Portugal:
Macroeconomic and financial outlook

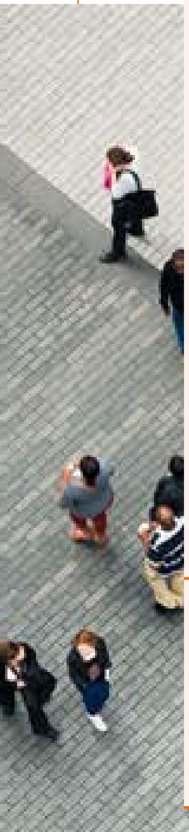
BPI *Research*

February 2024

Prepared with information available by February 7th , 2024

BPI Grupo CaixaBank

Main messages



Activity

- **In Q4, GDP grew 0,8% qoq, putting annual growth in 2023 at 2,3%, 0.1 p.p. below the BPI's research forecast.** According to INE, domestic demand accelerated and the contribute of foreign demand become less negative. **Economic data available for 2024 is still scarce, but suggests activity continues to expand at moderate pace**. **2024 will be a year with a positive trend.** 1H24 will still be conditioned by the impact of high financing costs, but as the easing cycle by the ECB begins, an acceleration of activity is expected. More robust balance-sheets in the Public sector, companies and households (low debt levels), a still robust labor market, the acceleration of reforms and the PRR execution should also be key to growth dynamics in the next couple of years. All in all, we see the economy to expand a little more than 1,5% in 2024 and probably accelerate higher than 2% in the following years.
- **Inflation rose again at the beginning of 2024, above 2%, in a move that had been somewhat anticipated.** In fact, the update of electricity prices on the regulated market and the end of the Zero VAT measure on a wide range of food products meant that this move was no surprise. Even so, we see the downward trajectory in inflation as a consistent trend for 2024 (the core component continued to slow down in January), supported not only by the cumulative effect of monetary policy but also, for example, by the fall in industrial production prices.
- **The tourism sector recorded an excellent performance in 2023 and we expect growth in 2024, albeit more contained.** On the one hand, the rebound effect of post-pandemic recovery is exhausted (pre-pandemic levels have been exceeded). On the other hand, we don't expect a recession in the eurozone (the main source market) and there will be some household income recovery via less inflation, wage rises and interest rate cuts expected this year.
- **In housing market we now expect the average house price increase in 2023 to be around 8 %, slowing down after the 12.6 % recorded in 2023,** but higher than our forecast (7,1%). This idea is reinforced not only by the data we have from price indices drawn up by alternative sources, but also by the fact that the amounts of mortgages contracted at the end of 2023 have increased monthly and year-on-year (in October, November and December). The resistance of this market to the peak in interest rates makes us believe that in 2024 the appreciation will continue, albeit in more modest terms.
- **The fiscal balance registered a surplus, on a cash basis, of 1,6% of GDP in 2023** (excluding 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). **This performance allowed the decline of the public debt ratio to 98,7% of GDP** for the first time since 2009 in 2023, a year earlier than the government had budgeted for 2024.
- **Upcoming elections (March 10th) may alter the implicit scenario for public accounts, depending on the new Government political composition. However, we do not expect major changes to the path projected although we should only have more visibility on this premise after the elections.** The most recent polls place the two political forces most committed to fiscal discipline among the voters' favorites.
- **Moody's upgraded Portugal's rating by two notches to A3, being the third agency pushing the Portugal's classification to the "A" class.** These revisions reflects the positive impact on country's credit conditions, coming from economic and fiscal reforms, reduction in the level of indebtedness in the private sector and the strengthening of the banking sector.

Banking Sector

- **NPLs ratio declined in Q3 2023.** The strong position of the labor market, expected to worsen only moderately, and the improved position of households and firms in terms of leverage, suggest that the interest rate impact on credit quality should kept contained, in a context of a stronger position of the banking sector. Additionally, macroprudential measures continue to be relatively tight and should also help to avoid major worsening of credit quality data: banks should reduce gradually average maturity of housing loans to 30 years; before mortgage loans decisions, institutions have to apply an interest rate shock (depending on the maturity, it can reach 150 bp) to assess the impact on the debt service of an hypothetical increase of interest rates.

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	5.7	6.8	2.3	1.8
Private Consumption	2.6	2.1	2.6	3.3	-7.0	4.7	5.6	0.9	0.7
Public Consumption	0.8	0.2	0.6	2.1	0.4	4.5	1.4	1.2	1.3
Gross Fixed Capital Formation (GFCF)	2.5	11.5	6.2	5.4	-2.2	8.1	3.0	1.3	5.0
Exports	4.4	8.4	4.1	4.1	-18.8	12.3	17.4	5.5	2.7
Imports	5.0	8.1	5.0	4.9	-11.8	12.3	11.1	1.6	2.5
Unemployment rate	11.4	9.2	7.2	6.6	7.0	6.7	6.2	6.5	6.5
CPI (average)	0.6	1.4	1.0	0.3	0.0	1.3	7.8	4.3	2.4
External current account balance (% GDP)	1.2	1.3	0.6	0.4	-1.2	-0.8	-1.4	1.2	1.2
General Government Balance (% GDP)	-1.9	-3.0	-0.3	0.1	-5.8	-2.9	-0.3	0.7	0.4
General government debt (% GDP)	131.5	126.1	121.5	116.6	134.9	125.5	112.4	98.7	98.6
Risk premium (PT-Bund) (average)	307	269	138	98	89	60	97	84	95

Source: *BPI Research*

2023: the economy accelerated in 4Q; annual growth stood at 2,3%...

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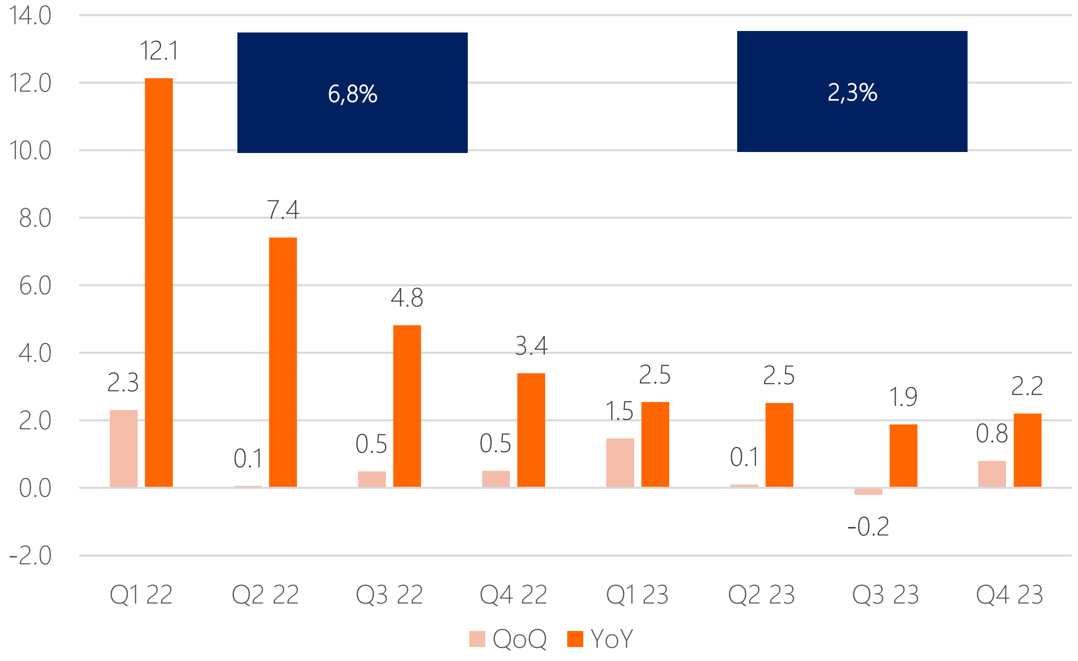
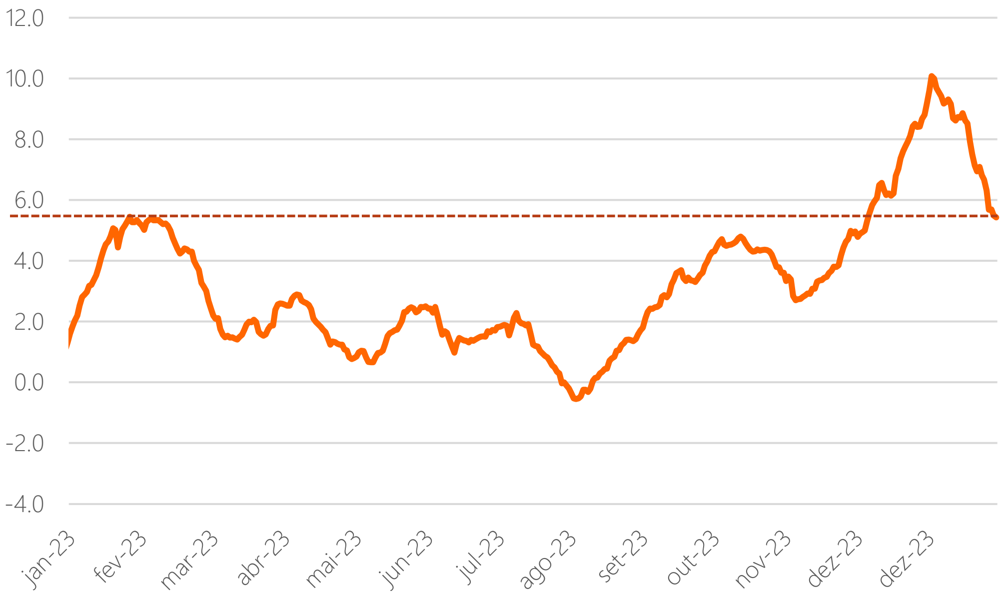
GDP: quarterly and homologous changes

