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Prepared with information available by March 8th , 2024

Portugal:
Macroeconomic and financial outlook

BPI *Research*

March 2024

BPI Grupo CaixaBank

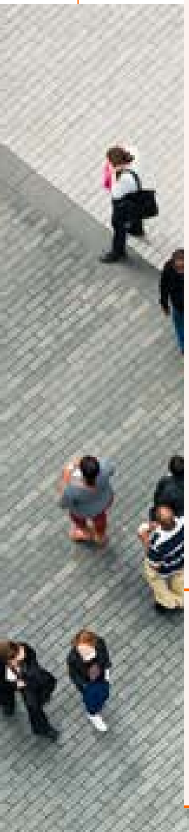
Main messages

Activity

- **In Q4, GDP grew 0,8% qoq, placing annual growth in 2023 at 2,3%.** Domestic demand contributed with 1,4 p.p. and foreign demand with 0,9 p.p.. This behaviour brought the carryover effect to 0,5%, giving some support to growth in 2024. 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 labour 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 slightly revised growth in 2024 and 2025 to 1,6% and 2,3%, respectively; in the following years economy is seen to advance around 2,4% per year. First indicators for 2024 are still scarce, but are showing positive performance: EC's economic sentiment improved to the level 100, indicative of growth close to historical norm, indicators related with consumption are resilient, tourism data is moderating as expected, but remains on positive field.
- **Inflation resumed its downward trend in February.** After a rate of 2.3% in January, which interrupted four consecutive months of declines, inflation in February stood at 2.1%. This movement was similar in the core component. Unlike what happened in 2023, the fall in inflation this year probably should not be supported by the fall in the energy component, which in February gave a significant contribution to the rise of the index.
- **For 2024, we expect new growth in the tourism sector, due also to diversification effort, but it will be more contained.** Our central scenario rules out recession in the Eurozone (Portugal's main source market for tourists), and this will continue to support growth in the sector along with some recovery in purchasing power. However, the post-pandemic rebound effect is exhausted and there will be no contribution from one-off events such as in 2023 (World Youth Day). January started with modest figures - an increase in tourists of 1.8% and a drop in overnight stays of -0.1% compared to January 2023.
- **For 2024, we estimate an average house price increase of 3.5% and a further reduction in the number of transactions (on average -4.2%), which keeps the dynamics of the residential property market on a moderation trend, but avoiding price correction.** House sales prices in mainland Portugal rose by 0.9% in January (reported by Confidencial Imobiliário) compared to December 2023, thus continuing the cycle of mild monthly increases that predominated in the second half of last year.
- **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 99% of GDP** for the first time since 2009 in 2023, a year earlier than the government predicted.
- **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 of consolidation 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.
- **S&P upgraded Portugal's rating to A-, keeping the positive outlook, reflecting the ongoing deleveraging process, both externally and internally**. The decision to keep the positive outlook is supported by the perspective that the deleveraging process will continue in the years ahead. So the rating agency foresees the maintenance of surplus on the current and public accounts in the next couple of years.

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 rise impact on credit quality should keep 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

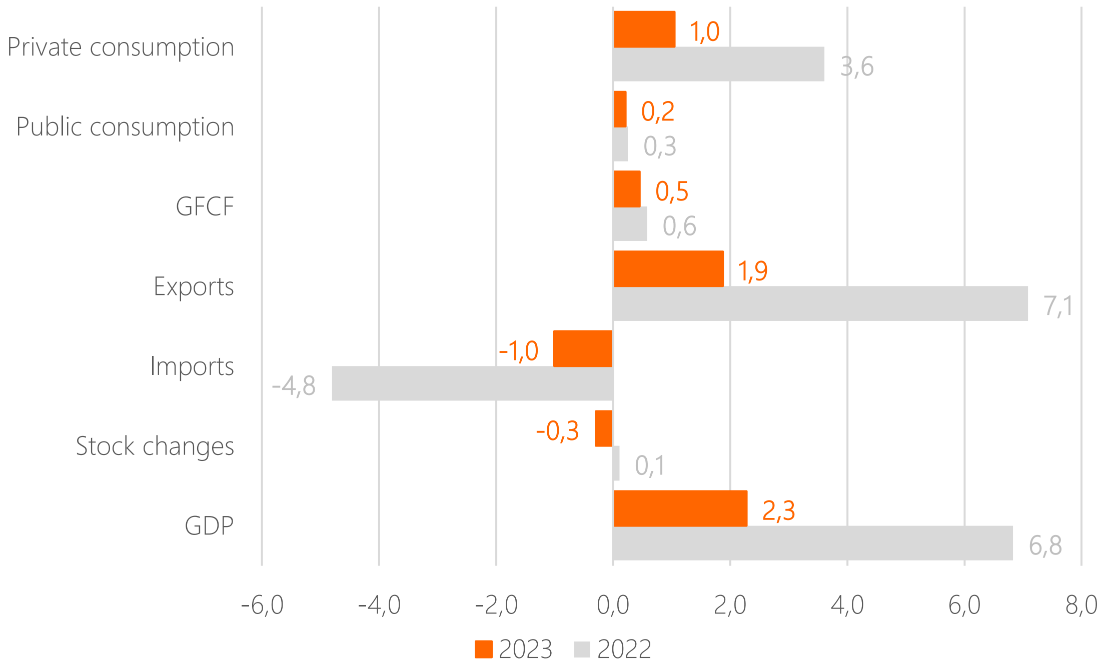
%, yoy	2016	2017	2018	2019	2020	2021	2022	2023	Forecasts 2024	Forecasts 2025
GDP	2,0	3,5	2,8	2,7	-8,3	5,7	6,8	2,3	1,6	2,3
Private Consumption	2,6	2,1	2,6	3,3	-7,0	4,7	5,6	1,6	1,0	1,7
Public Consumption	0,8	0,2	0,6	2,1	0,4	4,5	1,4	1,2	1,9	1,1
Gross Fixed Capital Formation (GFCF)	2,5	11,5	6,2	5,4	-2,2	8,1	3,0	2,4	3,3	5,1
Exports	4,4	8,4	4,1	4,1	-18,8	12,3	17,4	4,2	2,6	5,2
Imports	5,0	8,1	5,0	4,9	-11,8	12,3	11,1	2,2	2,9	5,1
Unemployment rate	11,4	9,2	7,2	6,6	7,0	6,7	6,2	6,5	6,7	6,5
CPI (average)	0,6	1,4	1,0	0,3	0,0	1,3	7,8	4,3	2,3	2,0
External current account balance (% GDP)	1,2	1,3	0,6	0,4	-1,2	-0,8	-1,4	1,4	1,2	1,4
General Government Balance (% GDP)	-1,9	-3,0	-0,3	0,1	-5,8	-2,9	-0,3	0,7	0,4	0,6
General government debt (% GDP)	131,5	126,1	121,5	116,6	134,9	125,5	112,4	98,7	98,6	93,7
Risk premium (PT-Bund) (average)	307	269	138	100	90	60	100	70	76	80

***Source**: BPI Research*

2023: GDP advanced 2,3% and is 0.6 p.p. above the 2019 level

GDP and contribution of components

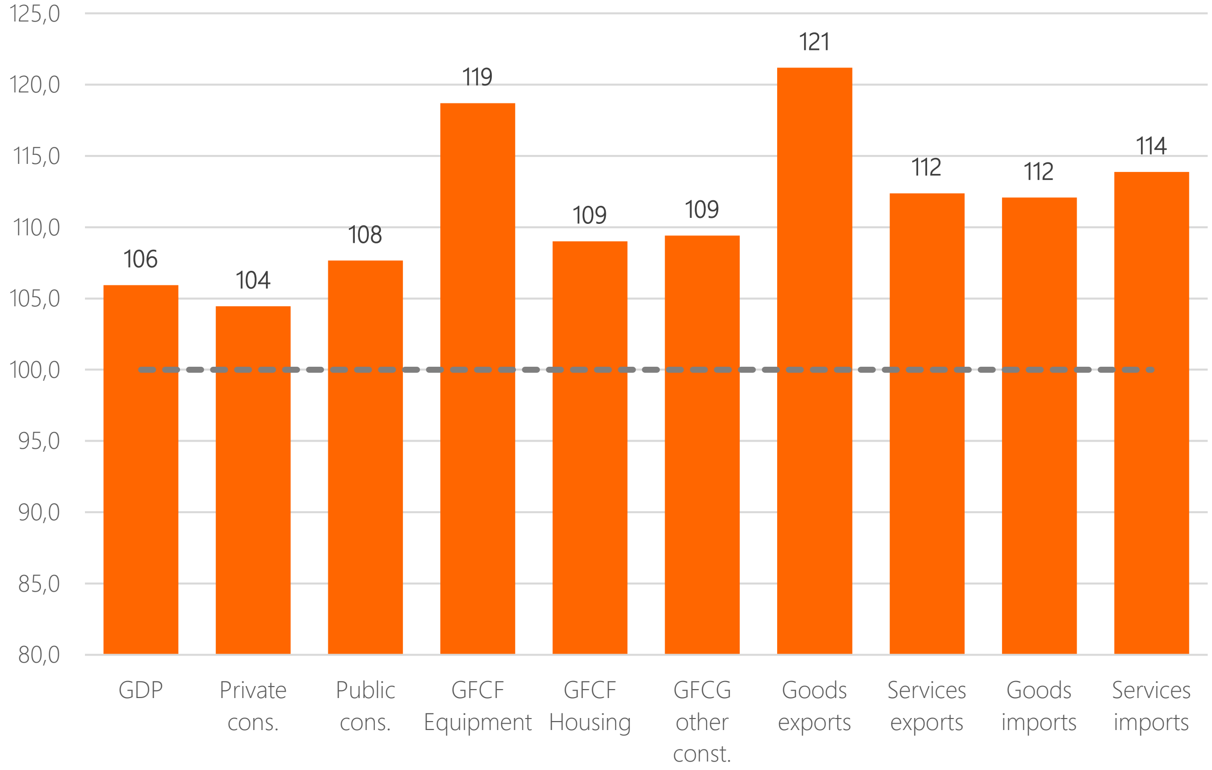
annual change and contribution in p.p.



