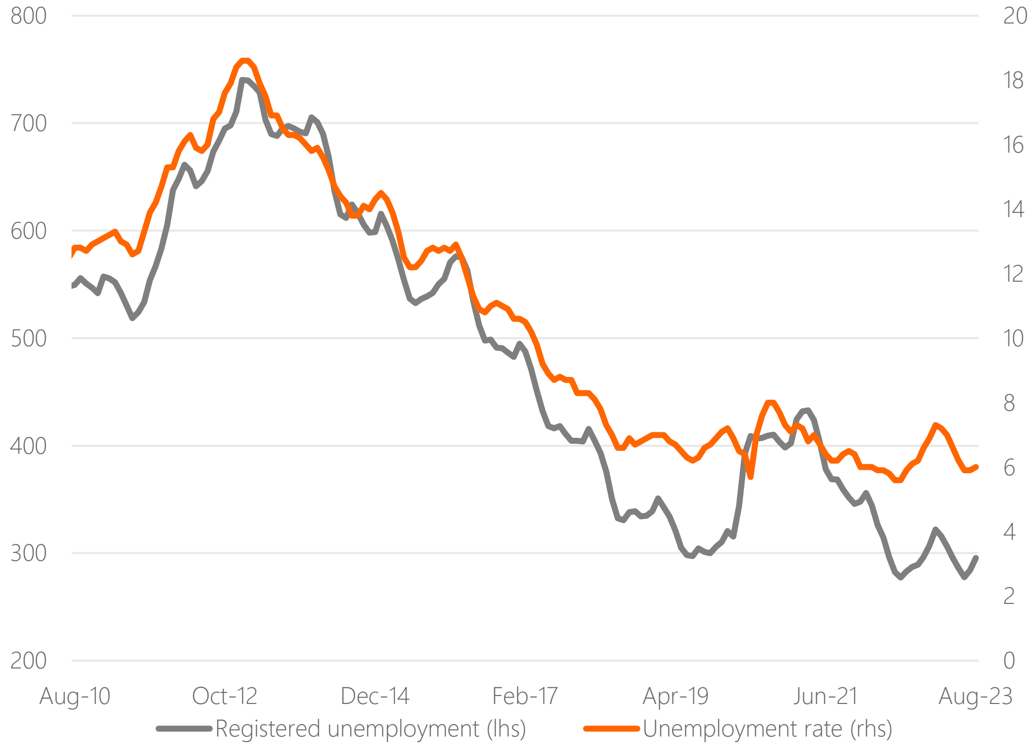
**Registered unemployment* and unemployment rate**

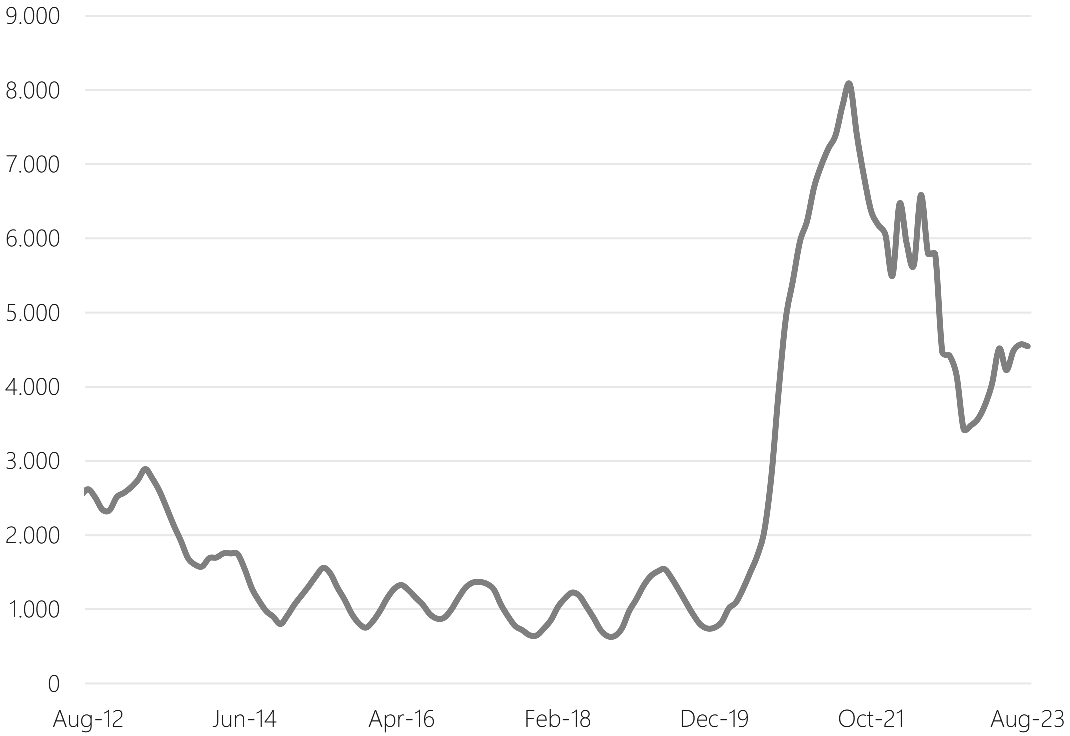
*Thousand people* (%)




