Portugal:
Macroeconomic and financial outlook

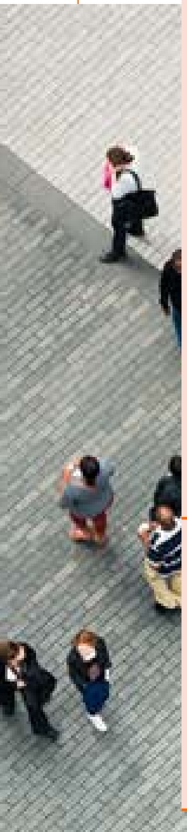
BPI *Research*

July 2024

Prepared with information available by July 12th, 2024

BPI Grupo CaixaBank

Main messages



Activity

- **GDP advanced 0,8% qoq and 1,5% yoy in the Q1 24**, benefiting from the contribution of external demand. Q1 data and the prospect that in the rest of the year activity will follow un upward trend, led us to recently **revise upwards the forecast for growth in 2024 from 1.6% to 1.7%.** The more recent indicators continue to point to sustained growth ahead, especially the ones referring to domestic demand: confidence has been improving and investment and sales data have been favourable, boding well to our forecast of 0,3% quarterly growth in 2Q24. Private consumption continues to be supported by a resilient labour market, and investment should be stimulated by lower interest rates and the implementation of European funds. Risks to our current forecast are balanced, but with a positive bias for the short run.
- **In June, CPI once again returned to the sub-3 per cent territory.** The global CPI fell 0.3 p.p. to 2.8 per cent and the core CPI fell 0.4 p.p. to 2.3 per cent. Although we still expect fluctuations in the trajectory in 2024, we anticipate a more benign path throughout the rest of the year and do not anticipate a CPI figure above 3 per cent again.
- **As for the labour market, latest data support our expectation that it will remain a relevant factor supporting activity.** Employment increased on year-on-year terms for the 38th consecutive month in May and remains near the monthly maximum (recorded in March). Additionally, the unemployment rate remains considerably below the historical figures, reaching 6,5% in May (vs 9,5% on average in the months of May of 5 pre-pandemic years).
- **Houses continue to appreciate in 2024 but the House Price Index slowed down (0.6% qoq compared to 1.3% in Q4 2023).** We now believe in a dynamic of greater appreciation in the second half of the year, which is also consistent with the process of monetary easing that will take place at the end of the year and forward looking expectations for sales are also on the rise.
- **Portugal registered a surplus in the current account of 2,6% of GDP in the first four months of 2024, continuing to support the decline of the external debt. Indeed,** foreign debt fell to 51,8% of GDP in Q1 2024, minus 2 percentage points than in the end of 2023. In nominal terms, external debt reached 139,7MM€, the lowest level since 2009.
- **Public accounts keep evolving more adversely than in the last couple of years, with small deficits both in cash (-2,1% GDP May ytd) and accrual basis (-0,2%GDP in 1Q).** Overall we continue to consider that it is still possible to achieve a small surplus in fiscal balance by the end of the year as expenditure has been impacted by adverse comparisons and there has been changes in some procedures both for revenue and expenditure, that have an impact on the fiscal balance evolution. Having said this, this is a situation that deserves to be closely monitored as several factors add to negative fiscal pressure: higher financing costs, lower nominal growth, higher pressures on the expenditure side.

Banking Sector

- **NPLs ratio declined in 2023 and exposure to commercial real estate (CRE) is low.** The resilience of the labor market 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. In 2023, loans collateralized by CRE only represent 5% of total assets; and exposure related to real estate investment funds is low and mostly concentrated in closed-end funds with lower liquidity risk: 7.3% of GDP in Portugal compared to 8.9% in the eurozone; and 68% of the units issued are closed-end funds. The non-performing loans ratio of the private sector stabilized at 3,4% in Q1 24; and the ratio of stage 2 loans fell to 10,6%, totally due to an improvement on the quality of loans to NFC (between families there was a small deterioration).

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	1.7	2.3
Private Consumption	2.6	2.1	2.6	3.3	-7.0	4.7	5.6	1.7	1.7	2.2
Public Consumption	0.8	0.2	0.6	2.1	0.4	4.5	1.4	1.0	1.2	0.8
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	3.4	5.3
Imports	5.0	8.1	5.0	4.9	-11.8	12.3	11.1	2.2	4.4	5.7
Unemployment rate	11.4	9.2	7.2	6.6	7.0	6.7	6.2	6.5	6.8	6.5
CPI (average)	0.6	1.4	1.0	0.3	0.0	1.3	7.8	4.3	2.5	2.1
External current account balance (% GDP)	1.2	1.3	0.6	0.4	-1.0	-0.8	-1.1	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.*

Convergence with EMU should continue

GDP: Other institutions' forecasts

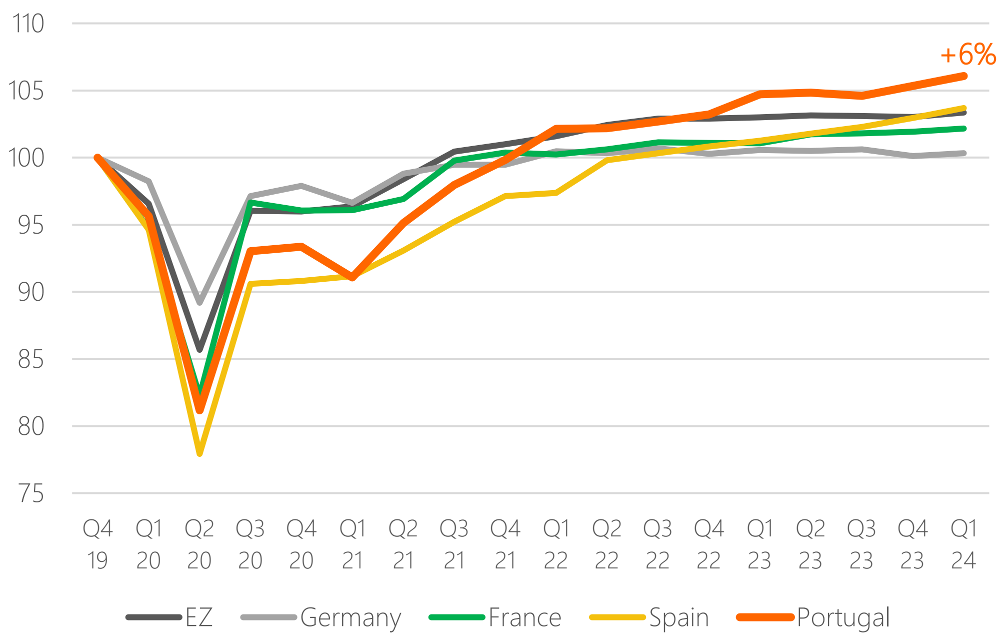
Annual growth

	2024	2025	2026	Cum. 24-26
BPI (May-24)	1,7	2,3	2,2	6,3
Focus Economics (July-24)	1,5	1,9	2,0	5,9
Banco de Portugal (June-24)	2,0	2,3	2,2	6,6
EIU (May-24)	1,9	2,0	2,0	6,0
IMF (April-24)*	1,7 (2,0)	2,1 (2,25)	2,0	5,9
European Commission (May-24)	1,7	1,9	-	-
OECD (May-24)	1,6	2,0	-	-
CFP (April-24)	1,6	1,9	2,1	5,7
NECEP (April-24)	1,5	1,8	2,0	5,4
Government (April-24)	1,5	1,9	2,0	5,5

Source: BPI Research, from INE, BoP, EC, EIU,….
IMF forecasts in () were disclosed in July within the presentation of the July 2024 Article IV and are still not known in detail.

Portugal compares favourably within EMU

GDP 4Q19=100



Source: BPI Research, with data from INE and Eurostat.

- The more recent forecasts keep pointing in a positive direction for the Portuguese economy, as the Bank of Portugal kept the scenario unchanged last June (2% growth expected in 2024 and 2,3 in 2025) and the IMF apparently revised the forecasts up within the release of the Article IV, in the first days of July. According to the Fund, after a remarkable recovery from the successive shocks that hit the global economy since the pandemic, a soft landing is within reach. The IMF recognized the huge drop of public debt since 2020 (36 p.p. of GDP) and the strength of the external position due to tourism, EU funds and improved terms of trade. However, challenges persist, namely low productivity growth, population aging, and subdued investment remain key constraints to higher growth while poverty and inequality need to be addressed.

