Portugal:
Macroeconomic and financial outlook

BPI *Research*

April 2024

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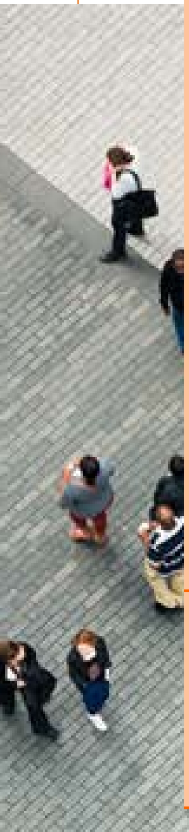
BPI Grupo CaixaBank

Main messages



Activity

- **2024 data better than expected so far,** with consumption related indicators suggesting that households' spending remains resilient; besides, sentiment are showing a positive trend in all sectors. We expect 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.
- **Bumpy inflation rises again in March,** accelerating 2 tenths to 2,3%**.** 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 March accelerated the pace of growth to 4,8% yoy, more 5 tenths than in February. CPI numbers continue in line with our forecast of average inflation in 2024 of 2.3%, which incorporates a disinflationary path not free of fluctuations, i.e. a gradual and non-linear downward disinflationary process.
- **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). In February the performance improved - an increase in tourists of 7.0% and 6.4% in overnight stays compared to February 2023.
- **Housing prices rose 8,2% in 2023, but the nº of houses sold declined.** For 2024, we estimate an average house price increase of 3.5% and a further reduction in the number of transactions (avg -4.2%), which keeps the dynamics of the residential property market on a moderation trend, but avoiding price correction.
- **Portugal registered an external surplus equivalent to 2,6% of GDP, supporting the decline of the external debt.** In 2023 the foreign debt ratio fell to 53,8% of GDP from 66,7% in 2022. Since the peak of 199% of GDP in 2015, the ratio of the external debt declined 55 p.p. In nominal terms, the external debt fell 48MM€ since 2015, to 142,7MM€ in 2023.
- **The fiscal balance registered a surplus of 1,2% of GDP in 2023,** taking advantage of an higher growth on revenues than on expenses. **This performance allowed the decline of the public debt ratio to 99,1% of GDP** for the first time since 2009.
- **The centre-right coalition, named AD, won the elections with a low margin compared to the second largest party, the PS.** The new government took office on April 2nd and its program will be presented on April 10th. PS will make an AD government viable (according to the announcement made by the PS's leader), but support is not expected when it comes to approving state budget, a relevant question at the end of October. However, the new PM (Luís Montenegro) suggested in his investiture speech that the non-approval of the budget for 2025 would not be an impeachment for the governance (duodecimal basis would apply).
- **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 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	1.7	1.0	1.7
Public Consumption	0.8	0.2	0.6	2.1	0.4	4.5	1.4	1.0	1.5	1.1
Gross Fixed Capital Formation (GFCF)	2.5	11.5	6.2	5.4	-2.2	8.1	3.0	2.5	3.6	5.1
Exports	4.4	8.4	4.1	4.1	-18.8	12.3	17.4	4.1	2.4	5.2
Imports	5.0	8.1	5.0	4.9	-11.8	12.3	11.1	2.2	2.8	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	1.2	0.4	0.6
General government debt (% GDP)	131.5	126.1	121.5	116.6	134.9	125.5	112.4	99.1	98.6	93.7
Risk premium (PT-Bund) (average)	307	269	138	100	90	60	100	70	76	80

Source: *BPI Research.*

2024 starts better than expected

Latest economic indicators

Yoy%

yoy, level		Q4 2023	Q1 24	Last month available
Synthetic indicators	Economic climate indicator	1.2	1.8	March
	Economic sentiment indicator	95.7	99.5	March
	Daily economic indicator	5.6	6.0	March[1]
Consumption	Consumer confidence	-28.2	-22.6	March
	Retail sales (yoy)	0.5	0.4	February
	Retail sales excl. fuels (yoy)	0.8	1.3	February
	Car sales (yoy)	7.9	13.7	March
Suply	Cement sales	3.6	13.8	February
	Industrial production	-2.3	-0.2	February
Demand	Electricity consumption adjusted for temperature&working days	3.6	2.5	March
	Number of flights (yoy)	7.2	2.2	March
Trade	Exports G&S (accum. Year)	5.0	3.1	January
	Imports G&S (accum. Years)	-1.6	-2.0	January
Labour market	Change in regist. unemployment (thousand people)	13.5	14.2	February
	Change in employment (thousand people)	79.1	113.2	February

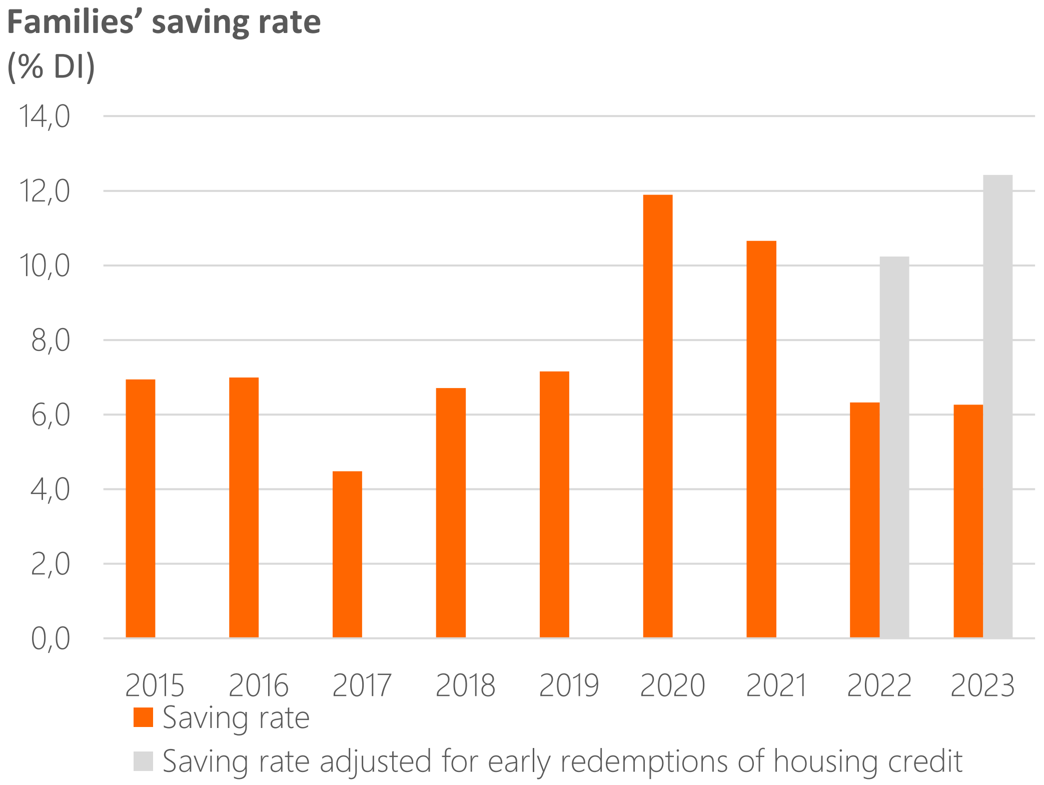
Source: BPI Research, from Bank of Portugal, INE