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

**Layoff***

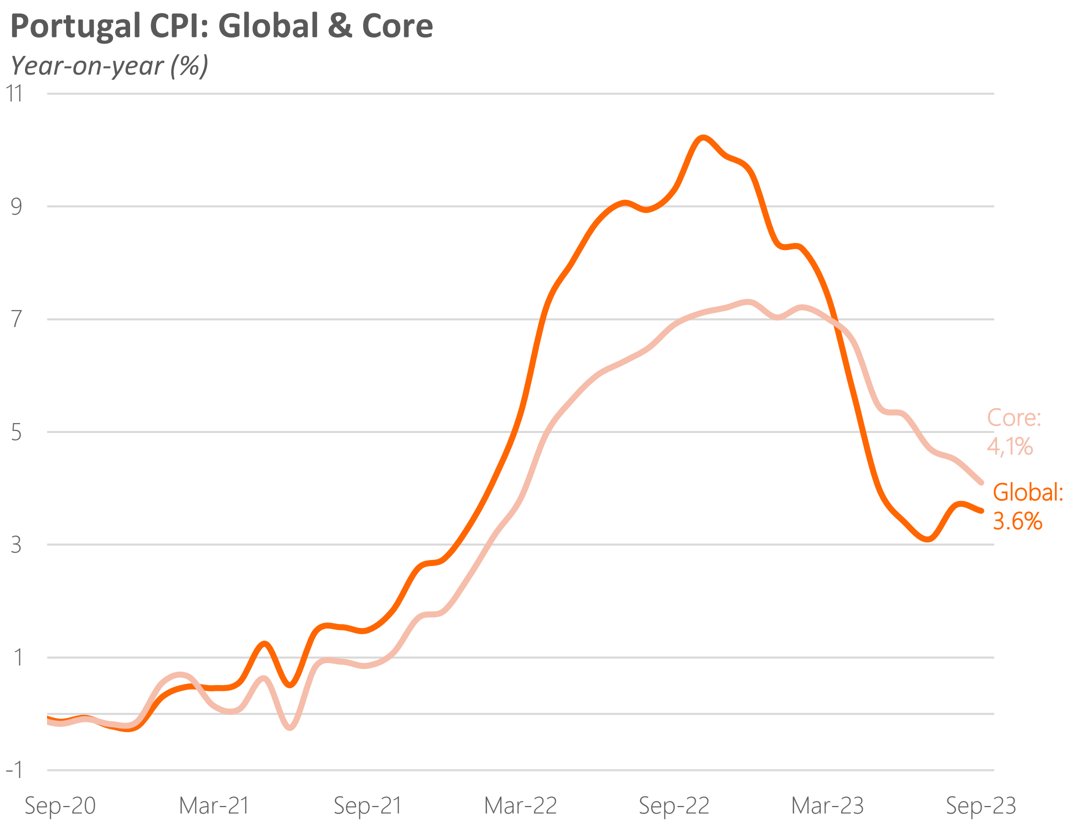
*6-months moving average (Number of individuals)*



