Portugal: Macroeconomic and financial outlook

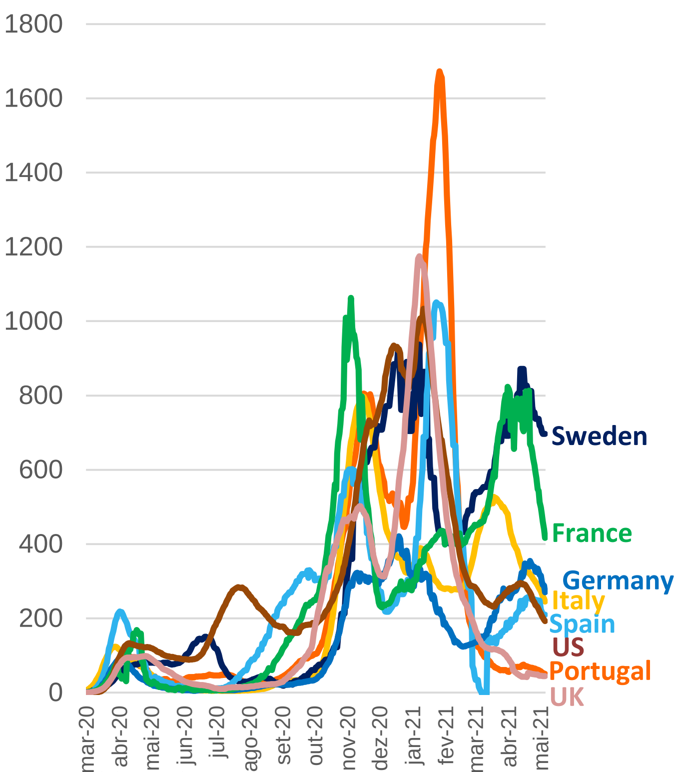
BPI Research
May 2021

Prepared with information available by 7th May 2021

Activity	▶ In Q1 2021, GDP declined by 3,3% qoq and 5,4% yoy, more than expected, reflecting the impact of the restrictive lockdown adopted between Jan 15th and Mar 15th to contain the spread of Covid-19. This performance means there are downside risks to our current forecast of an expansion of 4,9% in 2021. ▶ **Currently, the wave of infections is clearly controlled, bellow the Government threshold of 120 cases per 100 k inhabitants,** the occupation of the national health service is low and the level of mobility restrictions are now very reduced. ▶ **Most updated indicators suggest a strong rebound of activity in Q2**, and the growth path is seen to consolidate going forward. The vaccination plan is progressing and its speed is expected to accelerate in the coming months. Up to April 29th 23% of population has already received, at least, the 1st doses and immunization (70% of people vaccinated) is expected to be achieved in the Summer. ▶ **For 2022 and 2023 we see upside risks to our forecasts** as economic policies should remain supportive and the Recovery and Resilience Plan will start to produce some benefits in the form of increased investment, more resilience and a boost in potential growth.
Banking sector	▶ **The Portuguese banking system had a strong financial position prior to the crisis and will contribute to the recovery**. Credit quality improved significantly last years, but will constitute a major challenge, specially when debt moratoria expire and guaranteed loans start maturing. NPLs continue to decline and banks are building reserves to face future losses, with NPL coverage ratios at ~55%. Liquidity and solvency ratios have also been improving.
Policy	▶ **Portugal exited of the state of emergency in May** and entered in the calamity state, a less stringent situation, implying less constrains to full mobility whereas eventual restrictions might be imposed on a local basis. Frontiers with Spain were opened, schools are opened at all levels, restaurants and retail activities are opened subject to some timetable constrains, etc. ▶ **The policy response is offering a significant support to the economy** with a portfolio of direct measures, tax deferrals and public guarantees. Furlough schemes (which have been extended until end-2021) are proving very effective in cushioning the shock. ▶ **The Government funding needs are well covered**, helped by ECB purchases (expected to cover around 75% of financing needs in 2021), plenty of liquidity available and low interest rates. Public debt stands at 133.6% of GDP (30 pp are in ECB's balance-sheet). ▶ In 2020, the overall fiscal balance ended the year at -5.7% of GDP, lower than the -7.3% forecasted by the Government. For 2021, the need to prolong some measures or implement new ones should continue to pressure the public accounts. The uncertainty about the epidemic and economic situation, the possible execution of guarantees related to the credit lines and the financial situation of state-owned enterprises could add additional pressure on public accounts going forward.

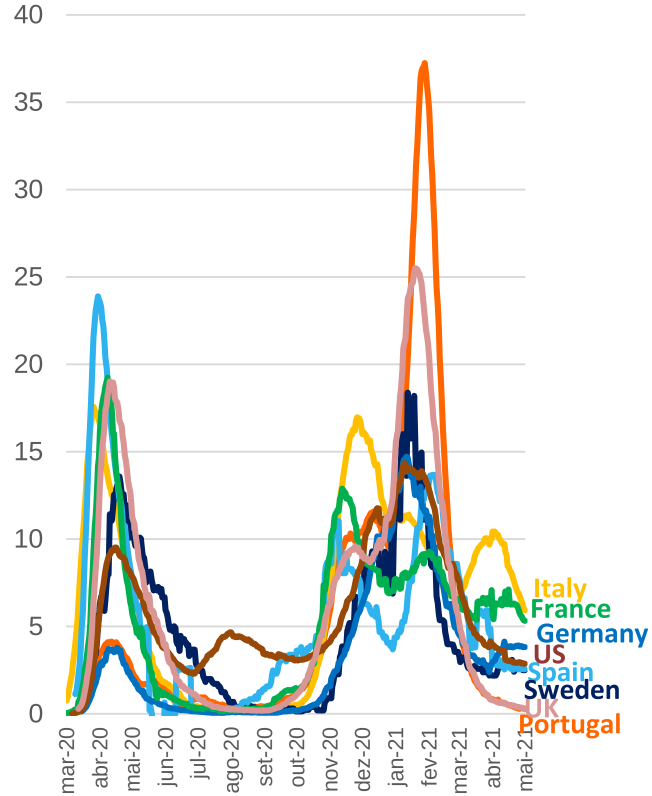
The third wave of COVID-19 infections develops with different timings

