# Portugal:
## Macroeconomic and financial outlook

**BPI** ***Research***

February 2022


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BPI Grupo CaixaBank

# Main messages

## Activity

- **GDP grew 4,9% in 2021, better than expected.** GDP increased 1,6% qoq and 5,8% yoy in Q4, reducing the gap for the pre-covid level to -1,4%. Detail will be known by end February, but according to INE, domestic demand and exports were the main drivers of growth.
- **Tourist activity keeps recovering (non-residents).** In January, the number of flights have more than doubled regarding the same period 2021, staying 16% below the January's 2019 level. Also positive in the beginning of 2022 was the increase of around 30% of payments done with non-residents cards. Signs of control of the disease and progress with vaccination are expected to contribute to a strong pick-up in tourism activity, more apparent in the Summer.
- **Less severe effects related with the Omicron variant and the lift of restrictions support the view that GDP should reach pre-crisis levels in mid-2022.** Even so, the first semester may witness some weakness related with the impact of supply bottlenecks and higher consumer prices curbing disposable income and companies' profits. Going forward, activity should be stimulated by the execution of NGEU and still favorable financial environment. **For all the year, the economy is expected to advance 4,9%, with upside risks to our scenario**.

## Banking sector

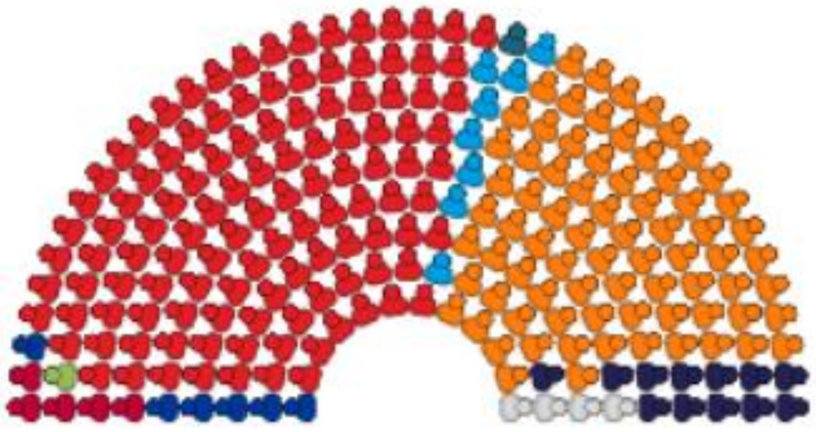
- **Despite the end of moratoria last September, the Portuguese banking system maintains a strong financial position**. NPLs continue to decline and banks are building reserves to face future losses, with NPL coverage ratios at ≈55%. Liquidity and solvency ratios continue also to improve. Healthy balance sheets will be key to accommodate a possible increase in bad loans due to the end of moratoria (according to press, last September, stage 3 credit stood at between 7% and 13% of debt under moratoria, in some banks) and also due to maturity of credit lines from mid-2022. Moreover, the possibility of restructuring debt under moratoria, with state guarantee, a measure aimed at the most vulnerable sectors, will probably reduce the impact.

## Policy

- **The majority obtained by the Socialist Party will accelerate the approval of the State Budget proposal for 2022, that probably will not differ much from the rejected one in the last months of 2021.** General elections results will also ease the approval of reforms and measures needed to receive NGEU funds reducing on a considerable way the risk of delays on the reception of these funds. Main risk on this issue is probably related to the scarcity of resources to go ahead with investments (for example, shortage of labour force in some sectors).
- **Despite the strong support to the economy, the fiscal deficit and public debt are declining.** In 2021 fiscal deficit stood at 4,2% of GDP – cash basis - (5,7% in 2020) and public debt declined to 127,5%, minus 7,7 p.p. than in 2020. This positive trend is expected to remain unchanged this year, but public accounts may face several challenges in the near future, namely the possible execution of guarantees related to Covid-credit lines and also the eventual additional financing needs of some SOE. Nevertheless, there is room to accommodate potential fiscal slippage as the economy is showing strong dynamics and as public debt increased comparatively less in 2020 than in other European peers.
- **The Government public funding needs will be less covered by ECB purchases in 2022 than in the two previous years, but ECB acquisitions will continue to be an important support, (expected to cover around 40% in 2022). Still, the Treasury liquidity cushion amounts to circa €16 bln (≈7% of GDP).**