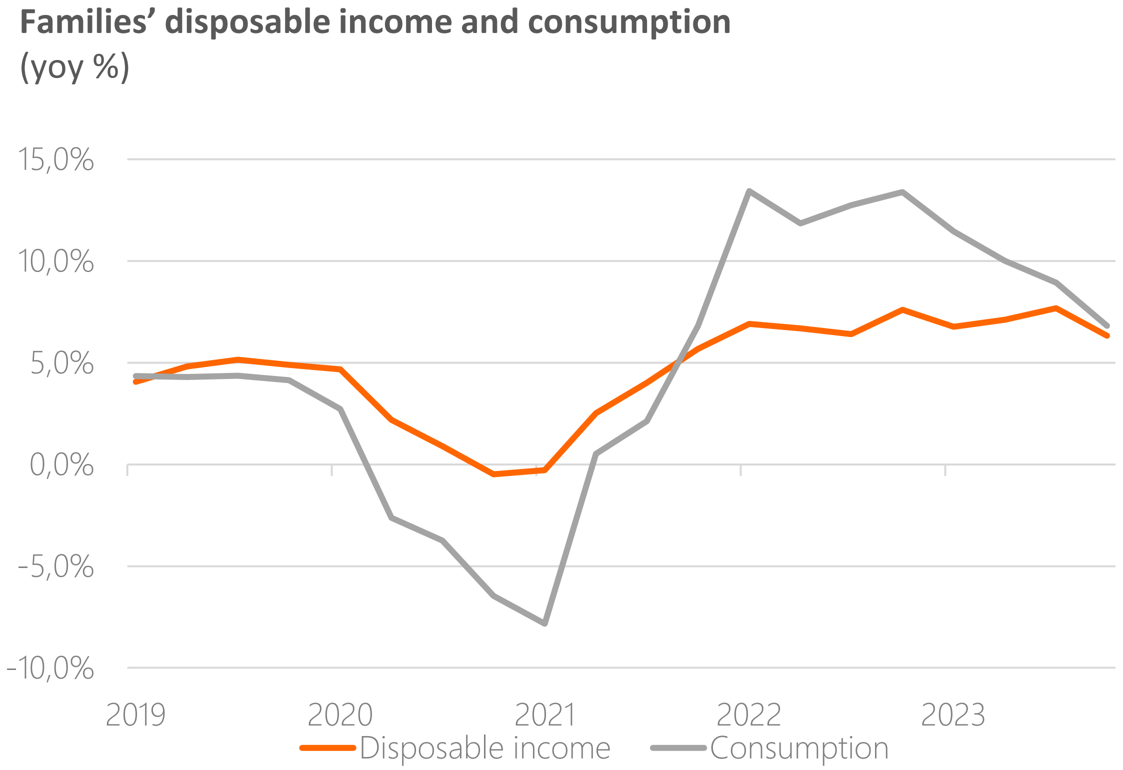
Daily activity indicator

yoy monthly moving average (%)

- **Indicators that give a more complete outlook for Q1 suggest that quarterly growth in the period could exceed our forecast of 0.4% quarterly growth:** Bank of Portugal's daily activity indicator, accelerated; also the economic climate indicator - which summarises sentiment in industry, retail, other services and construction - accelerated. And the same happened for the European Commission's economic sentiment indicator. In March it was again slightly above the 100 level (100.8), suggesting an acceleration in activity. Consumption should remain robust, especially durable goods (car sales accelerated in Q1), supported by stable labour market, the decline of interest rates and real disposable income growth.
- If this stronger behaviour is translated into stronger growth in Q1 than anticipated by BPI Research, the risks to our forecast of 1.6% growth for the year as a whole will be skewed upwards.

Families’ saving rate stabilized at 6,3%





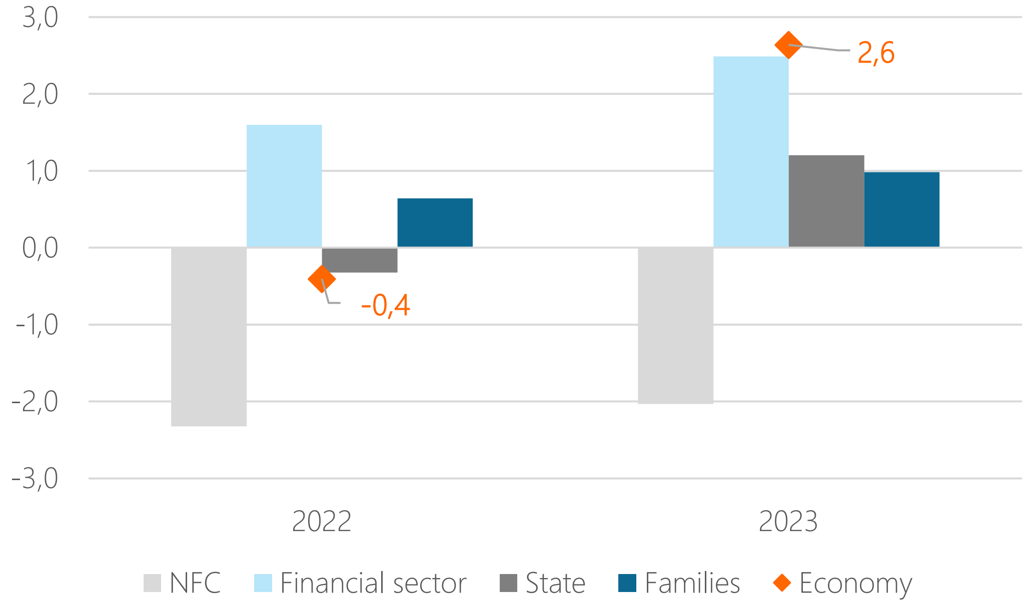
Source: CaixaBank Research, from INE, BoP

- **The families’ saving rate stabilized at 6.3% in 2023,** reflecting similar growth rates in disposable income and consumption.
- Although remaining close to historical lows, its evolution hides households' decisions to use their some of the extra savings built during the pandemic to early repay home loans. In 2023, these amounted to 11,689 million euros. If this amount hadn't been used for early repayment of mortgage loans, the savings rate would have been around 12,5% of disposable income.
- This suggests that in 2024, household budgets will be less pressured by financing costs associated to mortgages, which may boost consumption and/or strengthen savings.

Portugal returns to external surpluses, a positive indicator for the reduction of external debt