Covid-19 infections per 100,000 inhabitants
14-day moving average



Last available data: May 9th

Mortality per 100,000 inhabitants
14-day moving average



Total vaccinations per 100 inhabitants
May 8th

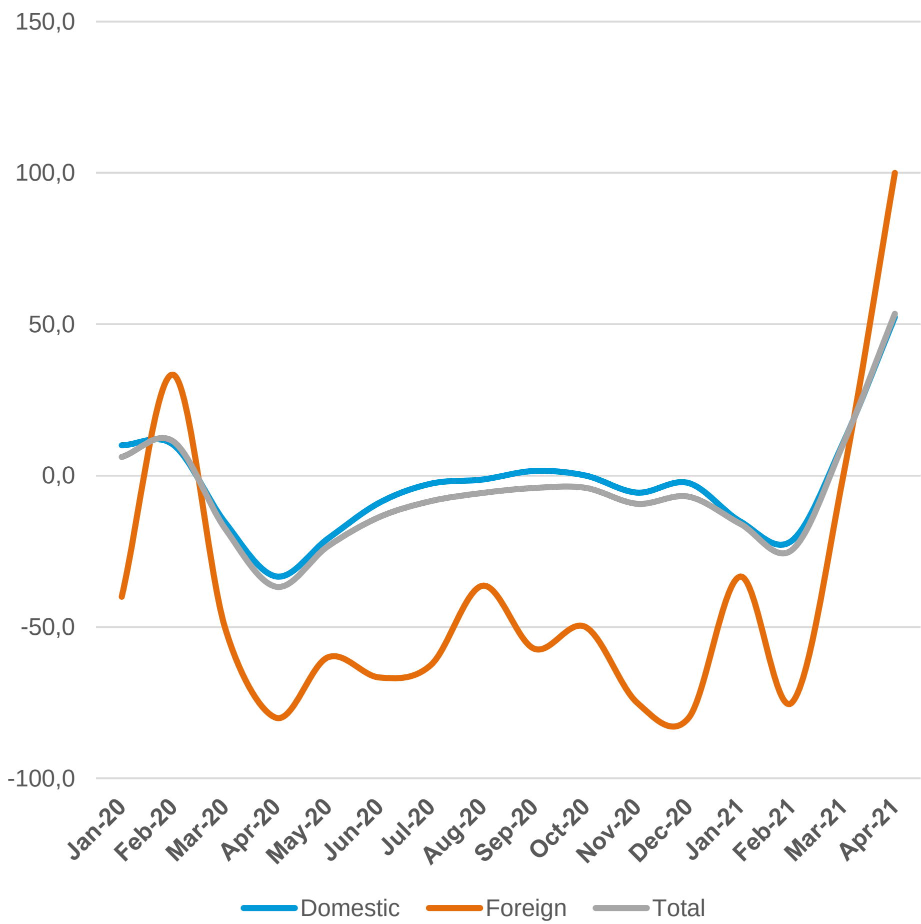
- 14-day cumulative incidence has stagnated, and is below the high-risk threshold of 120 cases per 100k set by the Government. On May 9th Portugal reached 58 cases per 100k inhabitants.
- The last phase of the lockdown (almost full reopening) began on May 1st,. More progresses on the reopening is dependent on the evolution of the pandemic situation, with two tracking metrics adopted to determine the level of the pandemic risk: 14-day MA incidence of new cases per 100k inhabitants (it should be below 120) and Rt (degree of contagion and should be below 1).
- Vaccination’s speed is expected to improve a lot in the coming quarter.

Grupo CaixaBank

Mobility and high-frequency indicators point to a rebound after contraction in Q1

Card activity (Electronic payments + Cash operations)

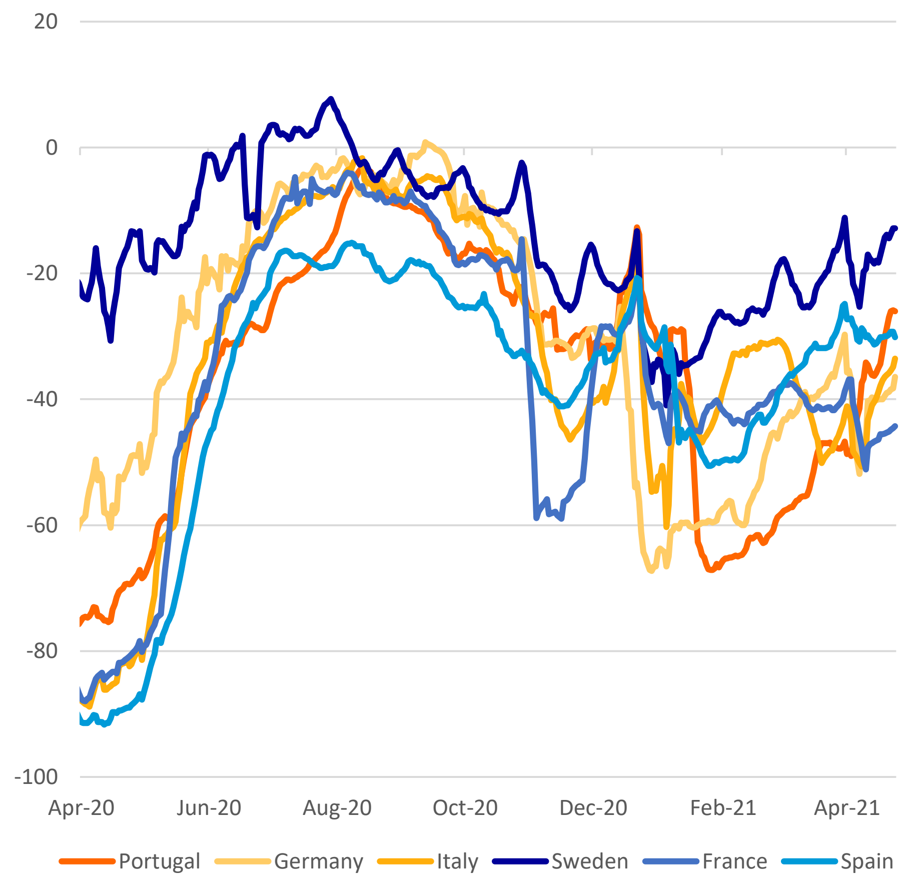
Year-on-year change (%)



Source: SIBS Analytics.

Population mobility: visits to retail and recreation

Deviation from base level (%), 7-day moving average



Source: Google Mobility Reports.

- Mobility is evolving in line with the ease of lockdown measures; some of the European countries have recently imposed new restrictions to contain the spread of a 3rd wave.
- Card data in April improved a lot between residents and non-residents, signaling consumption rebound; easing of restrictive measures was a key factor for this.

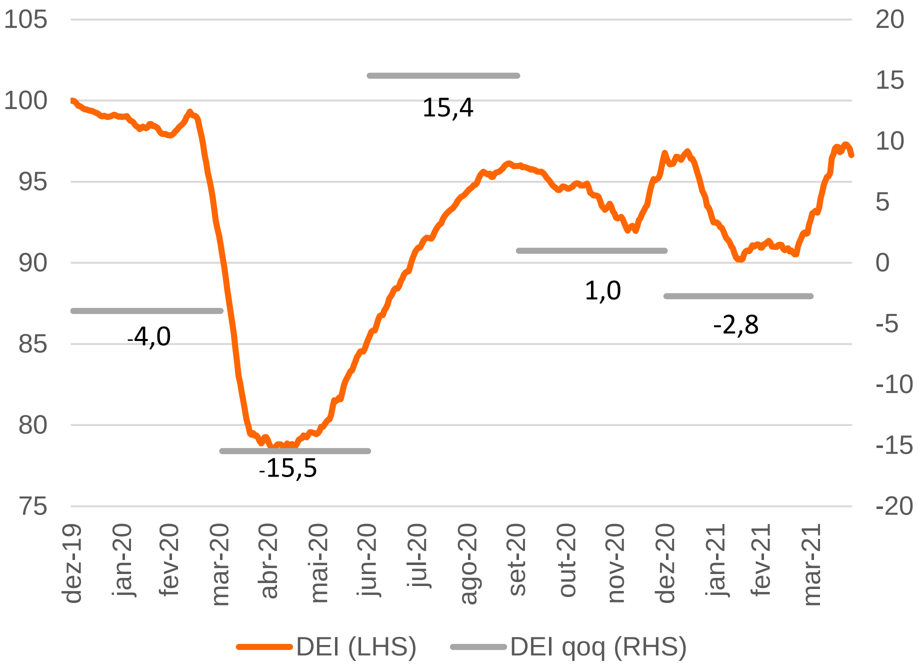
Mobility and high-frequency indicators point to a rebound after contraction in Q1

Year-on-year change (%)	Daily Economic activity indicator	Credit cards	Cement	New registrations of passenger cars	Electricity consumption	Industrial production	Retail sales	Unemployment	Number of tourists	Exports of goods	Exports of goods mln euros)
2019	-	6,5	15,1	-0,6	-0,2	-2,2	4,3	-6,1	7,9	3,5	59.903
2020	-7,7	-9,5	10,9	-30,2	-3,5	-7,0	-4,1	5,4	-61,3	-10,2	53.783
Q1 2020	-2,0	-0,5	5,5	-19,2	0,7	-1,4	2,2	-1,8	-18,2	-2,8	14.531
Q2 2020	-17,9	-24,3	14,3	-24,6	-11,8	-23,7	-13,2	-4,3	-91,3	-30,3	10.587
Q3 2020	-5,7	-6,2	11,8	-9,0	-0,7	-0,7	-2,1	21,2	-52,9	-3,0	13.773
Q4 2020	-5,3	-6,8	12,0	-20,0	-2,3	-2,5	-3,2	6,4	-68,2	-3,4	14.892
Q1 2021	-3,8			-23,2	-1,6					6,0	15.403
January	-6,8	-15,9	-2,6	-30,5	-1,7	-6,2	-10,7	-0,7	-78,8	-9,8	4.644
February	-7,1	-24,6	2,4	-59,0	-0,9	-2,4	-14,5	3,8	-86,9	2,8	5.011
March	1,7	10,5	30,8	19,8	-2,2	5,0	-0,1	3,7	-59,0	27,5	5.748
April	24,2	53,5			6,5						

Contraction in Q1 21 with signs of strong rebound in the post lockdown period

Daily Economic Indicator

Dec 2019=100, percentage change (%)



Source: BPI Research, from BoP data.

