Portugal:

Macroeconomic and financial outlook

BPI *Research*

July 2023

Prepared with information available by July 13th, 2023

BPI Grupo CaixaBank

Main messages

Activity

- **Indicators of economic activity have moderated in May and June, but not in all sectors:** car sales and the number of flights accelerated, indicating that activity continues supported by tourism and private consumption. Regarding soft data, families' confidence has been improving, but manufacturing and retail sectors keep a more cautious position. **Our view for the whole year is that GDP will advance around 2,5%, slowing down to a level closer, but below, 2% in 2024, as higher interest rates will curb investment and consumption decisions. However, the resilience of the labour market, gradual deceleration of inflation and European funds will compensate the impact of more restrictive financing conditions.**
- **Inflation decelerated in June bellow 4%.** The inflation rate fell to 3,4% yoy, from 4,0% and core inflation declined to 5,3%, from 5,4% in May. The predominant sentiment continues to be that the disinflationary process will be very gradual but consistent, taking into account the relief in the energy component and the negative year-on-year changes in Industrial Production Price Index.
- **Labor market remains robust**. The unemployment rate has decreased for the 4th consecutive month in May, above the same month of the previous year but below the pre-pandemic May. However, the layoff numbers are a little bit worrying, considering the values clearly above the historical series.
- **Good performance of tourism up to May.** Compared to the pre-pandemic period, overnight stays in the first five months of the year increased by 13%.
- **In Housing market the number of sales is down 19% yoy in Q2 2023.** Despite this, the latest price data continue to point to increases, albeit more moderate than at the beginning of the year. The narrowing gap between houses on the market and houses sold continues to provide support.
- **Public accounts are performing very well.** Up to May, the public balance registered a surplus equivalent to 0,7% of GDP (cash basis and adjusted by the transfer of the Caixa Geral de Depósitos Employees Pension Fund to Caixa Geral de Aposentações, of about EUR 3.0 billion, an one-off that will have no impact on the official final figure). At the end of the year, the budget balance is expected to remain at -0.4% of GDP in 2023 (accrual basis), according to the Government's forecasts, a scenario that we consider reasonable. Regarding public debt, in a scenario of economic growth around 2% and lower inflation in the medium-term, the public debt ratio is projected to fell below 100% of GDP in 2025 and a primary surplus is expected in all projected period. Nevertheless, the increase in financing costs will contribute to a worsening of the amount spent on interest; in fact, with a cautious view, the Government expects this item to reach levels close to 3% of GDP in 2025. We consider these projections included in the Stability Program 2023-2027 feasible and close to our own forecasts.

Banking Sector

- **NPLs ratio increased slightly in Q1 2023.** Macroprudential measures continue to be relatively tight and should help to avoid major worsening of credit quality data: banks are expected to reduce gradually average maturity of housing loans to 30 years; institutions have to communicate the impact on the debt service of an hypothetical increase of interest rates by 300 basis points on mortgages loans. Additionally, the strong position of the labor market, expected to worsen only moderately, and the improved position of households and firms in terms of leverage, also suggest that the interest rate impact on credit quality might be contained, in a context of a stronger position of the banking sector.

Main economic forecasts

%, yoy	2016	2017	2018	2019	2020	2021	2022	Forecasts 2023	Forecasts 2024
GDP	2.0	3.5	2.8	2.7	-8.3	5.5	6.7	2.5	1.5
Private Consumption	2.6	2.1	2.6	3.3	-7.0	4.7	5.7	0.9	0.7
Public Consumption	0.8	0.2	0.6	2.1	0.4	4.6	2.4	1.0	1.0
Gross Fixed Capital Formation (GFCF)	2.5	11.5	6.2	5.4	-2.2	8.7	2.7	3.1	7.5
Exports	4.4	8.4	4.1	4.1	-18.8	13.4	16.7	7.2	6.0
Imports	5.0	8.1	5.0	4.9	-11.8	13.2	11.0	2.6	7.3
Unemployment rate	11.4	9.2	7.2	6.6	7.0	6.6	6.0	7.1	6.9
CPI (average)	0.6	1.4	1.0	0.3	0.0	1.3	7.8	5.0	2.8
External current account balance (% GDP)	1.2	1.3	0.6	0.4	-1.2	-0.8	-1.4	0.8	0.7
General Government Balance (% GDP)	-1.9	-3.0	-0.3	0.1	-5.8	-2.9	-0.4	-0.3	-0.1
General government debt (% GDP)	131.5	126.1	121.5	116.6	134.9	125.5	113.9	107.7	104.1
Risk premium (PT-Bund) (average)	307	269	138	98	89	60	98	94	102

***Source**: BPI Research*

GDP: keeping a positive performance

Latest economic indicators
YoY, Level

yoy, level	Mar-23	Apr-23	May-23	Jun-23
Economic climate indicator	2.1	2.3	1.6	1.6
Economic sentiment indicator	102.0	102.1	99.0	99.9
Daily economic indicator	3.6	2.0	3.6	1.2
Retail sales (yoy)	0.9	2.5	3.1	-
Retail sales excl. fuels (yoy)	0.5	0.6	1.5	-
Car sales (number)	21,244	15,875	19,816	22,041
Car sales (yoy)	58.9	27.8	54.6	42.1
Imports of capital goods (accum. year)	10.4	8.9	8.8	-
Cement sales	-2.6	8.1	3.3	1.2
Electricity consumption	-1.0	-5.6	-1.8	0.6
Non-resident tourists (yoy 2019)	13.9	14.9	8.5	-
Number of flights (yoy 2019)	10.3	5.0	5.2	6.8
Change in regist. unemployment (thousand people)	-20.1	-19.0	-10.5	-
Change in employment (thousand people)	27.8	48.2	62.1	-

Bank of Portugal new macroeconomic scenario
% YoY

Portugal		2022	2023	2024	2025	Accum. 23-25
GDP	**BdP jun-23**	**6.7**	**2.7**	**2.4**	**2.3**	**7.6**
(annual, %)	BPI mai-23		2.5	1.5	2.4	6.5
Unemployment rate	**BdP jun-23**	**6.0**	**6.8**	**6.7**	**6.7**	**0.7**
(annual average, %)	BPI mai-23		7.1	6.9	6.7	0.7
Inflation [1]	**BdP jun-23**	**8.1**	**5.2**	**3.3**	**2.1**	**11.0**
(annual average, %)	BPI mai-23		5.0	2.8	2.0	10.1
Budget balance	BdP jun-23	-0.4	-0.1	0.2	0.2	0.6
(% of GDP)	BPI mai-23		-0.3	-0.1	0.1	0.5
Public debt	**BdP jun-23**	**113.9**	**103.4**	**97.1**	**92.5**	**-21.4**
(% of GDP)	BPI mai-23		107.7	104.1	100.4	-13.5

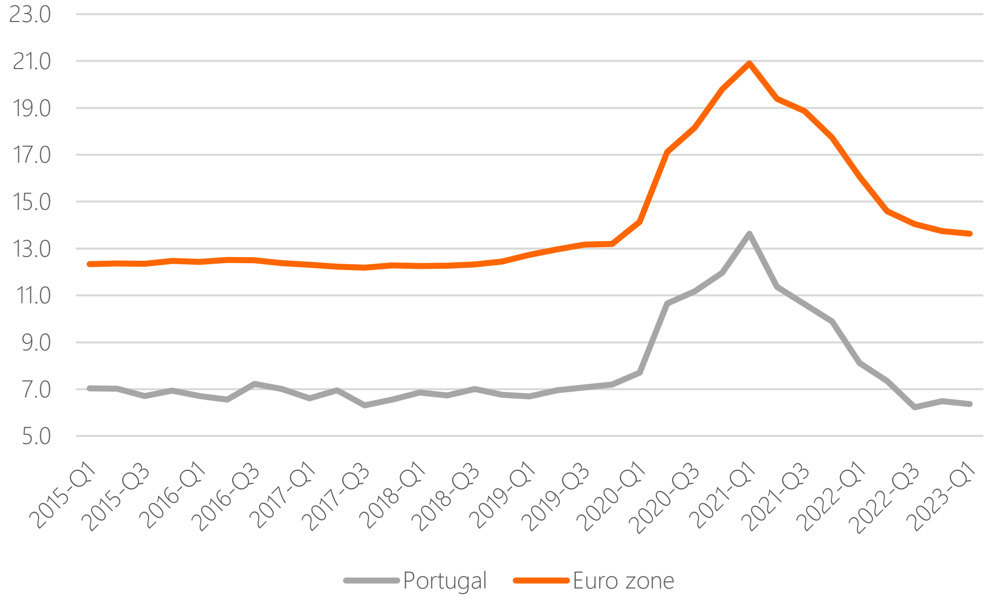
Note: [1] HCPI
Source: BPI Research, from INE, Bank of Portugal, EC

- **Activity is seen to continue to expand in Q2, albeit at a slower pace than in Q1, when GDP advanced 1,6% qoq. Recent data show that consumption and tourism keep evolving positively; other indicators as those related with labour market and investment (imports of capital goods) continue to perform well, being a support for growth going forward. Bank of Portugal updated its macroeconomic scenario, expecting GDP to post a 2,7% growth this year (1,8% in March).**
- In the coming quarters, growth should be supported by signs of deceleration of prices, some resilience seen in European economies, competitive gains (seen in tourism and other items) and the stimuli coming from the execution of NGEU. The expected absence of disruptions in the energy market, will support a gradual deceleration of inflation, helping households to improve its disposable income.

