Portugal: Macroeconomic and financial outlook

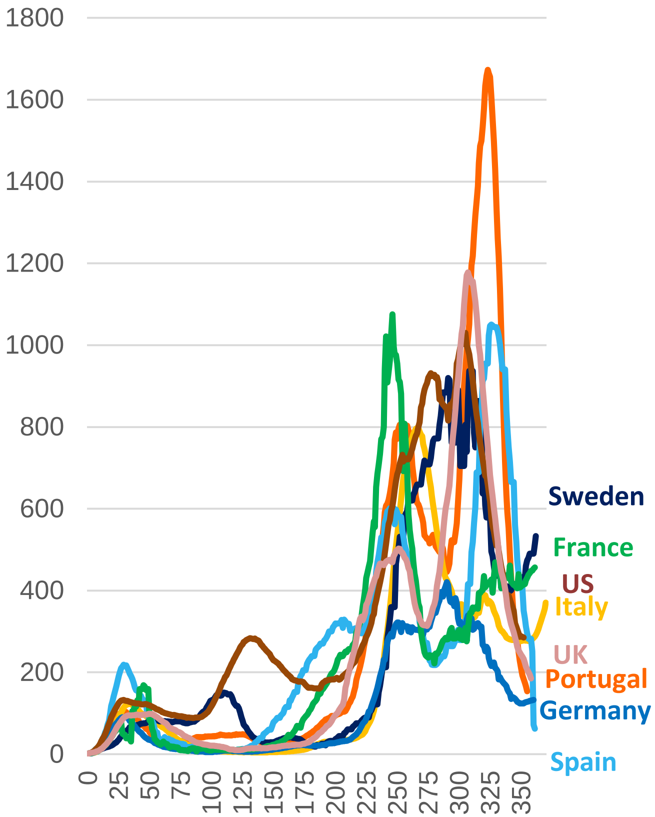
BPI Research
March 2021

Prepared with information available by 5th March 2021

Activity	▶ In 2021, economy shrunk 7,6%, less than expected, benefiting from a better-than-expected performance in Q4. GDP increased 0.2% qoq in Q4, but it remains 6,1% below last year's level. The recovery has recently lost steam. ▶ **The presence of new variants of the virus explained the huge increase in the Covid-19 infections last January, interrupting the recovery**. Since mid January, higher restrictions in mobility and in some sectors' activity compromise the economic recovery. However, the 3rd wave is clearly diminishing, despite some pressure that prevails in the health system. We expect lockdown measures to be smoothed after Easter. ▶ Given the new lockdown, it seems unavoidable a GDP contraction in 21Q1; however, **the economic consequences will be less severe than in March-April 2020** given the huge economic supports at play, the fact that companies and sectors changed to deal with this new situation (using more digital and online mode), thanks to our knowledge of viruses and forms of protection, and also because there is a prospect that it will be a temporary situation. Hence, **for now we keep the forecast to GDP in 2021 at +4,9%, although uncertainty remains high and dependent on the virus progression and the vaccination process**.
Banking sector	▶ **The Portuguese banking system has a strong financial position to face the crisis and 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 has declared the state of emergency again in the last quarter of 2020. Tighter restrictions were implemented since mid-January, including mandatory telework, schools closure (start of digital school from Feb 8th on), frontiers closure, etc. This more restrictive lockdown should be in place until at least mid/end March. ▶ **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 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 133,7% of GDP (30pp are in the hands of the ECB). ▶ In 2020, the public budget deficit should be lower than the 7,3% forecasted by the Government (recent official estimate points to -6.3%), supporting the increase of expenditure with new measures to support firms and families without compromising the achievement of the goal for 2021 (deficit of 4.3% of GDP). Furthermore the Budget for 2021 considers the execution of NGEU projects for 2021 (c.1.1% of GDP). Government's target for 2021 seems reasonable (with only ~4% of the Recovery and Resilience Fund included), but the high uncertainty about 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 next year.

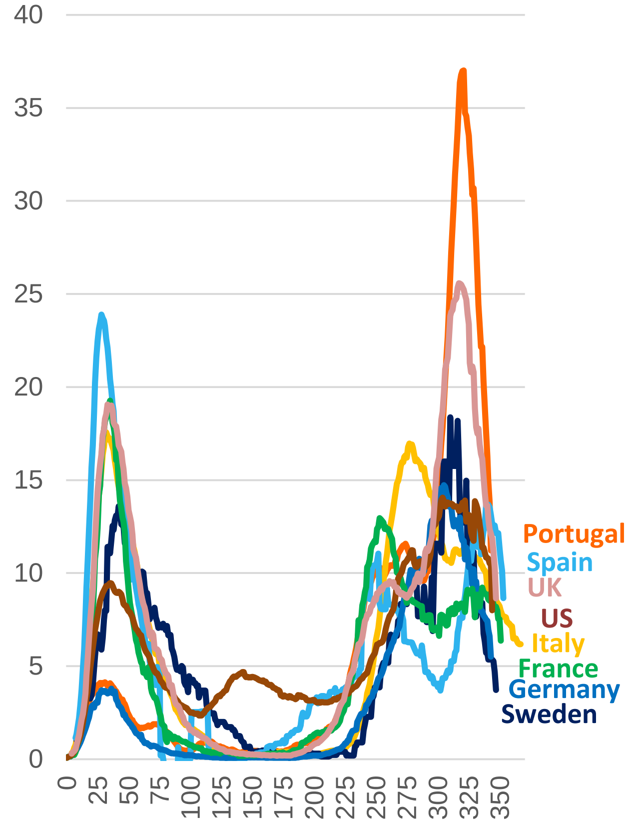
The third wave of COVID-19 infections with a much higher incidence