Financing needs(-)/capacity(+) of the economy

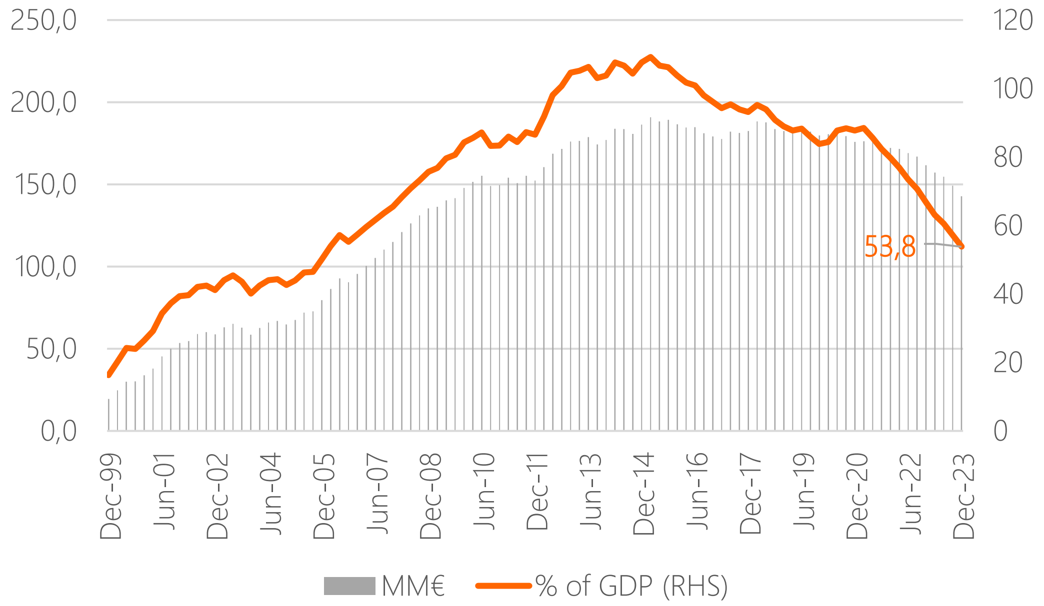
% of GDP



Source: BPI Research, from INE

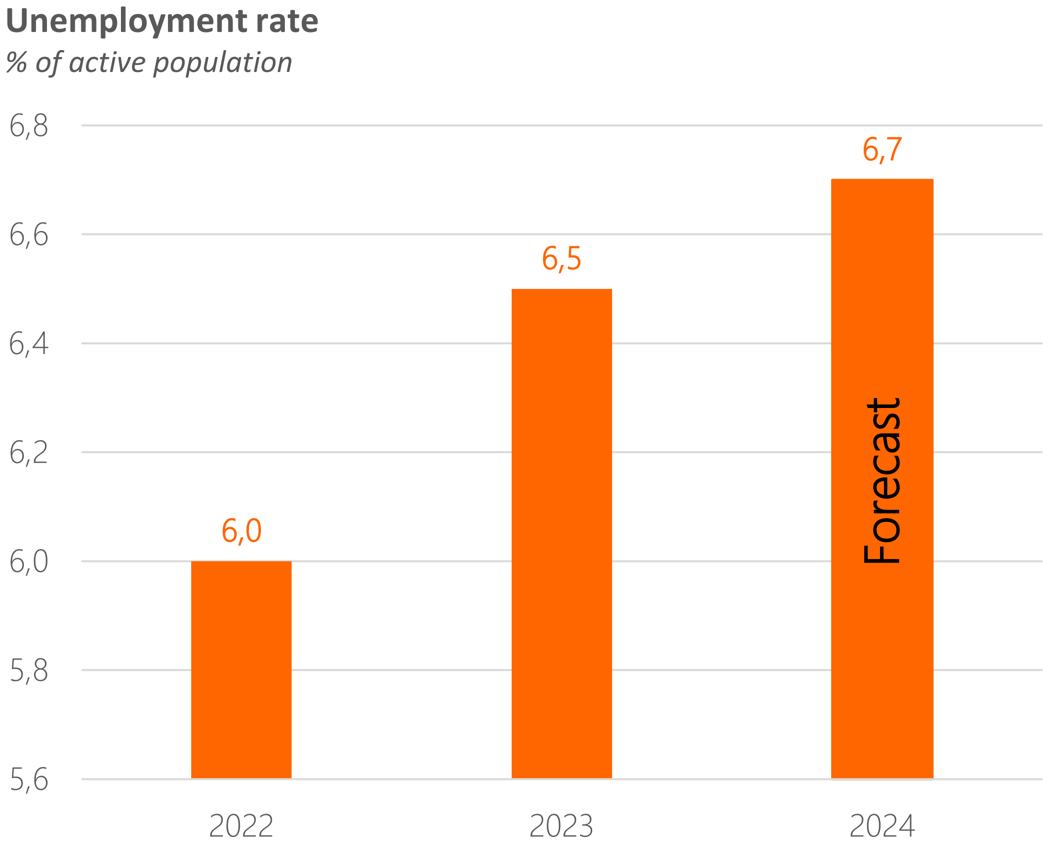
Net external debt

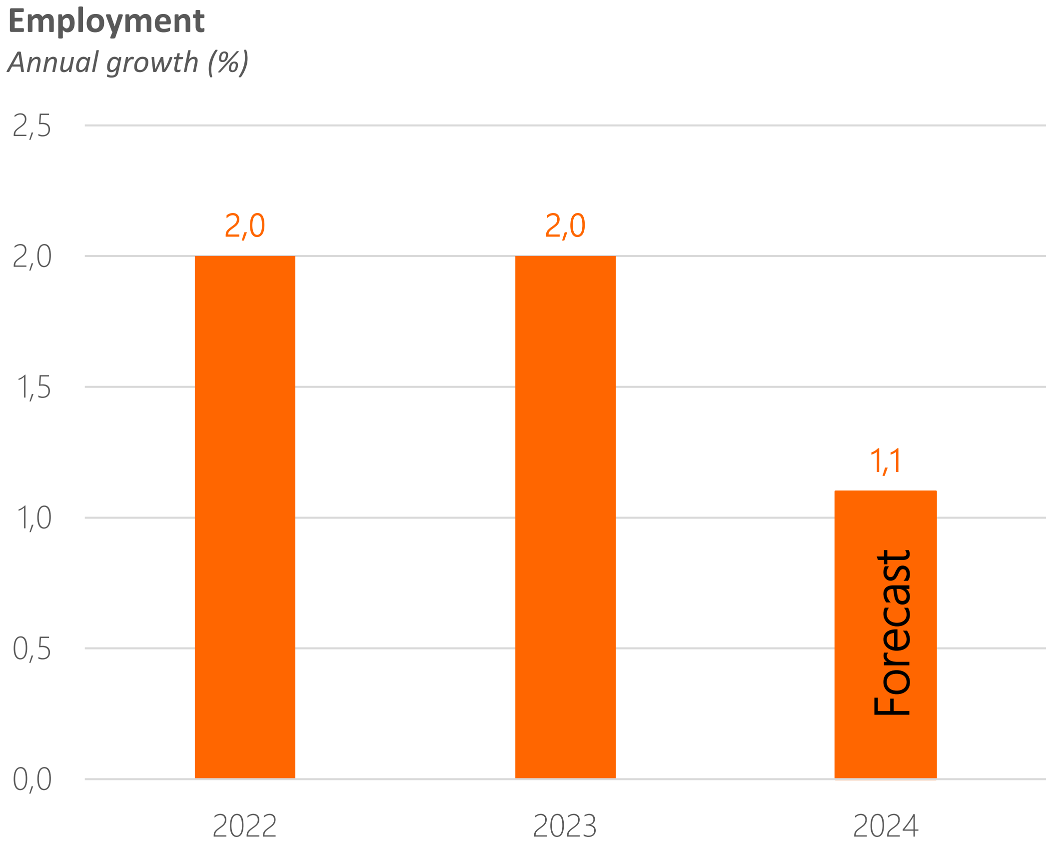
MM € *% of GDP*



- **The economy posted an external surplus equivalent to 2,6% of GDP** (halted in 2020 and 2022, supported by the surplus registered on the public administration (1,2% of GDP), an improvement of the families' surplus to 1% of GDP and on the financial sector. NFC (Non-financial companies) reduced their financing needs to 2% of GDP, 3 tenths less than in 2022, reflecting the 8.1% growth in gross operating surplus and a more moderate growth of GFCF (3.8% in 2023 vs 15% in 2022).
- The surplus strengthened the fall in foreign debt to 53,8% of GDP from 66,7% in 2022. Since the peak of 199% of GDP in 2015, the ratio of the external debt declined 55 p.p. In nominal terms, the external debt fell 48MM€ since 2015, to 142,7MM€ in 2023

Labor market continues resilient but it's losing momentum





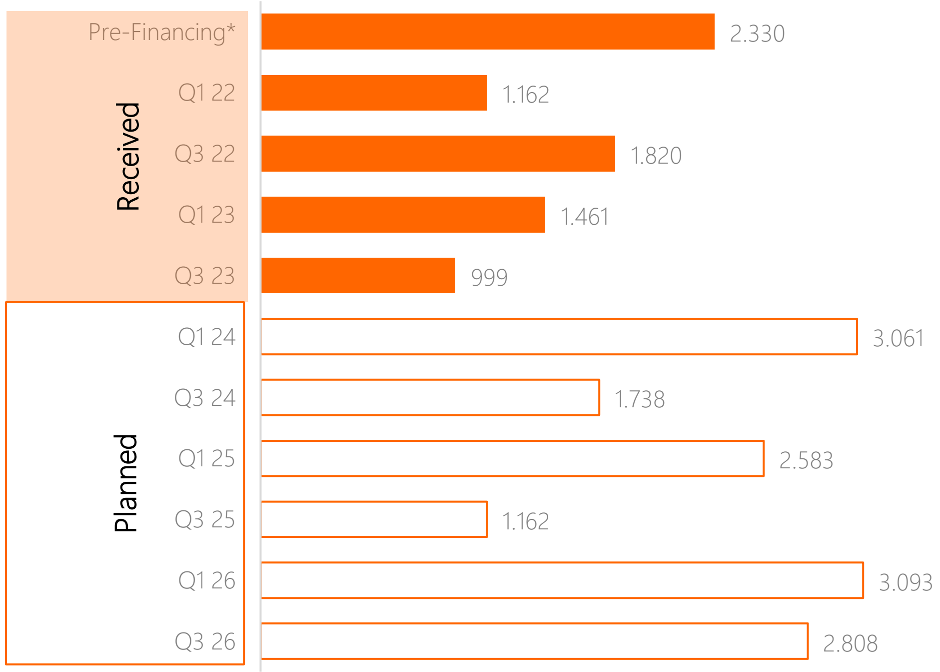
Source: BPI Research, from INE.

