Portugal:
Macroeconomic and financial outlook

BPI *Research*

January 2022

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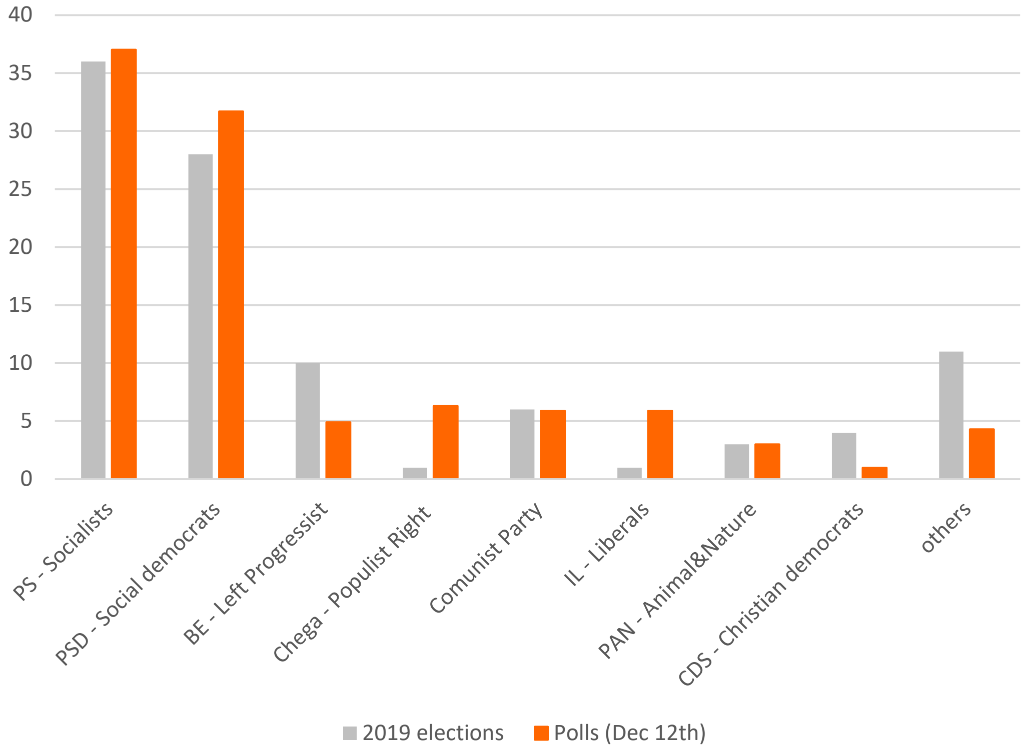
BPI Grupo CaixaBank

Main messages

Activity	▶ **Annual growth in 2021 revised upwards to 4,3%.** GDP increased +2,9% qoq and +4,2% yoy in Q3, reducing the gap for the pre-covid level to -3,2%. Consumption and exports were the main contributors to growth (3 and 3,9 p.p., respectively), but stronger growth on imports led to a negative contribution of foreign demand to growth of -0,5 p.p.. Annual growth in 2021 revised upwards to 4,3%. ▶ **New variant poses some risks to activity at the beginning of 2022,** but the strong rate of vaccination (89,6% of total population) should keep hospital pressure and restrictions at a low level, allowing recovery to proceed. ▶ **Tourist activity keeps recovering (non-residents).** In December, the number of flights have doubled regarding the same period 2020, reducing the gap for 2019 to -14% (-14% in November, -21% in October). 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 mid-2022.** We revised downward GDP growth in 2022 to 4,9% from 5,1%, as although the health situation will probably keep under control, the impact of supply bottlenecks may weaken growth in the first half of 2022. Going forward, activity should be stimulated by the execution of NGEU and favorable financial environment.
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. Moreover, 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 NGEU 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 given the milestones agreed with EC, 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. ▶ **After a week of containment, Government announced less restrictive measures**: teleworking is mandatory only until January 14th, schools, kindergartens and others will restart, discos and bars will reopen at 14th and the use of certificate is sufficient to enter in restaurants and accommodation. Additionally, there are new less restrictive rules for the isolation of the infected and for those who have already received the 3rd dose. ▶ **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 4,3% of GDP (5,7% in 2020) and public debt declined to ≈128% in November (≈133% in Nov 20). 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 SOE. 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 57% of financing needs in 2022), proactive management of public debt (average maturity 7 years) and low interest rates.

Political situation: elections in January may have an impact of NGEU funds execution in 2022

Elections: 2019 results and polls for January 2022
(% of votes)



The most recent poll prepared by Pitagórica.

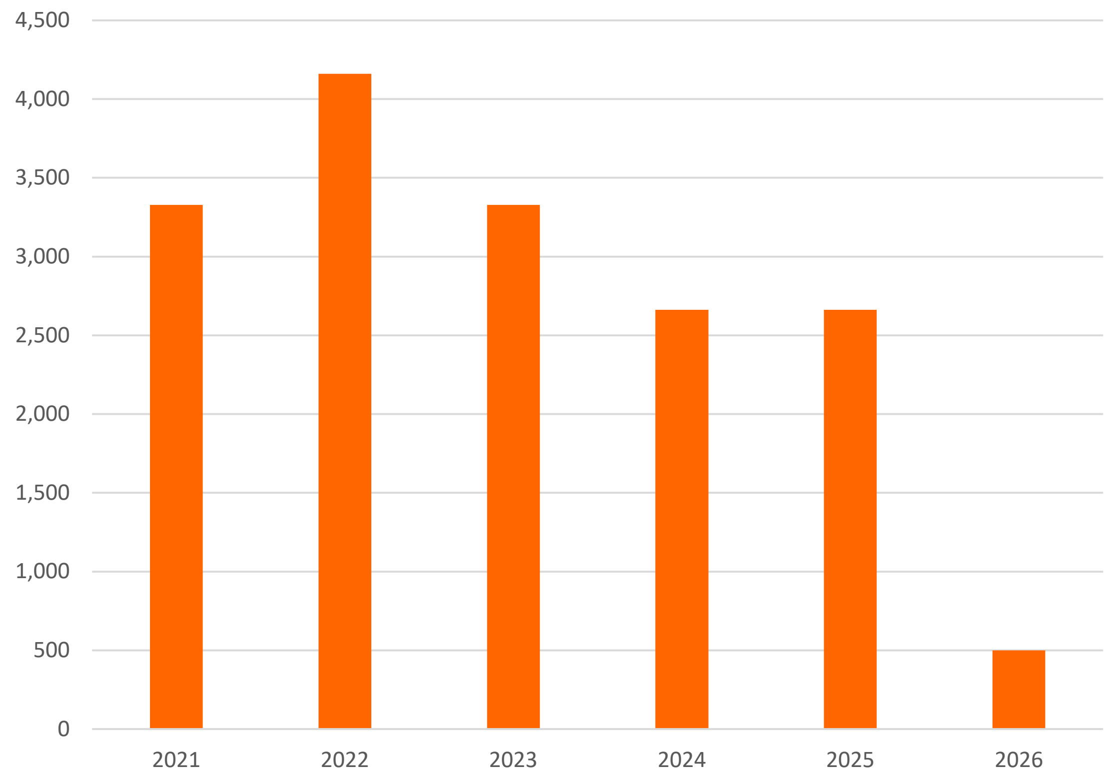
- **In the wake of the rejection of the state budget for 2022, general elections were called to January 30th and the possible outcome is uncertain**:
  - on one hand, according to recent polls, the Parliament will be more polarized, with the bigger **parties** (PS and PSD) increasing their position but 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.

- Uncertainty about the outcome is high raising the possibility of Portugal entering in a period of political deadlock. However, the recent re-election of Mr Rio as President of PSD, the social democrat party, apparently reduces this risk.

- **One of the most critical consequences of the present political situation 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 the end of 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 4,2 bn.