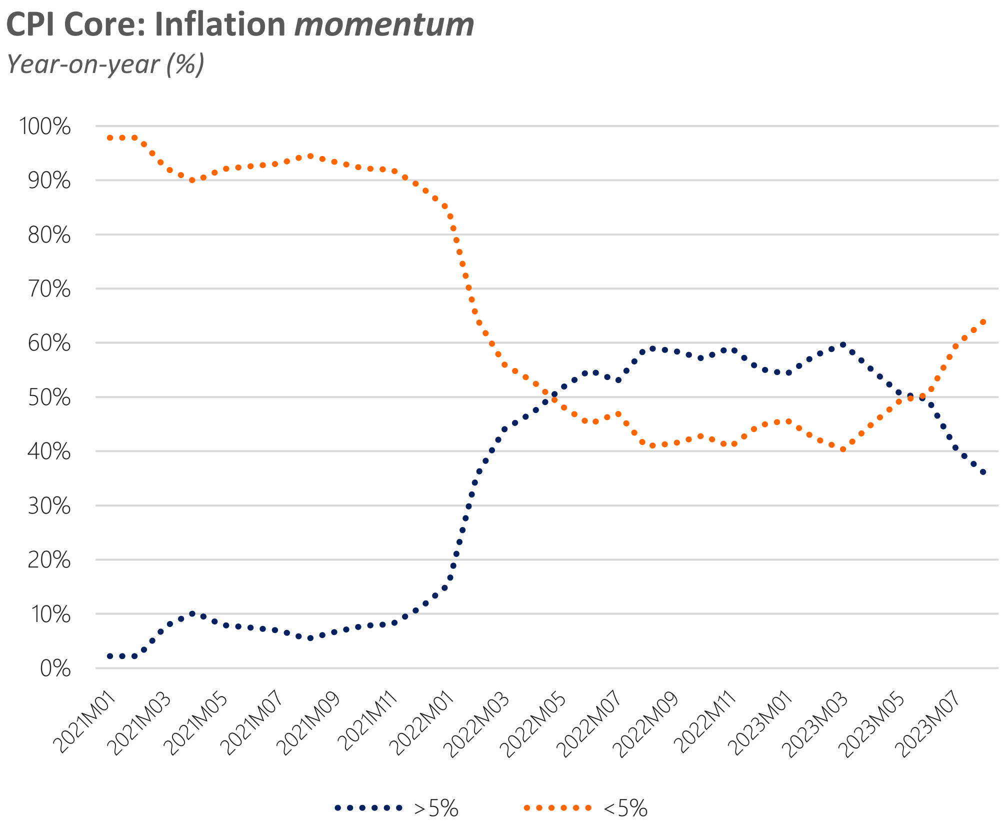

*Note (*): Labor code regime.*
*Source: BPI Research, from Social Security data.*

- **The labor market appears to have reach a plateau, but there are some risks in the more recent data.** The unemployment rate fell to 6.2% in August and the employed population reached a new high, rising 0,1% mom and 1,3% yoy. **Even so, there are some pockets of uncertainty:** the number of registered unemployed people increased on a monthly and yearly basis; the number of workers on a situation of layoff is above the long term average.
- **Despite these less positive signs, risks for BPI current forecast for the unemployment rate in 2023 (6,6%) are low, as it already incorporates an increase of unemployment in the H2 2023.**

# Inflation: return to the moderate pace in September




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

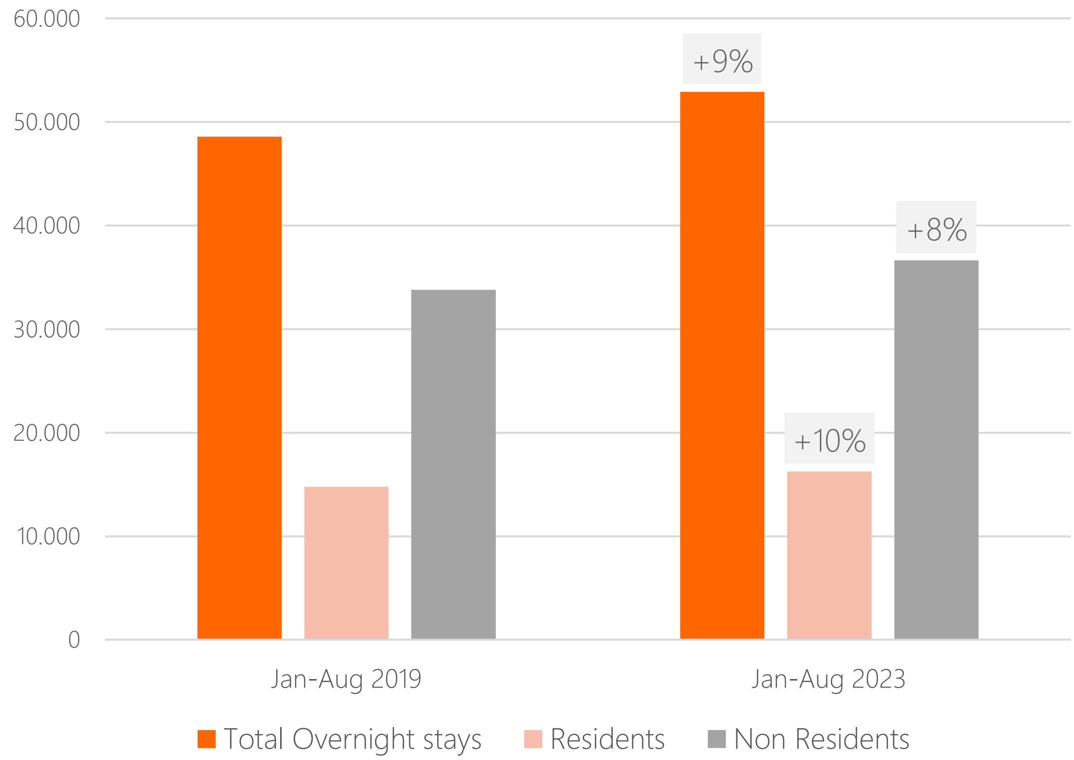



***Source***: *BPI Research, using data from INE.*

- **Inflation in September has resumed its deceleration trend, declining to 3,6% from 3,7% in August; and the core index continued to show a diminishing path, declining 4 tenths to 4,1%.** The energy component kept unchanged its declining trend, albeit at a slower pace than in previous months; in the same direction evolute food prices, with unprocessed food index decelerating to 4,1% from 4,5% in August.
- **We revised downwards our forecasts for annual inflation by 1 tenth, to 4,6%.** Looking for components growing more and less than 5%, we see that the weight of those components with inflation below 5% is rising and is expected to maintain this trend. The extension of the zero VAT measure on food until the end of the year and the expectation that prices for some more seasonal services may behave more favourably in the final months of the year, support the movement towards inflation correction. Currently, the main risk is the behavior of oil prices.