Analyst's Forecasts

GDP (Δ %)	2020	2021	2022	Acum. 20-21	Acum. 20-22
Commerzbank (April)	-7.6	4.7	5.7	-3.3	2.3
Citigroup (April)	-7.6	2.8	6.7	-5.0	1.4
Banco de Portugal (Marh)	-7.6	3.9	5.2	-4.0	1.0
Governo (April)	-7.6	4	4.9	-3.9	0.8
FMI (April)	-7.6	3.9	4.8	-4.0	0.6
Focus Economics (May)	-7.6	3.8	4.7	-4.1	0.4
Comissão Europeia (February)	-7.6	4.1	4.3	-3.8	0.3
EIU (February)	-7.6	4.3	4	-3.6	0.2
Fitch Ratings (April)	-7.6	3.5	4.5	-4.4	-0.1
BPI Research (November)	-7.6	4.9	3.1	-3.1	-0.1
Bank of America Merril Lynch (April)	-7.6	3.4	4.4	-4.5	-0.3
Unicredit (April)	-7.6	2.7	4.4	-5.1	-0.9
Católica (April)	-7.6	1	4.5	-6.7	-2.5
OCDE (December)	-7.6	1.7	2.9	-6.0	-3.3

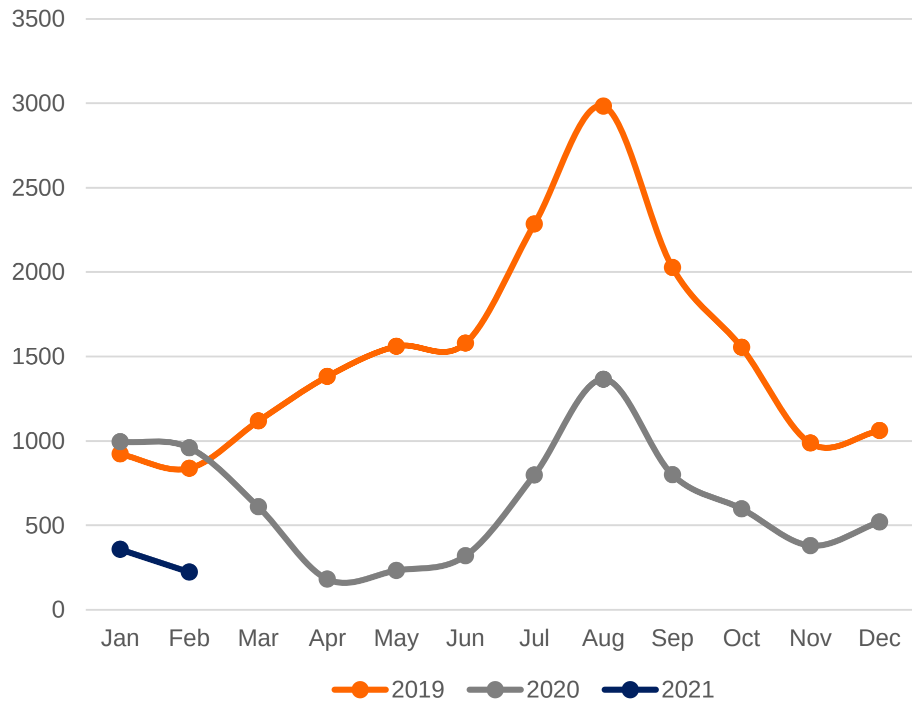
Central Scenario

- In Q1 21 the economy suffered a new contraction (-3,3% qoq; -5,4% yoy) reflecting the restrictive lockdown between Jan 15th and Mar 15th. Since then the economy is showing significant signs of rebound. In the months ahead we expect the consolidation of this dynamics. The growth outlook for 2021 is very depend on the pace of the vaccine rollout, but current plans suggest that the tourism sector will be able to reopen in the summer season. With restrictions removed, private consumption and investment will generate a more expressive recovery from the second half of 2021 on. Despite these positive prospects, we will probably revise downwards our forecast for growth in 2021, currently in 4,9%, with the incorporation of the Q1 data. However, growth in 2022 should be stronger than our current forecast of 3,1%. National and European supporting measures are operative and can be increased or fine-tuned. GDP is expected to reach pre-crisis levels in the beginning of 2023, slightly later than our main European partners, given the weight of the tourist sector and remaining structural weaknesses related with high leverage.
- Uncertainty is still high and risks continue slightly biased on the downside. But upside risks are also present and specially linked to the effectiveness of faster vaccination and effective easing of lockdown measures.

Tourism collapsed due to COVID-19 but should recover swiftly once the crisis is over

Expenditure of international tourists

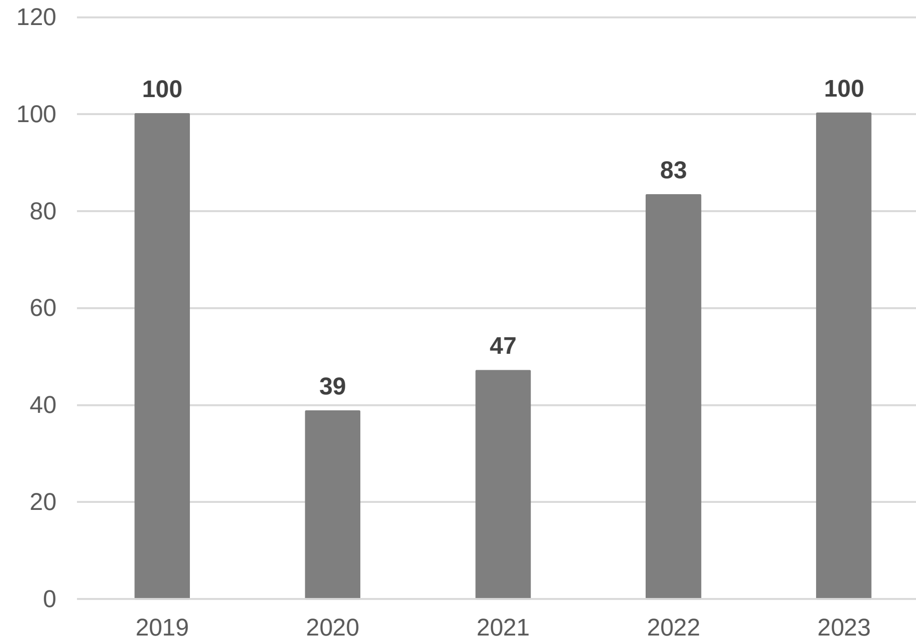
€ million



Source: INE and BPI Research forecasts..

