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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK
APRIL 2025

BPI

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK

April 2025

The *Monthly Report* is a publication developed jointly by CaixaBank Research and BPI Research (DF-EEF)

BPI Research (DF-EEF)
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Paula Carvalho
Chief Economist

CaixaBank Research
www.caixabankresearch.com
research@caixabank.com
Enric Fernández
Chief Economist
José Ramón Díez
Head of International Economies and Financial Markets
Oriol Aspachs
Head of Spanish Economy
Sandra Jódar
Head of Strategic Planning
David Martínez Turégano and Nuria Bustamante
Monthly Report coordinators

Date this issue was closed:
9 April 2025

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Trump's Tariffs: an own goal?

The Trump administration's announcements of increased customs duties have increased the average effective tariff applied by the US to its imports by more than 20 percentage points, reaching the highest levels in a century, although the decision has been suspended for 90 days (with the exception of China), during which a universal tariff of 10% will be applied. In addition to the arbitrary calculation method for estimating the country-by-country tariff, the decision will not serve to achieve the objectives of reducing the US external imbalance (which originates from an excess of investment over domestic savings), restoring jobs in sectors where the US has long lost its competitive advantages, or structurally balancing the country's deficit fiscal position. However, the price to pay is a return to a fragmented world and an exponential increase in uncertainty about the profile of economic and trade policy, which threatens to destabilise the global economy. We are thus faced with a decision that falls into the category of negative-sum games because it harms all the actors involved, and which will result, at the very least, in a scenario of lower global growth and higher inflation in the countries participating in the protectionist escalation. The behaviour of the financial markets in the days following the decision, with sharp falls in the stock markets, increased volatility and a rise in credit spreads, reflects the destabilising potential of the measures announced.

It is not easy to look for signs in the midst of noise and disturbance, to find order in disorder, or to find some pattern of rational behaviour in the face of decisions that are detrimental to all the agents involved in a game that, in theory, should be cooperative in order to achieve maximum efficiency. Just as the evolution of cultures is a continuous search for positive-sum solutions to the inevitable problems that arise from coexistence, advances in economic development are also based on win-win situations, many of which originate in the exploitation of competitive advantages by each of the players on the economic board. If innovation and the diffusion of knowledge are at the heart of the growth process, it seems difficult that, in economies with barriers to foreign competition, productive factors will be optimally allocated to the leading processes and sectors, which will limit progress in productivity and per capita income (something in which the US has been a leader in recent decades). Especially in the absence of a stable institutional environment with good protection of property rights. This was the general consensus among economists, at least until the now famous «Liberation Day».

And from here? The starting point is challenging, because shooting yourself in the foot isn't the most common thing when it comes to the economic policy of the world's biggest power. We are entering a new phase of global uncertainty, as the measures announced could be an initial reference for a multilateral negotiation that brings us closer to a less damaging balance point or lead to an escalation of trade tensions. In the first scenario, if some kind of agreement is reached quickly that involves a substantially lower average tariff than the one initially announced, the collateral damage would be limited, all the more so as it would reduce tension in the financial channel and increase the certainty of economic agents when making decisions. But if a scenario of widespread trade war opens up, the global economy will suffer a greater impact with the risk of being accompanied by an inflationary process. In any case, what seems clear is that we are witnessing the final stages of the process known as globalisation and the consolidation of trends such as: geopolitical fragmentation, the search for strategic autonomy, the reconfiguration and reduction of value chains, and the forced rebalancing of growth models that are highly dependent on external demand (Draghi is right about this too). We may like it more or less, but what worked in the last decades (German model?) may no longer work today. And the ability and flexibility to adapt to the new environment will determine whether you are one of the winners or losers, because after shuffling the cards we will reach the new point of global equilibrium. At the moment, the European response (beyond the hard trade negotiations) seems to be moving in the right direction, although it is probably insufficient given the level of the challenges. It will not be easy to strategically balance relations with the US and China in the short term, especially without improvements in governance. In the meantime, we will probably continue to witness the ceremony of confusion, between fireworks, liberation days and intense noise.

Cronologia

MARCH 2025

4 The European Commission presents its ReArm Europe plan to bolster the EU's defence capabilities.
6 The ECB cuts interest rates by 25 bps, leaving the depo rate at 2.50%.

FEBRUARY 2025

1 Trump signs the first executive orders imposing tariffs on China, Canada and Mexico.
10-11 Artificial Intelligence Action Summit in Paris, with the participation of governments, organisations and companies from over 100 countries.

JANUARY 2025

10 The EU's Copernicus programme reports that 2024 was the warmest year on record and the first to exceed the threshold of 1.5°C above the pre-industrial average.
30 The ECB cuts interest rates by 25 bps and lowers the depo rate to 2.75%.

DECEMBER 2024

12 The ECB cuts interest rates by 25 bps and leaves the depo rate at 3.00%.
18 The Fed cuts interest rates by 25 bps, placing them in the 4.25%-4.50% range.

NOVEMBER 2024

7 The Fed cuts interest rates by 25 bps, placing them in the 4.50%-4.75% range.
The BoE cuts interest rates by 25 bps to 4.75%.

OCTOBER 2024

17 The ECB cut interest rates by 25 bps and lowered the depo rate to 3.25%.

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1 Euro area: CPI flash estimate (March).
2 Spain: registration with Social Security and registered unemployment (March).
Spain: household savings rate (Q4).
8 Portugal: turnover in industry (February).
10 Spain: financial accounts (Q4).
11 Spain: Fitch rating.
17 Governing Council of the European Central Bank meeting.
China: GDP (Q1).
24 Spain: loans, deposits and NPL ratio (February).
28 Spain: labour force survey (Q1).
29 Spain: GDP flash estimate (Q1).
Spain: CPI flash estimate (April).
Portugal: bank credit portfolio (March).
Euro area: economic sentiment index (April).
30 Portugal: GDP flash estimate (Q1).
Portugal: CPI flash estimate (April).
Portugal: budget execution (March).
Euro area: GDP (Q1).
US: GDP (Q1).

MAY 2025

2 Euro area: CPI flash estimate (April).
6 Spain: registration with Social Security and registered unemployment (April).
6-7 Federal Open Market Committee meeting.
7 Portugal: employment and unemployment (Q1).
8 Spain: industrial production index (March).
9 Portugal: international trade (March).
14 Portugal: labour cost index (Q1).
16 Japan: GDP (Q1).
19 Spain: international trade (March).
26 Spain: loans, deposits and NPL ratio (March).
27 Euro area: economic sentiment indicators (May).
30 Spain: CPI flash estimate (May).
Portugal: GDP breakdown (Q1).
Portugal: loans and deposits (April).
Portugal: tourism activity (April).

Portugal facing the Trump shock

It was hoped that 2025 would be a normal year, when the economy would stabilise after the huge shocks of recent years. The outlook is that it will be a positive year, with growth in Portugal accelerating to 2.4%. But in just a few weeks, the new tenant of the White House has managed to shake the global economy, call into question all scenarios previously on the table, and spark fears of recession in multiple countries (particularly the US). In addition to the imposition of significant tariffs on multiple partners –which have now been partially suspended– his erratic, unpredictable and apparently economically illogical actions have caused a reassessment of prospects, fears of an economic crisis, which, in the meantime, have already been felt in sharp falls on the international financial markets and are also beginning to be reflected in confidence indicators.

How is Portugal positioned in the face of all this turmoil? The cyclical starting point can be considered favourable, as the economy advanced by 1.9% last year, with a strong boost in the last quarter which, in itself, has good consequences for 2025 (carry-over effect of 1.4 p. (+4.8 p. p.). Furthermore, Portugal has been one of the fastest growing economies in the Eurozone, being practically 9% above pre-pandemic levels and comparing quite well with its peers. Employment levels also maintain sustained growth and average wages ensure real gains, which, together with a high recent savings rate, supports consumption in the future.

Direct exposure to the US economy can also be considered moderate: exports of goods and services to the US represent less than 4% of GDP; considering only exports of goods, these account for less than 7% of all Portuguese exports (both figures for 2024) and some of the products most dependent on this market (such as pharmaceuticals or refined fuels, whose sales to the US account for around 33% and 22% of each group's total exports) are shielded from the greatest impact for the time being. On the other hand, there are segments of the business sector that are more exposed, namely those companies in which the North American market represents a significant portion of sales. From this perspective, the most vulnerable sectors are in the textile industry, non-metallic manufacturing, the beverage industry or the manufacture of computers and electronic equipment, with a high proportion of exporting companies depending on the US market for more than 10%. Even so, it is important to highlight the recent support measures approved by the Government, which are intended to stimulate diversification and the search for new markets.

Furthermore, we can say that the country is structurally firmer, more robust than in previous crises. The situation is different from the financial crisis, the experience of the sovereign debt crisis, and the pandemic. As we have been highlighting here, the imbalances are now much more contained and the structural indicators have evolved very favourably. Especially when we compare the situation with the time before the sovereign debt crisis, when the country was at the epicentre, we see that all the financial health indicators have evolved very favourably: household debt (2010: >90% GDP, now 54%; Eurozone 52%) and companies (2012: 140% GDP; now 78%; Eurozone (106%) is significantly lower and below or close to EMU levels; external debt returned to 45% of GDP compared to 108% in 2014; and public debt ended 2024 at 95% of GDP, registering one of the biggest falls among European countries compared to 2020 levels. Of course, not everything is resolved and Portugal will have to accelerate its trajectory and the implementation of reforms to meet the objective of convergence and strengthening the wealth and well-being of the population. Especially because much of the dynamism achieved is underpinned by stronger demographic dynamics (which can be interrupted for some reason) and the good performance of the tourism sector. Therefore, we need to strengthen our positioning, diversify partners and reinforce competitive advantages in order to reduce vulnerability in this uncertain context. One of the steps towards a more robust situation involves, for example, ensuring the smooth running of productive investment, the accelerated implementation of projects with future returns, ensuring the progression of the capital stock, which has been stagnant in recent years.

In short, in the first weeks of April, the risks surrounding growth forecasts for the Portuguese economy increased. We had recently presented adjustments to our forecasts that accommodated only a very slight impact from the introduction of tariffs and uncertainty. We will have to wait for new developments to have more visibility, but the risk is that the growth in activity will be a little lower than we anticipated in February, as a result of the impact of the more adverse external situation.

Paula Carvalho

Lisbon, 15 April 2025

Average for the last month in the period, unless otherwise specified

Financial markets

	Average 2000-2007	Average 2008-2019	Average 2020-2022	2023	2024	2025	2026
INTEREST RATES							
Dollar							
Fed funds (lower limit)	3.18	0.54	0.67	5.25	4.25	4.00	3.75
3-month SOFR	3.62	1.01	1.07	5.37	4.37	4.07	3.85
12-month SOFR	3.86	1.48	1.48	4.95	4.19	4.01	3.93
2-year government bonds	3.70	1.04	1.21	4.46	4.24	4.35	4.10
10-year government bonds	4.69	2.57	1.76	4.01	4.40	4.80	4.50
Euro							
ECB depo	2.05	0.20	–0.30	4.00	3.09	1.75	2.00
ECB refi	3.05	0.75	0.20	4.50	3.24	1.90	2.15
€STR	–	–0.54	–0.38	3.90	3.06	1.70	2.06
1-month Euribor	3.18	0.50	–0.32	3.86	2.89	1.74	2.10
3-month Euribor	3.24	0.65	–0.21	3.94	2.83	1.76	2.11
6-month Euribor	3.29	0.78	–0.07	3.93	2.63	1.91	2.14
12-month Euribor	3.40	0.96	0.10	3.68	2.44	2.09	2.18
Germany							
2-year government bonds	3.41	0.35	–0.21	2.55	2.02	1.87	1.96
10-year government bonds	4.30	1.54	0.14	2.11	2.22	2.00	2.15
Spain							
3-year government bonds	3.62	1.69	0.18	2.77	2.26	2.41	2.58
5-year government bonds	3.91	2.19	0.38	2.75	2.48	2.52	2.72
10-year government bonds	4.42	3.17	0.99	3.09	2.90	2.70	2.95
Risk premium	11	164	85	98	68	70	80
Portugal							
3-year government bonds	3.68	3.33	0.07	2.33	2.03	1.95	2.10
5-year government bonds	3.96	3.94	0.35	2.42	2.15	2.16	2.36
10-year government bonds	4.49	4.67	0.96	2.74	2.68	2.55	2.85
Risk premium	19	314	82	63	46	55	70
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.13	1.09	1.05	1.02	1.08
EUR/GBP (pounds per euro)	0.66	0.84	0.87	0.86	0.83	0.81	0.80
EUR/GBP (yen per euro)	129.56	126.41	129.91	156.99	161.18	158.00	154.00
OIL PRICE							
Brent ($/barrel)	42.3	80.1	71.0	77.3	73.1	73.5	69.2
Brent (euros/barrel)	36.4	62.5	63.9	70.9	69.8	72.1	64.0

Forecasts

Change in the average for the year versus the prior year average (%), unless otherwise indicated

International economy

	Average 2000-2007	Average 2008-2019	Average 2020-2022	2023	2024	2025	2026
GDP GROWTH							
Global	4.3	3.3	2.5	3.3	3.2	3.1	3.1
Developed countries	*2.7*	*1.5*	*1.6*	*1.7*	*1.8*	*1.6*	*1.7*
United States	2.7	1.8	2.1	2.9	2.8	2.1	1.9
Euro area	2.3	0.8	1.2	0.5	0.8	0.9	1.3
Germany	1.6	1.3	0.2	–0.1	–0.2	0.0	0.9
France	2.3	1.0	0.6	1.1	1.1	0.5	1.1
Italy	1.5	–0.3	1.6	0.8	0.5	0.5	1.3
Portugal	1.5	0.4	1.5	2.6	1.9	2.4	2.1
Spain	3.6	0.7	0.6	2.7	3.2	2.5	2.1
Japan	1.4	0.4	–0.2	1.5	0.1	1.0	1.0
United Kingdom	2.8	1.2	1.0	0.4	1.1	1.0	1.3
Emerging and developing countries	*6.3*	*4.8*	*3.1*	*4.4*	*4.2*	*4.1*	*4.1*
China	10.6	8.0	4.7	5.4	5.0	4.2	3.9
India	7.2	6.7	3.6	7.7	6.5	6.8	6.6
Brazil	3.6	1.6	1.5	3.2	3.4	2.0	1.8
Mexico	2.3	1.5	0.5	3.3	1.5	1.0	1.4
Russia	–	1.4	0.7	3.6	4.1	1.7	1.3
Türkiye	5.5	4.5	6.3	5.1	3.2	2.1	2.9
Poland	4.2	3.7	3.6	0.1	2.8	3.6	3.3
INFLATION							
Global	4.1	3.7	5.5	6.7	5.8	4.6	3.9
Developed countries	*2.1*	*1.6*	*3.7*	*4.6*	*2.6*	*2.6*	*2.3*
United States	2.8	1.8	4.6	4.1	3.0	3.1	2.7
Euro area	2.2	1.4	3.7	5.4	2.4	2.4	1.9
Germany	1.7	1.4	4.1	6.0	2.5	2.6	2.0
France	1.9	1.3	2.8	5.7	2.3	2.0	1.9
Italy	2.4	1.4	3.5	5.9	1.1	1.9	1.8
Portugal	3.1	1.1	3.0	4.3	2.4	2.2	2.0
Spain	3.2	1.3	3.7	3.5	2.8	2.5	2.2
Japan	–0.3	0.4	0.7	3.3	2.7	1.5	1.5
United Kingdom	1.6	2.3	4.2	7.3	2.5	2.6	2.1
Emerging and developing countries	*6.9*	*5.6*	*6.9*	*8.1*	*7.8*	*5.7*	*4.7*
China	1.7	2.6	1.8	0.2	0.2	0.8	1.3
India	4.6	7.3	6.1	5.7	5.0	4.6	4.4
Brazil	7.3	5.7	6.9	4.6	4.4	4.9	4.2
Mexico	5.2	4.2	5.7	5.5	4.7	4.4	3.7
Russia	14.2	7.9	8.0	5.9	8.5	8.4	6.0
Türkiye	22.6	9.6	34.7	53.9	58.5	36.1	26.1
Poland	3.5	1.9	7.4	10.8	3.7	4.6	3.4

Forecasts

Change in the average for the year versus the prior year average (%), unless otherwise indicated

Portuguese economy

	Average 2000-2007	Average 2008-2019	Average 2020-2022	2023	2024	2025	2026
Macroeconomic aggregates							
Household consumption	1.8	0.5	1.2	1.9	3.2	2.3	1.8
Government consumption	2.2	–0.3	2.0	0.6	1.1	0.9	0.8
Gross fixed capital formation	–0.4	–0.7	2.9	3.6	3.0	5.5	5.2
Capital goods	3.3	2.7	5.5	5.6	5.8	–	–
Construction	–1.4	–2.4	2.6	1.2	2.4	–	–
Domestic demand (vs. GDP Δ)	1.3	0.0	1.9	1.7	2.5	2.7	2.3
Exports of goods and services	5.3	4.0	3.6	3.8	3.4	3.4	3.7
Imports of goods and services	3.6	2.7	4.0	1.8	5.0	4.0	4.1
Gross domestic product	**1.5**	**0.4**	**1.5**	**2.6**	**1.9**	**2.4**	**2.1**
Other variables							
Employment	0.4	–0.4	1.1	2.3	1.2	1.0	1.5
Unemployment rate (% of labour force)	6.1	11.4	6.6	6.5	6.4	6.4	6.4
Consumer price index	3.1	1.1	3.0	4.3	2.4	2.2	2.0
Current account balance (% GDP)	–9.2	–2.8	–1.1	0.6	2.2	–	–
External funding capacity/needs (% GDP)	–7.7	–1.5	0.1	2.0	3.3	4.2	3.9
Fiscal balance (% GDP)	–4.5	–5.1	–3.0	1.2	0.7	0.3	0.2

Forecasts

Spanish economy

	Average 2000-2007	Average 2008-2019	Average 2020-2022	2023	2024	2025	2026
Macroeconomic aggregates							
Household consumption	3.7	0.0	0.0	1.7	2.8	3.1	2.4
Government consumption	4.5	0.9	2.6	5.2	4.1	1.9	0.8
Gross fixed capital formation	5.7	–1.2	–1.0	2.1	3.0	3.1	3.0
Capital goods	4.9	0.2	–2.5	1.1	2.3	3.8	1.5
Construction	5.7	–2.6	–1.9	3.0	3.5	3.0	3.8
Domestic demand (vs. GDP Δ)	4.4	–0.2	0.7	1.7	2.8	2.7	2.1
Exports of goods and services	4.7	2.9	2.5	2.8	3.1	2.1	2.3
Imports of goods and services	7.0	0.2	2.5	0.3	2.4	2.9	2.5
Gross domestic product	**3.6**	**0.7**	**0.6**	**2.7**	**3.2**	**2.5**	**2.1**
Other variables							
Employment	3.2	–0.5	1.4	3.2	2.4	2.0	1.8
Unemployment rate (% of labour force)	10.5	19.5	14.5	12.2	11.3	10.7	10.2
Consumer price index	3.2	1.3	3.7	3.5	2.8	2.5	2.2
Unit labour costs	3.1	0.6	3.6	6.1	4.0	3.3	2.7
Current account balance (% GDP)	–5.8	–0.2	0.6	2.7	3.0	2.9	3.1
External funding capacity/needs (% GDP)	–5.2	0.2	1.4	3.7	4.2	3.9	4.1
Fiscal balance (% GDP)[1]	0.3	–6.5	–7.1	–3.5	–3.2	–2.8	–2.6

Note: *1. Excludes losses for assistance provided to financial institutions.*

Forecasts

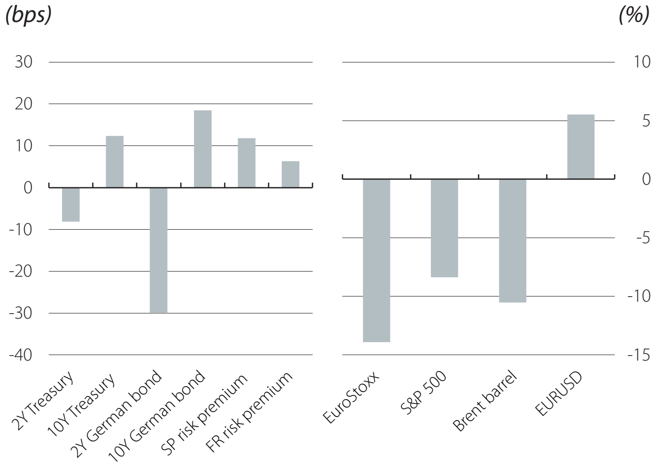
Trump’s tariffs send markets plummeting

Trump’s tariffs dent investor risk appetite. The tariffs, coupled with the government spending reforms in Germany, dominated investors’ attention amid growing concerns that the US could enter stagflation in the next two years. As a result, the slopes of sovereign yield curves steepened on both sides of the Atlantic in view of the likelihood of seeing short-term rate cuts and the prospect of higher public spending in the long term. Central banks adopted a cautious stance in this environment, although the implied money market rates reflect a more dovish monetary policy for 2025. The dollar weakened against major developed-market currencies, prolonging a trend which, against the euro, had already begun with the announcement of higher future public spending in Germany. The risk aversion caused sharp declines in the stock markets, especially in developed economies, while energy commodities and industrial metals also came under pressure due to demand concerns. This contrasted with the performance of gold, which capitalised on its role as a safe-haven asset.