%



Daily activity indicator

yoy monthly moving average (%)



Source: BPI Research, from Bank of Portugal, INE

- **GDP surprised in Q4, advancing 0,8% qoq, pushing annual growth to 2,3%, close to 2,4% forecasted by BPI Research**. Detail will be available only on February 29th, but according to INE domestic demand accelerated and the contribute of foreign demand became less negative. Available data suggest that this performance came from an acceleration of private consumption through the acquisition of durable goods, normalization of AutoEuropa's production, with impact on exports, and good performance in tourism.
- The daily economic indicator suggest a deceleration at the beginning of 2024, but continues to show a good performance. Still, the carryover effect brings 0,5p.p. of growth to 2024. Having said this, we see the economy to advance a little bit more than 1,5% in 2024.

… and 2024 begins with some positive signs

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Economic indicators from - to +

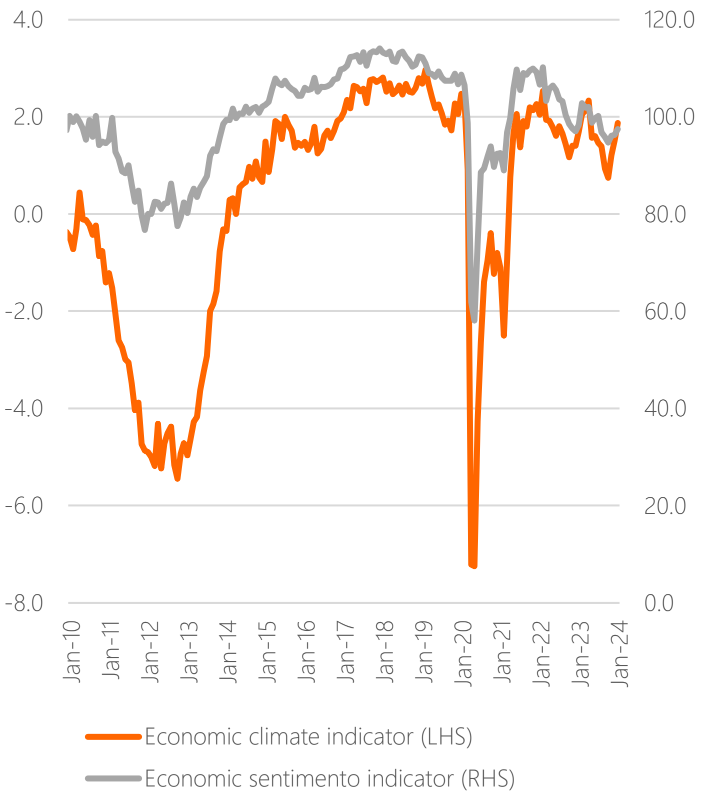
% annual growth

yoy, level		Nov-23	Dec-23	Jan-24
Synthetic indicators	Economic climate indicator	1.2	1.5	1.9
	Economic sentiment indicator	95.9	96.3	97.5
	Daily economic indicator	4.9	9.3	3.5
Consumption	Consumer confidence	-30.8	-26.0	-23.9
	Retail sales (yoy)	2.1	-	-
	Retail sales excl. fuels (yoy)	2.3	-	-
	Car sales (number)	15,769	15,481	5,394
	Car sales (yoy)	2.7	11.1	7.5
Investment	GFCF indicator	-	-	-
	Imports of capital goods (accum. year)	2.4	-	-
Suply	Cement sales	10.8	-7.5	-
	Industrial production	-1.1	-5.0	-
Demand	Electricity consumption adjusted for temperature&working days	3.2	5.4	3.0
	Non-resident tourists (yoy 2019)	15.7	10.1	-
	Number of flights (yoy)	6.6	6.7	-0.8
Trade	Exports G&S (accum. Year)	5.2	-	-
	Imports G&S (accum. Years)	-1.6	-	-
Labour market	Change in regist. unemployment (thousand people)	15.6	10.7	-
	Change in employment (thousand people)	87.1	85.1	-

Source: BPI Research, from INE, BoP, EC.

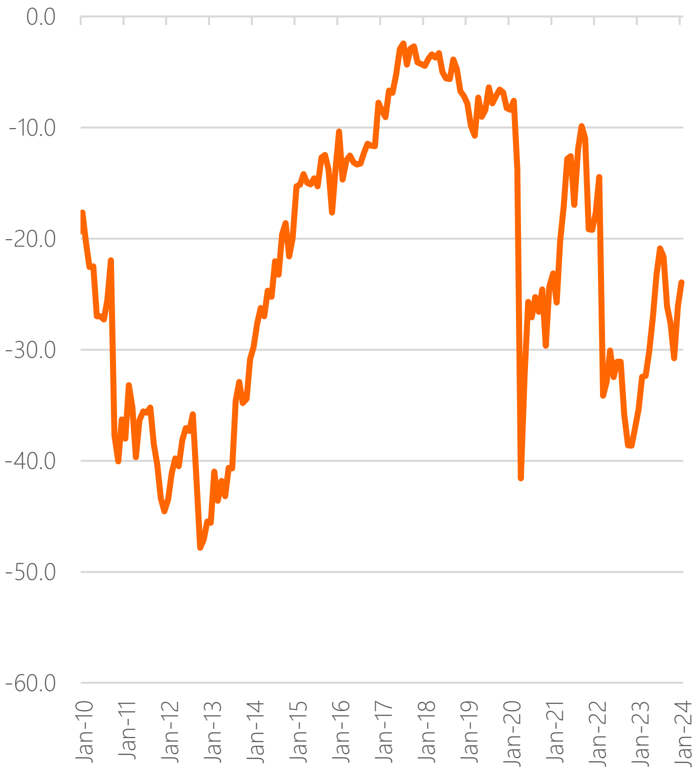
Synthetic sectoral sentiment indicators

% yoy, level



Consumer confidence

Level

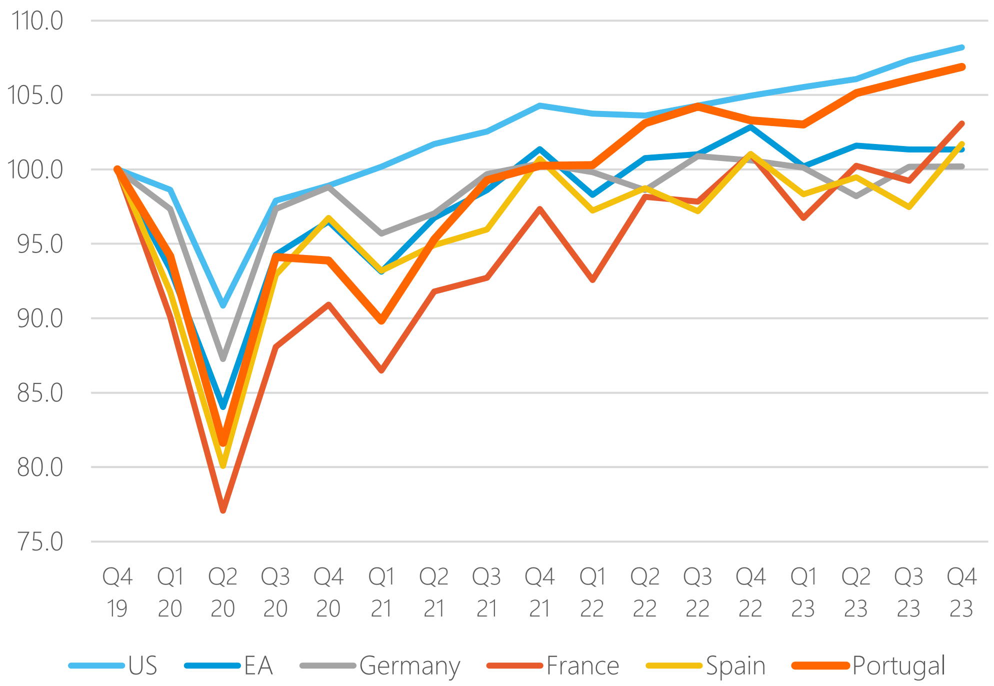


▶ **Sentiment indicators performed well in January, specially among consumers, industrials and services sector.** Activity indicators are still scarce, but suggest that consumption continues to be the main growth engine. The number of flights contracted a bit in January, but continues above the 2019 level, in line with our prediction that market is entering in cruse speed.