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

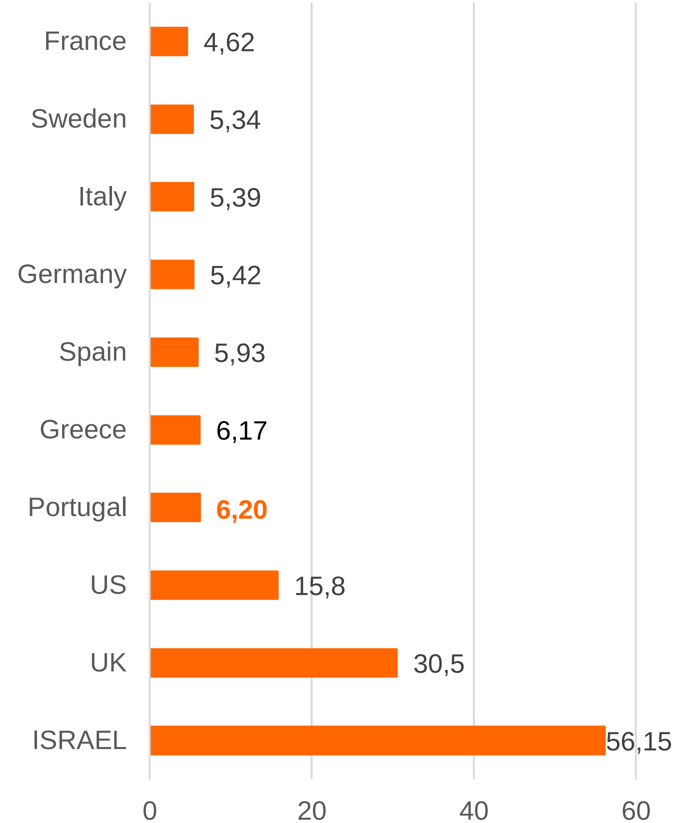


Last available data: March 3rd

Mortality per 100,000 inhabitants
14-day moving average



Total vaccinations per 100 inhabitants
March 3rd

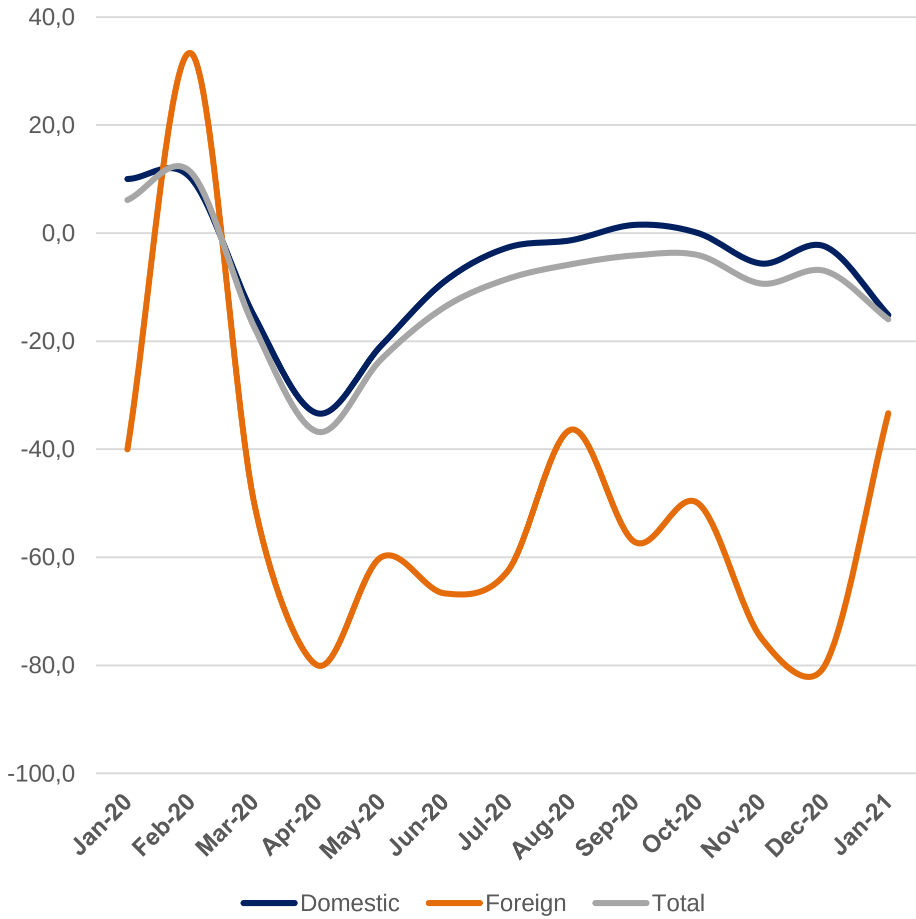


- 14-day cumulative incidence is rapidly declining, and is now below the high-risk threshold of 480 cases per 100k set by the Government. On March 3rd Portugal reached 153 cases per 100k inhabitants.
- In this scenario, lockdown measures remain unchanged, but the new measures for a eased lockdown will be announced on March 11th.
- Vaccination's speed is improving, but additional efforts are needed to get closer to group immunity until the summer.

Mobility and high-frequency indicators are cooling down due to new restrictions pointing to a contraction in Q1

Card activity (Electronic payments + Cash operations)

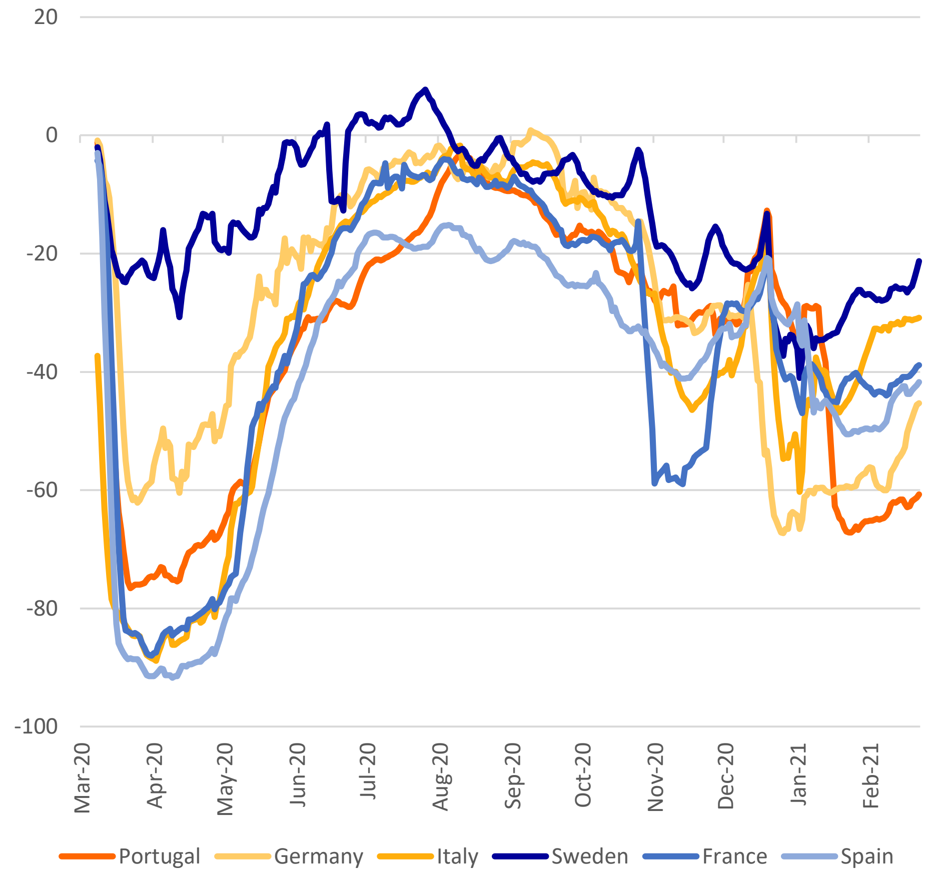
Year-on-year change (%)