Central banks navigate turbulent waters. Central banks recognised their growing dependence on the data and their limited ability to guide the market on future steps in this environment of exceptional uncertainty in economic and trade policy. After cutting rates by 25 bps in March (placing the depo rate at 2.5%), the ECB stated that rates were no longer clearly restrictive, given the 150-bp reduction accumulated since June 2024, and that at its future meetings it would act according to the data. Thus, after the implied money market rates anticipated a terminal depo rate of 2% following the announcement of higher spending in Germany, Trump's tariffs pushed ECB rate expectations back to the levels of earlier in the month, with an anticipated terminal rate of 1.75%. The Fed, meanwhile, kept rates stable (4.25%-4.50%), while investors went on to anticipate four rate cuts as the most likely scenario for 2025 following Trump’s tariff announcement, although after the pause announced on 9 April they finally settled on three cuts. The Fed revised its growth outlook downwards and its inflation outlook upwards, citing tariffs as a key factor, although noting that they are still assessing whether the impact on prices will be permanent.

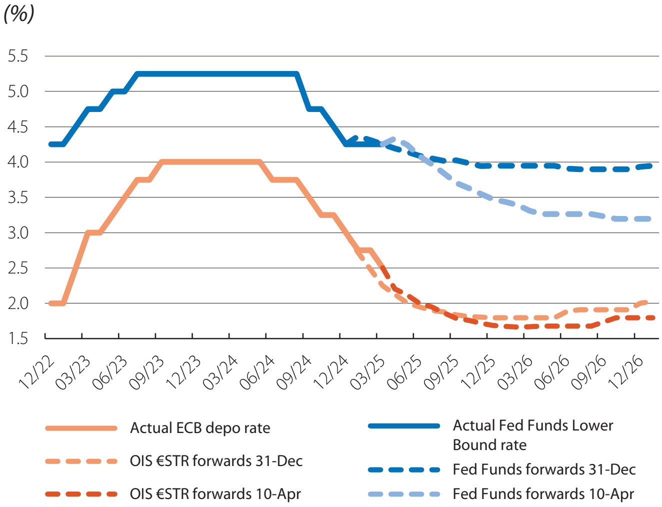
Widespread steepening of sovereign yield curves on both sides of the Atlantic. The doubts surrounding US growth due to Trump’s tariffs, a potential deterioration in the US fiscal outlook and some movements related to the closure of speculative positions, triggered declines in short-term sovereign debt yields and rebounds in the longer segments of the curve. As for inflation expectations, they picked up in the shorter segments and declined in the longer term. All of this resulted in lower short-term real rates, highilighting investors’ concerns about an economic slowdown with inflation slightly above the Fed’s target. The European yield curve also saw a steepening of its slope: yields on the 2-year benchmarks fell sharply, while the longer segments registered increases on expectations of higher government spending in Germany, which later

Monthly performance of the main financial assets



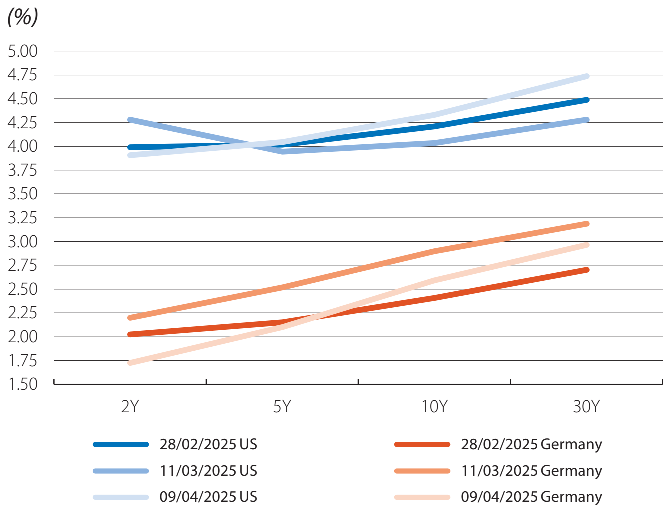
Note: *Data from 28 February to 9 April.*
Source: *BPI Research, based on data from Bloomberg.*

Market expectations regarding policy rates



Source: *BPI Research, based on data from Bloomberg*

Changes in US and German sovereign yield curves



Source: *BPI Research, based on data from Bloomberg.*

moderated as the EU delayed a coordinated fiscal agreement. Spreads in the periphery countries, which had remained stable following the announcement of higher public spending in Germany, which later moderated as the EU delayed a coordinated fiscal agreement.

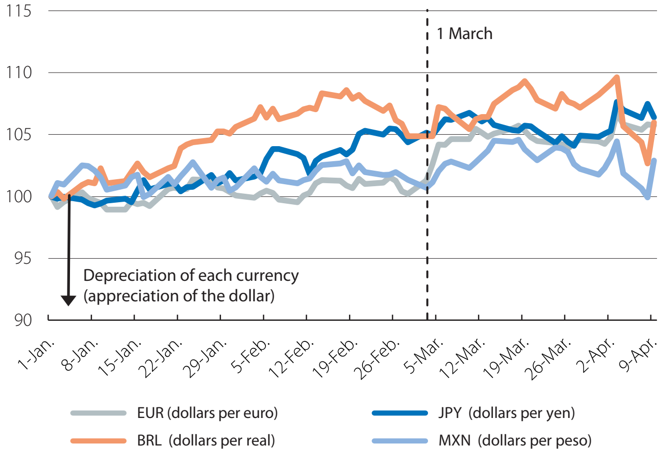
The tariffs also weigh on the dollar. The dollar dropped more than 4% against major peers, largely due to the aforementioned decline in short-term real rates and as investors continue to search for the new equilibrium for US assets. Although the depreciation was widespread against the major currencies, the strengthening of the euro was one of the biggest contributors (more than 5%) in a move that began with the announcement of a defence and infrastructure spending package in Germany. The Swiss franc acted as a safe-haven asset and appreciated around 5%, while appreciations were also recorded by the Mexican peso (+1.5%) and the Canadian dollar (+2.6%) in a context of high volatility. Among emerging currencies, the Brazilian real appreciated slightly due to high rates and low exposure to the US market, while the Turkish lira depreciated in a context of greater political instability.

High volatility in the stock markets, especially in developed economies. Risk assets were the most affected, in a context marked by high uncertainty and fears of a slowdown in global growth, although they rebounded rapidly following the announcement of a pause in the reciprocal tariffs. In this up-and-down environment, the MSCI All Country World Index recorded one of the biggest setbacks in the month, sliding 9%. US indices followed suit, with small caps and domestically-focused firms hit hardest, as well as tech firms due to them being among the country's top exporters. Finally, the main indices were down around 8%. The European indices also recorded losses, with the Stoxx 600 falling more than 15%, while the Iberian indices showed the best relative performance despite the IBEX 35 also closing the month with significant losses of around 11%. Emerging markets initially resisted the downturn, although it ended up affecting them all the same, with the MSCI Emerging Markets Index closing with losses of just under 10%. The main exception was the Latin American stock markets, thanks to the better relative performance of the Brazilian stock market and, to a lesser extent, Mexico's.

Fall in the commodities most dependent on the business cycle. Oil prices dropped over 10% in the month after Trump's tariff announcement, amid doubts surrounding aggregate demand and the resilience of the cycle. Natural gas prices also plunged, with Dutch TTF futures falling over 20%, weighed down by expectations of greater supply in Europe given that Trump's tariffs could have a bigger impact on Asian economies. Similarly, industrial metals showed some weakness in the month amid the prospect of dampened global demand, with aluminium and copper prices losing over 8%. On the other hand, gold benefited from uncertainty and its safe-haven appeal, ending the month up around 8%. Finally, livestock prices also picked up (+5%), as the tariffs are expected to increase the price of meat in the US.

Selected currencies against the dollar

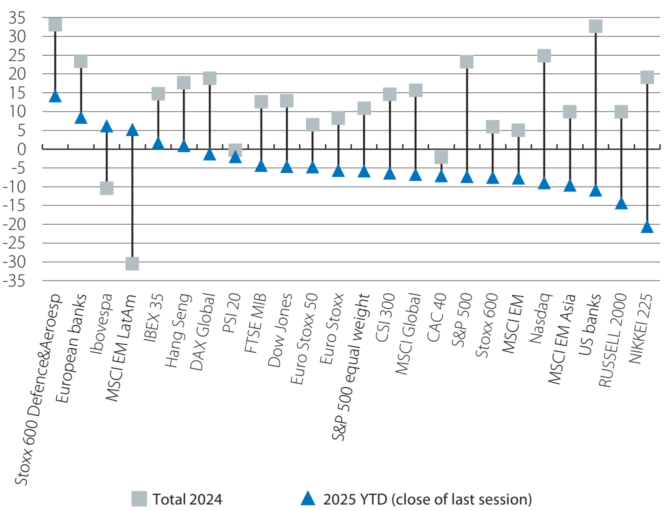
Index (100 = 31/12/2024)



Source: *BPI Research, based on data from Bloomberg.*

Performance of stock market indices

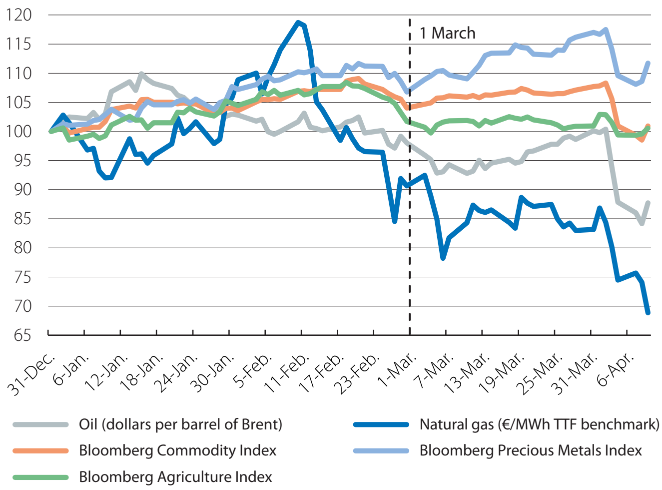
(%)



Source: *BPI Research, based on data from Bloomberg.*

Commodity prices

Index (100 = 31/12/2024)



Source: *BPI Research, based on data from Bloomberg.*

Germany's fiscal shift and the *bund*: when security comes at a price

Germany has shifted gears in its public spending policy. At the beginning of March, the leaders of the CDU/CSU, the SPD and the Greens presented a proposed agreement to reform the constitutional debt ceiling and significantly boost military and infrastructure spending, and on 21 March the agreement was ratified by the legislative chambers. The total spending approved for the next decade will finally amount to over one trillion euros.[1] In this article, we analyse the impact of this new policy on German sovereign debt and, in particular, on the yield of its 10-year benchmark (known as the *bund*, being the federal bond, which is considered the euro area's main risk-free asset) as well as its future outlook.

A big change to the surprise of expectant investors

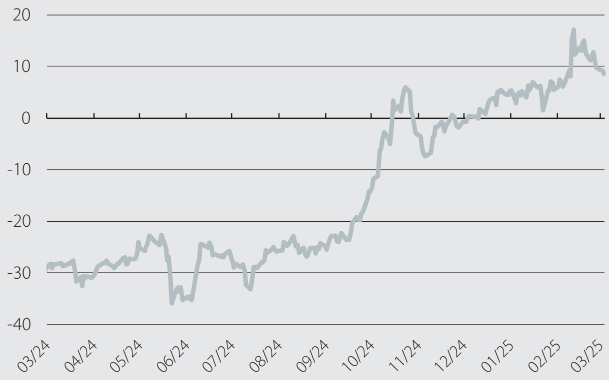
The market reaction to these announcements was significant and, in the week in which the pre-agreement was reached, the yield on the *bund* rose 50 bps. Let us begin by analysing this movement relative to that of other financial assets. The first thing to note is that the yield on German debt had already priced in a likely future increase in public spending. The spread of the *bund* relative to an interest rate highly dependent on the ECB's intervention rate (which can be interpreted as a German risk premium) had already widened significantly since the end of last summer, when doubts began to arise about the stability of the previous German government and the country's economic expectations deteriorated (43 bps between 10 September and 5 March, see first chart).[2]

This expansion is also apparent in some valuation models for the *bund*. For example, in a model which takes into account medium-term expectations for euro area interest rates and general conditions for risk, liquidity and the supply of public debt, we see a clear upward trend since the summer in the yield on German debt, distancing it from what would be expected based on its historical relationship with these variables (see second chart). Between the end of last year and the week prior to the announcement, the spread of the *bund* relative to the theoretical value indicated by this model stood at around 30 bps (or a standard deviation), probably because investors were already anticipating higher public spending in Germany.

1. On the one hand, there is a specific fund of 500 billion euros for infrastructure, to be implemented over the next 12 years, which will mean around 42 billion euros per year on average (1% of 2024 GDP). In addition, 100 billion euros will be allocated to environmental and energy transformation policies, and the federal states will be allowed to invest more, which could amount to another 15 billion euros per year (0.35% of GDP). On the other hand, defence spending exceeding 1% of GDP will be exempted from the constitutional debt limit.
2. Risk premium measured as the spread between the yield on the *bund* and that of the 6-month Euribor swap rate.

Spread between the* bund *and the 10-year swap rate on the 6-month Euribor

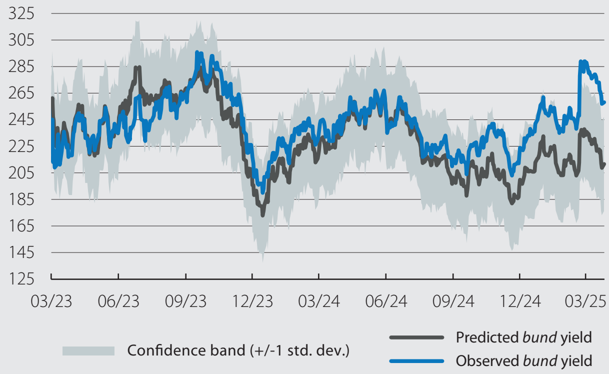
(b. p.)



Source: *BPI Research, based on data from Bloomberg.*

Expected yield on the* bund *according to investor expectations for euro area interest rates

(b. p.)



Note: *The model includes the forward swap of the ESTR 1Yx3Y, a risk premium of the euro area periphery countries (average of the spread between their 10-year sovereign debt and Germany's, weighted by their GDP) and the size of the ECB's balance sheet as a percentage of euro area GDP.*
Source: *BPI Research, based on data from Bloomberg.*

The financial outlook: a *bund* that reflects a shift in the fiscal paradigm

In the week in which the agreement was finalised, the price of the *bund* rebounded, as mentioned, by 50 bps, while its theoretical value according to this model was up 30 bps. We can thus interpret that 30 bps of the upturn in the *bund* was due to the change in monetary policy expectations, while the other 20 bps (which correspond to the widening of the spread between the theoretical and observed values) correspond to the fact that the fiscal boost was greater than that already priced in by the market. Following the announcement, the *bund* seems to have stood those 50 bps above its theoretical value, and this gap has persisted with the market movements triggered by Trump's tariffs.

This difference between the actual yield on the *bund* and that suggested by other market variables allows us to reflect on two possible future scenarios. In the first, based on the assumption that the historical relationship with other instruments has not changed, one of the two assessments – either the observed one or the predicted one – would converge with the other. In other words, either the German spending programme will manage to revive the country's economy and exert a pull effect on the rest of the euro area, in which case we should see an increase in interest rate expectations, or alternatively the programme is unsuccessful and we would see a drop in the yield on the *bund* from its current levels.

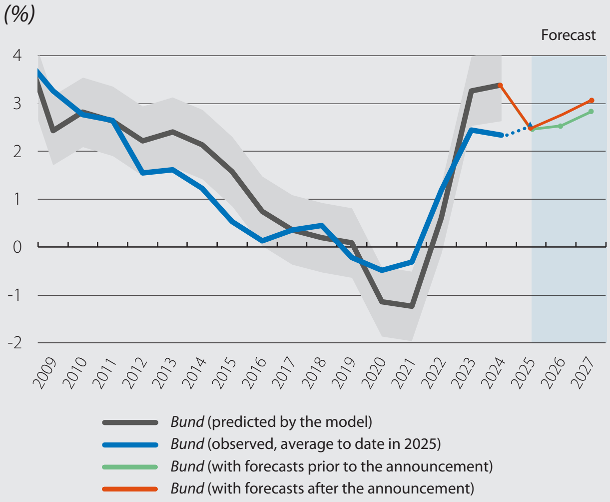
In the second scenario, the historical relationship would have been altered and with the change in gear in its public spending policy the spread between the yield on the *bund* and that of other low-risk assets would now be structurally greater. This scenario seems likely, primarily because on the supply side the change in public spending policy does not appear to be cyclical. On the demand side, and even if this were already the case prior to the German spending announcement, the increased volume of German debt issues is coming at a time when the ECB is no longer making reinvestments under its asset purchase programmes, so from now on the demand it previously provided will have to be substituted by other market players. That said, the increase in public debt is expected across the euro area, and possibly in all developed markets. This could therefore result in Germany maintaining its status – relatively speaking, of course – as an economy with limited debt, which will nevertheless pay slightly more to place that debt in the market.

The macroeconomic perspective: a moderate impact of the stimulus appears to be already priced in

Another way to analyse both the movement of the *bund* and its likely future performance would be to look at the impact of macroeconomic variables on the price of the debt. From this perspective, what the historical relationships reveal is that, as we would expect, policy rates (i.e. the rates set by the ECB) are the main determining factors for the yield on the *bund*. Inflation also has a significant impact on the yield, although it is somewhat variable, since it depends on how concerned investors are about prices at any given time.

As for GDP growth in Germany, it does not seem to have any influence beyond that detected through the impact which growth has on ECB interest rates. Moreover, economic growth acts through other channels, such as determining the debt/GDP ratio. More indirectly, how effective the spending is in stimulating the German economy and its long-term growth will influence where long-term interest rates lie.

Bund *predicted by the macroeconomic fundamentals*
(%)



Note: *The model includes Germany's inflation and debt-to-GDP ratio, the ECB's depo rate and the evolution of its balance sheet.*
Source: *BPI Research, based on data from Bloomberg.*

The level of public debt, on the other hand, does have a more stable and constant impact on the yield on the *bund* over time. However, as already mentioned, just as important as Germany's debt-to-GDP ratio is that of the rest of the euro area. Any widespread increase in this ratio across the euro area, as occurred during the COVID-19 pandemic, does not create additional pressure exclusively on the *bund*, as it allows Germany to continue to have a low level of debt relative to other countries.

While the definition and implementation of the fiscal stimulus is being finalised, both in Germany and in the rest of the euro area, we estimate that a gradual increase in the debt-to-GDP ratio, consistent with the expectations of a gradual implementation of the stimulus, would cause the yield on the bund to be around 30 bps higher compared to a situation without any stimulus (see third chart). This level reflects both slightly higher inflationary pressures in Germany and the country's growing funding needs,[3] in a context in which the impact of the ECB's balance sheet reduction programme (quantitative tightening) on the price of public debt is still limited, given that liquidity remains high and there is an appetite for this class of asset among investors.

3. In a scenario with a gradual implementation of the stimulus, the country's additional funding needs would represent approximately 0.3 pps of GDP in 2025, 0.8 pps in 2026 and around 0.9 pps in 2027. We estimate a moderate impact on GDP and a very mild impact on inflation. The debt-to-GDP ratio would only increase by 3 pps by 2027 relative to its 2024 levels. The depo rate would behave as currently predicted by money market implied rates.