2024: structural improvements will help to avoid a strong deceleration

Portuguese recovery compares well with other economies

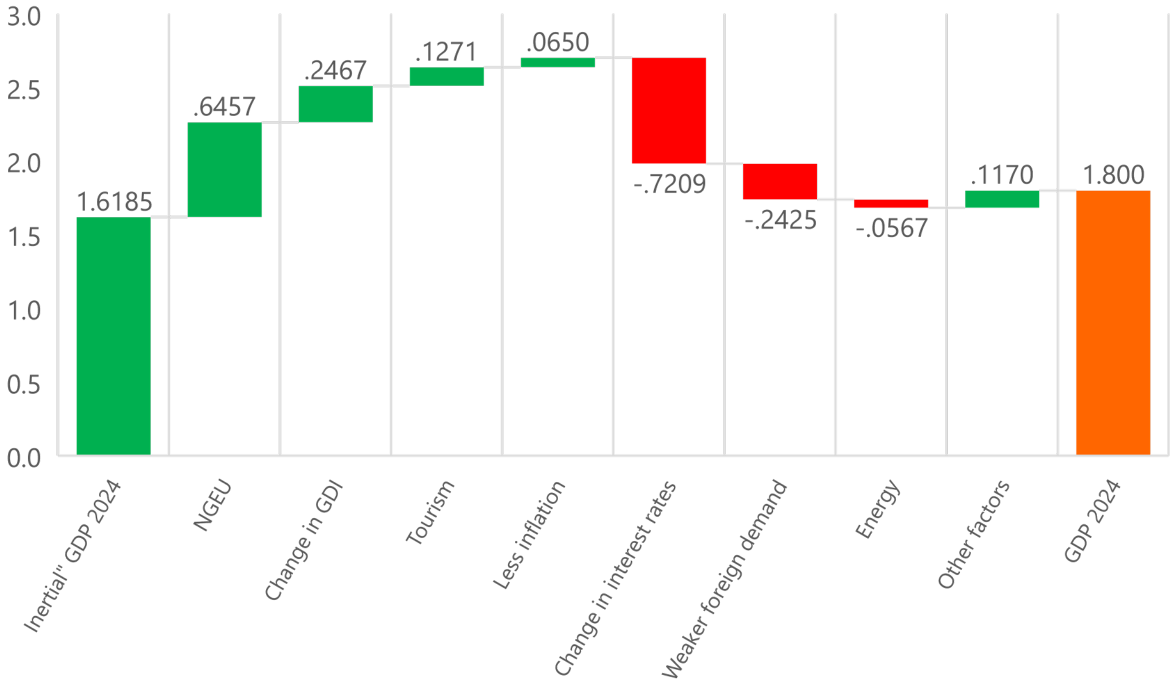
GDP Q4 19=100



Source: BPI Research, from IMF, INE, BoP

GDP 2024: tail and headwinds

Percentage points



- **For 2024, we expect a deceleration.** Our current forecast points to annual growth of 1,8%, but this forecast may prove to be slightly optimistic, being possible a modest downward revision next month, reflecting the still high financing costs and the impact of weak growth in euro zone, where are our main trade partners.
- **The headwinds and tailwinds seem almost balanced, but 2024 will begin dominated by political uncertainty which could lead to a deterioration in the headwinds.** The risk of an intensification of the Israeli-Palestinian conflict, with an impact on the price of energy commodities, would imply more inflation and probably more tightening by the ECB, with a considerable impact on growth. In this alternative scenario (whose probability looks contained, for now), the already negative impact of the expected increase in the price of oil would worsen; the positive contribution associated with a more benign scenario for inflation would disappear (or become more of a headwind...); and the negative impact associated with the slowdown in trading partners would be greater than estimated in the central scenario. In other words, our forecast of 1,8% growth would be compromised. **All in all, there are conditions for the Portuguese economy to remain resilient in 2024, but the risks and external factors are significant, once again generating high uncertainty in the scenario.**

Lower energy prices, more tourism and structural improvements brought external accounts to surplus again (and reduced external debt)

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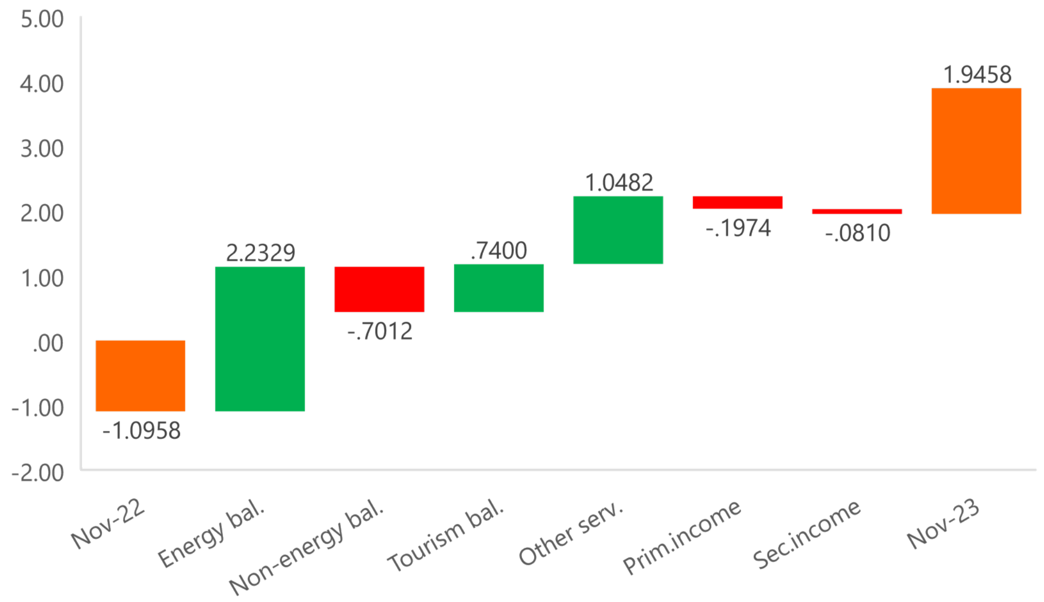
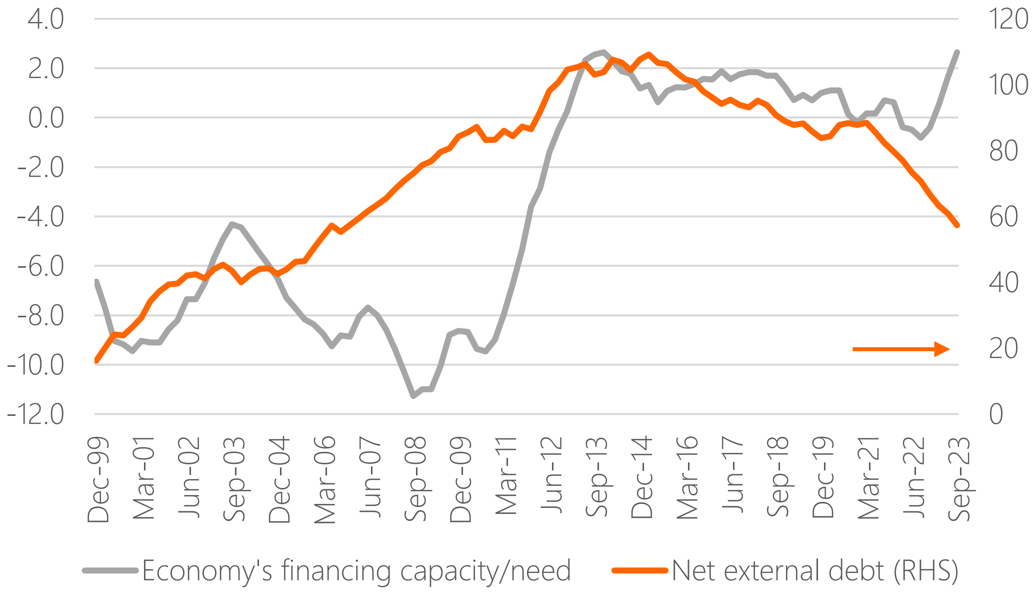
Current account evolution up to November 2023