Tourism GDP forecasts

Index (2019 = 100)



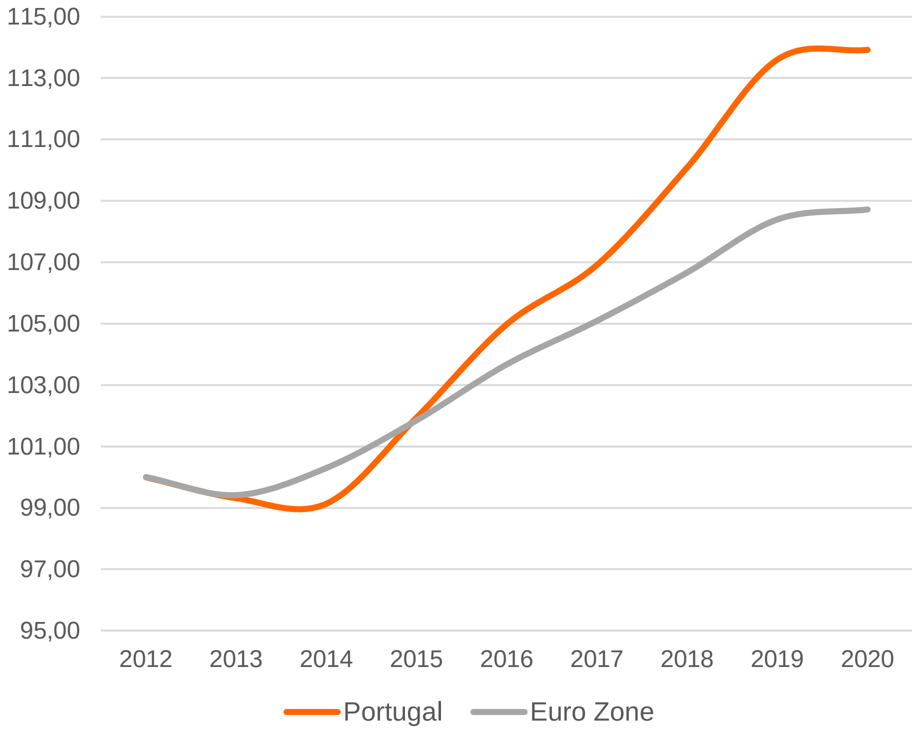
Source: INE and BPI Research forecasts.

- **Tourism has been severely hit by the pandemic**. In 2020, the number of tourists declined 61%, specially due to the decrease of 76% in the number of foreign tourists – with direct consequences on the current account balance. In Q1 2021, tourism activity must have remained curbed, due to the third wave of the pandemic and strict lockdown measures to contain the contagion that included frontier closure. We expect the situation to start improving in Q2 2021.
- **Tourism GDP should have declined around 60% in 2020** and is expected to reach pre-pandemic values by 2023, according to the World Tourism Organization.
- **The Portuguese tourism industry is the 12th most competitive in the world.** Hence, its recovery should be quick once vaccination process is completed. However, the revival is subject to strong uncertainty as confidence is one of the main constraints.

The real estate sector: resilience and solid fundamentals

Families disposable income per capita

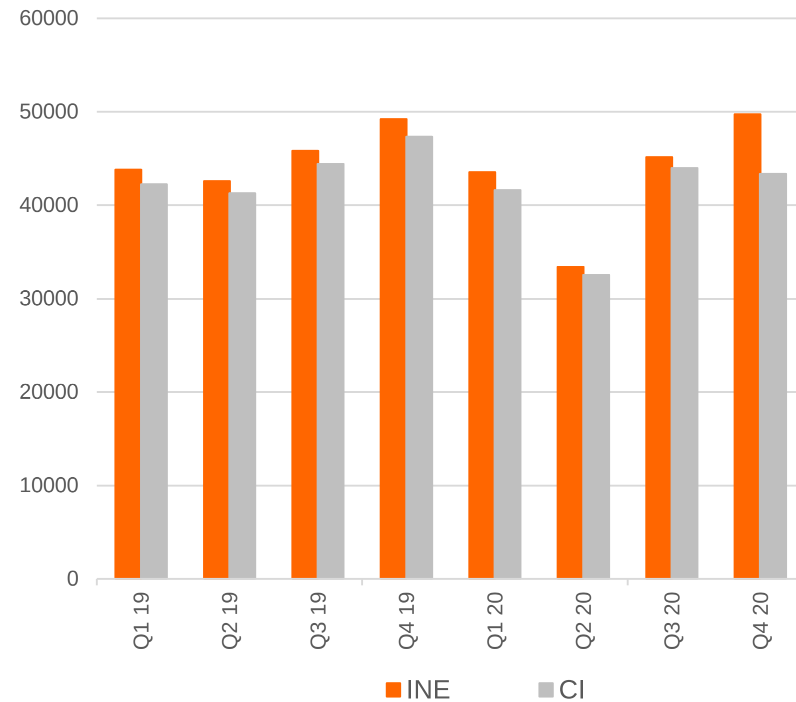
Index (Q4 18=100)



Source: Eurostat

Housing Transactions

Units



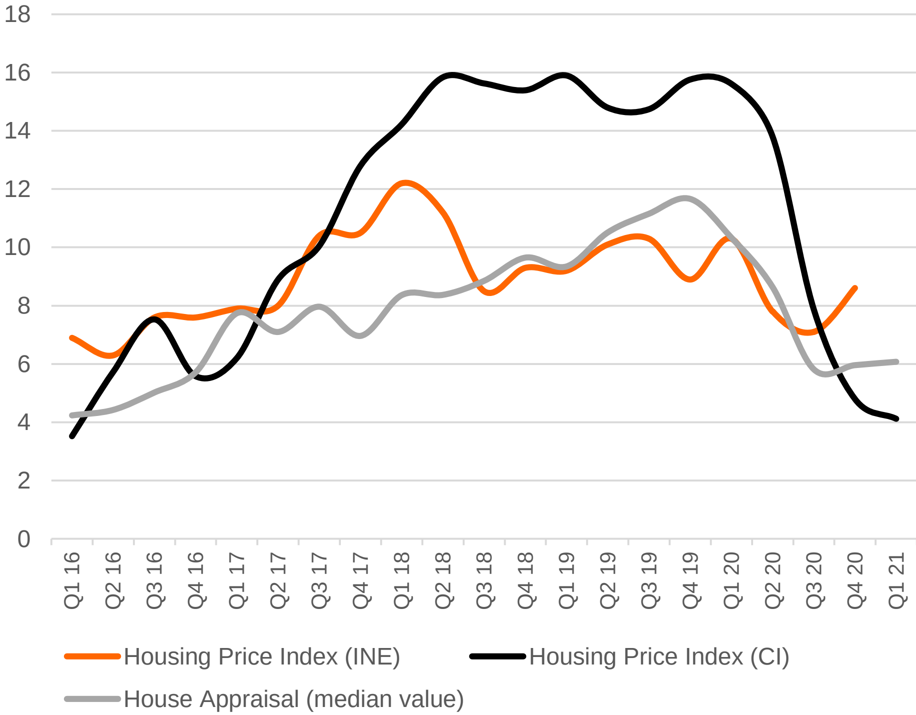
Source: INE and Confidencial Imobiliário.

- **The families' disposable income per capita has remained relatively steady up to 2020**. Measures such as the lay-off regime, moratoria on credits and tax deferrals helped families to preserve a large share of their income.
- **According to INE, housing sales increased 10.2% qoq in Q4 and 1.0% yoy. For the whole year, INE data points to a decline of 5.3% on house transactions.**
- In 2021, housing sales should remain contained, reflecting the more restrictive lockdown in Q1, persistence of uncertainty leading people to delay investment decisions. But the postponement of the end of Golden Visa regime in Lisbon and Porto for the end of 2021, as well as the very supportive financial framework, should give keep given support to the market.