- **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.
- First data for 2024 showed that employment continues to grow (1,9% yoy in Feb.), unemployed people continues to decline (1,2% yoy in Feb.) and the unemployment rate fell 2 tenths, to 6,7% from the same month of 2023.

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

Disbursements received and planned along the program

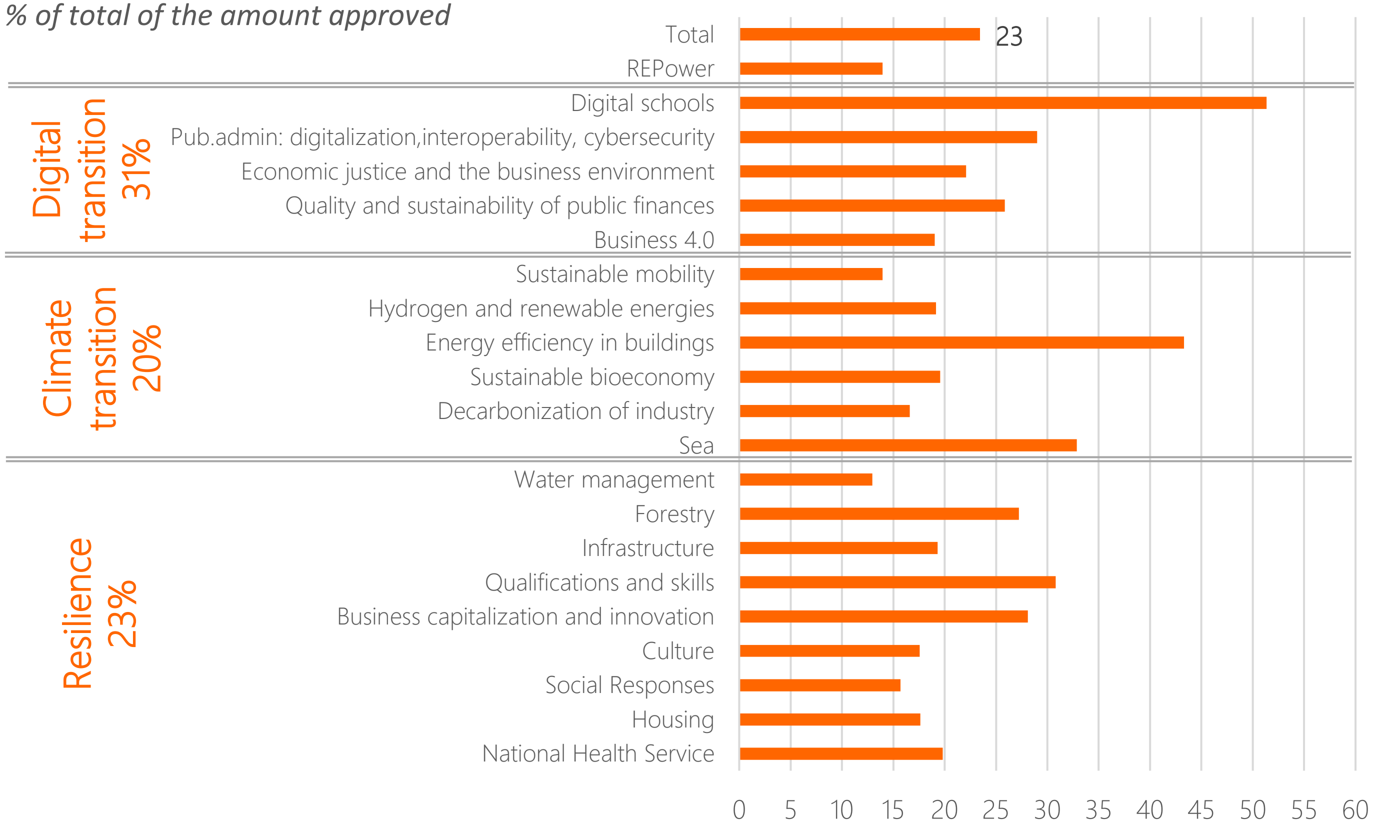
EUR Million



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

Payment rate up to March 27th

% of total of the amount approved



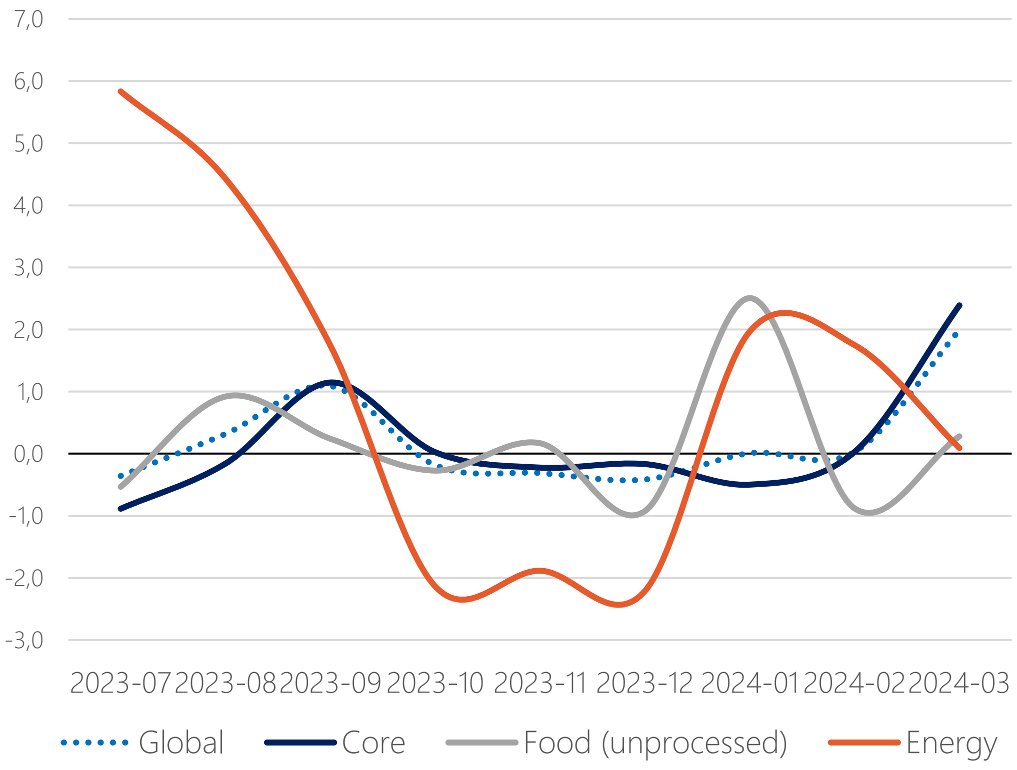
Source: BPI Research, from Recuperar Portugal.