Households: saving rate is declining but also due to debt reduction

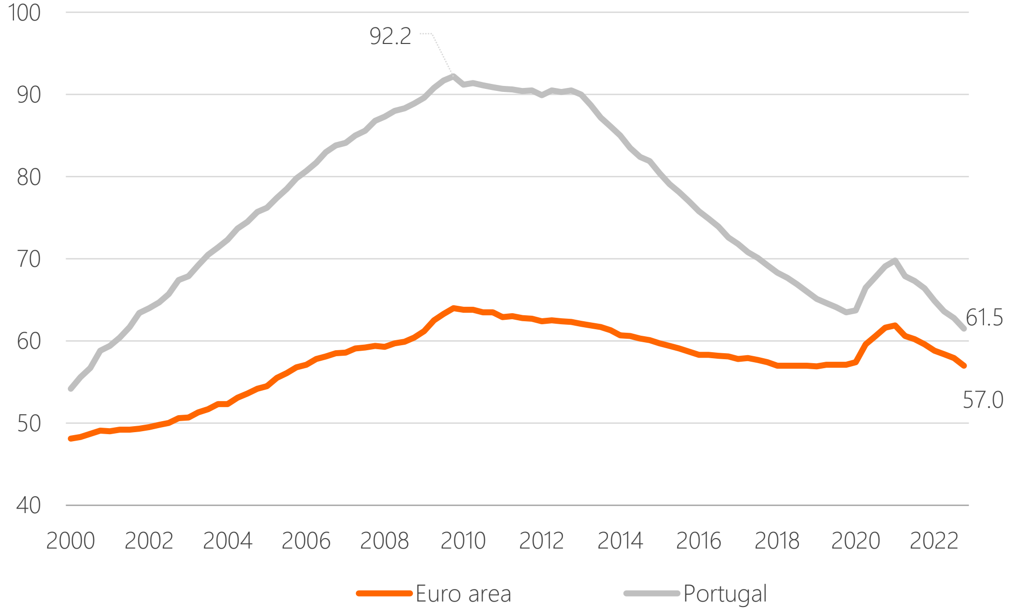
Saving rate (annual average)

% of Disposable income



Households debt

% of GDP



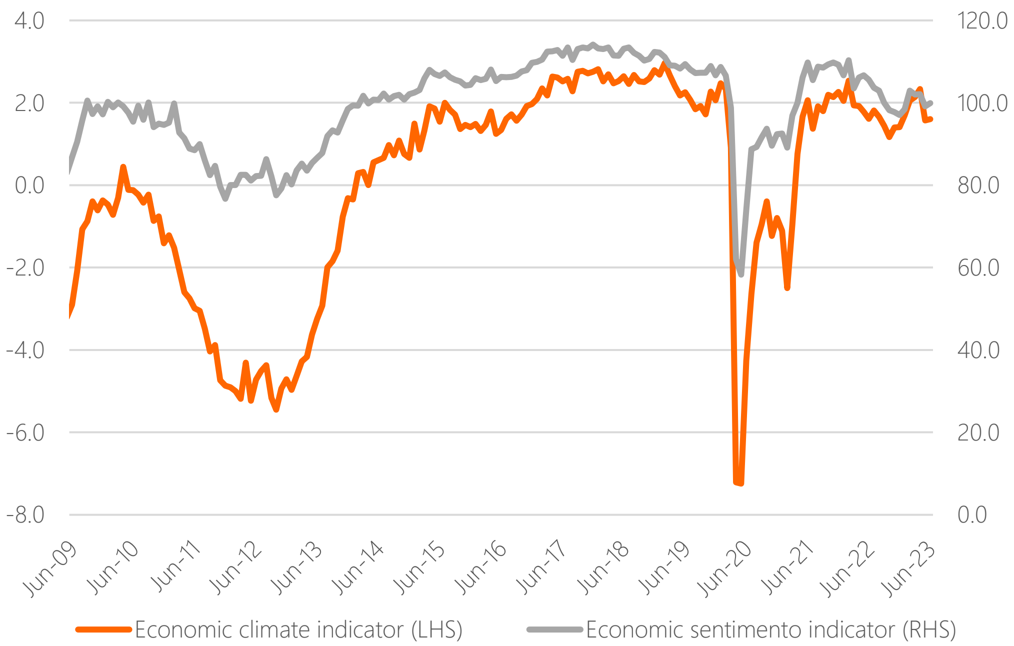
Source: BPI Research, from Eurostat

- **Last year, the savings rate declined markedly from the levels seen in 2020-21**, and reached 6,1% of disposable income (DI), on average. However, according to our calculations, extra savings during the pandemic were not yet completely depleted, but they are now much lower and should be concentrated in higher income households: by the end of 2022, we estimate that these extra accumulated savings still amount to circa EUR 6,6 bln, ie ~3% of GDP.
- **Worth to mention the reduction in households debt levels since the maximums reached during the pandemic**: less 7 p.p. to 61,5% of GDP. Indeed, according to the Bank of Portugal, early repayments of home loans have been increasing: in March, they represented 0,8% of the credit stock, similar to that recorded in first two months of 2023, but higher than the monthly average of 0,54% recorded in 2022.

