Portugal:
Macroeconomic and financial outlook

BPI Research

November 2021

Prepared with information available by November 11th, 2021

BPI Grupo CaixaBank

Main messages

Activity

- **Recovery consolidated in Q3.** GDP increased +2,9% qoq and +4,3% yoy, reducing the gap for the pre-covid level to -3,1%, mostly driven by domestic demand. Economic data for Q4 suggest some moderation, pointing to yoy growth around +2,5%, well in line with our forecast (4%). Indeed, risks for 2021 growth seem to be biased slightly to the upside.
- **Fully vaccinated people aged over 50 reached 100%,** key to ease hospital pressure and restrictions, allowing economic activity to pick up substantially. Group immunity was reached at the beginning of October, with 85% of population already vaccinated, essential to combat the Delta variant.
- **Tourist activity keeps recovering (non-residents), with very positive signals.** In the first 8 days of November, the number of flights have almost doubled regarding the same period 2020, reducing the gap for 2019 to -14% (-21% in October, -27% in September and -45% in June). Progress with vaccination is expected to contribute to a strong pick-up in tourism activity, more apparent in 2022.
- **GDP should reach pre-crisis levels in 2H 2022.** We see 2022 GDP advancing 5,1% with somewhat negative risks. Indeed, although the health situation will probably keep under control, the impact of supply bottlenecks and the effect on confidence of the recent political instability may weaken growth next year.

Banking Sector

- **Despite the end of moratoria last September, the Portuguese banking system maintains a strong financial position**. NPLs continue to decline and banks are building reserves to face future losses, with NPL coverage ratios at ~55%. Liquidity and solvency ratios continue also to improve. Healthy balance sheets will be key to accommodate a possible increase in bad loans due to the end of moratoria (according to press, last September, stage 3 credit stood at between 7% and 13% of debt under moratoria, in some banks) and also due to maturity of credit lines from mid 2022. However, the possibility of restructuring debt under moratoria, with state guarantee, a measure aimed at the most vulnerable sectors, will probably reduce the impact.

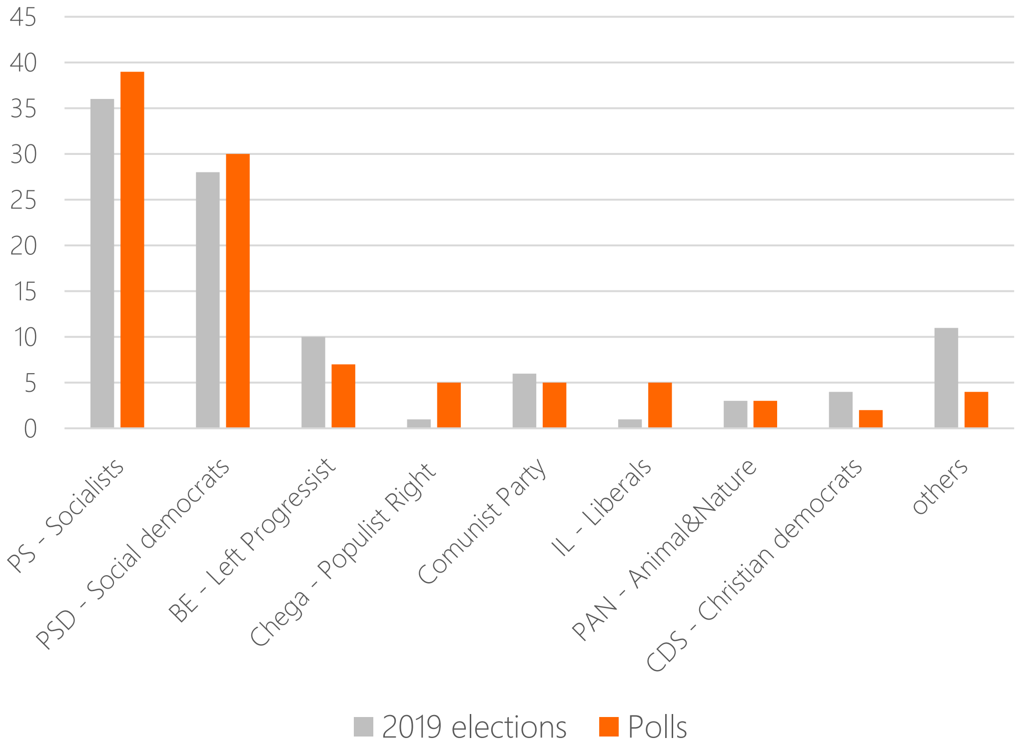
Policy

- **The State Budget proposal for 2022 was rejected by the Parliament and early elections were called to January 30th.** If the reception of NG funds is interrupted by the suspension of Parliament, or the result of the elections is inconclusive, recovery in 2022 will be weaker than foreseen. But according to Government sources legislation needed within the Recovery and Resilience Plan is not dependent on Parliament's approval, meaning that funds will be received most probably according to the plan.
- **Domestic restrictions to mobility and activity have mostly been removed.** Since October 1st green passport is only mandatory for air and sea traveling.
- **Despite the strong support to the economy, the fiscal deficit keeps contained and public debt is declining, in line with our scenario.** Official estimates for 2021 fiscal deficit stand at 4,5% of GDP (5,7% in 2020), close to our own forecast (4,8% of GDP), and in Q3 public debt declined to 131,4% from 135,5% in Q2. However, public accounts may face several challenges in the near future, namely the possible execution of guarantees related to Covid-credit lines and also the eventual additional financing needs of some state-owned companies. Nevertheless there is room to accommodate potential fiscal slippage as the economy is showing strong dynamics and as public debt increased comparatively less in 2020 than in other European peers.
- **The Government funding needs are well covered**, helped by ECB purchases (expected to cover around 85% of financing needs in 2021), plenty of liquidity available and low interest rates. Public debt stands at 131,4% of GDP (~35 pp is in ECB's balance-sheet).

Political situation: elections in January may delay the reception of NGEU funds in 2022

Elections: 2019 results and polls for January 2022

(% of votes)



- **In the wake of the rejection of the state budget for 2022, the Parliament was dissolved and general elections were called to January 30th.**
- Uncertainty about the outcome is high and most recent polls suggest that there will be no significant changes in the Parliament, raising uncertainty about the possibility of Portugal entering in a period of political instability.
- **One of the most critical consequences is related with a possible delay on the execution of the EU Next Generation funds, with a possible negative impact on growth in 2022.**
- However, according to the Government, the amounts scheduled to be received at the beginning of 2022, can be executed within the twelfths' regime (*duodécimos*) that will be applied up to the approval of the new state budget for 2022, probably only by end H122. Indeed, the Ministry of Finance declared that **dissolution of the Parliament will not be an obstacle to the fulfillment of the goals and milestones enrolled in the RRP** for the country to be able to request the payment of the first tranche, of EUR636 billion euros, at the beginning of 2022, since reforms in question do not depend on the approval of the Parliament.
- In 2021, Portugal has already received EUR 2,2 bln, circa 90% of total planned for this year that should be mostly allocated to the capitalization and business innovation. For 2022, Portugal is expected to receive EUR 3,3 bn, of which EUR 636 mln are scheduled to be received in the beginning of 2022.

- **On the political front scenarios are not brilliant**: On one hand, according to recent polls results, the Parliament will be more polarized, with the bigger parties (PS and PSD) increasing their position but with reduced probability of any of them achieving absolute majority. On the other hand, the remaining political forces will be, apparently, more fragmented. The left wing parties (BE and PCP) that supported the outgoing Government, moved away from the socialist's options in relevant matters (labour legislation, for example); however, a left wing coalition seems to be, for now, the most probable scenario. Meanwhile, right-wing parties are plagued by internal conflicts and face internal elections, hindering a possible change in the Parliament's design.