- **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 due to the Government transition.
- **Projects already approved amount to 17,5 billion euros (79% of the total amount) and payments reached 4,1 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.**

Bumpy inflation rises again in March

CPI by components

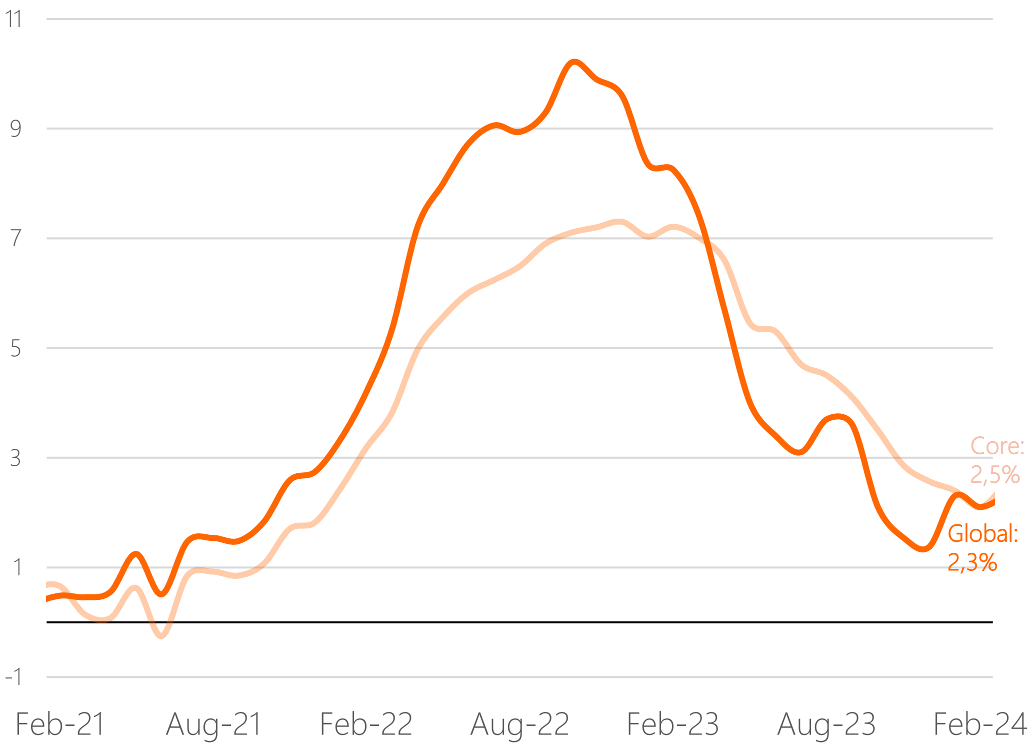
Month-on-month (%)



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

Portugal CPI: Global & Core

Year-on-year (%)



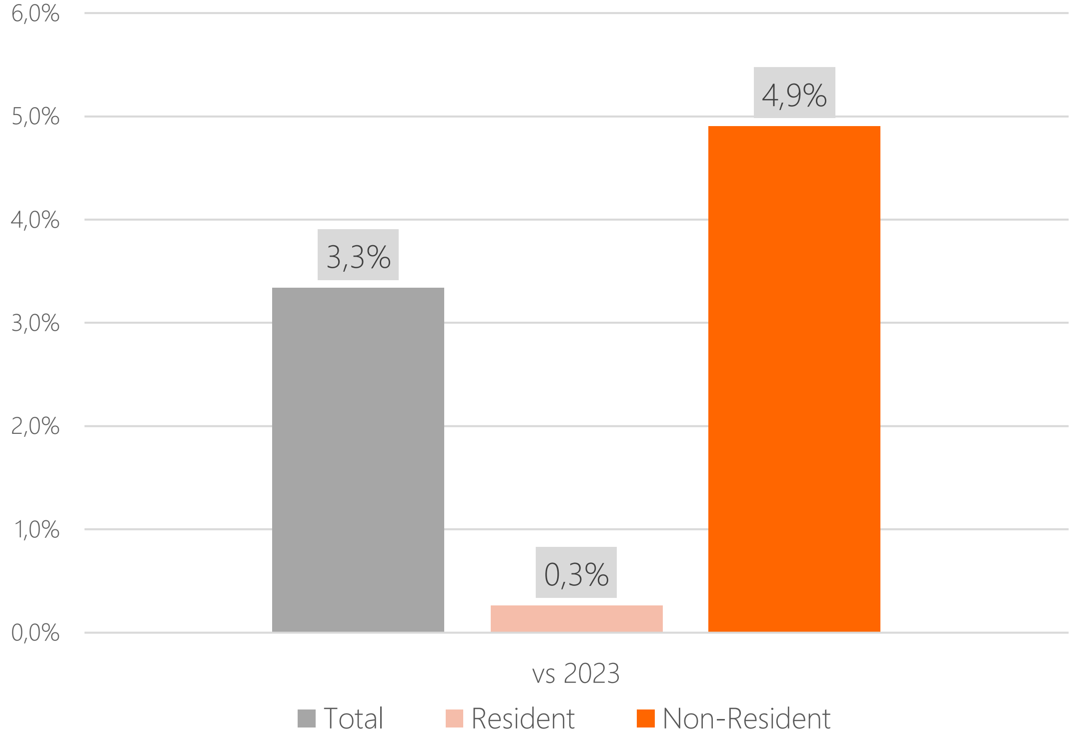
***Source**: BPI Research, using data from INE.*

- **The year-on-year rate of change in the Consumer Price Index (CPI) rose to 2.3% in March, from 2.1% in February and above BPI Research's forecast of 1.7%.** The rise in overall inflation was also accompanied by the core inflation rate, which rose by 2.5% (2.1% in February). 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.
- **Energy prices increased again**, reinforcing the February trend (4.8% year-on-year, compared to 4.3% in February), **while unprocessed food prices slowed down** to -0.46% year-on-year (compared to 0.8% in February).

Tourism: shy start in 2024

Overnight stays

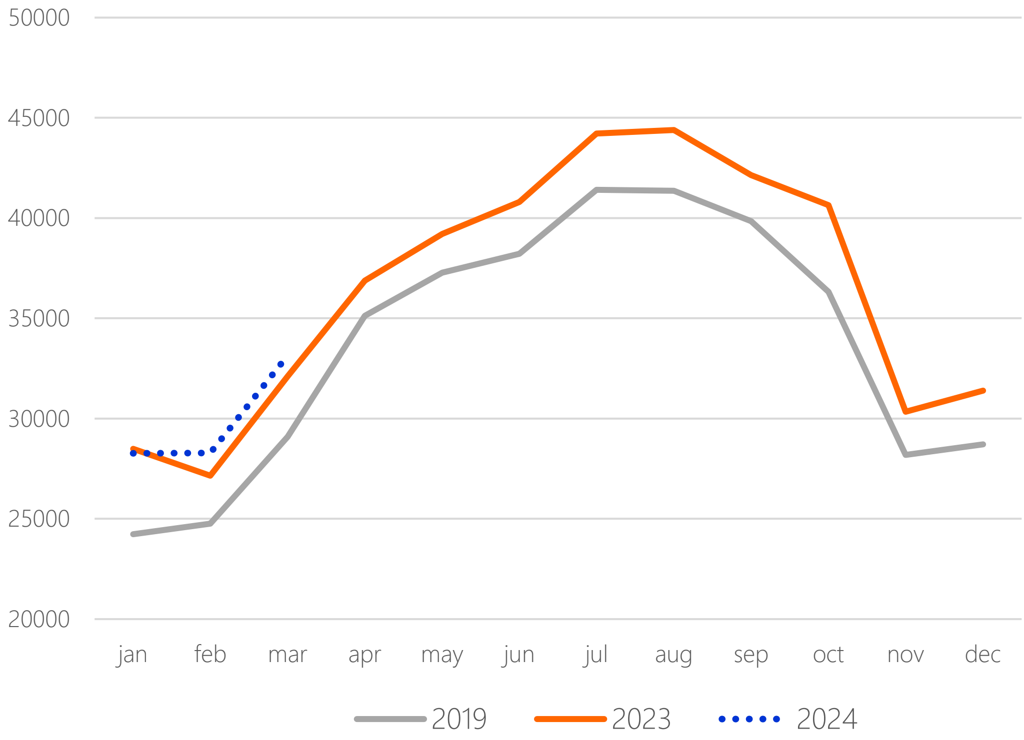
Change in January and February 2024 versus January and February 2023 (%)