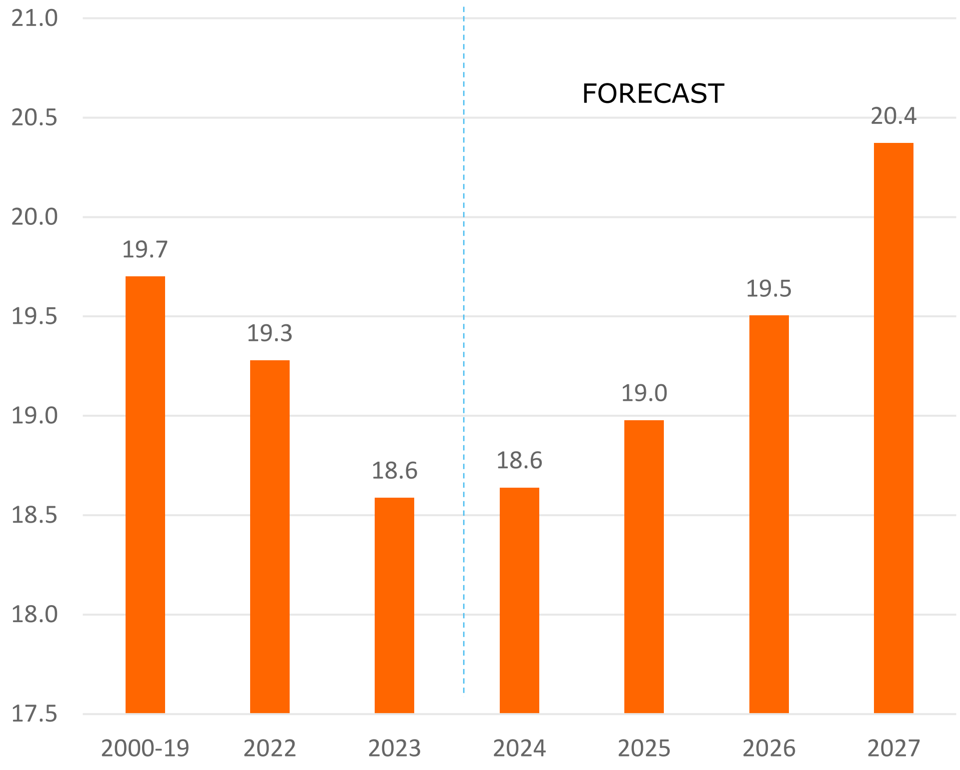
Consumption, investment and exports will be the main growth drivers

BPI Forecasts for Portugal
Annual, in volume (%)

	2024	2025	2026	2027
GDP	1,7	2,3	2,2	2,1
Private Consumption	1,7	2,2	2,1	1,8
Public Expenditure	1,2	0,8	0,8	0,9
Investment	3,6	5,1	6,7	5,7
Exports	3,4	5,3	5,1	4,4
Imports	4,4	5,7	6,3	5,0

Source: BPI Research, with data from Bank of Portugal and own forecasts

Gross Fixed Capital Formation
(%) GDP



- Private consumption should continue the favourable performance in the middle run, expanding slightly less than GDP, supported by a robust labour market and real income gains. The decline seen in financing costs and the execution of EU funds should also support investment, that should also take advantage of higher leeway of the government to foster public investment.
- Exports are also seen to behave positively on the back of the recovery seen in external markets and also due to market share gains, with tourism, other services and also some goods behaving very positively.

Q2 indicators supports good prospects for growth

Latest economic indicators

Yoy%

yoy, level		Q1 24	Q2 24	Last month available
Synthetic indicators	Economic climate indicator	1.9	1.9	June
	Economic sentiment indicator	99.4	101.1	June
	Daily economic indicator	5.5	3.3	June
Consumption	Consumer confidence	-22.6	-17.2	June
	Wholesale and retail trade (yoy)	1.4	3.5	May
	Retail sales excl. fuels (yoy)	2.0	3.5	May
	Card withdrawals and purchases deflated (yoy)	7.5	7.0	May
	Car sales (yoy)	13.7	-0.1	June
Investment	GFCF indicator	0.9	3.0	April
	Imports of capital goods (accum. year)	-0.4	6.0	May
Suply	Cement sales	4.1	8.5	May
	Industrial production	1.4	3.3	May
Demand	Electricity consumption adjusted for temperature&working days	3.1	1.6	June
	Non-resident tourists (yoy)	9.9	17.1	May
	Number of flights (yoy)	2.2	2.8	June
Trade	Exports G&S (accum. Year)	2.7	3.8	April
	Imports G&S (accum. Years)	-1.7	0.5	April
Labour market	Change in regist. unemployment (thousand people)	15.6	23.7	May
	Change in employment (thousand people)	104.1	75.5	May

Source: BPI Research, from Bank of Portugal, INE

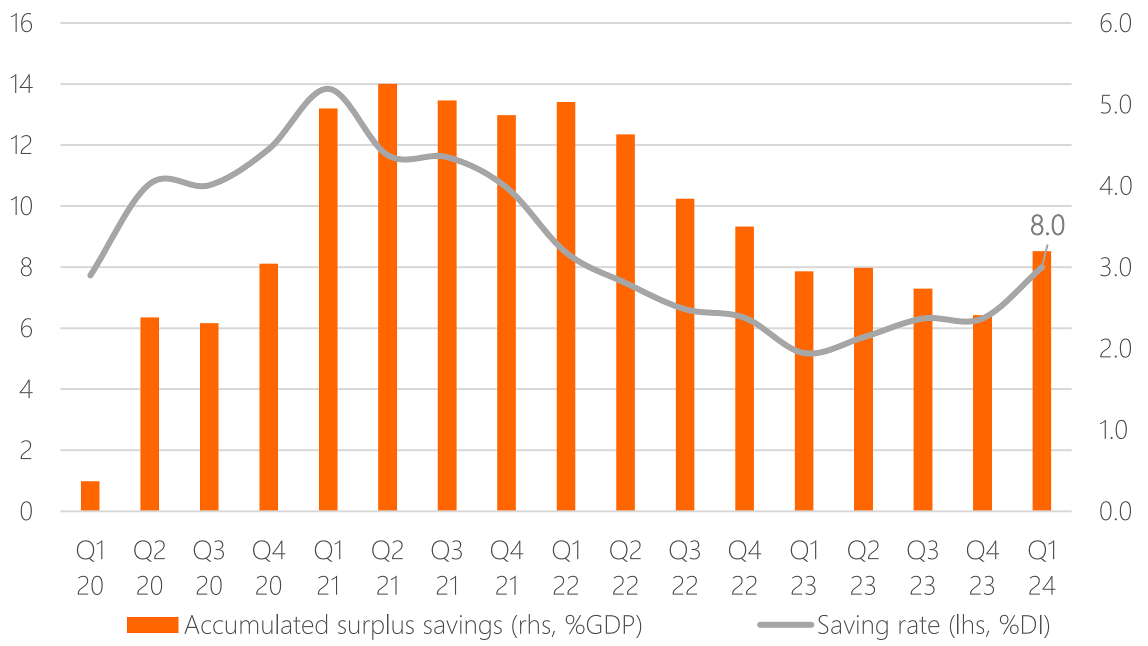
Daily activity indicator

yoy monthly moving average (%)

- **Indicators for Q2 are in line with a prolonged positive trend:** retail sales (excluding fuels) grew 4.3% yoy in May, suggesting stronger growth in Q2 than in Q1; data related with activity in the construction and manufacturing sectors suggest acceleration in Q2 and tourism data and indicators related to investment improved considerably.
- **Less positive was the behaviour of the daily economic indicator,** that in June decelerated to 1,8%, pushing down the average growth in Q2 to 3,3% from 5,5% in Q1, but it may be impacted by the registration of several local holidays; also car sales performed badly in June (although reaching an high plateau), which may reflect the fact that in H124 the monthly average of cars sold exceeded the number of cars sold in years prior to the pandemic. This suggests less support to growth from the consumption of durable goods (10% of total consumption), but this could be offset by higher consumption of other goods and services, in line with the growth in retail sales and electronic payments.