The Recovery and Resilience Plan: a key element for recovery

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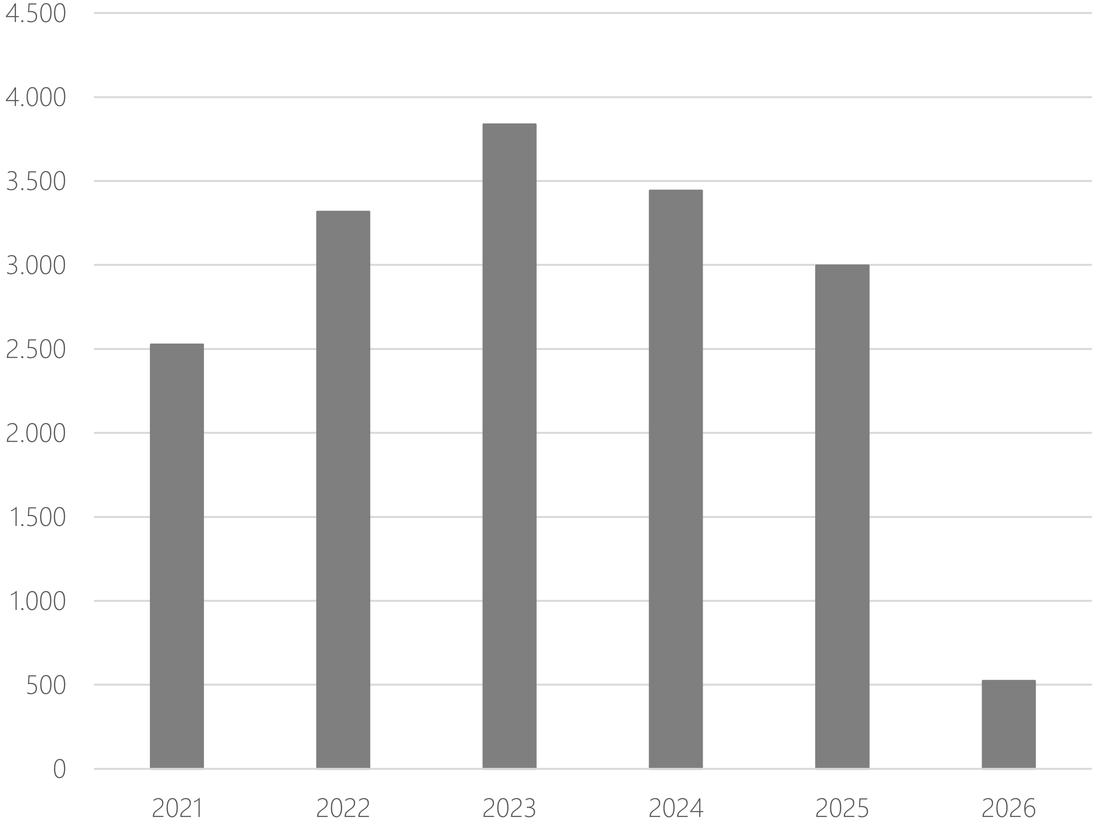
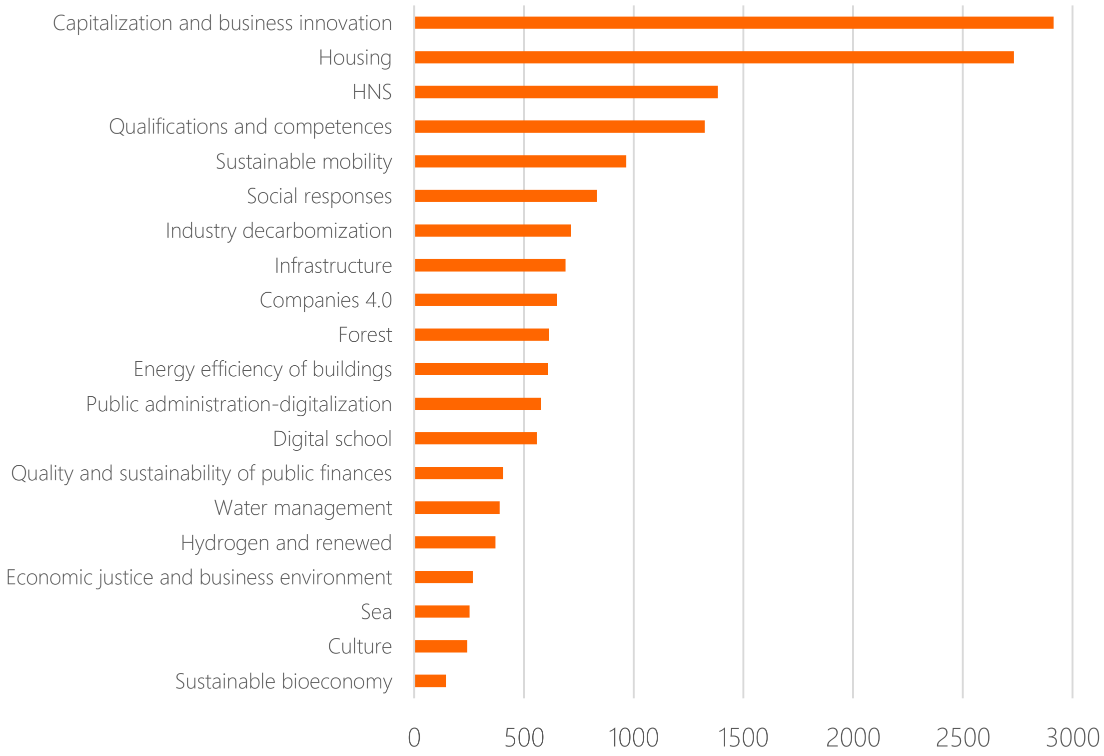
Time distribution of NGEU transfers

(million of euros)



Allocation of European Funds: Distribution by Areas of Activity

(million of euros)



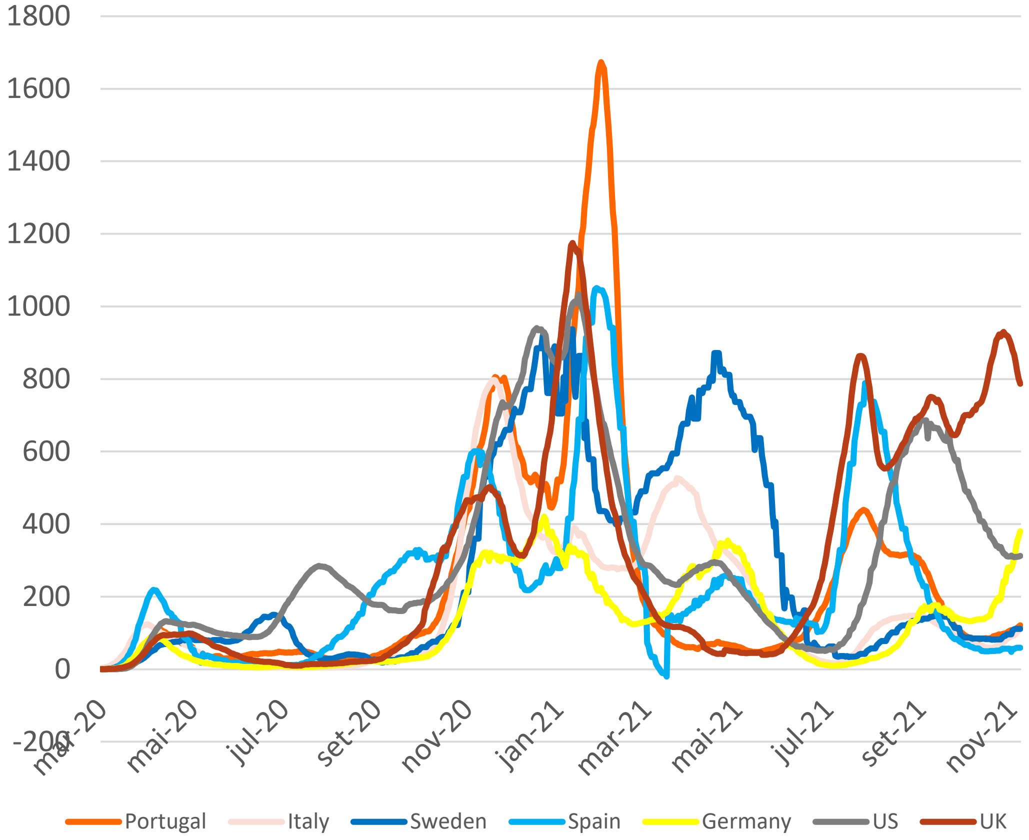
Source: BPI Research, based on Government figures.

- **Portugal will receive €13,9 bn (≈6.5 of 2019 GDP) between 2021 and 2026** as subventions from the European Recovery and Resilience Mechanism. Additionally, the country can apply to receive €5,0 bn of funds in the form of loans; **Portugal has already received the first tranche: ≈€2,2 bln as pre-financing and the following payment (≈€10,000m) is expected at the end of the year**.
- **MACRO IMPACT:** We anticipate that about half of the funds received will be executed in 2021, with a growth contribution of ~0.2%.In 2022, the impact on growth will be ≈0.6 p.p. Between 2021-26, funds will probably add to Portugal's annual GDP between 0.8 and 1.5 p.p. on average.
- **Main risk:** the current scenario of elections in January 30th may led to some delays in the reception of funds, which might reduce 2022 economic growth (our scenario:+5,1%).