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

Monthly flights in Portuguese airports

Number

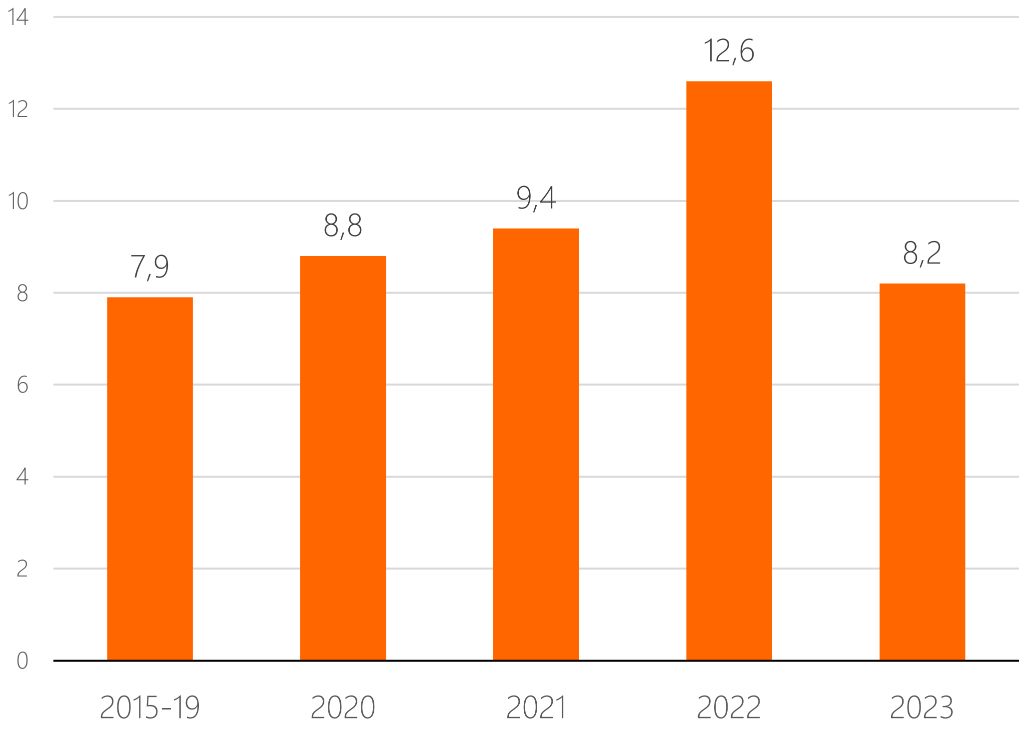


Source: *BPI Research, using data from Eurocontrol.*

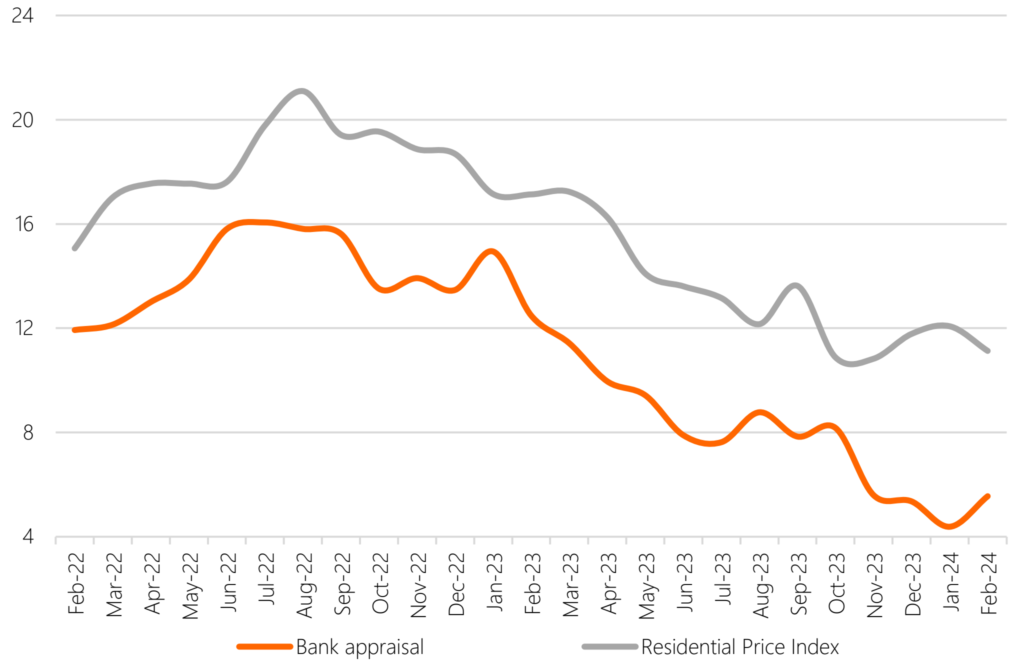
- **In the first two months of 2024, Portugal received 3.2 million guests and 7.7 million overnight stays**. This represents an increase in tourists of 4.6% and in overnight stays of 3.3% compared to Jan-Feb 2023. Non-residents supported growth in the first two months, while residents continue to show a more anemic performance.
- Flights at national airports in the first 3 months are slightly above those received in 2023, but is showing a deceleration in its pace of growth, suggesting that activity in the sector is approaching its cruising speed.

Housing prices rose 8,2% in 2023

Residential Price Index
Annual growth(%)



Bank appraisal and the Residential Price Index
Year-on-year change in amount (%)



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

- **In 2023, were sold 136,400 dwellings, down 18.7% yoy, and prices grew by 8.2% (below the 12.6% increase in 2022).**
- **Available data for 2024 continues to point to an increase in prices.** The value per m2 of bank appraisals for mortgage loans rose in the first two months of the year (+5.5% year-on-year in February); and data from the Residential Price Index also points to an increase in prices (in February compared to the end of 2022, they will have risen by around 1.5%). On this scenario, although we expect activity as a whole to be less dynamic in 2024, we continue to believe that this market is supported and that prices will increase by around 3.5%.

Public Administration reached a surplus of 1,2% of GDP

Key items in the public accounts

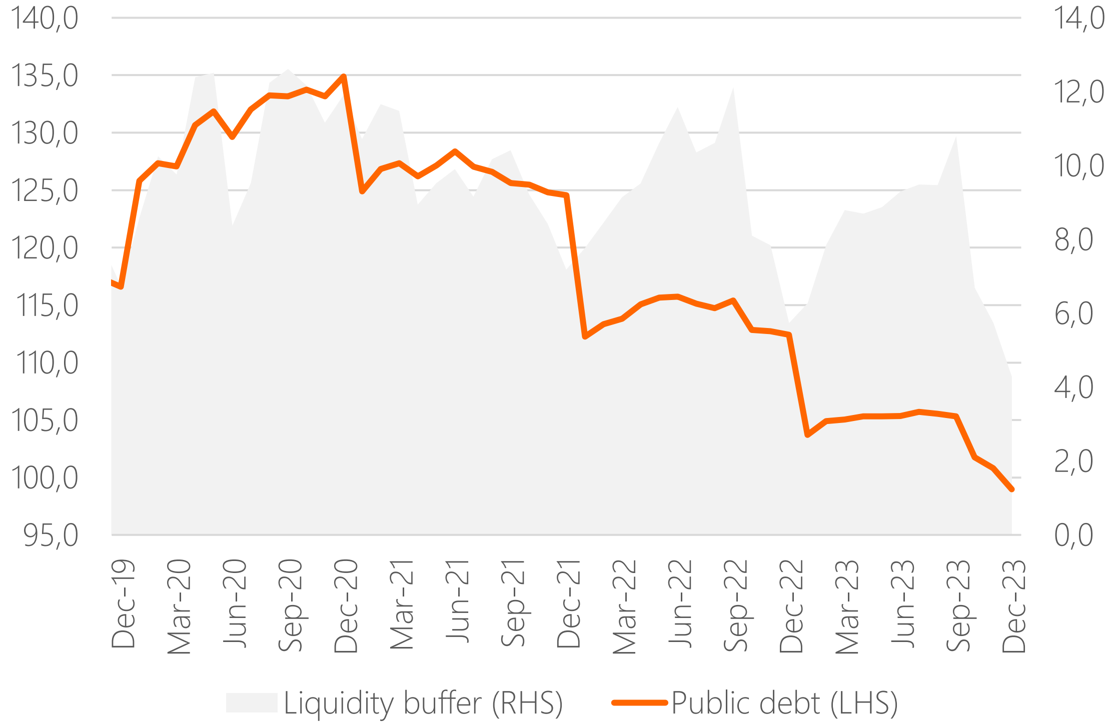
% of GDP

	2019	2023	Change 2023-2022 YOY %	Change 2023-2022 Contribution	Change from the 2024 State Budget
Current revenue	42.2	42.6	8.1	8.0	924
Tax and contributory revenue	36.6	37.5	8.7	7.5	1,135
Capital revenue	0.4	0.9	68.9	1.0	-354
Total revenue	**42.6**	**43.5**	**9.0**	**-**	**564**
Intermediate consumption	5.1	5.3	5.0	0.6	-406
Personnel costs	10.8	10.5	7.6	1.8	14
Social benefits	18.1	17.5	3.4	1.4	-472
Interest	3.0	2.2	23.3	1.0	84
Investment	1.8	2.6	17.5	1.0	-579
Total expenditure	**42.5**	**42.3**	**5.2**	**-**	**-438**
Primary Current Expenditure	**36.7**	**36.3**	**3.7**	**3.2**	**-354**
Overall Balance	**0.1**	**1.2**	**-**	**-**	**1,003**
Public Debt	**116.6**	**99.1**	**-**	**-**	**-**