Source: BPI Research, from Bank of Portugal, INE

GDP components: 2023 vs 2019

Real Index (2019 = 100)



- **The economy grew by 2.3% in 2023**. Domestic demand contributed 1.4 percentage points to growth, (consumption added 1 p.p. and GFCF 0.5 p.p.). Private consumption advanced by 1.6% in the year, with durable goods still heavily influenced by the recovery in car sales. GFCF rose by 2.4% with an acceleration in transport equipment and in machinery and equipment of 18,7% and 4,2%, respectively. The contribution from external demand was 0.9 percentage points, the result of 4.2% growth in exports, with services continuing to grow at double digits (10.6%) and goods slowing to 1.1%, due to weak growth in some of the main trading partners. Imports rose by 2.2%, goods +1.6% and services +5.4%.
- **In the external sector, the terms of trade improved** due to the fall of the import deflator (-4.0%), heavily influenced by the price of energy goods. The export deflator also slowed down, but remained positive (0.7%), contributing to the improvement in the terms of trade.

2024: adjustments on the macroeconomic scenario

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GDP and components: new scenario
(%)

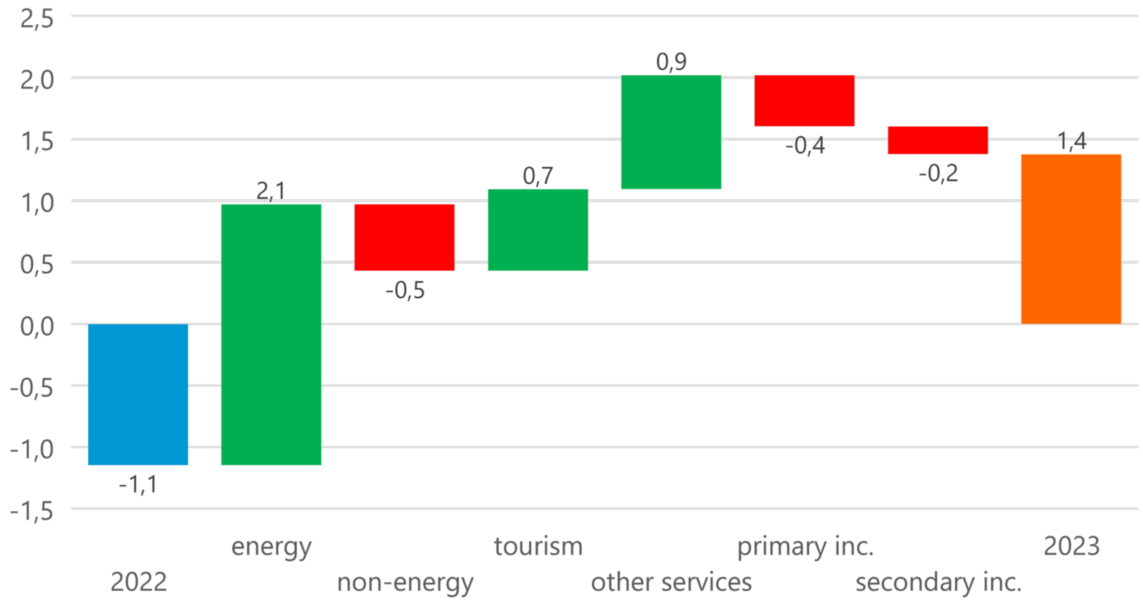
	2023	2024	2025	2026	Acum. 2024-26
GDP					
Feb 2024	2,3	1,6	2,3	2,5	6,6
Sep 2023	2,4	1,8	2,5	2,4	6,7
Inflation rate					
Feb 2024	4,3	2,3	2,0	2,0	6,5
Sep 2023	4,6	2,4	2,1	2,0	6,6
Housing prices					
Feb 2024	8,1	3,5	2,0	2,5	8,1
Sep 2023	4,0	-0,1	1,2	2,5	3,6
Unemployment rate					
Feb 2024	6,5	6,7	6,5	6,5	0,0
Sep 2023	6,6	6,5	6,3	6,1	-0,5

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

- **GDP: the 0,8% qoq growth in Q4, brought the carryover effect to 0,5%, giving some support to economic growth in 2024.** 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 labour 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 slightly revised downwards growth in 2024 and 2025; in the following years economy is seen to advance around 2,4% per year.
- **Inflation** performed well in 2023, converging faster than expected towards 2%; for 2024 we made a small adjustment reflecting this better than expected performance. A more moderate scenario for demand in the H1 2024, and absence of upward pressions in prices of energy will allow the continuation of the disinflationary process. The end of the zero VAT rate in food and the inclusion of some changes already announced (rents (+6,9%); telecommunications (4,3%); electricity (3.7%)) will be pressuring on the upside.
- **Labour market** is foreseen to remain robust in part due to sustained economic activity, and also because some sectors continue to reveal labour shortages. Changes on the unemployment rate, reflect lower GDP growth and an expected increase in active population due to immigration.
- **Housing market** continues strong and was the variable with higher revision from the September scenario, signalling the expectation of a gradual slowdown. There is still no information for Q4 23, but the available data points to stronger growth than was forecasted in September. This will result in a much higher carryover effect than previously anticipated. Additionally, there are factors supporting the market, such as a positive migratory balance, resilience of demand, supply shortages and still a robust labour market; in addition, the criteria for access to credit have improved with higher number of fixed-rate contracts and low nonperforming loans ratios. Partially offsetting the supporting factors will be the more moderate growth of the economy and the reduction in the search for yield associated with better returns on risk-free investments, such as deposits.

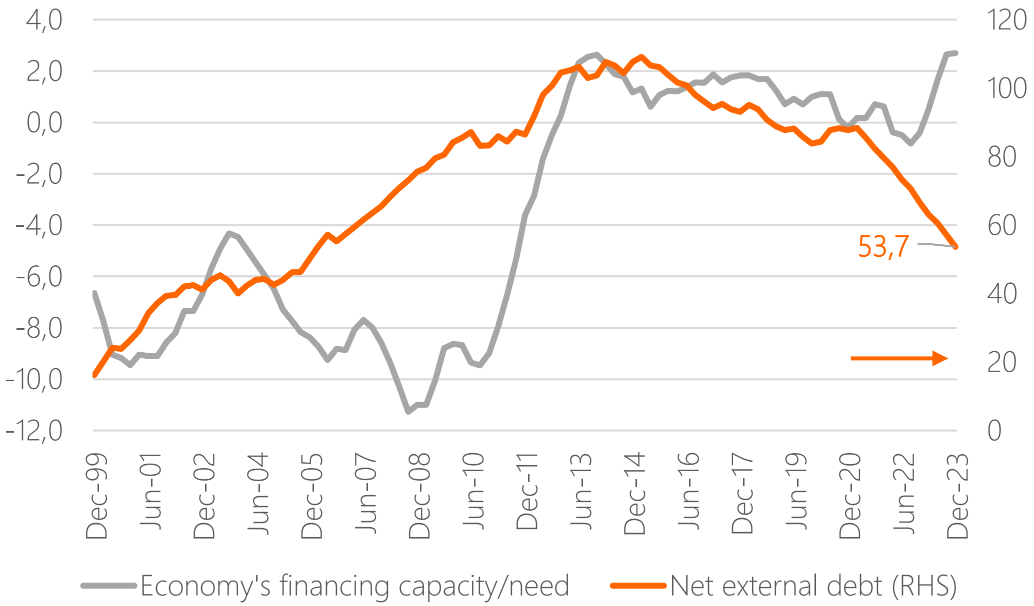
Lower energy prices, more tourism and structural improvements brought external accounts to surplus again (and reduced external debt)