Source: SIBS Analytics.

Population mobility: visits to retail and recreation

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



Source: Google Mobility Reports.

- Mobility and activity are cooling down due to the third wave of coronavirus infections.
- Card data show that consumption slowed after the rebound from minima in the summer months. Spending by foreigners remains weak but recovered in January.

Mobility and high-frequency indicators are cooling down due to new restrictions pointing to a 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	Registered unemployment	Number of tourists	Foreign tourists
2019	-	6.5	15.1	-0.6	-0.2	-2.2	4.3	-6.1	7.9	3.5
2020	-7.8	-9.4	10.9	-30.2	-3.5	-7.0	-4.1	5.8	-61.3	-10.2
Q1 2020	-2.0	0.0	5.6	-23.7	0.7	-1.4	2.2	-0.9	-18.2	-2.8
Q2 2020	-17.9	-24.6	8.0	-71.7	-11.8	-23.7	-13.2	-4.5	-91.3	-30.3
Q3 2020	-5.8	-6.1	11.8	-10.1	-0.7	-0.7	-2.1	21.5	-52.9	-2.9
Q4 2020	-5.4	-6.8	12.0	-20.1	-2.3	-2.5	-3.3	7.0	-68.1	-3.5
November	-7.1	-9.3	27.8	-27.9	-3.7	-3.3	-5.3	6.3	-77.0	-0.2
December	-3.7	-7.0	6.8	-19.6	-1.4	-4.6	-4.2	-0.2	-70.9	-7.8
January	-6.2	-15.9	-2.6	-30.5	-1.7	-6.5	-10.9	2.7	-78.3	
February	-6.2			-59.0	-0.8					

Historical contraction in GDP in 2020 with signs of resilience in the post lockdown period

GDP growth

Percentage change (%)

	2019	1T20	2T20	3T20	4T20	2020
Real GDP	2,5	-2,2	-16,3	-5,7	-6,1	-7,6
Private consumption	2,6	-0,8	-13,8	-4,1	-4,8	-5,9
Public consumption	0,7	0,1	-4,0	2,8	3,1	0,5
GFCF	5,4	-0,3	-8,5	0,6	-0,4	-2,2
Exports	3,9	-4,8	-40,0	-15,9	-14,1	-18,6
Imports	4,7	-1,7	-29,1	-11,0	-6,5	-12,0

Source: BPI Research, from INE data.

Analyst's Forecasts

GDP (Δ %)	2020	2021	2022	Acum. 20-21	Acum. 20-22
FMI (October)	-7.6	6.5	4.8	-1.6	3.1
Oxford Economics (January)	-7.6	4.4	6.7	-3.5	2.9
ING Group (January)	-7.6	3.8	6	-4.1	1.7
Commerzbank (January)	-7.6	3.7	5.7	-4.2	1.3
Focus Economics (March)	-7.6	4.2	4.3	-3.7	0.4
Comissão Europeia (February)	-7.6	4.1	4.3	-3.8	0.3
Banco de Portugal (December)	-7.6	3.9	4.5	-4.0	0.3
EIU (February)	-7.6	4.3	4	-3.6	0.2
Citigroup (March)	-7.6	3.7	4.6	-4.2	0.2
BPI Research (November)	-7.6	4.9	3.1	-3.1	-0.1
Fitch (March)	-7.6	4.8	2.9	-3.2	-0.4
Banco de Portugal (December, severe)	-7.6	1.3	3.1	-6.4	-3.5
OCDE (December)	-7.6	1.7	1.9	-6.0	-4.2
Católica (janeiro)	-7.6	-2	4.5	-9.4	-5.4