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

Public debt ratio and the liquidity buffer

% of GDP; bln EUR

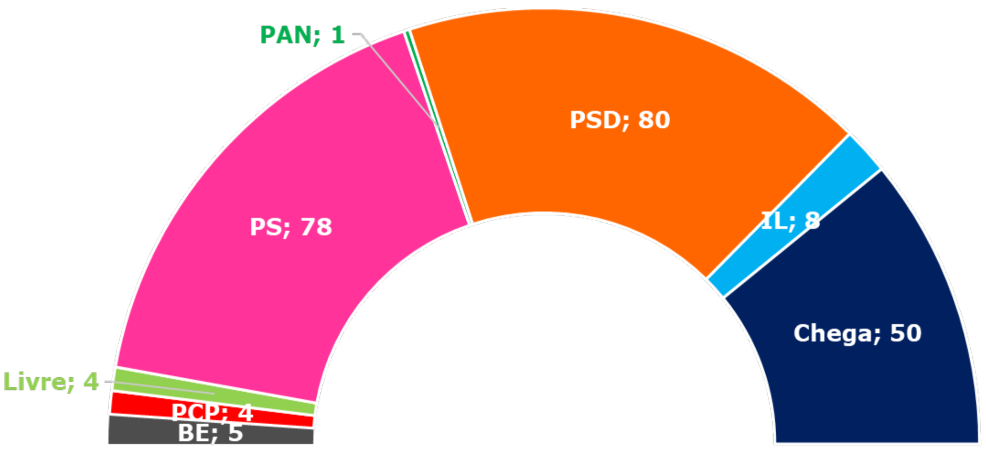


- **In 2023, Public Administration reached a surplus of 1,2% of GDP,** taking advantage of the higher growth in revenue (9.0%) than in expenditure (5.2%). Tax and contributory revenues contributed to around half of the increase in total revenue and exceeded the government's latest forecast by more than 1 billion euros. Also capital revenue increased significantly, due to European funds, namely from the RRP. On expenses, main contributions came from personnel costs, social benefits and interest.
- This performance, helped to reduce the public debt ratio to 99,1% of GDP, the lowest ratio since 2009.

The Parliament after March 10 elections

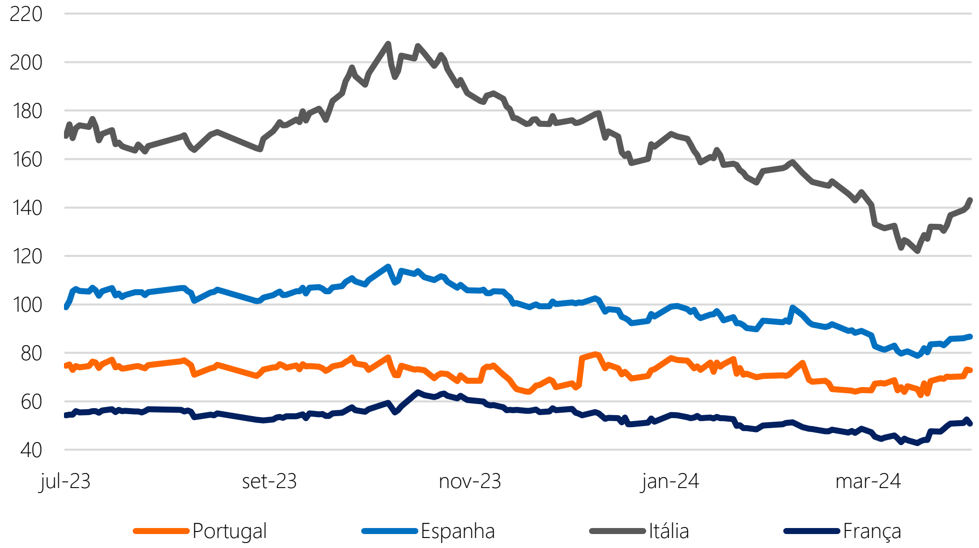
New composition of the Portuguese Parliament

number of deputies from each party



Sovereign spread

Percentage points

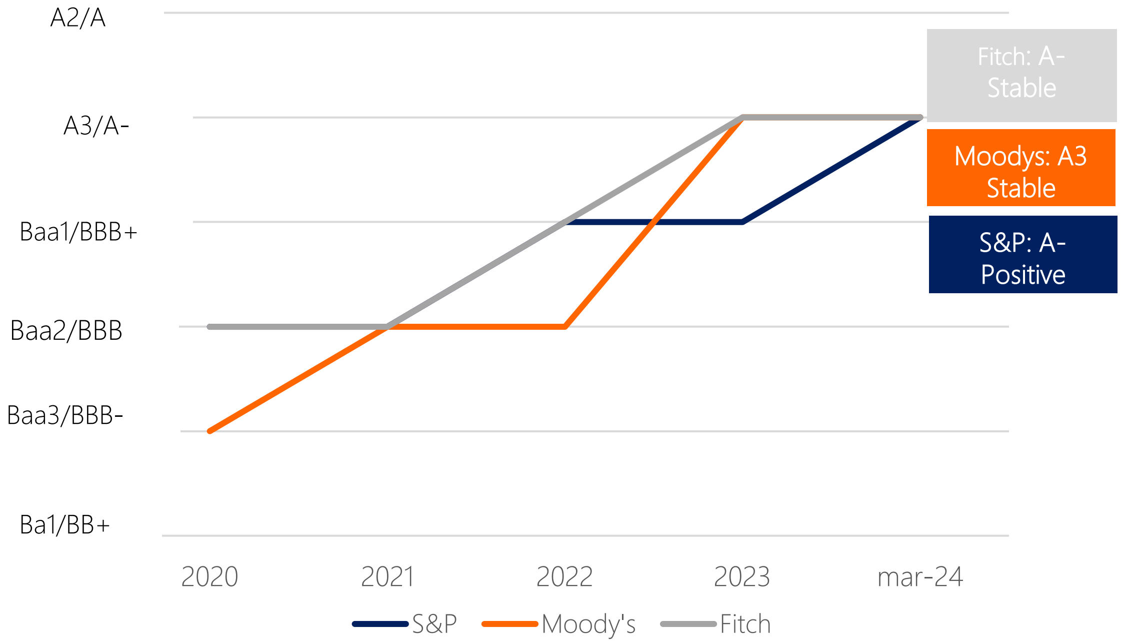


Source: BPI Research, from Marktest and Bloomberg.

- **The centre-right coalition), named AD, won the elections with a low margin compared to the second largest party, the PS. The new government took office on April 2nd and its program will be presented on April 10th.** The PS will make an AD government viable (according to the announcement made by the PS's leader), but support is not expected when it comes to approving state budget, a relevant question at the end of October. However, the new prime minister (Luís Montenegro) suggested in his investiture speech that the non-approval of the budget for 2025 would not be an impeachment for the governance, as it could be done on a duodecimal basis.
- The focus in the coming months will be on measures dependent on the executive branch (for example, the health action plan, negotiations with teachers and police....), rather than measures that need parliamentary support. This may serve to gain public confidence, reinforcing the prospect that the opposition parties may not be interested in early elections happening so soon. In any case, the atmosphere is one of greater instability.
- In his speech at the takeover ceremony, the new prime minister reaffirmed the commitments made during the electoral campaign, particularly with regard to the remuneration policy for police officers and teachers - which has an impact on spending - without forgetting the need to maintain a cautious fiscal policy. Another aspect emphasized at the first speech was the reduction in the tax burden.