Current account evolution in 2023
% of GDP and p.p. changes



Source: BPI Research, from INE

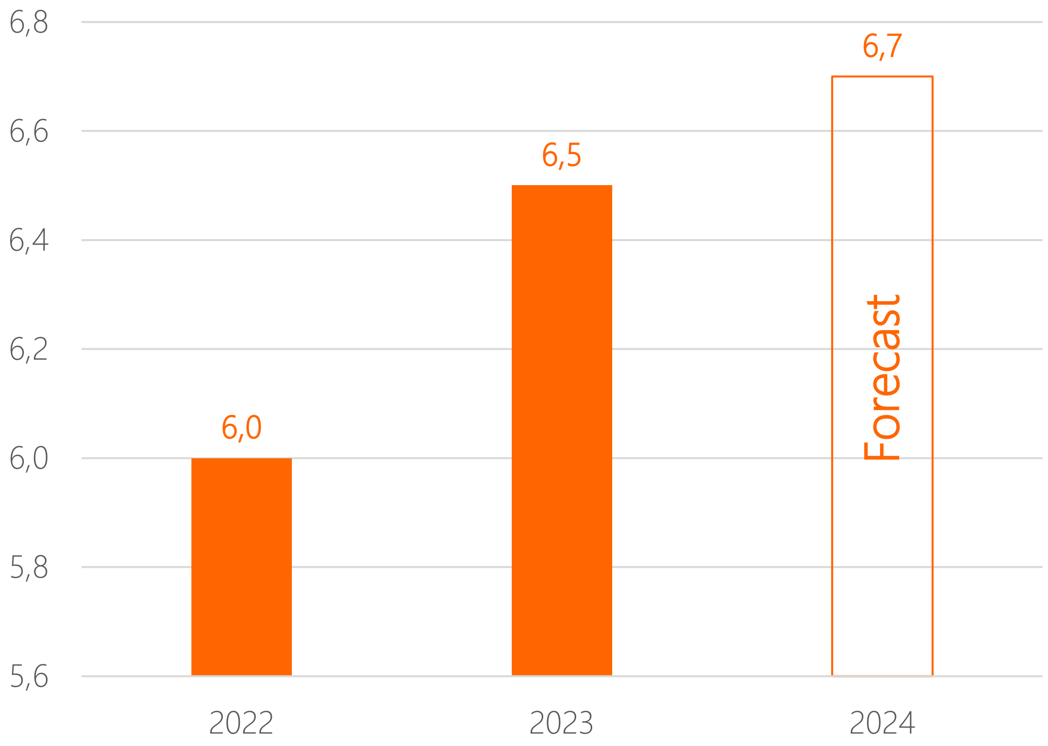
Economy financing capacity and external debt
% of GDP



- **The current account ended 2023 with a surplus equivalent to 1.4% of GDP,** the highest level since March 2017, halting a 3-year cycle of deficits. Compared to 2022, when the current account recorded a deficit of 1.1% of GDP, the main changes occurred in the energy account (deficit shrank by 2.1 p.p. to 2.7%) and surpluses increased in services, both tourism (+7.1% of GDP, an increase of 7 tenths) and other services (+3.5% of GDP, an improvement of 9 tenths). The non-energy goods balance saw the only worsening, from a deficit of 6.1% of GDP in 2022 to -6.7% in 2023.
- The capital account recorded a surplus of 1.4% of GDP (0.9% in 2022), benefiting from the funds received under the NGEU, contributing to an external financing capacity of 2.7% of GDP and for the **reduction of the net external debt to 53,7% of GDP, the lowest level since 2006 and minus 13 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 2024.

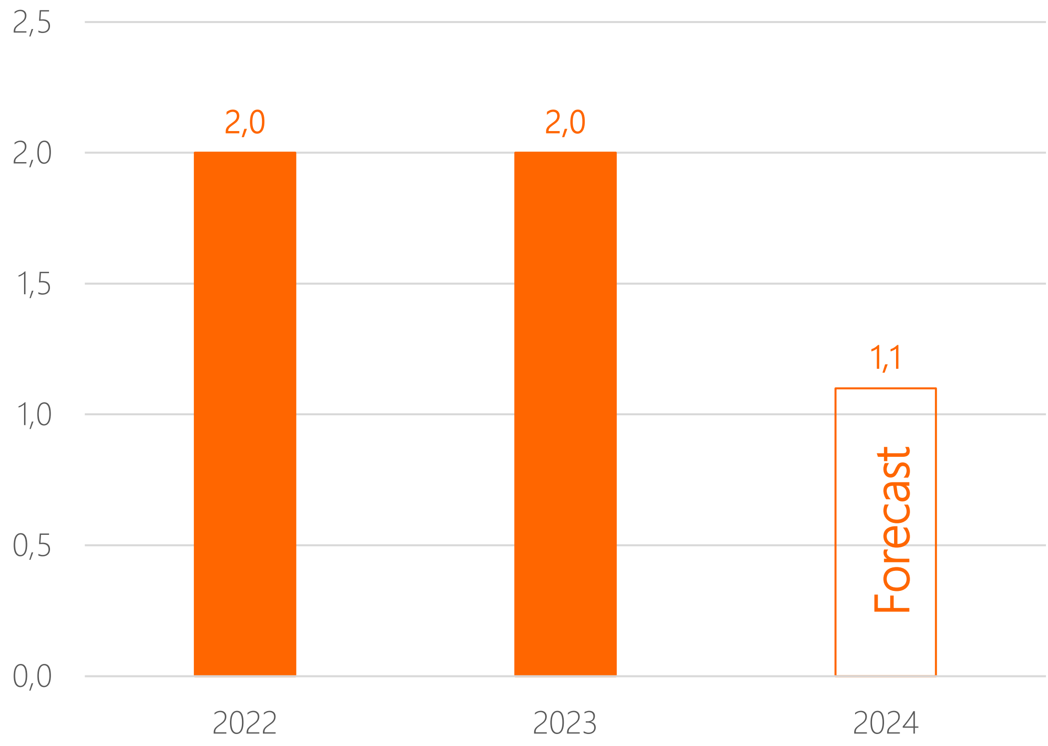
Labor market continues resilient but it's losing momentum

Unemployment rate
% of active population



Source: BPI Research, from INE.

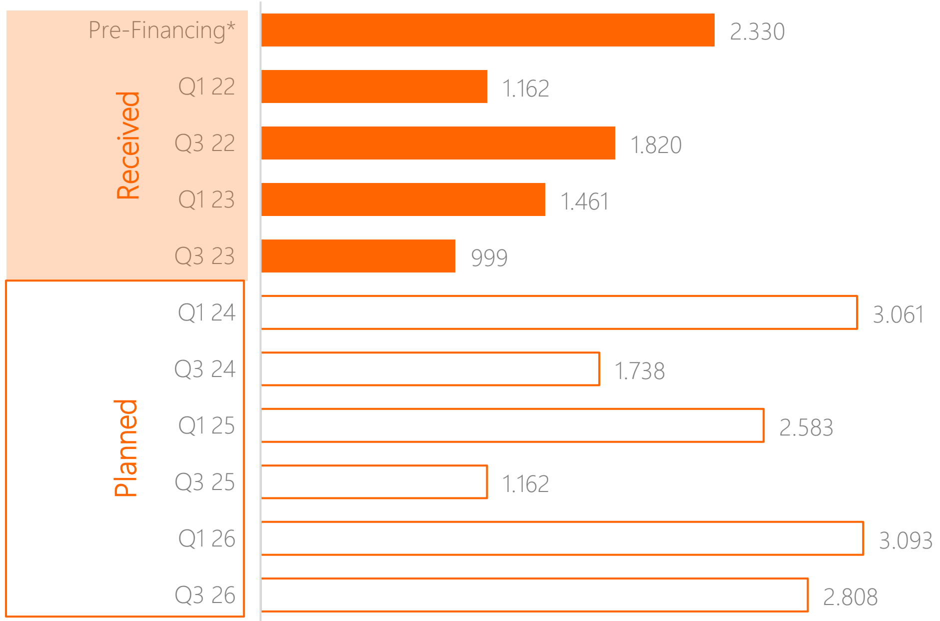
Employment
Annual growth (%)



- **The labour market performed better than expected in 2023 and is seen to remain supported in 2024.** Employment grew 2% in 2023 and is seen to advance around 1% in 2024 due to the persistence of shortages in some sectors. Indeed, the ratio of job vacancies per unemployed person is well above the historical average (16 against an historical average of 4 people). However, lower growth, a continued positive migration balance - with an impact on the increase in the active population - and some saturation of the labour market - reducing the capacity to absorb the inflow of active people - will led to a rise on unemployment rate.