Delta variant is pressuring incidence but not casualties and hospitalizations remain low

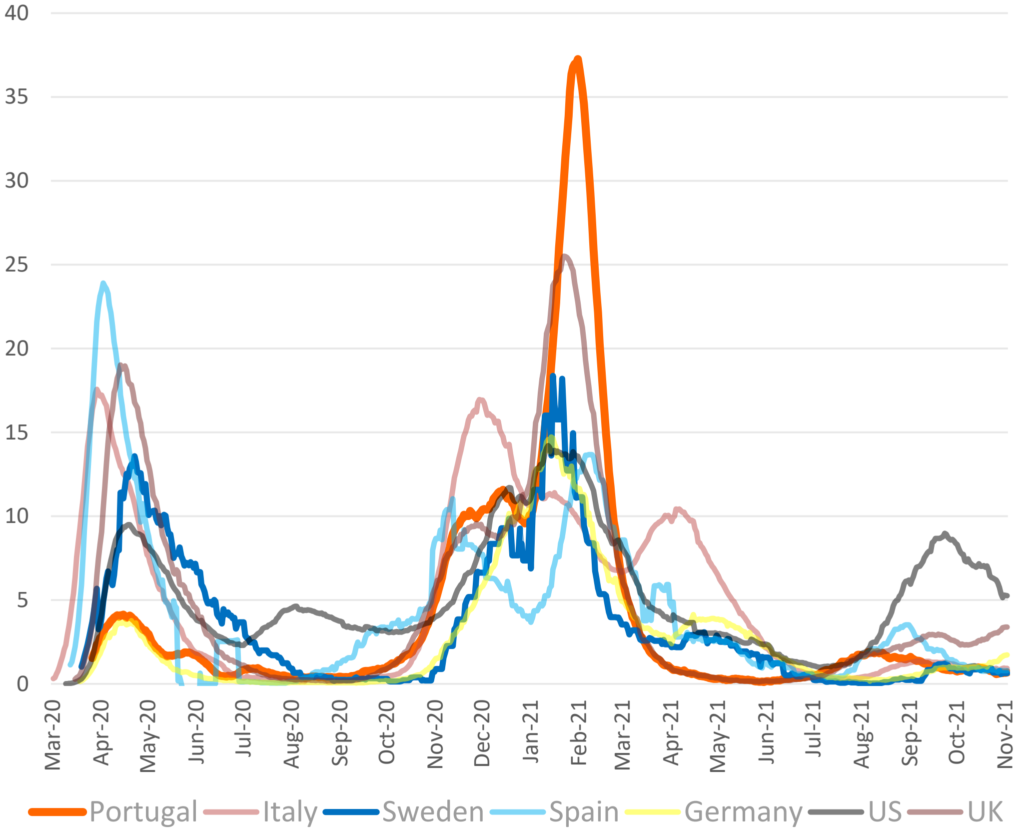
COVID-19 cumulative incidence

Infections per 100k inhabitants accumulated in 14-day



Mortality per 100,000 inhabitants

14-day moving average



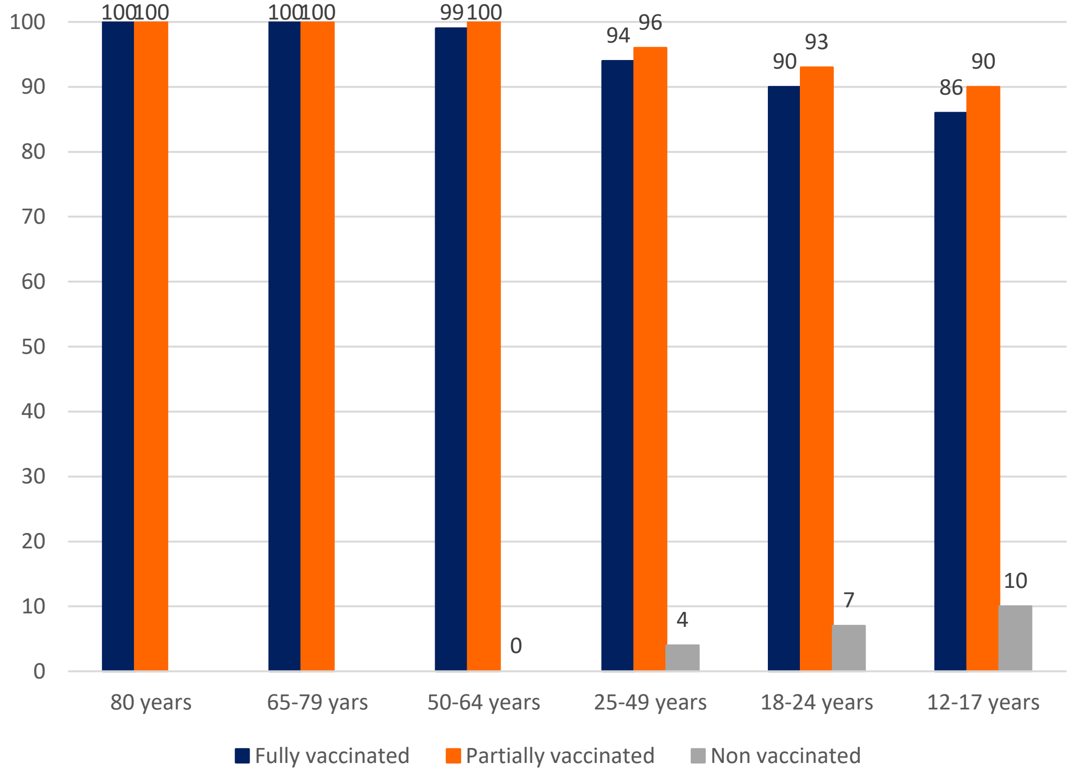
***Notes**: as of November 7th.*

- **14-day cumulative incidence has been increasing and in the beginning of November was in line with the threshold of 120 cases per 100k set by the Government (121/100k).**
- **But the high rate of vaccination is avoiding the increase of serious cases, allowing to continue the gradual opening of the activity. Hospitalizations and mortality continue contained.**

Vaccination of high-risk groups reached 100%

Vaccinated population by age

% of population by group age

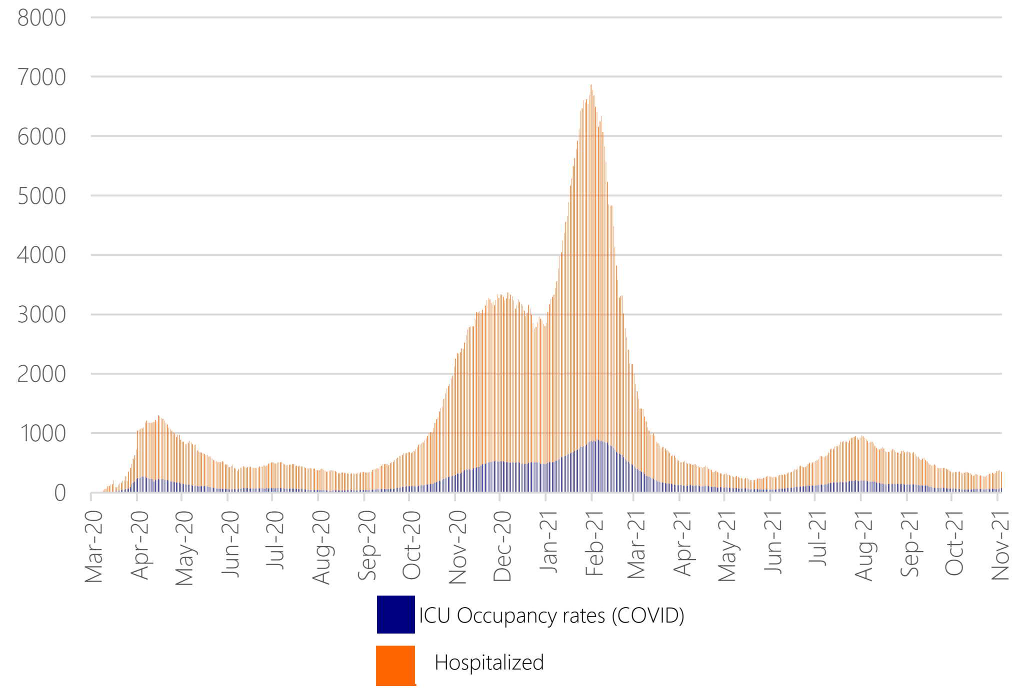


***Notes**: as of October 30th.*

Key take-away: Risk groups have already been vaccinated and inoculations are progressing fast among people below 25 years old.

Number of admissions to wards and ICE occupancy

Unit

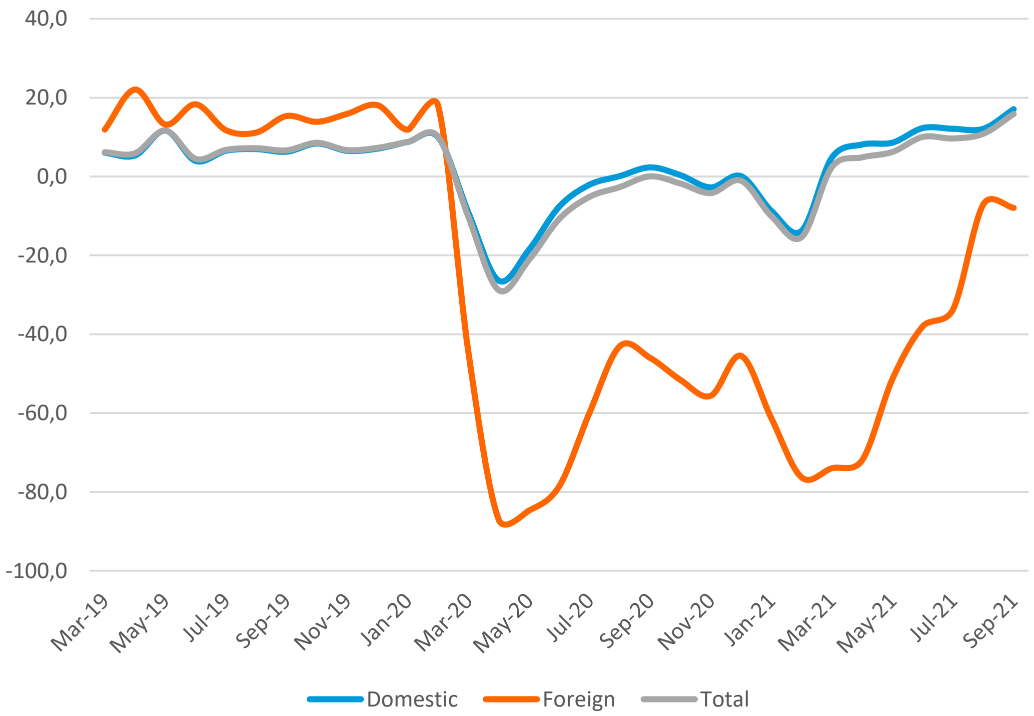


Key take-away: The well succeeded vaccination process is reducing hospital pressure before winter.