% of GDP and p.p. changes



Economy financing capacity and external debt

% of GDP



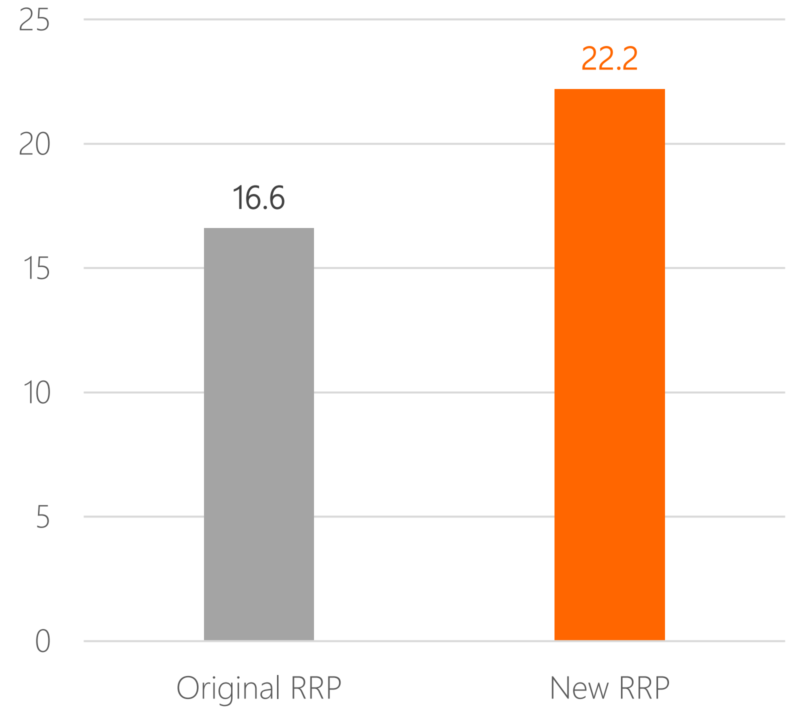
Source: BPI Research, from INE

- **Up to November, current account posted a surplus equivalent to 1,9% of GDP.** Compared to the same period a year ago, the main contributions for this improvement came from the energetic balance and balance of services, both tourism and other services. The latter is gaining strength, suggesting higher diversification of the economy.
- **The return of the current balance to a surplus is an important boost for the rise of the financing capacity and foreign debt reduction. In Q3, economy registered an external financing capacity equivalent to 2,6% of GDP, the highest level in more than twenty years, contributing for the reduction of the net external debt to 57,3% of GDP, the lowest level since 2006 and minus 9 p.p. than in the end of 2022.** By the end of the year and in 2024, it is expected further declines in the external debt, as the current account should be in surplus during the period. We are forecasting a surplus of 1,2% of GDP for the current account in both 2023 and 2024.

NGEU: high rate of approved projects (74% of the amount), but payments are still low

RRP amount after the rescheduling

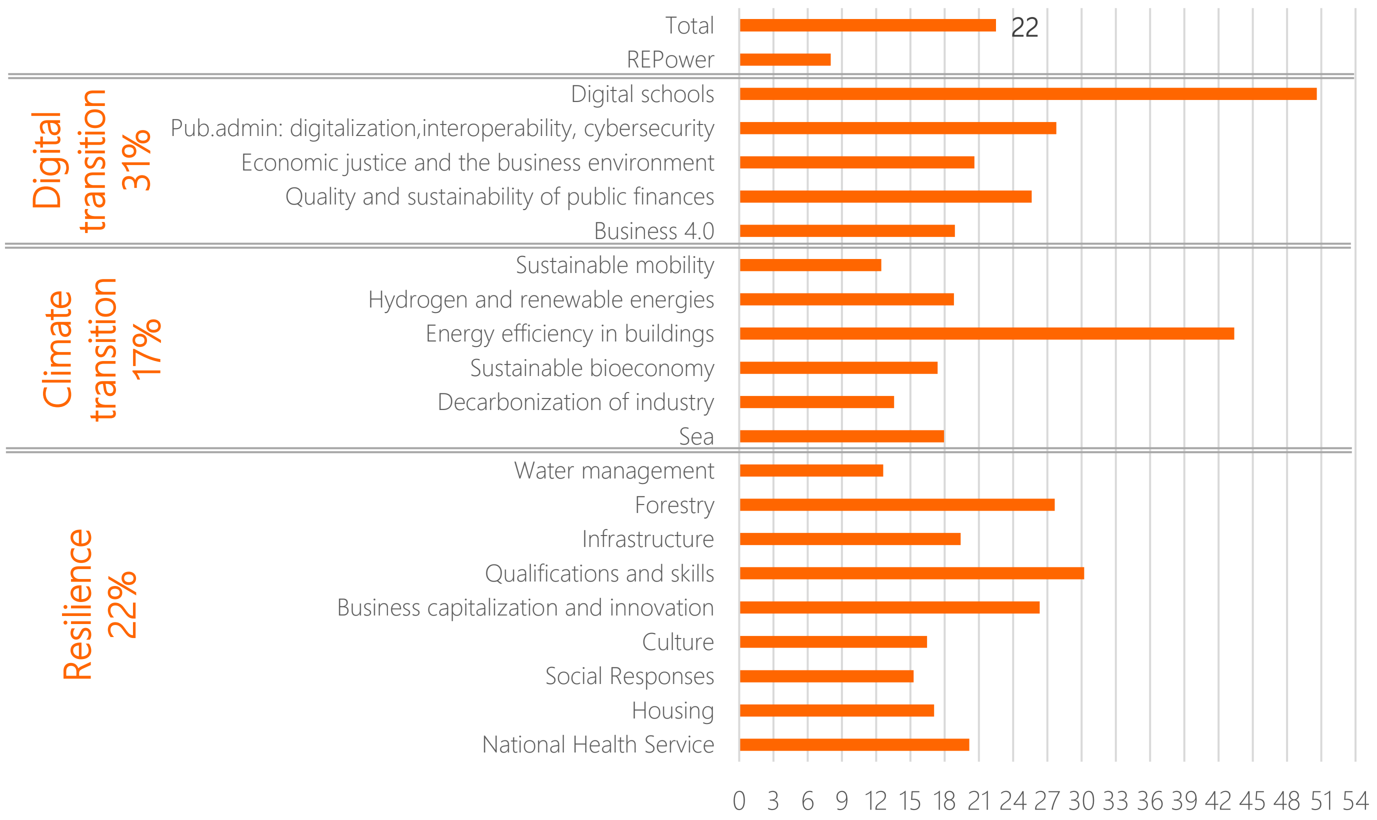
EUR billion



Source: BPI Research, from Recuperar Portugal.

Payment rate up to January 31st

% of total of the amount approved

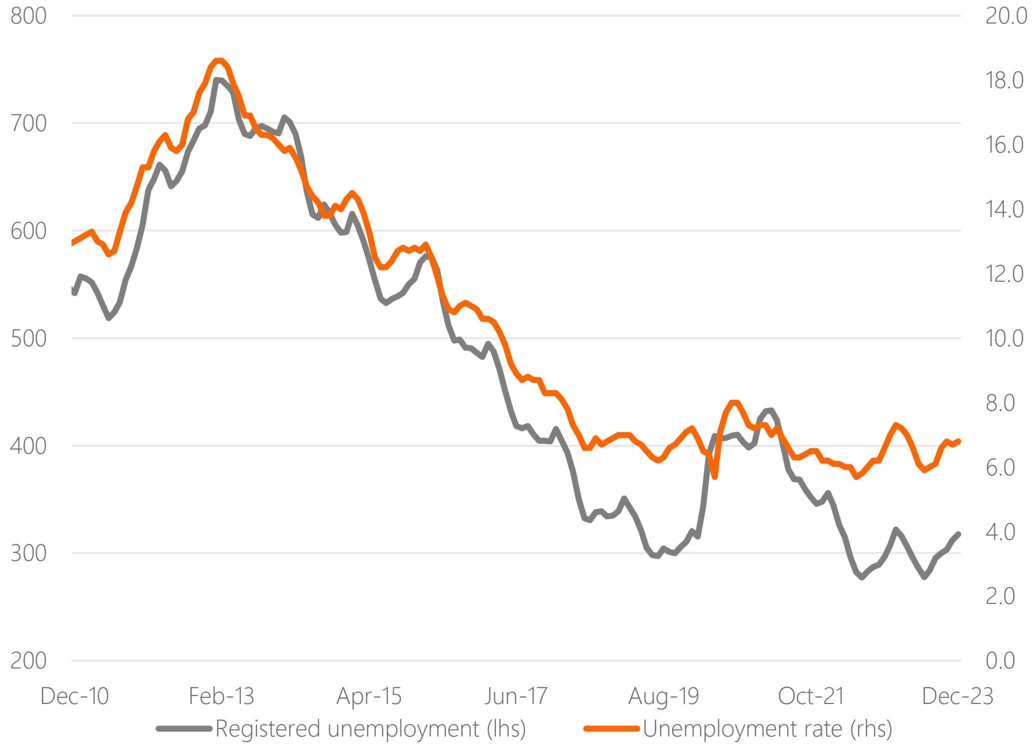


- The Regulation of the Resilience and Recovery Mechanism foresees adjustments in the distribution of NGEU funds among the various countries according to the accumulated growth of real GDP in 2020-21, which **in the case of Portugal led to an increase of the funds to be received from 16,6 billion euros to 22,2 billion euros (2,4 billion grants and 3,2 billion loans).** Some priorities for these additional 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. **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. The new amount is equivalent to 8,5% of GDP (2023), + 2,5 p.p. than the original amount.**
- **In the last days of 2023, Portugal received both tranches scheduled for 2023 in a total of 2.46 billion, reenforcing the ability to the execution of the RRP. In total, Portugal has already received 34% of the total amount of the RRP. Projects already approved amount to 15,7 billion euros, but the rate of payments fulfilled is only 22%.**