Interest rates (%)

	31-March	28-February	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	2.65	2.90	–25	–50.0	–185.0
3-month Euribor	2.34	2.46	–13	–37.8	–155.5
1-year Euribor	2.31	2.39	–9	–15.4	–135.7
1-year government bonds (Germany)	2.01	2.02	0	–22.9	–136.7
2-year government bonds (Germany)	2.05	2.03	2	–3.5	–81.6
10-year government bonds (Germany)	2.74	2.41	33	37.1	37.7
10-year government bonds (Spain)	3.37	3.05	33	31.1	18.2
10-year government bonds (Portugal)	3.26	2.94	32	41.2	22.4
US					
Fed funds (lower limit)	4.25	4.25	0	0.0	–100.0
3-month SOFR	4.29	4.32	–3	–1.7	–101.4
1-year government bonds	4.02	4.08	–6	–12.3	–97.5
2-year government bonds	3.88	3.99	–11	–35.8	–76.4
10-year government bonds	4.21	4.21	0	–36.4	–10.4

Spreads corporate bonds (bps)

	31-March	28-February	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	64	54	10	6.3	10.5
Itraxx Financials Senior	69	57	12	5.4	6.9
Itraxx Subordinated Financials	120	100	21	8.2	8.8

Exchange rates

	31-March	28-February	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.082	1.038	4.3	4.5	–0.2
EUR/JPY (yen per euro)	162.21	156.27	3.8	–0.4	–1.1
EUR/GBP (pounds per euro)	0.837	0.825	1.5	1.2	–2.3
USD/JPY (yen per dollar)	149.96	150.63	–0.4	–4.6	–0.9

Commodities

	31-March	28-February	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	547.1	539.2	1.5	2.0	0.9
Brent ($/barrel)	74.7	73.2	2.1	0.1	–17.6
Gold ($/ounce)	3,123.6	2,857.8	9.3	19.0	36.3

Equity

	31-March	28-February	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	5,611.9	5,954.5	–5.8	–4.6	9.0
Eurostoxx 50 (euro area)	5,248.4	5,463.5	–3.9	7.2	3.5
Ibex 35 (Spain)	13,135.4	13,347.3	–1.6	13.3	18.4
PSI 20 (Portugal)	6,865.6	6,800.1	1.0	7.7	8.8
Nikkei 225 (Japan)	35,617.6	37,155.5	–4.1	–10.7	–10.4
MSCI Emerging	1,101.4	1,097.3	0.4	2.4	5.0

Political decisions will shape the international economy

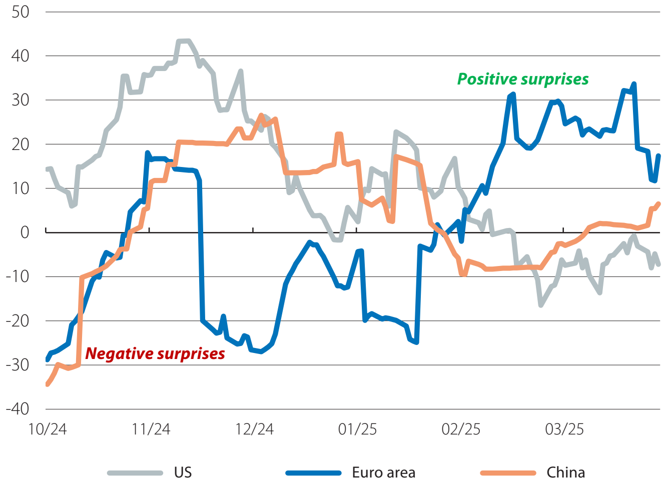
In the last month, we have witnessed a surge in uncertainty (see the Financial Markets - Economic Outlook section). Unlike what we have experienced in the last three years, we are now beginning to look with caution at the impact the Trump administration's policies could have on volatility. The latest – and most disruptive – such episode was the tariffs announced on so-called «Liberation Day» which, if applied, would end up raising the average tariff on US imports from 3% to around 25%, their highest level in over a century. For the moment, since 5 April a universal tariff of 10% has been in force and Trump has left the additional increases on hold for 90 days, with the exception of China, with which he has entered into an intense protectionist escalation. We are thus entering a new phase, with negotiations that could lead to tariffs lower than those initially announced or, in a worst-case scenario, retaliation that would increase the risks of a trade war. For now, the surge in uncertainty and the tariff hikes introduce downside risks to global growth, as well as upside risks to US inflation, while the impact on prices for the rest of the world is much more uncertain.

Germany reaches an historic pact to reform the «debt brake» and approve a large fiscal package. The three majority parties of the outgoing parliament (CDU/CSU, SPD and the Greens), which held well over two thirds of the seats, reached an agreement to amend the constitution and loosen restrictions around the well-known debt brake. This rule, introduced in 2009, established that the structural budget deficit should not exceed 0.35% of GDP and has only been put on hold once, during the COVID pandemic. With this agreement, an Infrastructure Investment Fund amounting to 500 billion euros (12% of 2024 GDP) has been approved for the next 12 years, it has been decided to raise defence spending to 3.5% of GDP (2.1% currently) and, at the same time, defence spending exceeding 1% of GDP will not count towards the debt brake limit. In addition, the European Commission has announced its ReArm Europe plan, with which it plans to bolster the continent's military capabilities and which has been allocated a budget of some 800 billion euros (4.5% of 2024 GDP) over the next four years. To this end, private investment in the defence industry will be encouraged, Member States will be given more leeway to increase their defence spending through the temporary easing of EU fiscal limits and the Security Action for Europe (SAFE) instrument will be created. SAFE is intended to provide loans to Member States and will be allocated 150 billion euros, much of which could come from loans already approved under the NGEU funds that have not been requested by countries.

Highly uncertain outlook for the euro area economy. The sheer volume of the measures announced will support growth, particularly in 2026 and 2027. However, caution must be exercised, not only because the increase in trade protectionism would limit the magnitude of the fiscal boost announced, but also because certain details are yet to be clarified, including how the increase in defence spending in the EU will be carried out, the timetable for implementing Germany's Infrastructure Investment Fund, as well as what the fiscal multiplier of these measures is expected to be. The experience with NGEU funds (see the Dossier «The transformative capacity of NGEU and other fiscal stimulus plans» in the MR03/2025) shows the difficulties involved in implementing such vast investment projects. For the moment, the business opinion indicators improved amid expectations of this fiscal stimulus, but they have not

Economic surprise index

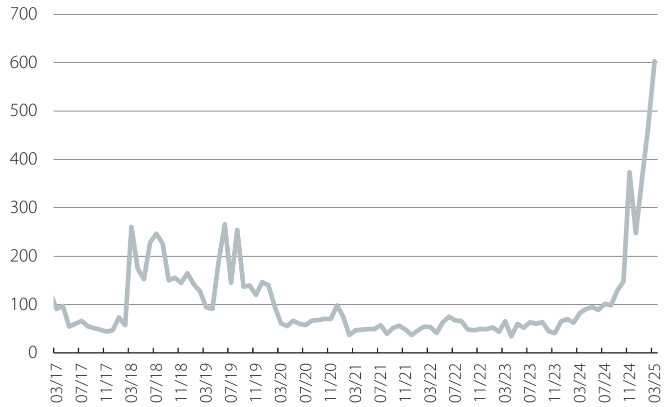
Deviation from expectations



Source: BPI Research, based on data from Citigroup.

Trade policy uncertainty index

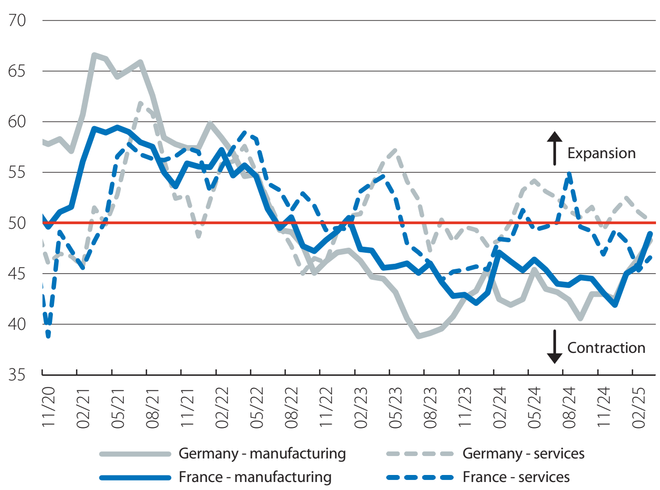
Frequency of joint occurrences of trade policy and uncertainty terms in the press



Source: BPI Research, based on data from D. Caldara, M. Iacoviello, P. Molligo, A. Prestipino and A. Raffo (2020). Updated at https://www.matteoiacoviello.com/tpu.htm#overview.

Euro area: PMI by component

Index



Source: BPI Research, based on data from S&P Global.

yet captured the possible impact of the latest tariffs announced by Trump. In fact, in March, Germany's ZEW Indicator of Economic Sentiment recorded its biggest increase in almost two years, and the Ifo business confidence indicator reached its highest levels since the summer of 2024 (+1.4 points, to 86.7); meanwhile, the composite PMI for the euro area rose to 50.4, marking the third consecutive month above the 50-point threshold that indicates positive growth, thanks to the manufacturing sector.

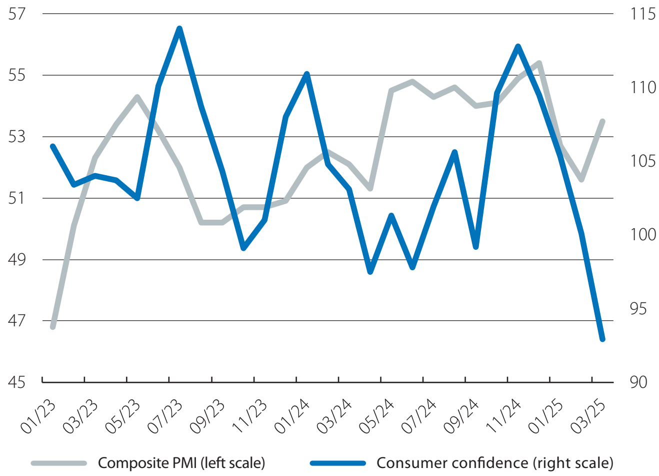
In the US, the risks of a sharper economic slowdown increase. The continuous tightening and loosening of tariffs and the cuts in government spending have fuelled fears – especially after «Liberation Day» – that the economy could experience a sharper than expected slowdown. Consumer confidence has been the first indicator to reflect this increase in uncertainty, as households fear a deterioration in the labour market and a rebound in inflation due to the trade protectionist policies. Thus, the index produced by the Conference Board has been declining all year and, in March, stood at its lowest level since January 2021. However, the business climate and opinion indicators, which hint at a slight moderation in activity in Q1 2025, still remain at levels compatible with positive but modest growth. In fact, in March, the composite PMI increased significantly (+1.9 points, to 53.5) and the services ISM indicator managed to stay above the 50-point threshold (50.8 vs. 53.5), while the ISM indicator for manufacturing was at levels that suggest a practical stagnation (49.0 vs. 50.3).

The labour market remains highly buoyant in Q1. In March, 228,000 non-agricultural jobs were created, the unemployment rate increased just 0.1 pp to 4.2%, and redundancies were at a low of 1.0% of total employment. These figures reveals that the impact of the measures adopted by DOGE, which have resulted in a cumulative loss of around 14,000 federal jobs between February and March, is quite small, for now. This is because the public sector accounts for only 15% of all non-agricultural employment, and this figure falls to a mere 1.8% in the case of federal employment.

Upside risks for US inflation and no clear bias in the euro area. In February, both headline and core US inflation fell for the first time in five months and were down 0.2 pps, to 2.8% and 3.1%, respectively. Despite the encouraging data, the risks to inflation remain concentrated to the upside due to the current context of deteriorating trade tensions. In fact, in its March macroeconomic outlook, the Fed revised inflation upwards precisely because of the impact of the tariffs and the heightened uncertainty. Thus, the Fed has pushed back the date when inflation is expected to return to its 2.0% target to 2027. Meanwhile, in the euro area, inflation resumed its path of moderation: in March, headline inflation declined 0.1 pp to 2.2%, while the core index fell 0.2 pps to 2.4%, thanks to the continued decline of inflation in services (3.4% vs. 3.7%), and it is now at its lowest level since June 2022. In addition, the ECB revised its 2025 inflation estimate modestly upwards, but kept its forecast for the next two years unchanged.

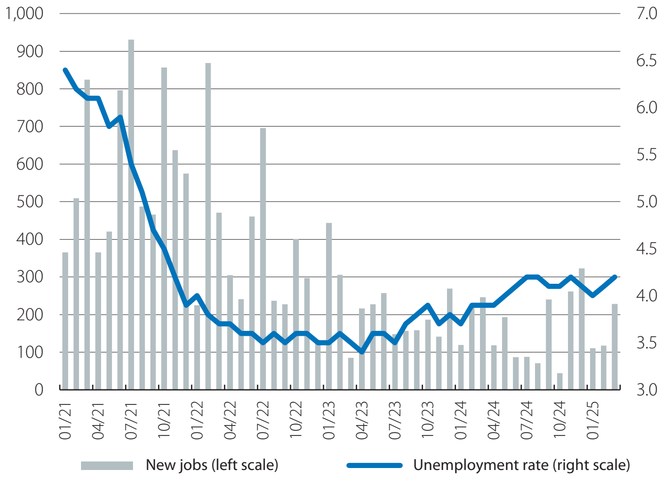
China will need to continue to implement stimulus measures to meet its growth targets. At its annual meeting of the Two Sessions, the Chinese government once again set a growth target of around 5% and, in order to achieve this, will pursue a «moderately expansive» fiscal policy, still heavily focused on supply-side measures. However, the bilateral protectionist escalation with the US has raised concerns about the Chinese economy (exports to the US account for around 3% of its GDP).

US: confidence indicators
(Index = 50) *(Index = 100)*



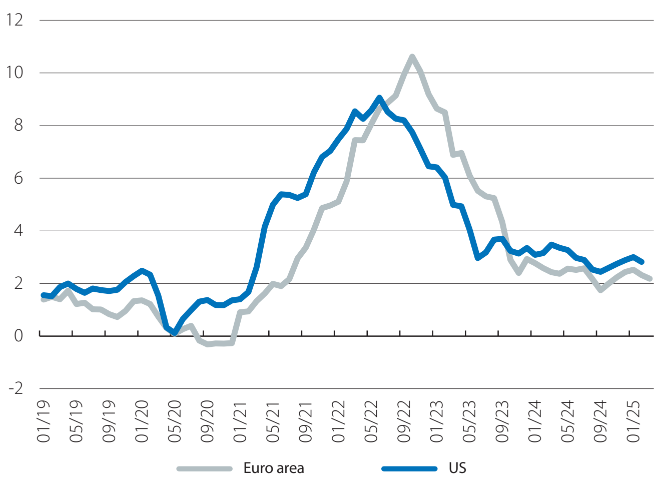
Source: *BPI Research, based on data from the Conference Board and S&P Global.*

US: labour market
(Thousands of people) *(%)*



Source: *BPI Research, based on data from the Bureau of Labor Statistics.*

Headline inflation
Year-on-year change (%)



Source: *BPI Research, based on data from Eurostat and the Bureau of Labor Statistics.*

A shift in the EU's political priorities

The new European Commission has completed its first 100 days amid turmoil in transatlantic relations. The implementation of Trump's agenda (and the accompanying drama) is accelerating the change in political priorities that was already foreseen for von der Leyen's second term. The urgent need to build a more competitive EU now seems indivisible from the goal of maintaining the security and integrity of its borders. The next 2028-2034 budget cycle should reflect the bloc's ambition in relation to these medium-term challenges, but between now and when that budget will be defined, there are tough negotiations to be had on how to finance it and critical questions to be answered on matters such as the future of Ukraine and climate commitments.

A plan to find direction in global competitiveness

On 29 January, the European Commission presented the Competitiveness Compass.[1] This is a roadmap for 2025-2026 that translates the recommendations of the Letta and Draghi reports[2] into policy actions focusing on the three key objectives of the latter report: to close the innovation gap vis-à-vis global competitors, to pursue competitive decarbonisation and to reduce strategic dependencies. In addition to the specific actions proposed for each of these objectives, the roadmap includes five general priorities, which include simplifying business regulation, making further progress in the integration of the Single Market, boosting financing with new savings and investment products, ensuring the provision of appropriate skills in the labour market and improving the coordination of European instruments with a boost to common projects.

The European Commission has already put forward several proposals for political action in relevant areas, and these must now be endorsed by the Council and the European Parliament. The proposals include two packages of measures aimed at simplifying regulation in the sphere of sustainability, with a view to easing the administrative burden on companies by at least 25% (35% in the case of SMEs). Another of the proposals is a new clean industry pact, which includes the deployment of 100 billion euros for the production of clean technologies in the EU and an action plan to cut energy costs for consumers and businesses, which could entail savings of 45 billion in 2025 (and up to 260 billion in 2040).

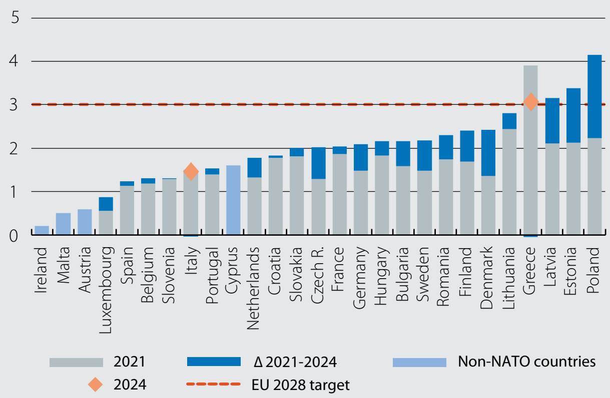
As for what is yet to come in 2025, there are high expectations for the revision of regulations covering state aid and the competition framework, as well as the strategy for reducing the fragmentation of the internal market. On this latter note, a proposal has already been put forward to establish a Savings and Investments Union (SIU),[3] the main objective of which is to facilitate the channelling of household savings into financing for strategic sectors.

Defence spending, more and faster than expected

In 2025, between the Competitiveness Compass and new geopolitical realities, the EU is hastening to reduce its strategic dependence on the US in defence matters.[4] The catalyst for this urgency has been the new Trump administration's unilateral approach to foreign policy, which has fractured the transatlantic axis with harsh rhetoric against Europe – far from the expected transactional approach – and has given Russia leeway beyond the Ukraine conflict.[5] The response has come in the form of an ambitious package of measures (ReArm Europe), which is expected to include the activation of the escape clause in the fiscal rules, enabling the release of some 650 billion for defence spending over the next four years, as well as a new EU instrument with 150 billion in loans to Member States to facilitate joint purchases and to bolster pan-European capabilities (Security Action for Europe, SAFE).

This package of measures would allow annual defence spending for the EU as a whole to increase by just over 1 point of GDP by 2028, bringing it above 3% and approaching the US' levels of the last decade. However, the starting point varies widely, so if a common objective is set then the fiscal effort would also vary widely between Member States (see first chart). For obvious

Defence spending in 2021 and increase up until 2024
(% and pps of GDP)



Note: *Latest available data for non-NATO EU countries (2023 for Austria and 2022 for Cyprus, Ireland and Malta); the 2024 figures are marked with diamonds for countries with a reduction in their defence spending since 2021 (Greece and Italy).*
Source: *BPI Research, based on data from NATO and Eurostat.*

1. See European Commission (2025). «A Competitiveness Compass for the EU», communication from the European Commission, COM(2025) 30 final.
2. See the Focus «Draghi proposes a European industrial policy as a driving force to address the challenges of the coming decades» in the MR10/2024.
3. European Commission (2025). «Savings and Investments Union: A Strategy to Foster Citizens' Wealth and Economic Competitiveness in the EU», communication from the European Commission, COM(2025) 124 final.
4. European Commission (2025). «Joint White Paper for European Defence Readiness 2030», JOIN(2025) 120 final.
5. See the Focus «Ukraine's reconstruction and its potential energy implications for Europe» in this same *Monthly Report.*

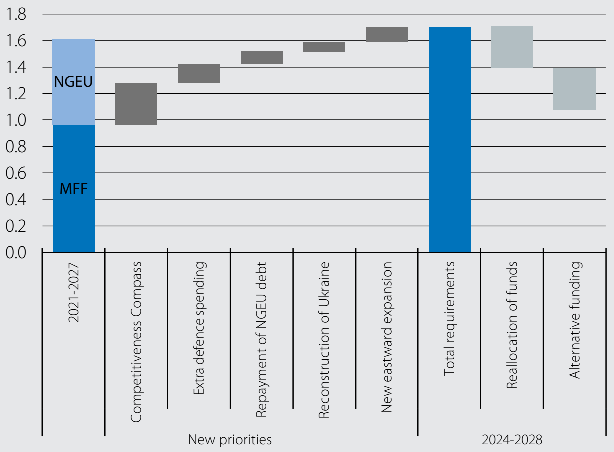
reasons, the countries bordering Russia and Ukraine have registered the sharpest increase in defence spending since 2021 and have shown the highest ratios in 2024, with Poland standing out at 4.2%. Among the bloc's large economies, Germany and France were around the average, followed some way behind by Italy (1.5%) and Spain (1.2%). In some cases, filling this gap will put additional stress on their limited fiscal space,[6] so it is likely that they will redirect unused EU funds, such as those from the NGEU programme.[7]

Prioritising with a budget that is up to the challenges ahead

The European Commission will present its proposal for the Multiannual Financial Framework (MFF) 2028-2034 in July this year. This new budget cycle begins in a very different context from the previous one, which was approved in 2020 at the height of the pandemic. The geopolitical environment seems more hostile, with an armed conflict on the EU's eastern border and a breakdown of the historical transatlantic alliance, including the geo-economic alliance, with risks of escalating protectionism and trade fragmentation. Addressing this scenario will require considerable resources in order to simultaneously fund the Competitiveness Compass, higher defence spending, the reconstruction of Ukraine[8] and a possible new phase of eastward expansion led by this country,[9] as well as the repayment of the pooled debt issued to finance the NGEU programme.[10] Taking all these factors into consideration, we estimate that the EU's annual budget could increase from 1% of GDP in 2021-2027 to total expenditure requirements of 1.7% in 2028-2034, a similar jump to that entailed by the NGEU funds (see second chart).[11] A portion of this increase could be channelled through a reorientation of resources from the previous cycle, including those not used from NGEU, as well as other alternative sources of funding: issues of pooled debt, new internal EU funds or even the use of Russian assets that were frozen following the invasion of Ukraine.[12]

Estimate of the EU annual budget for 2028-2034

(% of GDP)



Source: *BPI Research, based on the Draghi report (2024) and references cited in this article published in Bruegel (2024) and the European Parliament (2024, 2025).*

The road to the approval of a new MFF will not be free of obstacles. Internal political fragility has intensified after the latest electoral cycle, including the European Parliament elections in 2024. Also, the prospect of higher public spending could add tension to the sovereign debt markets,[13] and it remains to be seen what socio-political bill will be left by the new European Commission's apparent shift on environmental matters, with a climate agenda that is increasingly subordinated to the drive for competitiveness.