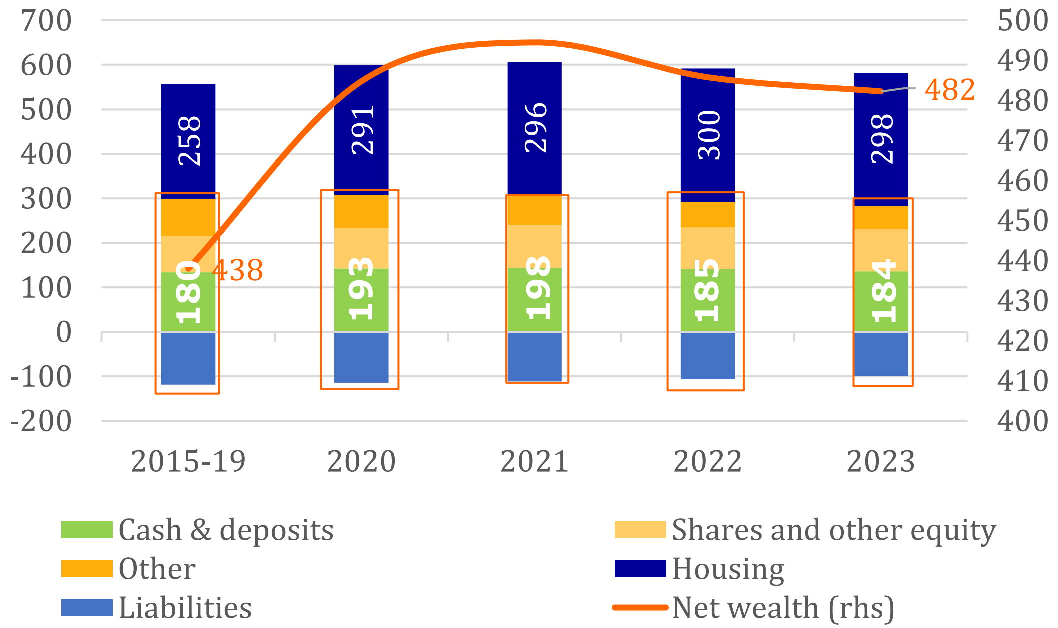
Private consumption is seen to continue to perform well

Families' saving rate and excess savings
(% of GDP, DI)



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

Families' wealth
% of DI



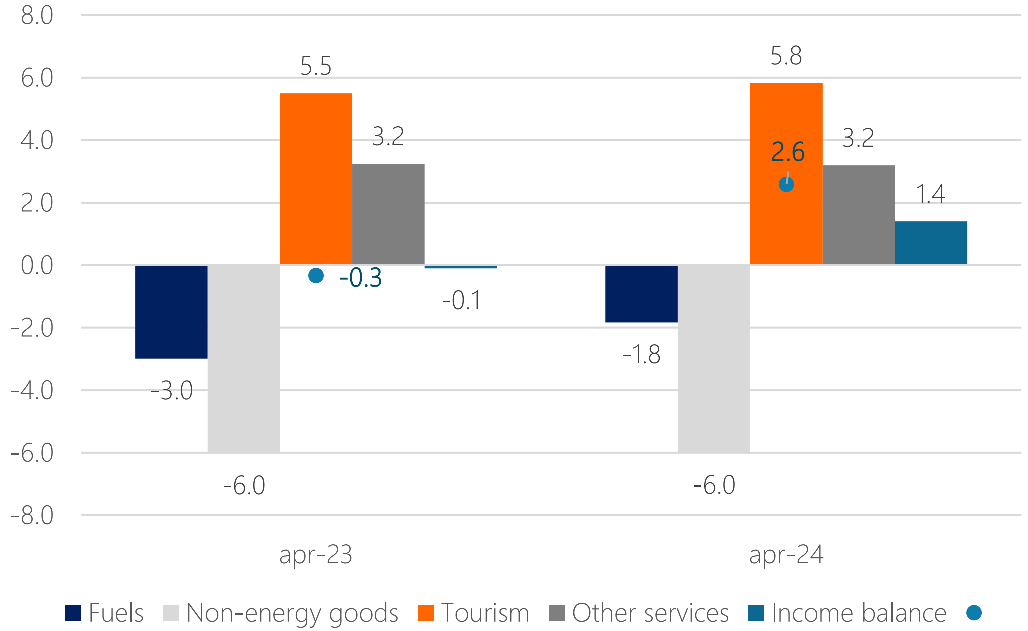
*the amount for housing in 2023 was estimated by updating the 2022 value based on the growth in house prices in 2022 plus the investments in real assets made in 2023.

- The household's saving rate rose to 8% in Q1 24, increasing the so-called surplus savings formed during the pandemic. In addition, in the first 5 months of 2024, households repaid around 3.6 billion euros (EUR 8,3 bln in 2023), potentially freeing up funds for consumption.
- Families' wealth improved from 438% of disposable income in 2015-19 to 482% in 2023, mainly due to higher housing wealth. After the reduction of extra savings accumulated during the Covid period, households net wealth seems to be stabilising.

The external surplus will allow the continuing reduction of external debt

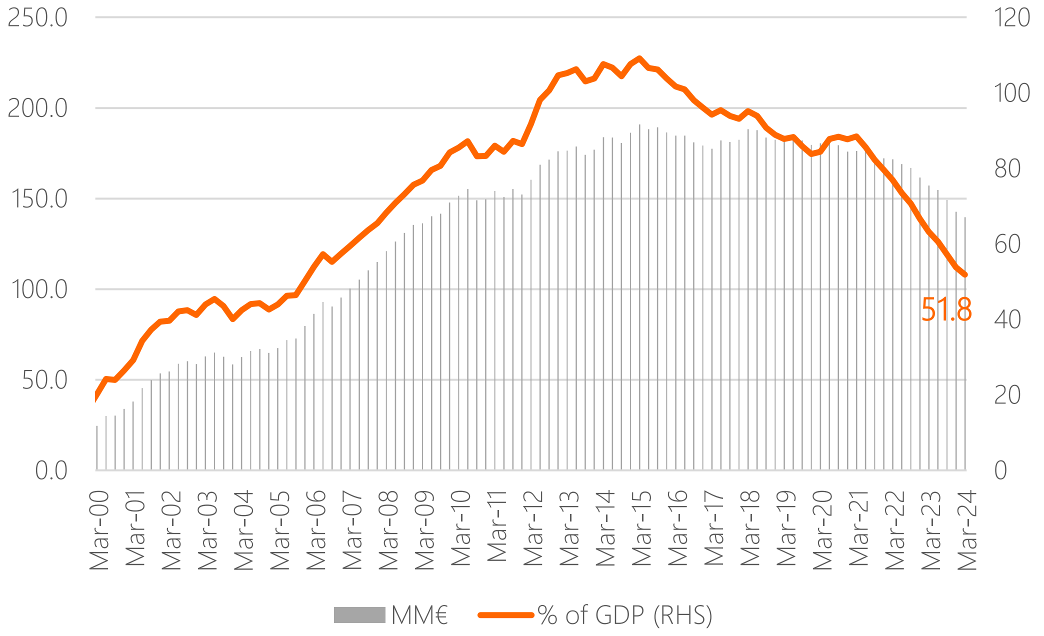
Current account up to April

% of GDP



Net external debt

MM € *% of GDP*

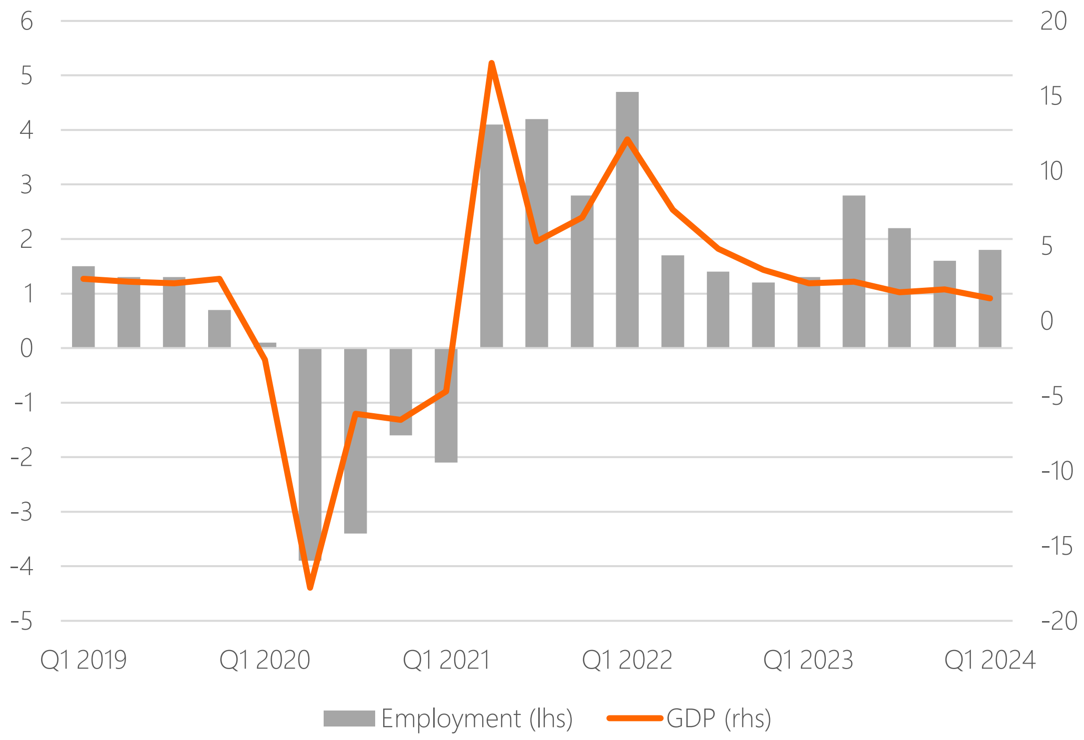


Source: BPI Research, from BoP.