Labor market continues robust but it's losing momentum

Registered unemployment* and unemployment rate

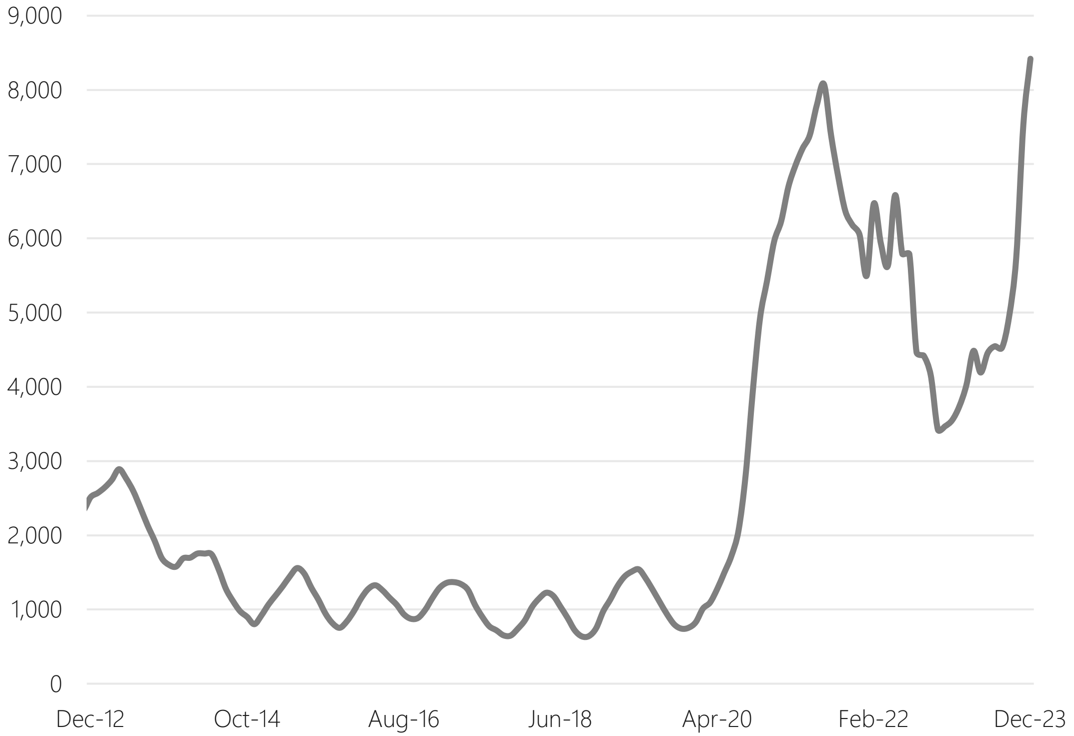
Thousand people (%)



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

Layoff*

6-months moving average (Number of individuals)



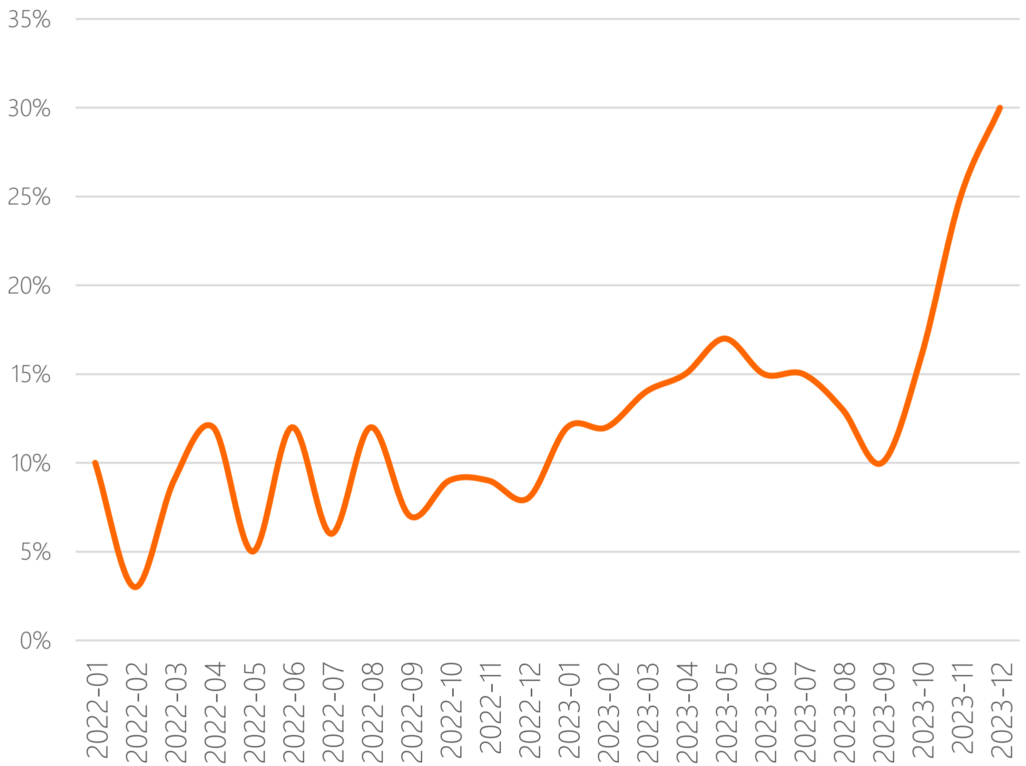
Note (*): Labor code regime.
Source: BPI Research, from Social Security data.

- **The labour market appears to have reached a plateau.** The unemployment rate rose to 6,8% in December (+0,1 pp than in November, but the same than in October) and the employed population stabilized on a monthly basis, being 1,7% above the level of December 2022. In the same month, the number of registered unemployed people increased 1,7% mom and 3,5% on an year on year basis; however, the number of workers in layoff is considerably above the long-term average and very near the maximum registered in 2021, representing a limited, but not negligible, risk for unemployment in the months ahead, as it continues to represent a small portion of employed (0,2%).

Bumpier inflation in early 2024

Global CPI

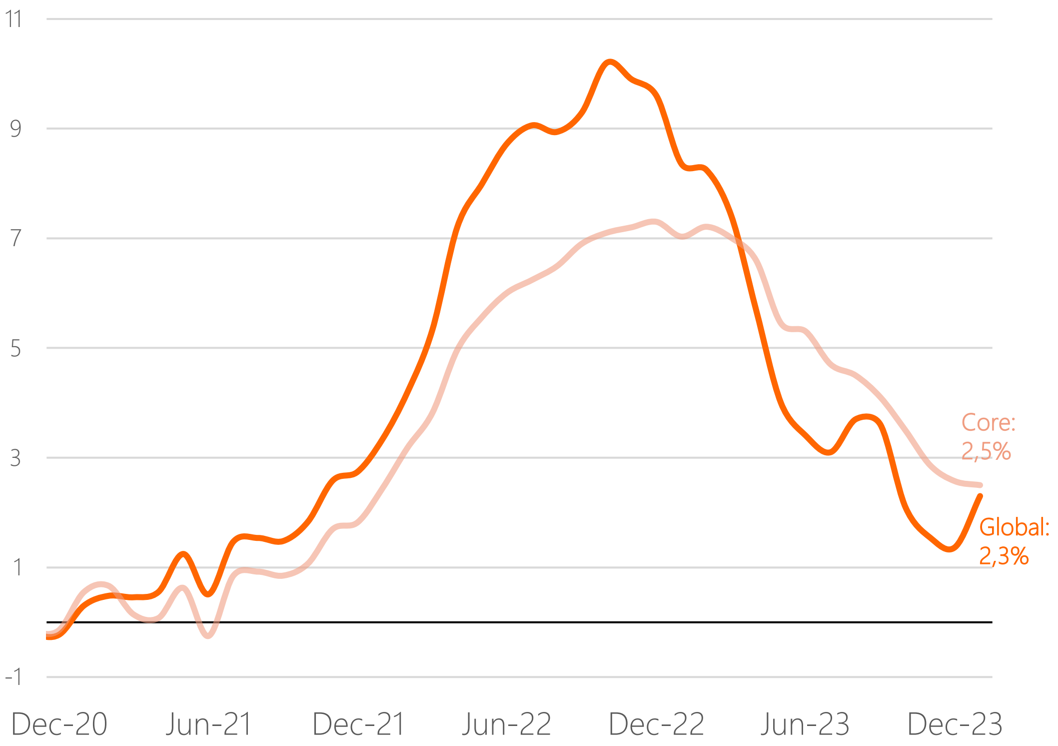
% of CPI Basket with inflation < or = to 0%