The Recovery and Resilience Plan: a key element for recovery

Time distribution of NGEU transfers
(million of euros)



***Source**: BPI Research, based on Government figures.*

Approvals and Payments to Direct and Final Beneficiaries
(million of euros)

Up to December 31th	Amount approved	Amount payed
Families	21	19
Solidarity and Social Economy Institutions	1	0
Non-financial corps.	0,1	0,1
Institutions of the scientific and technological system	0	0
Higher education institutions	0	0
Schools	228	30
Municipalities and metropolitan areas	120	16
Public entities	1.536	140
Public enterprises	1.614	155
Total	**3.520 (21% of 16,4 MM)**	**360 (2% of 16,4 MM)**

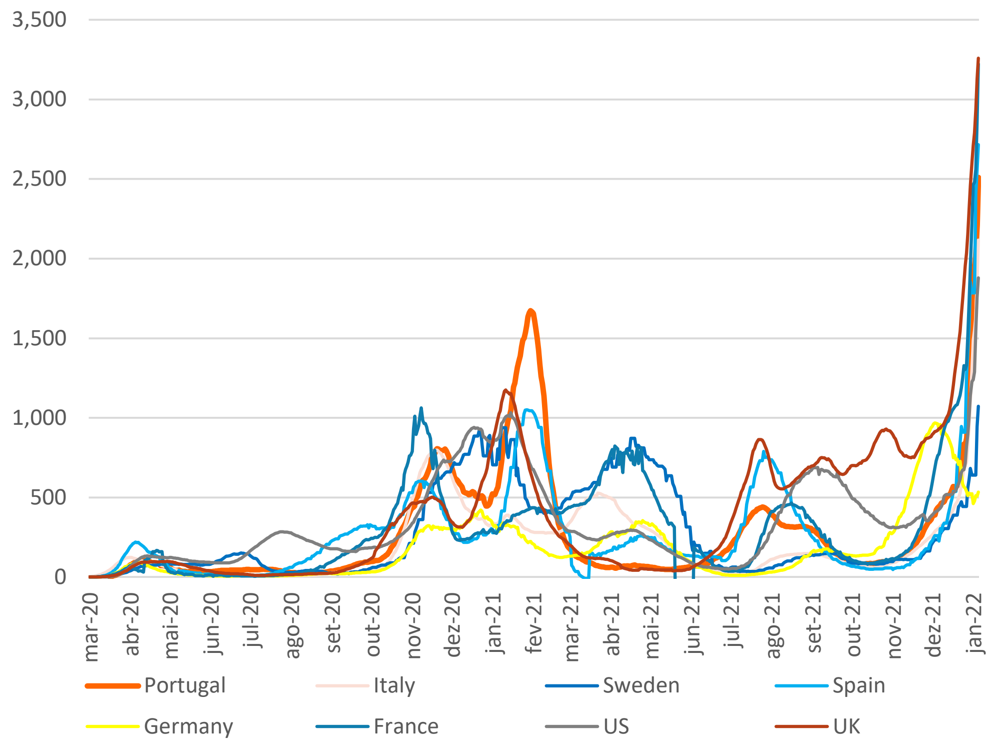
***Source**: BPI Research, based on Government figures.*

- **Portugal will receive €13,9 bn (≈6.5% of 2019 GDP) between 2021 and 2026** as subventions (+€2,7 bl as loans) from the European Recovery and Resilience Mechanism. **Portugal has already received the first tranche: ≈€2,2 bln as pre-financing**.
- **Macro impact:** We anticipate that the execution rate in 2021 will be ~50%, with a growth contribution of ~0.2 p.p...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/execution of funds, which might reduce 2022 economic growth (our scenario:+4,9%). Another risk is related to the scarcity of resources to go ahead with investments (for example, shortage of labour force in some sectors).

Omicron variant is pressuring incidence but not mortality

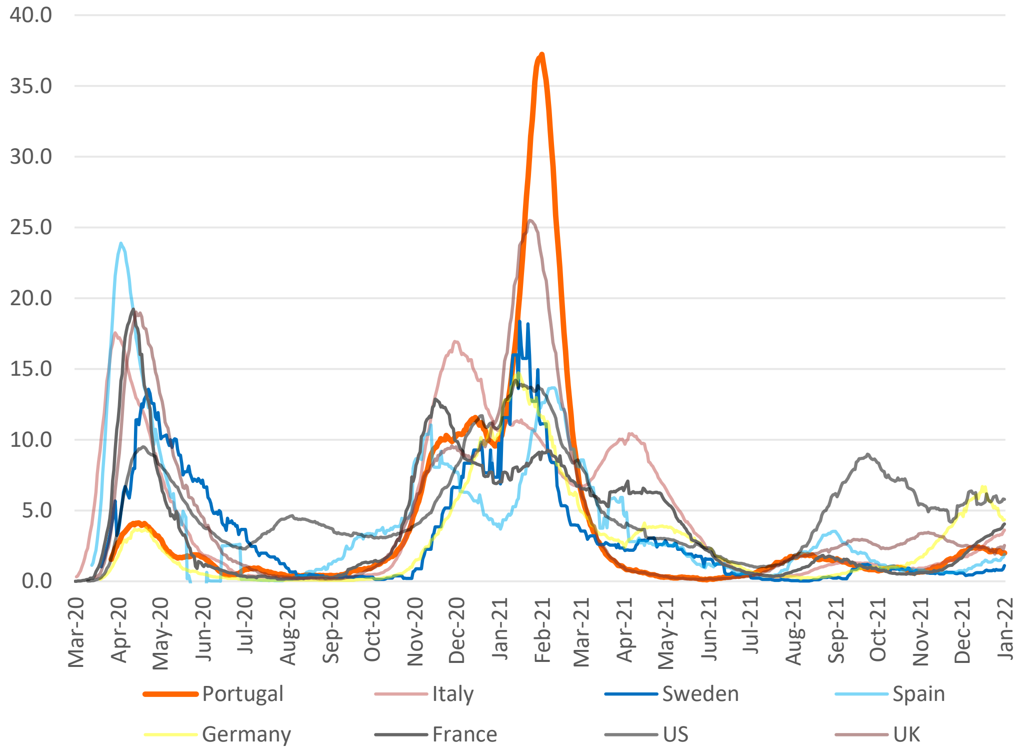
COVID-19 cumulative incidence

Infections per 100k inhabitants accumulated in 14-day



Mortality per 100,000 inhabitants

14-day moving average



- **14-day cumulative incidence has been increasing and at the beginning of January is well above the threshold of 120 cases per 100k set by the Government (≈2.500/100k).** However, the **high rate of vaccination is avoiding the increase of serious cases**, allowing to keep UCI occupation low, circa 30% of levels seen one year ago. Hospitalizations and mortality continue contained and below the levels registered in the beginning of 2021.
- The increase of infections led to the application of some more restrictive measures in the last week of December and the first of January, namely the presentation of a negative test in certain events/places, mandatory teleworking, schools, bars and discos closed. Recently, **the Government announced less restrictive measures**: teleworking is mandatory only until January 14th, schools, kindergartens and others will open as expected, discos and bars will reopen at 14th and the use of certificate is sufficient to enter in restaurants and accommodation. Additionally, there are new less restrictive rules for the isolation of the infected and for those who have already received the 3rd dose. A new strict lockdown is improbable even with the Omicron proliferation; however the spread of infection with the new variant over the world may impact negatively on tourism activity.