However, the Council's unanimity in endorsing the European defence plan proposal, together with the recent green shoots in Paris-Berlin relations, has given cause for some optimism to pursue an ambitious budget that is up to the challenges of the time. Unlike the urgency that guided the historic agreements for NGEU in 2020, we now have the advantage that a thorough prior reflection on the EU's priorities has been carried out through the Letta and Draghi reports, thus facilitating the selection of policy actions that can have a real impact and that are meaningful in the medium term for the 450 million Europeans.

6. See the Focus «The new EU economic governance framework» in the MR01/2025.
7. See the Dossier «The transformative capacity of NGEU and other fiscal stimulus plans» in the MR03/2025.
8. World Bank (2025). «Ukraine: Fourth Rapid Damage and Needs Assessment Fourth Rapid Damage and Needs Assessment».
9. See Z. Darvas and J. Mejino-López (2024). «What enlargement could imply for the European Union's budget», Bruegel.
10. See Z. Darvas and C. McCaffrey (2024). «Management of debt liabilities in the EU budget under the post-2027 MFF», European Parliament.
11. We assume the following hypotheses in the detailed calculation shown in the chart: (i) the public sector finances a quarter of the 800 billion per year identified in the Draghi report as investment needs, while another 25% is covered by the EU budget through the Competitiveness Compass funds; (ii) the extra defence expenditure corresponds to pooled funding of 25% of an increase of 1 point of GDP, not including the needs already identified in the Draghi report (20 billion per year); (iii) the repayment of the NGEU pooled debt is in the range of 20-25 billion per year; (iv) we consider that half of the cost of rebuilding Ukraine (500 billion over the next 10 years, according to the World Bank) will be borne by European institutions and that, based on what has been observed to date, 50% will be pooled; (v) according to different sources, the cost of a possible eastward expansion would be around 20 billion per year for the EU budget; (vi) reallocation of 25% of the funds for the period 2021-2027; and (vii) the alternative funding considers the rollover of the NGEU pooled debt, the use of around 100 billion of frozen Russian assets and new internal funds amounting to 35 billion annually.
12. K. Kowald and M. Pari (2025). «Future of EU long-term financing», European Parliament.
13. See the Focus «Germany's fiscal shift and the *bund*: when security comes at a price» in this same *Monthly Report*.

Ukraine's reconstruction and its potential energy implications for Europe

Since Donald Trump's arrival in the White House, attempts have been made to bring Russia and Ukraine to the negotiating table. On 25 March, a first step was taken with the signing of a partial ceasefire deal between Ukraine and Russia, with the aim of guaranteeing the safety of navigation and trade in the Black Sea. In addition, it included a commitment not to carry out attacks against energy infrastructure, highlighting the sector's importance for both domestic needs and fossil fuel export revenues in these two countries. Beyond the political and social considerations, a lasting peace agreement would have a positive impact on international energy flows and would favour an easing of prices, especially in the case of gas. The EU, aware of this advantage and of the need to restore the energy facilities damaged during the war, has begun planning the rebuilding of Ukraine's energy infrastructure and other sectors vital for economic growth.

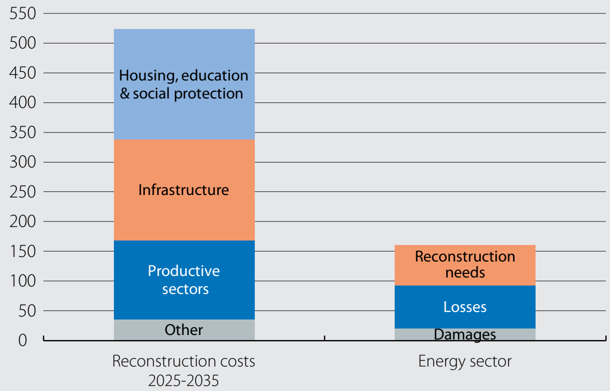
The costs of reconstruction

Together, the World Bank, the EU and the United Nations[1] have estimated that the value of direct damage from the war in Ukraine, between February 2022 and December 2024, amounts to 176 billion dollars (170 billion euros), which is 15.8% higher than the figure calculated at the end of 2023. Over the past year, there has been a widespread increase in damage across the residential, transportation, trade and industrial sectors. However, losses in the energy sector rose by 70% as a result of damage to assets related to electricity generation and transmission, energy distribution infrastructure and urban heating (see first chart).

These three international organisations estimate that the cost of Ukraine's reconstruction and recovery needs in both the public and private sectors over the next decade amount to 524 billion dollars (506 billion euros), approximately 2.8 times Ukraine's estimated nominal GDP in 2024. Housing (16%) would top the aid priority list, followed by transportation (15%), energy (12%), trade and industry (12%) and agriculture (11%).

At the same time, and in order to obtain the necessary support for Ukraine's future accession to the EU, the Ukrainian government has launched a programme

Ukraine: costs of the economic and energy reconstruction
(USD billions)



Source: *BPI Research, based on data from the World Bank, the EU and the UN.*

of reforms and investments set out in the Ukraine Plan.[2] Ukraine is taking steps to attract private investment into the energy sector and legislative and structural reforms (focusing on improving energy security and the transition to renewable energy) have been accelerated in order to align the sector with EU regulations and standards, as an essential requirement in order to compete in European markets.

What will happen to the European energy scenario following peace agreements?

One of the most highly debated issues around a partial or total peace agreement and the reconstruction process is what will happen to the European energy scenario. Questions remain over whether Europe will resume significant imports of Russian energy or what impact Russia's return to the European scene will have on oil and gas prices remain central to the unresolved questions.

With regards to oil, following the invasion of Ukraine, the West sanctioned Russian crude oil exports,[3] although this did not prevent Russia from maintaining a high production rate. Since then, flows from Russia to Europe

1. See «Fourth Rapid Damage and Needs Assessment (RDNA4)». World Bank Document, February 2025.

2. In May 2024, the Ukrainian government adopted the EU's Ukraine Plan. This is a comprehensive reform and investment programme for the period 2024-2027, covering most sectors of the Ukrainian economy.
3. In 2022, the US and the UK banned imports of oil and derivative products from Russia. The EU also banned them beginning in late 2022 and, in 2023, restricted the provision of associated services (shipping and maritime insurance) for importers of Russian oil. In parallel, in 2022, the G7 imposed a cap on the sale price of a barrel of Russian oil transported by sea at 60 dollars. This cap does not affect the crude oil that arrives in Europe via pipelines to countries without access to the sea.

have been effectively minimised (see second chart), and Russian oil shipments have been redirected to China, India and Turkey. Europe, for its part, has made up for this shortfall by buying barrels from the Middle East and the US. In a potential peace agreement, there is a possibility that the US might ease sanctions related to the price cap imposed by the G7, in which case the discount premium at which the Urals barrel is currently being traded would be diluted, causing it to lose its competitive advantage over the Brent barrel price for Asian buyers. This is unlikely to significantly affect Europe's oil import volumes and prices could register downward pressures related to the increase in OPEC's supply beginning in April.

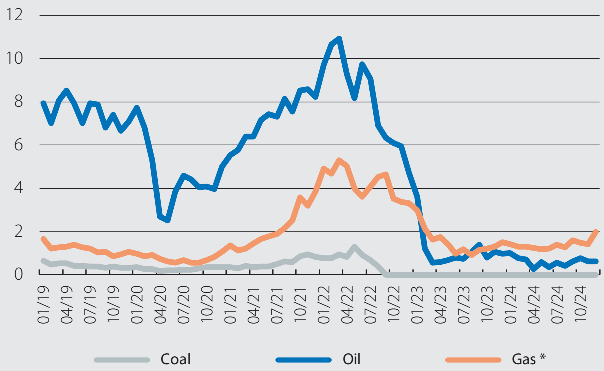
In the case of gas, in contrast, a peace agreement could have bigger implications for Europe. The current European gas scenario is very different to before the outbreak of the war. On the one hand, the demand for natural gas in Europe fell by 20% between 2021 and 2024. The increase in the gas price in Europe since the start of the war, the deployment of renewable energies and the energy-saving policies promoted by the EU[4] have led to a considerable drop in demand. On the other hand, Europe has sought alternative suppliers of natural gas and has placed greater emphasis on liquefied natural gas (LNG), mainly from the US, as well as on the entire storage and regasification industry associated with this fuel. Although Russian gas exports to Europe have plummeted, it is worth noting that since 2022, Russia has continued to sell LNG to Europe, accounting for 18% of the total LNG imported by Europe (excluding Turkey) in 2024.

Another factor that has changed dramatically is the routes used to import gas from Russia to Europe via pipeline. Of the four access routes that existed at the start of the war (the Yamal pipeline through Poland, Nord Stream through Germany, Brotherhood through Ukraine and Turk Stream through Turkey), only the Turkish gas pipeline is currently operational. Unlike oil, the EU has not explicitly sanctioned natural gas flows via pipeline, and the interruptions in supply have been due to legal, political and logistical issues.

However, when peace comes, it seems unlikely that the volume of Russian gas exports to Europe will return to pre-war levels. In the last three years, EU countries have inverted their preference for cheap energy in favour of energy security. Most Member States are opposed

Russia: exports of fossil fuels to the EU

(USD billions)



Note: ** Includes both natural gas and LNG.*
Source: *BPI Research, based on data from Bruegel.*

to the return of Russian gas to Europe, with the exception of Slovakia and Hungary, so they will support the diversification of suppliers and will not make significant investments in reinstating the disused pipelines. In addition, the war has accelerated a series of structural changes in the EU with a longer-term profile, such as investment in renewable energy sources, the relocation of some gas-intensive industries and the development of LNG capacity, all of which diminish the potential growth of demand for Russian gas.

All in all, in the event of a balanced peace agreement between Russia and Ukraine, the return of Russian oil and gas flows to Europe is unlikely to reach pre-war levels. In addition to the political, legal and security issues, the significant damage suffered by Ukraine's energy infrastructure during the conflict, despite being a priority objective for the reconstruction, will slow down the normalisation of these flows.

4. See «REPowerEU: energy policy in EU countries' recovery and resilience plans», which aims to end dependence on Russian fossil fuels by 2027, saving energy and diversifying supplies. And «Fit for 55», the EU package of measures on European climate legislation with the goal of cutting EU greenhouse gas emissions by at least 55% by 2030.

Year-on-year (%) change, unless otherwise specified

UNITED STATES

	2023	2024	1T 2024	2T 2024	3T 2024	4T 2024	01/25	02/25	03/25
Activity									
Real GDP	2,9	2,8	2,9	3,0	2,7	2,5	–	–	–
Retail sales (excluding cars and petrol)	5,2	3,4	2,8	3,4	3,5	3,8	3,6	3,5	...
Consumer confidence *(value)*	105,4	104,5	104,5	98,9	102,2	110,6	105,3	100,1	92,9
Industrial production	0,2	–0,3	–0,5	0,0	–0,4	–0,2	1,9	1,4	...
Manufacturing activity index (ISM) *(value)*	47,1	48,2	48,8	48,5	47,3	48,2	50,9	50,3	49,0
Housing starts *(thousands)*	1.421	1.368	1.407	1.340	1.332	1.392	1.350	1.501	...
Case-Shiller home price index *(value)*	312	330	325	329	332	336	339	...	...
Unemployment rate *(% lab. force)*	3,6	4,0	3,8	4,0	4,2	4,1	4,0	4,1	...
Employment-population ratio *(% pop. > 16 years)*	60,3	60,1	60,2	60,1	60,0	59,9	60,1	59,9	...
Trade balance [1] *(% GDP)*	–3,1	–2,9	–2,8	–2,8	–2,9	–3,1	–3,4	...	...
Prices									
Headline inflation	4,1	3,0	3,2	3,2	2,6	2,7	3,0	2,8	...
Core inflation	4,8	3,4	3,8	3,4	3,2	3,3	3,3	3,1	...

JAPAN

	2023	2024	1T 2024	2T 2024	3T 2024	4T 2024	01/25	02/25	03/25
Activity									
Real GDP	1,5	0,1	–0,7	–0,7	0,7	1,1	–	–	–
Consumer confidence *(value)*	35,2	37,2	38,9	37,0	36,8	36,3	35,2	35,0	...
Industrial production	–1,4	–3,0	–4,3	–3,5	–1,8	–2,5	2,3	4,5	...
Business activity index (Tankan) *(value)*	7,0	12,8	11,0	13,0	13,0	14,0	–	–	–
Unemployment rate *(% lab. force)*	2,6	2,5	2,6	2,6	2,5	2,5	2,5	2,4	...
Trade balance [1] *(% GDP)*	–3,0	–1,1	–1,2	–1,0	–1,1	–1,0	–1,0	–0,9	...
Prices									
Headline inflation	3,3	2,7	2,5	2,7	2,8	2,9	4,0	3,6	...
Core inflation	3,9	2,4	3,2	2,2	2,0	2,3	2,6	2,6	...

CHINA

	2023	2024	1T 2024	2T 2024	3T 2024	4T 2024	01/25	02/25	03/25
Activity									
Real GDP	5,4	5,0	5,3	4,7	4,6	5,4	–	–	–
Retail sales	7,8	3,3	4,7	2,6	2,7	3,8	...	4,0	...
Industrial production	4,6	5,6	5,8	5,9	5,0	5,6	...	5,9	...
PMI manufacturing *(value)*	49,9	49,8	49,7	49,8	49,4	50,2	49,1	50,2	50,5
Foreign sector									
Trade balance [1,2]	865	995	841	864	897	995	1.049	1.041	...
Exports	–5,1	4,6	–1,7	4,4	5,4	10,0	5,5	–2,3	...
Imports	–5,5	1,1	1,6	2,5	2,2	–1,7	–16,5	1,5	...
Prices									
Headline inflation	0,2	0,2	0,0	0,3	0,5	0,2	0,5	–0,7	...
Official interest rate [3]	3,5	3,1	3,5	3,5	3,4	3,1	3,1	3,1	3,1
Renminbi per dollar	7,1	7,2	7,2	7,2	7,2	7,2	7,3	7,3	7,3

Notes: *1. Cumulative figure over last 12 months. 2. Billion dollars. 3. End of period.*
Source: *BPI Research, based on data from the Department of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Standard & Poor's, ISM, National Bureau of Statistics of Japan, Bank of Japan, National Bureau of Statistics of China and Refinitiv.*

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2023	2024	1T 2024	2T 2024	3T 2024	4T 2024	01/25	02/25	03/25
Retail sales *(year-on-year change)*	–1,9	1,2	0,1	0,4	2,1	2,1	1,5	...	...
Industrial production *(year-on-year change)*	–1,6	–3,0	–4,7	–3,9	–1,7	–1,5	0,0	...	...
Consumer confidence	–17,4	–14,0	–15,3	–14,2	–13,0	–13,4	–14,1	–13,6	–14,5
Economic sentiment	96,2	95,7	95,7	95,8	96,1	95,2	95,3	96,3	95,2
Manufacturing PMI	45,0	45,9	46,4	46,3	45,8	45,5	46,6	47,6	48,6
Services PMI	51,2	51,5	50,0	53,1	52,5	52,1	51,3	50,6	51,0
Labour market									
Employment (people) *(year-on-year change)*	1,4	1,2	1,1	1,0	1,0	0,7	–	–	–
Unemployment rate *(% labour force)*	6,6	6,4	6,5	6,4	6,3	6,2	6,2	6,1	...
Germany *(% labour force)*	3,0	3,4	3,3	3,4	3,5	3,4	3,5	3,5	...
France *(% labour force)*	7,3	7,4	7,5	7,4	7,4	7,3	7,3	7,4	...
Italy *(% labour force)*	7,7	6,6	7,1	6,7	6,3	6,1	6,2	5,9	...
Real GDP *(year-on-year change)*	0,5	0,8	0,5	0,5	1,0	1,2	–	–	–
Germany *(year-on-year change)*	–0,1	–0,2	–0,1	–0,2	–0,3	–0,2	–	–	–
France *(year-on-year change)*	1,1	1,1	1,4	1,0	1,2	0,6	–	–	–
Italy *(year-on-year change)*	0,8	0,5	0,3	0,6	0,6	0,6	–	–	–

Prices

Year-on-year change (%), unless otherwise specified

	2023	2024	1T 2024	2T 2024	3T 2024	4T 2024	01/25	02/25	03/25
General	5,5	2,4	2,6	2,5	2,2	2,2	2,5	2,3	2,2
Core	5,0	2,8	3,1	2,8	2,8	2,7	2,7	2,6	2,4

Foreign sector

Cumulative balance over the last 12 months as % of GDP of the last 4 quarters, unless otherwise specified

	2023	2024	1T 2024	2T 2024	3T 2024	4T 2024	01/25	02/25	03/25
Current balance	2,1	3,5	2,6	3,2	3,3	3,5	3,4	...	...
Germany	5,6	5,7	6,0	6,4	6,3	5,7	5,4	...	...
France	–1,0	0,4	–0,5	–0,4	0,0	0,4	0,2	...	...
Italy	0,0	1,4	0,5	0,9	1,1	1,4	1,3	...	...
Nominal effective exchange rate [1] *(value)*	**94,7**	**95,1**	**95,2**	**95,2**	**95,6**	**94,2**	**93,2**	**92,7**	**94,6**

Credit and deposits of non-financial sectors

Year-on-year change (%), unless otherwise specified

	2023	2024	1T 2024	2T 2024	3T 2024	4T 2024	01/25	02/25	03/25
Private sector financing									
Credit to non-financial firms [2]	2,7	0,8	0,3	0,4	1,0	1,4	2,0	2,2	...
Credit to households [2,3]	1,7	0,5	0,2	0,3	0,5	0,9	1,3	1,5	...
Interest rate on loans to non-financial firms [4] *(%)*	4,6	4,9	5,1	5,1	4,9	4,4	4,1	...	...
Interest rate on loans to households for house purchases [5] *(%)*	4,4	4,6	4,8	4,8	4,7	4,3	4,1	...	...
Deposits									
On demand deposits	–8,5	–3,9	–8,8	–5,5	–2,5	1,2	2,9	3,8	...
Other short-term deposits	21,1	12,3	18,3	14,3	10,5	5,9	3,3	2,0	...
Marketable instruments	20,3	20,2	20,6	19,8	22,1	18,5	17,3	19,8	...
Interest rate on deposits up to 1 year from households *(%)*	2,7	3,0	3,2	3,1	3,0	2,6	2,3	...	...

Notes: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*

Source: *BPI Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

Economy signals slowdown in first months of 2025

Activity shows signs of slowing down. These are reflected in the behaviour of synthetic indicators, such as the European Commission's economic sentiment indicator (which rose from 106.5 in Q4 24 to 104.4 in Q1 25), and the daily activity indicator (which rose from 2.2% year-on-year in Q4 24 to 1.5% in Q1 25). Looking at the hard indicators, information is still scarce, but it suggests that consumption should remain dynamic, though with less importance in durable goods. In the external sector, information available refers only to January, and points to stronger growth in the volume of exports of goods than in imports. The question remains whether this power was an anticipatory move in light of the announced increase in customs duties. In short, we remain confident about the expansion of activity in Q1 25 – the flash estimate will be released on 30 April – but we are alert to signs of a cooling associated with the worsening of risks both internationally and domestically, following the political crisis that culminated in the fall of the government and the announcement of early legislative elections on 18 May.