The sentiment continues strong, albeit with mixed signals

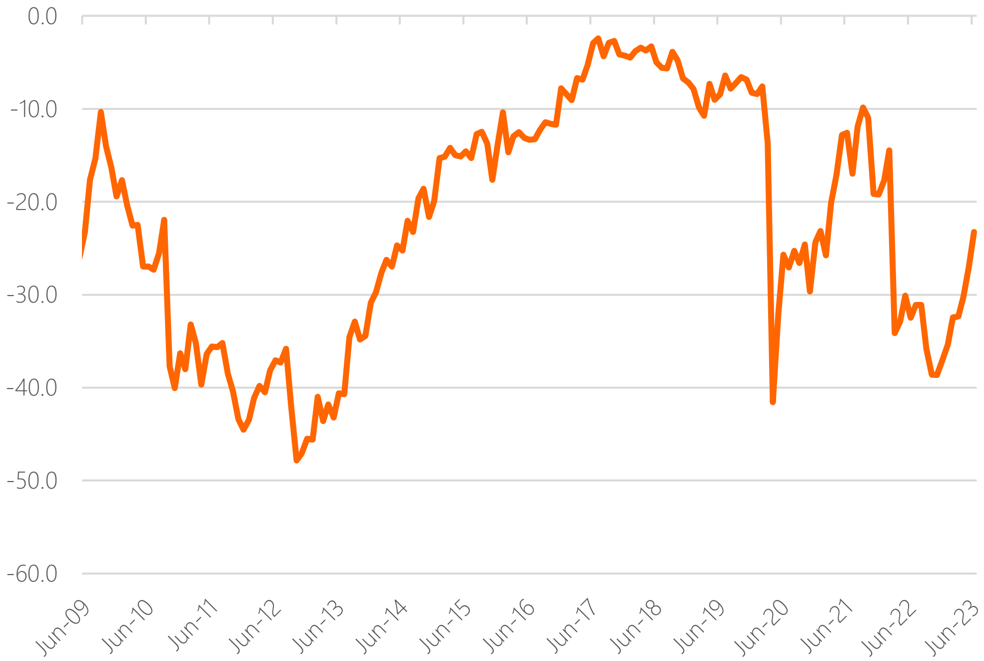
Grupo CaixaBank

Synthetic sectoral sentiment indicators
% yoy, level



Source: BPI Research, from INE, EC

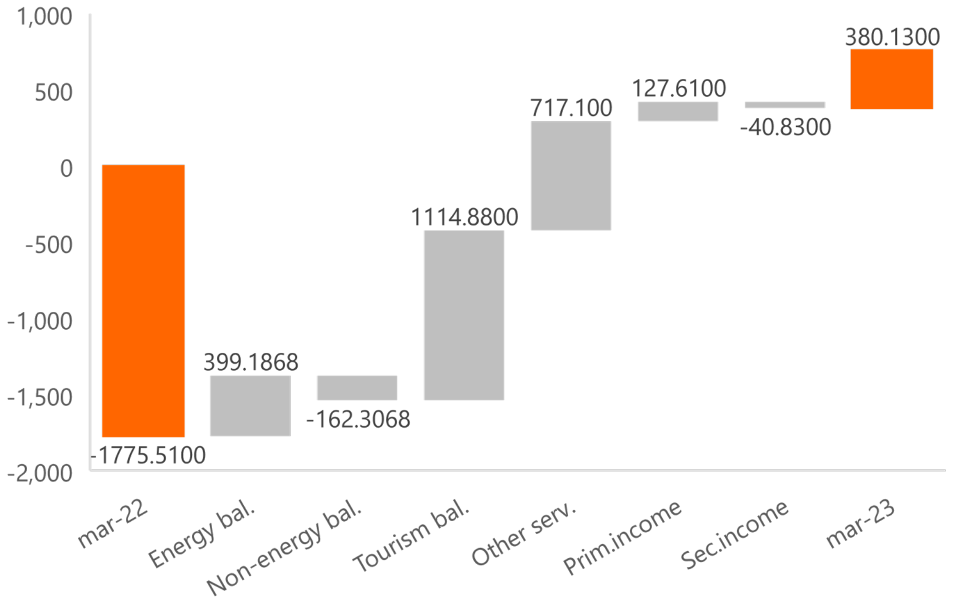
Consumer confidence
Level



- **INE's economic climate and EC economic sentiment indicators improved slightly in June, but continue at strong levels.** June's improvements was due to advances in confidence in services and construction.
- **Between consumers, confidence continues to recover**, reflecting a better outlook for price developments and positive evaluation of the labor market.

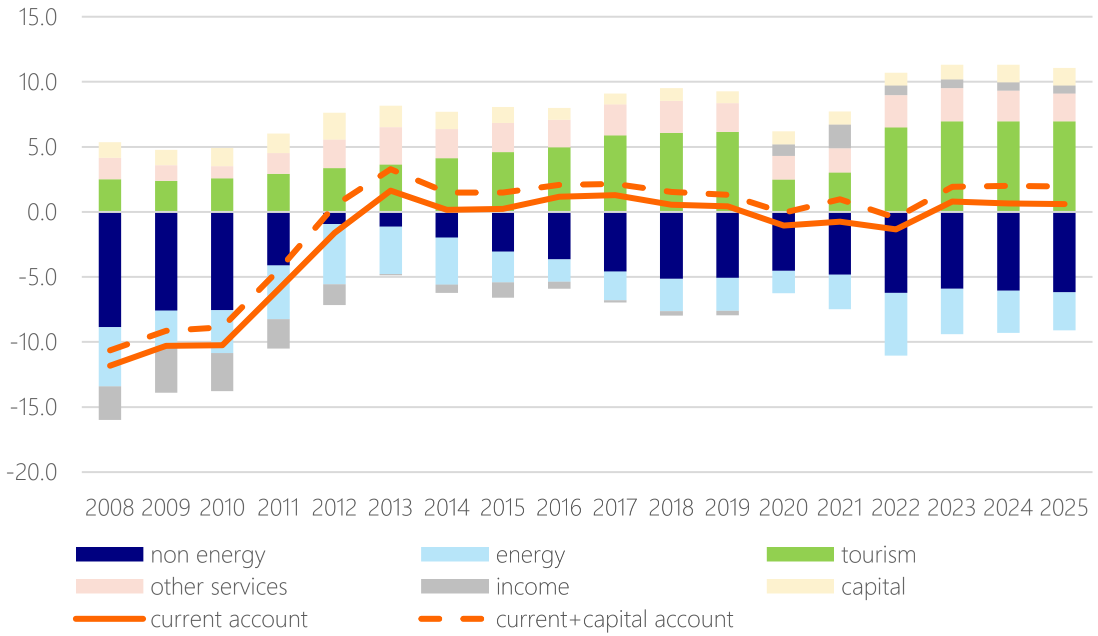
External accounts returned to surplus due to reduced energy prices, tourism dynamism and also structural improvements

Current account evolution in Q1 2023
EUR Million



Source: BPI Research, from INE

Current & capital account by components
% of GDP

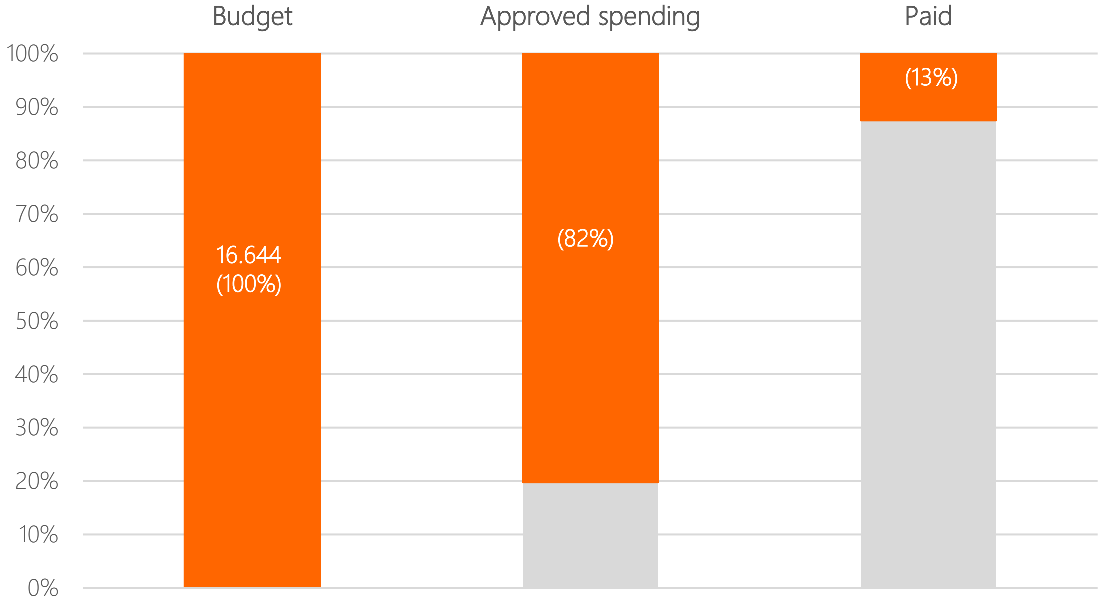


- **The current account posted a surplus in the Q1 2023, for the first time since 2018 (with the exception of a tinny surplus in 2021).** Compared to the same period a year ago, the main contributions to this improvement came from the services account (surplus of 5.2 billion, up 1.8 million from a year ago), particularly tourism (surplus of 3.3 million, +1.1 million), and the energy account (deficit of 2.1 billion, down 400 million from March 2022), reflecting the reduction in energy prices, which in March 2022 were at historically high levels.
- **Worth to mention the increase in the market share of services, with particular emphasis to tourism. The data now published and the dynamics expected for global and domestic activity suggest the possibility that the current account balance will again record a surplus at the end of 2023, equivalent to 0,8% of GDP.**