The real estate sector: resilience and solid fundamentals

Housing prices

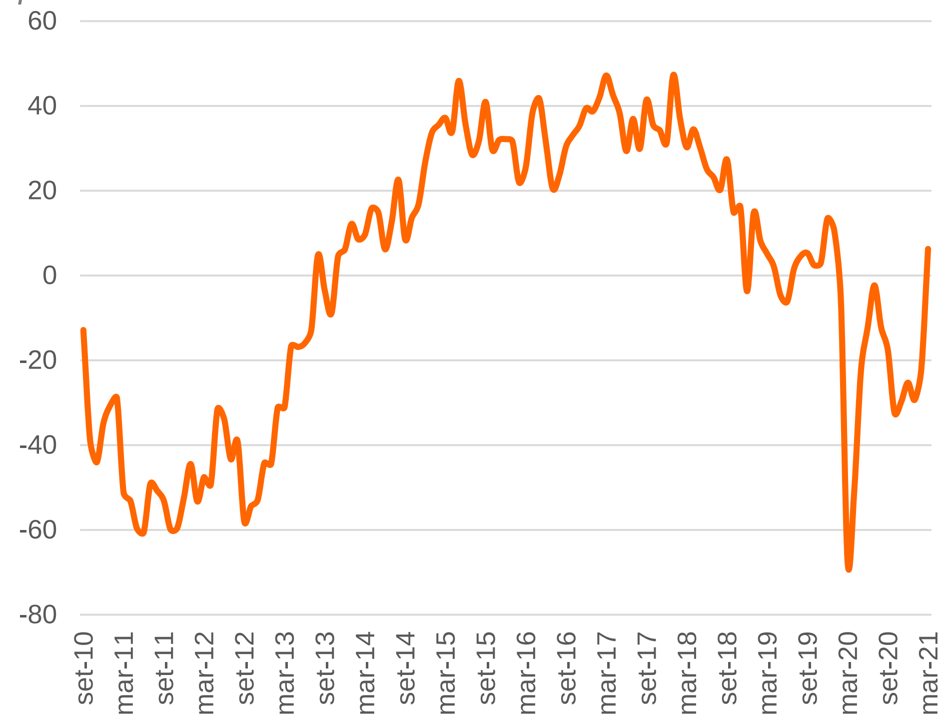
Year on year (%)



Source: BPI Research from INE and Confidencial Imobiliário.

Real Estate confidence indicator

points

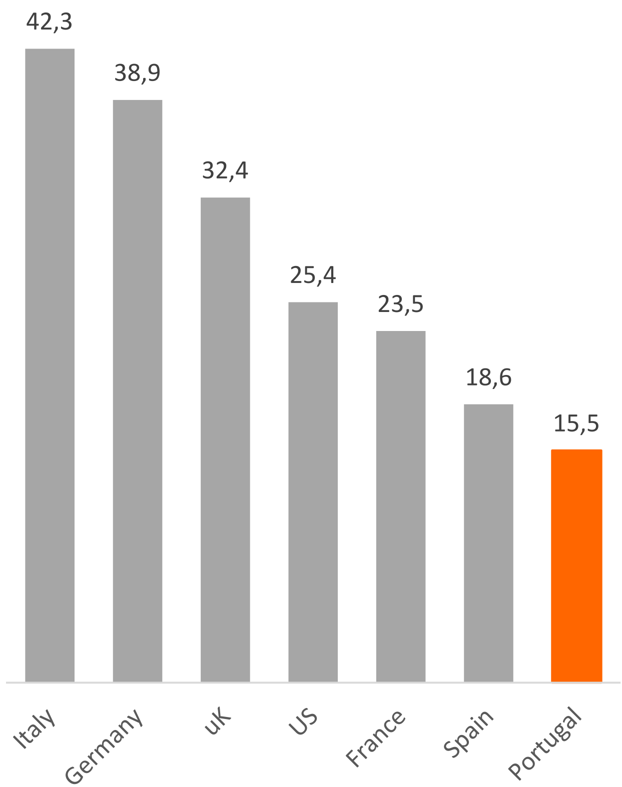


Source: BPI Research Confidencial Imobiliário.

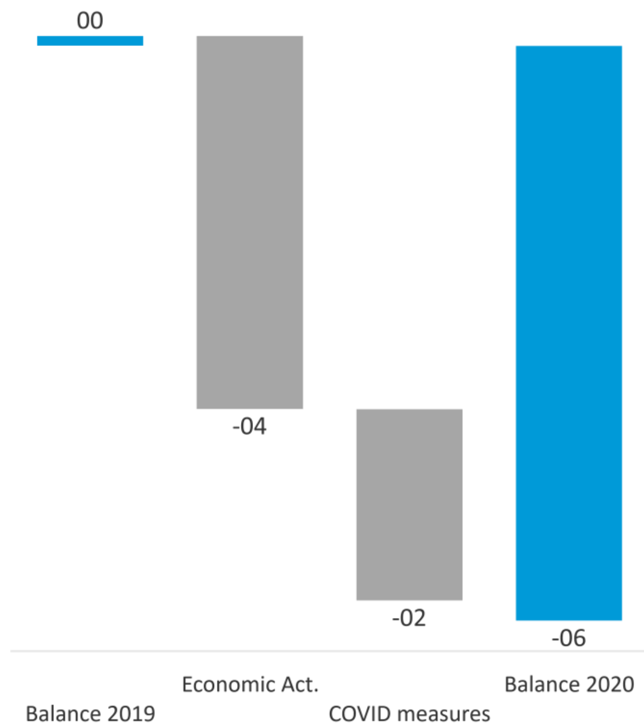
- **The housing sector experienced a slowdown in 2020,** with prices decelerating to 8.4% and sales decreasing 5.3%. This behaviour is explained by the restrictions imposed in the country to contain the spread of the virus.
- The median value of the housing appraisals increased to 1,185/m² in March, a 6.8% yoy increase and a monthly increase of 0.9%.
- In 2021, the slowdown path is expected to continue. In fact, the end of the moratorium regime in September 2021 (currently affects circa 15% of the total housing credit) will likely increase the financial constraints of the Portuguese families and unemployment is expected to increase. Thus, a decline on prices is a possibility, but only marginally and on very short period of time.

Public accounts in 2020: deficit contained despite the pandemic

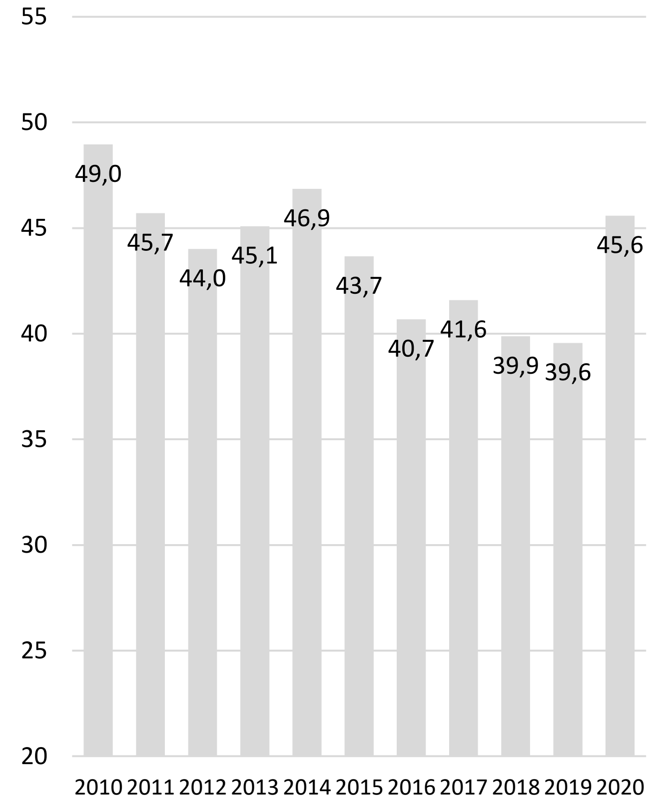
Measures to support the economy (Covid)
(% GDP)