Pressure in National Health Service under control with high rate of vaccination

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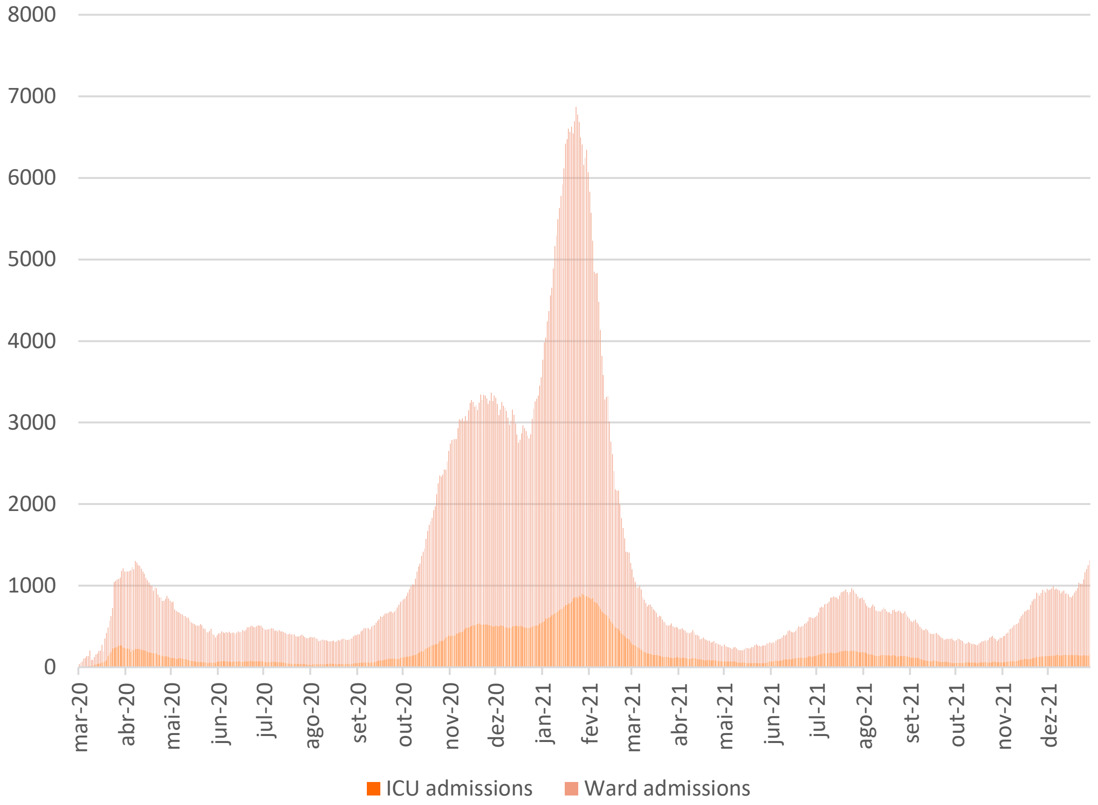
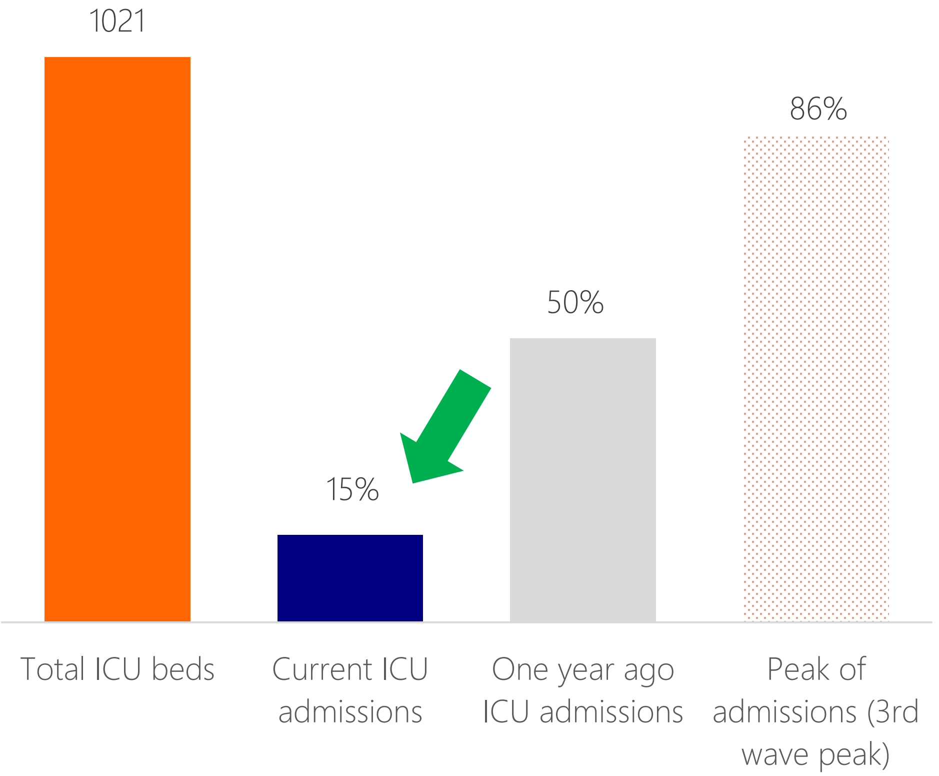
Number of admissions to wards and IC occupancy