The recovery proceeds at a more moderate pace

Card activity (Electronic payments + Cash operations)

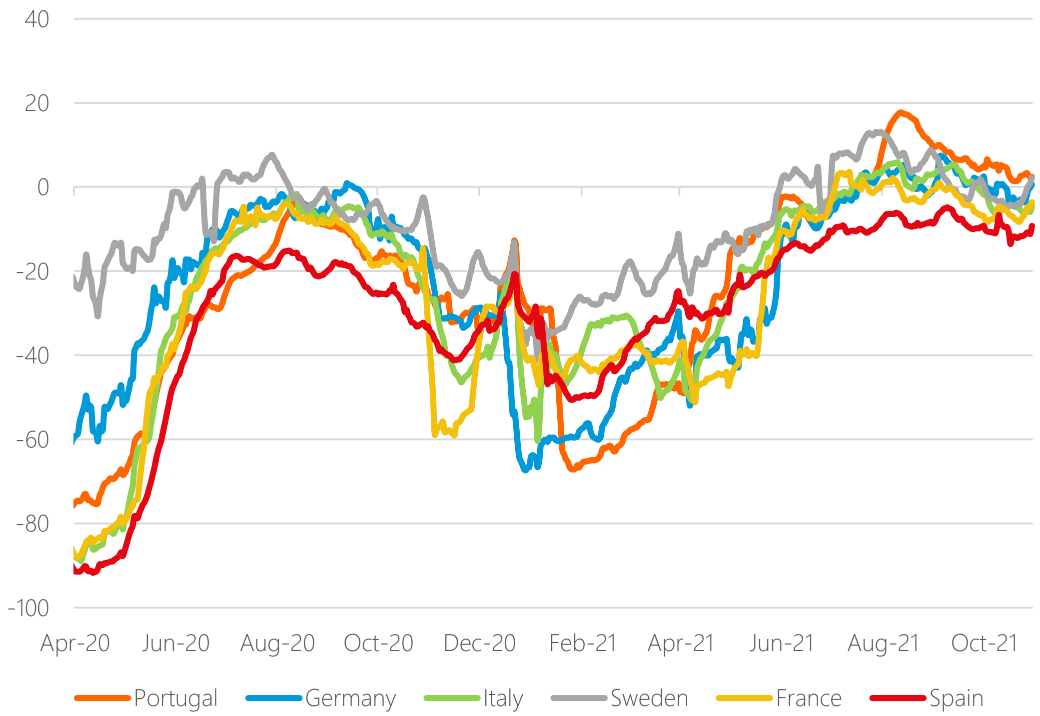
Year-on-year change (%)



***Notes**: From March onwards, the yoy rate is computed using the level of the same month of 2019.*

Population mobility: to retail and recreation

Deviation from base level (%)



- The increased pace of vaccination, the favorable evolution of epidemiological data and the withdrawal of the state of alarm have had a positive impact on confidence which is already showing on a broad range of economic indicators.
- **Since March, card data has been exceeding the 2019 levels.** In September 2021, card and ATM payments exceeded in 16% the level of September 2019.
- **The pace of recovery slowed down at the beginning of Q4**. Activity is still 3% below 2019 level. In September retail sales surpassed in 4,4% the same month of 2019; the industrial production gap narrowed to 2,5%

Activity monitor – several indicators are already above 2019 levels

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
2019	-	6.5	15.1	-0.6	-0.2	-2.2	4.5	-6.1	7.9	3.5
2020	-8.6	-9.5	10.9	-30.2	-3.5	-6.9	-2.8	5.8	-61.6	-10.2
Q1 2020	-2.4	-0.5	5.5	-19.2	0.7	-1.0	5.3	-0.3	-18.6	-2.8
Q2 2020	-19.6	-24.3	14.3	-24.6	-11.8	-24.1	-13.0	-3.9	-91.6	-30.3
Q3 2020	-6.3	-6.2	11.8	-9.0	-0.7	-0.5	-3.0	21.2	-53.1	-3.0
Q4 2020	-6.0	-6.8	12.0	-20.0	-2.3	-2.1	-0.5	6.3	-68.5	-3.3
Q1 2021	-4.3	-11.3	10.2	-23.2	-1.4	-0.8	-8.9	2.6	-78.7	6.9
Q2 2021	-3.5	7.1	21.9	-27.2	-3.6	-5.8	1.9	4.4	-64.5	3.3
Q3 2021	-1.9	12.1	15.3	-31.6	-1.3					
June	-3.1	10.1	25.5	-25.1	-1.0	-5.5	2.1	3.5	-50.2	8.4
July	-3.9	9.7	9.8	-33.1	-3.2	-7.3	0.3	1.6	-42.2	4.1
August	-1.4	10.9	19.9	-35.9	-0.2	-6.5	-0.1	-1.8	-23.6	14.1
September	-0.4	15.9	16.2	-25.9	-0.5	-2.5	4.6	-2.8	-23.6	10.4
October	-3.0			-32.4						

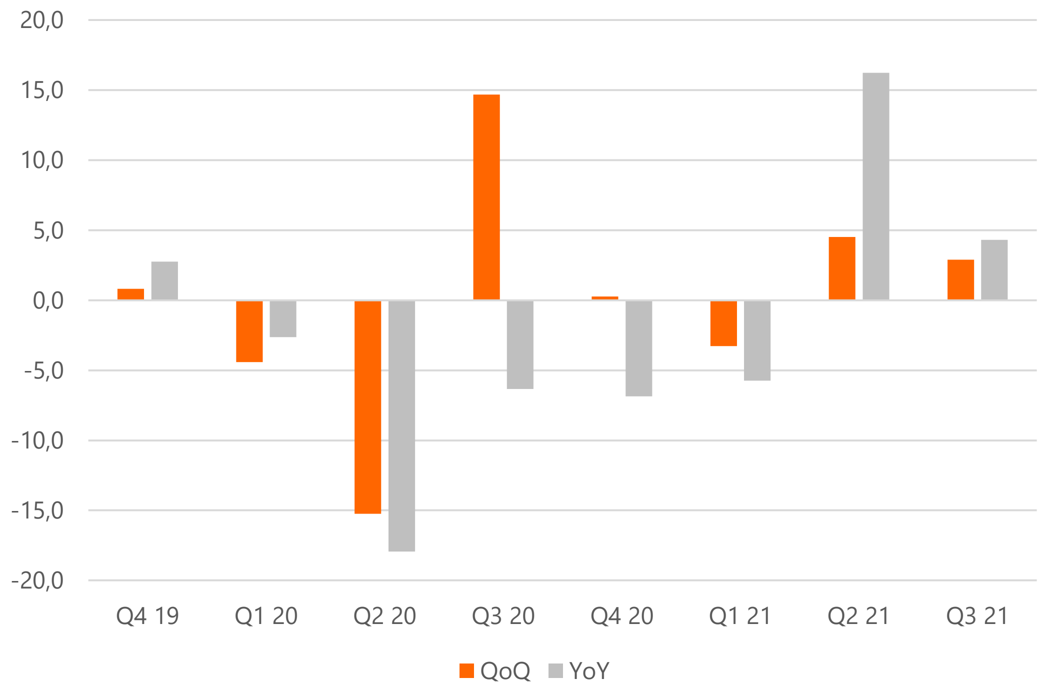
Note: After March 2021 (inclusive), the comparisons are made with the respective month in 2019.
Q1 2021 as average of monthly 2019 yoy changes

Rate >= avg. prev. quarter **Rate < avg. prev. quarter**

Activity continues to recover in Q3

GDP growth

Percentage change (%)