NGEU: a lot of projects in the pipeline

NGEU Funds up to May 2023

EUR million



Source: BPI Research, from Recuperar PortugalPI

Approvals and payments to direct and final beneficiaries

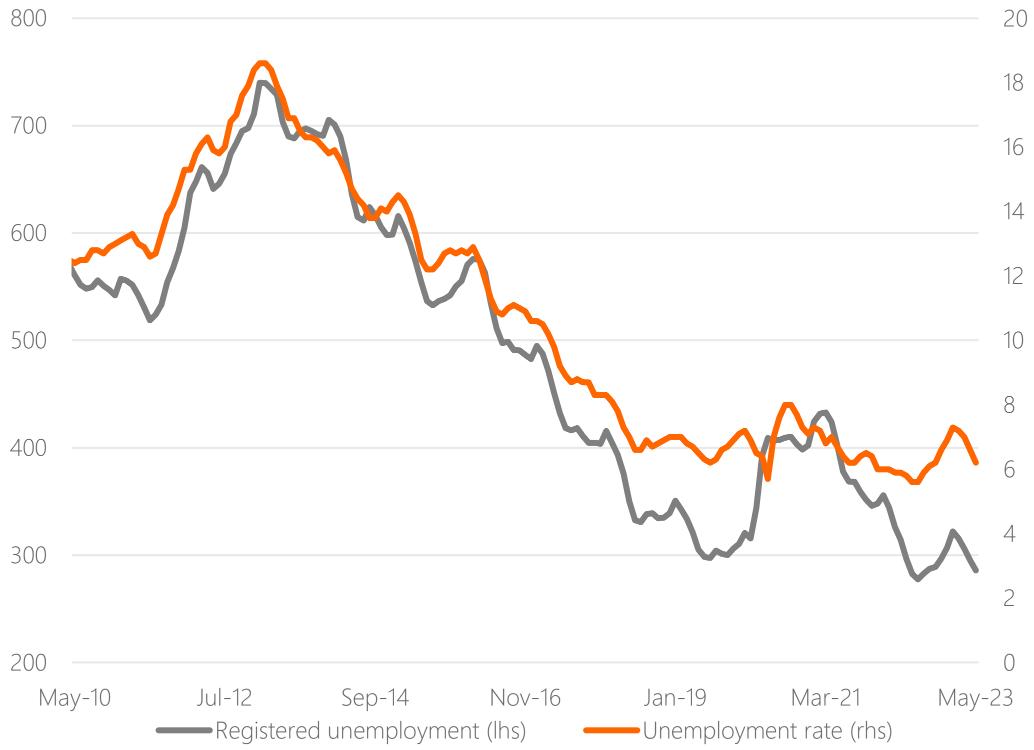
(Up to 5 July)	Approved (EUR million)	Paid (EUR million)	Paid rate
Families	173	144	83.2
Social and solidarity economy institution	337	45	13.4
Firms	3,711	523	14.1
Institutions of the scientific and technolc	328	36	11.0
Higher Education Institutions	624	70	11.2
Schools	369	221	59.9
Municipalities and metropolitan areas	1,338	142	10.6
Public entities	4,242	606	14.3
Public firms	2,240	308	13.8
Total (million euros)	**13,362**	**2,095**	**15.7**
(% total RRP)	***80.3%***	***12.6%***	

- **Up to 5/07/2023, the approval rate was of 82%, which looks promising for the use of the funds that Portugal will receive until 2026.**
- The Regulation of the Resilience and Recovery Mechanism foresees adjustments in the distribution of NGEU funds among the various countries according to the accumulated growth of real GDP in 2020-21, which **in the case of Portugal led to an increase of the funds to be received from 16,6 billion euros to 22,2 billion euros (2,4 billion grants and 3,2 billion loans).** Some priorities for these additional of grants and loans are the increase of the amounts available for companies, for the STEAM program (intended to strengthen labor force skills) and for the reinforcement of social equipment's. **The Portuguese authorities estimate that the impact of the funds currently available for the implementation of the RRP will led to an increase of 4,1% in potential GDP over the next 10 years.**

Labor market continues robust but it's worth to keep monitoring

Registered unemployment* and unemployment rate

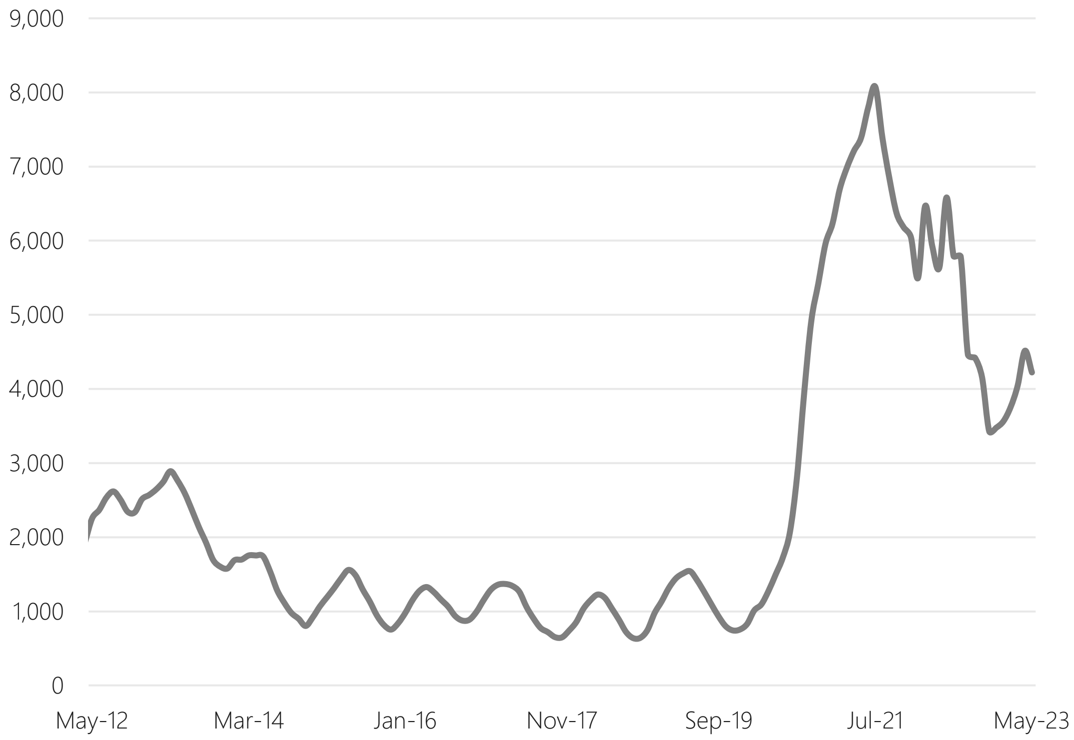
Thousand people (%)



Notes: (*) not seasonally adjusted. Source: BPI Research, from INE and IEFP.

Layoff*

6-months moving average (Number of individuals)



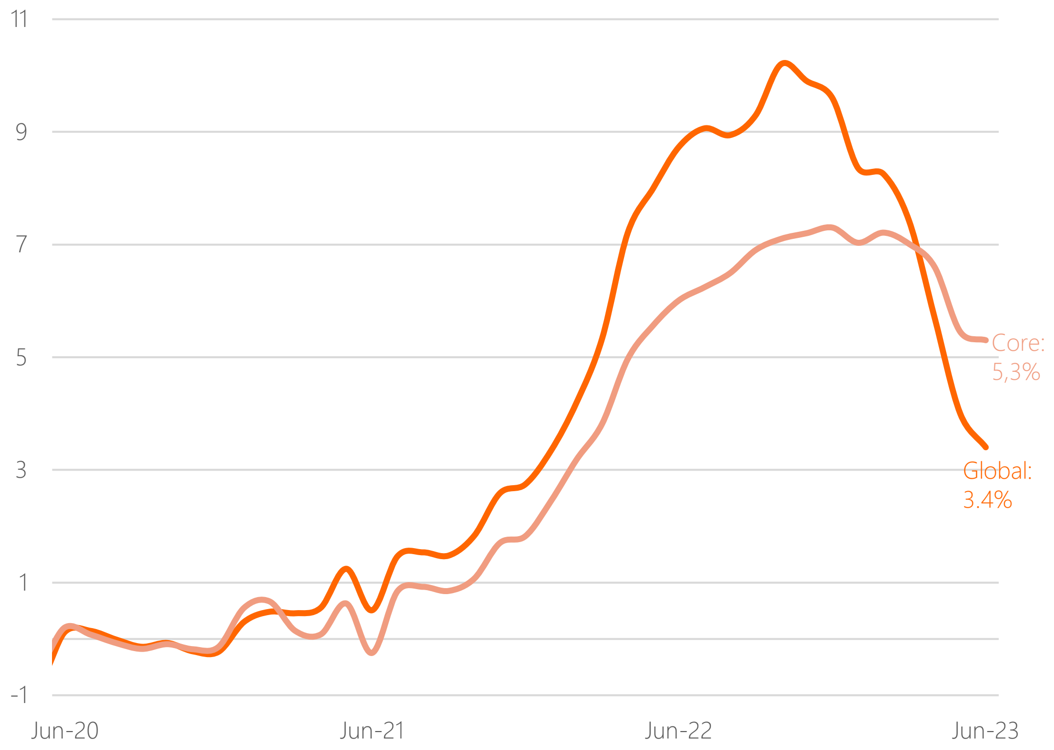
Note (*): Labor code regime. Source: BPI Research, from Social Security data.