Unit



UCI admissions vs. UCI installed capacity

Unit, %

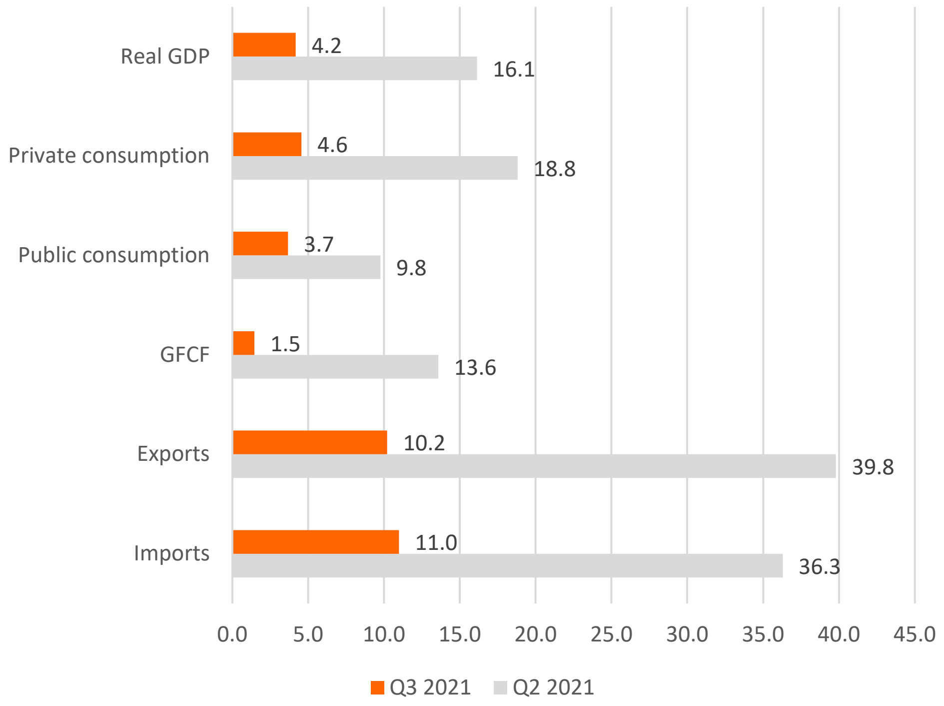


***Notes**: as of December 9nd.*

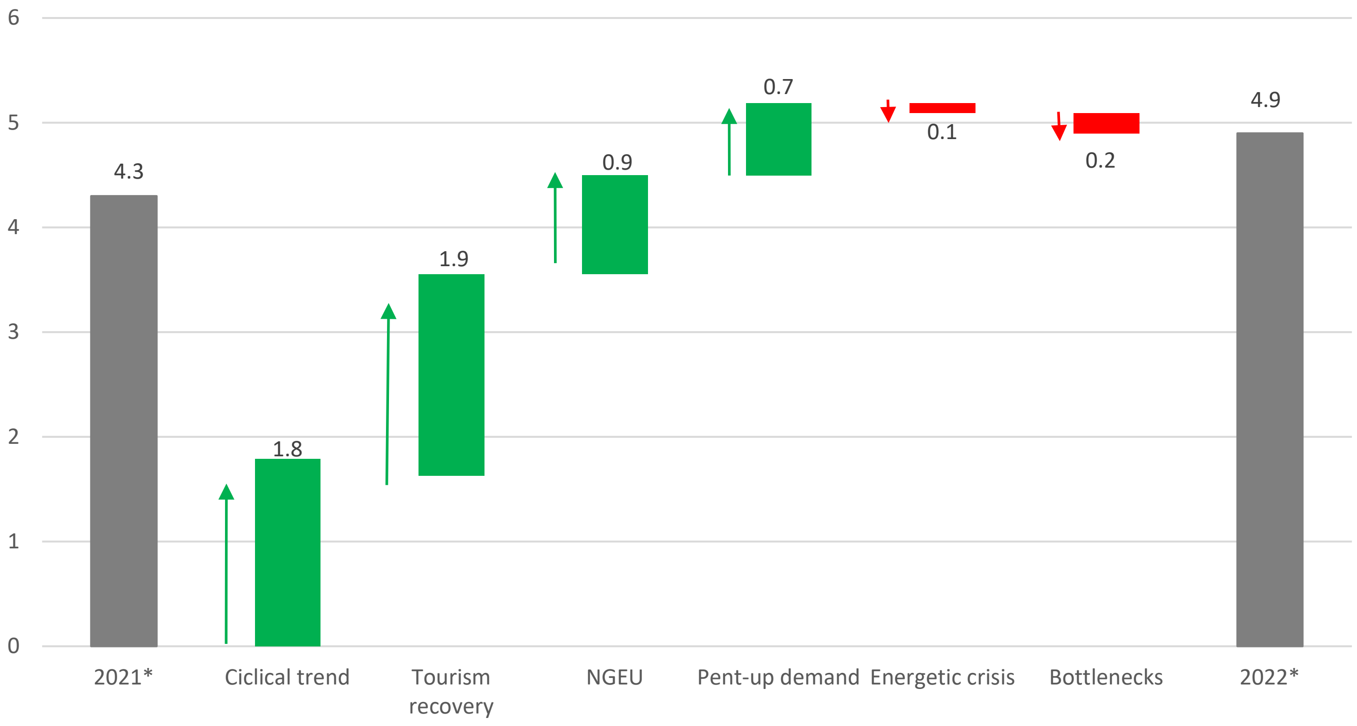
Key take-away: 89,6% of population fully vaccinated and already more than 3 millions vaccinated with 3rd dose.

Growth in Q3 supported by consumption and exports

GDP growth
Percentage change (%)



GDP 2022: contributions to economic growth
Percentage points



- **GDP posted a 2,9% qoq and 4,2% yoy in Q3 2021, supported by consumption and exports.** The former contributed with 3,0 percentage points and the later with 3,9 p.p.. On exports (as well as in imports) services advanced strongly: exports of services climbed 33% and imports of services jumped 30,1%.
- **Central scenario**: our main scenario sees GDP advancing 4,3% this year and 4,9% in the next. Uncertainty is still high and mainly related to the health situation and emergence of new variants. Furthermore, bottlenecks on the supply side, due to global disruptions, and the energetic crisis may moderate growth. However the tail winds – tourism, European funds and pent-up demand - should be stronger, helping GDP to reach pre-crisis levels in mid-2022.

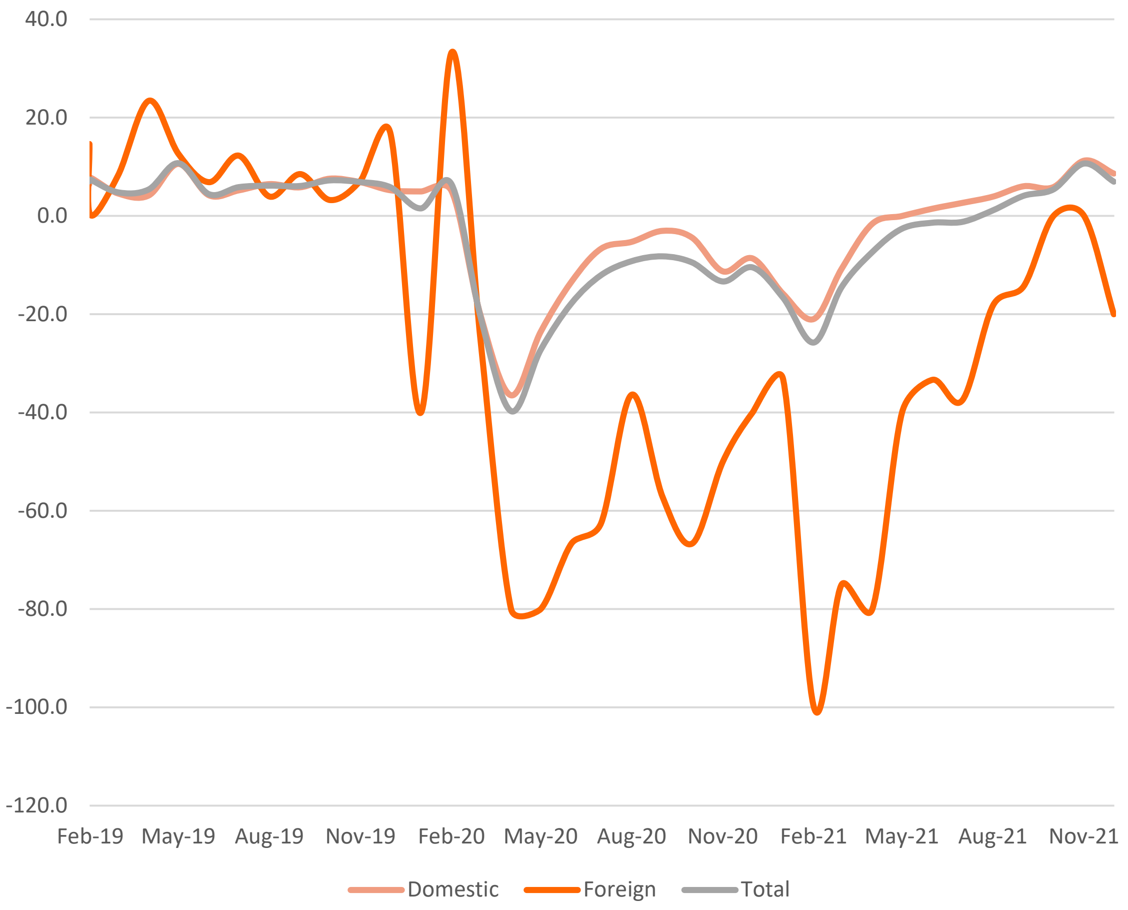
The recovery proceeds at a more moderate pace with resilient consumer confidence

Consumer confidence indicator: important purchases in the next 12 months

Points

Cards activity

Year-on-year (%)



- **The economy lost some ground in last quarter of 2021**, especially due to the emergence of a new variant of the virus, the need to implement some more restrictive measures at the end of the year and the shortages related to the supply bottlenecks around the world, which should have affected especially the industry. On the other hand, private consumption should have performed positively, in line with cards activity performance, consumer confidence and positive developments in the labour market (unemployment rate at 6.3% in November).