- **The current account started the year with positive recordings, reaching a surplus equivalent to 2,6% of the GDP in the first four months of the year, an improvement from the small deficit seen in homologous period.** This performance mainly reflects the decline of the deficit in the energy balance to 1,8% from 3,0% a year ago in line with the decline of the energy prices over the period; the improvement seen in services balance – both tourism and non-tourism related – added to this achievement.
- The surplus strengthened the fall in foreign debt to 51,8% of GDP in Q1 2024, minus 2 percentage points than in the end of 2023. Since the peak of 108% of GDP in Q1 2014, the ratio of the external debt declined 56 p.p. In nominal terms, and in the same period, the external debt fell 44MM€ since 2015, to 139,7MM€, the lowest nominal level since 2009.

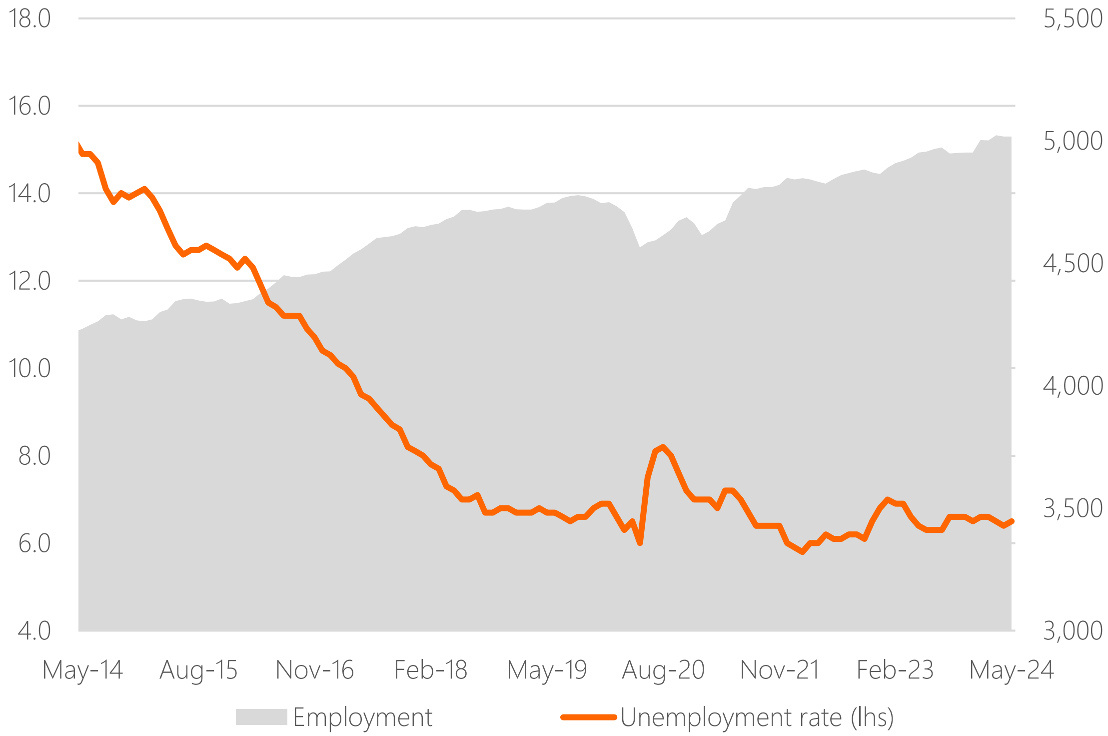
The labour market keeps resilient

Employment and GDP
Yoy (%)



Source: BPI Research, from INE.

Unemployment rate and employed population (monthly figures)
% of active population *Thousand individuals*

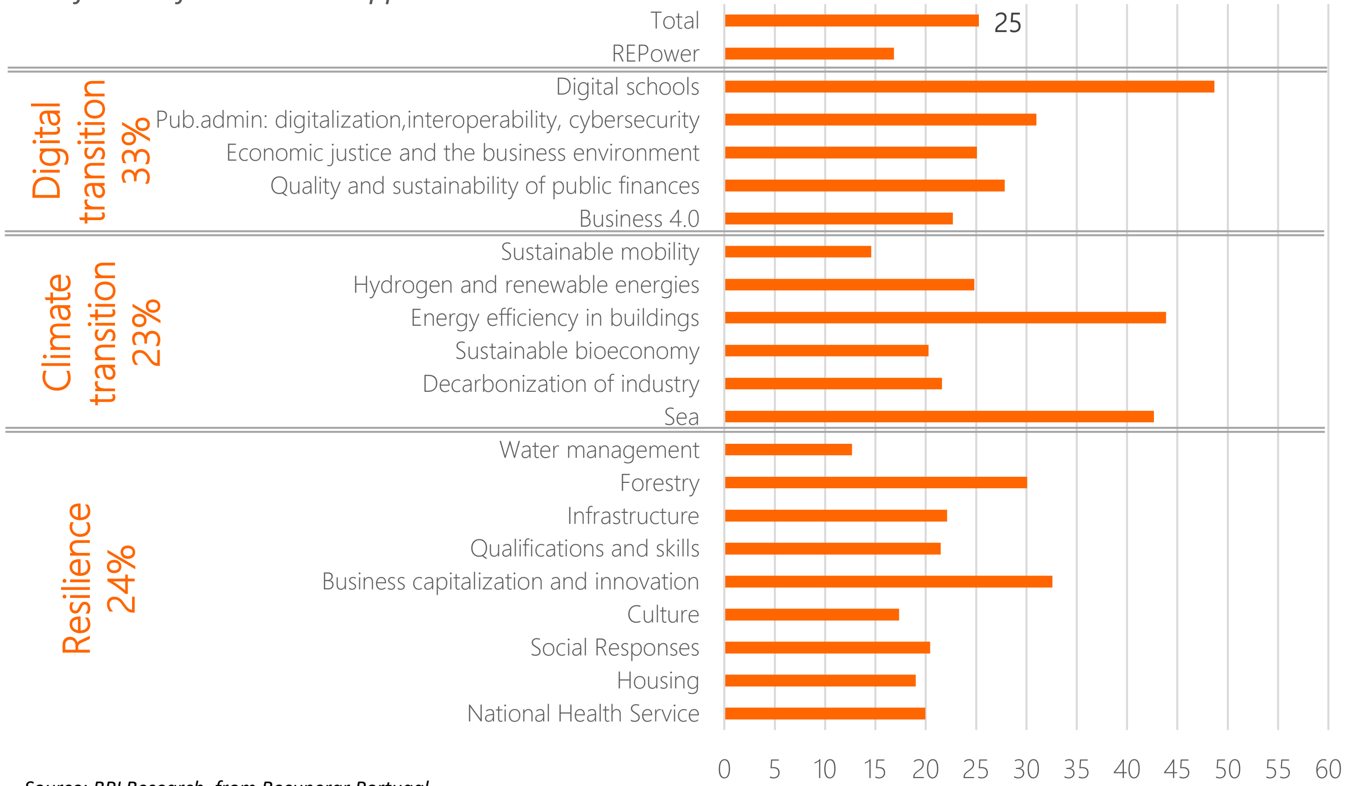


- **The latest data corroborates our expectation that the labour market will remain a relevant factor supporting activity.** Employment increased on year-on-year terms for the 38th consecutive month in May and remains near the monthly maximum (recorded in March). Additionally, the unemployment rate remains considerably below the historical figures, reaching 6,5% in May (vs 9,5% on average in the months of May of 5 pre-pandemic years).
- **Nonetheless, some data seems to indicate that we are close to peak employment levels and the capacity to absorb the influx of people into the labour market is likely to be decreasing**, as evidenced by the evolution of job offers (around 40% below the historical average recorded in the months of May in the 5 pre-pandemic years).