Analyst's Forecasts

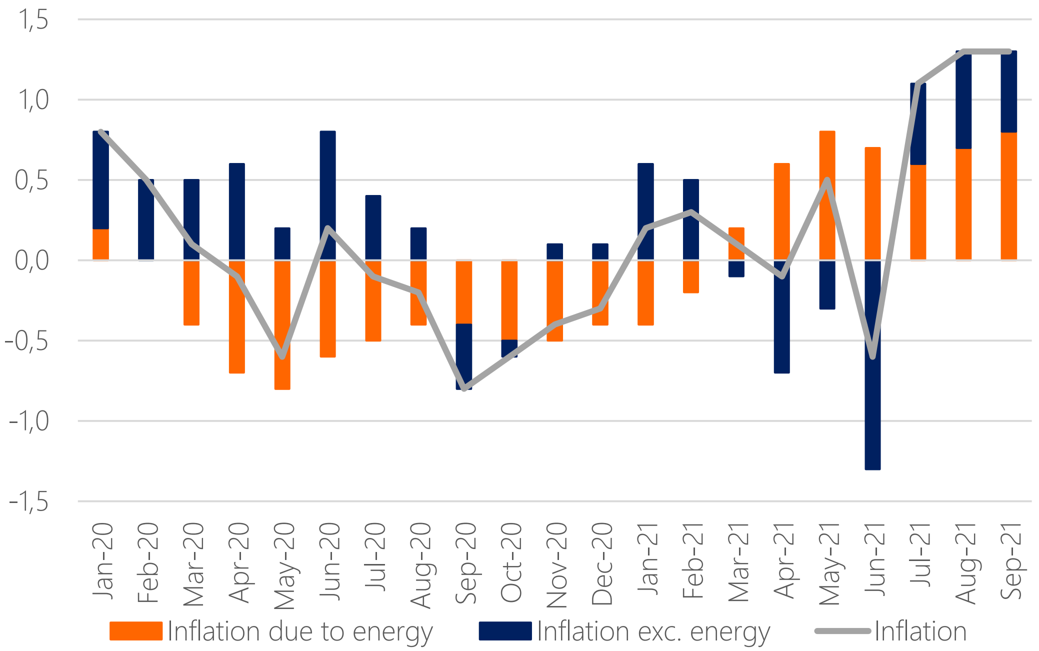
GDP (Δ %)	2020	2021	2022	Acum. 20-21	Acum. 20-22
Commerzbank (October)	-8.4	5.4	5.6	-3.5	2.0
Capital Economics (September)	-8.4	4.3	6.3	-4.5	1.6
Banco de Portugal (October)	-8.4	4.8	5.6	-4.0	1.4
Governo (October)	-8.4	4.6	5.5	-4.2	1.1
Bank of America Merril Lynch (October)	-8.4	4.4	5.7	-4.4	1.1
Citigroup (September)	-8.4	4.1	5.9	-4.6	1.0
European Commission (November)	-8.4	4.5	5.3	-4.3	0.8
FMI (October)	-8.4	4.4	5.1	-4.4	0.5
Focus Economics (November)	-8.4	4.3	5	-4.5	0.3
EIU (August)	-8.4	4.1	5.1	-4.6	0.2
Fitch Solutions (November)	-8.4	4.5	4.6	-4.3	0.1
BPI Research (September)	-8.4	4.0	5.1	-4.8	0.1
Oxford Economics (November)	-8.4	4.5	4.5	-4.3	0.0
Católica (October)	-8.4	3.7	4.3	-5.0	-0.9

- **GDP posted a 2,9% qoq and 4,3% yoy in Q3 2021, surpassing our forecasts and putting positive risks to our scenario for annual growth (4% at the moment).** Improvements in health situation and high accumulated savings by households will continue to support the recovery in the quarters ahead. In addition, economic activity will be supported by the start of the execution of the NGEU funds.
- Our forecasts assume that new bouts of contagion may continue to occur in the coming months, but the pressure on the health system will remain low as the high-risk groups of population are already vaccinated. As a result, the need for more stringent restrictions will be low during the Winter period.
- GDP is expected to reach pre-crisis levels in the H2 2022 – slightly later than the main European partners, given the important weight of the tourism sector.
- **Central scenario**: our main scenario sees GDP advancing 4% this year and 5,1% in the next. Uncertainty is still high and mainly related to the health situation due to the possibility that new more aggressive variants might emerge. Furthermore, bottlenecks on the supply side due to global disruptions are also apparent in the poor performance of industrial sector and auto sales, for instance. Considering all the factors at play, we consider our scenario still conservative, and risks seem to be slightly biased to the upside.

Inflation remains contained

Inflation

Percentage change (%)



Source: BPI Research, from Eurostat.

6-month moving average

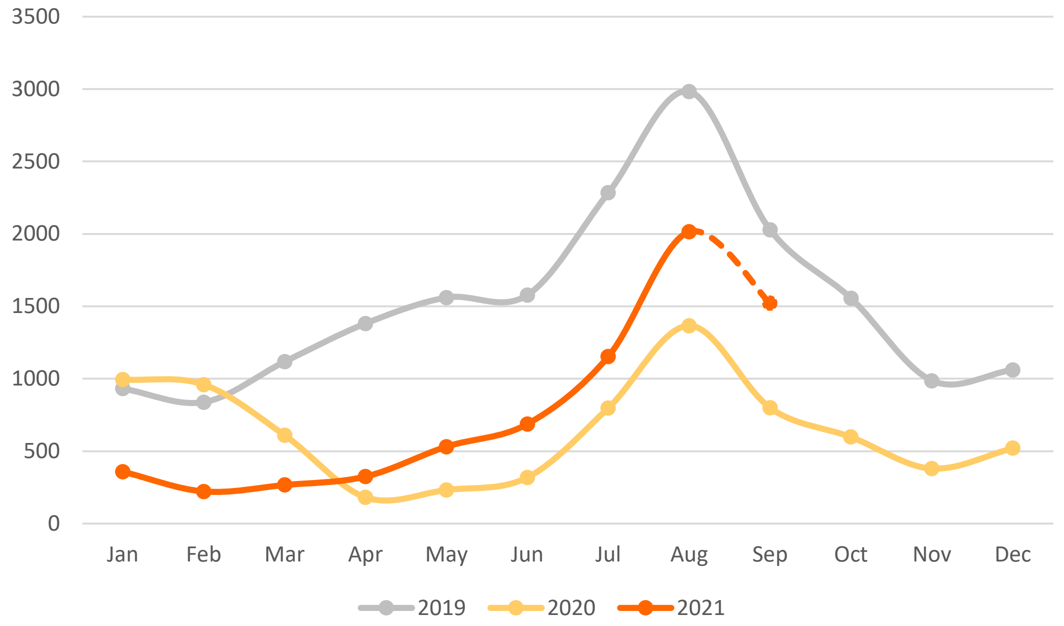
Percentage change (%)

	Euro zone	Portugal	Δ PT-EMU
All-items HICP	**2.4**	**0.6**	**-1.8**
Electricity, gas, solid fuels and heat energy	8.6	1.0	-7.6
Restaurants and hotels	1.3	-3.4	-4.6
Energy	**13.9**	**9.6**	**-4.3**
Housing, water, electricity, gas and other fuels	4.3	1.8	-2.5
Services (overall index excluding goods)	**1.1**	**-1.0**	**-2.1**
Transport	6.7	5.0	-1.7
Furnishings, household equipment and routine household maintenance	1.3	-0.3	-1.6
Industrial goods	4.6	3.0	-1.6
Goods (overall index excluding services)	**3.3**	**1.9**	**-1.4**
Education	-0.1	-1.5	-1.3
Alcoholic beverages, tobacco and narcotics	2.3	1.2	-1.1
Food including alcohol and tobacco	1.2	0.4	-0.8
Recreation and culture	0.2	-0.6	-0.8
Food and non-alcoholic beverages	0.9	0.2	-0.7
Miscellaneous goods and services	1.9	1.5	-0.4
Non-energy industrial goods	1.3	1.0	-0.3
Clothing and footwear	0.7	0.7	0.0
Communications	-0.5	0.5	1.0
Health	0.3	2.3	2.0