Fiscal balance: from 2019 to 2020
(% GDP)



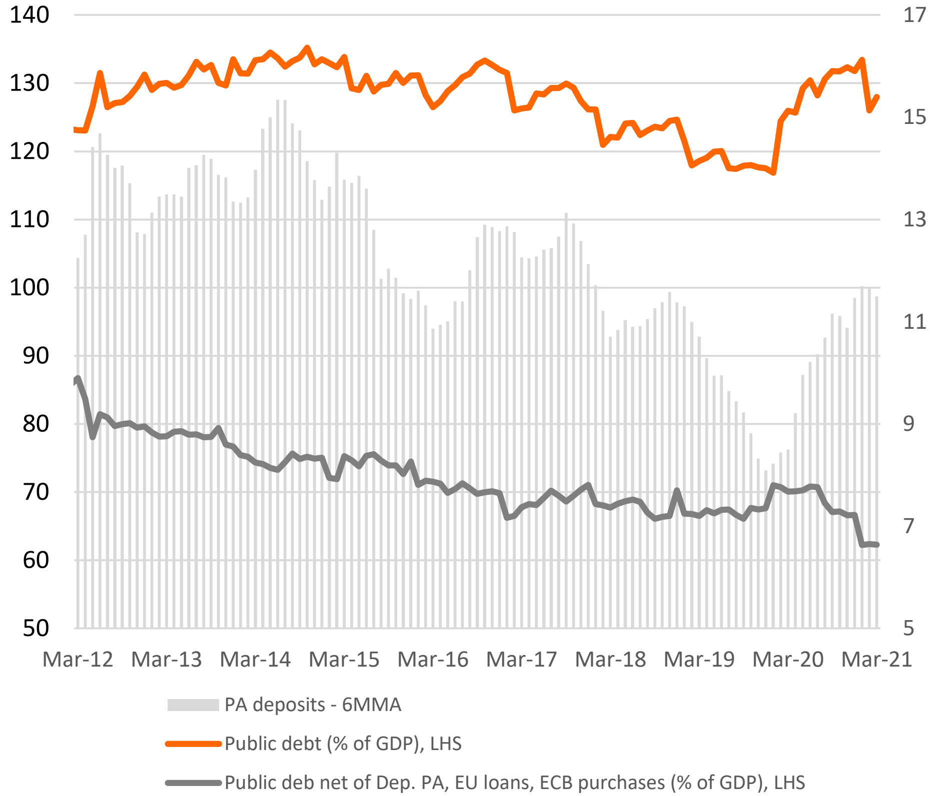
Primary expenditure
(% GDP)



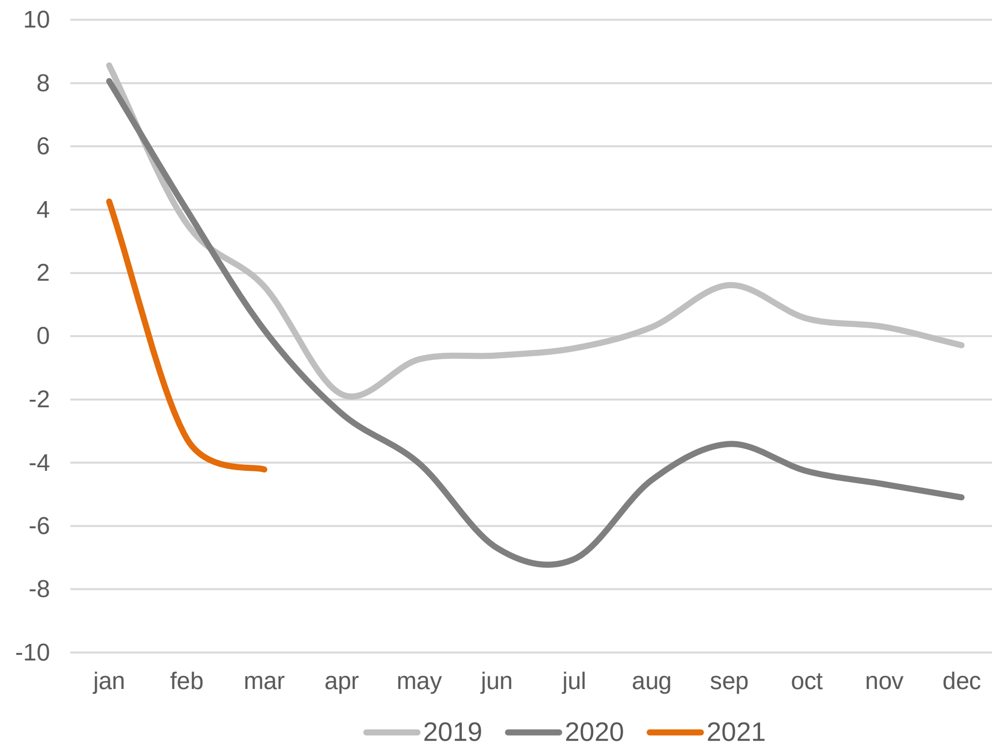
- **The fiscal effort to support companies, households and the health system was lower in Portugal than in other countries,** especially in comparison to those more reliant on tourism (like Spain). If we exclude measures like moratoriums and credit lines, the impact of COVID measures on GDP in Portugal was around 2% of GDP in 2020.
- **Overall fiscal balance ended 2020 at -5.7% of GDP** (accrual basis), lower than Government official target (-7.3%). This behavior is explained by a lower than expected decline of revenues (lower GDP contraction and the impact on labour market than expected) and a lower expenditure execution. Part of the increase in expenditure was due to the COVID support measures, such as the simplified layoff or health-related expenditure (these measures, both from revenue and expenditure side, represented 1.9% of GDP, around 3,700 million euros).

In spite of the increase in public debt, funding needs are well covered

Public debt
(% GDP)



Public net borrowing needs (-) or capacity (+)
(% GDP)



Note: cash basis. Source: BPI Research, based on DGO figures.

- **The Government funding needs are well covered**, helped by ECB purchases (expected to cover around 75% of financing needs in 2021), plenty of liquidity available and low interest rates. The 2021 Government's forecast point to a 4.5% fiscal deficit and a revenues from the NGEU of around 700 m€ (lower than 10% of total). 18% of total debt are EU loans linked to the Economic and Financial Assistance Program. Excluding deposits, EU loans and ECB purchases, public debt stood at ~62% in March 2021.
- The budget execution in the first three months of 2021 reflects the impact of the new lockdown on economic activity and public accounts; **overall fiscal balance stood at -4.2% of GDP until March. COVID measures have reached 3.6% of GDP until March.**