Activity monitor – consumption and exports well anchored above 2019 levels

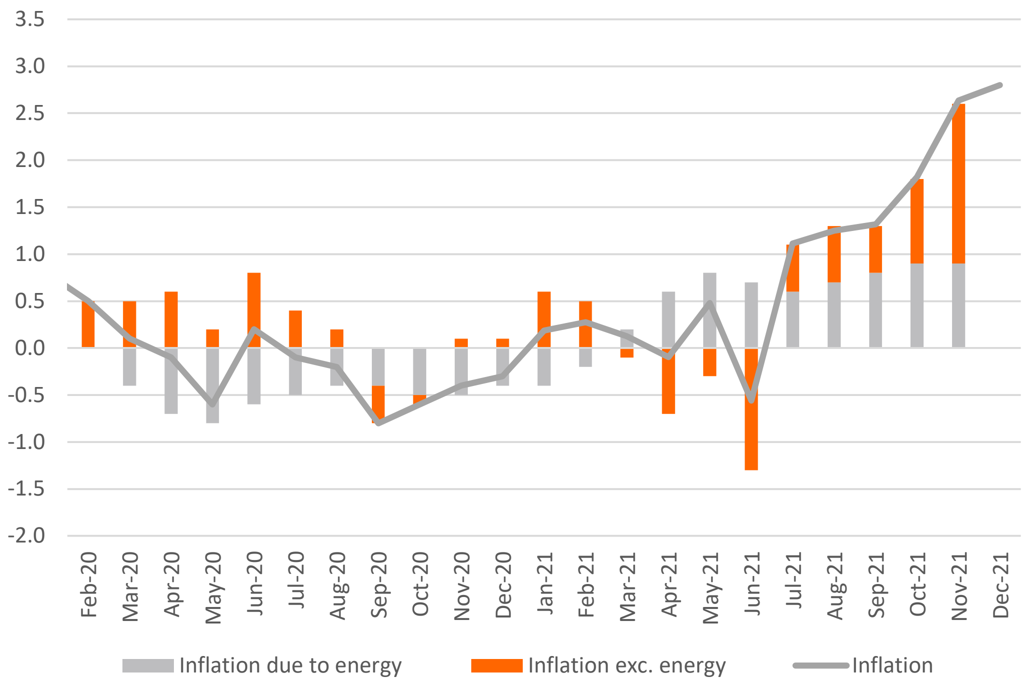
Year-on-year change (%)	Daily Economic activity indicator	Credit cards	Cement	New registrations of passenger cars	Electricity consumption	Industrial production	Retail sales	Unemployment	Number of tourists	Exports of goods (ytd)	Imports of goods (ytd)
2019	-	6.5	15.1	-2.0	-0.1	-2.3	4.3	-6.4	7.9	3.5	6.0
2020	-8.7	-13.5	10.9	-35.0	-3.0	-7.0	-3.3	5.8	-61.6	-10.3	-14.8
2021				0.8	0.9						
Q1 2021	-4.5	-12.8	10.2	-31.5	-1.7	-0.8	-8.9	2.6	-78.7	-10.3	-17.6
Q2 2021	-3.0	-3.8	21.9	157.6	-3.6	-5.8	1.9	30.2	-64.5	19.0	6.8
Q3 2021	-2.7	1.4	15.3	-23.8	-1.3	-5.4	1.8	21.4	-31.6	22.1	17.8
Q4 2021	-4.4	7.7	14.2	-14.2	-2.1	-3.9	4.7	15.1	-15.9	17.7	18.8
October	-5.5	5.4	0.6	-32.4	-3.3	-5.1	4.1	17.2	-14.8	17.8	18.1
November	-3.6	10.7	27.8	-33.4	-1.2	-2.8	5.4	13.0	-17.0	17.6	19.5
December	-4.2	7.0		-28.9	-1.9						

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**

Inflation accelerated in last months of 2021 and should continue in 2022

Inflation
Percentage change (%)



***Source**: BPI Research, from Eurostat.*

6-month moving average (until Nov)
Percentage change (%)

	Eurozone	Portugal	Δ PT-EMU
All-items HICP	**3.3**	**1.3**	**-2.0**
Electricity, gas, solid fuels and heat energy	11.4	1.9	-9.4
Energy	18.5	10.5	-8.0
Restaurants and hotels	2.0	-1.4	-3.4
Housing, water, electricity, gas and other fuels	5.5	2.2	-3.3
Industrial goods	5.6	3.0	-2.7
Transport	7.9	5.6	-2.2
Goods (overall index excluding services)	4.1	2.0	-2.2
Services (overall index excluding goods)	1.5	-0.1	-1.7
Furnishings, household equipment & routine household maintenance	1.7	0.0	-1.7
Alcoholic beverages, tobacco and narcotics	2.2	1.1	-1.1
Clothing and footwear	0.9	-0.6	-1.6
Food including alcohol and tobacco	1.7	0.6	-1.1
Food and non-alcoholic beverages	1.4	0.4	-1.0
Non-energy industrial goods	1.8	0.7	-1.1
Education	-0.4	-0.9	-0.4
Miscellaneous goods and services	2.0	1.2	-0.7
Recreation and culture	0.1	0.3	0.2
Communications	0.0	1.0	0.9
Health	0.5	2.1	1.6

- **Portuguese inflation accelerated in November** to 2,5% (1,8% in Oct.), driven by higher prices on energetic goods. However, it remains contained when compared to the Eurozone observed HICP levels: on the 6 months ended in November, the average inflation in Portugal stood at 1,3%, minus 2,0 p.p. than in the Eurozone. Recently, **the flash CPI accelerated to 2,8% in December**.
- Portuguese inflation is lower than the European one in almost all the items considered in 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 of 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 2,2% in 2022 (1,3% in 2021), decelerating to 1,7% in 2023.

Tourism should recover as vaccines demonstrate their effectiveness

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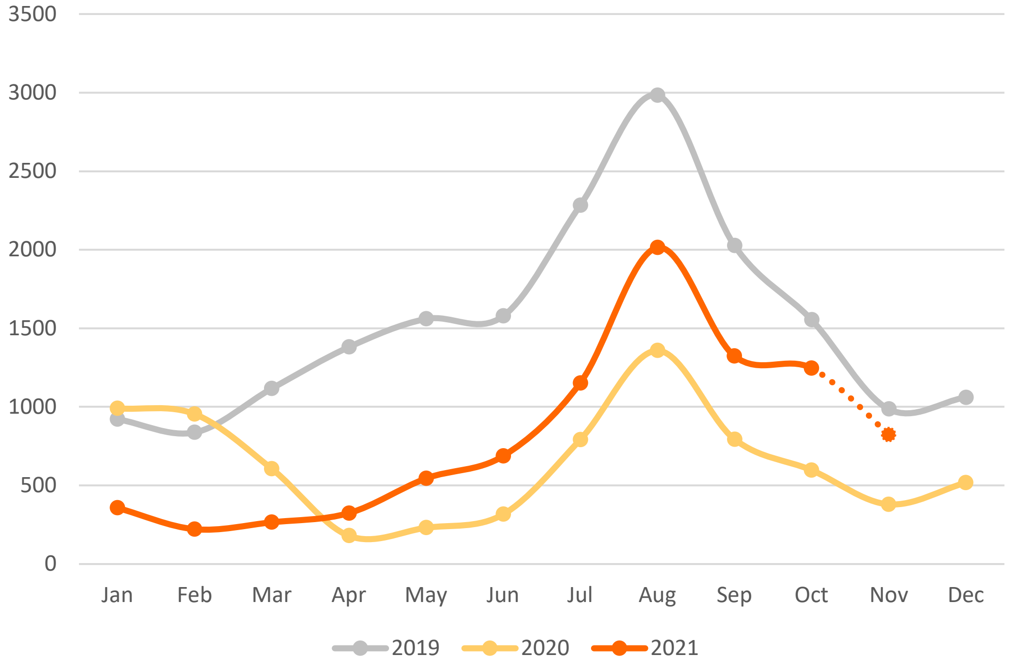
Expenditure by foreign tourists