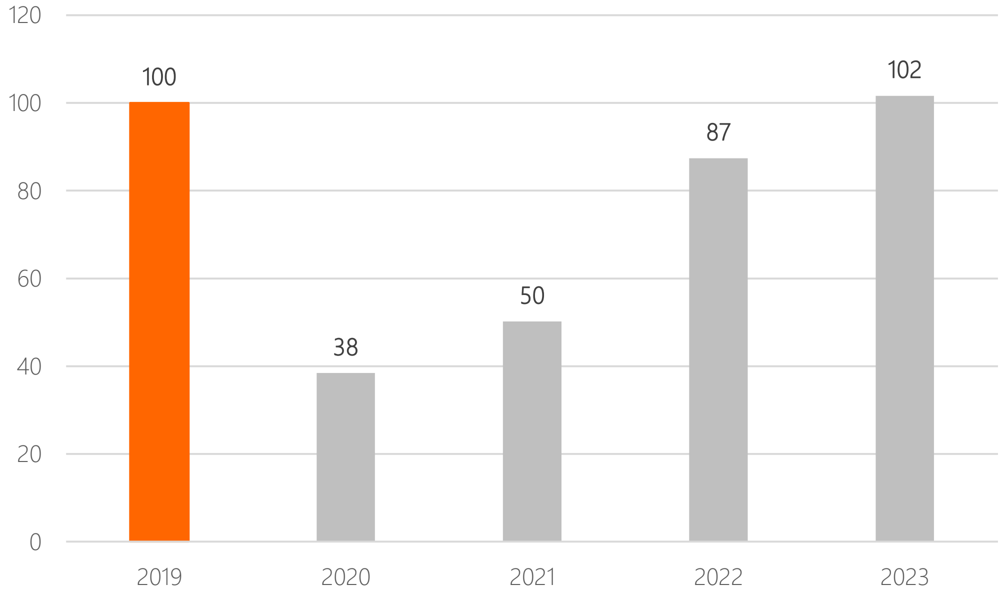
- Inflation remains contained when compared with the euro zone observed HICP levels. On the 6 months ended in September average inflation in Portugal stood at 0,6%, minus 1,8 p.p. than in the euro zone. Even so, prices are accelerating its pace of growth, explained by the increase (much lower that in the rest of the Europe) on energy prices.
- Portuguese inflation is lower than the European one in almost all the items belonging to the CPI basket. This difference is more apparent in classes related to energy – fuels, gas, electricity – and to activities within the Tourism sector – namely Restaurants and Hotels. The behavior of this last sub-group reflects the higher weight of tourism in the Portuguese economy, sector whose activity is still far below pre-covid levels. As for energy prices, the smoother behavior is related to some internal price-setting mechanisms, which accommodate greater price volatility in international markets. This is the case for electricity prices, given the price setting components and the frequency of updating by the regulator, in Portugal only once a year.
- Central scenario: our main scenario sees annual inflation reaching 1,2% in 2021 and 1,4% in 2022, with risks slightly biased to the upside.

Tourism could recover swiftly as vaccination progresses

Expenditure by foreign tourists
€ million



Tourists (foreign and national)
Index (2019 = 100)

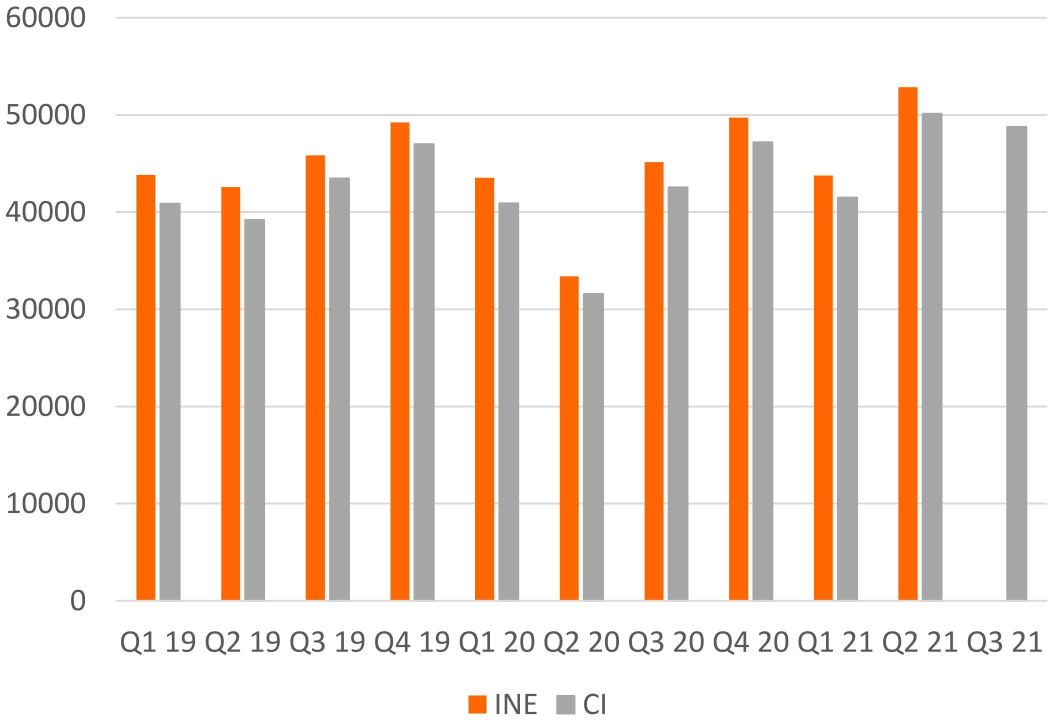


- **Tourism has been the sector hardest hit by the pandemic:** Up to September the number of tourist reached 9831k, 14% more than in 2020, but still 54% below the same period in 2019. In the last months, the number of international tourists visiting Portugal has been increasing at a strong pace, but the total number of foreign guests is still 72% below the 2019 level. Domestic tourism (40% of total tourism demand in pre-covid world) remains 25% below the accumulated level of 2019. However, last August the number of domestic tourists reached an all time high on a monthly basis.
- **The number of tourists is expected to increase by around 30% in 2021 from year ago levels** thanks to a significant improvement in tourism activity in the Summer months and an expected positive performance in the last quarter of the year as restrictions to mobility and vaccination are improving confidence.
- **Fundamentals remain strong and are complemented by the well succeeded vaccination process.** The Portuguese tourism industry is the 12th most competitive in the world and “safety & security” is viewed as one of its biggest assets. Hence, recovery should be supported by the successful vaccination process with more than 85% of the population already fully vaccinated. However, the revival is subject to some uncertainty as confidence is one of the main constraints and also some headwinds can arise associated with a slower than expected recovery of the European airline business.

The real estate sector: resilience and solid fundamentals

Housing Transactions

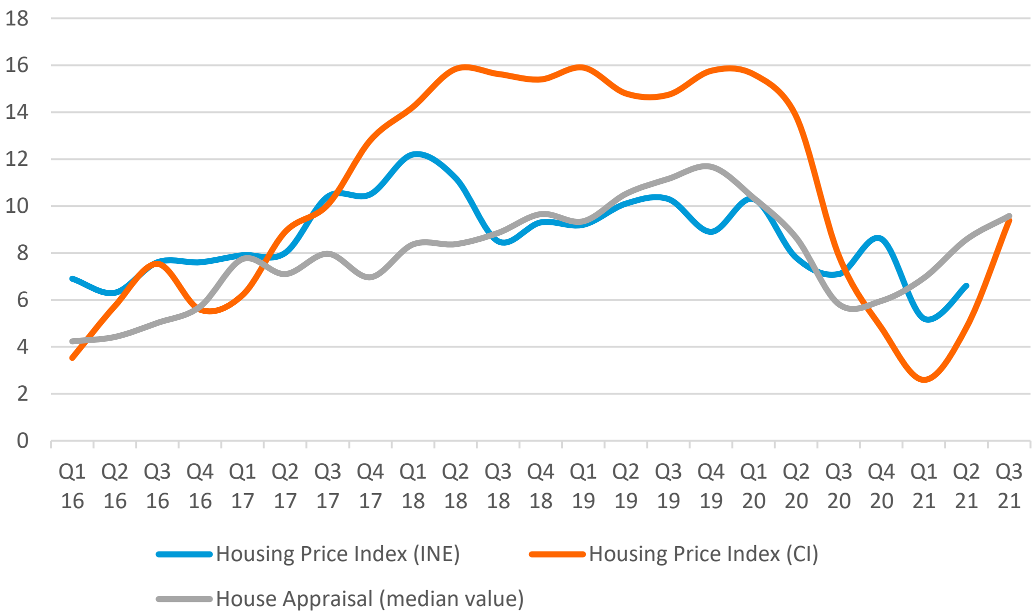
Units



Source: INE and Confidencial Imobiliário data.

Housing prices

Year on year (%)