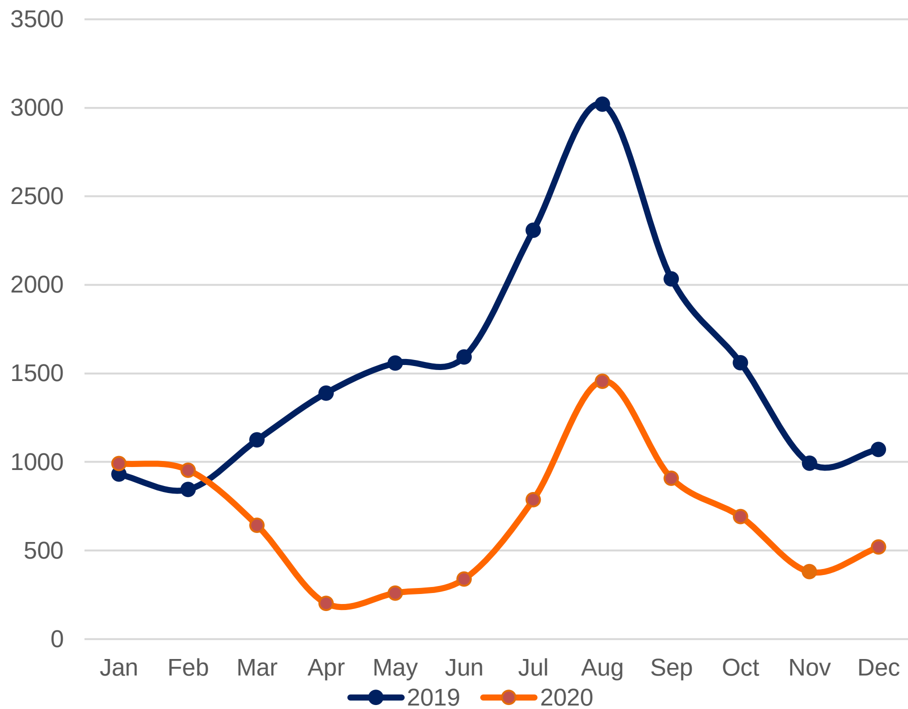
Central Scenario

- In 2020, GDP recorded a historical contraction of 7.6%, with a sharp drop in activity in H1 and a significant recovery in H2, showing the resilience of the economy and opening room for strong recovery after the current lockdown and progresses in vaccination.
- For 2021, we expect the economy to grow 4,9%, taking into account the better than expected performance in 2020, as firms are better adapted to the digital and online sales, national and European supporting measures are already planned and operative, and the vaccination plan already in place, meaning that there is "Light at the end of the tunnel". New bouts of contagious will continue to weigh on the speed of the recovery, particularly in the tourism sector, which will continue to operate well-below potential in 2021. GDP is not expected to reach pre-crisis levels until 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 are mainly biased on the downside. But upside risks are also present and specially linked to the effectiveness of faster vaccination.

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

Expenditure of international tourists

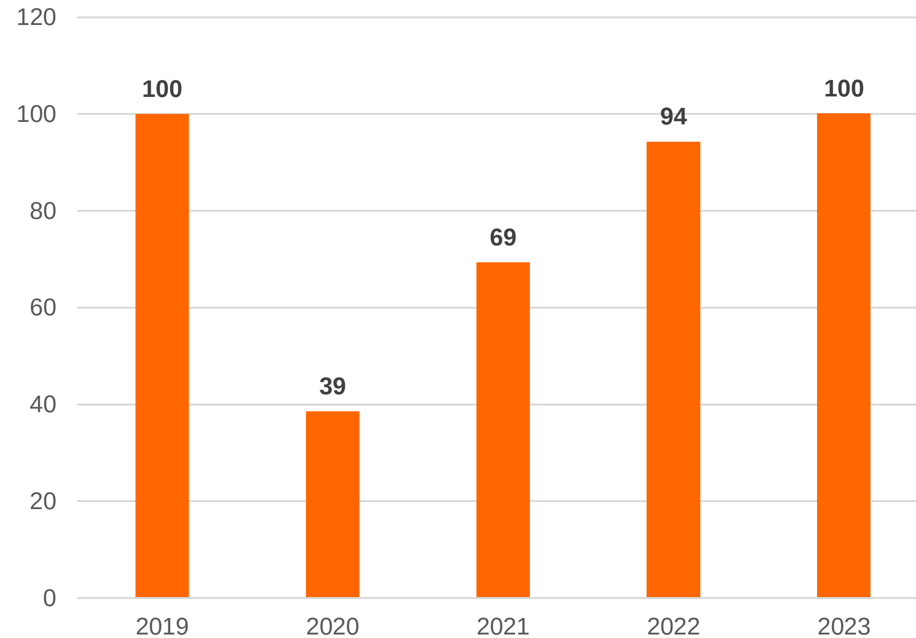
€ million



Source: INE and BPI Research forecasts..

Tourism GDP forecasts

Index (2019 = 100)



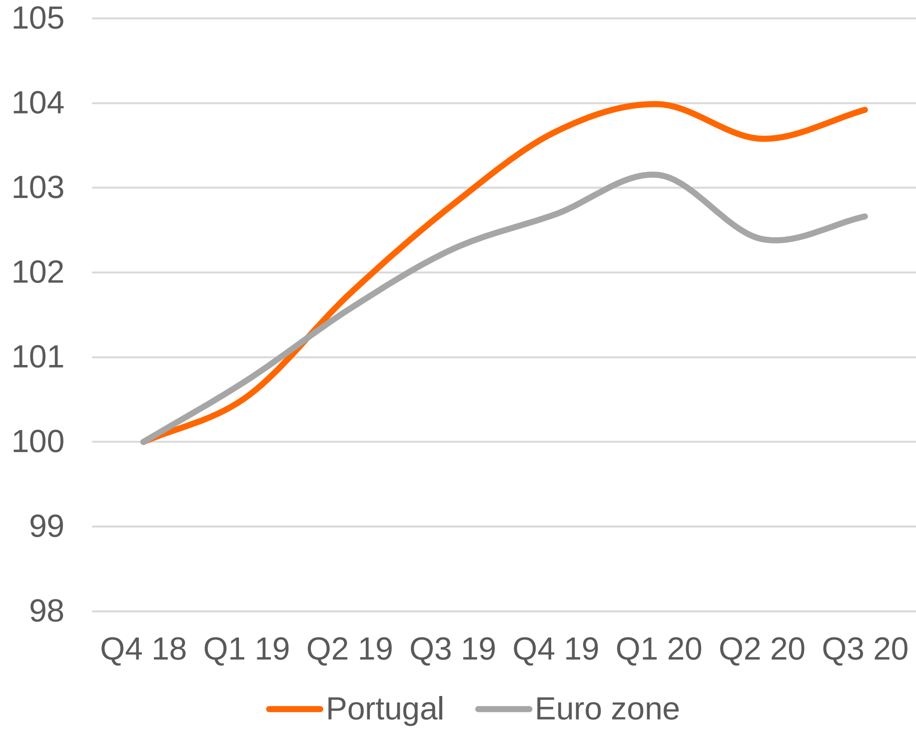
Source: INE and BPI Research forecasts.

- **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 balance. In Q1 tourism activity will remain curbed, due to the third wave of the pandemic and lockdown measures to contain the contagion that includes frontier closure. We expect the situation to start improving significantly in Q2 2021.
- **Tourism GDP is expected to have declined around 60% in 2020** and 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 vaccines become available and distributed by the population, process which, for Portugal, began at the end of December. There is also a collective effort by the remaining countries to initiate the Vaccination Program as soon as possible. However, the revival is subject to strong uncertainty as confidence is one of the main constraints.