NGEU: payment rate improves slightly and a new tranche has been requested from the EC

Payment rate up to July 10th

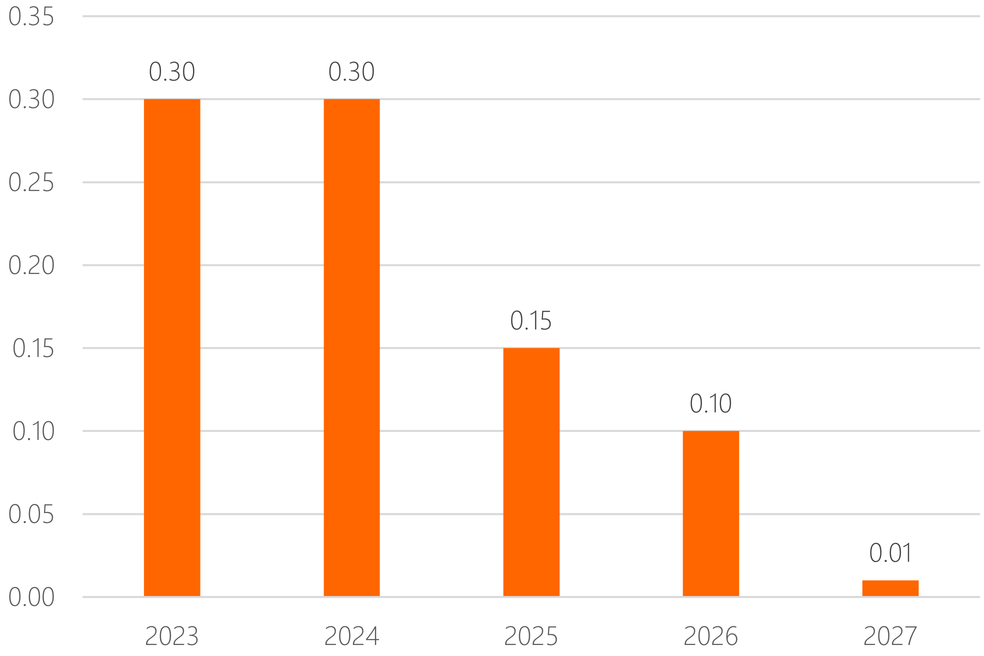
% of total of the amount approved



Source: BPI Research, from Recuperar Portugal.

RRP: own estimates for contribution for real GDP growth

p.p.

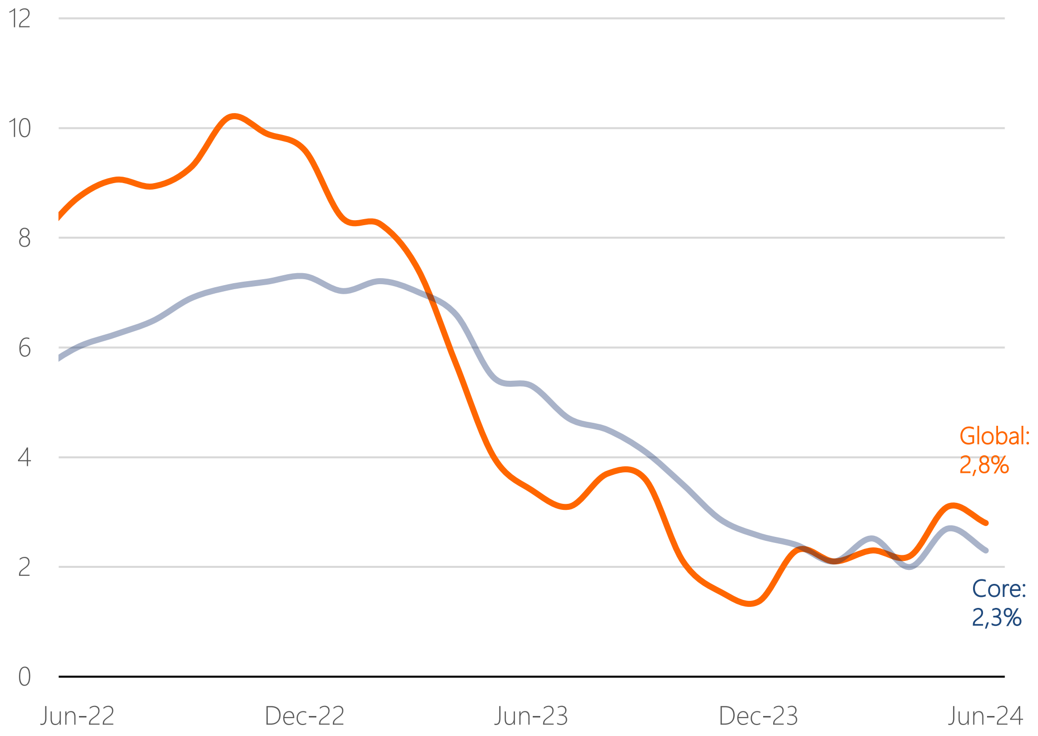


- **Up to now, Portugal received 7,7 billion euros, equivalent to 35% of the total amount of the RRP and in July was requested the 5th tranche amounting to €2.9 bln** .
- **Projects already approved amount to 18,5 billion euros (83% of the total amount) and payments reached 4,7 billion,** representing circa 60% of the total amount received. Since May there was a small improvement of 1 p.p. of the payment rate. We highlight improvements in the payment rates for the sea (+10 p.p.) and business 4.0 (+4 p.p.) components.
- **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.**

Inflation resumes downward trend

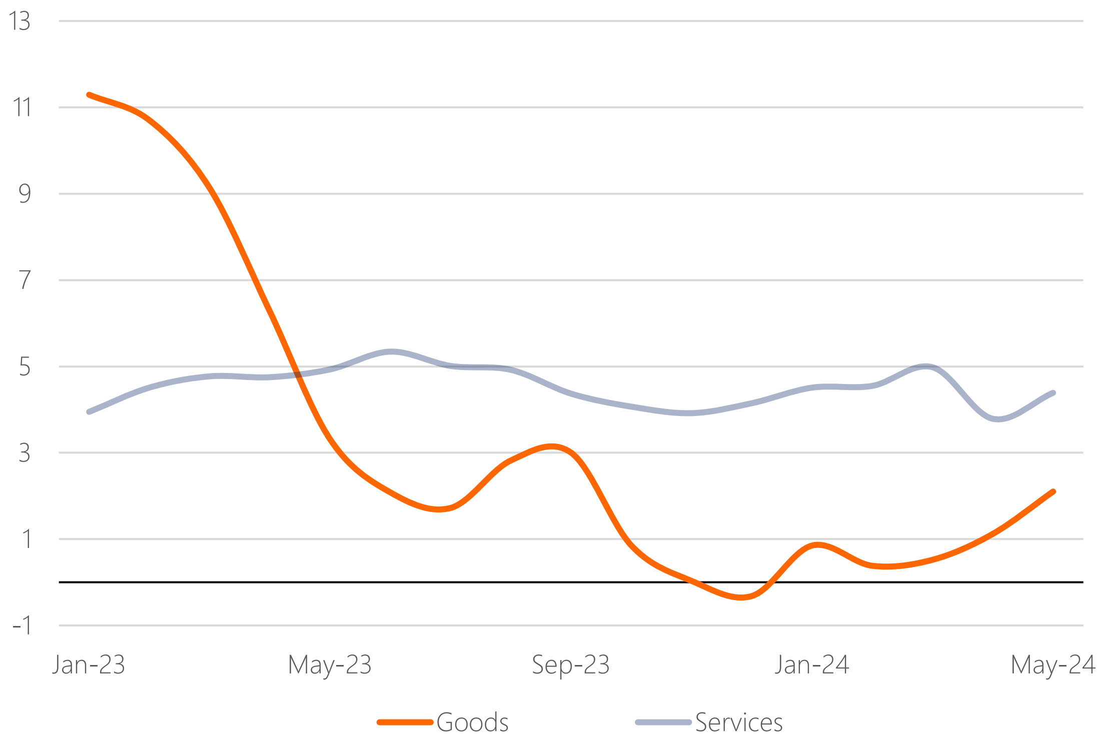
Portugal CPI: Global & Core

Year-on-year (%)



Goods inflation vs Services inflation

Year-on-year (%)



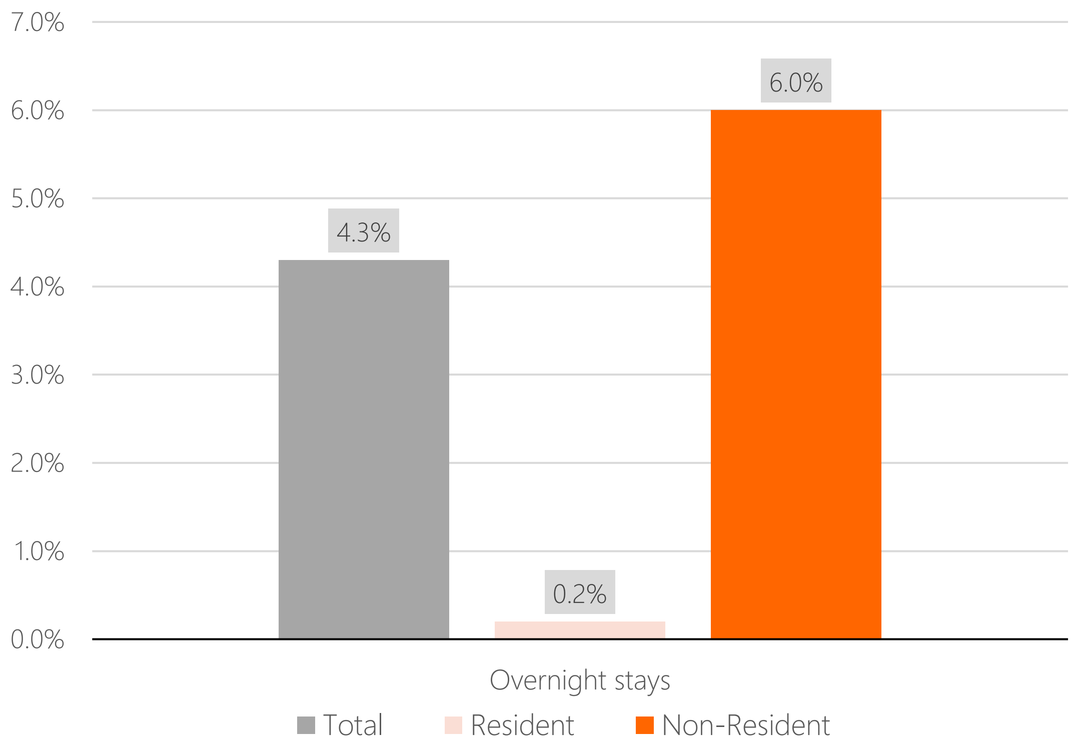
***Source**: BPI Research, using data from INE.*