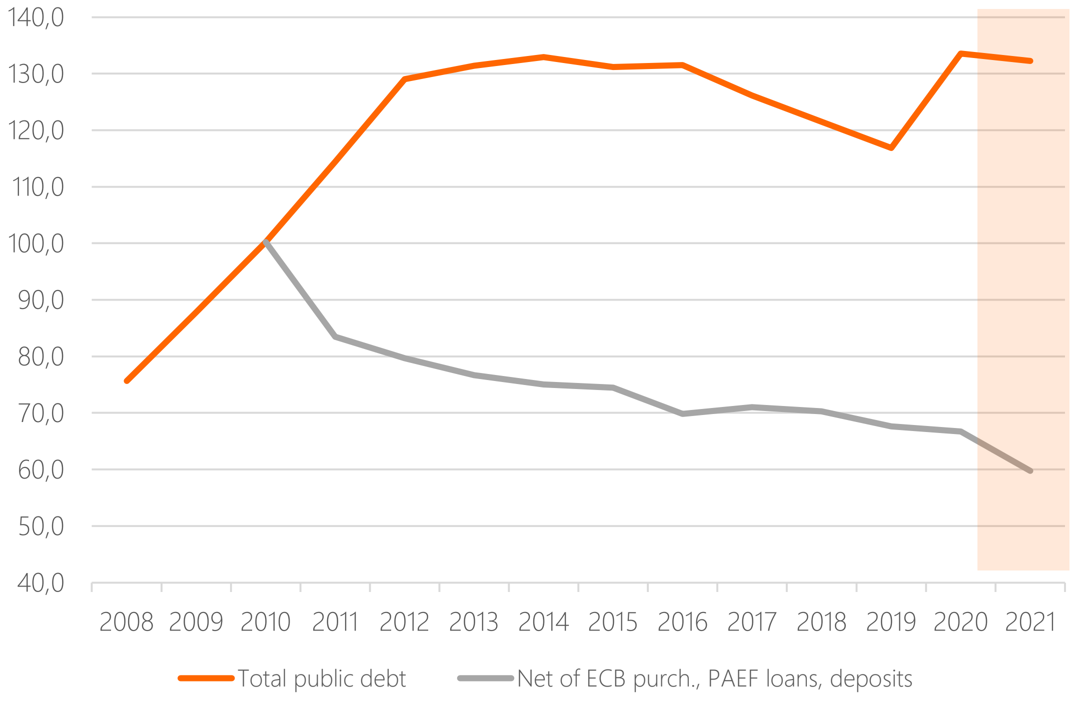


Source: INE and Confidencial Imobiliário data.
Note: Q2 2021 data refers to May

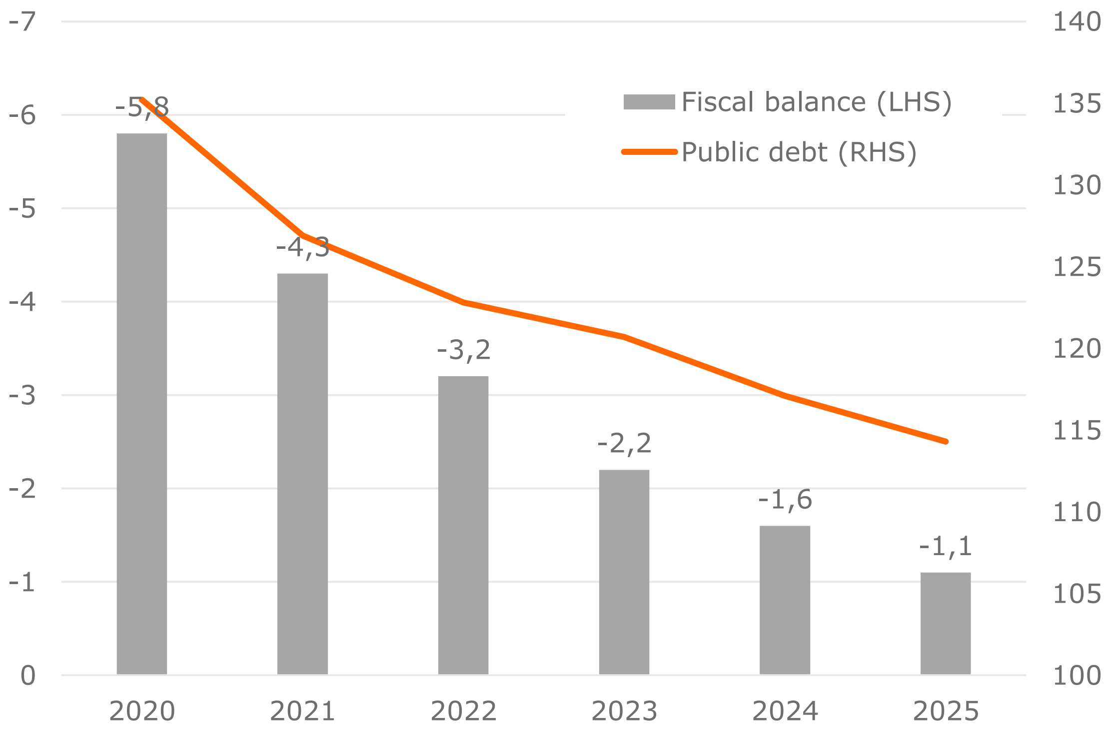
- **After the minimum reached in 1Q21 (+2,6%) housing prices continue to accelerate: According to Confidencial Imobiliário average data for the 3rd quarter, prices rose 2,1% qoq and 9,4% yoy.** Going forward, the market is expected to keep supported. This is suggested by the house appraisal performance that has also been accelerating at a fast pace. Even so, prices may decelerate somewhat up to the end of the year, with some cooling down expected from domestic buyers due to the end of some covid-related supporting measures (namely moratoriums). We expect housing prices to advance 5,7% this year and 3,7% in 2022, with upside risks to our scenario.
- **According to Confidencial Imobiliário, activity remained strong in 3Q, as 48.770 houses were sold, an increase of 12% from 3Q2019**.
- Houses built and building permits are evolving on a positive trend (+17% and 10% yoy, respectively in H1), but continue well below the (absolute) levels seen before the 2008 crisis, suggesting that pressures on prices will continue to fade away very gradually.

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

Public debt
(% GDP)



Overall fiscal balance and public debt ratio
(% GDP)



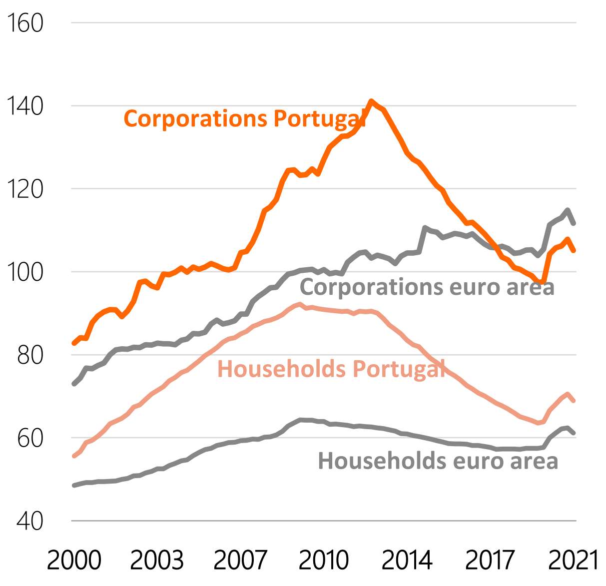
Source: ECB, Bank of Portugal, Government's Stability Report 2021-2025, State Budget 2022

- **Public debt (% of GDP) increased by 17 p.p. in 2020,** reflecting the supportive measures to companies, families and the health system due to the Covid-19 pandemic. Despite large, this increase was smaller than the evolution seen in other European countries – such as France, Spain, Italy… - where supporting measures were larger. Despite this moderation, **according to Government's forecasts, the public debt ratio should reach 2019 levels only in 2025. Going forward, keeping a sustained pace of economic growth, a moderate fiscal stance and low financing costs will be key for the achievement of these goals.**
- **Public funding needs are well covered, helped by ECB purchases** (expected to cover around 85% 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 (close to our own: 4.8%) and 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 (PAEF). **Excluding deposits, EU loans and ECB purchases, public debt stood at ~57% in September 2021. Currently, the treasury liquidity cushion amounts to €22,5 bln (~10% of GDP), above the average level between 2008 and 2019 0f €21 bln.**

The Portuguese banking system: resilient and supporting the economy (1)

Gross private debt

% of GDP, non consolidated debt.



Source: Eurostat

Private domestic credit

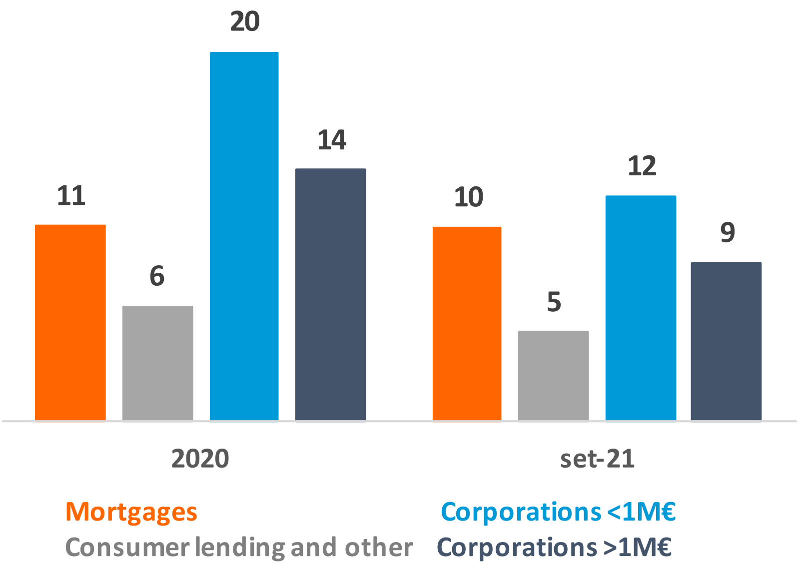
Year on year (%)

	Dec 2020 % yoy	Sep-2021 % yoy	2021 (For.) % yoy
Credit to the non-financial private sector	**4.6%**	**4.2%**	**3.4%**
Households	1.4%	3.2%	3.5%
Housing mortgages	2.1%	1.6%	2.0%
Other purposes	-1.2%	9.4%	9.4%
Consumer lending	-0.3%	0.3%	0.8%
Non-financial corporations	10.5%	5.8%	3.2%