The real estate sector: temporary contraction but solid fundamentals

Families disposable income per capita

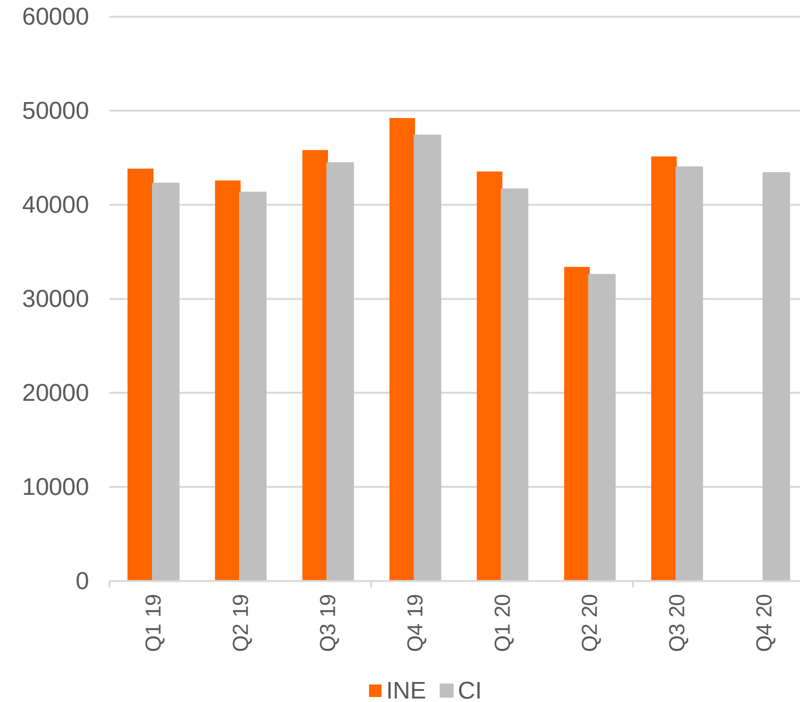
Index (Q4 18=100)



Source: Eurostat

Housing Transactions

Units

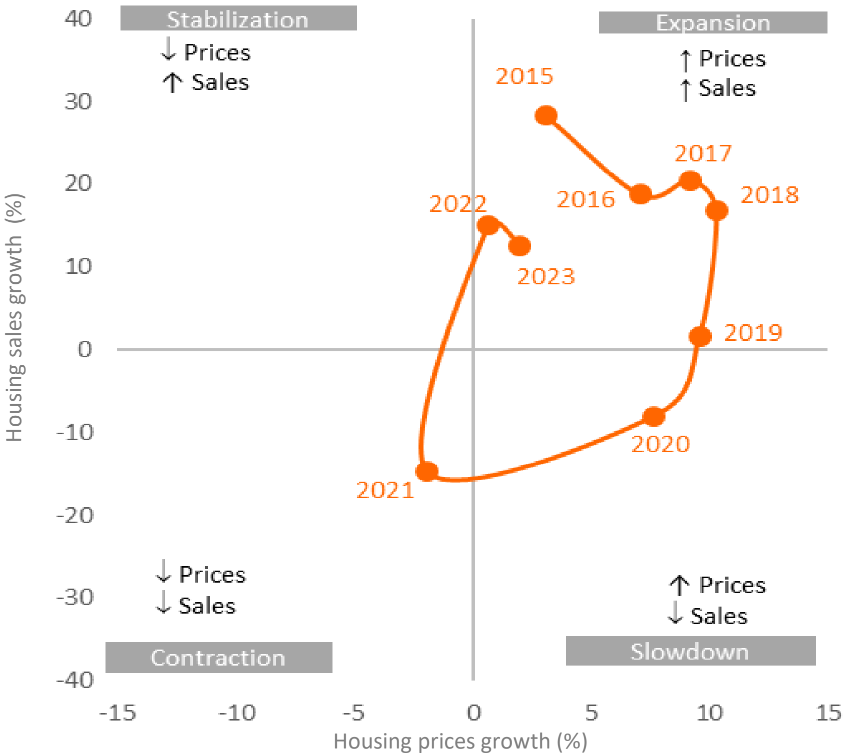


Source: INE and Confidencial Imobiliário.

- **The families' disposable income per capita has remained relatively steady up to Q3 2020,** while for the Eurozone suffered a larger decrease. 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 Confidencial Imobiliário, housing sales fell 10% qoq in Q4 and 8,4% yoy, confirming the cooling down of the market. For the whole year, CI data points to a decline of 8% on house transactions.**
- In 2021, housing sales should decline further, 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 in Lisbon and Porto for the end of 2021, may give some support to the market.

The real estate sector: temporary contraction but solid fundamentals

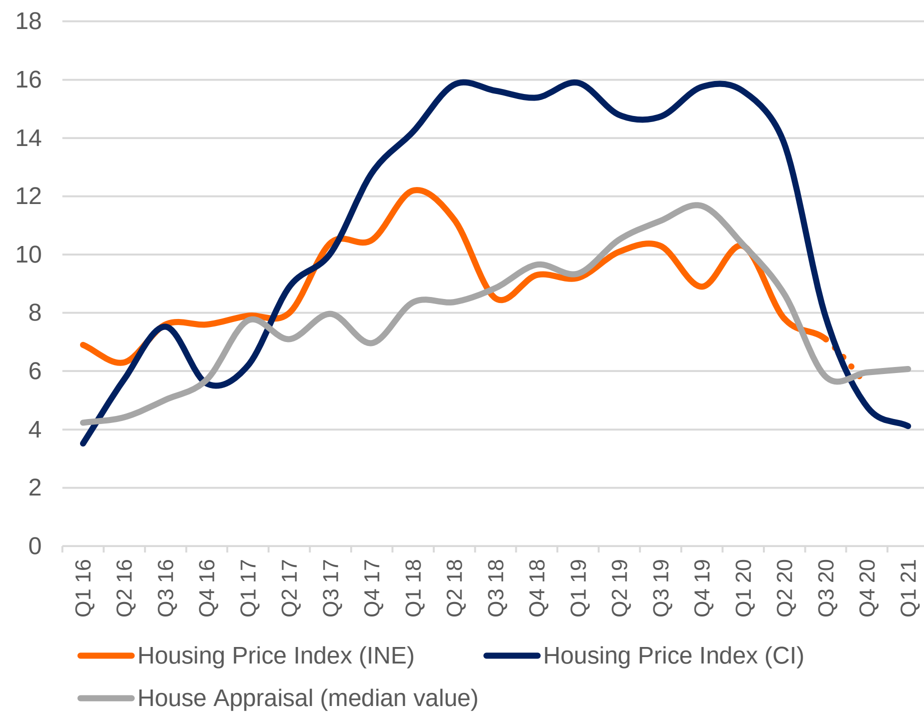
Real estate clock



Source: INE and BPI Research forecasts.