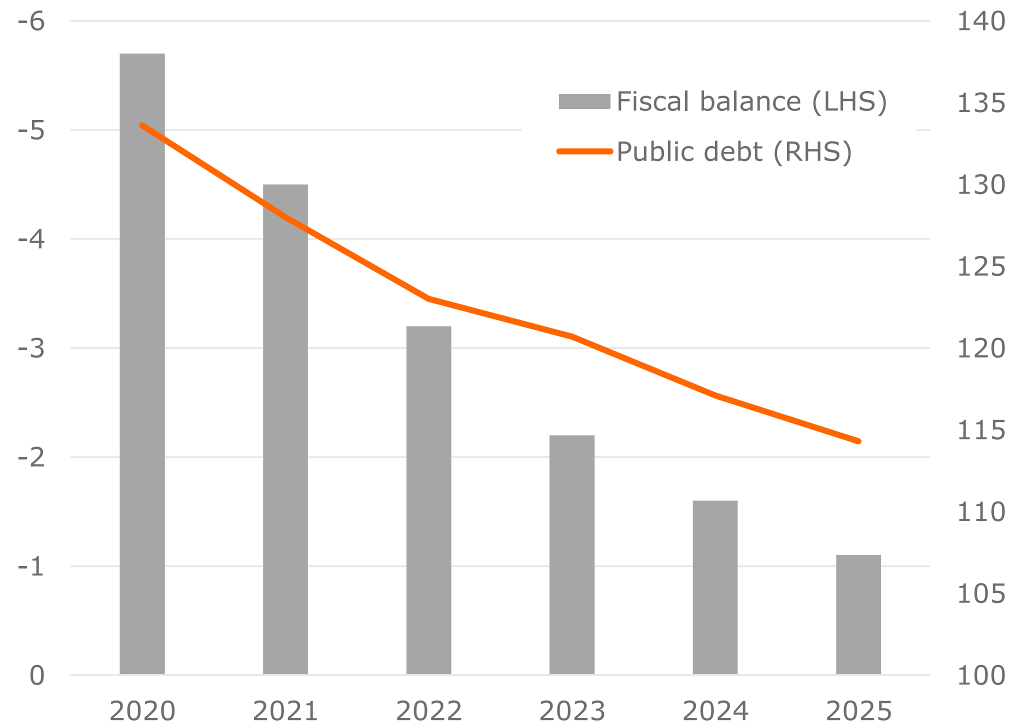
The Stability and Growth Program: fiscal deficit below 3% expected for 2023

Macroeconomic scenario inscribed in the Stability Program 2021-2025

	SGP 2021-2025							BPI
	2020	2021	2022	2023	2024	2025	Cum. 2020-25	Cum. 2020-25
GDP (real, %)	-7.6	4.0	4.9	2.8	2.4	2.2	8.4	5.0
Inflation rate (%)	-0.1	0.8	0.9	1.1	1.3	1.4	5.5	6.7
Unemployment rate (%)	6.8	7.3	6.7	6.4	6.0	5.8	-1.0	-0.3
Employment (yoy %)	-1.7	0.2	1.1	0.8	0.8	0.8	2.0	0.6
Current account (% GDP)	-1.1	0.0	0.6	0.4	0.1	0.0	1.1	1.1

Overall fiscal balance and public debt ratio

(% GDP)



- **The Government revised downwards the GDP growth in 2021, due to the impact of new lockdown period at the beginning of this year.** However, the Government is expecting to reach pre-COVID levels in 2022, in contrast to our expectation (2023).
- Considering the **impact of lockdown period on the economic activity and public accounts, the Executive revised slightly upwards the forecast for public deficit, to -4.5%** of GDP, from -4.3% in State Budget 2021. The fiscal deficit will be lower than 3% in 2023, probably the year when the European rules will be under place again.
- **Public debt will be below 2019 level only in 2025**, according to the Government's forecasts.

	Main measures
Direct fiscal measures	• **Allowance of 100% of the remuneration** in case of prophylactic isolation (14 days). • **For self-employed without dependent workers,** financial support was provided if the turnover fell more than 40%**; for those with dependent workers,** the financial support was provided only if they applied for the layoff regime – minimum wage held. • **Extraordinary financial incentive** to support the normalization of the company's activity**.** • **Financial support from Social Security to pay remuneration** in cases of assistance to children under 12 years old. • **Simplified layoff**
Deferrals	• **Mortgage and consumer credit moratoria** for families directly or indirectly affected by the pandemic. • **Exceptional and temporary scheme for the payment of housing** rent for families that have been affected by a cut in their monthly income. • **Deferral of the payment of contributions by workers.** • **For companies:** flexibility in the payment of tax obligations and reduction of social contributions; exceptional and temporary regime for the payment of non-housing rent.

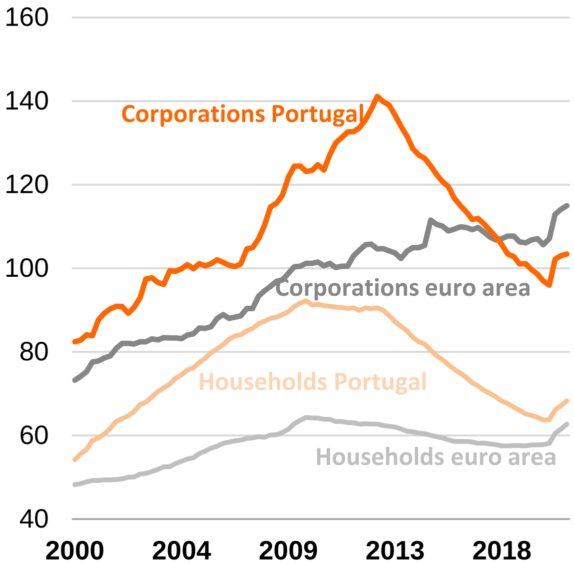
Credit guarantees and capital injections	• **Credit lines available to all sectors, especially for the most affected. The most recent lines:**
	  • **Apoiar.PT:** 750 million euros (non-repayable - grants) if jobs are kept during the period of the support, for micro and SME.
	  • **Exporting firms**: 1,050 million with state guarantee; 20% of this line may be converted in non-repayable funds, if jobs are maintained.
	  • **Cash reserve for the micro and small firms**: 750 million euros
	  • **Large companies most affected sectors**: 750 million euros
	  • **Extension of Turismo de Portugal microcredit to small companies**: 100 million euros
	  • **Credit lines reopened**: 400 million euros

	Components and investments	
• **Total (8.2% of GDP 2020):** **Grants: 13,944 M€** (6.9% of GDP) **Loans: 2,699 M€** (1.3% of GDP)	**Direct to corporates: 5,000 M€ (30% of total)** • Innovation: 1,364 M€ • Industry decarbonisation: 715 M€ • Human Resources qualification: 630 M€ • Digital transition: Business 4.0: 650 M€ • Capitalization measures, Banco de Fomento: 1,550 M€ • Bio-economy: 145 M€	
• **Resilience** **11,125 M€**	• National Health Service (1,383 M€) • Housing (2,733 M€) • Social area (833 M €) • Culture (243 M€) • Corporates capitalization and innovation (2,914 M€ M€)	• Qualifications and skills (1,324 M€) • Infrastructures (690 M€) • Forest (615 M€) • Water sector (390 M €)
• **Climate transition** **3,059 M€**	• Sea (242 M€) • Sustainable mobility (967 M€) • Industry de-carbonization (715 M€)	• Sustainable bio economy (145 M€) • Energy efficiency in buildings (610 M€) • Hydrogen and Renewables (370 M€)
• **Digital transition** **2,460 M€**	• Digital school (559 M€) • Industry 4.0 (650 M€) • Efficiency of Public Finances (578 M€) • Justice, economy, business environment (267 M€) • Public administration quality (406 M€)	

The Portuguese banking system: supporting an economy hit by COVID-19 (1)

Gross private debt

% of GDP, non consolidated debt.