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

Rating evolution
level



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

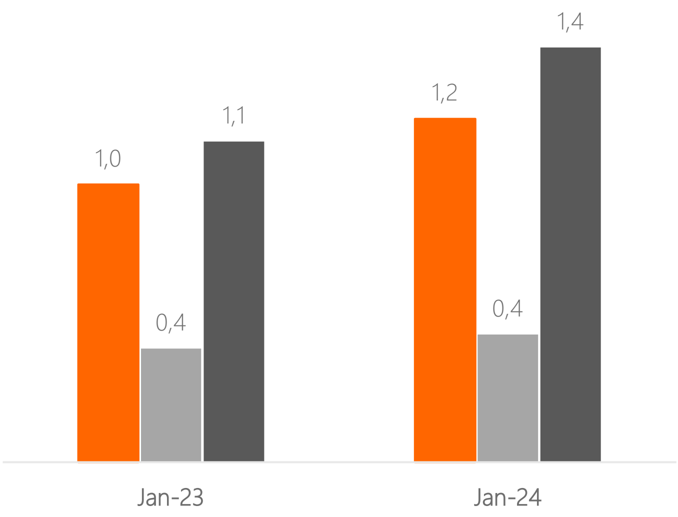
Macroeconomic scenario S&P vs BPI
%

	2023	2024	2025	2026	Acum. 2024-26
GDP					
BdP (Mar 24)	2.3	2.0	2.3	2.2	6.6
BPI (Feb 24)		1.6	2.3	2.5	6.6
S&P (Mar 24)		1.4	1.8	1.8	5.1
Inflation rate					
BdP (HCPI)	5.3	2.4	2.0	1.9	6.4
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					
BdP	6.5	6.5	6.5	6.5	0.0
BPI		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	1.2	0.4	0.6	0.6	-0.6
S&P		0.2	0.1	0.1	-1.1

- **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

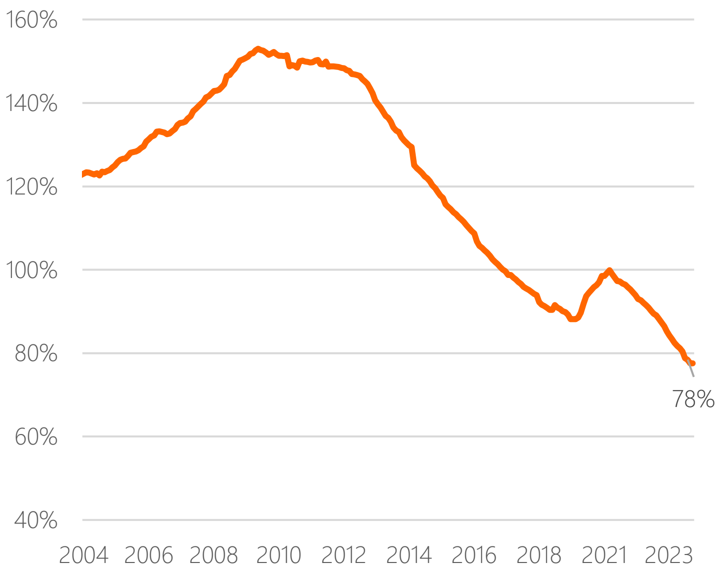
Banking system: a solid position to face the economic slowdown (1)

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



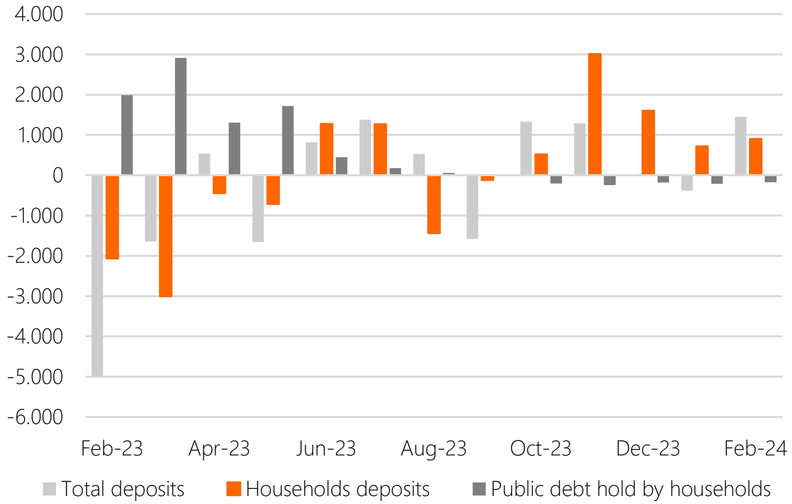
Source: BPI Research, base on data from Bank of Portugal and ECB.

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€)

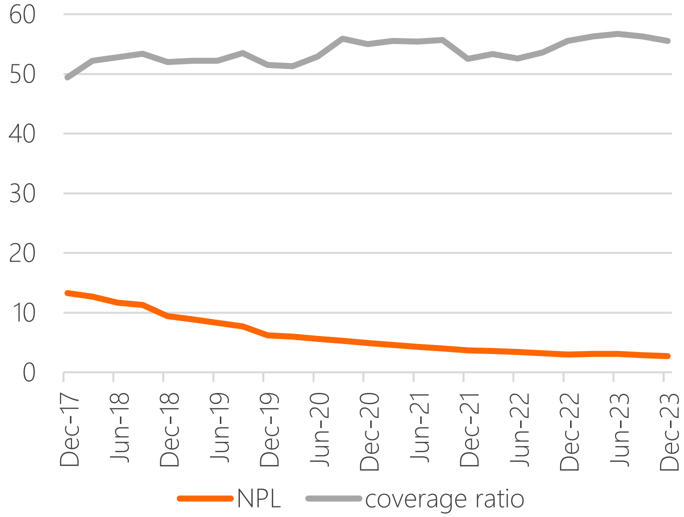


Notes (*): Public debt by households includes Certificados de Aforro and Certificados do Tesouro, which can only be subscribed by resident households. The maximum amount that Government can issue for these retail instruments (CA and CT) is 16.5 bn Eur in 2023.
Source: BPI Research, base on data from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

- **The stock of credit is decelerating since mid-2022, but the pace is slowing:**
  - **Mortgage credit:** in February declined 1,2% (less than in January), but new operations accelerated in the same period by 5% continuing to suggest 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 February 2024 it fell 2,0%; new loans increased by 21,7%.
- Deposits of the private sector rose 1,0% in February. Households' deposits rose 2,0% yoy, as interest rates for new deposits continue to be higher (2,8% in February) 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
0.4% in 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%**	**2,7%**	**2,9%**	**2,6%**
Net fees	0,8%	0,9%	0,8%	na	0,6%	0,7%
Gains on financial assets	0,1%	0,0%	0,3%	na	0,2%	0,1%
Other net profits	-0,2%	-0,1%	0,0%	na	0,0%	-0,2%
Gross income	**3,1%**	**3,3%**	**3,7%**	**na**	**3,6%**	**3,1%**
Operating expenses	-1,4%	-1,0%	-0,9%	na	-1,0%	-1,1%
Operational result	**1,7%**	**2,3%**	**2,8%**	**na**	**2,6%**	**2,0%**
Impairement losses, taxes and others	-0,1%	-0,6%	-0,2%	na	-0,7%	-0,3%
Profit	**1,1%**	**1,2%**	**1,8%**	**1,2%**	**1,3%**	**1,7%**
ROTE[1]	16,0%	16,0%	23,4%	na	14,0%	20,4%

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

Banks' solvency and liquidity position

*In % (2023)**

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

- **NPLs ratio fell 0.3 p.p. in 2023.** The total NPL ratio stood at 2,7% in 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 rose to 1,3%, more 2 decimal than in 2022. For NFC, the ratio decreased 1,5 p.p. to 5,0%. 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**, between 2022 and 2023** it improved by 6,1 p.p., to 14,8% (ROE).
- **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

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