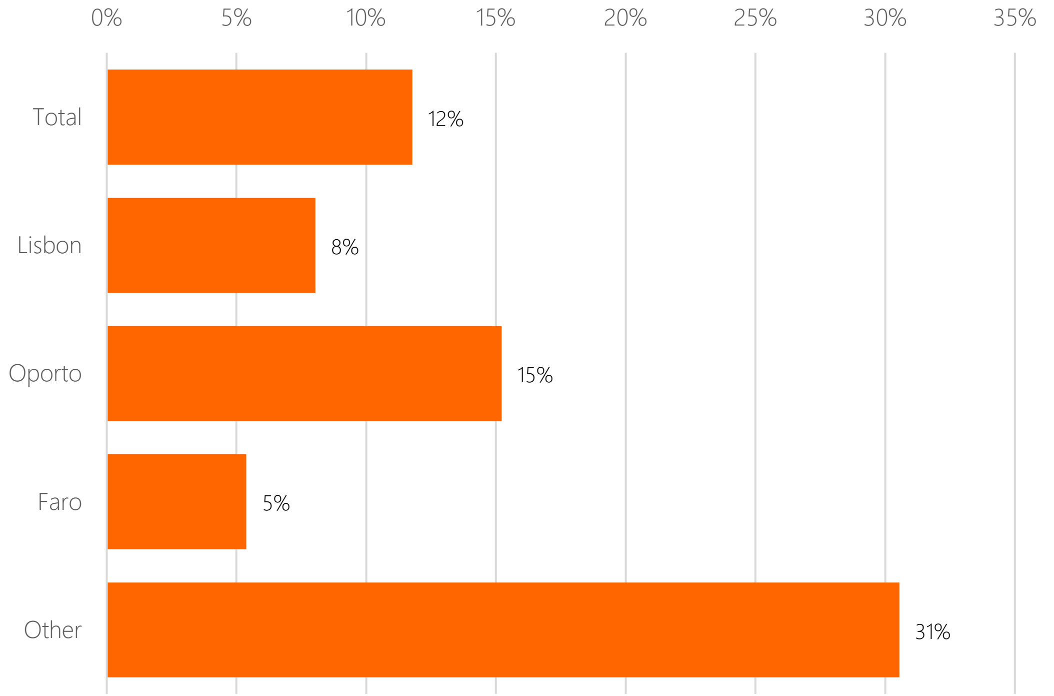
# Tourism: keeping up the good trend

## Overnight stays: Ytd August 2019 *versus* Ytd August 2023
*thousands*




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

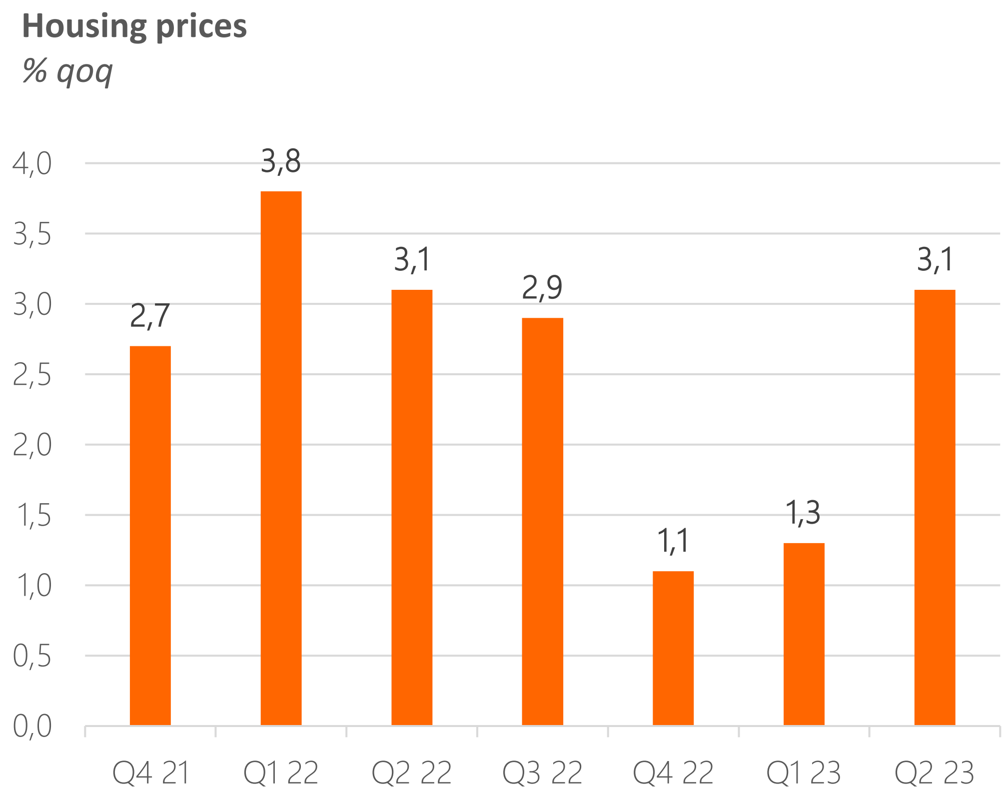
## Air traffic by airport in the first seven months of 2023
*Change compared to the same period of 2019 (%)*