- **Labor market remains robust.** Employed population keeps improving gradually, recording in May the highest value since the beginning of the series (1998), more than 4,9 million people. Additionally, the unemployment rate decreased for the 4th consecutive month in May, to 6,4%, even though it remains 0,4 p.p. above the rate recorded a year ago. Another positive signal is the inactive population, which is near the minimum, despite the recent slight increase.
- **However, there are some less positive signals.** Looking to the layoff data, the number of people in this situation is considerably above the average for May in the last 5 pre-pandemic years (5.043 individuals vs 1.069 on average). It seems that firms are trying to keep their employees in this uncertain context, probably taking into consideration the shortage of labor force reported.

Inflation: bellow 4% in June

Portugal CPI: Global & Core

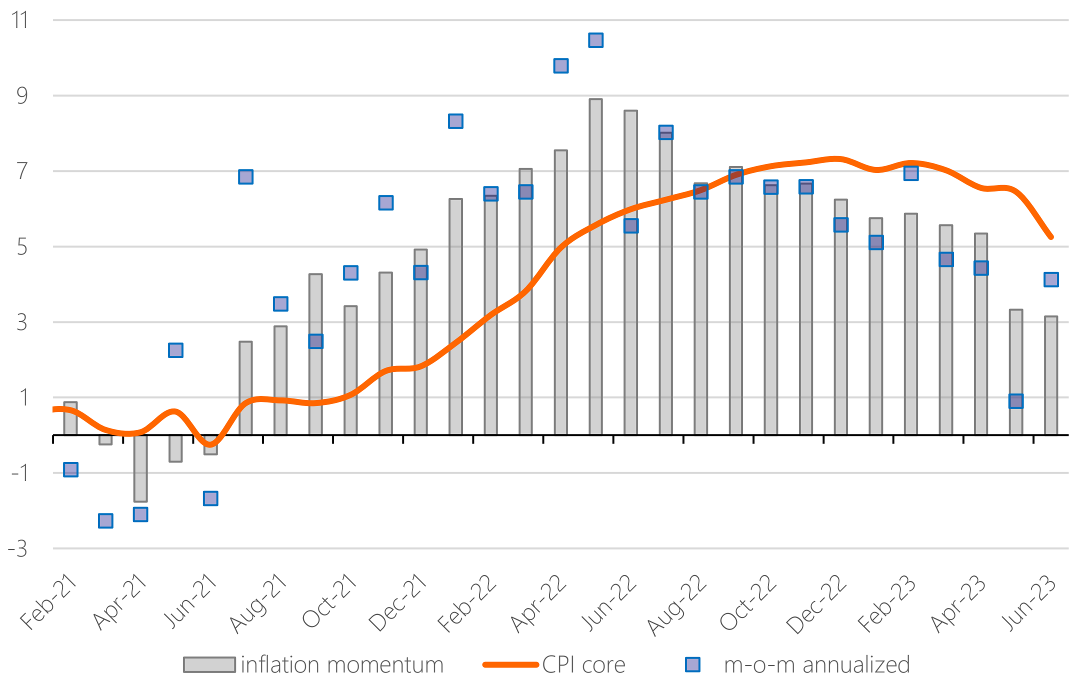
Year-on-year (%)



Source: BPI Research, using data from INE.

CPI Core: Inflation *momentum*

Year-on-year (%)

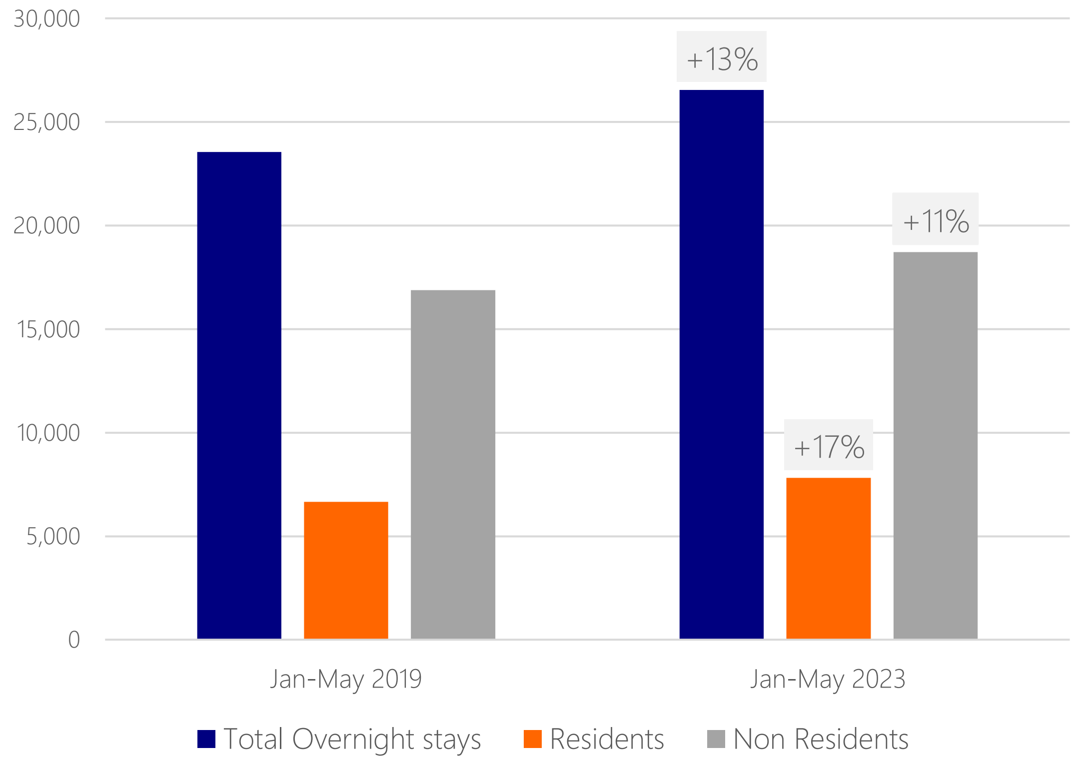


***Source**: BPI Research, using data from INE. Note: momentum refers to the 3-month average of annualised and seasonally adjusted month-on-month inflation.*

- **Inflation is now bellow 4%.** The yoy rate of change of the Consumer Price Index (CPI) slowed down to 3,4% in June, from 4,0% in May. The core inflation rate decelerated too, and kept above the global inflation: 5,3% (5,4% in May). Energy prices declined at a stronger pace (-18,8% yoy, down from -15,5% in May). Despite these year-on-year declines, the index as a whole returned to a positive month-on-month rate of change of +0,3% (-0.7% in May)
- Despite the positive monthly change in Core inflation (+0,16%) when we look at inflation momentum we see that the trend continues to be downward (3,2% vs 5,2% observed in June).

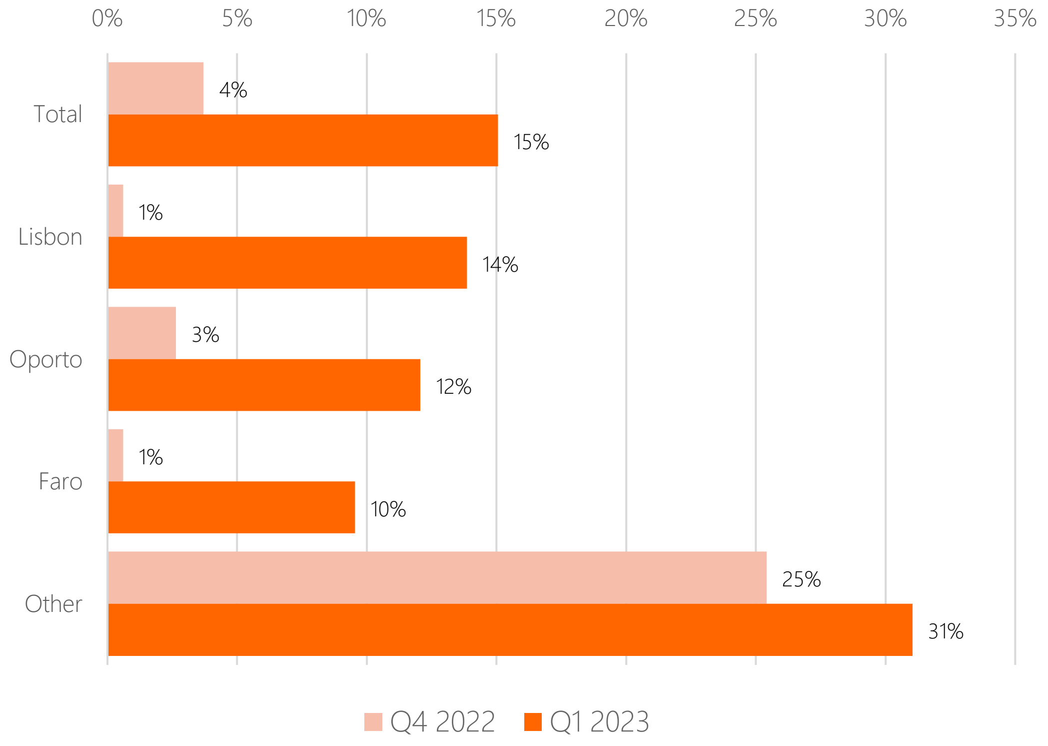
Tourism: keeping up the good trend

Overnight stays: Ytd May 2019 *versus* Ytd May 2023
thousands



Source: BPI Research, using data from INE.