Housing prices

Year on year (%)



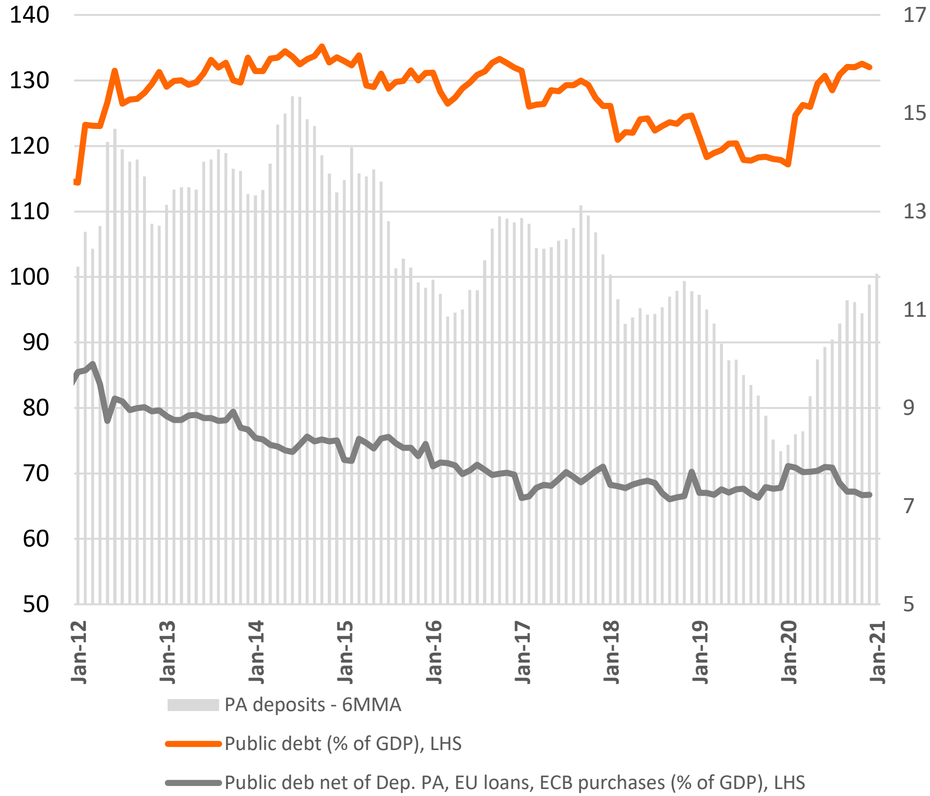
Source: INE and Confidencial Imobiliário and BPI Research

- **The housing sector experienced a slowdown in 2020,** with prices still increasing but sales expected to decrease (final figures disclosed in March).
- In 2021, a different scenario is expected, as tourism will probably recover very gradually. Besides the end of the moratorium regime in September 2021 (currently affects circa 20% of the total housing credit), will likely increase the financial constraints of the Portuguese families and unemployment is expected to increase. Thus, prices and sales are likely to decline, albeit only slightly.
- **Housing prices have been slowing down in the last quarters, according to INE data.** In January 21, *Confidencial Imobiliario* data points to a year-on-year increase of 4.1%, the lowest reading since Q4 2016 while more recent data hints at a further deceleration in prices. Hence, we predict an annual change in prices of around 7% for 2020 and a smooth annual decline of ~ 2% in 2021.
- The median value of the housing appraisals increased to 1,170/m^2 in November, a 6.1% yoy increase and a monthly increase of 1.2%.

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

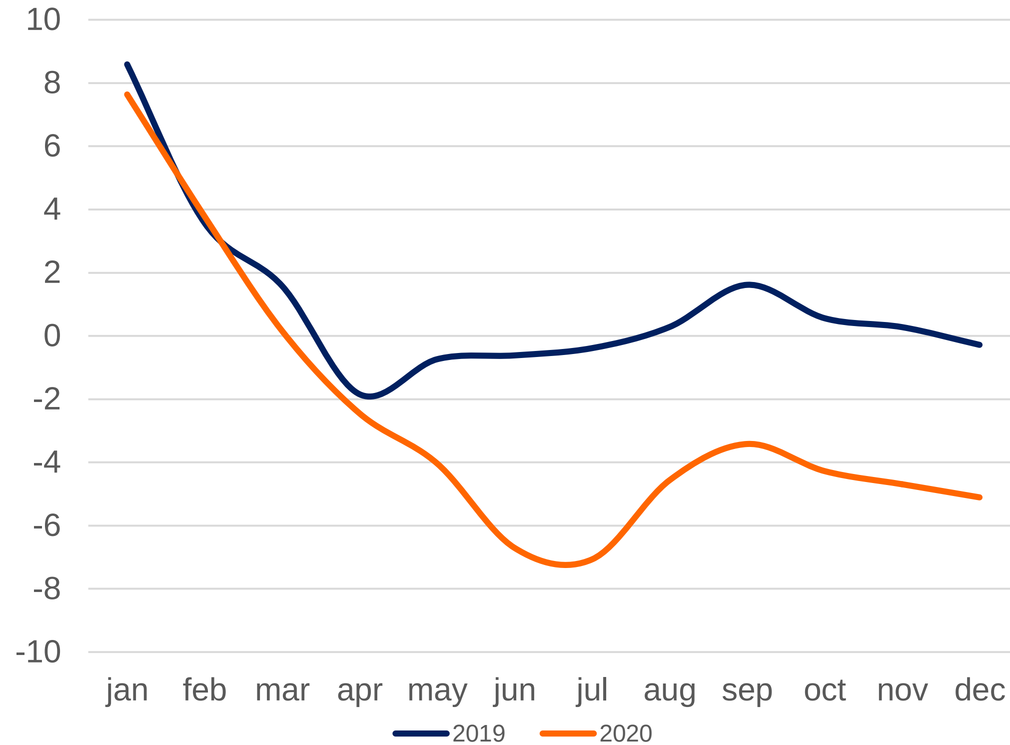
Public debt

(% GDP)



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

(% GDP)



Note: cash basis. Forecast for whole 2020 is accrual basis.