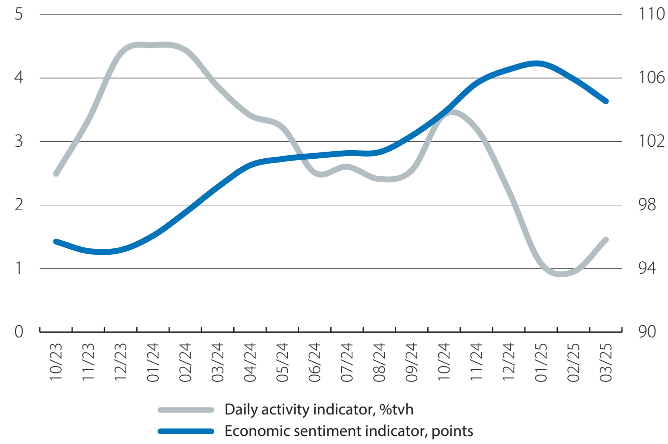
Inflation below 2% in March. Since August 2024 we have not had a year-on-year variation in the Global CPI below this important level. It is also more encouraging because the Underlying CPI has not been below 2% since December 2021, which should also mean some easing in the evolution of service prices (we do not yet have this data). Industrial production prices continue to support the slowdown in inflation (–0.4% year-on-year in February) and the evolution of real wages at the end of last year was already much more moderate (close to 3% year-on-year). The data thus seem to point towards a path of normalisation in price developments; however, a more aggressive escalation of tariff policies and unpredictable effects on energy prices (associated with ongoing armed conflicts) appear to be the main risks.

Employment continues to hit historic highs. In February, the employed population increased by 2.2% year-on-year (preliminary and seasonally adjusted data), placing the total (of 5,163,500 people) at the highest level in the historical series. In turn, the unemployment rate increased slightly from 6.3% in January to 6.4% in February, a movement similar to that observed in the same period last year. This data indicates that the unemployment rate could be between 6.7%-6.8% in the 1st quarter of the year; if confirmed, it would be below BPI Research's forecast (of 6.9%), explained by the exceptional behaviour that employment continues to show.

In 2024, the economy improved its financing capacity vis-à-vis the outside world to 2.9% of GDP (1.7% in 2023). Households contributed to this, with their financing capacity increasing to 4.7% of GDP, 2.5 pp more than in 2023, reflecting the increase in savings to 24,292 million euros, 9,322 million euros more than in 2023, thanks to stronger growth in wages (9%) and disposable income (10.5%) than in consumption (5.8%). This resulted in the savings rate rising to 12.2% of disposable income, the highest level since 2004 (excluding the years of the pandemic when the increase in savings was a forced move). In the remaining sectors, the financing capacity

Synthetic indicators of activity and sentiment

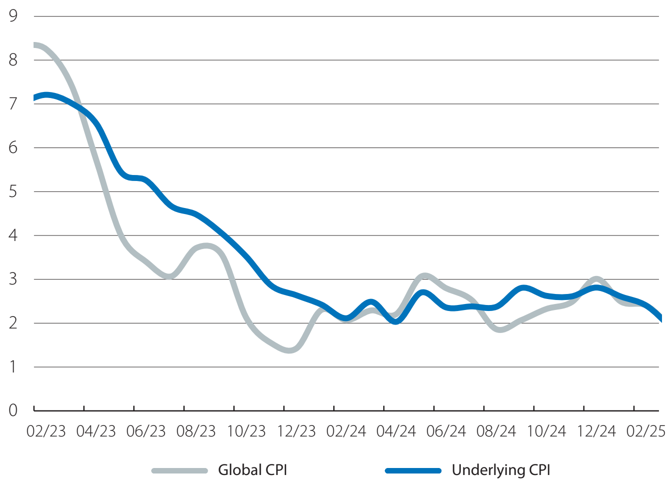
3-month moving average (% tvh) *(Points)*



Source: *BPI Research, based on BdP and EC data.*

CPI

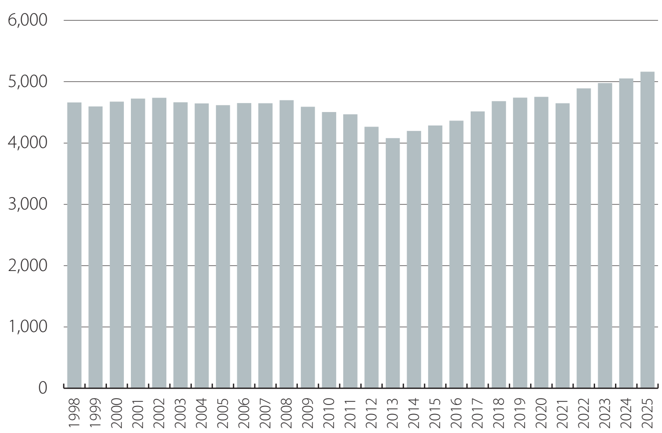
Y-o-Y Var. (%)



Source: *BPI Research based on data from the National Institute of Statistics.*

Employed population in February each year

(Thousand individuals)



Note: *Seasonally adjusted data. Data for 2025 are preliminary.*
Source: *BPI Research based on data from the National Institute of Statistics.*

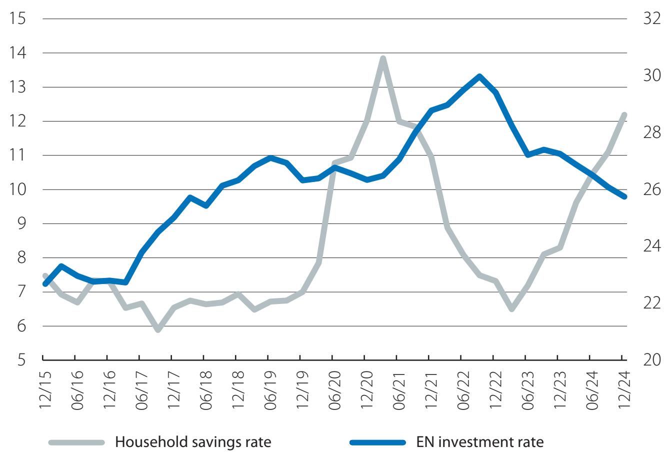
deteriorated compared to 2023, with emphasis on the public sector, which still remains with a surplus (decreased by 5 tenths to 0.7% of GDP) and the financial sector (minus 2 tenths to 1.9% of GDP). Non-financial companies increased their financing needs to 4.4% of GDP, +0.6 pp compared to 2023. In the non-financial business sector, there was little significant growth in gross capital formation (1.2% year-on-year). However, this trend could change in the short term, given the expectation of a reduction in financing costs and a possible acceleration in the implementation of European funds.

After another surprising year, budget execution remains favourable. The budget balance once again surprised on the upside in 2024, recording a surplus of 0.7% of GDP, above the government's forecast (0.4%) and that of BPI Research (0.5%). As the monthly budget execution data throughout the year revealed, expenditure growth exceeded revenue growth, which justifies the decrease in the budget surplus compared to what had been recorded in 2023 (1.2%).[1] However, the execution up to February does not reveal any major surprises: revenue continues to increase significantly (11.1%), mainly due to the performance of tax revenue (explaining 74% of the year-on-year increase), while the increase in expenditure (4.1%) is mainly due to the performance of personnel costs and social benefits, as anticipated in the 2025 State Budget (includes the updating of pensions in accordance with the law and the salary increase for civil servants). We estimate that the budget balance was 4.2% of GDP in the first two months of the year, compared to 1.8% in the same period last year.

The credit quality indicators of the Portuguese banking sector remained robust in 2024. Indeed, the NPL ratio decreased at the end of 2024 (–0.3 pp) compared to the end of 2023, to 2.4%, explained by all segments, with special emphasis on the more significant reduction in the case of non-financial companies. At the same time, the percentage of *stage 2* loans fell in the various segments, with the drop being particularly significant in the case of housing (–1.5 pp, to 8.3%). In the same sense, a recent publication by the Bank of Portugal reveals that the granting of housing credit has been more prudent than in the past; for example, 69% of new credit operations had a weighted average loan-to-value ratio of 69%, almost 60% of new operations were granted to individuals with low credit risk (compared to 3% with high risk), and the weighted average maturity of new operations continued to decrease, reaching 31 years in 2024, compared to the maximum of 33.7 years recorded in January 2021 (despite the reduction, it remains high in the European comparison). Meanwhile, the portfolio of loans to the non-financial private sector continues to rise: in February, it increased by 3.0% year-on-year, with more significant growth in the segments of credit to individuals, namely housing credit (4.5% year-on-year) and consumer credit (5.8%); the increase in the NFC credit portfolio was smaller (0.3%). Even so, despite the growth in the individual credit portfolio, as a percentage of GDP, the ratio remains at minimum levels, around 48%.

1. Ver artigo nesta publicação «Excedente orçamental supera (novamente) as expetativas».

Household savings and NFC investment rates



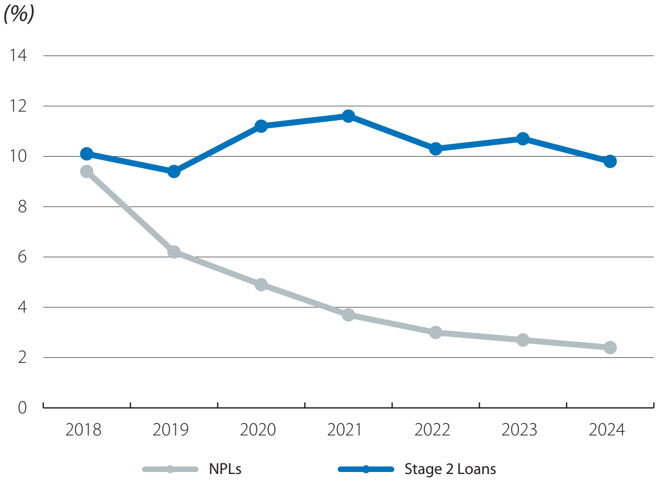
Source: *BPI Research based on data from the National Institute of Statistics.*

Budget Execution of the Public Administration (main headings)

January-February (% GDP, unless otherwise stated)	2019	2023*	2024	2025	Var. 2025 *vs.* 2019	Var. 2025 *vs.* 2024 (million euros)
Revenue	39.9	36.8	36.3	38.2	–1.6	1.921
Tax	23.5	21.0	19.4	21.2	–2.3	1.415
Social Sec. Contributions	9.9	10.1	10.4	10.7	0.7	388
Expenditure	36.3	31.6	34.5	34.0	–2.3	671
Personnel expenses	8.4	8.1	8.4	8.6	0.2	327
Current transfers	16.0	14.8	16.1	16.0	0.0	371
Acquisition of goods and services	4.4	4.1	4.3	4.1	–0.3	15
Interest	4.2	2.6	2.6	2.1	–2.1	–168
Investment	1.8	0.9	1.7	1.8	0.0	97
Budget balance	3.6	5.2	1.8	4.2	0.6	1,250

Note: ** Adjusted value of the transfer from the CGD Pension Fund to CGA.*
Source: *BPI Research, based on data from the Directorate-General for the Budget.*

Ratio of NPLs and loans at stage 2 *



Note: ** These include loans that have not yet defaulted, but whose credit risk has increased significantly compared to the start of the contract.*
Source: *BPI Research, based on data from Banco de Portugal.*

Capital stock: a handicap of the Portuguese economy

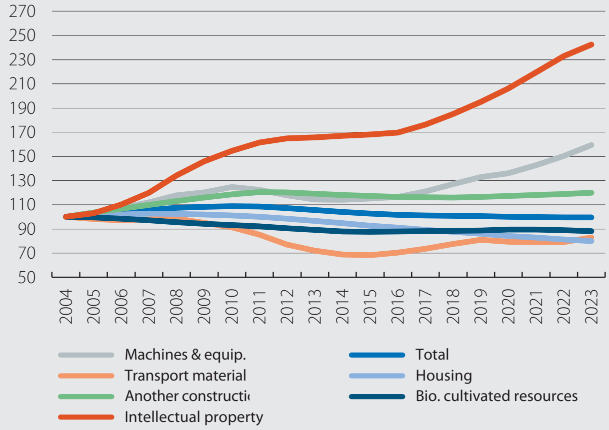
In the last two decades, the capital stock at constant prices has practically stagnated, which indicates that the gross fixed capital formation that took place in the same period only compensated for the depreciation of fixed assets, not constituting a real increase in the existing capital in the economy, which is a penalising factor for the advancement of the Portuguese economy's growth potential.

In 2023, global capital stock amounted to €746.3 billion, a level similar to that recorded in 2004. From the point of view of the capital allocated to each of the sectors of activity, this stagnation results from the fall in investment in the residential real estate sector, which, representing more than half of the capital stock, decreased by 20% between 2004 and 2023, explaining around 1/3 of the stagnation of the capital stock. However, there are other sectors where the movement was reversed, with growth in gross fixed capital formation contributing to an increase in the respective assets. Among these are the most productive sectors of the economy, such as machinery, equipment and weapons systems, whose 88% increase in GFCF between 2004 and 2023 will mean that the capital stock in this segment will rise from 32 billion euros in 2004 to 51 billion euros in 2023, an increase of 60%; and intellectual property products, whose fixed assets increased by 142%, almost as much as the GFCF in the sector (147%), amounting to 21.3 billion euros.

Despite this development, both fixed assets in the machinery and equipment sector and in the intellectual property products sector continue to compare poorly

Capital stock by sector (volume)

2004 = 100



Source: *BPI Research, based on data from the BdP.*

with other European countries. In fact, in Portugal, assets in the machinery and equipment sector represent 7.6% of the total,[1] just over half of that observed in other economies (in Spain, for example, it represents 13.9%); and in the intellectual property products sector it represents only 2.3% of the total capital stock, half the levels recorded in the largest European and online economies, but below the levels recorded in countries with the same size as Portugal. Despite the reduction in the capital stock in the residential real estate sector, the weight of capital stock in construction remains above levels observed in other economies.

The high weight of the construction sector and the low importance of capital invested in sectors that generate

Capital stock by sector

(% of total)

2022	Housing	Other buildings	Other structures	Machinery, equip. and armament	Bio. resources cultivated	R&D	*Software* and databases	Other prod. Intel. property	Inventories
Germany[1]	50.1	21.4	10.5	13.1	0.1	4.4	0.6	0.1	0.0
France	56.2	8.8	17.0	7.7	0.2	2.3	1.8	0.1	5.8
Italy	44.8	16.8	15.9	12.1	0.1	1.8	1.0	0.2	7.3
Spain	40.9	16.4	22.3	13.9	0.4	–	–	2.7	3.3
Estonia	29.9	38.2	9.0	13.9	0.2	1.3	1.4	0.2	6.0
Hungary	23.7	24.8	26.3	14.8	0.2	1.3	0.9	0.1	8.0
Slovenia	26.4	24.9	16.8	13.3	0.3	2.0	0.7	0.1	15.4
Portugal	**48.2**	**15.2**	**17.5**	**7.6**	**0.7**	**1.3**	**0.9**	**0.1**	**8.5**
Poland	23.2	24.0	29.3	15.5	0.5	1.7	–	1.7	4.1
Greece	45.8	11.9	16.3	13.1	0.1	1.6	0.5	0.1	10.6
Czech Republic	41.8	21.5	9.3	11.9	0.2	1.9	1.5	0.3	11.6

Note: *1. Data for Germany are from 2017.*
Source: *Banco BPI based on Eurostat data.*

1. The source of this data is Eurostat, which for the chosen set of countries only provides data at current prices between 2012 and 2022.

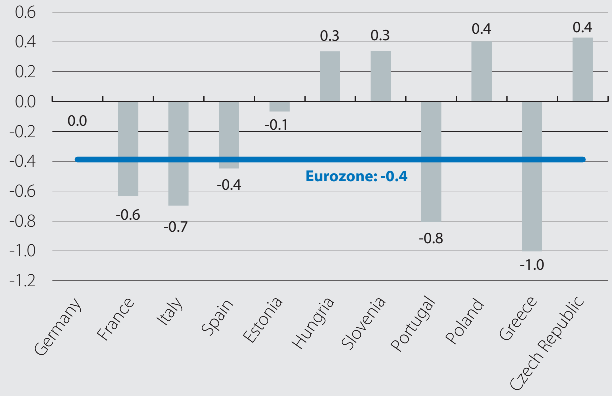
more added value explain why, on average, total factor productivity has evolved unfavourably compared to other countries similar to ours. Bearing in mind that total factor productivity reflects an economy's capacity for growth beyond the accumulation of productive factors – labour and capital – it seems that its evolution shows limited progress associated with technological transformations, innovation and efficiency.

Complementing the data provided by Banco de Portugal and Eurostat, with information collected on the website of the *Conference Board*, which disaggregates the contributions of the labour and capital factors to GDP growth in quantity and quality,[2] in the case of the labour factor and capital divided into ICT and non-ICT equipment, the signals coming from the distribution of capital across the various sectors of activity are confirmed. Indeed, it can be seen that Portuguese economic activity has been very much based on labour-intensive sectors, with the contribution made by the level of employment in the economy standing out, while the contributions of the other factors are considerably less substantial, namely the contribution of the capital factor, both in terms of investments in more traditional productive sectors and in sectors linked to new technologies.

The picture of this aspect of the economy is still not favourable, but there are signs of change that need to be consolidated so that we don't miss out on the productivity gains needed to boost the population's income and purchasing power. Among aspects expected to be consolidated in the coming years, it should be noted that since 2015 fixed assets in the productive sectors of the economy have been growing at a faster rate than gross domestic product. In fact, since 2015, the capital *stock* in machinery, equipment and weapons systems has grown at an average annual rate of 4.2% and in the intellectual property products sector at an annual rate of 4.7%, which compares with an average real GDP growth of 0.9%. In the same period, employment among the most qualified population increased by 4.7% per year, while total employment grew at a rate of 2.1%. Finally, a reference to the foreign direct investment made in recent years, which shows signs of a change in the destination sector, from more traditional sectors to sectors with greater incorporation of advanced technologies.[3]

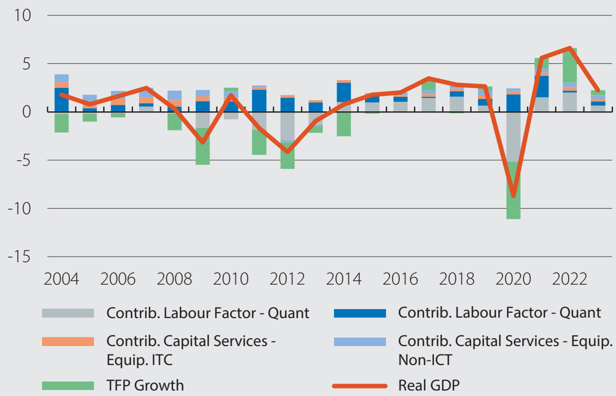
2. As regards the work variable, the separation between quantity and quality results from the fact that, in the first case, aggregated data relating to employment are used based on hours worked, or if these are not available, using the total number of people employed. To assess the work factor in terms of quality, changes in the composition of the workforce are taken into account, using information on employment and remuneration by level of qualifications of the employed population.
3. About IDE see the article in IM03: More foreign investment and greater diversification

Average growth in total factor productivity
Between 2004-2023 (%)



Source: *BPI Research com base em dados do Conference Board.*

Contributions of capital and labour factors to real GDP growth
Values presented in logar



Source: *BPI Research based on Conference Board data.*

Graphically, the contributions of the qualifications of the employed population are already visible in figure 4. They are positive, but still small in the capital components, highlighting the need for more investment in productive activities.

Teresa Gil Pinheiro

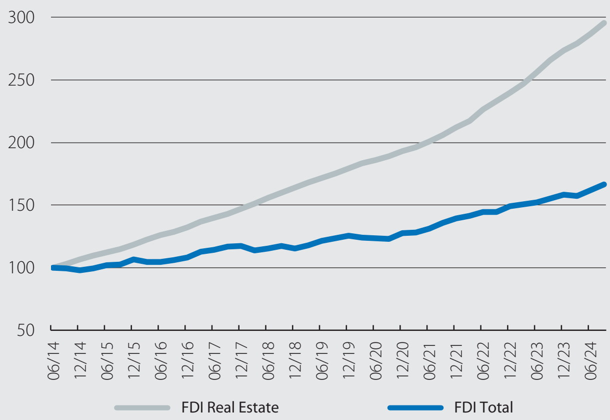
Foreign Direct Investment in Real Estate in Portugal

In the IM03 report we already touched on the subject of Foreign Direct Investment (FDI) in Portugal,[1] looking at topics such as growth compared to other European countries, attractiveness factors, origins of capital, breakdown by sector and prospects. Continuing with that theme, in this article we focus specifically on the topic of real estate FDI. We intend to assess its weight, how it has evolved (also in relation to FDI as a whole), recent dynamics and the origin of capital. In fact, in a year 2024 in which investment as a whole (Gross Capital Formation) slowed compared to the previous year, it is important to understand how FDI in real estate has behaved given its strategic importance, having an influence on the housing market and hotels, for example.