NGEU: high rate of approved projects, may accelerate transfer of funds to final beneficiaries

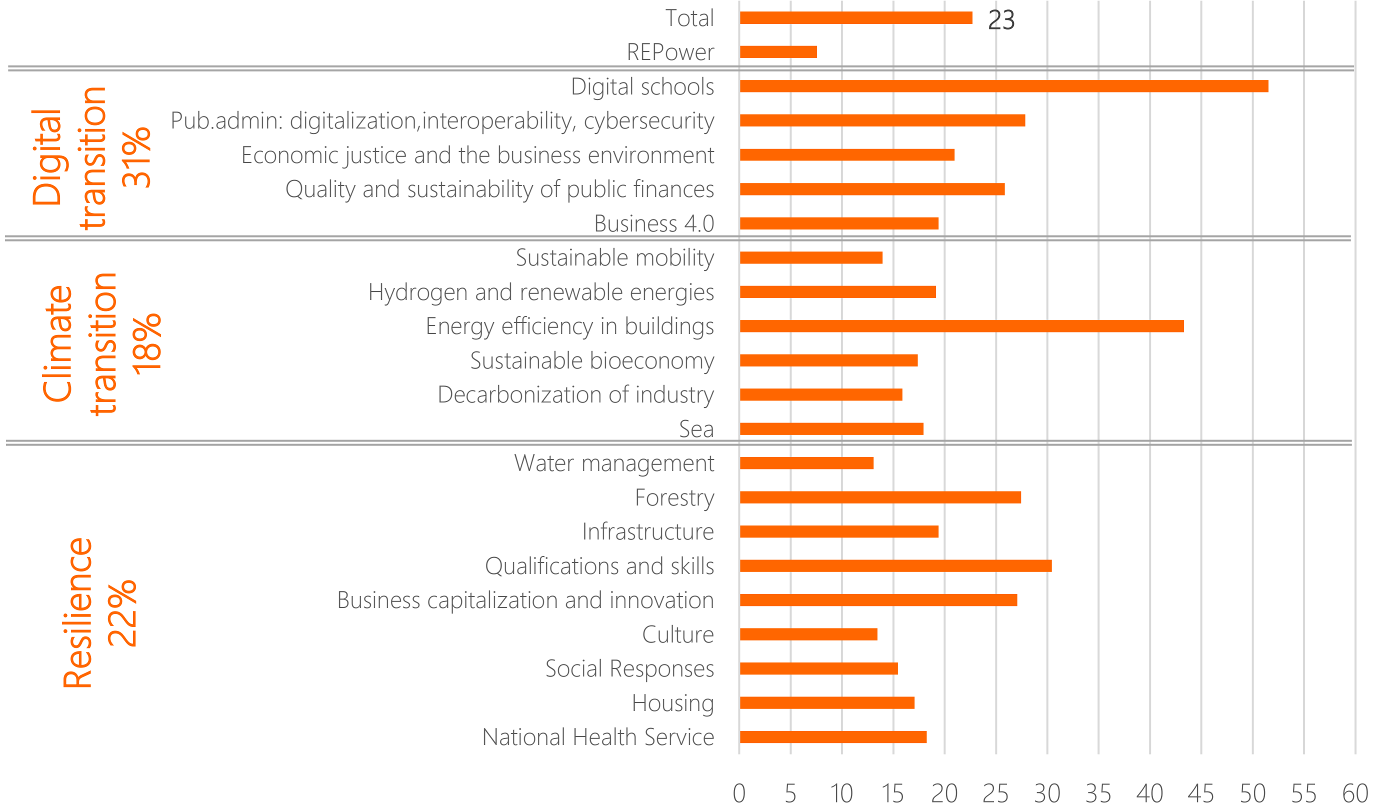
Disbursements received and planned along the program
EUR Million



* Pre-Financing includes the readjustment received after the rescheduling to 22,2 mm€

Source: BPI Research, from Recuperar Portugal.

Payment rate up to February 28th
% of total of the amount approved

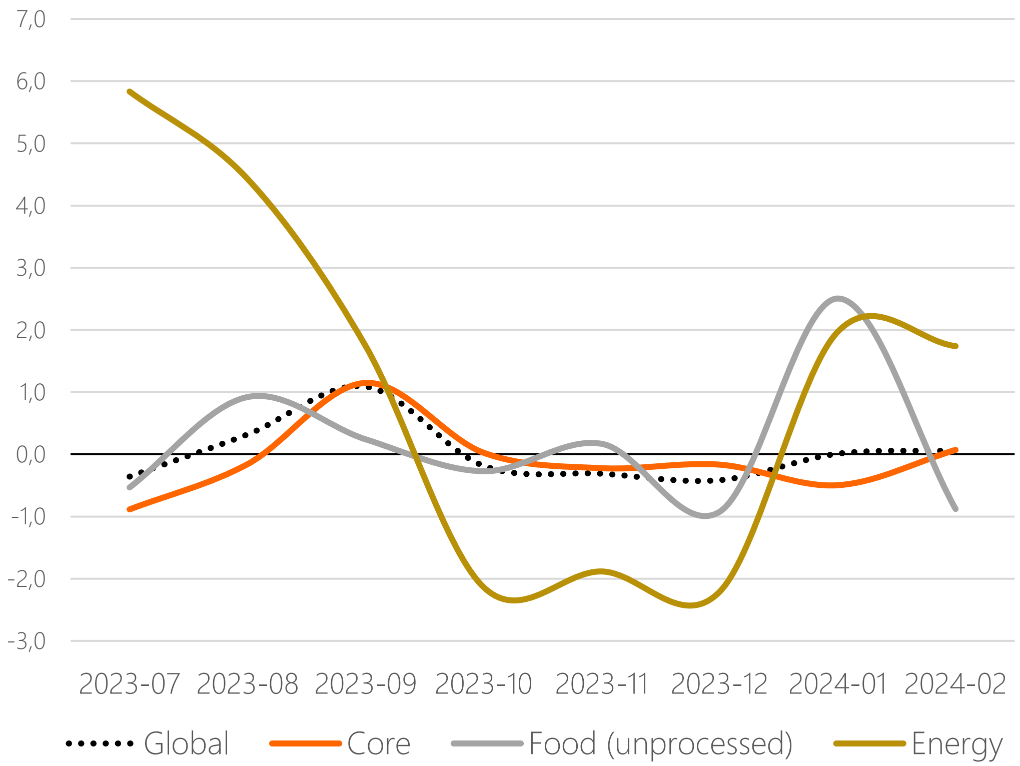


- **Up to the end of 2023 Portugal received 7,7 billion of euros, equivalent to 35% of the total amount of the RRP**. In 2024 it should be received an additional 4,8 billion of euros, that may suffer delays linked to the outcome of the March 10 elections.
- **Projects already approved amount to 16,9 billion euros (76% of the total amount) and payments reached 3,8 billion,** representing 23% of the approvals, but circa 50% of the total amount received.
- **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.**

Inflation returns to downward trend in February

CPI by components

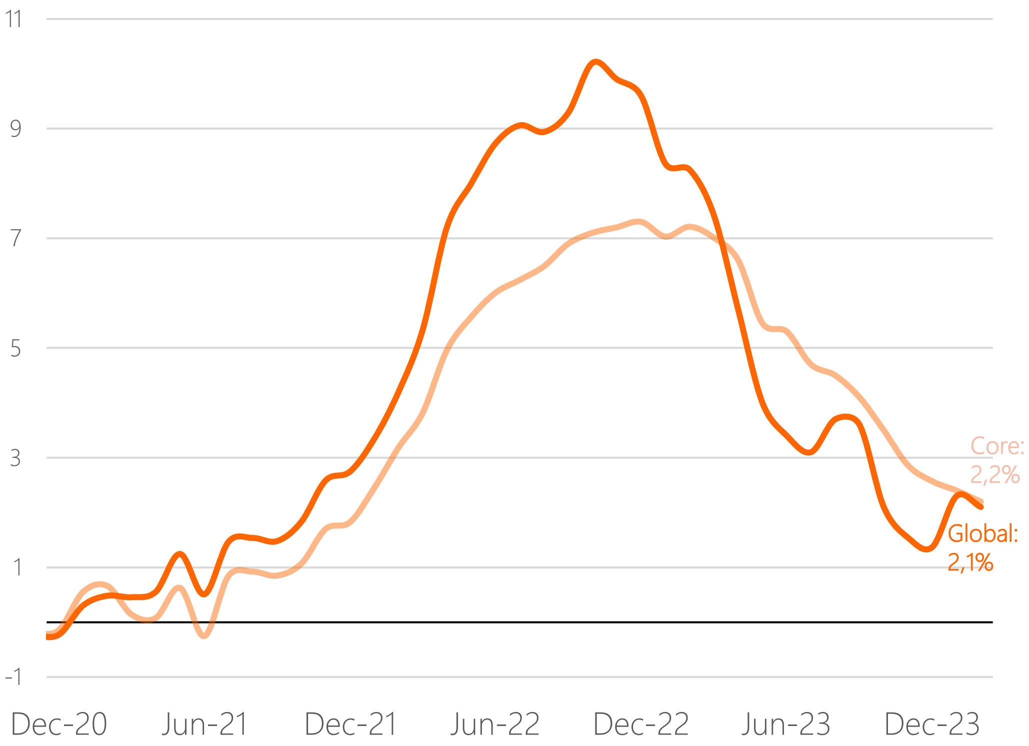
Month-on-month (%)



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

Portugal CPI: Global & Core

Year-on-year (%)