Source: *CaixaBank Research, using data from INE.*

Portugal CPI: Global & Core

Year-on-year (%)



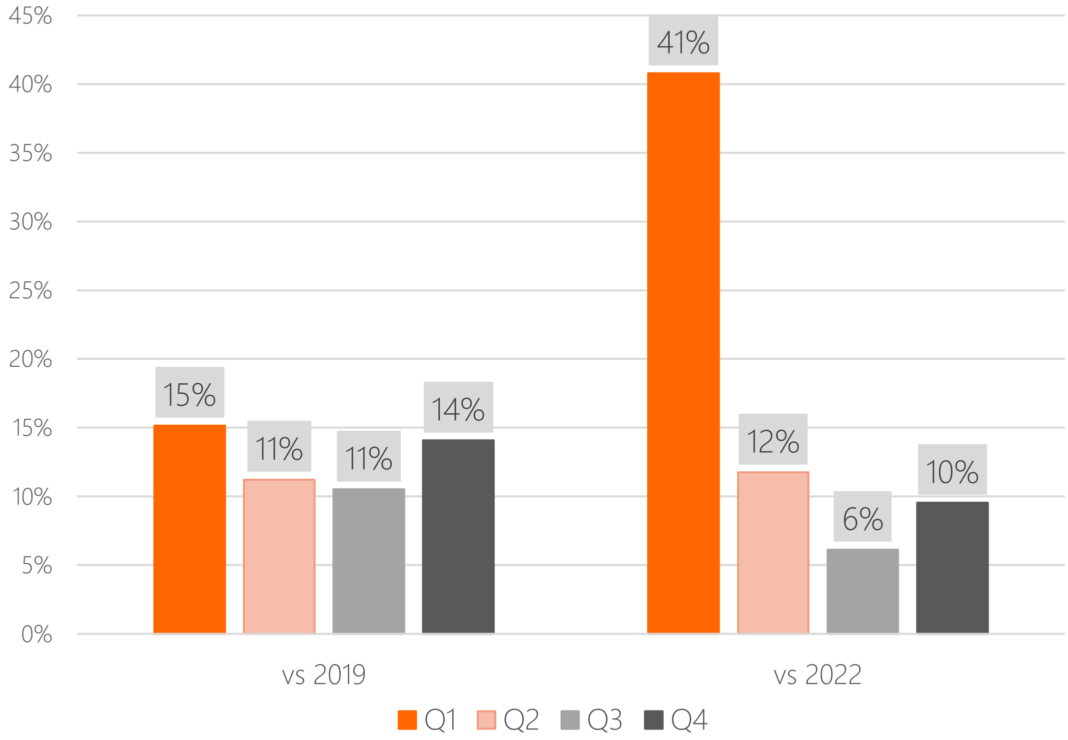
Source: *CaixaBank Research, using data from INE.*

- **Inflation kept a strong downward stance in late 2023**. In fact, when we look at the December subcomponents of the overall index we see a significant increase in the ones with inflation equal or bellow 0%, reaching 30% of the basket. The main drivers of this figure are sub-components as diverse as Clothing; Fuels and lubricants; Fish, crustaceans and mollusks; and Milk, cheese and eggs.
- **Inflation surpassed once again 2% at the start of 2024. In fact, the Global CPI rate in January stood at 2.3%, going against the downward trend of the last few months of 2023 (1.4% in December).** As the INE points out, this increase was associated with two factors that had already been anticipated: the adjustment of electricity prices (particularly in the regulated market) and the end of the "Zero VAT" measure. We believe, however, that average inflation should follow a downward path this year, which is also signaled by the behavior of the core component, which slowed down again in January (2.5% year-on-year).

Tourism: 2023 record figures and growth expected in 2024

Number of guests

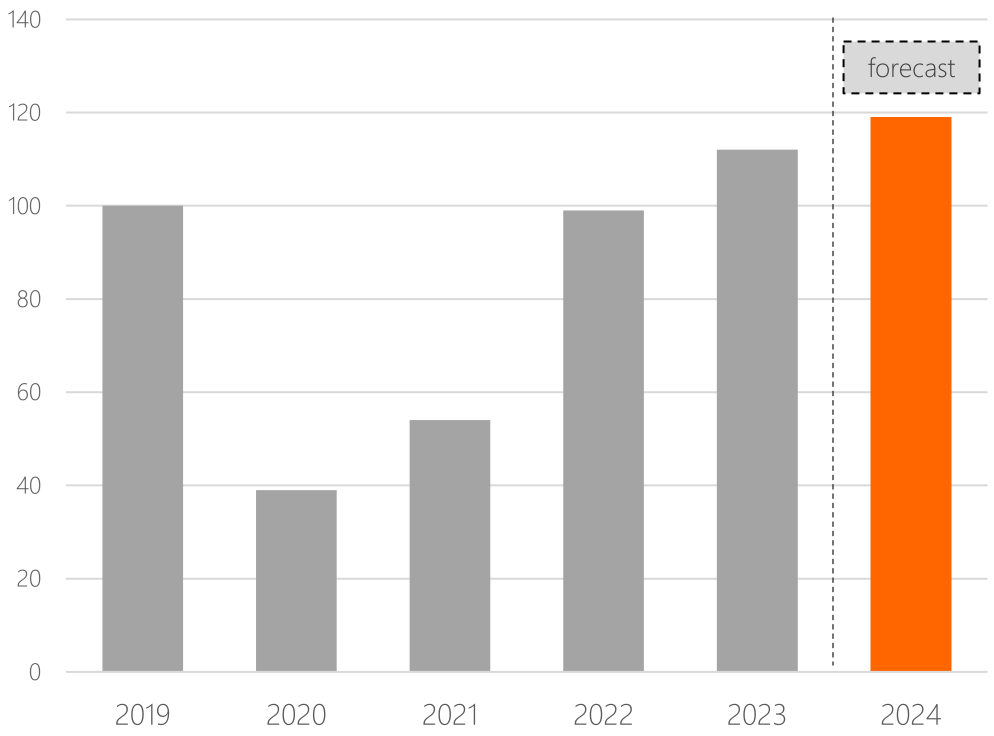
Change in 2023 versus pre-pandemic and 2022 quarters (%)



***Source**: CaixaBank Research, using data from INE.*

Tourists

Level (2019=100)