At the close of Q3 2024, the stock of real estate FDI amounted to 33.8 billion euros, around 17% of the total FDI stock. Although the average growth of FDI as a whole in Portugal is higher than the EU average,[2] the growth rate of the stock of real estate FDI is even stronger as can be seen in the first graph. Taking as a starting point the quarter in which the country left the financial assistance of the «Troika», we see that in Q3 2024 the stock of FDI associated with real estate investment almost tripled, a much higher variation compared to the stock of FDI as a whole (+67%). Thus, over the last 10 years FDI as a whole has grown at a CAGR[3] of 5.1% while real estate FDI has registered a CAGR of 10.9%.

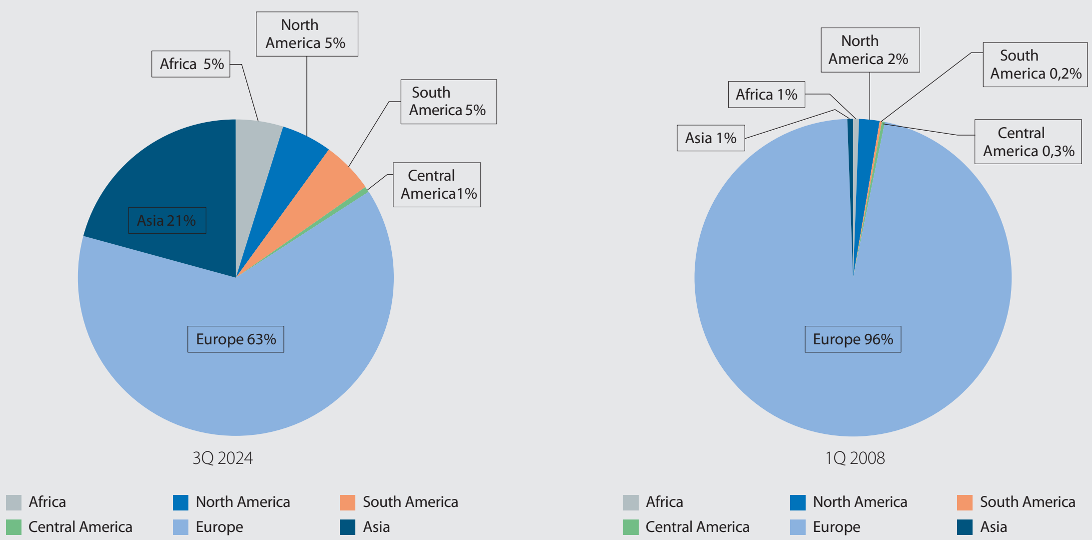
Total FDI and FDI in Real Estate

Level (Q2 2014 = base 100)



***Source:** BPI Research, based on data from Banco de Portugal.*

But where do these foreign investments in real estate come from? According to the latest available data, Europe clearly remains the main source of capital with 63% of the *stock*, followed by Asia (21%), as we can see in the second image. However, compared to 2008 (the start of the data series), the weight of the investment *stock* originating in Europe fell very substantially (–33 pp). This was mainly due to the increase in the weight of the *stock* of capital originating in Asia (+20 pp) but also in other countries – Africa (+4 pp), North America (+3 pp) and South America (+4.8 pp). So, according to the latest figures, the UK has the largest share of the real estate FDI stock (21%



***Source:** BPI Research, based on data from Banco de Portugal.*

1. See the article «More foreign investment and greater diversification» in IM03/2025.
2. Average annual growth of 6.2% over the last five years compared to 2.8% in the EU.
3. Compound annual growth rate.

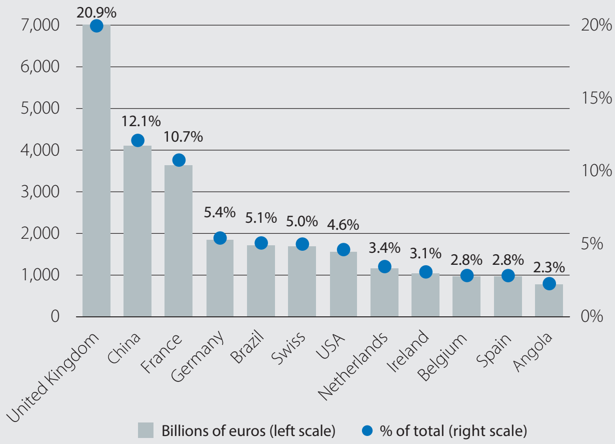
of the total), followed by an Asian country, China, with 12% of the total. In fifth and seventh position we also find countries outside the European continent – Brazil (5.1%) and the USA (4.6%).

These data provided by Banco de Portugal, while interesting, have some limitations. Indeed, we do not know the purpose of real estate investments – whether they are residential properties or commercial properties, for example. We also do not know which institutional sector the investor belongs to – whether it is an individual, a company or even an investment fund. However, by cross-referencing information we obtain some clues. For example, we know that under the *gold* visa programme the amount channelled into real estate purchases amounted to more than 6.4 billion euros.[4] This figure represents around 31% of the total real estate FDI flows between 2013 and 2023. On the other hand, if we add up the flows in this period from China, the USA and Brazil, these amount to 6.3 billion. Although we cannot make a direct correspondence between this value and the value of the *gold* visas allocated to the purchase of real estate, the truth is that the annual flows of real estate FDI from these geographies before and after the entry into force of the *gold* visas increased very substantially. Until 2012, the average annual flows from China, the USA and Brazil were 1 million, 9.5 million and 4.2 million respectively. After that year, the annual average of real estate FDI flows increased to 321.5 million, 113.3 million and 139.7 million for China, the USA and Brazil, respectively. These countries stood out, but others in the euro zone also increased their flows, so in addition to the *gold* visas there must be other reasons for this strong dynamic: the prolonged period of low interest rates and specific investment opportunities (also associated with tourism properties), for example.

Tiago Belejo Correia

4. Latest official data from the now defunct SEF (covers the period between October 2012 and September 2023).

Real estate FDI stock: top positions by country



Note: *Stock in Q3 2024.*
Source: *BPI Research, based on data from Banco de Portugal.*

Portuguese tourism in 2025

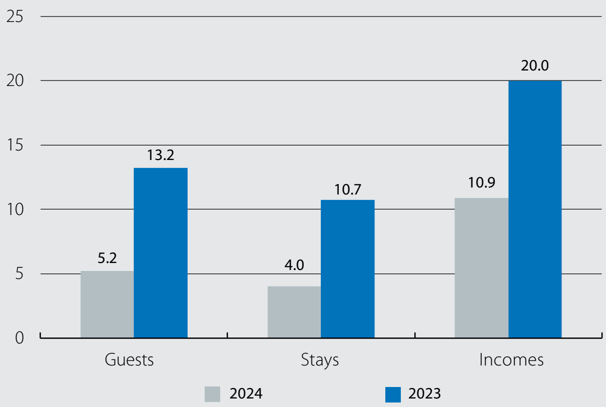
In 2024, national tourism recorded another year of new records in its main metrics. 31.5 million guests responsible for 80.3 million overnight stays and 6.6 billion euros of total revenue in tourist accommodation establishments. A performance that places the number of guests, overnight stays and revenue above pre-pandemic levels by 16.4%, 14.5% and 55.2%, respectively. Despite this positive performance, growth has lost some momentum compared to the pace of 2023 (see first graph), which in a way was to be expected, given that pre-covid levels had already been surpassed and we were entering a phase of growth closer to a cruising pace. Demand indicators reflect a disparate behaviour between tourism by residents and non-residents, with the latter continuing to register more significant growth rates (see second graph). For 2025, we continue to expect a positive performance, with growth, although again at a slightly lower rate than in 2024. In this article we explain the underlying rationale for our view.

At the time of writing, we already have preliminary tourism data for the first two months of 2025. The table shows the growth rate in the last three months of data compared to the same period of the previous year and, to give us an idea of the trends, we compare this with the growth rate of each issuer in 2024. If the year-on-year growth rate for the last three months is higher than that for 2024 as a whole, this could signal a trend of more positive growth in 2025. Firstly, it should be noted that in the last 3 months there has been an increase in both resident and non-resident tourists as a whole, although the inbound markets of the United Kingdom, Spain, France and Brazil have seen slight falls. This means that on average the number of tourists is growing by more than 3%. In the case of France, it had already registered a lower number of tourists in 2024 than in 2023. Regarding more fundamental trends, we believe that in the case of Brazil, this year the number of tourists should be maintained compared to 2024. The Brazilian economy is expected to record a year of growth (although the weakest since the pandemic) and monetary policy is expected to enter even more restrictive territory. The Real is expected to remain weak against the Euro, making it difficult for tourism from this source to recover, which in 2024 was still below pre-pandemic levels (–14.9%). In fact, within the group of the 15 main emitting countries, Brazil and Sweden (–9.7%) are the only ones that have not surpassed the pre-pandemic level. In the French case,[1] year-on-year growth in the last three months of data is still negative,

1. We believe that the event of the Olympic Games in Paris in 2024 may also have played a role in the negative performance of tourism originating in France in 2024, diverting some French tourists to domestic tourism rather than travelling abroad.

Guests, overnight stays, and income

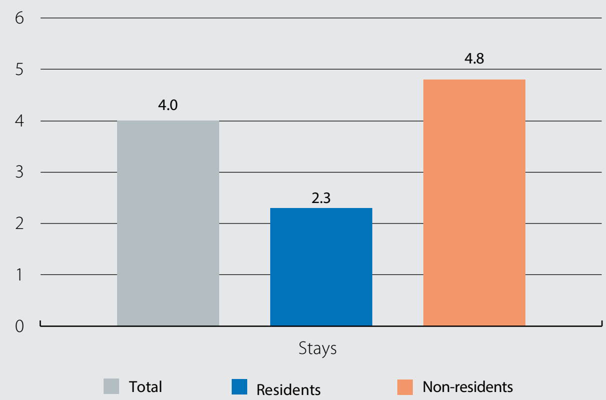
Rate year-on-year rate of change (%)



Source: *BPI Research based on data from the National Institute of Statistics.*

Overnight stays in 2024

Rate year-on-year rate of change (%)



Source: *BPI Research based on data from the National Institute of Statistics.*

but the trend is positive. Bearing in mind that this market closed 2024 with a level of tourism only 1% higher than pre-pandemic period, we believe that this year it will grow to the point where it will replace the number of tourists registered in 2023. In addition to the growth we expect from tourists from France, the other two eurozone countries that are among the main source markets – Spain and Germany – should also continue to provide good support for the growth of national tourism. Spain's economic growth has been above the EMU average and in 2024 there was already a growth in outbound travel in that market above domestic travel, benefiting Portuguese tourism, among others. In the case of Germany, after two years of recession, a return to growth is expected, with a positive impact on travel abroad. In these two countries and in most countries in the eurozone, we foresee a recovery in real wages, with inflation returning to around the 2% target, which will be reflected in the availability to travel. In the case of the United Kingdom, the negative trend in the latest data and the stability in the exchange rate that we foresee for much of 2025 means that the growth rate projected for 2025 (3%) will be slightly lower than that seen in 2024 (4.3%).

For the USA, a market that has been gaining weight in recent years, despite the negative trend, we have good reason to believe that growth will continue to be solid (we predict 10%, slightly below the growth of 2024). The good performance of the economy, together with the appreciation of the dollar against the euro, should continue to sustain the good *momentum* of this source market. Added to this is some tourism that may be generated by Americans who don't see themselves reflected in the political environment of the new Trump administration, and are looking for alternatives to take up residence. Other smaller, long-haul source markets should benefit both from some stability in the price of Brent (not making airline tickets too expensive) and from the growth of the middle class (emerging countries). Finally, resident tourists, where we expect a further increase in guests (+2%). Despite the positive trend we maintain that this growth will be lower than that recorded in 2024 (+4%) because we have been noticing a higher growth rate in trips by residents abroad than in domestic trips (see fourth graph). In other words, despite the expected improvement in family budgets, we believe that this will translate into greater allocation to trips abroad. [2]

All things considered, we project a very similar growth in guests to 2024 (around 5%). Although the Tourism Satellite Account data for 2024 are not yet available, we estimate that the weight of the tourism sector in GDP has risen to 17.2% (from 16.5% in 2023) and that it will stand at 17.9% in 2025, given that the sector's growth rate is stronger than the overall growth rate of the economy. Tourism is expected to contribute around 0.7 pp to global GDP growth, which we project to be 2.4% in 2025.

Tiago Belejo Correia

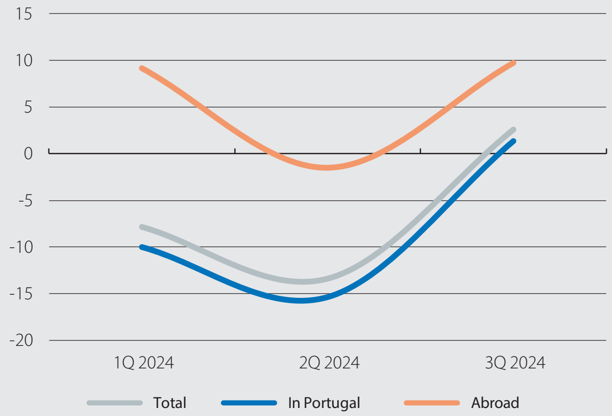
Growth in the number of tourists

Tourists	2024 *vs.* 2023	Last 3 months *vs.* year-on-year	*Trend*
Residents	3.5%	3.8%	
Non-residents	6.3%	3.9%	
United Kingdom	4.3%	–1.3%	
Germany	6.6%	4.5%	
Spain	0.8%	–1.0%	
France	–3.0%	–1.6%	
USA	11.8%	3.9%	
Brazil	–1.0%	–5.0%	
Others	21.5%	18.2%	

Source: *BPI Research based on data from the National Institute of Statistics.*

Number of trips made by residents

Year-on-year change (%)



Source: *BPI Research based on data from the National Institute of Statistics.*

2. Situation also exacerbated by weak competitiveness in the price factor. See Travel & Tourism development index 2024 do World Economic Forum. Portugal ranks 93rd among the countries analysed in terms of «Price Competitiveness».

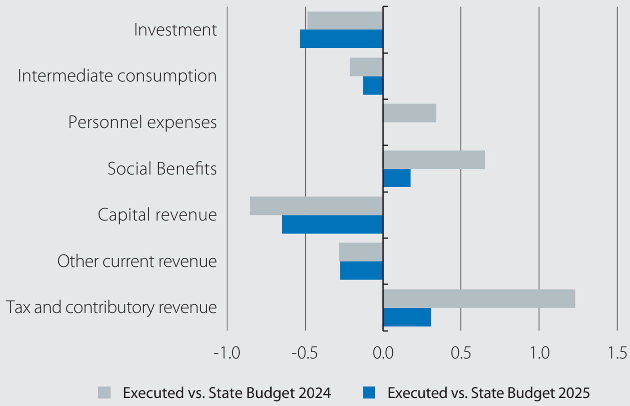
Budget surplus exceeds expectations (again)

Another year has come to an end and, for the second consecutive period, public accounts not only remained in positive territory, but once again surprised on the positive side. The budget surplus was 0.7% of GDP (equivalent to around 1.994 billion euros), which represents a decrease (already expected) compared to that recorded in 2023 (1.2% of GDP, 3.247 billion euros). Even so, the balance was above the Government's latest estimate, included in the State Budget for 2025, which pointed to a surplus of 0.4% of GDP.

On the one hand, revenue increased by 6.3% in the year, equivalent to an increase of around 7.35 billion euros compared to 2023. This growth is largely supported by tax revenue and social security contributions. Firstly, tax revenue, which accounts for more than half of the increase in total revenue, grew by almost 6% compared to 2023 and exceeded the Government's estimates, 683 million euros higher and more than 1.6 billion euros if we compare it with the forecast included in the 2024 State Budget. At this point, the behaviour of indirect taxes stands out, which stood at almost 880 million euros above the Government's latest forecast. Secondly, social security contributions explain more than 40% of the increase in total revenue, with an amount that is almost 200 million euros above the 2025 State Budget estimate and 1.9 billion euros above the 2024 State Budget. It is important to bear in mind that employee remuneration (a variable that depends on wages and job creation) increased by around 9% in 2024, which will have contributed to this significant growth in social security contributions. Overall tax and social security contribution revenue thus increased by 6.9%, slightly above what the historical relationship of this item with GDP suggests and which points to growth of slightly above 6%. One of the possible explanations lies, for example, in the more notable growth of the wage bill in relation to GDP. Conversely, capital revenue fell by almost 21%, explained by the reduction in European funds (except, as mentioned by the INE, the component relating to the RRP, which increased by 26%). Overall, the growth in total revenue was practically in line with the increase in nominal GDP, which explains why its weight as a percentage of GDP was maintained, but below the Government's expectations. Thus, and given the behaviour of capital revenue, the revenue collected was more than 1.7 billion euros below the forecast, equivalent to 0.6 pp of GDP.

However, the budget surplus was higher than expected, and this is explained by the lower expenditure execution compared to the Government's estimate (around –0.9 pp). Thus, despite the 7.6% increase in 2024 (+8.606 billion euros), more than 2.6 billion in expenditure forecast by the Government in the 2025 State Budget remained unspent, with public investment standing out. Indeed, despite the 10.9% growth last year, the level of implementation was around 84% compared to what was expected in the 2025 State Budget; that is, the investment contributed to improving the budget balance compared to that projected in the 2025 State Budget by around 0.5 pp. Despite the lower execution rate, it is important to highlight that public investment reached 2.7% of GDP in 2024, the highest level since 2011.

Deviation in the execution of public accounts items from budgeted levels
(p. p. of GDP)



Source: *BPI Research, based on data from INE and State Budgets 2024 and 2025.*

Even so, the increase in expenditure is mainly explained by personnel expenses and social benefits. It should be remembered that, throughout the year, there was an update of public servants' salaries and a review of careers in some professional groups, and that, in the case of social benefits, there were also adjustments in various forms of support, namely pensions (with the update already foreseen in the 2024 State Budget and the extraordinary payment made to the lowest pensions in October)[1] and reviews of other forms of support, such as the Solidarity Supplement for the Elderly. Overall, these two items were 0.2 pp above the Government's latest estimate, but reached 1 pp if compared with the 2024 State Budget. In turn, interest rates increased for the second consecutive year, reflecting the increase in charges for public debt retail products, namely those arising from Postal Savings Certificates, which, at the end of last year, reached historic highs. According to the INE, the increase in charges includes the increase in interest rates, along with retention premiums. Overall, at the end of the year, the increase was around 13% compared to the end of 2023.

1. The increase in pensions is also justified by the increase in the number of pensioners, according to the INE.

In conclusion, the weight of public expenditure in GDP increased by 0.5 pp, to 42.8%. Even so, the increase is even more significant in the case of primary current expenditure, a more rigid expenditure item, which increased by 1 pp to 37.3%, the highest level since 2017 (excluding the pandemic period).

In this context, the public debt ratio fell for the fourth consecutive year, with the 94.9% recorded in 2024 representing the lowest ratio since 2009. The outlook included in the publication of the PDE reveals that the Government is now more optimistic about the evolution of the ratio for 2025, anticipating that it could reach 91.8%, when, in the 2025 State Budget, it pointed to 93.3%, maintaining the expectation for the budget balance (at 0.3% of GDP). In our scenario, we project that the budget balance may be slightly above what the Government anticipates, given the recent upward revision of our expectation for economic growth in 2025, which could translate into a budget surplus of around 0.4% of GDP; in this context, we expect the public debt ratio to decrease to 91.3% of GDP this year.

Given these data, everything indicates that the new normal when we talk about public accounts is to discuss the size of the budget surplus, but the risks continue to be present, as always. The year 2025 seems to bring a certain normality to the economy: GDP is expected to grow by more than 2% this year, the labour market should remain robust and support private consumption (through increased employment and wages), inflation will continue on track towards the 2% target, and the reduction in financing costs should ease the burden on families and companies. However, geopolitical challenges (wars and tariffs), efforts to strengthen European defence, together with the upcoming electoral cycle, with the resulting uncertainty regarding policies and future parliamentary composition, together with the (still) high level of public debt, remind us of the importance of maintaining prudence in public accounts as a future focus.