- **Inflation resumed its downward trend in June.** In fact, after the bump of the previous month (0.9 p.p. increase in the year-on-year rate), the CPI once again returned to the sub-3 per cent territory. The global CPI fell 0.3 p.p. to 2.8 per cent and the core CPI fell 0.4 p.p. to 2.3 per cent. The surprise in June came from the energy component, with this index increasing by 1.95 per cent on a monthly basis, despite average retail fuel prices being lower than in May according to some official sources.
- **Persistent Services inflation (on average above 4% in the first half of the year)** should continue to be supported by resilient demand (good performance by tourism and recovery in household disposable income), with a slight drop towards the end of the year. On the Goods side, the industrial production price index has practically stabilized year-on-year with little room for consumer prices to fall.

Tourism at cruising speed

Overnight stays

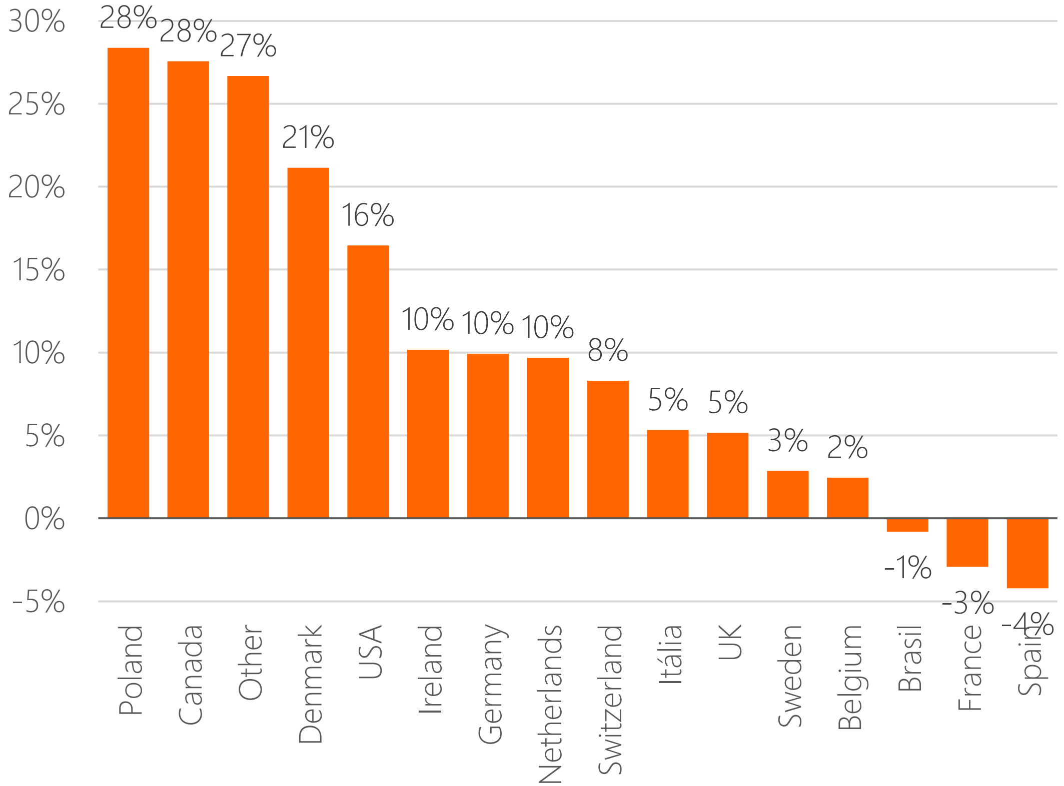
Ytd May 2024 versus Ytd May 2023 (%)



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

Non-resident guests

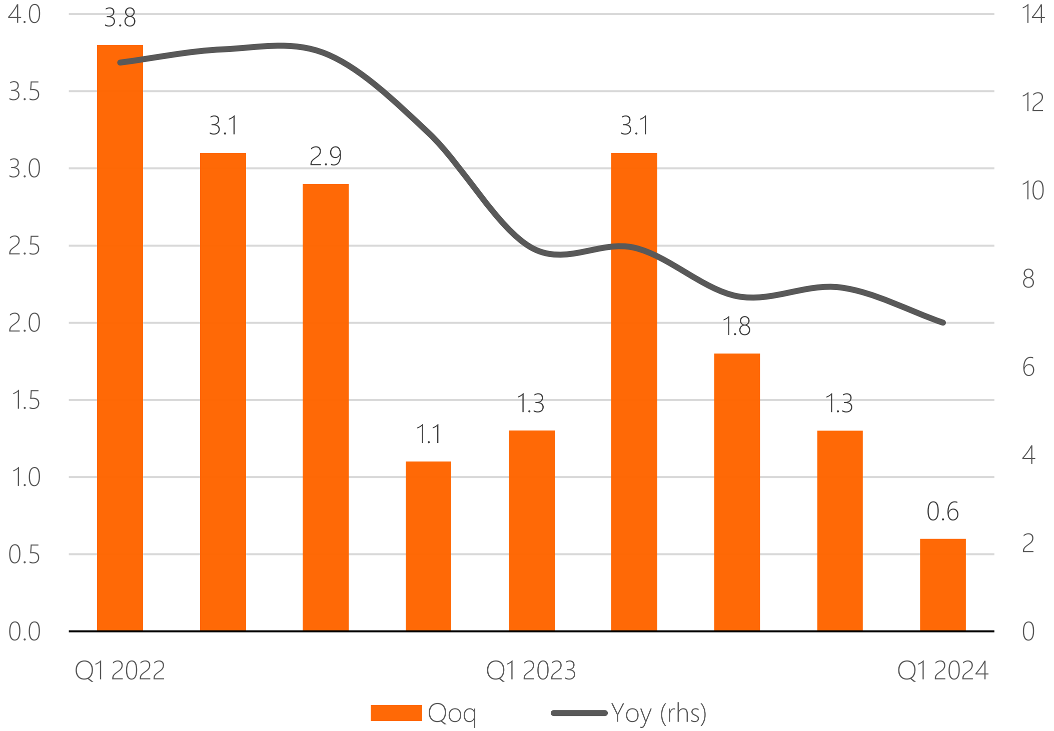
Ytd May 2024 versus Ytd May 2023 (%)



- **This year the tourism sector is expected to behave less exuberantly.** Having lost the momentum of the post-pandemic rebound, the performance of this year is in line with what we projected: an overall increase in guests of around 5 per cent (+5.2 per cent until May).
- **Non-resident tourism has grown more vigorously in the first five months and the pre-pandemic guest mix has been resumed: 60% non-resident tourists and 40% resident tourists.** By origin, the strongest growth is in markets of origin that have less weight in absolute terms, such as Poland, Canada, Denmark and others. Some important markets, such as France and Spain, performed poorly and the high pace of tourism from the United States currently places them as the second most important source market.