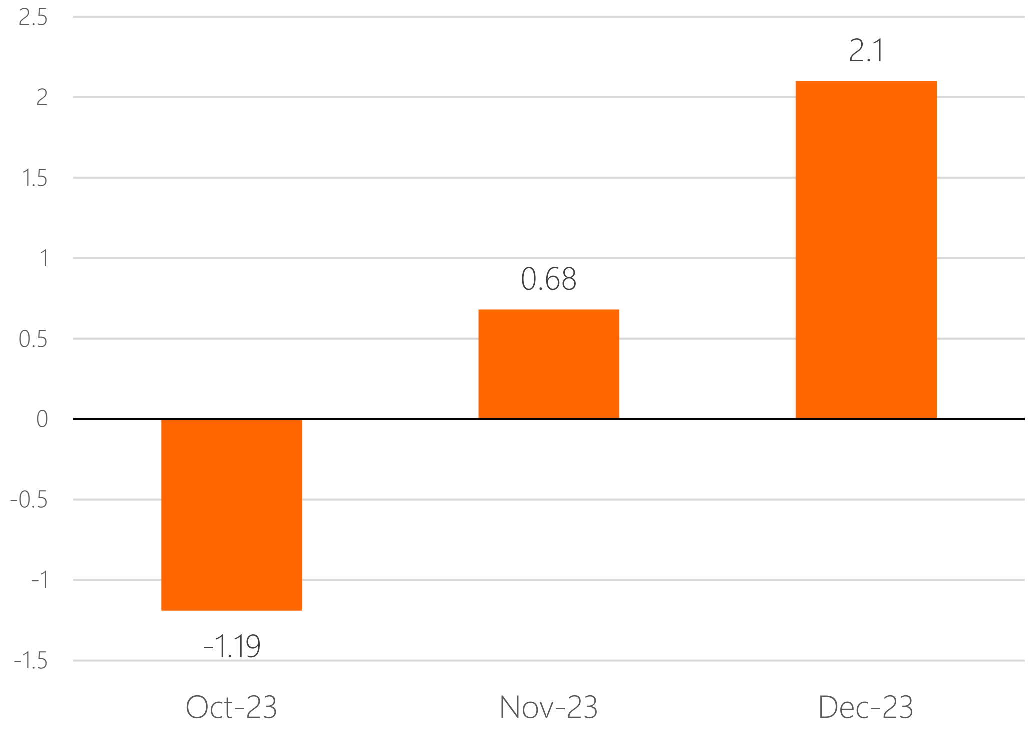


***Source**: CaixaBank Research, using data from INE.*

- **Tourism sector closes 2023 with more than 30 million guests and 77 million overnight stays.** This data puts tourists at a level above the best pre-pandemic year (+12% compared to 2019) and extends the sector's recovery trajectory. The UK remained the main source market in 2023 (18.4% of overnight stays from non-residents) but the biggest growths were in the Canadian and US markets (+56% and +70% vis-à-vis 2019 levels, respectively).
- **For 2024 an increase in the number of tourists of around 6% is expected, more modest than in 2023 (+13%).** The central macro scenario, which does not include recession in the Eurozone (Portugal's main source markets), will continue to support tourism growth.

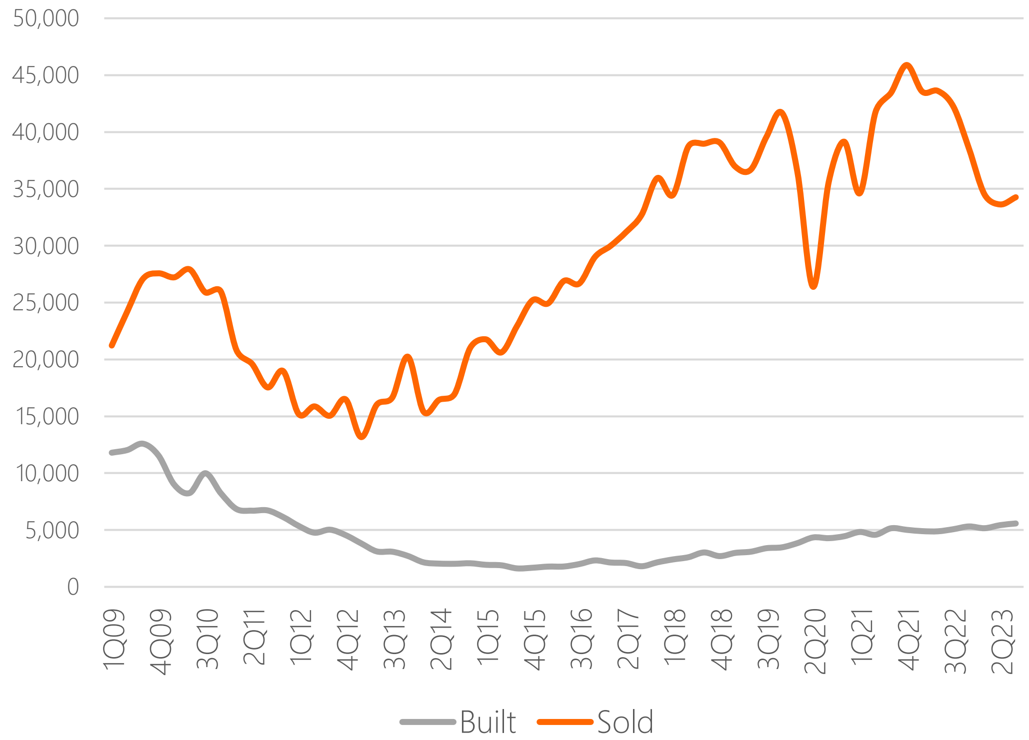
Housing market: expected another price increase in 2023 Q4 official figures

Residential Price Index
monthly change (%)



Source: *BPI Research, using data from Confidencial Imobiliário.*

Houses built and sold
Quarterly number



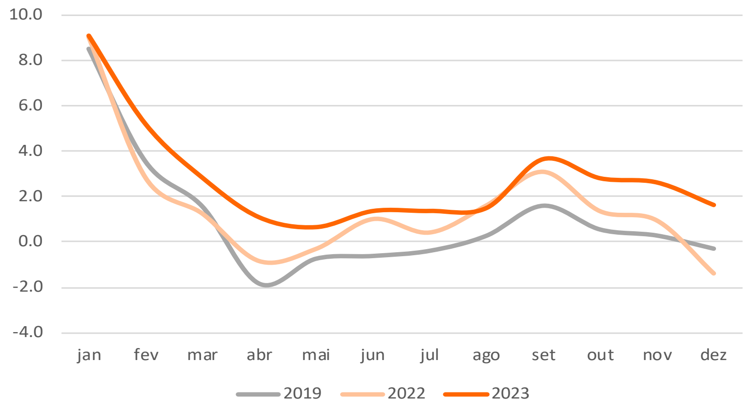
Source: *BPI Research from data of INE.*

- **Although we still don't have the House Price Index data (from INE) for the whole of 2023, data from alternative sources (Confidencial Imobiliário) continues to show house price rises in the last quarter of the year.** We therefore expect the average house price increase in 2023 to be around 8 %, slowing down after the 12.6 % recorded in 2023.
- **Limited supply, a robust labor market and strong resilience to rising interest rates have underpinned the market and should continue to do so next year.**

Commitment with fiscal consolidation brings the public debt ratio to historical low levels: 98,7%

Overall fiscal balance*

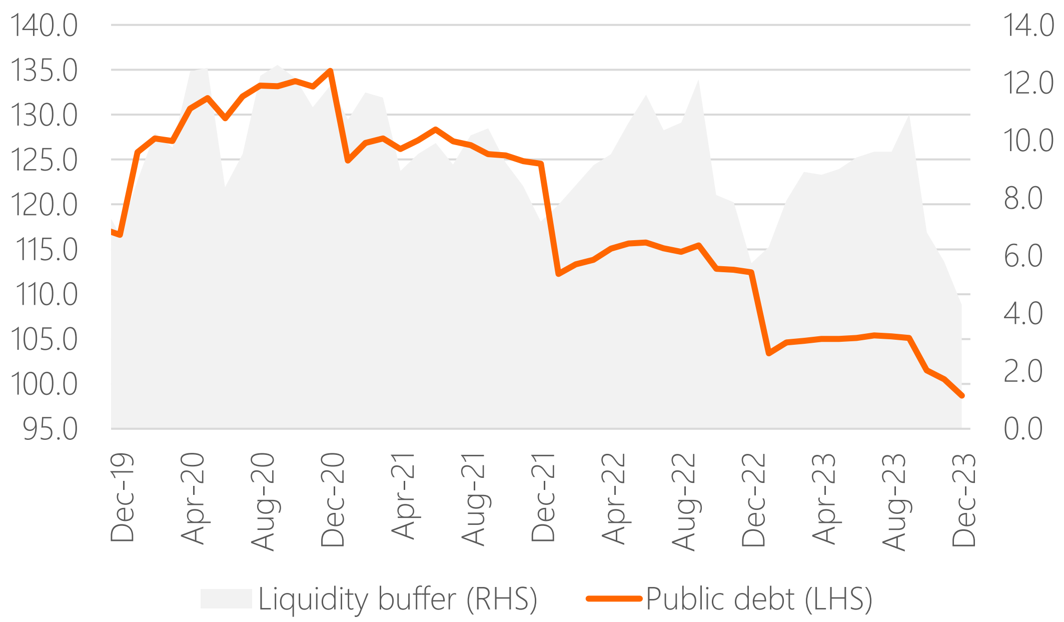
% of GDP



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

Public debt ratio and the liquidity buffer

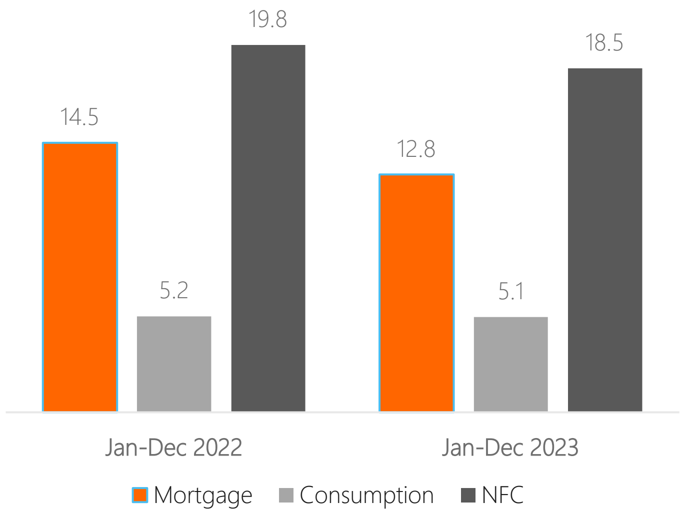
% of GDP; bln EUR



- **On a cash basis, the fiscal balance registered a surplus equivalent to 1,6% of GDP in 2023** (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). This performance allowed the decline of the public debt ratio to 98,7% of GDP for the first time since 2009 in 2023, a year earlier than the government official forecasts.
- **Upcoming elections may alter the implicit scenario for public accounts**, depending on the new Government political composition. However, **we do not expect major changes to the path projected** although we should only have more visibility on this premise after the elections. The most recent polls place the two political forces most committed to fiscal discipline among the voters' favorites.