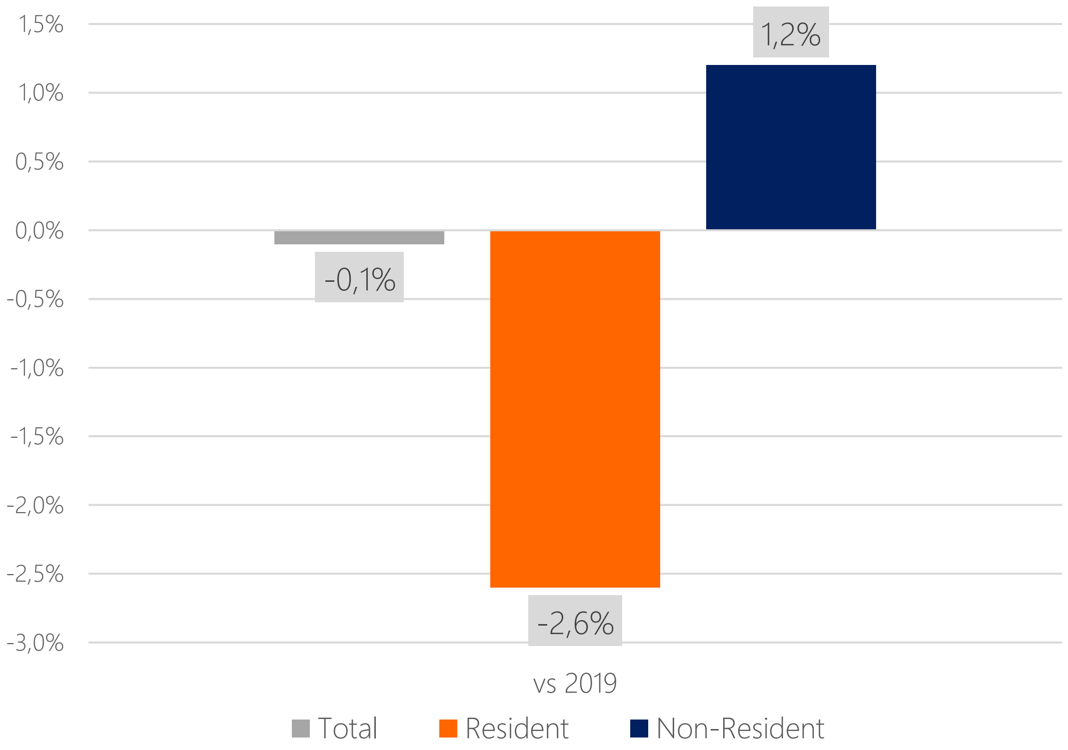
Source: *BPI Research, using data from INE.*

- The year-on-year rate of change in the Consumer Price Index (CPI) fell to 2.1% in February, down from 2.3% in January and slightly above BPI Research's forecast of 1.9%. The drop in overall inflation was also accompanied by the core inflation rate, which fell - excluding the most volatile products (unprocessed food and energy) prices rose by 2.2% (2.4% in January). The CPI figures at the beginning of the year confirm our overall view of a very gradual easing of prices over the course of this year.
- The Energy component showed a stronger than expected increase in prices, contrary to seasonality (a monthly increase of 1.7%, compared to an average monthly change of 0.13% in February between 2015 and 2021). This is associated with increases in the Brent price at the start of the year (+8.6%); in fact, in February, in national retail, 95 petrol and diesel increased by an average of 3.5% and 4.7%, respectively, compared to January. In turn, after the sharp rise in prices in January (associated with the withdrawal of the "Zero VAT" measure), food prices (processed and unprocessed) fell again.

Tourism: shy start in 2024

Overnight stays

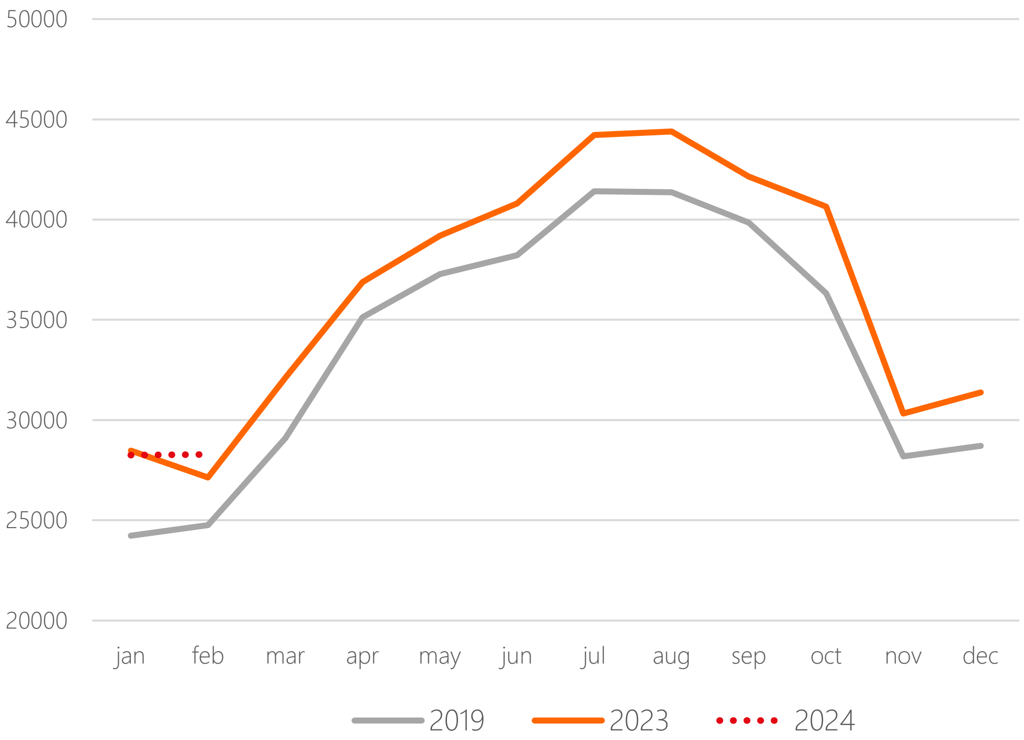
Change in January 2024 versus January 2023 (%)