Source: Eurostat

Private domestic credit

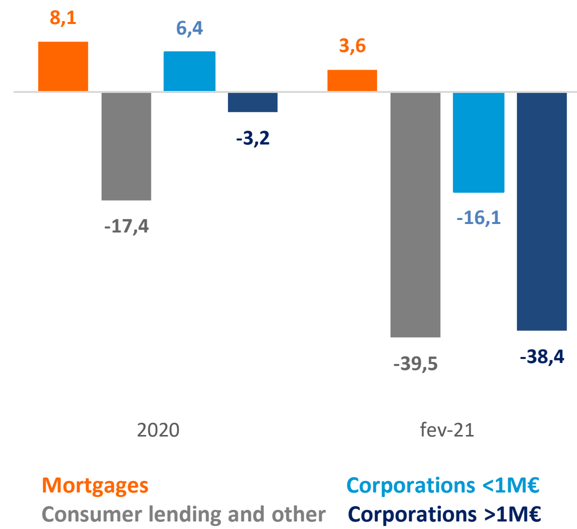
Year on year (%)

	Dec 2020 % yoy	Mar-2021 % yoy	2021 (For.) % yoy
Total Credit*	4.6%	5.1%	3.9%
Households	1.4%	1.8%	0.0%
Housing mortgages	2.1%	3.0%	1.6%
Other purposes	-1.2%	0.4%	0.5%
Consumer lending	-0.3%	-1.5%	0.5%
Non-financial corporations	10.5%	11.1%	7.6%

Source: Bank of Portugal

New lending activity by sector

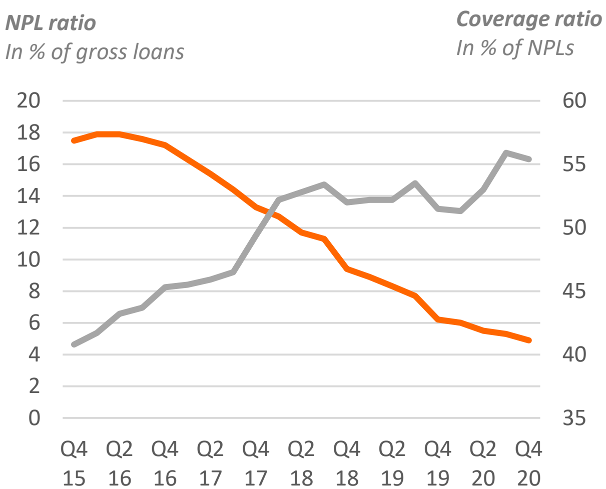
Year on



- **Corporate debt levels** remain below euro area averages despite the recent pick-up in credit. Household debt has increased more modestly reflecting expanding mortgage lending, as well as the effect of moratoria. We expect the deleveraging trend to return after the COVID crisis.
- In both cases – corporates and families – the increase of the indebtedness ratios are mainly explained by the contraction of the nominal GDP (-5.6%) and effects from moratoria that covered more than 20% of the stock of credit (a temporary effect). New lending to the private sector contracted 0.3% in 2020, mainly due to the decline of new lending for consumption, while new mortgage credit showed some resilience. New credit to NFC rose by 0.5%
- **In February, new lending slumped for both families and corporates.** Higher uncertainty related with the 3rd wave of infections and the adoption of a more cautious stance by both banks and economic agents may explain the credit decline at the beginning of 2021.

The Portuguese banking system: supporting an economy hit by covid-19 (2)

NPLs and coverage ratios



Moratoria	Cost of risk[1]
Feb21: 15.8% of loans to households; 33% of loans to NFC	0.5% in 2019 1% in Q4 2020

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 20; trailing 12M)

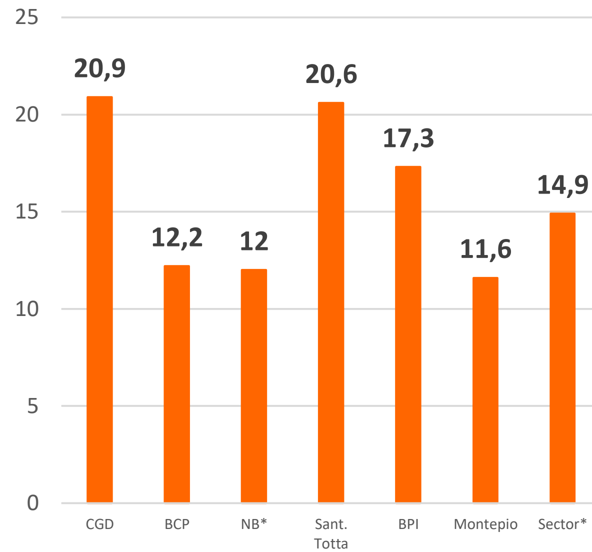
	BPI	BCP	San Totta	CGD	NB*	Montepio
Net interest income	**1.3%**	**1.4%**	**1.4%**	**0.8%**	**1.2%**	**1.4%**
Net fees	0.7%	0.8%	0.6%	0.5%	0.6%	0.6%
Gains on financial assets	0.0%	0.1%	0.2%	0.0%	-0.9%	0.1%
Other net profits	0.0%	-0.1%	0.0%	0.1%	-0.3%	0.1%
Gross income	**2.0%**	**2.3%**	**2.3%**	**1.5%**	**0.6%**	**2.2%**
Operating expenses	-1.3%	-1.1%	-1.0%	-0.7%	-0.9%	-1.6%
Operational result	**0.7%**	**1.2%**	**1.3%**	**0.7%**	**-0.3%**	**0.6%**
Impairement losses, taxes and others	-0.5%	-0.8%	-0.6%	-0.1%	-2.2%	-1.2%
Profit	**0.2%**	**0.2%**	**0.5%**	**0.5%**	**-2.5%**	**-0.5%**
ROTE[1]	2.7%	3.1%	6.9%	6.1%	nd	nd

[1]average 4 quarters; for BCP and CGD data available is for ROE

* Q3 2020

Banks' solvency

In % (2020)



Source: Banks publications, BoP

** 2020 Q3*

- **NPL trend continues to improve.** In Q4 2020, the NPL ratio fell to 4.9%, -1.3 p.p. than in Q4 2019; also the stock of NPLs declined in Q4, probably helped by moratoria schemes. This trend will probably reverse as debt moratoria expire (September 2021) and companies and households start facing normal repayments of guaranteed loans.
- **Covid adds even more pressure to banking profitability and the need to further consolidation:**
  - Interest rates are now expected to remain lower for longer.
  - After a temporary pick-up in loan demand, businesses and households are expected to focus on balance sheet repair.
  - The cost of risk has risen. Banks have already booked a significant amount of provisions in the first half of 2020.
- **The capital position of Portuguese banks provides buffers to weather the COVID19 shock.**

Main economic forecasts

%, yoy	2012	2013	2014	2015	2016	2017	2018	2019	2020 (Forecasts)	2021 (Forecasts)
GDP	-4.1	-0.9	0.8	1.8	2.0	3.5	2.8	2.5	-7.6	4.9
Private Consumption	-5.3	-1.0	2.4	2.0	2.6	2.1	2.9	2.6	-5.9	3.8
Public Consumption	-3.5	-2.0	-0.5	0.8	0.8	0.2	0.6	0.7	0.5	3.5
Gross Fixed Capital Formation (GFCF)	-16.7	-4.8	2.3	5.9	2.5	11.5	6.2	5.4	-2.2	3.8
Exports	3.1	7.2	4.3	6.2	4.4	8.4	4.1	3.5	-18.6	15.8
Imports	-6.4	4.7	8.1	8.1	5.0	8.1	5.0	4.7	-12.0	12.4
Unemployment rate	15.6	16.2	13.9	12.4	11.1	8.9	7.0	6.5	6.8	9.1
CPI (average)	2.8	0.3	-0.3	0.5	0.6	1.4	1.0	0.3	0.0	0.9
External current account balance (% GDP)	-1.6	1.6	0.2	0.2	1.2	1.3	0.6	0.4	-1.2	-0.4
General Government Balance (% GDP)	-6.2	-5.1	-7.4	-4.4	-1.9	-3.0	-0.3	0.1	-5.7	-5.7
General government debt (% GDP)	129.0	131.4	132.9	131.2	131.5	126.1	121.5	116.8	133.6	131.2
Risk premium (PT-Bund) (average)	903	464	252	189	307	269	138	98	89	52

Notes: All GDP figures are based on ESA-2010 methodology.

Source: BPI Research.