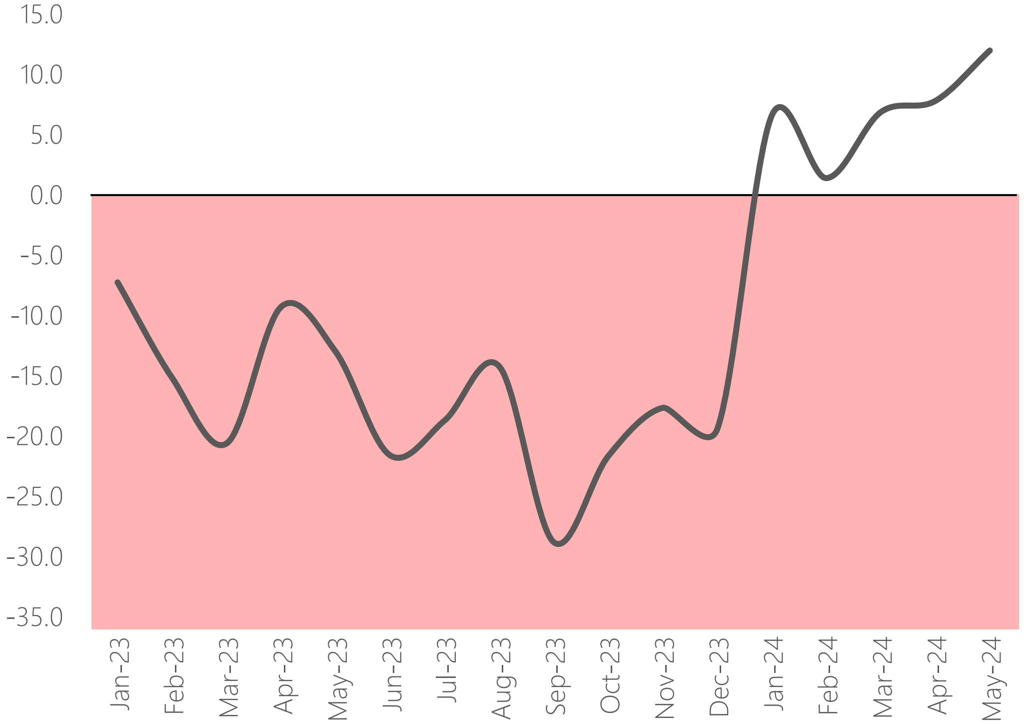
House prices continue to rise in 2024 despite a loss of momentum

House Price Index
Qoq and Yoy change (%)



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

Expectations for House Sales (in 3 months)
% Balance of surveyors



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

- **Houses continue to appreciate in 2024.** Q1 2024 was the third in a row in which the quarterly increase in the House Price Index slowed down (0.6% compared to 1.3% in Q4 2023), but house prices are still 7% higher than a year ago. The number of homes transacted also fell compared to the last quarter of 2023 (-3.1%) and the same quarter of the previous year (-4.1%), although the trend points to stabilisation at around 30,000 properties/quarter (above the pre-pandemic average of 25,300/quarter). Translated with DeepL.com (free version).
- **This Q1 figure does not jeopardise our overall vision for 2024**: that of a slowing market with an appreciation in the value of homes more in line with the series' history. We now believe in a dynamic of greater appreciation in the second half of the year, which is also consistent with the process of monetary easing that will take place at the end of the year (with no rate cut bye the ECB in July). In the meantime, the legislative measures approved ("IMT" tax exemption for young people up to the age of 35), which should only come into force in August, also supports the idea of a more dynamic second half of the year.

Small fiscal deficit at the beginning of 2024 but consolidation should remain in the horizon

Key items in the public accounts*

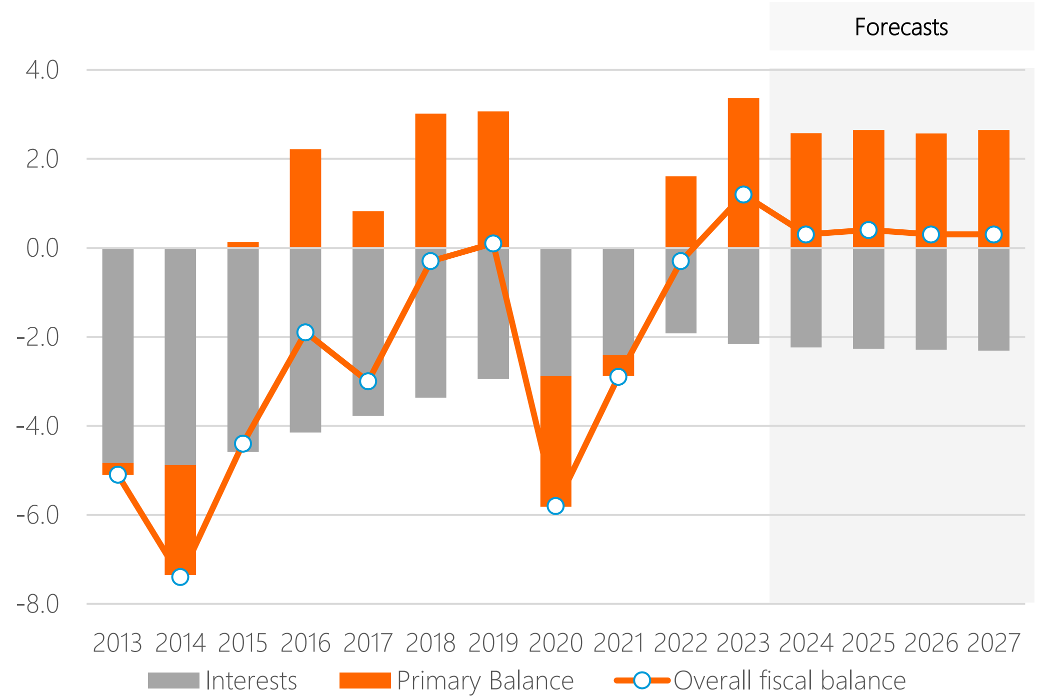
% of GDP

January-May	2019	2021	2022	2023	2024	Change 2024 vs 2019	Change 2024 vs 2023 (million euros)
Revenues	36.0	34.7	36.1	35.5	36.9	0.9	-1,472
Fiscal revenues	19.2	17.8	19.4	19.2	19.1	-0.1	-98
Social security contributions	9.6	10.0	9.9	10.1	11.0	1.4	1,097
Expenditure	36.7	41.0	36.4	34.8	39.2	2.5	4,805
Staff costs	8.6	9.5	8.7	8.5	9.2	0.5	695
Current transfers	15.8	18.5	15.9	15.2	17.9	2.2	3,087
Aquisition of goods & services	5.1	5.3	5.3	5.1	5.5	0.3	428
Interests	4.1	3.7	2.9	2.6	2.8	-1.3	156
Investment	1.8	2.3	2.1	2.0	2.0	0.3	65
Primary current expenditure	9.6	10.0	9.9	10.1	11.0	1.4	1,097
Budget balance	-0.7	-6.4	-0.3	0.7	-2.3	-1.6	-3,333

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

Overall fiscal balance in accrual basis

% of GDP

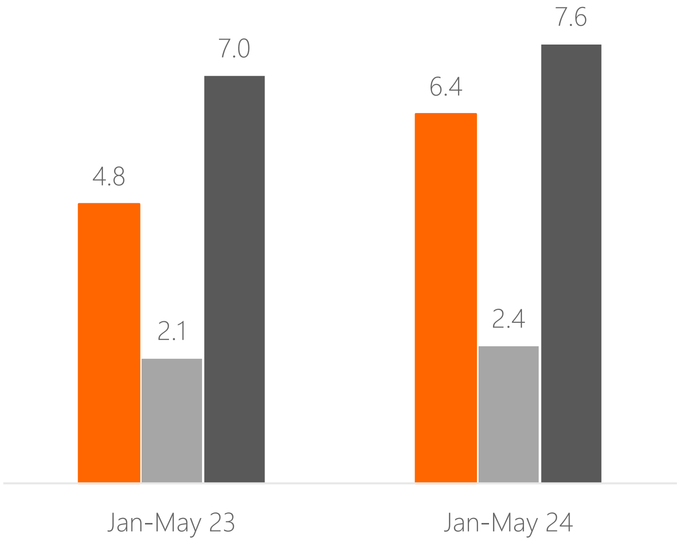


Source: BPI Research, based on INE.

- **On a cash basis, the public sector reached a deficit of 2,3% of GDP in the first five months of the year,** with revenues advancing 3,7% and expenses 12,5%. Expenses growth was due to changes in its execution profile, which particularly affected the year-on-year comparison in the first half of the year. These changes include i) the mid-term update of public servants salaries from May 2023 and the 2024 salary update; ii) an increase in health costs, especially in local and regional administration; iii) and, in particular, the increase in pension costs, resulting from the ordinary updating of pensions at the beginning of the year, the increase in the number of pensioners (+1.1%) and the incorporation of the extraordinary updating carried out in July 2023. Adjusting current expenditure for these factors, deficit would be around 1.5% of GDP.
- **On an accrual basis, the deficit reached 0,2% of GDP in Q1.** In line with the cash basis's figures, expenditure increased above the revenue (11% and 7,3%, respectively), with the yoy comparison adversely affected by the factors mentioned in the previous paragraph. Additionally, this performance does not mean that public accounts entered again in a negative trend, considering that Q1 is typically a worst quarter. We continue to expect a slightly surplus in the following years, even though not considering the eventual implementation of new fiscal measures.