- **Budget data exhibits a deterioration in the public balance in 2020 to 5.1% (cash basis),** reflecting the increase in expenditure and the decrease in revenue, in line with the negative effects of COVID-19 on public finances. In fact, these measures reached a total of 4.532 million euros, that is, about 2.3% of GDP, a considerable amount, but, even so lower than what the Government estimated in the State Budget 2021 (5.357 million euros, about 2.7% of GDP). Revenues fell 5.1% and spending increased 5.2%). The deficit on a cash basis, suggests that final accrual measure will remain below the Gov. forecast of 7.3% (recent estimate: 6.3%) . Data for January shows a 9.9% decline on revenues and a small expenditure increase of 0.3%.
- **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 budget envisages a decline in the fiscal deficit from 7.3% in 2020 to 4.3% and the execution of NGEU projects of 500 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 ~66% at end 2020.

The Government Budget Plan: strong but controlled increase in revenues and spending

Government's draft budgetary plan 2021

Key elements	% GDP 2019	% GDP 2020	% GDP 2021	2019-2021 change (EUR millions)	2019-2021 growth rate (%)
Total revenue	**42.7**	**42.6**	**43.4**	**462**	**0.5**
Indirect taxes (VAT,...)	15.0	14.5	14.5	-1,544	-4.8
Taxes on income and wealth	9.8	9.3	9.4	-931	-4.5
Social contributions	11.8	12.5	12.2	459	1.8
Total spending	**42.7**	**49.9**	**47.8**	**9,771**	**10.7**
Worker salaries	10.7	12.0	11.7	1,704	7.4
Social transfers (excl. unemployment)	17.6	19.7	19.1	2,753	7.3
Unemployment schemes	0.6	0.8	0.8	455	38.3
Interest payments	3.0	2.9	2.6	-844	-13.3
Balance	**0.1**	**-7.3**	**-4.3**	**-9,309**	**...**

Revenue

- Government expects to reach 43.4% of GDP in 2021 (42.7% in 2019). In total, it represents an increase of 462m€ compared to 2019, explained by social contributions (€459m) and European funds.
- Expected growth in tax revenue and social contributions in 2021 compared to 2020 in line with the growth of nominal GDP (+ 6.0% vs 6.3% respectively)
- Capital revenues can be underestimated: expected only 4% of PRR, instead of 10%

Spending

- They are expected to reach 47.8% of GDP in 2021 (42.7% in 2019), +9.771m€ compared to 2019.
- Main contributions: social benefits, personnel expenses and investment. Public investment includes 500m€ from PRR.
- The unemployment benefit item may be underestimated, if the unemployment rate goes up again in 2021.
- Primary current expenditure is increasing, which means high levels of expenditure rigidity.

Assessment

- The Government public deficit target of 4.3% in 2021 is slightly optimistic as the high uncertainty about epidemic and economic situation, the execution of guarantees related to the credit lines and the financial situation of state-owned enterprises could add additional pressure on public accounts next year.

	• 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.
• **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

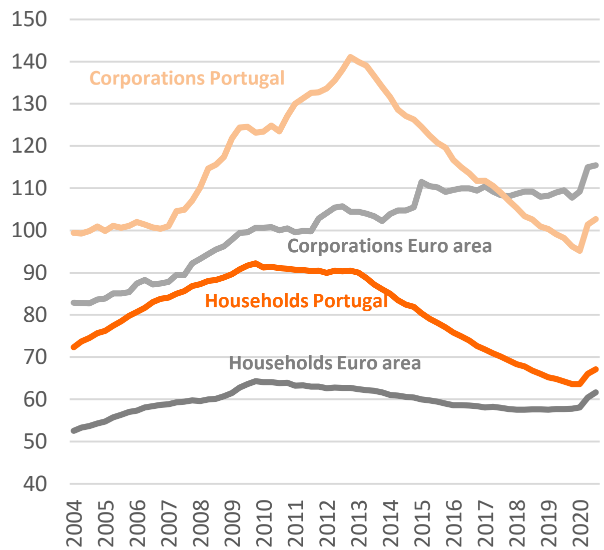
Government Proposal - Components and investments

• **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: 4.000 M€ (24% of total)** • **Reindustrialization: 1209 ME** • **Industry decarbonisation: 715ME** • **Employment support: 370ME** • **Digital transition: Business 4.0: 650ME** • **Capitalization measures, Banco de Fomento: 1250 M€**	
• **Resilience** **Grants: 8543 M€** **Loans: 2399 M€**	• National Health Service • Housing • Social area • Eradication of poverty • Investment and innovation (Grants 1396€ + Loans 1250 M€)	• Qualifications and skills • Infrastructures • Forest • Water sector
• **Climate transition** **Grants: 2888 M€** **Loans: 300 M€**	• Sustainable mobility • Industry de-carbonization (Grants 715 M€)	• Sustainable bio economy (Grants 150 M€) • Energy efficiency in buildings • Hydrogen and Renewables
• **Digital transition** **Grants: 2513 M€** **Loans: 0 M€**	• Digital school • Industry 4.0 (Grants 650 M€) • Qualification and sustainability of Public Finances • Justice, economy, business environment • Public administration	

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

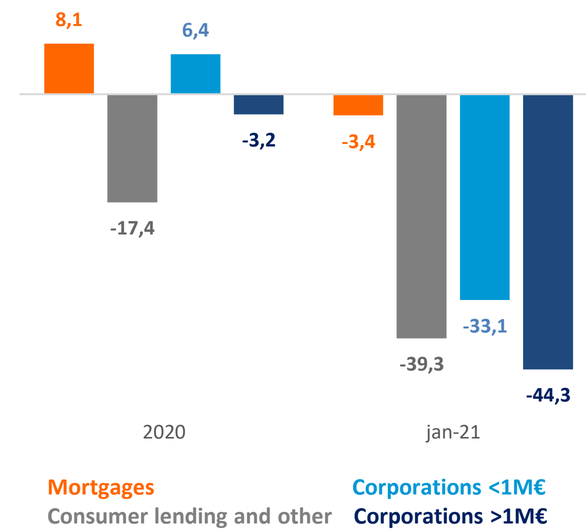
Year on year (%)