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

Monthly flights in Portuguese airports

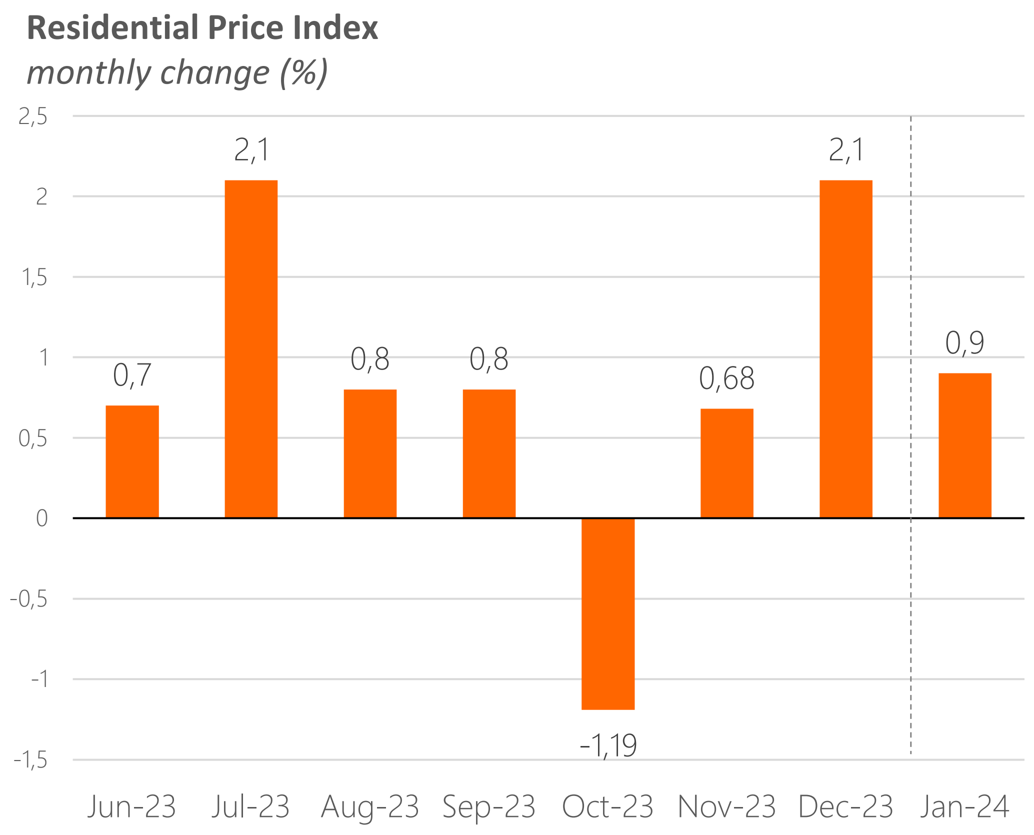
Number



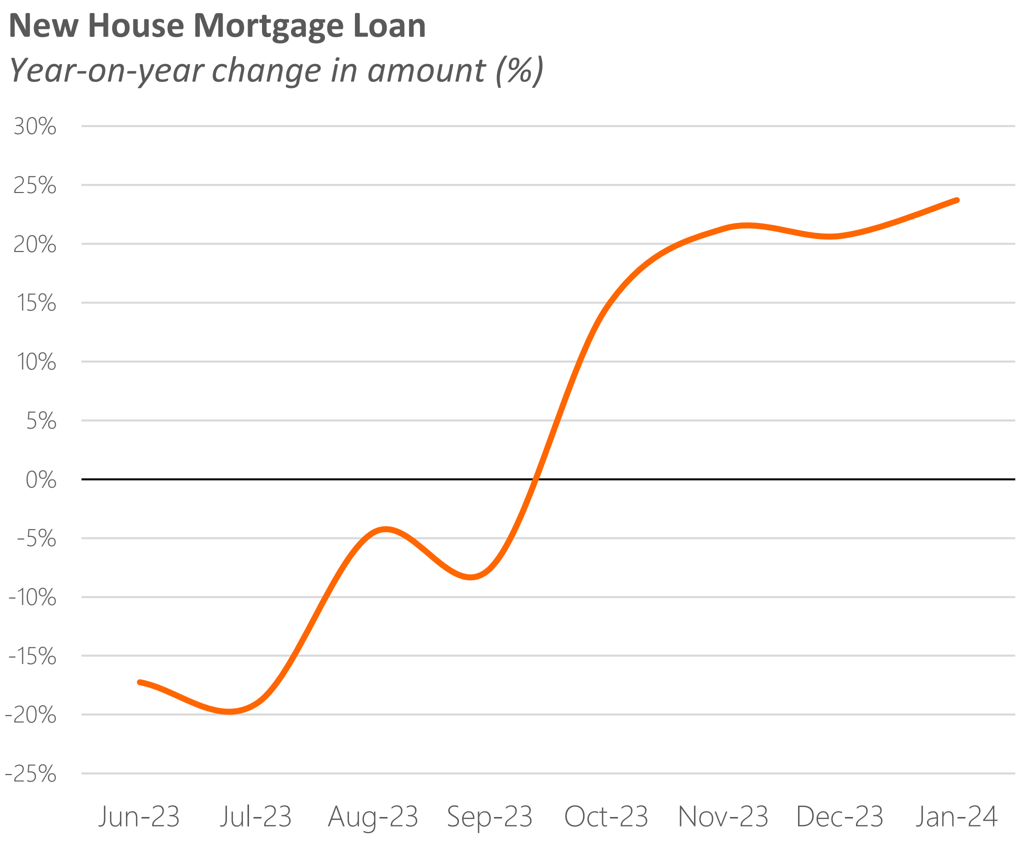
***Source**: BPI Research, using data from Eurocontrol.*

- **Tourism starts 2024 with 1.5 million guests and 3.5 million overnight stays in January**. This represents an increase in tourists of 1.8% and a drop in overnight stays of -0.1% compared to January 2023. The modest behavior is mainly explained by the dynamics of resident tourism, which weakened. In terms of overnight stays from residents, there was a very significant drop in overnight stays in the region of Lisbon (-11%) and Madeira (-17%). Despite this moderation, January's figures continue the trend seen in 2023 of surpassing pre-pandemic levels (+16% in Guests and +18.6% in Overnight stays).
- After a January with flights at national airports below what was seen in 2023 (-1%), February seems to indicate a slight recovery and the previous year's figure was exceeded by 4%.

Housing market: mortgage loans for housing increasing



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



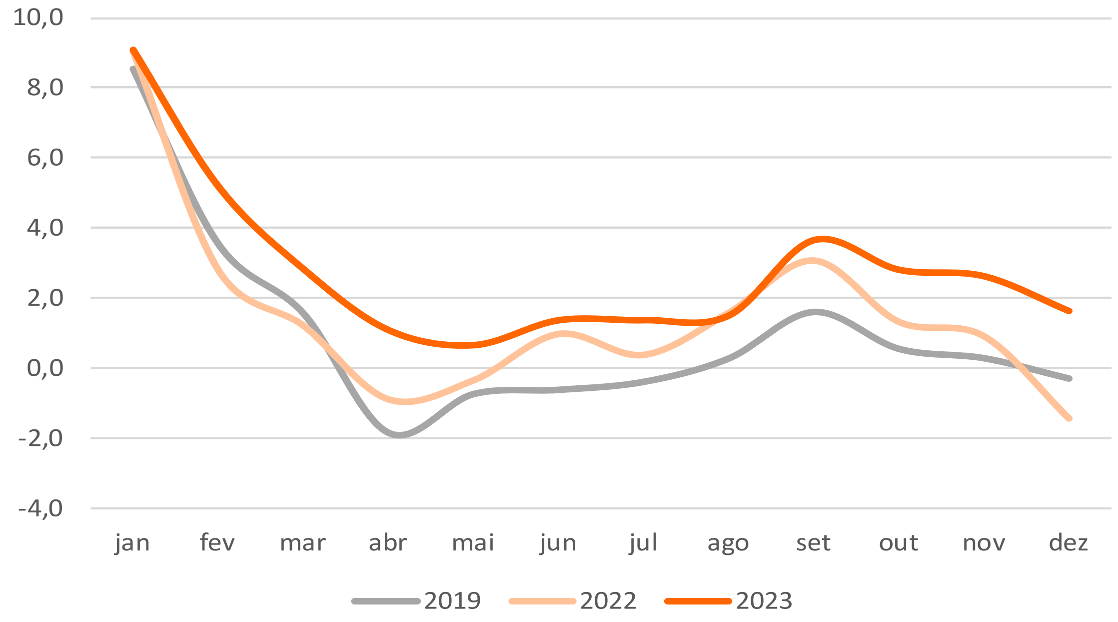
Source: *BPI Research from data of Bank of Portugal.*

- **In January, house sales prices in mainland Portugal rose by 0.9% (reported by Confidencial Imobiliário) compared to December 2023,** thus continuing the cycle of mild monthly increases that predominated in the second half of last year.
- **Since October 2023, we have also seen a recovery in the amount of mortgages contracted in year-on-year terms, signaling that the market is regaining confidence, possibly as a result of greater visibility in relation to a cut in interest rates.** The number of transactions (reported by Confidencial Imobiliário) also increased quarter-on-quarter in Q3 and Q4 2023.

Commitment with fiscal consolidation brings the public debt ratio to historical low levels: 99%

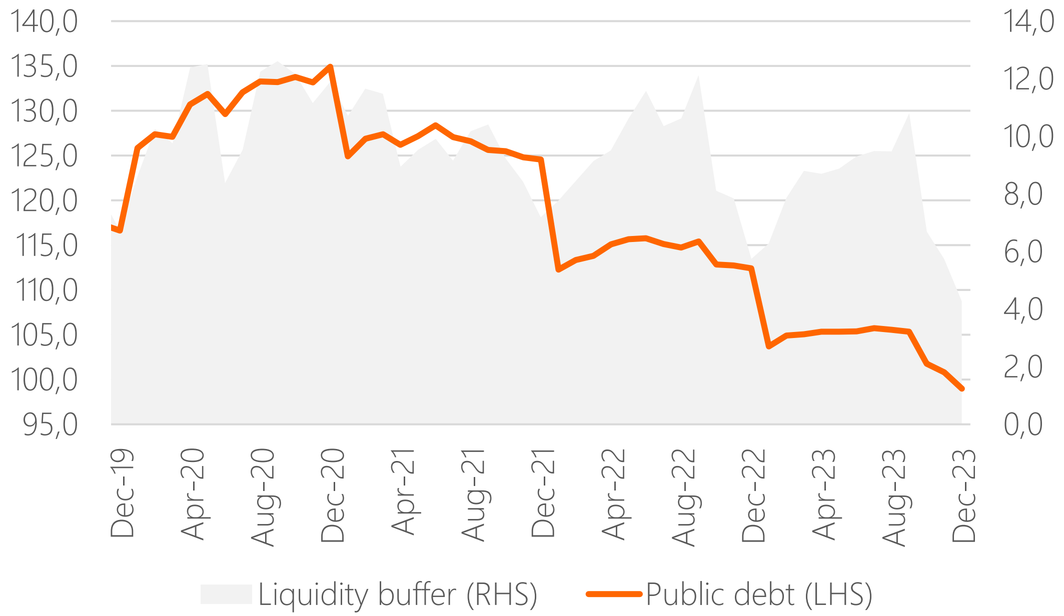
Overall fiscal balance*

% of GDP



Public debt ratio and the liquidity buffer

% of GDP; bln EUR



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

- **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 in 2023 to 99% of GDP for the first time since 2009, 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.