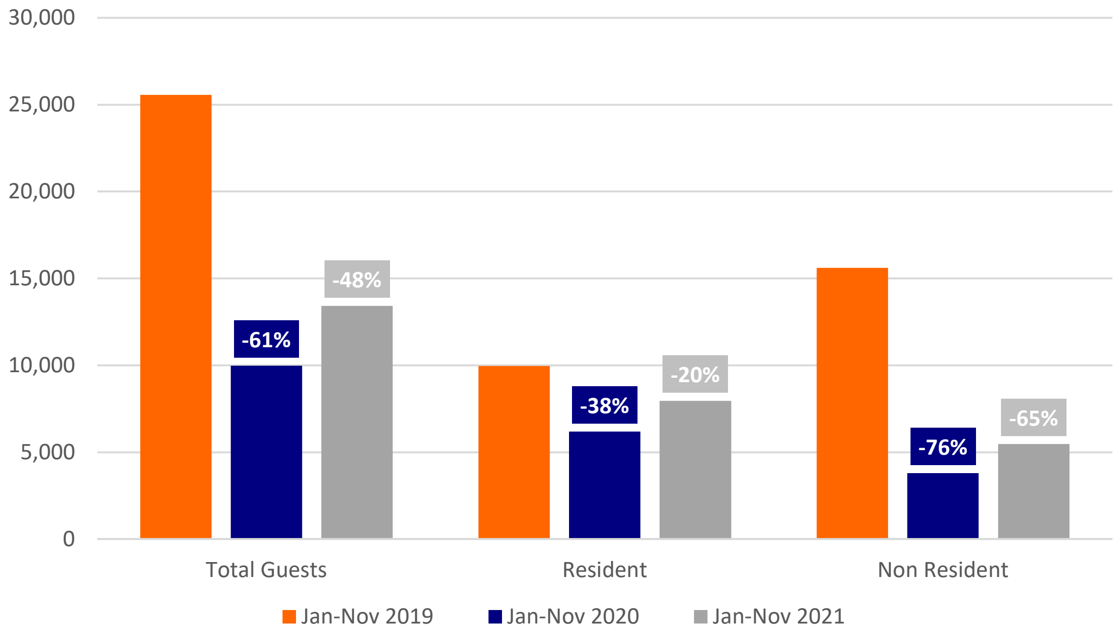
€ million



Source: *BPI Research, based on INE data.*

Number of guests (foreign and national)

YTD (Thousand)

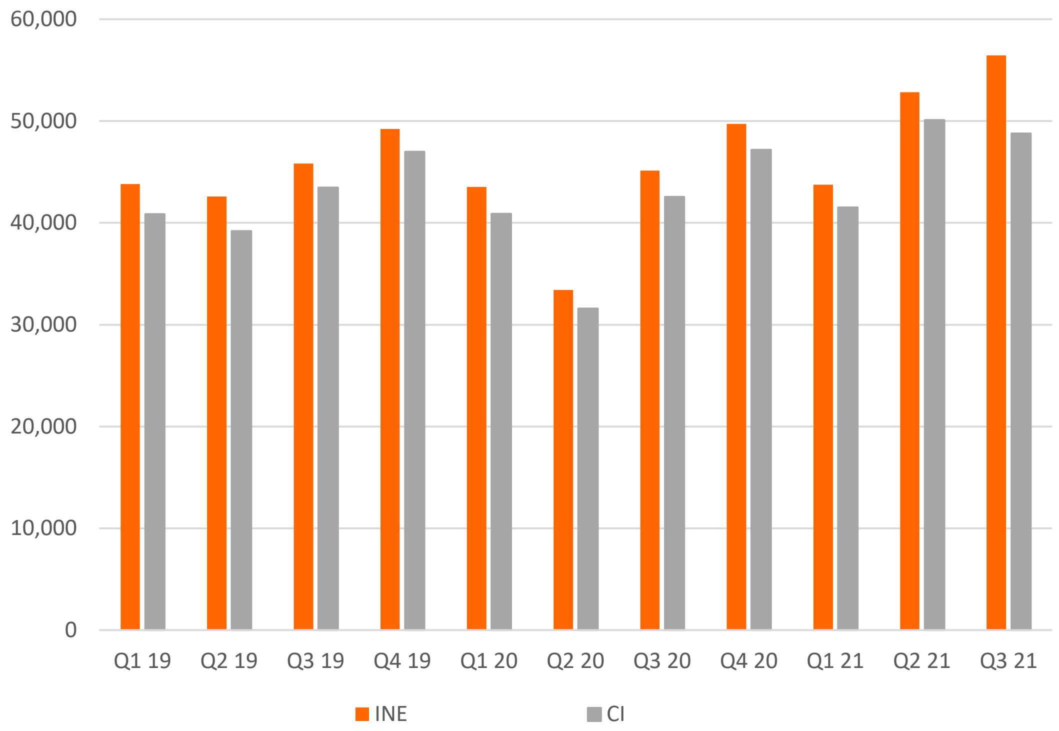


Source: *BPI Research, based on INE data.*

- **Tourism has been the sector hardest hit by the pandemic:** Up to November, the number of tourists reached 13.419k, 34% more than in 2020, but still 48% 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 65% below the 2019 level. Domestic tourism (40% of total tourism demand in pre-covid era) remains 20% below the accumulated level of 2019.
- **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 89% of the population already fully vaccinated and the effectiveness of vaccines to minimize the pressure on health sector. 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.

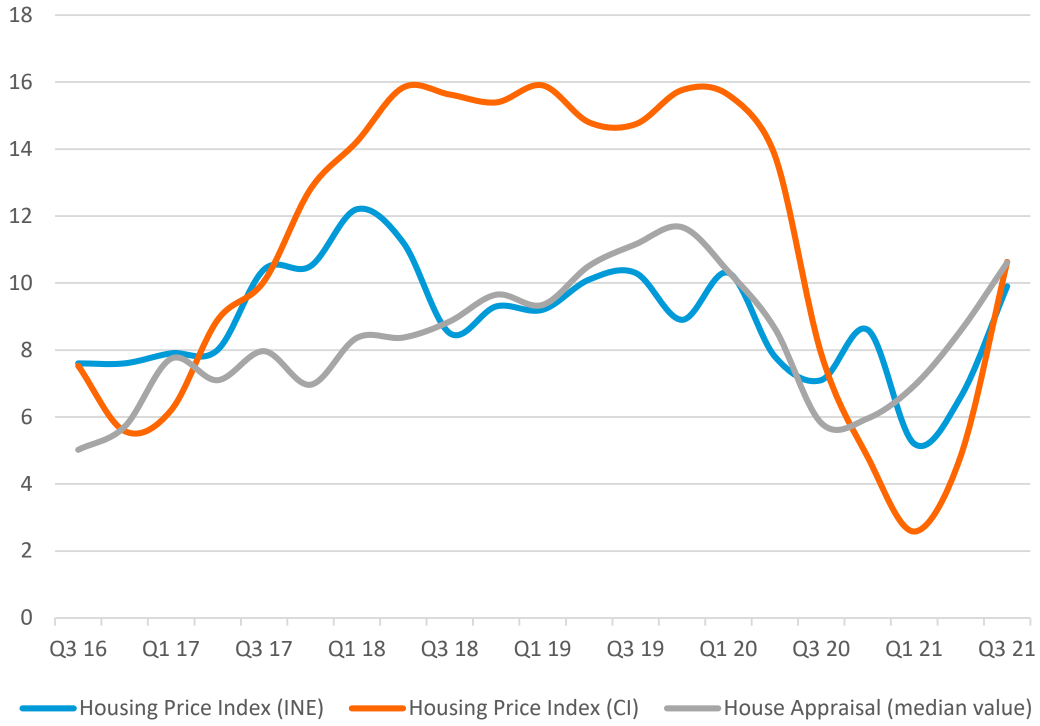
The real estate sector: resilience and solid fundamentals

Housing Transactions
Units



***Source**: BPI Research, based on INE and Confidencial Imobiliário data.*

Housing prices
Year on year (%)