	Dec 2019 % yoy	Dec-2020 % yoy	2021 (forecast) % yoy
Total Credit*	-0.1%	4.6%	3.9%
Households	2.1%	1.4%	0.0%
Housing mortgages	-1.3%	2.4%	1.6%
Other purposes	16.5%	-3.6%	0.5%
consumer lending	25.6%	-0.3%	0.5%
Non-financial corporations	-3.7%	10.4%	7.6%

Source: Bank of Portugal

New lending activity by sector

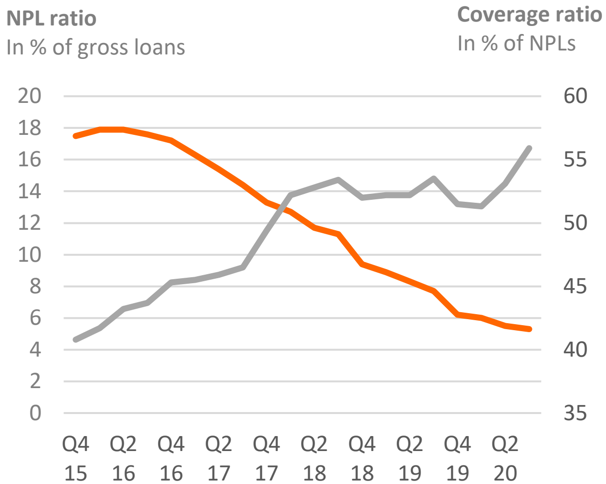
Year on year (%)



- **Corporate debt levels** remain below euro area averages despite the recent pick-up in credit. **Household debt** has increased more modestly reflecting expanding mortgage and consumer lending, as well as the effect of moratoria. We expect a protracted period of deleveraging 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 showed some resilience. New credit to NFC rose by 0,5%
- **In January new lending slumped in both families and corporates.** Higher uncertainty related with the 3rd wave of infections, adoption of a more cautious stance by both banks and economic agents and delays in the allocation of credit lines may explain the huge decline in the beginning of 2021.

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

NPLs and coverage ratios



Moratoria
Q3 2020: 17% of loans to households; 32% of loans to NFC

Cost of risk[1]
0.5% in 2019
1% in Q3 2020

[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)

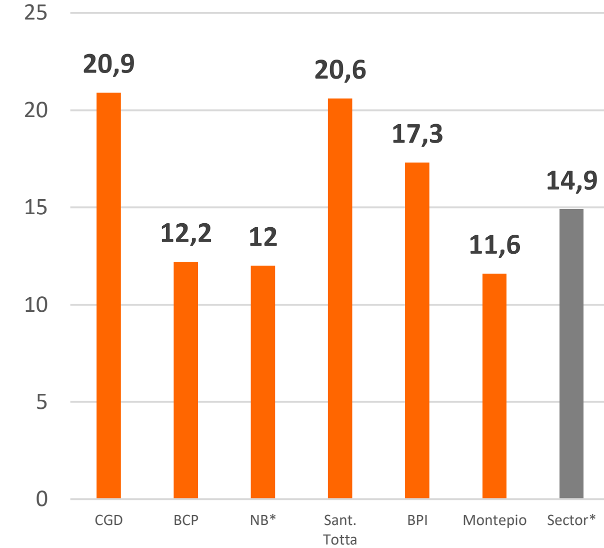
	BPI	BCP	San Totta	CGD	NB*	Montepio
Net interest income	**1,3%**	**1,4%**	**1,4%**	**0,8%**	**1,2%**	**1,3%**
Net fees	0,7%	0,8%	0,6%	0,5%	0,6%	0,6%
Gains on financial assets	0,0%	0,1%	0,2%	0,0%	-0,9%	0,1%
Other net profits	0,0%	-0,1%	0,0%	0,1%	-0,3%	-0,1%
Gross income	**1,9%**	**2,2%**	**2,2%**	**1,4%**	**0,6%**	**1,9%**
Operating expenses	-1,2%	-1,1%	-1,0%	-0,7%	-0,9%	-1,5%
Operational result	**0,6%**	**1,1%**	**1,2%**	**0,7%**	**-0,3%**	**0,5%**
Impairement losses, taxes and others	-0,4%	-0,9%	-0,6%	-0,2%	-2,2%	-0,9%
Profit	**0,2%**	**0,2%**	**0,6%**	**0,5%**	**-2,5%**	**-0,4%**
ROTE[1]	4,8%	3,4%	8,0%	6,6%	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 Q3 2020, the NPL ratio fell to 5.3%, -0.8 p.p. than in Q1 2020; also the stock of NPLs declined in Q3, probably helped by moratoria schemes. This trend will probably reverse as debt moratoria expire (September 2021) and companies and households start facing 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	Forecasts 2020	Forecasts 2021
GDP	-4.1	-0.9	0.8	1.8	2.0	3.5	2.8	2.5	-7.6	4.7
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
GFCF - equipment & transports	3.1	7.2	4.3	6.2	4.4	8.4	4.1	3.5	-18.6	15.8
GFCF - construction	-6.4	4.7	8.1	8.1	5.0	8.1	5.0	4.7	-12.0	12.7
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	12.7
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	-1.0
General Government Balance (% GDP)	-6.2	-5.1	-7.4	-4.4	-1.9	-3.0	-0.3	0.1	-6.3	-5.7
General government debt (% GDP)	129.0	131.4	132.9	131.2	131.5	126.1	121.5	117.2	133.7	131.4
Risk premium (PT-Bund) (average)	903	464	252	189	307	269	138	98	89	53

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

1/ The general government deficit excludes one-off bank restructuring costs of 3.7% of GDP in 2012, 0.3% of GDP in 2013, 0.1% in 2014, 0.05% in 2015, 0.2% in 2016, 0.04% in 2017 and 0.01% in 2018.
2/ General government debt includes ESM/FROB related borrowings equivalent to 3.9% of GDP in 2012.

Source: BPI Research.