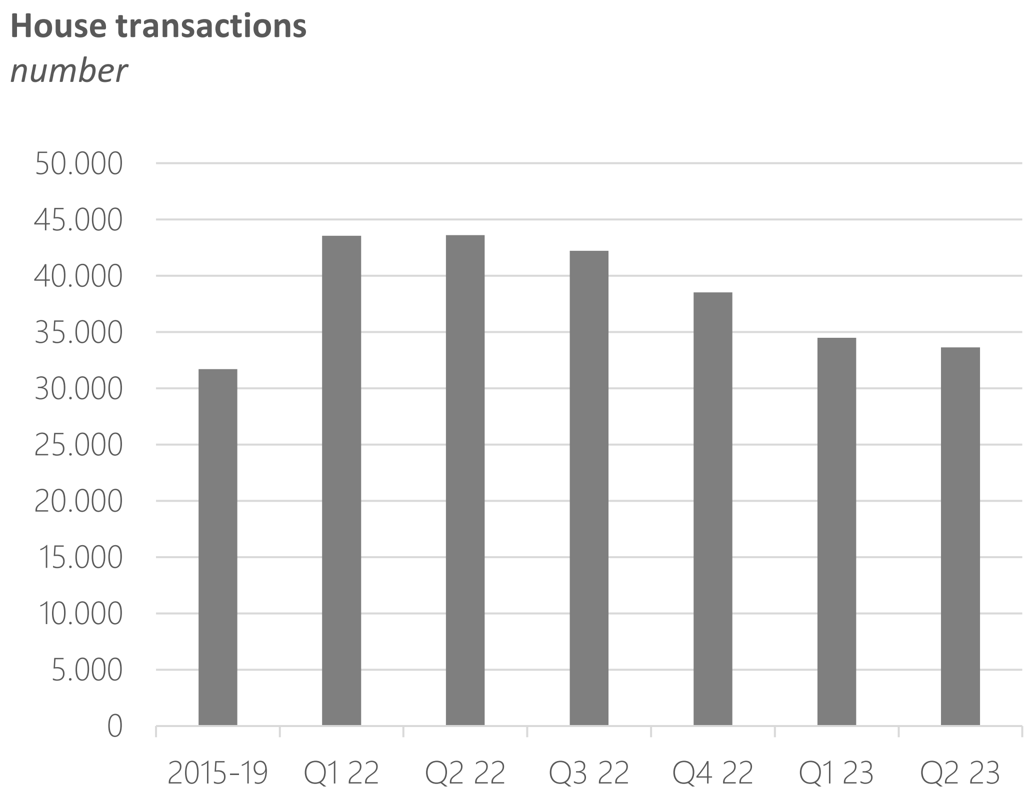



*Source: BPI Research, using data from INE.*

- **Up to August, the number of overnight stays in tourist accommodation establishments reached circa 53 million.** Compared with the same period of 2019, overnight stays represents plus 9% in accumulated terms. The performance was similar considering the origin of guests: both tourism from residents and non-residents exceeded that of the same period of 2019 (by +10% and +8%, respectively).
- **The evolution of flight data also signals an auspicious dynamic.** All airports have more flights compared to the same period of 2019.

# Housing market: strong price dynamic in a context of decelerating sales




*Source: BPI Research from data of INE.*

- **Housing prices grew by a significant 3.1% in Q2 2023 compared to Q1 2023,** a rise in prices not seen since the first half of 2022. The year-on-year growth rate, remained the same as in Q1 (8.7%).
- **For the first time, the average value of homes transacted exceeded 200,000 euros (205,300), even in a context of a sharp slowdown in the number of transactions** (-3% compared to the previous quarter and -23% year-on-year). This dynamic, also still driven by strong demand from foreigners, undermines our forecast for average price growth this year (4%), which should be revised upwards.