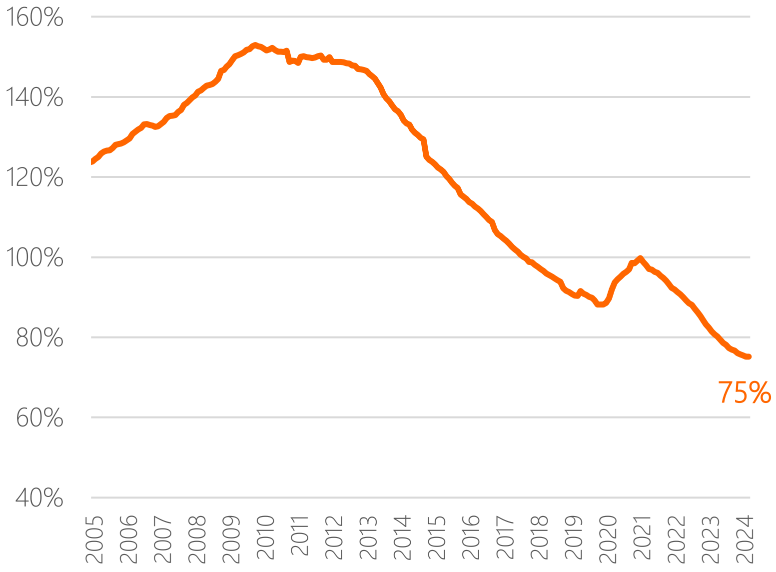
Banking system: deleveraging and high liquidity

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



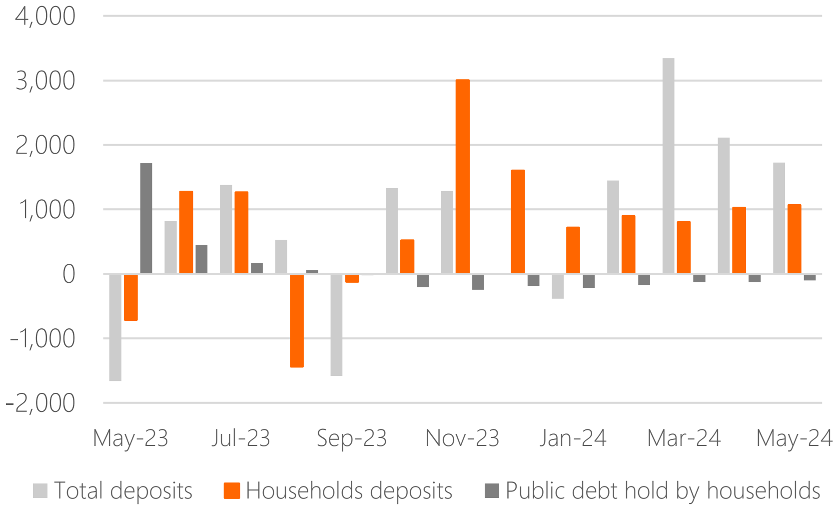
Source: BPI Research, base on data from Bank of Portugal and ECB.

Bank credit to the non-financial private sector
% GDP



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

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

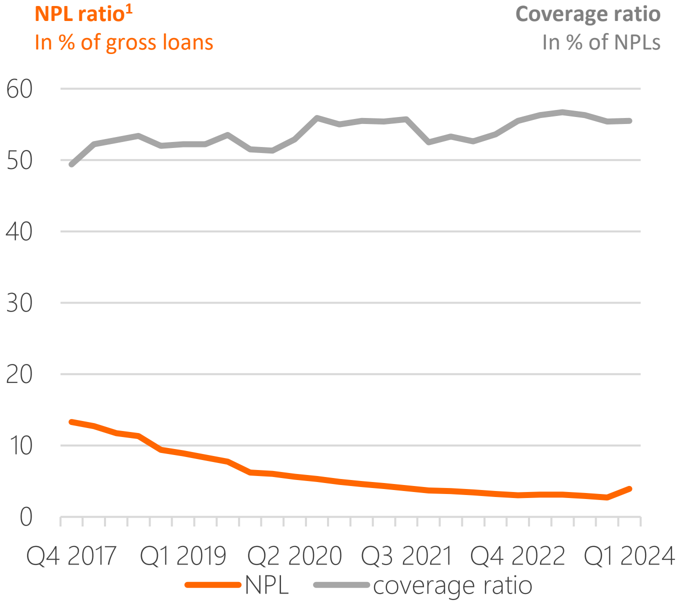


Notes (*): Public debt by households includes Certificados de Aforro and Certificados do Tesouro, which can only be subscribed by resident households. The maximum amount that Government can issue for these retail instruments (CA and CT) is 16.5 bn Eur in 2023.
Source: BPI Research, base on data from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

- **The stock of credit to companies and households has been declining since April 2023, but the pace is gradually changing:**
  - **Mortgage credit:** the stock declined 0,2% in May, but new operations accelerated in the same period by 32,2% (including transfers among banks which Banco de Portugal has been reporting at approximately 30% of total new mortgage credit), indicating that the declining path seen since July 2023 is changing. Indeed, the stock has been increasing gradually since January. Signs that the peak on interest rates should be behind us may have contributed to this.
  - **NFC:** the stock has been declining since mid-2022, due to the redemptions of COVID-credit lines (which we estimate that should be circa 80% completed), low investment, favorable level of deposits and continuing feeble new credit operations. In May, the stock fell 1,4% and new loans increased by 7,8% in accumulated Jan.-May.
- **Deposits of the private sector rose 5,1% in May**. Households' deposits rose 6,1% yoy, as interest rates for new deposits continue to be higher (2,72% in May) 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 support the economy

NPLs and coverage ratios



Cost of risk[1]
0.5% in Q4 2019
0.2% in Q1 2024

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

Banks' profitability

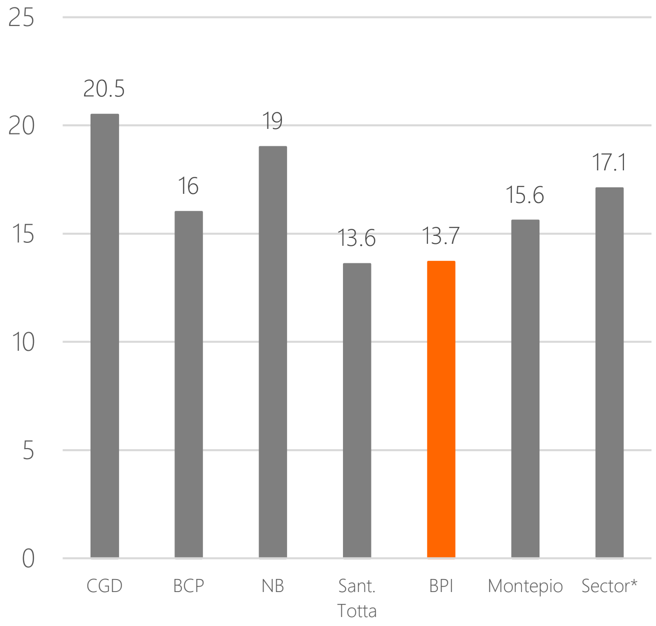
In % of average total assets (Q1 2024; trailing 12M)

	BPI	BCP	San Totta	CGD	NB	Montepio
Net interest income	**2.5%**	**2.2%**	**3.1%**	**2.7%**	**2.9%**	**2.7%**
Net fees	0.8%	0.9%	0.9%	-	0.6%	0.7%
Gains on financial assets	0.1%	0.0%	0.0%	-	0.2%	0.0%
Other net profits	-0.2%	0.0%	0.0%	-	-0.1%	-0.3%
Gross income	**3.3%**	**3.2%**	**4.0%**	**-**	**3.6%**	**3.1%**
Operating expenses	-1.4%	-1.0%	-0.9%	-1.0%	-1.2%	-1.1%
Operational result	**1.9%**	**2.2%**	**3.1%**	**-**	**2.4%**	**2.0%**
Impairement losses, taxes and others	-0.2%	-0.4%	-0.1%	-	0.1%	-0.3%
Profit	**1.2%**	**1.3%**	**2.1%**	**1.6%**	**1.6%**	**1.7%**
ROTE[1]	17.2%	15.0%	27.2%	-	16.8%	17.3%

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 the end of 2023*

- **NPLs ratio kept unchanged in Q1.** The total NPL ratio stood at 2,7% in Q1 2024, due to a slightly deterioration in NPL ratio for housing credit (+0,1 p.p., to 1,4%, considerably below the maximum seen in Q1 2016, of 7,4%) and a stabilization in the case of NFC (at 5%). 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, but not expecting a huge deterioration of credit quality.
- **Profitability remains well above the pre-pandemic period.** According to the Bank of Portugal, ROE increased to 15,5% in Q1 (vs 14,8% in Q4 2023).
- **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