Elections in March 10th with an uncertain outcome

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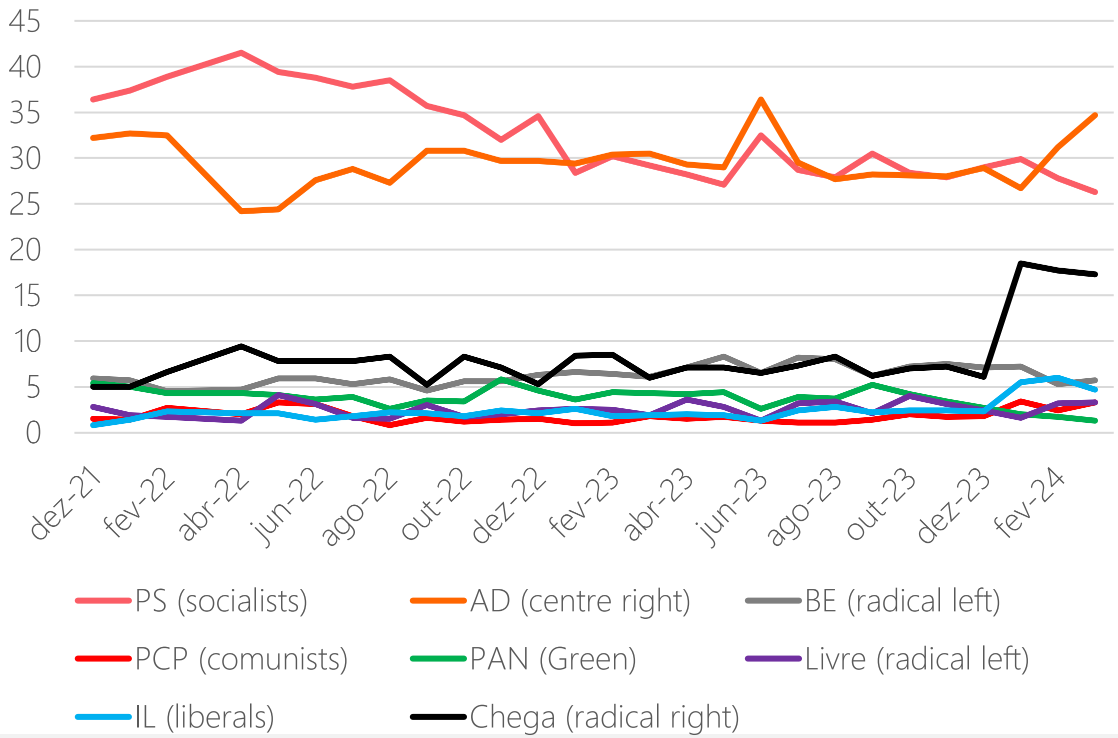
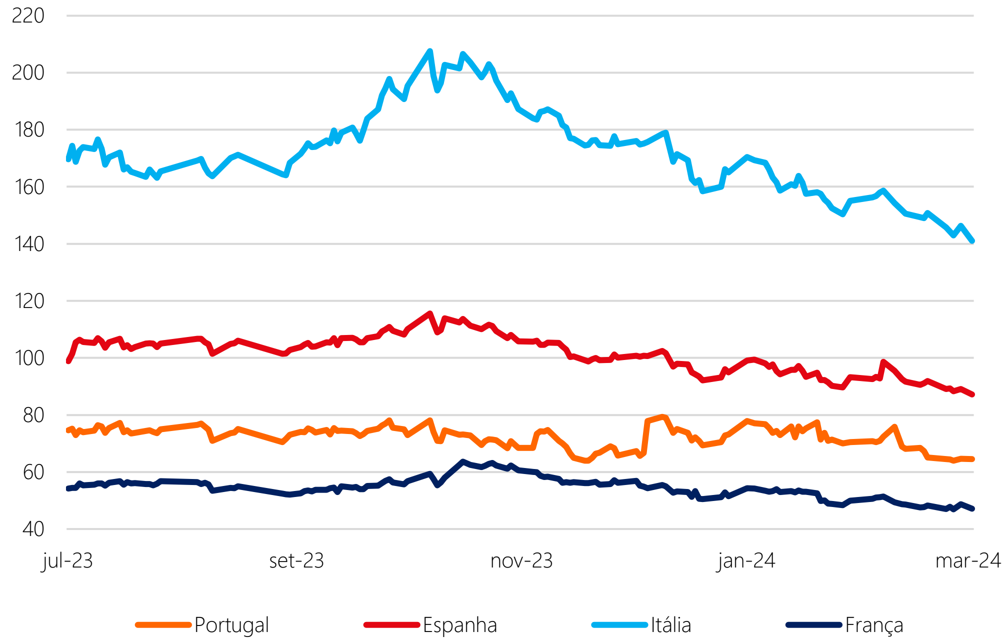
Polling trends since the last elections (January 2022)

(%)



Sovereign spread

Percentage points



*Source:*BPI Research, *from Marktest and Bloomberg.*

- **The most recent polls point to a victory for the AD (centre-right coalition), but without an absolute majority and still uncertain.** A possible solution is an AD coalition with the Liberals, but still insufficient for an absolute majority (39%) according to recent polls. Another possibility is for the PS to allow an AD minority government to go ahead and then abstain from voting on the State Budget. Whatever the outcome, one of the two main parties will probably win elections, ensuring a government committed with public accounts consolidation, a scenario that guarantees confidence for the markets and international institutions. Both parties project a balanced budget (in the case of the PS) or a slight surplus (in the case of the AD) and a reduction in the public debt ratio to around 80% by 2028.
- **The focus of the two parties' policies is different,** with AD focused on tax cuts (compensated by contained growth of current primary expenditure) and a commitment to private initiative; on the PS side, there is a scenario of continuity, where the main ideas are based on the definition of strategic sectors to public support, an increase in the weight of current primary expenditure in GDP, and gradual reduction in personal income tax and practically no changes to corporate income tax.

S&P raises the Portuguese rating emphasizing improvement in external liquidity risks

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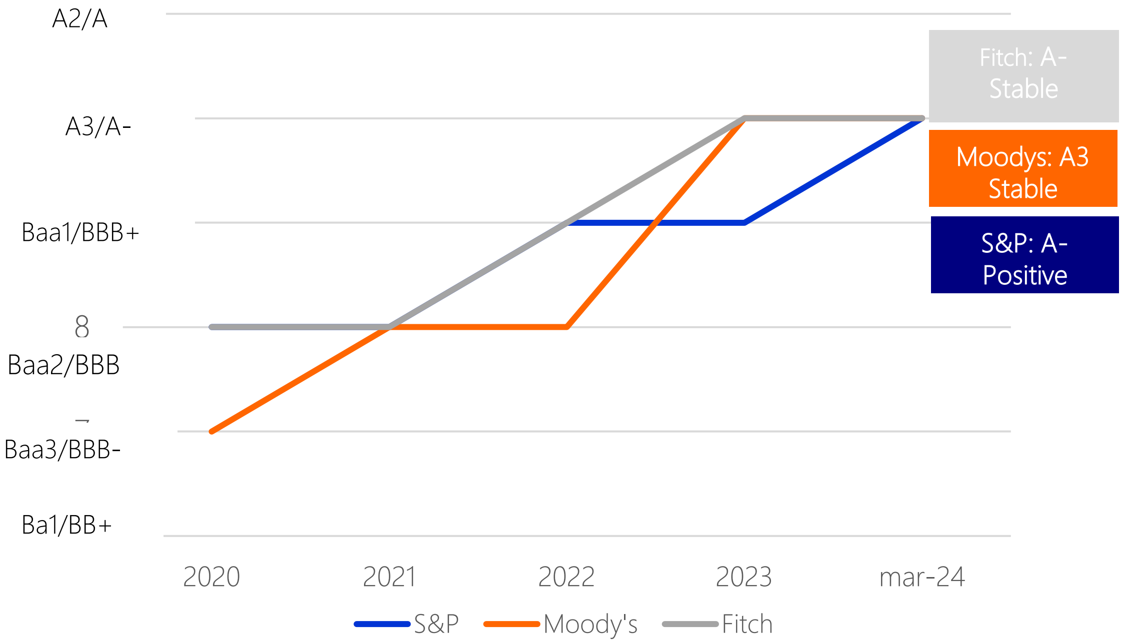
Rating evolution

level



Source: BPI Research, from Fitch, Moodys and S&P raters.

Macroeconomic scenario S&P vs BPI

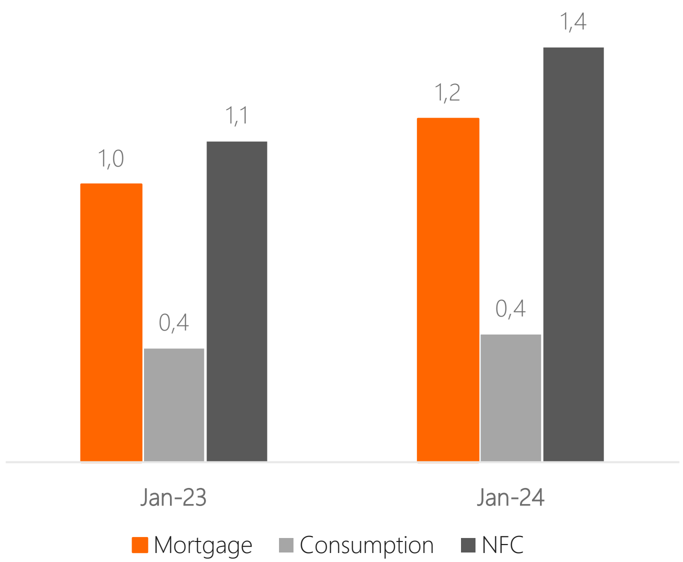
%

	2023	2024	2025	2026	Acum. 2024-26
GDP					
BPI	2.3	1.6	2.3	2.5	6.6
S&P		1.4	1.8	1.8	5.1
Inflation rate					
BPI (CPI)	4.3	2.3	2.0	2.0	6.5
S&P (HCPI)	5.3	3.5	2.1	2.0	7.8
Unemployment rate					
BPI	6.5	6.7	6.5	6.5	0.0
S&P		6.7	6.5	6.5	0.0
Current account % of GDP					
BPI	1.4	1.2	1.4	1.4	0.0
S&P		1.3	1.5	1.5	0.1
Public balance % of GDP					
BPI	1	0.4	0.6	0.6	-0.4
S&P		0.2	0.1	0.1	-0.9
Public debt ratio % of GDP					
BPI	99	98.6	93.7	89.1	-9.9
S&P		94	90.1	86.5	-12.5