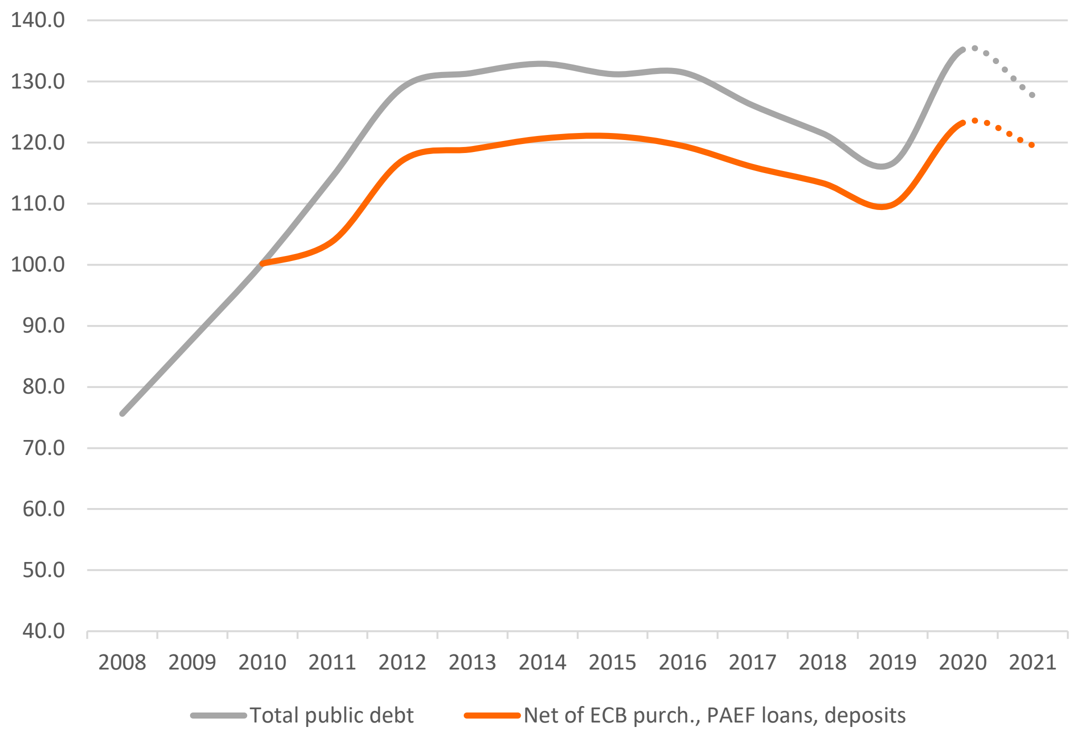


***Source**: BPI Research, based on INE and Confidencial Imobiliário data.*

- After the minimum reached in Q1 21 (+2,6%), **housing prices continue to accelerate**: +9,9% in yoy in Q3 according to the INE. Additionally, in Q3 were bought more 25% houses than in the same period of 2020 and more 23% in comparison to Q3 19; in Q3 21, it was recorded the highest value. The extension of Vistos Gold in Lisbon and Oporto may have supported this behavior, as well the lower interest rate context and high savings.
- Going forward, **the market should continue resilient: no signals of oversupply, but the prices should decelerate in the coming years**, in line with the end of Vistos Gold in main cities as well as some cooling down expected from domestic buyers due to the end of some covid-related supporting measures (namely moratoriums). Housing prices may have increased 6,4% in 2021 and should decelerate to 4,0% in 2022, with upside risks to our scenario.

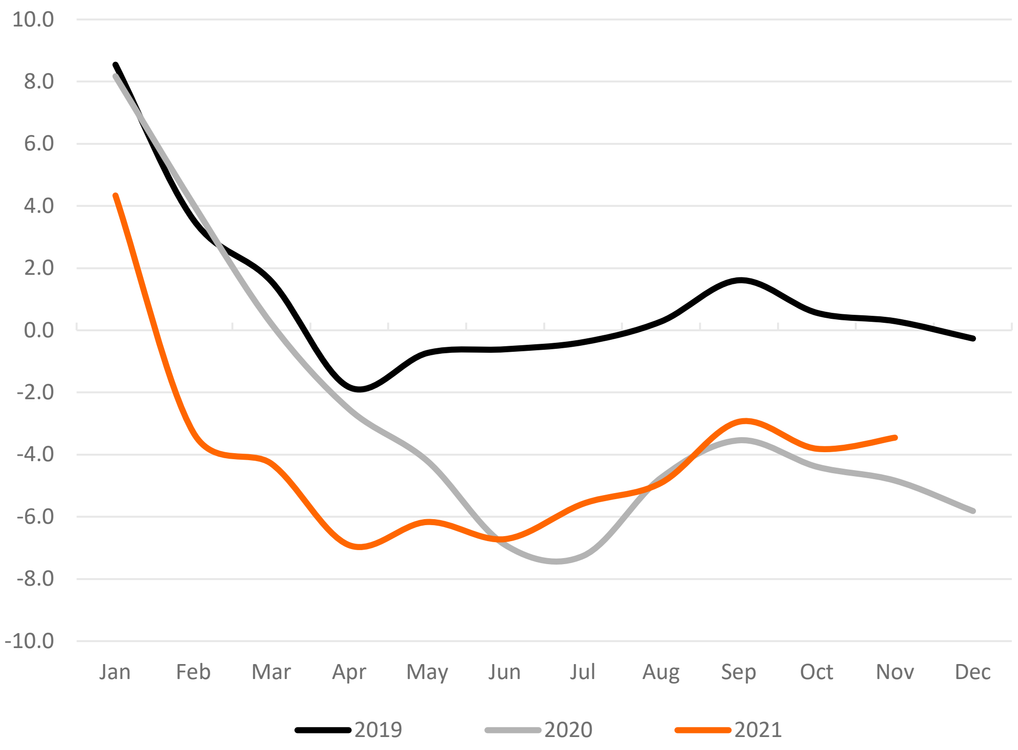
In spite of a strong increase in public debt, funding needs are well covered

Public debt
(% GDP)



***Source**: BPI Research, based on ECB and BoP data.*

Overall fiscal balance of Public Administration*
(% GDP)

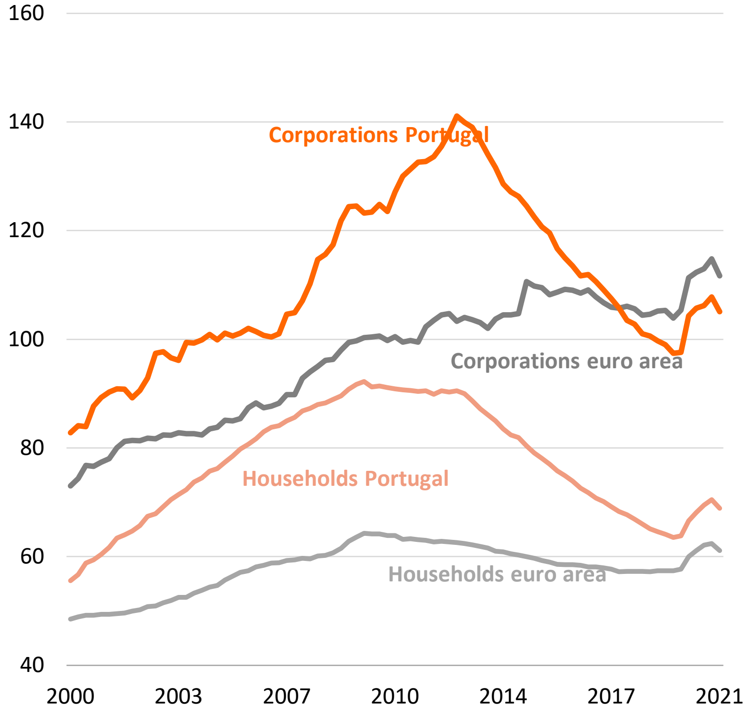


***Note (*):** Budget execution according to the cash basis.*
***Source**: BPI Research based on DGO.*

- **Public debt (% of GDP) increased by 18,6 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 57% in 2022), plenty of liquidity available and low interest rates. In 2021, deficit may have reached 4,3% of GDP and receipts from the NGEU of around 2,2 m€ (pre-financing). 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 ≈49% of GDP in November 2021. Currently, the Treasury liquidity cushion amounts to €18 bln (≈9% of GDP).**

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

Gross private debt
% of GDP, non consolidated debt.

