Portugal

Outlook

	Average 10-14	2015	2016	2017	2018	2019	2020 (Forecasts)	2021 (Forecasts)	2022 (Forecasts)
Growth in GDP (%)	-0.8	1.8	2.0	3.5	2.8	2.2	-8.3	4.9	3.1
CPI inflation (%)*	1.6	0.5	0.6	1.6	1.2	0.3	0.0	0.9	1.3
Fiscal balance (% of GDP)	-7.5	-4.4	-1.9	-3.0	-0.3	0.1	-7.2	-5.7	-3.1
Public debt (% of GDP)	121.6	131.2	131.5	126.1	121.5	117.2	133.9	132.9	130.7
Reference rate (%)*	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exchange rate (EUR/USD)*	1.3	1.1	1.1	1.1	1.2	1.1	1.1	1.2	1.2
Current account balance (% of GDP)	-3.2	0.2	1.2	1.3	0.4	-0.1	-1.8	-1.0	-0.6
External debt (% of GDP)	227.2	214.9	203.6	197.9	193.3	189.9	207.7	203.5	199.4

Note: * Annual average.
Source: BPI Research, based on data from Thomson Reuters Datastream.

- **Portugal is one of the European countries hardly hit by the Covid-19 pandemic, although the GDP drop in 2020 (-8.3%) should be close to the Euro area average.** The lower incidence of the first wave of the pandemic, the strong policy support both internal (moratoria, tax deferrals, layoff schemes, etc) and external (EC funds and ECB policy), as well as a strong momentum pre-Covid, support this less severe evolution when compared to peers. However, the economy will recover only gradually and we expect that by the end of 2021 GDP will remain circa 4 p.p. below the pre-Covid levels, due to the high exposure to Tourism related activities and some structural weaknesses. On the political front, the Socialist Party won the 2019 elections, but without absolute majority. The government's parliamentary base is weaker that in the previous legislature as the formal pact between the PS and the leftwing parties—in place in 2015–19—was not renewed. The Government will probably continue to manage support with either party on a case-by-case basis (ex: SB 2021, with support of PCP). The pandemic is testing this relationship, but there is no appetite from opposition parties to trigger a political crisis in the short-term.

- **Covid-19 economic shock.** The Portuguese economy revealed strong growth momentum in 2017-2019, benefiting from an external sector boom (especially, tourism), favorable investor sentiment and supportive financial conditions. Despite the still high public debt, fiscal consolidation effort marked the years prior to the pandemic: in 2019, Portugal recorded for the first time in democracy a fiscal balance surplus (0.1% of GDP) and registered a significant primary surplus for the fifth year in a row.

  1. Portugal decreed the state of emergency in March 18th, with mandatory lockdown, closing of non-essential public spaces (such as restaurants, malls) and schools and, if possible, mandatory remote working. These strict measures began to relax in the beginning of May. More recently, the state of emergency was implemented again and can be renewed every two weeks, via parliamentary approval;
  2. Restrictions on mobility and uncertainty on the development of the pandemic had an atrocious impact on tourism. Portugal's activity has shown that it can recover fast when restrictions are lifted, but the recovery will take time to be complete due to the importance of the tourism sector. The direct impact of tourism on the Portuguese gross value added is ~8% and the overall impact is estimated to account for 16.5% of the Portuguese GDP and 10% of employment.

- **Economic policy response**

National fiscal policy: The Government took a series of fiscal measures to cushion the impact of the pandemic (tax deferrals, layoff scheme, credit lines, moratoria…), so the fiscal deficit should reach 7.2% of GDP this year. Public debt will probably exceed 133% of the GDP, but will decline afterwards on the back of a cautious fiscal stance and the expected economic revival.

Closing date of this edition: 28 December 2020

Outlook (continuation)

- **European policy.** The EU approved a series of aid packages for Member States of which Portugal is expected to be one of the main beneficiaries. These measures include loans from the SURE fund to finance work adjustment programmes (of which Portugal will receive about 5.9 billion euros) and the European Recovery Plan (or NGEU) from which Portugal could obtain about 15.3 billion euros of non-refundable grants between 2021 and 2026. In 2021, the Government adopted a cautious view and included in the Budget only a fraction of the expected inflow from NGEU (circa 4% of the total, as opposed to 10% that could be received).
- **Monetary policy.** The launch of the ECB's asset purchase programmes has helped to keep interest rates on Portuguese debt at very low levels and is expected to continue to do so in the coming quarters. The Pandemic Emergency Purchase Programme (PEPP) was extended until March 2022. At the end of 2019, the ECB held close to 20% of Portuguese sovereign bonds. This figure is likely to have increased to circa 30% in 2020 as the ECB reinforced its purchases to support the economy in the pandemic environment.

- **Financial vulnerabilities**. Despite the debt increase expected with the COVID-19 shock, the risk of unsustainable debt is contained. Even though funding needs have increased (to 28% of GDP in 2020 from 23% in 2019), they are manageable thanks to the maturity profile of the debt that has lengthened in recent years, low interest rates, EU aid and a strong and stable base of investors (retail investors and public entities).
  - The average maturity of the debt is about 7.5 years and the risk of refinancing is contained.
  - The policy conducted by the ECB led the Portuguese interest rate to historically low levels (around 0% for 10-year bonds).
  - In the coming years, we expect the Government to keep strong commitment to fiscal consolidation once the pandemic is overcome. Additionally, both the ECB's actions and the various European support plans mentioned above will help cover funding needs. Finally, the economic recovery and the return to a strong path of economic growth will also be key for the improvement in the public accounts.

Main risks

- **Sovereign:** Portugal's rating remains above the investment level, with stable and positive outlooks. However, a worsening of the macroeconomic and financial conditions may push Portugal below the investment level, which would exclude the country from the ECB's asset purchase programme (APP). Nevertheless, it is expected that purchases can always continue under the PEPP programme, which is the ECB's major policy tool against the pandemic and it was recently extended and expanded.
  - **Fitch kept Portugal's rating in November.** While it highlighted the excessive public debt of this year, it noted that it should be exceptional and that it is expected to decrease significantly in the coming years.
  - **Moody's kept the positive outlook on Portugal's rating in July.** However, Moody's outlines the risks of business bankruptcies over the next years due to the reduced reserves of the smaller firms (which account to a large share of the GDP and employment) and the shortage of alternatives of funding and shorter horizons.
- **Macroeconomic:** The European funds that Portugal will receive pose a significant opportunity for the country to invest in the digitalization of the economy, greener and cleaner technologies and to counter the harmful effects of the pandemic. Good management of these funds will be vital for the economic recovery and to foster productivity growth.
- **Political:** The Socialist Party has a relatively weakened power ever since the 2019 elections since it depends on other party to get the majority of voting, without formal support. In this context, political room for maneuver in the coming years could be smaller than in the past, specially if we take into account that the already chosen decisions in response to the challenges that this pandemic imposes (i.e. supports to families and firms) has narrowed the policy options for the next few years

	Rating	Last changed	Outlook	Last changed
Standard & Poor's	BBB	24/04/20	Stable	24/04/20
Moody's	Baa3	09/08/19	Positive	09/08/19
FitchRatings	BBB	17/04/20	Stable	17/04/20

■ Indicates that the country has "investment grade".
□ Indicates that the country does not have "investment grade".