Air traffic by airport in Q4 2022 and Q1 2023
Change compared to the same quarter of 2019 (%)

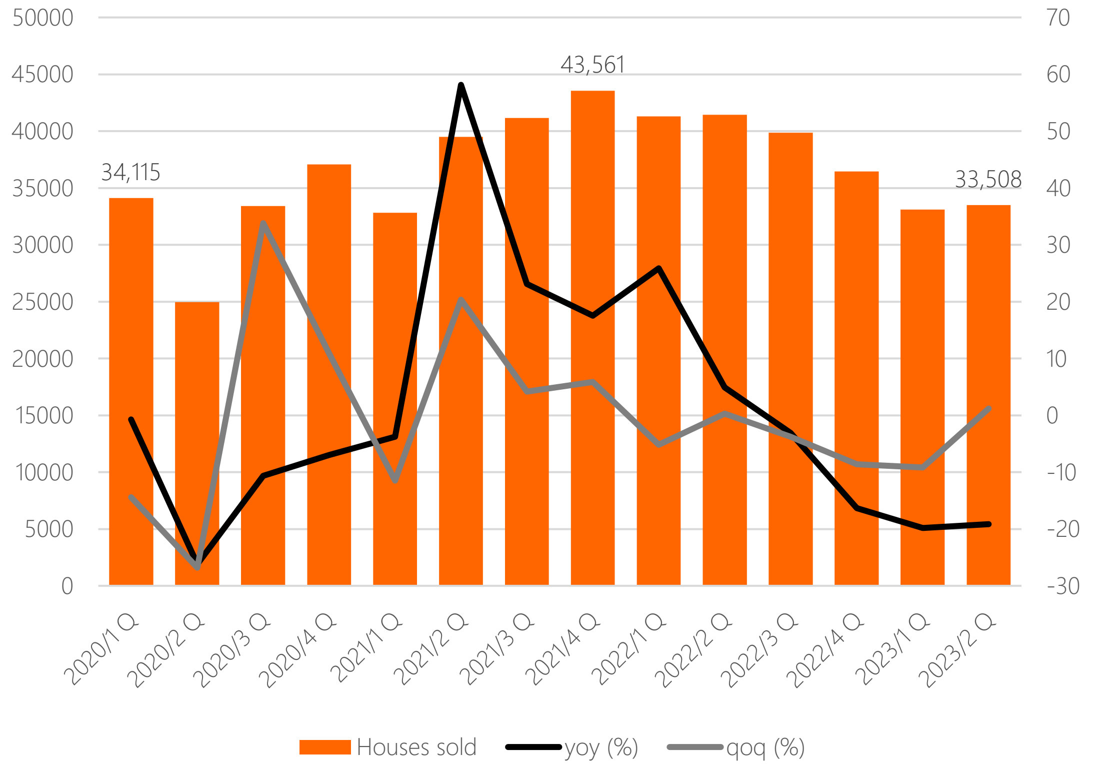


Source: BPI Research, using data from INE.

- **Up to May, the number of overnight stays in tourist accommodation establishments exceeded 26 million.** Compared with January-May 2019, overnight stays represents plus 13% in accumulated terms. The performance was similar considering the origin of guests: both tourism from residents and non-residents exceeded that of the same period of 2019 (by +17% and +11%, respectively).
- **The evolution of flight data also signals an auspicious dynamic.** All airports have more flights compared to the same quarter of 2019 and this change increased in Q1 2023 compared to Q4 2022.

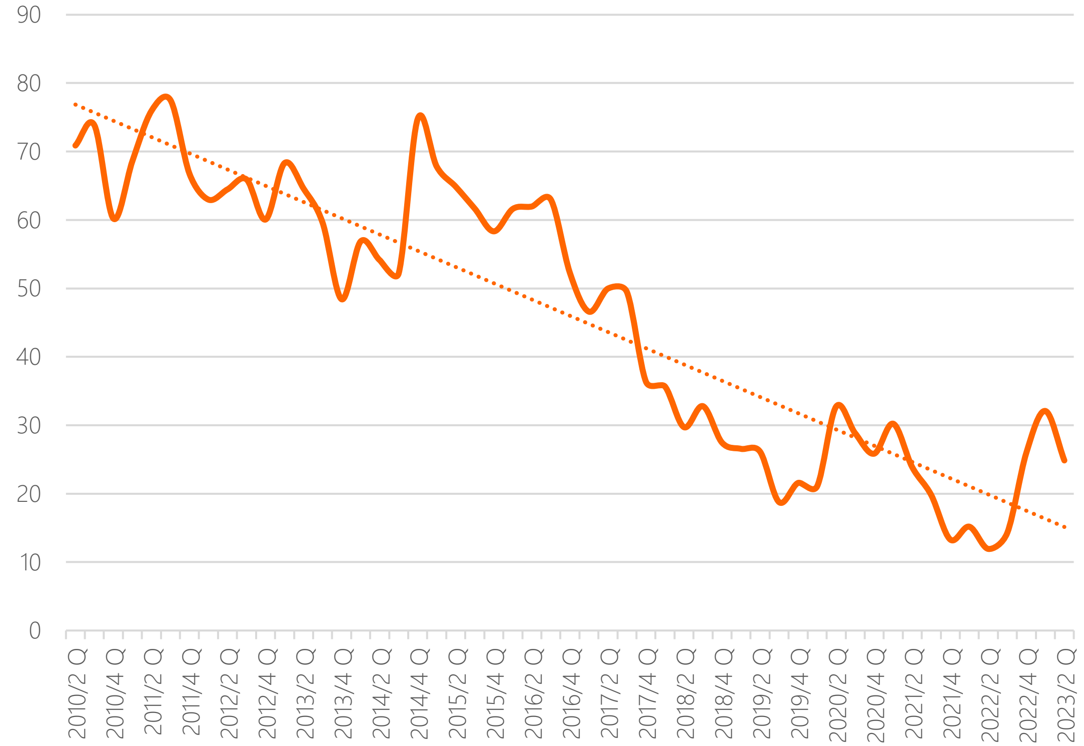
Housing market: sales down on a year-on-year basis

House sales (Confidencial Imobiliário)
Number (lhs) / % change (rhs)



Source: BPI Research, using data from Confidencial Imobiliário.

House surplus*
thousands

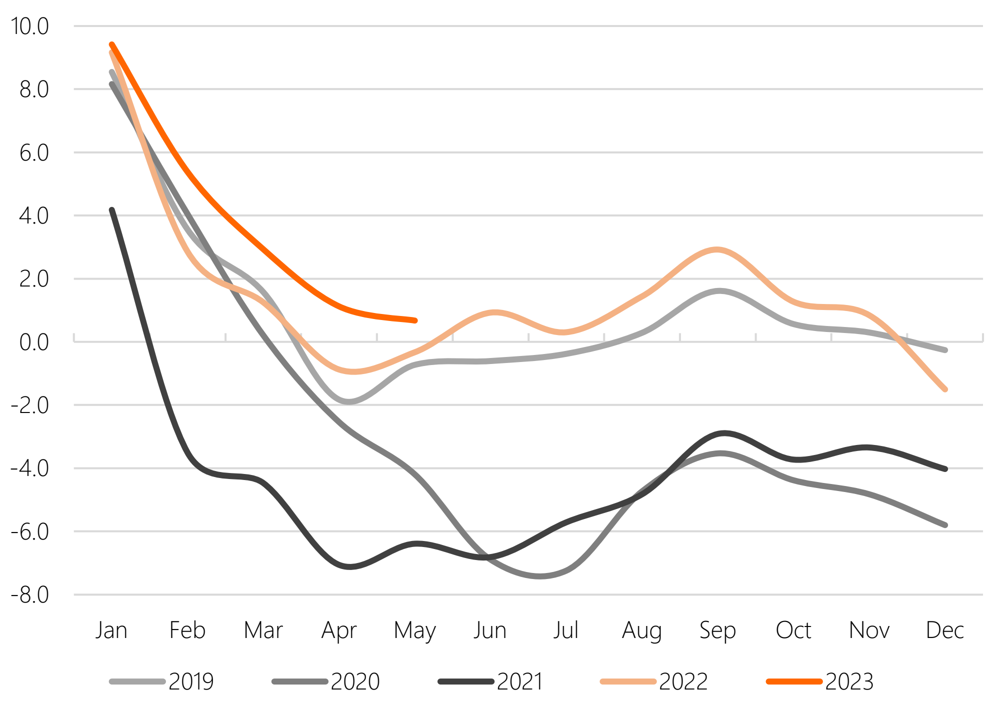


*Source: BPI Research, using data from Confidencial Imobiliário. *surplus corresponds to the difference between houses on the market and houses sold in each quarter*