Vânia Duarte

Forecasts from various institutions for the public accounts

(% GDP)	Budgetary Balance			Public debt		
	2024	2025	2026	2024	2025	2026
BPI	0.7	0.4	0.3	94.9	91.3	88.2
Government[1]	–	0.3	0.1	–	91.8	90.4
EIU (January)	–	0.7	0.5	–	91.4	89.8
OECD (December)	–	0.3	0.2	–	92.2	89.3
BdP (December)	–	–0.1	–1	–	86.5	83.5
European Com. (November)	–	0.4	0.3	–	92.9	90.5
IMF (October)	–	0.2	0.2	–	89.8	86.2
CFP[2] (September)	–	0.4	0.1	–	88.3	84.5

Notes: *1. The Government's forecasts for 2025 are those contained in the PDE (March; for 2026, are those of the Medium-Term Budget Plan (October). 2. The CFP updated its forecasts for 2025 when analysing the 2025 State Budget (October).*
Source: *BPI Research, based on data from various institutions.*

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2023	2024	Q2 2024	Q3 2024	Q4 2024	Q1 2025	01/25	02/25	03/25
Coincident economic activity index	3.5	1.8	1.7	1.6	1.8	...	1.8	1.8	...
Industry									
Industrial production index	–3.1	0.2	1.4	–0.8	–1.0	...	–3.1	0.9	...
Confidence indicator in industry *(value)*	–7.4	–6.2	–6.7	–6.2	–3.9	–5.1	–4.7	–5.2	–5.4
Construction									
Building permits - new housing (number of homes)	7.5	4.9	8.4	12.4	20.2	...	...	...	...
House sales	–18.7	14.5	10.4	19.4	32.5	...	–	–	–
House prices *(euro / m² - valuation)*	9.1	8.5	6.8	8.5	13.2	...	14.5	16.0	...
Services									
Foreign tourists *(cumulative over 12 months)*	19.0	6.3	9.5	7.8	6.3	...	6.4	5.8	...
Confidence indicator in services *(value)*	7.6	5.5	4.3	–0.4	11.9	15.8	20.2	16.5	10.7
Consumption									
Retail sales	1.1	3.3	2.2	3.9	5.5	...	5.4	3.0	...
Coincident indicator for private consumption	2.9	2.8	2.4	2.8	3.6	...	3.9	4.0	...
Consumer confidence index *(value)*	–28.6	–18.0	–18.7	–14.3	–14.3	–15.5	–15.1	–15.3	–16.0
Labour market									
Employment	2.3	1.2	1.0	1.2	1.3	...	2.0	2.2	...
Unemployment rate (% *labour force*)	6.5	6.4	6.1	6.1	6.7	...	6.3	6.4	...
GDP	**2.6**	**1.9**	**1.5**	**2.0**	**2.9**	**...**	**–**	**–**	**–**

Prices

Year-on-year change (%), unless otherwise specified

	2023	2024	Q2 2024	Q3 2024	Q4 2024	Q1 2025	01/25	02/25	03/25
General	4.4	2.4	2.7	2.2	2.6	2.3	2.5	2.4	1.9
Core	5.1	2.5	2.4	2.5	2.7	2.3	2.7	2.5	1.9

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2023	2024	Q2 2024	Q3 2024	Q4 2024	Q1 2025	01/25	02/25	03/25
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–1.4	2.5	–3.7	0.7	2.5	...	3.5	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–4.0	2.1	–5.6	–0.8	2.1	...	3.1	...	...
Current balance	**1.5**	**6.1**	**4.2**	**5.2**	**6.1**	**...**	**5.9**	**...**	**...**
Goods and services	4.0	6.7	5.7	6.1	6.7	...	6.7	...	...
Primary and secondary income	–2.5	–0.5	–1.5	–0.9	–0.5	...	–0.8	...	...
Net lending (+) / borrowing (–) capacity	**5.3**	**9.3**	**7.9**	**8.6**	**9.3**	**...**	**8.9**	**...**	**...**

Credit and deposits in non-financial sectors

Year-on-year change (%), unless otherwise specified

	2023	2024	Q2 2024	Q3 2024	Q4 2024	Q1 2025	01/25	02/25	03/25
Deposits [1]									
Household and company deposits	–2.3	7.5	5.6	6.0	7.5	...	7.3	7.1	...
Sight and savings	–18.5	–0.3	–8.6	–6.7	–0.3	...	1.9	2.5	...
Term and notice	22.2	15.3	24.0	20.9	15.3	...	12.5	11.4	...
General government deposits	–12.4	26.7	4.5	29.1	26.7	...	27.1	40.6	...
TOTAL	**–2.6**	**7.9**	**5.6**	**6.7**	**7.9**	**...**	**7.8**	**7.9**	**...**
Outstanding balance of credit [1]									
Private sector	–1.5	2.1	–0.3	1.0	2.1	...	2.7	3.0	...
Non-financial firms	–2.1	–0.6	–1.8	–0.6	–0.6	...	0.3	0.3	...
Households - housing	–1.4	3.2	0.1	1.4	3.2	...	3.8	4.5	...
Households - other purposes	–0.3	4.7	2.5	4.0	4.7	...	4.6	4.8	...
General government	–5.5	0.6	–5.8	–4.1	0.6	...	–0.3	1.0	...
TOTAL	**–1.7**	**2.0**	**–0.5**	**0.9**	**2.0**	**...**	**2.6**	**2.9**	**...**
NPL ratio *(%)* [2]	**2.7**	**2.4**	**2.6**	**2.6**	**2.4**	**...**	**–**	**–**	**–**

Notes: *1. Residents in Portugal. The credit variables exclude securitisations. 2. Period-end figure.*
Source: *BPI Research, based on data from the National Statistics Institute of Portugal, Bank of Portugal and Refinitiv.*

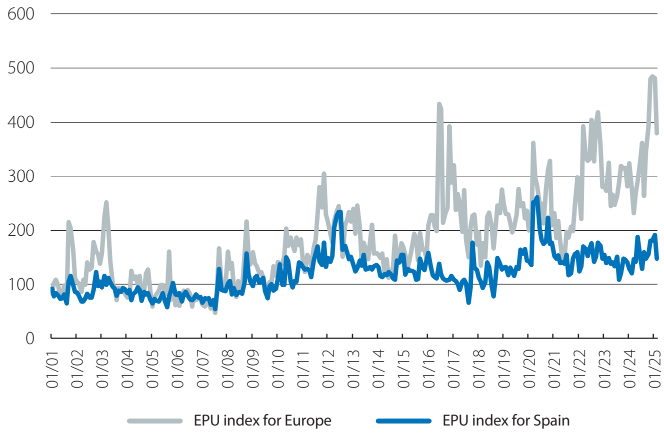
The Spanish economy continues to grow at a steady pace despite the uncertain international environment

Uncertainty is the buzzword of the moment, but it is felt less in our economy than elsewhere in Europe. The turbulent international context, shaken by the actions of the Trump administration, remains the subject of the utmost attention and concern. There is high uncertainty surrounding several elements: regarding the trade war unleashed by the US, about developments in the war between Russia and Ukraine and about the transatlantic relationship itself. Faced with so much uncertainty, it is worth differentiating its intensity by country. In Spain, the uncertainty indices, measured through textual analysis of the country's main newspapers, show a lower upturn than that observed for Europe as a whole. Spain's more contained exposure to trade with the US compared to Europe as a whole, or its distance from the Ukrainian front, could be some of the explanations for this gap. That being the case, for the moment, and while we wait for events to unfold, it seems that our economy ought to weather this period of uncertainty better than our main trading partners.

The services sector continues to enjoy rapid growth, while the turbulent international context is being felt in industry. On the services side, in Q1 the Purchasing Managers' Index (PMI) for the sector stood at 55.3 points, 0.2 points higher than in the previous quarter. Also, the production index for the services sector climbed a notable 1.5% month-on-month in January, propelling the year-on-year rate from 2.1% to 4.2%. In contrast, the manufacturing PMI fell 3.6 points in the Q1 2025 average compared to Q4 2024, to 50 points. This decline s explained by the weakness of foreign demand, affected by the uncertainty surrounding tariffs. In the same vein, the industrial production index began the year on a bad footing, with a month-on-month decline of 1.0%. On the consumption side, the signals are mixed. In the January and February average, the retail trade index was up 0.2% from the previous quarter average and the CaixaBank Research consumption indicator showed growth of 3.4% year-on-year, with data up until the third week of March, compared to the 4.0% registered in the previous quarter. However, it should be noted that the March readings were particularly modest, mainly because of the in-person consumption category, which may have been affected by the heavy rains during the month as well as by a calendar effect caused by Easter, which in 2024 fell in March. Finally, as we will discuss below, employment has continued to make good progress. Thus, despite their nuances, the available indicators continue to point to a significant rate of GDP growth, which we place in the range of 0.6%-0.7% quarter-on-quarter.

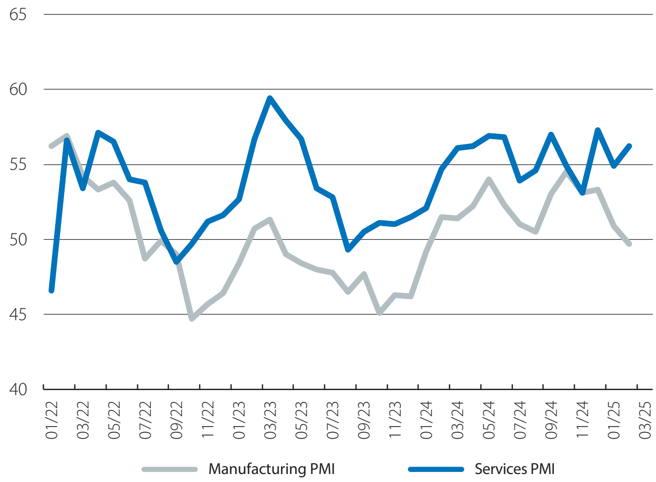
Job creation remains dynamic in March despite the fact that Easter falls in April this year. In March, the number of S.S. affiliates increased by 161,492 people (0.8% month-on-month).

Spain: economic policy uncertainty indices
Index



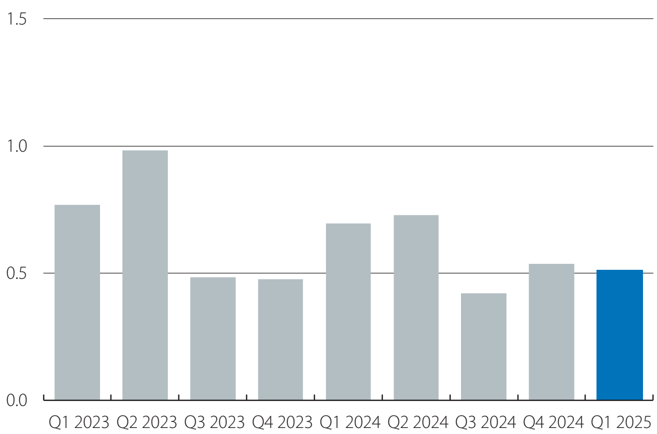
Source: *BPI Research, based on data from S.R. Baker, N. Bloom and S. Davis, and C. Ghirelli, J.J. Pérez and A. Urtasun.*

Spain: PMI
Level



Source: *BPI Research, based on data from S&P Global PMI.*

Spain: registered workers affiliated with Social Security
Quarter-on-quarter change (%)



Note: *Seasonally adjusted series of affiliates not on furlough (ERTE).*
Source: *BPI Research, based on data from the Ministry of Inclusion, Social Security and Migration (MISSM).*

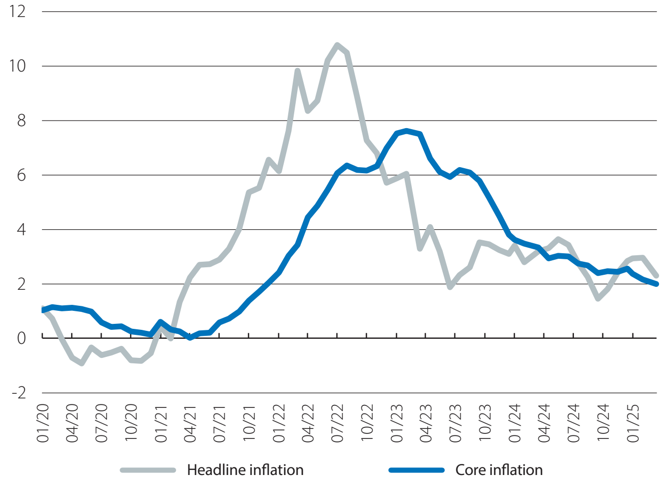
This is in line with the usual increase for this month of the year, but is slightly below the growth recorded in March 2024 (0.9%), given that last year Easter fell in March. In Q1 as a whole, the growth rate in the number of affiliates accelerated by 0.1 pp compared to the previous quarter, with an increase of 0.6% quarter-on-quarter after correcting for seasonality.

Significant reduction in inflation in March. Headline inflation fell by 0.7 pps in March to 2.3% and core inflation by 0.2 pps to 2.0%. This decline in headline inflation is largely a response to the drop in electricity prices. On the other hand, core inflation is following a pattern of sustained reduction, having fallen 0.6 pps in just three months, although this month's figure could be influenced by a calendar effect. Last year Easter fell in March, and this entailed an increase in the price of tourism services which has not materialised this month. The sharp price correction of the main energy commodities in March, coupled with the lower oil prices anticipated by the futures markets, suggests that energy prices should contribute to a moderation in inflation over the coming months.

The budget deficit fell to 3.2% of GDP in 2024 and stood just below 50.2 billion euros; this is equivalent to 3.15% of GDP and represents a reduction of almost 2.5 billion compared to 2023. Without counting the exceptional expenditure linked to the floods in Valencia, which was 5.59 billion euros, the deficit stood at 2.8% of GDP, 0.2 pps below the 3.0% target set by the government and the European Commission. Government revenues increased by 7.1%, driven by dynamic economic activity and still relatively high inflation, while spending grew by 6.2%, mainly due to increases in pension spending and public sector wages. 2024 closed with a considerable fiscal adjustment of 0.7 pps, if we exclude the exceptional expenditure due to the flooding.

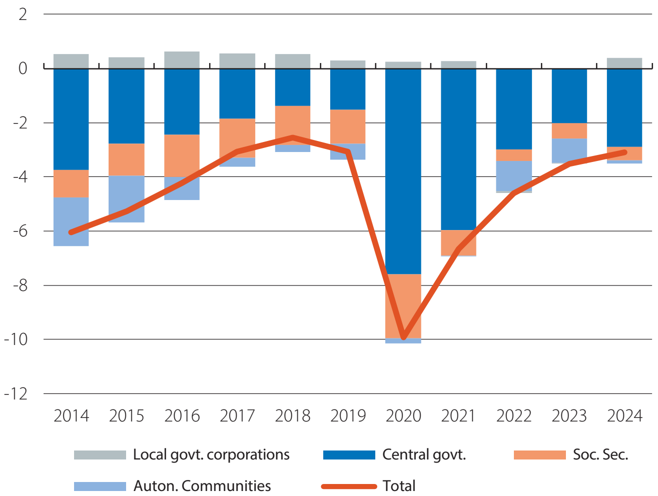
The foreign debtor position continues to decline thanks to the strength of the foreign sector. The current account balance closed 2024 with a surplus of 3.0% of GDP, up from the 2.7% of the previous year and very close to the historical peak of 3.1% reached in 2016. Both the balance of trade in goods and that of services contributed to the improvement in the current account balance: the deficit in the case of goods fell 0.3 pps to 2.0% pps of GDP, thanks to the energy component as a result of cheaper imports, while the surplus in services grew 0.1 pp, to 6.3%, thanks to the boost from tourism. In contrast, the deficit in the income balance remained stable at 1.3%. The healthy state of the current account, in conjunction with the surplus in the capital account, has further reduced the deficit in the net international investment position – the difference between the value of our assets abroad and that of foreigners' assets in this country – a dynamic which is discussed in more detail in the Focus «The high lending capacity continues to help reduce Spain's foreign debt» in this same *Monthly Report*. Specifically, the NIIP closed 2024 with a debit balance of 44% of GDP, 7.3 pps less than in 2023 and a level not seen since 2002.

Spain: CPI
Year-on-year change (%)



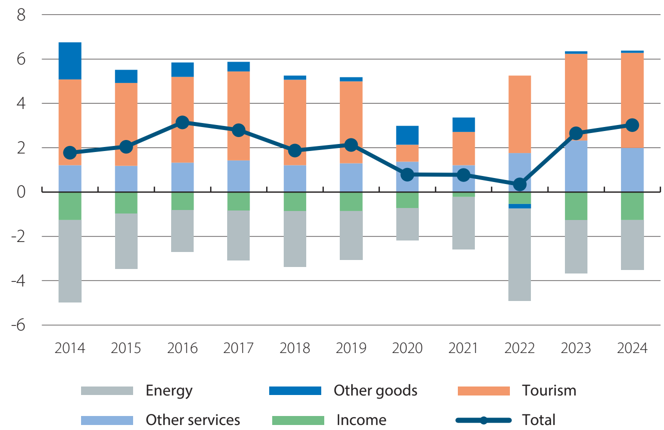
Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

Spain: general government balance
(% of GDP)



Source: *BPI Research, based on data from the Ministry of Finance.*

Spain: current account balance
(% of GDP)



Note: *Data on the trade in energy goods according to the classification of usage groups.*
Source: *BPI Research, based on data from the Bank of Spain and the Customs Department.*

Increase in Spanish household savings in 2024

The household savings rate has increased in 2024, favoured by the sharp rise in disposable income. Specifically, the savings rate rose to 13.6% of gross disposable income (GDI), up from the 12.0% recorded in 2023 and the historical average of 8.6% between 2000 and 2019 (see first chart). This amounts to 139.9 billion euros of gross savings, 26 billion more than in 2022 and 86 billion more than the average for the period 2015-2019. If we look at savings per household, the figure has gone from 5,800 euros per household in 2023 to more than 7,000 in 2024.

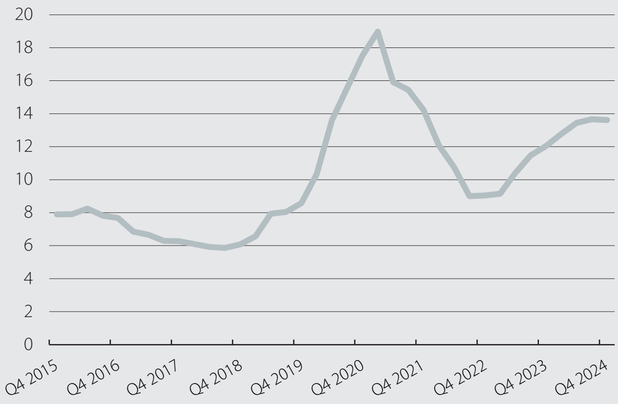
What is behind these figures? The increase in the savings rate has been driven by nominal GDI growth of 8.7% year-on-year. This is a dynamic growth rate, albeit slightly below that of 2023 (10.7%), and it is much higher than that recorded by household final consumption expenditure, which rose by 7.1% (see second chart). But what economic factors underlie these trends? The buoyancy of GDI has been due to a significant increase in wage-earners' remuneration (7.7%), reflecting the intense job creation that took place in 2024 (resulting in an increase in the number of wage earners) as well as the strength of wages themselves, as indicated by the 4.7% rise in the remuneration per worker. Other factors that have also contributed to the rise in incomes include social benefits received, which increased by 5.9% year-on-year as a result of the growth in the number of pensioners and the pension rise of 3.8%, self-employment income and net property income, thanks to an increase in the collection of dividends and other investment income in an environment of high interest rates that stimulate savers. All this has more than offset the increase in the negative contribution of direct taxes and social security contributions paid (see third chart). Finally, for the year as a whole, net interest payments (14.45 billion)[1] fell by 9% year-on-year and the debt burden represented 1.4% of GDI, versus 1.7% in 2023.

The increase in GDI clearly outpaced both average annual inflation (2.8%) and the growth in the number of households (0.7% according to the LFS) in 2024, enabling a recovery of purchasing power. Thus, in 2024 real GDI per household stood 4.1% above pre-pandemic levels, after having recovered that level in 2023, as shown in the fourth chart.