# Commitment with fiscal consolidation pushes up the sovereign rating

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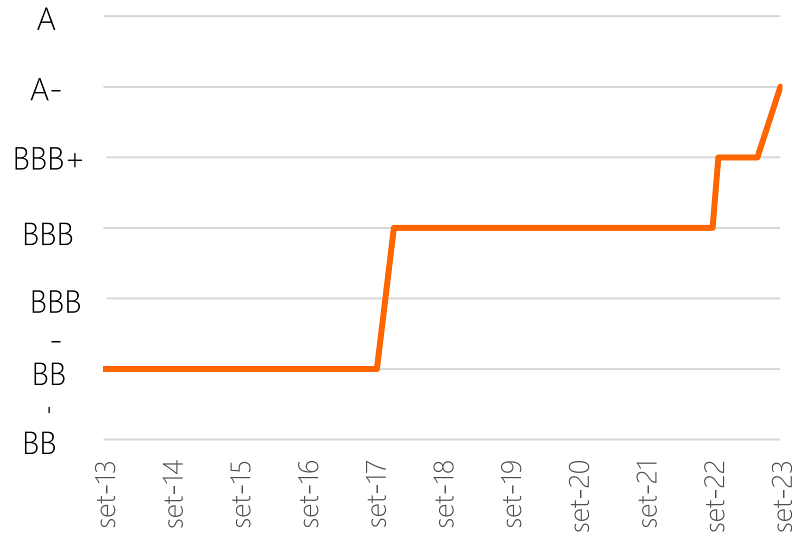
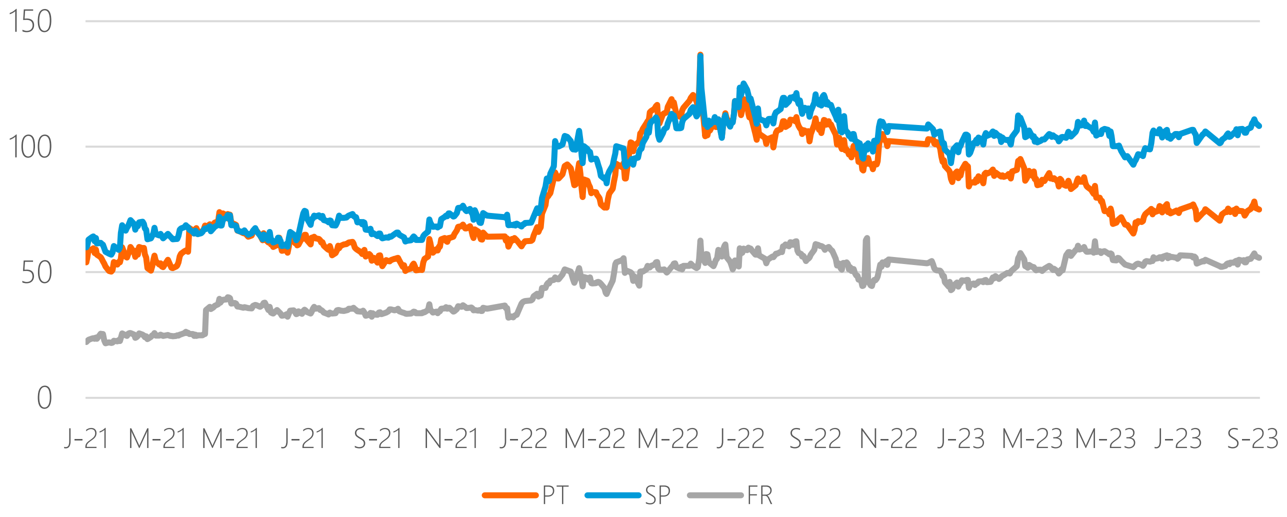
### Fitch Rating evolution

*level*




### Sovereign premium risk

*Basis points*



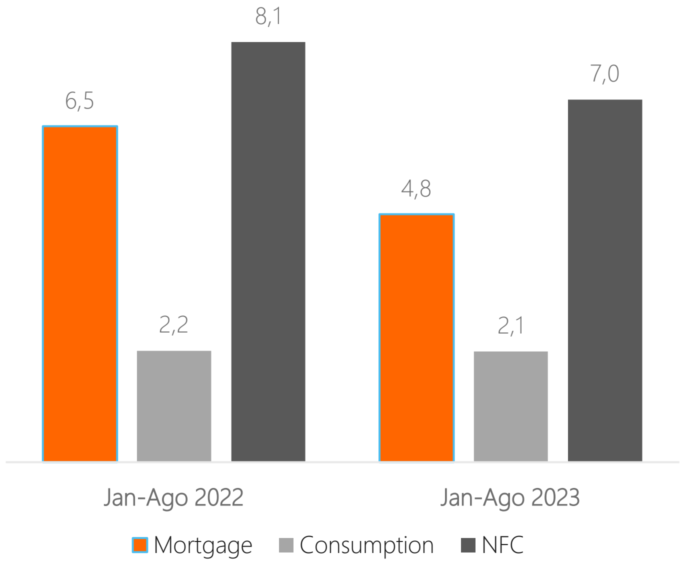

*Source: BPI Research, from Fitch Ratings and Refinitiv*

**Fitch upgraded the Portuguese sovereign rating to A- from BBB+ (best classification since 2011) with main drivers being:**