- **S&P upgraded Portugal's rating to A-, keeping the positive outlook, reflecting the ongoing deleveraging process, both externally and internally.**
- **The outlook remained positive, suggesting that in the next 2 years, a new upgrade is possible.** This decision is reliant on the consolidation of the surplus position of the current account, supporting new declines on external debt; and maintenance of cautious fiscal policy assuring the gradual decline of the public debt ratio.
- **Macroeconomic scenario:** S&P cautious about accumulated growth in the medium term, but aggressive regarding variables linked to the deleveraging process.
- **Risks evaluated as contained:** disruptions to international trade due to geopolitical tensions in the Red Sea is limited; limited external liquidity risks due to a significant share of external debt services being due to the Eurosystem; Banking sector risks limited due to improvements on profitability, lower nonperforming loans and risk of asset quality deterioration is contained due to strong labour market and public support to loans restructuring

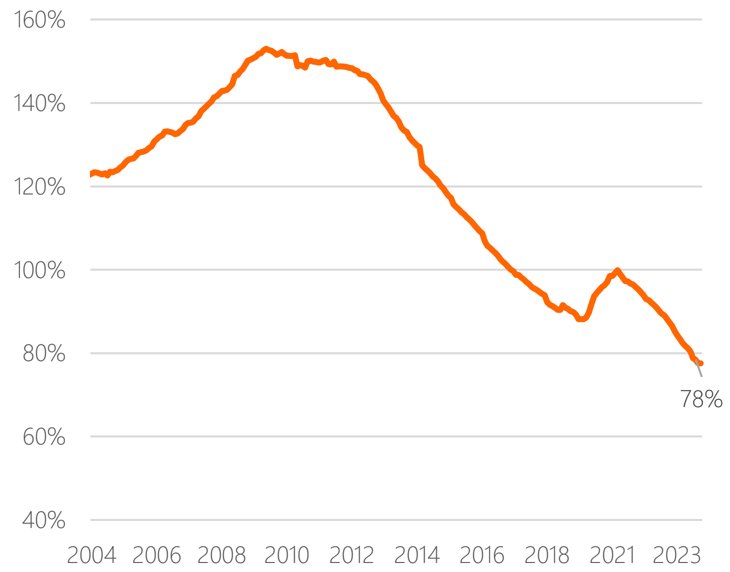
Banking system: a solid position to face the economic slowdown (1)

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



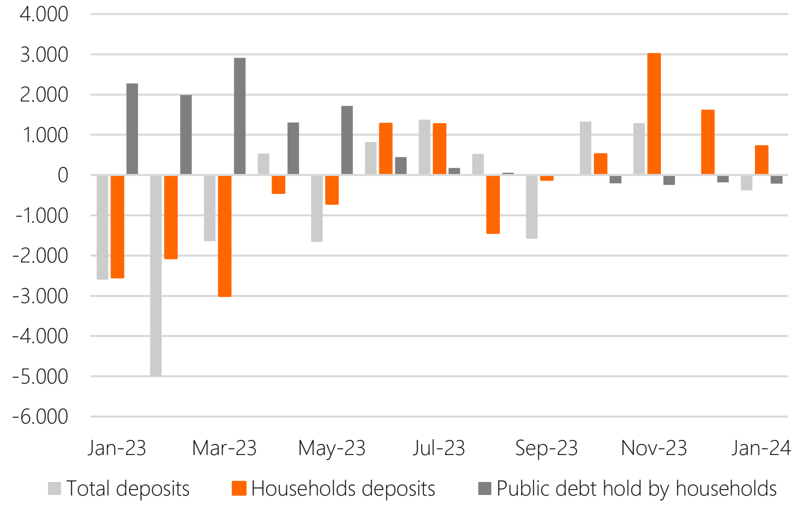
Source: BPI Research, base on data from Bank of Portugal and ECB.

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€)

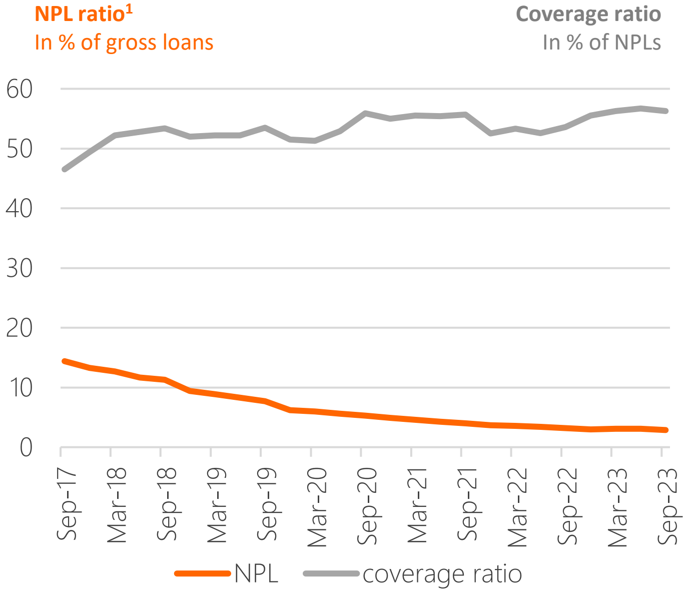


Notes (*): Public debt by households includes Certificados de Aforro and Certificados do Tesouro, which can only be subscribed by resident households. The maximum amount that Government can issue for these retail instruments (CA and CT) is 16.5 bn Eur in 2023.
Source: BPI Research, base on data from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

- **The stock of credit is decelerating since mid-2022:**
  - **Mortgage credit: in the 1st month of 2024** declined 1,4%, but new operations accelerated in the same period by 23,7% suggesting that the declining path seen since July 2023 may be changing. First signs that the peak on interest rates may be behind us may have contributed to this. 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, lower investment, favorable level of deposits and continuing weak new credit operations. In January 2024 it fell 2,5%, but new loans increased by 29,4%.
- Deposits of the private sector declined 1,7% in the 1st month of 2024. Households' deposits declined -3,0% yoy, but increased 0,6 million on a monthly basis, as interest rates for new deposits continue to be higher (2,9% in January) than the one paid by government retail products (CA's new subscription conditions consider a maximum interest rate of 2,5%).

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

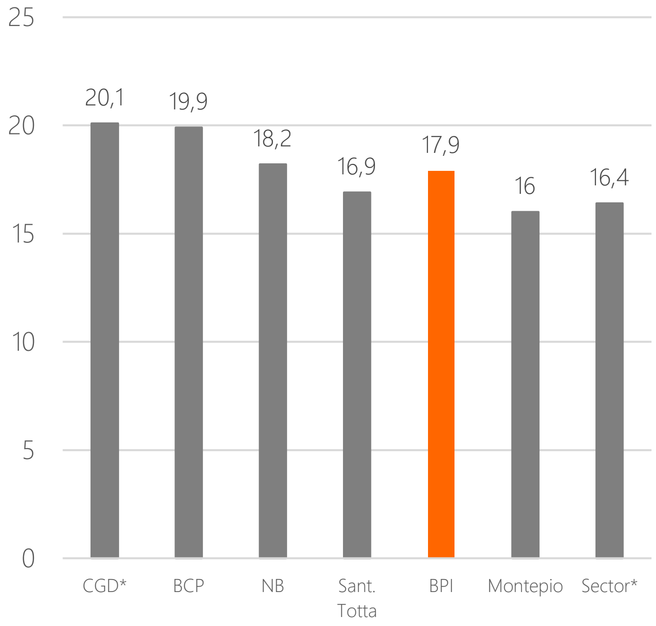
In % of average total assets (2023; trailing 12M)

	BPI	BCP	San Totta	CGD	NB	Montepio
Net interest income	**2.4%**	**2.4%**	**2.6%**	**2.0%**	**2.6%**	**2.2%**
Net fees	0.8%	0.9%	0.8%	na	0.7%	0.7%
Gains on financial assets	0.1%	0.0%	0.3%	na	0.1%	-0.1%
Other net profits	-0.2%	-0.1%	0.0%	na	-0.2%	0.0%
Gross income	**3.1%**	**3.3%**	**3.7%**	**na**	**3.1%**	**2.8%**
Operating expenses	-1.4%	-1.0%	-0.9%	na	-1.1%	-1.4%
Operational result	**1.7%**	**2.3%**	**2.8%**	**na**	**2.0%**	**1.4%**
Impairement losses, taxes and others	-0.1%	-0.6%	-0.2%	na	-0.3%	-0.4%
Profit	**1.1%**	**1.2%**	**1.8%**	**1.0%**	**1.7%**	**0.2%**
ROTE[1]	16.0%	16.0%	23.4%	na	20.4%	nd

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 % (2023)**



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.**

BPI

Grupo CaixaBank