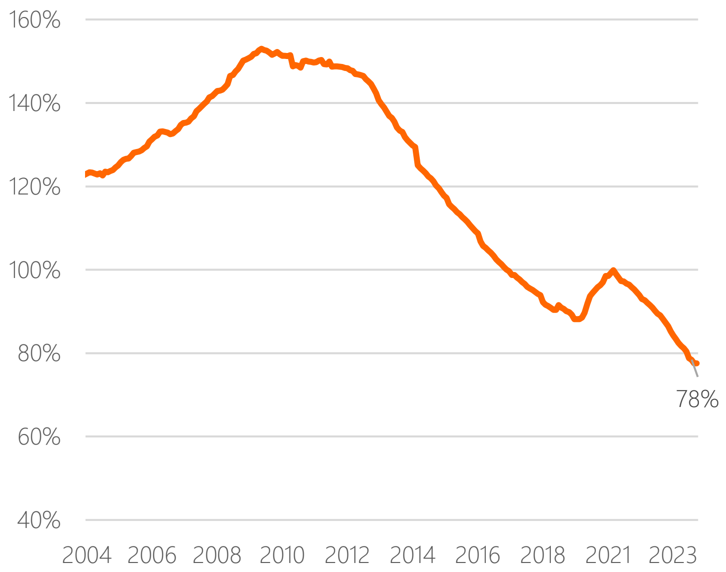
Banking system: a solid position to face the economic slowdown (1)

New lending activity by sector
Accumulated in the year, billion euros



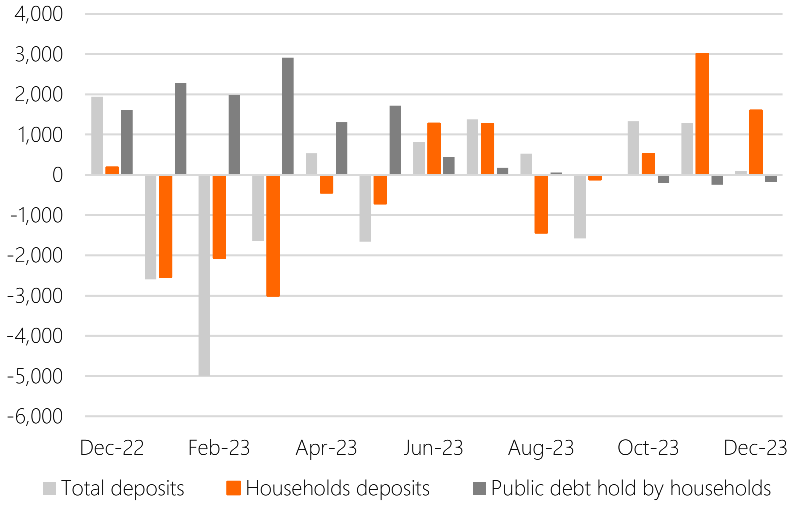
Source: CaixaBank Research, base on data from Bank of Portugal and ECB.

Bank credit to the private non-financial sector
% GDP



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

Deposits and public debt hold by families*
Monthly variation (M€)

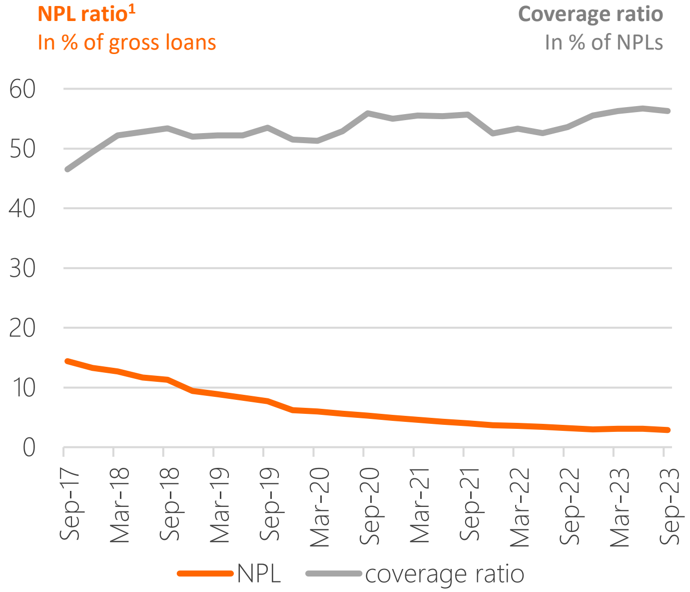


Notes (*): Public debt by households includes Certificados de Aforro and Certificados do Tesouro, which can only be subscribed by resident households. The maximum amount that Government can issue for these retail instruments (CA and CT) is 16.5 bn Eur in 2023.
Source: CaixaBank Research, base on data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

- **The stock of credit is decelerating since mid-2022:**
  - **Mortgage credit: in 2023** declined 1,4%, in line with the drop in new operations (-11,8% in 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 and are showing some monthly increases since August.
  - **NFC:** the stock has been declining since mid-2022, due to the redemptions of COVID-credit lines, lower investment, favorable level of deposits and continuing weak new credit operations. In 2023 it fell 1,9%, with new loans to be 6,4% below those contracted in 2022.
- Deposits of the private sector declined 2,5% in 2023, but on a monthly basis, we are witnessing an increase of the stock since October, which should be linked with better interest rates offered by banks. Households' deposits declined -1,5%, but meanwhile, interest rates for new deposits have been increasing (last December, household's deposit interest rate reached 3,08%, which, together with the recent change in CA's new subscription conditions (maximum interest rate of 2,5%), should sustain the recovery of banking deposits.

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

NPLs and coverage ratios



Cost of risk[1]
0.5% in 2019
0.5% in Q3 2023

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

Banks' profitability

In % of average total assets (2023; trailing 12M)

	BPI	BCP	San Totta	CGD	NB	Montepio
Net interest income	**2.4%**	**1.8%**	**2.6%**	**2.6%**	**2.2%**	**0.0%**
Net fees	0.8%	0.7%	0.8%	0.7%	0.7%	0.0%
Gains on financial assets	0.1%	0.0%	0.3%	0.1%	-0.1%	0.0%
Other net profits	-0.2%	-0.1%	0.0%	-0.2%	0.0%	0.0%
Gross income	**3.1%**	**2.4%**	**3.7%**	**3.1%**	**2.8%**	**0.0%**
Operating expenses	-1.4%	-0.7%	-0.9%	-1.1%	-1.4%	0.0%
Operational result	**1.7%**	**1.6%**	**2.8%**	**2.0%**	**1.4%**	**0.0%**
Impairement losses, taxes and others	-0.1%	-0.4%	-0.2%	-0.3%	-0.4%	0.0%
Profit	**1.1%**	**0.9%**	**1.8%**	**1.7%**	**0.2%**	**0.0%**
ROTE[1]	16.0%	16.8%	23.4%	20.4%	nd	0.0%

Notes: 1) the values for BCP and CGD refer to ROE; calculation methodologies differ between banks. In the case of CGD and NB indicators refer to consolidated activity. For both indicators are for Q3.

Banks' solvency and liquidity position

*In % (q3 23)**

Source: Banks publications, BoP
*Note: *data for Q3*

- **NPLs ratio fell 0.2 p.p. in Q3.** The total NPL ratio stood at 2,9% in Q3 2023, due to an improvement on the NPL ratio in the case of credit to consumption and to NFC. The ratio related to mortgage operations remained in 1,2%. For NFC, the ratio continued to decrease (-0,3 p.p., to 5,9%). It is possible that these metrics 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.** According to Bank of Portugal, it decreased by 0,9 p.p., to 14,6% (ROE) in Q3. Profitability is expected to keep benefitting from high interest rates.
- **The capital position of Portuguese banks provides buffers against the risks that could arise, due to the conflict in Ukraine, other geopolitical risks and the impact of high interest rates on NPL's.**

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