- **Strong commitment to fiscal consolidation.** Fitch expects public debt to fell to 104,3% in 2023, keeping the downward trend up to 2025 to 96,5%. The level forecasted for 2025 is still well above the average of countries rated with A, but risks to debt sustainability are mitigated by a moderate debt amortization schedule.
- **An expected budget surplus in 2023.** Fitch foresees a surplus equivalent to 0,5% of GDP, due to the impact on expenditure of the end of pandemic and energy measures implemented to support economic agents activity. For 2024-25, are also expected surplus of 0,4% and 0,3 of GDP, respectively.
- **Return of current account to surpluses:** lower import prices and strong dynamic of exports (mainly services) will push the current account balance to +0,8% of GDP in 2023. For 2024-25, current account will maintain surpluses, but less strong than in 2023.
- **Financial stability risks** related with the impact of higher interest rates on families are mitigated by the decline of indebtedness, concentration of debt in higher income families; and also by the implementation of measures to alleviate debt services stress for some families.
- **Resilient banking system:** Q2 2023 data shows NPL ratio at 2,1%; Tier 1 capital ratio in 16,4%.
- **Fitch sees GDP to grow 2,1% in 2023 (1,3% in April) and 1,8% in 2024**, due to the expected slowdown of activity in the main Portuguese trade partners and an expected slowdown on the pace of NGEU finds distribution.
- **Annual inflation** is forecasted to average 5,3% in 2023, slowing to 3,1% in 2024 and to 2,2% in 2025.

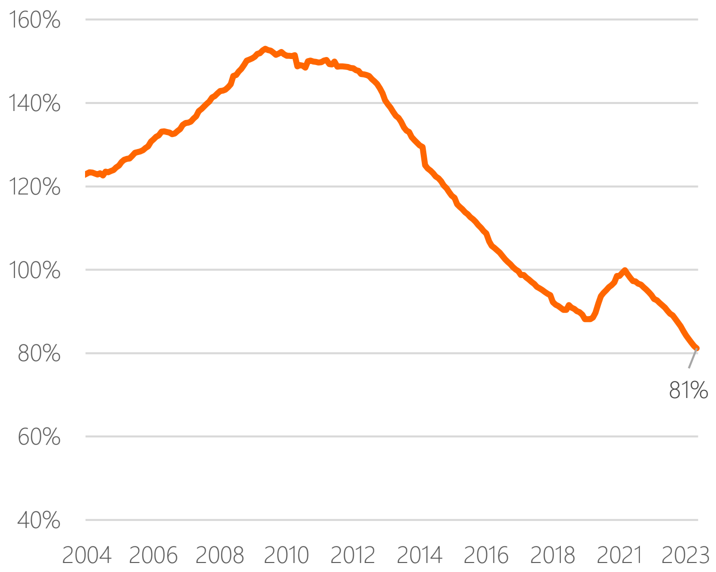
# Banking system: a solid position to face the economic slowdown (1)

### New lending activity by sector
*Accumulated in the year, billion euros*



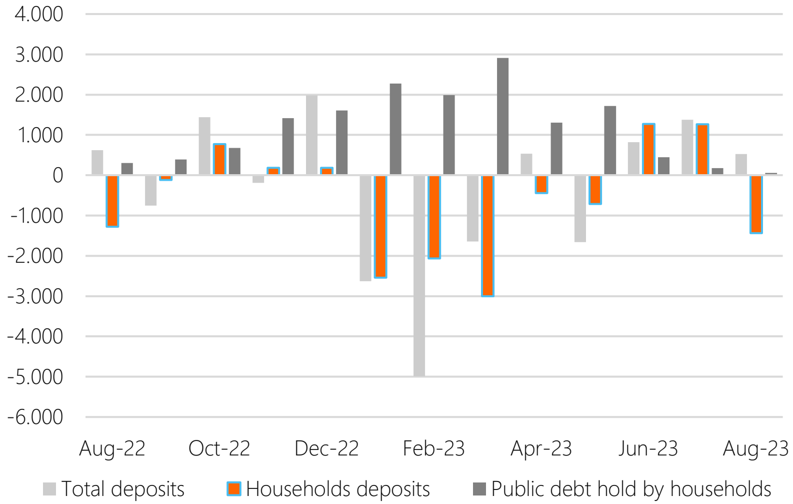

*Source: BPI Research, base on data from Bank of Portugal and ECB.*

### Bank credit to the private non-financial sector
*% GDP*




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

### Deposits and public debt hold by families*
*Monthly variation (M€)*

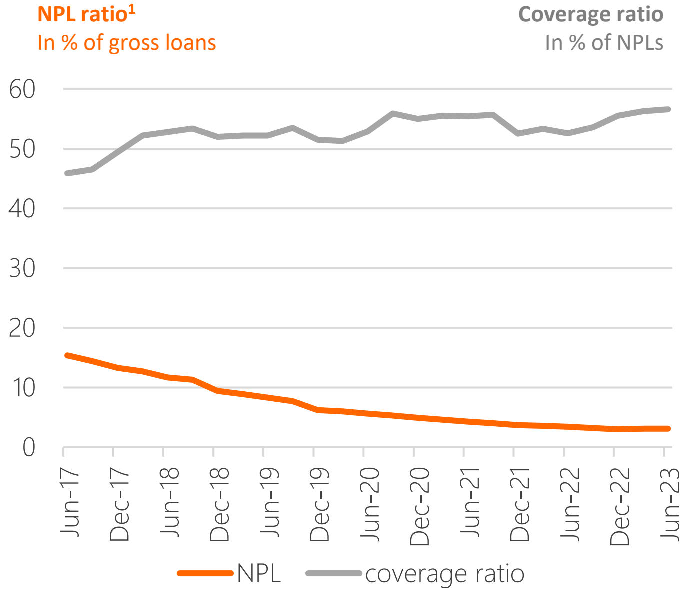



*Notes (*): Public debt by households includes Certificados de Aforro and Certificados do Tesouro, which can only be subscribed by resident households. The maximum amount that Government can issue for these retail instruments (CA and CT) is 16.5 bn Eur in 2023.*
*Source: BPI Research, base on data from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