- **Home sales are down year-on-year.** In fact, in the second quarter of 2023 transactions decreased by -19.1% year-on-year (-19.8% in Q1 2023). However, in quarterly terms they increased slightly (+1,2%), indicating some market stabilization.
- **Shortage of supply.** The tightness of the market continues to be a major support for house price increases (which according to Confidencial Imobiliário data will continue in Q2 2023). We can observe that the difference between houses for sale and houses sold has a consistent decreasing trend over the last decade.

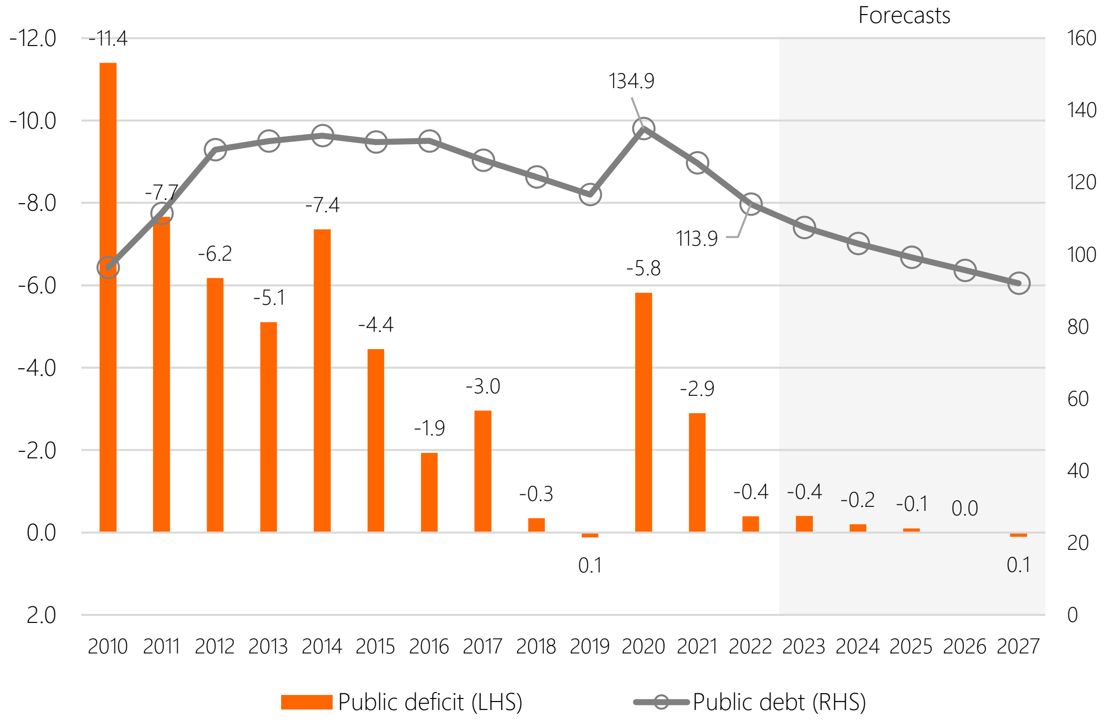
Committed with fiscal consolidation

Overall fiscal balance*
(% GDP)



Note (*): cash basis. Source: BPI Research, based on INE.

Public deficit and public debt ratio
(% of GDP)



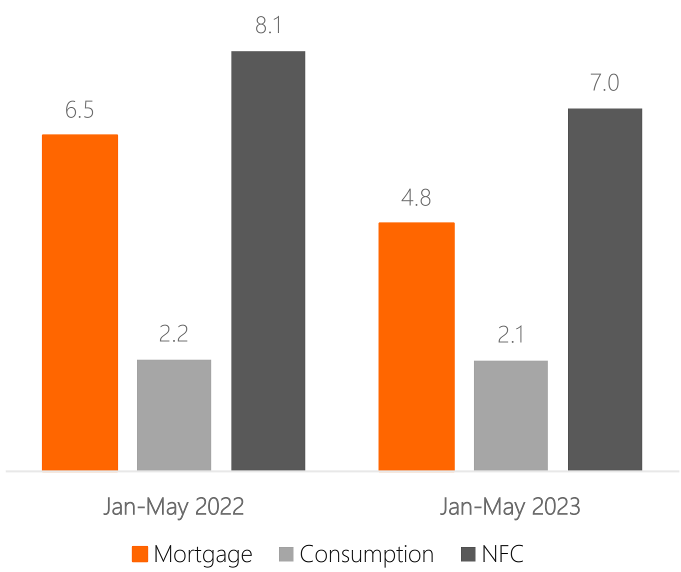
Source: BPI Research, based on INE and Stability Program 2023-2027.

- **Balanced public accounts is the medium-term target.** The budget balance is expected to keep at -0,4% of GDP in 2023, suggesting moderate support to the economic activity (Government estimates the reduction of the structural balance from -0,5% to -0,4%). In the medium-term, without the impact of the measures implemented to help families and companies to deal with higher inflation, the Government expects a slight surplus in 2027 (0,1% of GDP). This includes a projected adjustment to household taxes (income-related taxes) and an upward revision to pensions.
- In a scenario of economic growth around 2% and lower inflation, the public debt ratio is projected to fell below 100% of GDP in 2025 and a primary surplus is expected in all projected period. Nevertheless, the increase in financing costs will contribute to a worsening of the amount spent on interest; in fact, with a cautious view, the Government expects this item to reach levels close to 3% of GDP in 2025.
- Given the evolution of the public debt since 2019, in comparison with European peers, **Portugal is one of the countries that registers debt levels already below 2019 (113,9%)**, whereas the distance from Spain and France has been reduced (as both countries registered debt-to-GDP ratios above 100% by end-2022).

Banking system: a solid position to face the economic slowdown (1)

New lending activity by sector

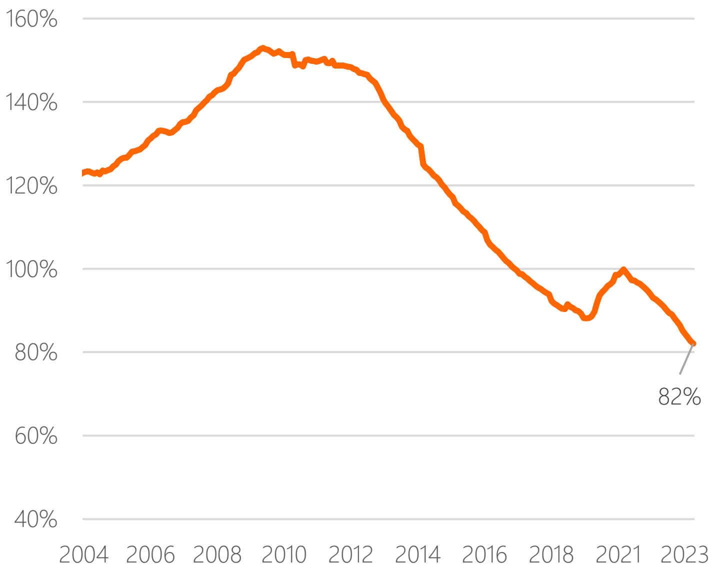
Accumulated in the year, billion euros



Source: BPI Research, base on data from Bank of Portugal and ECB.