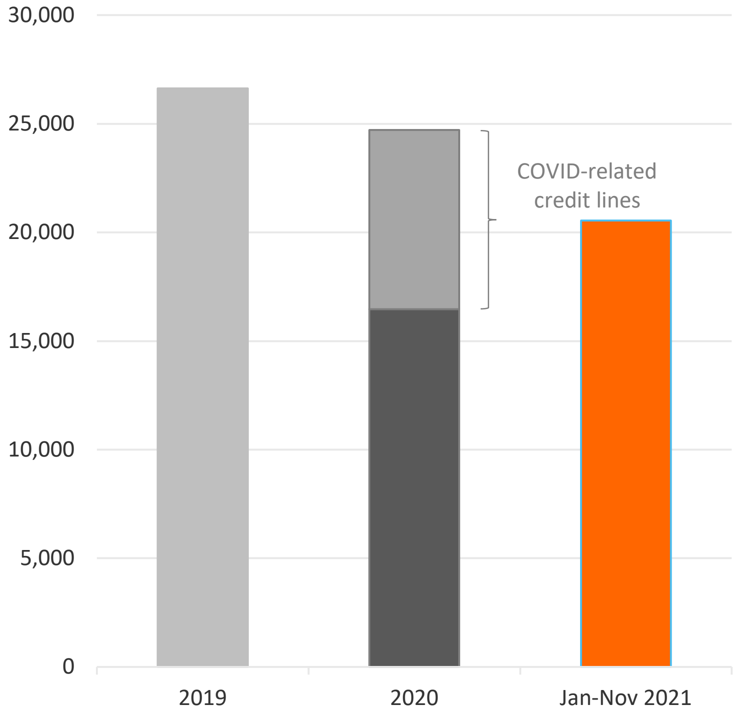


Source: *BPI Research, based on Eurostat data.*

Households: New lending activity
YoY variation accumulated in the year (%)

Note: *excluding renegotiations.*
Source: *BPI Research, based on BoP data.*

Non-financial corporations: New lending activity
Accumulated in the year (Million euros)

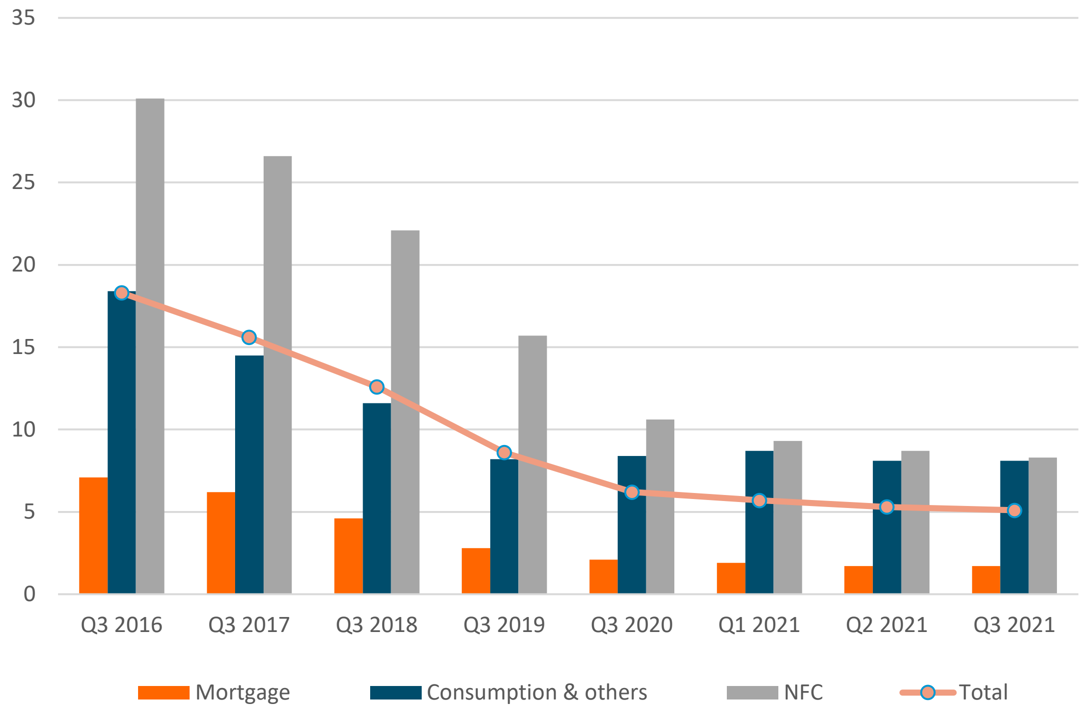


Note: *excluding renegotiations.*
Source: *BPI Research, based on BoP data.*

- **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 November, new lending contracted 0,5% yoy**, reflecting the fall of new credit to NFC (-16,8%). However, when excluding Covid-related credit lines, credit to companies is revealing dynamism (+24,8% 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 11 months of 2021 increased 26,2%, due to the rise of 38% 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 2006-07.

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

Non financial private sector: Non-performing loans
(%)



Private domestic credit
Year on year (%)

	Dec 2020 % yoy	Nov-2021 % yoy	2021 (For.) % yoy
Credit to the non-financial private sector	**4.6%**	**4.1%**	**3.4%**
Households	**1.4%**	**3.3%**	**3.4%**
Housing mortgages	**2.1%**	**3.2%**	**1.7%**
Other purposes	**-1.1%**	**3.4%**	**9.9%**
Consumer lending	**-0.3%**	**0.6%**	**0.7%**
Non-financial corporations	**10.5%**	**5.5%**	**3.4%**

Source: *BPI Research, based on BoP data.*

- **Moratorium was an important supporting measure for both households and firms in this current uncertain context.** This measure was especially important to firms: **between August and October 2020, credit under moratorium reached a maximum of 34,1% of total credit for NFC. Moratorium ended at the end of 2021** for those who applied until March 2021.
- Considering the importance of this measure and the potentially negative impacts on the firms' solvency after its end, 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). **Given the ample cushions in the banking system and the healthy balance sheet of households and companies compared with past situations, we don't expect a significant deterioration in NPL's due to the end of moratoria**.

Main economic forecasts

									Forecasts	
%, yoy	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
GDP	-0.9	0.8	1.8	2.0	3.5	2.8	2.7	-8.4	4.3	4.9
Private Consumption	-1.1	2.5	1.9	2.6	2.1	2.6	3.4	-7.3	5.0	4.8
Public Consumption	-2.0	-0.5	0.8	0.8	0.2	0.6	2.1	0.4	4.6	0.8
Gross Fixed Capital Formation (GFCF)	-4.8	2.3	5.9	2.5	11.5	6.2	5.4	-2.7	4.4	6.2
GFCF - equipment & transports	7.2	4.3	6.2	4.4	8.4	4.1	4.1	-18.6	-18.6	9.4
GFCF - construction	4.7	8.1	8.1	5.0	8.1	5.0	4.9	-12.1	-12.1	11.0
Exports	7.2	4.3	6.2	4.4	8.4	4.1	4.1	-18.6	9.4	10.4
Imports	4.7	8.1	8.1	5.0	8.1	5.0	4.9	-12.1	11.0	8.7
Unemployment rate	17.1	14.5	13.0	11.4	9.2	7.2	6.6	7.0	6.6	6.1
CPI (average)	0.3	-0.3	0.5	0.6	1.4	1.0	0.3	0.0	1.3	2.2
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	-4.3	-2.9
General government debt (% GDP)	131.4	132.9	131.2	131.5	126.1	121.5	116.6	135.2	127.7	124.5
Risk premium (PT-Bund) (average)	464	252	189	307	269	138	98	89	62	73

Source: BPI Research.

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