- **The stock of credit is decelerating since mid-2022:**
  - **Mortgage credit:** declined 0,7% yoy in August, in line with the drop in new operations (-21,8% yoy accumulated in the first eight 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, lower investment, favorable level of deposits and continuing weak new credit operations.
- Deposits of the private sector decreased in August (-2,2% yoy) for the fifth month in a row, especially due to households' deposits (-3,7% yoy). Meanwhile, interest rates for new deposits have been increasing (last August, household's deposit interest rate reached 1,81%, the highest rate since May 2014), which together with the recent change in CA's new subscription conditions (maximum interest rate of 2,5%), may limit futures declines in deposits.

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

## NPLs and coverage ratios




**Cost of risk[1]**
0.5% in 2019
0.5% in Q2 2023

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

## Banks' profitability

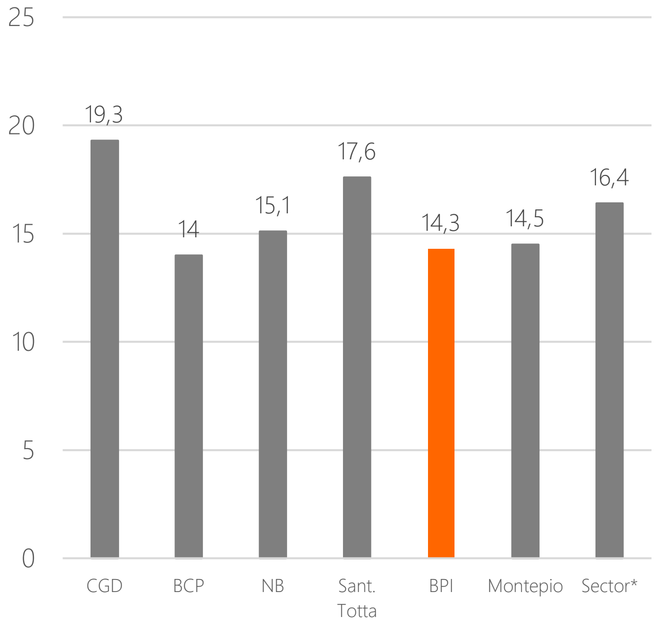
*In % of average total assets (H1 23; trailing 12M)*

| | BPI | BCP | San Totta | CGD | NB | Montepio |
|---|---|---|---|---|---|---|
| **Net interest income** | **2.2%** | **2.2%** | **2.0%** | **2.6%** | **2.3%** | **2.0%** |
| Net fees | 0.7% | 0.9% | 0.8% | 0.6% | 0.6% | 0.7% |
| Gains on financial assets | 0.1% | 0.0% | 0.0% | 0.3% | 0.2% | -0.2% |
| Other net profits | -0.2% | -0.2% | 0.0% | -0.1% | -0.3% | -0.2% |
| Gross income | **2.8%** | **2.9%** | **2.8%** | **3.4%** | **2.9%** | **2.4%** |
| Operating expenses | -1.2% | -0.9% | -0.9% | -1.1% | -1.0% | -1.3% |
| **Operational result** | **1.6%** | **2.0%** | **1.9%** | **2.3%** | **1.9%** | **1.1%** |
| Impairement losses, taxes and others | -0.1% | -0.5% | -0.2% | -0.5% | -0.2% | -0.2% |
| Profit | **1.0%** | **1.1%** | **1.1%** | **1.2%** | **1.6%** | **0.7%** |
| **ROTE[1]** | 11.6% | 16.8% | 17.6% | 13.5% | ver nota | nd |

*Notes: 1) the values for BCP and CGD refer to ROE; calculation methodologies differ between banks. In the case of CGD and NB indicators refer to consolidated activity*

## Banks' solvency and liquidity position

*In % (H1 23)**




*Source: Banks publications, BoP*
*Note: *Q2 for the whole sector*

- **NPLs ratio kept unchanged in Q2.** The total NPL ratio stood at 3,1% in Q2 2023, even though the ratio related to the mortgage increased slightly (0.1 p.p. to 1.2%). For NFC, the ratio continued to decrease (-0,1 p.p., to 6,2%). It is possible that these measures will worsen 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 Q2, it decreased by 0.2 p.p., to 13,7% (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, other geopolitical risks and the impact of high interest rates on NPL's.**

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