Bank credit to the private non-financial sector

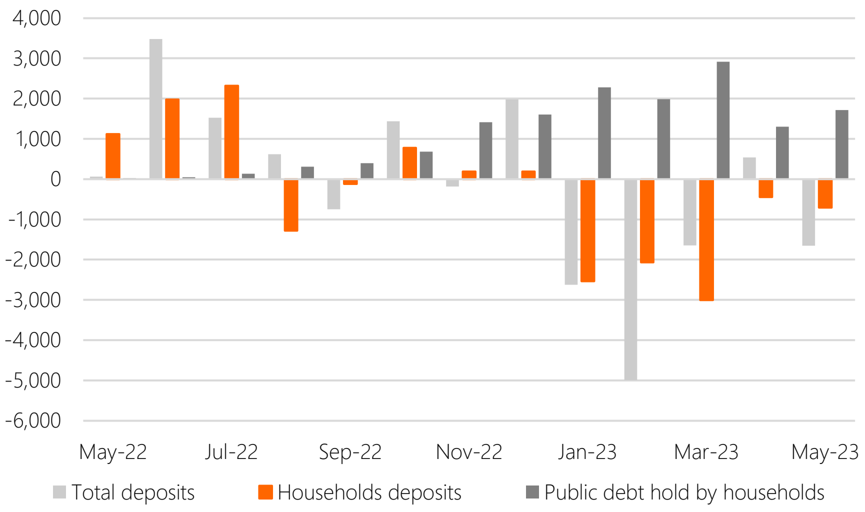
% GDP



Source: BPI Research, base on data from Bank of Portugal and INE.

Deposits and public debt hold by families*

Monthly variation (M€)

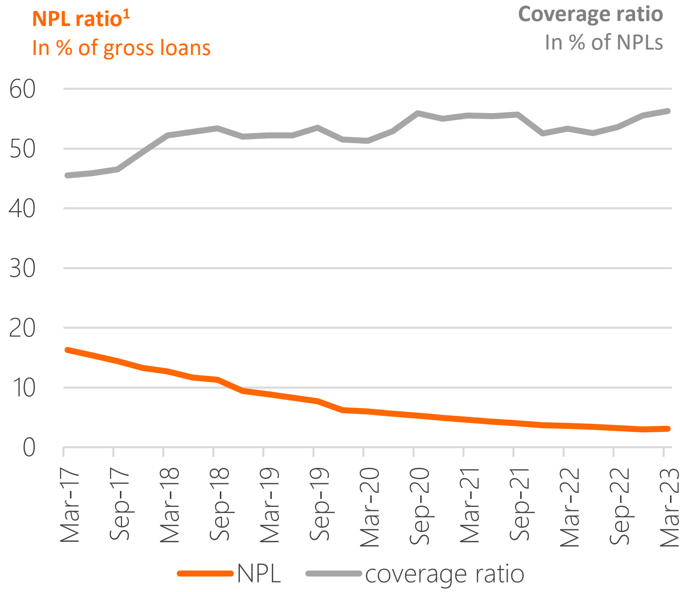


Notes (*): Public debt by households includes Certificados de Aforro and Certificados do Tesouro, which can only be subscribed by resident households. The maximum amount that Government can issue for these retail instruments (CA and CT) is 16.5 bn Eur in 2023. Source: BPI Research, base on data from Bank of Portugal and IGCP.

- **The stock of credit is decelerating since mid-2022:**
  - **Mortgage credit:** significant deceleration (0,5% yoy in May vs 2,7% in January), in line with the drop in new operations (-26,2% yoy accumulated in the first five months of 2023) and the amount of early redemptions. High levels of interest rates, inflation and housing prices explain this decline, which should continue next months. However, the absolute amount of new mortgage operations remains high by historical standards.
  - **NFC**: the stock has been declining since mid-2022, due to the redemptions of COVID-credit lines and the worst start of the year for new credit operations (the lowest value since the beginning of the series, 2003).
- Since December, **deposits in the banking system have been declining** (-11,8bnEur ytd). The pursuit for alternative applications (especially in the case of households, which can subscribe Treasury products directed to the retail segment - Certificados de Aforro (CA's) and Certificados do Tesouro, for instance), the early repayment of debt or higher expenditure needs (due to the high inflation and interest rates) are some of the reasons behind this evolution. However, considered together, the aggregate amount of households' deposits and Treasury products is stable, meaning that this specific financial savings keeps stable.
- Deposits of the private sector decreased in May (-1,6% yoy) for the second consecutive month, especially due to households' deposits (-2,7% yoy). Meanwhile, interest rates for new deposits have been increasing (last May, household's deposit interest rate reached 1,26%, the highest rate since November 2014). Together with the recent change in CA's new subscription conditions (maximum interest rate of 2,5%), this may probably limit the recent outflows to retail instruments.

Banking system: a solid position to face the economic slowdown (2)

NPLs and coverage ratios



Cost of risk[1]
0.5% in 2019
0.3% in Q4 2022

Notes: (1) flow of impairments to credit as a percentage of total gross.
Source: Bank of Portugal

Banks' profitability

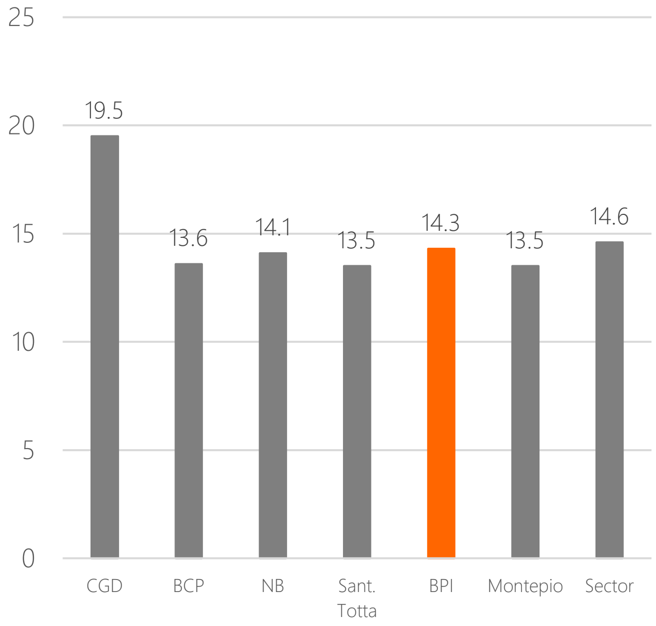
In % of average total assets (Q1 23; trailing 12M)

	BPI	BCP	San Totta	CGD	NB	Montepio
Net interest income	**2.0%**	**2.0%**	**1.8%**	**2.1%**	**2.2%**	**1.9%**
Net fees	0.7%	0.8%	0.8%	0.6%	0.6%	0.7%
Gains on financial assets	0.1%	0.1%	0.1%	0.4%	0.2%	0.0%
Other net profits	-0.3%	0.0%	0.0%	-0.2%	-0.4%	-0.2%
Gross income	**2.6%**	**3.0%**	**2.7%**	**2.8%**	**2.5%**	**2.3%**
Operating expenses	-1.2%	-0.9%	-0.8%	-0.9%	-1.0%	-1.4%
Operational result	**1.4%**	**2.1%**	**1.9%**	**1.9%**	**1.6%**	**1.0%**
Impairement losses, taxes and others	-0.2%	-0.6%	-0.1%	-0.2%	-0.2%	0.2%
Profit	**0.7%**	**1.0%**	**1.2%**	**1.0%**	**1.3%**	**0.7%**
ROTE[1]	9.5%	17.7%	19.7%	13.1%	-	9.3%

Notes: 1) the values for BCP and CGD refer to ROE; calculation methodologies differ between banks.

Banks' solvency and liquidity position

*In % (Q1 23)**



Source: Banks publications, BoP
*Note: *Q4 for the whole sector*

- **NPLs reverted slightly from the descending trend seen in last years.** The total NPL ratio increased by 0,1 p.p., to 3,1% in Q1 2023, due to the behavior of consumption & other (7,0% vs 6,9% in Q4 2022). For NFC, the ratio continued to decreased (-0,2 p.p., to 6,3%). It is possible that these ratios will worsen slightly in the coming months, reflecting the impact of increasing interest rates and prolonged inflation in households and firms consumption and costs.
- **Profitability remains well above the pre-pandemic period,** in Q4 it improved by 5,2 p.p., to 13,9% (ROE). Profitability is expected to benefit from higher interest rates.
- **The capital position of Portuguese banks provides buffers against the risks that could arise, due to the conflict in Ukraine and the impact of high interest rates on NPL's.**

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