1. Before financial brokerage services (SIFMI).

Spain: household savings rate

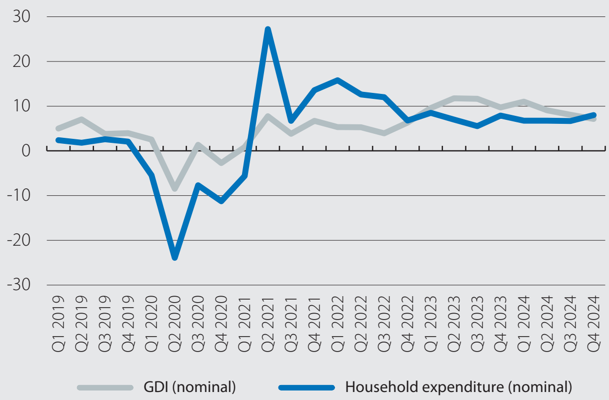
(% of gross disposable income)



Note: *Four-quarter cumulative data.*
Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

Spain: household gross disposable income and final consumption expenditure

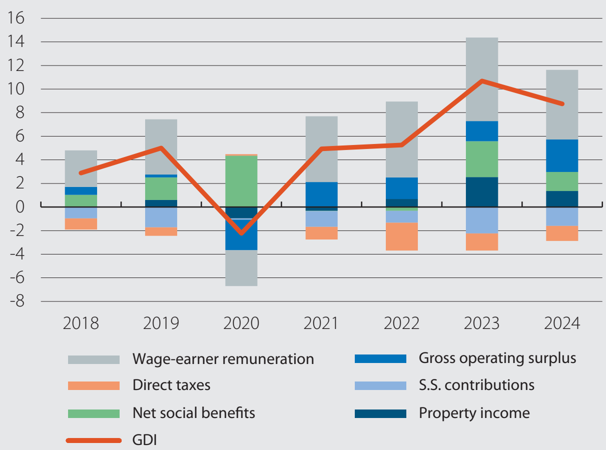
Year-on-year change (%)



Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

Spain: household gross disposable income

Annual change (%) and contributions



Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

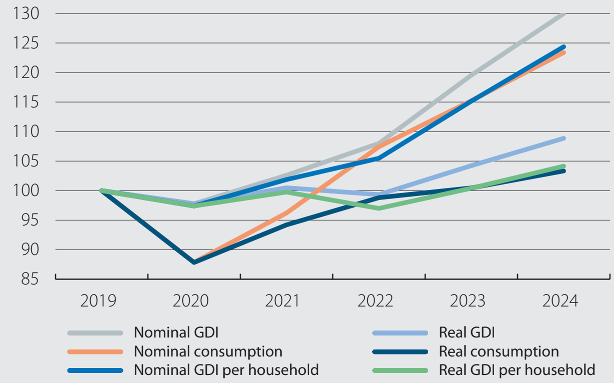
For this year, GDI growth is expected to remain dynamic thanks to the strength shown by the labour market. In fact, the final GDI figure for 2024 coupled with the good labour market data for Q1 2025 suggest that the growth of GDI could slightly exceed 5.0% this year. Such a growth rate is consistent with the good outlook in the labour market and the anticipated increase in pension spending, which AIReF estimates will reach 5.0% (2.8% due to pension rises plus 2 points driven by the replacement effect/new entries). Thus, if household spending registers a growth rate of around 6% – slightly lower than in 2024 in nominal terms due to the lower inflation – then the savings rate would be reduced by half a point this year to 13%. After the savings rate increased in 2024 with the rise in interest rates, in a context of falling rates it would be logical to see a decline in the savings rate. Other factors besides rates, such as uncertainty and differences between age brackets and income percentiles, help explain these high aggregate savings rates. According to a previous analysis by CaixaBank Research,[2] households of retirement age and those with higher incomes are the ones that have experienced the biggest increase in savings relative to the pre-pandemic period.

In Q4 2024, for the first time since Q4 2022, nominal GDI growth was lower than that of final consumption expenditure, indicating that in 2025 the savings rate is likely to decline. In Q4 (for the quarter only), nominal GDI grew by 7.2% year-on-year (8.1% in Q3), while final consumption expenditure grew by 8.0% (6.7% in Q3), reflecting the greater dynamism of private consumption in real terms. In order for these dynamics to consolidate this year, it is important that uncertainty, which has spiked as a result of the trade tensions, returns to more moderate levels.

Finally, households' lending capacity surged in 2024, going from 44.6 billion euros in 2023 to 74.4 billion euros in 2024. The reasons behind this increase include the higher savings (increase in gross savings from 26 billion to 139.9 billion) and the smaller relative increase in investment by households: gross fixed capital formation, which includes real estate purchases (new construction) and investment in physical assets by self-employed workers, stood at 70.7 billion euros in 2024, 6 billion more than in 2023. However, according to these statistics, investment is beginning to pick up following the revival of the housing supply: its growth stood at 9.5% year-on-year in 2024 after stagnating in 2023. In short, the strength of the labour market paved the way for a significant increase in household GDI in 2024. This increase, together with a more moderate pattern in spending despite its gradual revival, enabled significant growth in household savings.

Spain: household gross disposable income and consumption

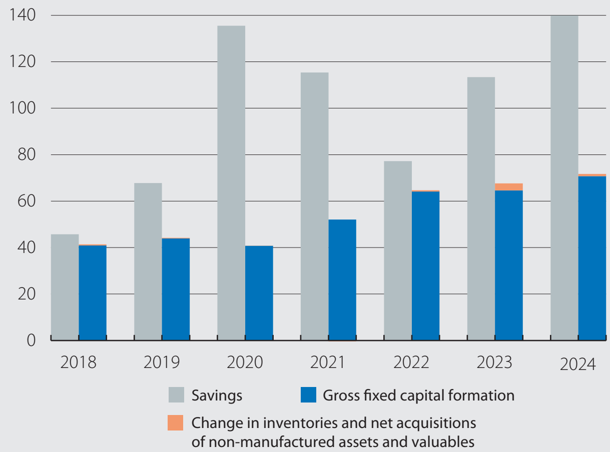
Index (100 = 2019)



Note: *Seasonally-adjusted data.*
Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

Spain: household savings and investment

(EUR billions)



Note: *Investment is the sum of gross fixed capital formation (acquisition of new housing and investment by self-employed workers in machinery and vehicles) plus the change in inventories, the net acquisition of valuable assets and the net acquisition of non-manufactured assets.*
Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE).*

2. See the Focus «The rise in savings: magnitude, distribution and the importance of demographics» in the MR01/2025.

The high lending capacity continues to help reduce Spain's foreign debt

The Spanish economy continues to reduce its foreign indebtedness – one of its main macroeconomic imbalances and a source of vulnerability in the event of potential shocks in the financial markets. This reduction is contributing to the lending capacity which the economy has been continuously generating for the past 13 years and which in 2024 reached a new all-time high (4.2% of GDP vs. 3.7% in the previous year). By economic agent, this high lending capacity was derived mainly from the non-financial private sector, including both corporations (0.9% of GDP) and, above all, households (4.7%): in the case of the former, the figure is much lower than in 2023 (2.0%) and also compared to the pre-pandemic average (3.2% in the period 2014-2019); in contrast, households showed an improvement relative to the 3.0% recorded in 2023 and to the 1.2% average of 2014-2019.[1]

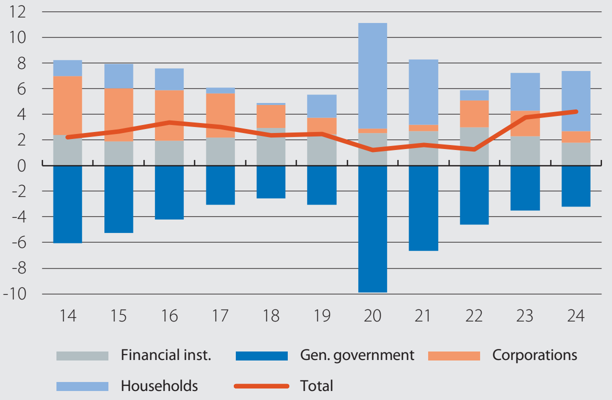
As a result, in 2024, the net international investment position (NIIP), which measures the balance of financial assets and liabilities vis-à-vis the rest of the world, showed a debit (negative) balance equivalent to 44.0% of GDP; this represents a significant reduction compared to the previous year (51.3%) and is the lowest figure since 2001. Despite the significant reduction in recent years (–53.2 points since the 2009 peak), it remains above the alert threshold set by the European Commission (35.0%) in the Macroeconomic Imbalance Procedure (MIP)[2] (see third chart).

Excluding the Bank of Spain, in 2024 the debit balance of the NIIP resumed the downward path that had been interrupted in the previous year and fell by 109.7 billion euros, bringing it to 530.4 billion: we need to go back to 2012 to find a bigger decrease. This improvement came from both a positive net change in value due to exchange rate fluctuations (the effect of the depreciation of the euro was somewhat more intense on the assets than on the liabilities) and price fluctuations (given their higher volume, the price reduction had a greater impact on the liabilities), and above all due to net financial transactions

1. The lending capacity reflects the positive difference between savings and investment. In the case of households, the improvement in recent years is due to the significant increase in savings, plus net capital transfers, of 4.4 points of GDP relative to the 2014-2019 average. This is more than enough to fund investment, which has also grown, but by somewhat less (1.6 points). In the case of corporations, besides the weakness of investment (which has lost 1.6 points of GDP) there has also been a significant decline in savings (–3.6 points).
2. A supervisory mechanism intended to prevent and correct potentially dangerous macroeconomic imbalances that could adversely affect economic stability in EU countries.

Spain: lending capacity/funding needs by economic agent

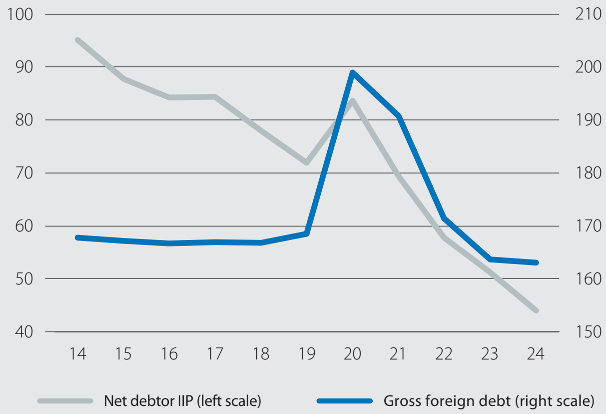
(% of GDP)



Source: *BPI Research, based on data from the Spanish National Statistics Institute (INE, non-financi accounts).*

Spain: debtor NIIP and gross foreign debt

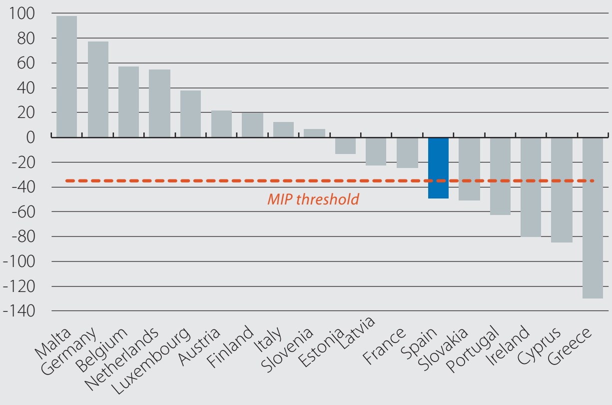
(% of GDP) *(% of GDP)*



Source: *BPI Research, based on data from the Bank of Spain.*

Euro area: NIIP

(% of GDP)



Note: *Data for Q3 2024.*
Source: *BPI Research, based on data from Eurostat.*

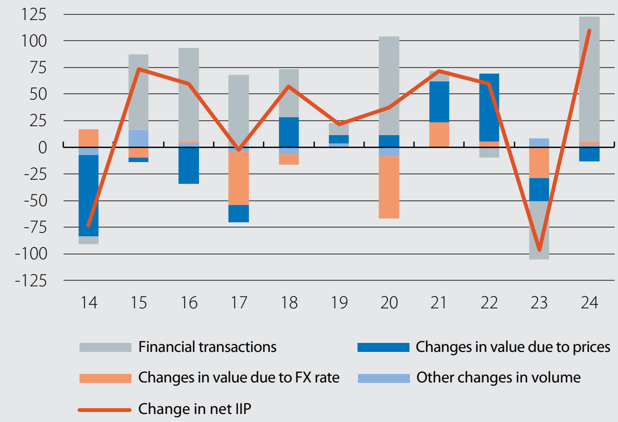
with other countries (the positive net transactions in the assets exceeded those in the liabilities, as shown in the fourth chart).

By financial instrument, all categories improved their balance in 2024, especially other investment;[3] this category went from –2.8% to 3.8% of GDP, marking its highest level since 1995, mainly thanks to foreign financial transactions (in addition to an increase in assets, there was a sharp drop in liabilities.) On the other hand, the debit balances reduced slightly, both in the case of direct investment[4] (–d14.6% vs. –15.6% of GDP) and for portfolio investment (–22.7% vs. –24.3% of GDP); in both cases this was thanks to positive transactions (the assets grew more than the liabilities), which more than offset the negative impact of prices.

By sector, last year only the general government sector registered a deterioration in its NIIP, which went from –38.1% to –40.2% of GDP, its worst figure since 2021. In contrast, significant improvements were recorded both in the Other Domestic Sectors category («OSR» in Spanish)[5] and, most notably, in Monetary Financial Institutions excluding the Bank of Spain («OIFM»):[6] in both cases, they went from a debtor balance to a creditor balance, reaching 2.5% and 4.3% of GDP, respectively (versus –1.8% and –2.8% the previous year), and marking the highest figures in the series. In the case of Other Domestic Sectors, this is also the first time this has happened: households and corporations have switched to having a net creditor position vis-à-vis the rest of the world. In other words, they have more assets than liabilities. This is the result, above all, of the savings generated by the non-financial private sector in recent years, which has been used, on the one hand, to reduce the level of debt (deleveraging) and, on the other hand, to acquire assets abroad (investment). The downside to this phenomenon is that this investment is not carried out in Spain, meaning that the positive effect it would have on economic activity, employment, innovation, productivity and business confidence is lost.

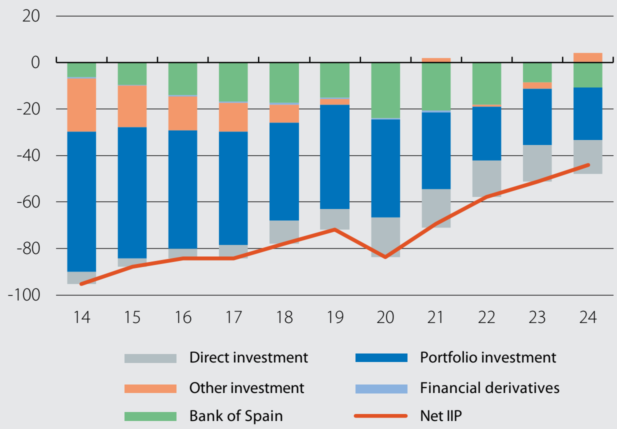
3. Mainly loans, repos and deposits.
4. Shares and other forms of equity, reinvested profits, investments in real estate and financing between related companies.
5. Households, corporations and non-monetary financial institutions (non-MFIs), including insurance firms and pension funds, among others.
6. Credit institutions, money market funds, electronic money institutions and financial credit establishments.

*Spain: change in NIIP by component **
(EUR billions)



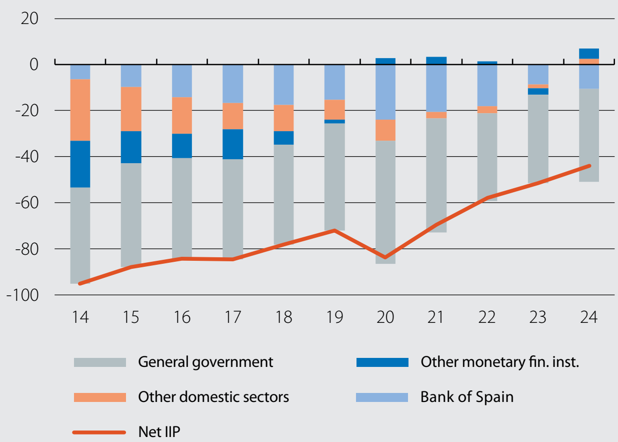
Note: ** Excluding the Bank of Spain.*
Source: *BPI Research, based on data from the Bank of Spain.*

Spain: NIIP by financial instrument
(% of GDP)



Source: *BPI Research, based on data from the Bank of Spain.*

Spain: NIIP by institutional sector
(% of GDP)



Source: *BPI Research, based on data from the Bank of Spain.*

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2023	2024	Q1 2024	Q2 2024	Q3 2024	Q4 2024	01/25	02/25	03/25
Industry									
Industrial production index	–1.6	0.4	0.7	0.0	–0.2	1.2	–1.0	...	...
Indicator of confidence in industry *(value)*	–6.5	–4.9	–5.1	–5.5	–2.9	–6.0	–4.4	–6.3	–5.6
Manufacturing PMI *(value)*	48.0	52.2	50.7	52.8	51.5	53.6	50.9	49.7	49.5
Construction									
Building permits *(cumulative over 12 months)*	0.5	16.7	2.0	4.6	10.2	16.7	13.7	...	...
House sales *(cumulative over 12 months)*	–10.2	10.0	–10.9	–10.0	–1.1	10.0	11.2	...	...
House prices	4.0	8.4	6.3	7.8	8.2	11.3	...	...	...
Services									
Foreign tourists *(cumulative over 12 months)*	18.9	10.1	15.8	14.3	12.3	10.1	9.7	7.7	...
Services PMI *(value)*	53.6	55.3	54.3	56.6	55.2	55.1	54.9	56.2	54.7
Consumption									
Retail sales[1]	2.5	1.8	1.2	0.5	2.6	2.8	2.3	3.6	...
Car registrations	16.7	7.2	3.2	8.5	1.7	14.4	5.3	10.5	23.2
Consumer confidence index *(value)*	–19.2	...	–17.2	–14.5	–13.7	...	...	...	...
Labour market									
Employment[2]	3.1	2.2	3.0	2.0	1.8	2.2	...	...	...
Unemployment rate (% labour force)	12.2	11.3	12.3	11.3	11.2	10.6	...	...	...
Registered as employed with Social Security[3]	2.7	2.4	2.6	2.4	2.3	2.4	2.4	2.4	2.2
GDP	**2.7**	**3.2**	**2.6**	**3.2**	**3.3**	**3.4**	...	...	...

Prices

Year-on-year change (%), unless otherwise specified

	2023	2024	Q1 2024	Q2 2024	Q3 2024	Q4 2024	01/25	02/25	03/25
General	3.5	2.8	3.1	3.5	2.2	2.4	2.9	3.0	2.3
Core	6.0	2.9	3.5	3.0	2.6	2.5	2.4	2.2	2.0

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2023	2024	Q1 2024	Q2 2024	Q3 2024	Q4 2024	01/25	02/25	03/25
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–1.4	0.2	–6.9	–4.9	–1.8	0.2	0.3	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–7.2	0.1	–9.8	–7.1	–3.1	0.1	0.8	...	...
Current balance	**39.8**	**48.1**	**41.3**	**45.1**	**48.3**	**48.1**	**45.3**	...	...
Goods and services	58.8	68.1	60.4	65.2	68.3	68.1	66.0	...	...
Primary and secondary income	–19.1	–20.0	–19.1	–20.2	–20.0	–20.0	–20.7	...	...
Net lending (+) / borrowing (–) capacity	**56.0**	**66.6**	**56.4**	**61.2**	**65.7**	**66.6**	**63.7**	...	...

Credit and deposits in non-financial sectors[4]

Year-on-year change (%), unless otherwise specified

	2023	2024	Q1 2024	Q2 2024	Q3 2024	Q4 2024	01/25	02/25	03/25
Deposits									
Household and company deposits	0.3	5.1	3.3	5.2	4.3	5.1	5.4	5.3	...
Demand and notice deposits	–7.4	2.0	–5.2	–1.9	–1.6	2.0	3.0	3.6	...
Time and repo deposits	100.5	23.5	96.7	68.0	47.5	23.5	18.7	14.4	...
General government deposits[5]	0.5	23.1	–4.6	–4.1	14.8	23.1	22.7	24.6	...
TOTAL	**0.3**	**6.3**	**2.7**	**4.5**	**5.1**	**6.3**	**6.6**	**6.6**	...
Outstanding balance of credit									
Private sector	–3.4	0.7	–2.6	–1.3	–0.3	0.7	1.4	1.5	...
Non-financial firms	–4.7	0.4	–3.6	–1.8	–0.6	0.4	1.5	1.3	...
Households - housing	–3.2	0.3	–2.5	–1.5	–0.7	0.3	0.8	1.1	...
Households - other purposes	–0.5	2.3	–0.1	0.7	1.2	2.3	2.8	3.0	...
General government	–3.5	–2.6	–4.8	–2.7	–5.4	–2.6	–0.8	0.0	...
TOTAL	**–3.4**	**0.5**	**–2.7**	**–1.4**	**–0.7**	**0.5**	**1.2**	**1.4**	...
NPL ratio (%)[6]	**3.5**	**3.3**	**3.6**	**3.4**	**3.4**	**3.3**	**3.3**	...	...

Notes: *1. Deflated, excluding service stations. 2. LFS. 3. Average monthly figures. 4. Aggregate figures for the Spanish banking sector and residents in Spain. 5. Public-sector deposits, excluding repos. 6. Data at the period end.*

Sources: *BPI Research, based on data from the Ministry of Economy, the Ministry of Transport, Mobility and Urban Agenda (MITMA), the Ministry of Inclusion, Social Security and Migration (MISSM), the National Statistics Institute (INE), S&P Global PMI, the European Commission, the Department of Customs and Excise Duties and the Bank of Spain.*

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