Source: Bank of Portugal

New lending activity by sector

Accumulated in the year, Bn euros



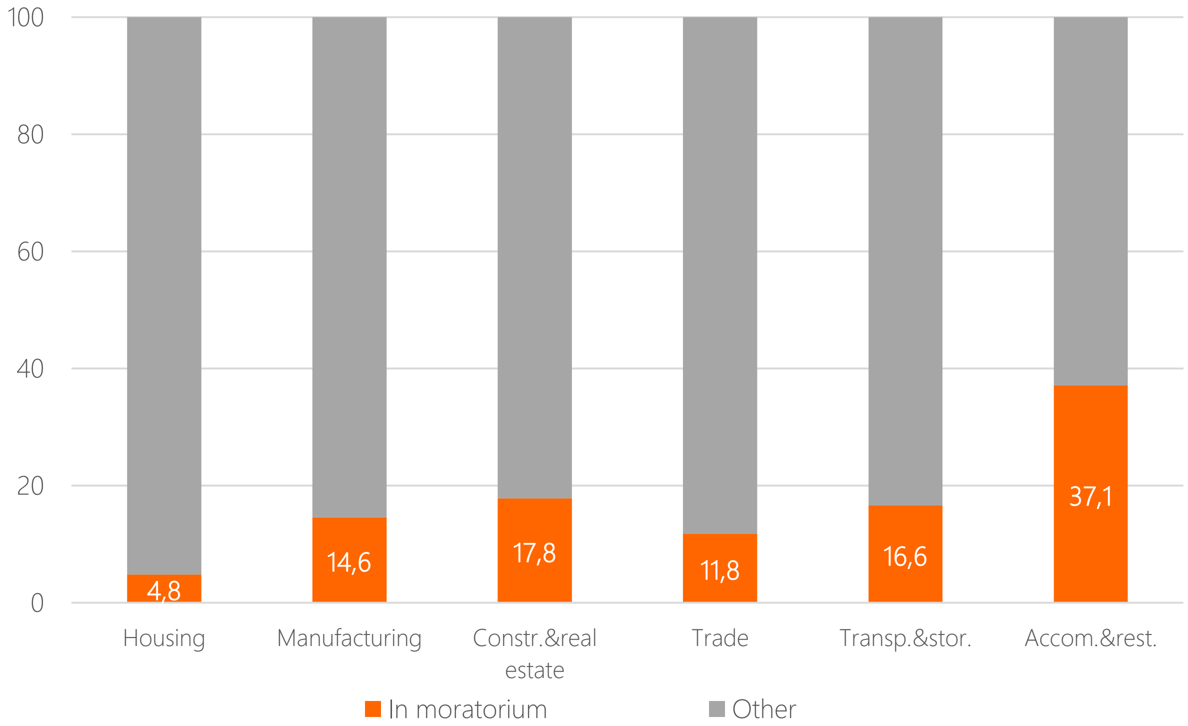
Source: Bank of Portugal

- **Corporate debt levels** remain below euro area average despite the recent pick-up in credit outstanding (mostly due to state guaranteed credit lines, issued back in 2020, and moratoria to companies). **Household debt** has increased, reflecting expanding mortgage lending, as well as the effect of moratoria. We expect the deleveraging trend to return to private sector credit after the COVID crisis and with the end of moratoria.
- **Up to September, new lending contracted 5% yoy**, reflecting the fall of new credit to NFC (-23%). However, when excluding Covid-related credit lines, credit to companies is revealing dynamism (+36% yoy), which should be the result of the robust investment pace of growth. **Data for households shows also a strong performance: new lending in the first 9 months of 2021 increased 27%, due to the rise of 41% on mortgages**. The strength seen on the housing market, favorable financing conditions, the employment-supporting measures and the past households' balance-sheet improvements (deleveraging) explain this performance, although new mortgage credit (in volume) is still far distant from the highs of the years 2005-06.

The Portuguese banking system: resilient and supporting the economy (2)

Loans in moratorium (September)

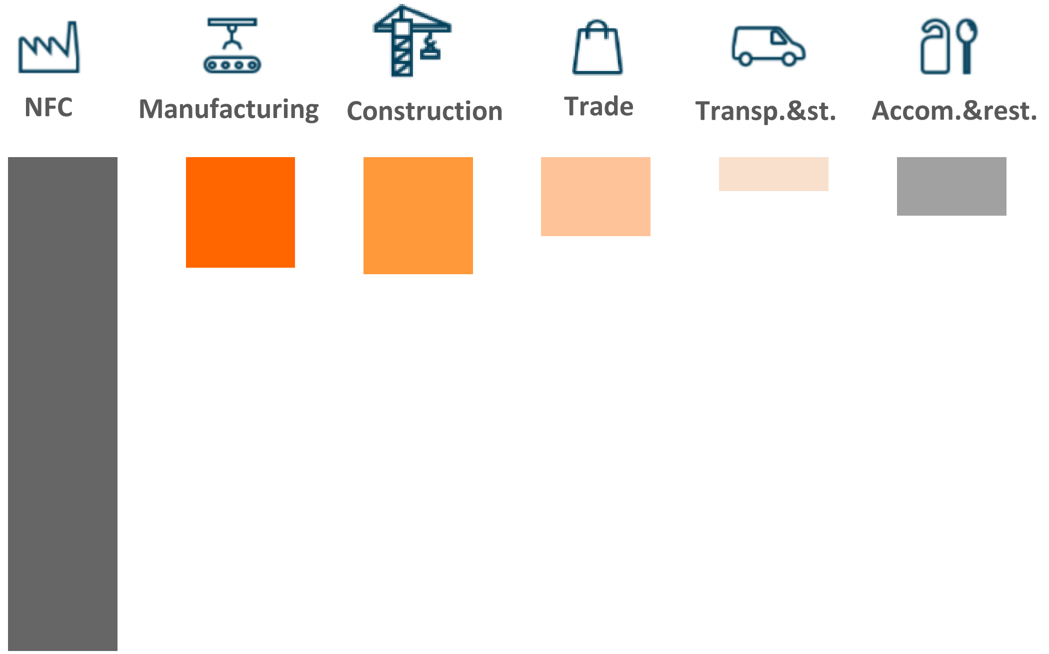
In % of stock of credit in each segment



Source: Bank of Portugal

NFC: credit moratorium, by sector (September)

Variation in comparison to the maximum (Million euros)



- **Moratorium has been an important supporting measure for both households and firms in this current uncertain context.** This measure was especially important to firms: **in September, credit under moratorium represented 17.6% of total credit for NFC (28,5% in August 2021).**
- By sector, **this measure was particularly relevant for accommodation & restaurants**, one of the sectors most affected by the pandemia (37.1% of total credit to the sector in September).
- **Among families, credit under moratorium represented 4.2% of total credit to families (11.1% in August 2021).**
- Considering the importance of this measure and the potentially negative impacts on the firms' solvency after its end (September 2021), the Government decided to give a public guarantee (maximum of 25% of credit) directed towards the most affected sectors (with revenue drop of at least 15% in 2020 in comparison to 2019; shall not have achieved the 2019 revenues level yet) and those who previously renegotiate with banks their credits (extending the grace period – without capital reimbursements - and enlarging the maturity)

Main economic forecasts

%, yoy	2013	2014	2015	2016	2017	2018	2019	2020	Forecasts 2021	Forecasts 2022
GDP	-0.9	0.8	1.8	2.0	3.5	2.8	2.7	-8.4	4.0	5.1
Private Consumption	-1.1	2.5	1.9	2.6	2.1	2.6	3.4	-7.3	4.6	4.1
Public Consumption	-2.0	-0.5	0.8	0.8	0.2	0.6	2.1	0.4	4.6	0.5
Gross Fixed Capital Formation (GFCF)	-4.8	2.3	5.9	2.5	11.5	6.2	5.4	-2.7	5.4	7.3
Exports	7.2	4.3	6.2	4.4	8.4	4.1	4.1	-18.6	5.8	9.6
Imports	4.7	8.1	8.1	5.0	8.1	5.0	4.9	-12.1	7.5	6.7
Unemployment rate	17.1	14.5	13.0	11.4	9.2	7.2	6.6	7.0	7.0	6.9
CPI (average)	0.3	-0.3	0.5	0.6	1.4	1.0	0.3	0.0	1.2	1.4
External current account balance (% GDP)	1.6	0.2	0.2	1.2	1.3	0.6	0.4	-1.2	-0.7	-0.5
General Government Balance (% GDP)	-5.1	-7.4	-4.4	-1.9	-3.0	-0.3	0.1	-5.8	-4.7	-3.2
General government debt (% GDP)	131.4	132.9	131.2	131.5	126.1	121.5	116.6	135.2	132.2	128.0
Risk premium (PT-Bund) (average)	464	252	189	307	269	138	98	89	60	63

Source: BPI Research.