# Political situation: stability for the next four years

**Elections: 2022 results and the Parliament distribution**



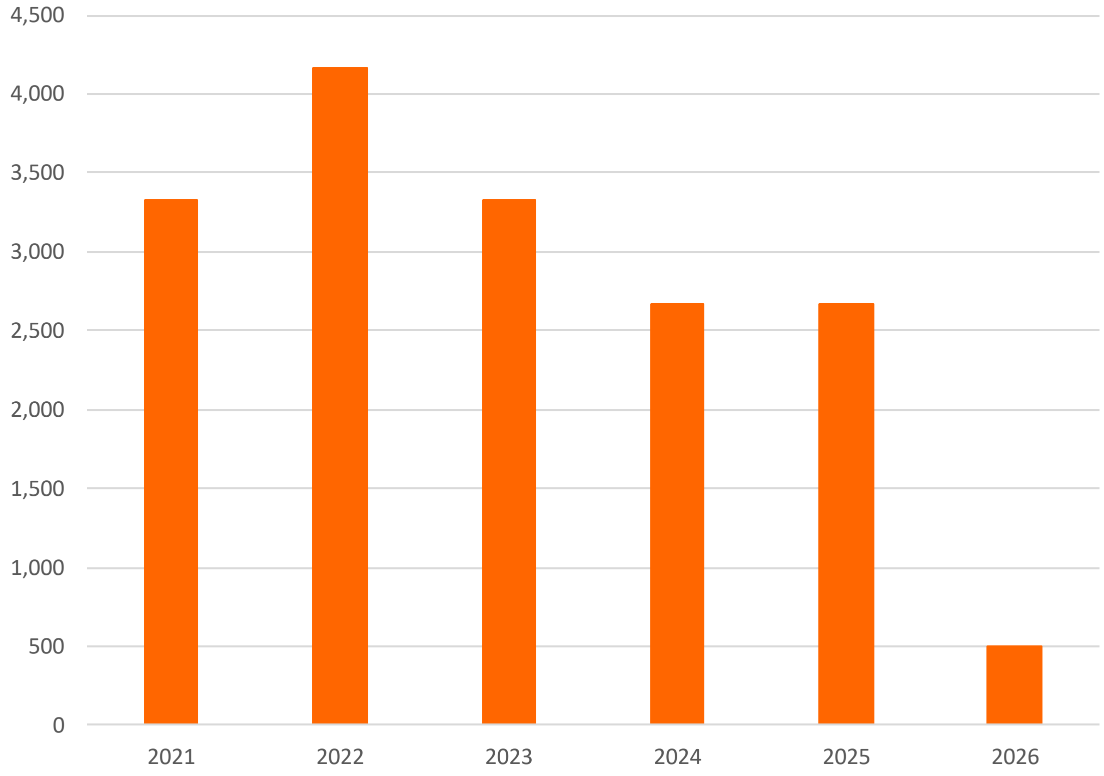
| | % | Number of seats |
|---|---|---|
| PS | 41,68% | 117 |
| PPD/PSD | 27,80% | 71 |
| CH | 7,15% | 12 |
| IL | 4,98% | 8 |
| B.E. | 4,46% | 5 |
| PCP-PEV | 4,39% | 6 |
| PAN | 1,53% | 1 |
| L | 1,28% | 1 |
| PPD/PSD.CDS-PP | 0,94% | 3 |
| PPD/PSD.CDS-PP.PPM | 0,53% | 2 |

- **The Socialist Party wined the majority of the Parliament in last elections (41,7%; seats>116)**, against the polls' results. The other two left-wing parties, Bloco de Esquerda and Communist Party, have lost 20 seats in the Parliament, punished by the rejection of the State Budget 2022 in October. On the other hand, two right-wing parties have gained importance: Chega and the Liberals (+11 and +7 seats, respectively).
- With this result, **the country will benefit from the political stability during the next 4 years**.
- Given this scenario, **the process of preparing and submitting the State Budget Proposal for 2022 will be quick**, considering that the rejected proposal in October will be presented (or very close to it), probably updated with the latest economic data. The State Budget for 2022 will be under place probably in April/May.

# The Recovery and Resilience Plan: a key element for recovery

## Time distribution of NGEU transfers

*(million of euros)*




***Source***: *BPI Research, based on Government figures.*

## Approvals and Payments to Direct and Final Beneficiaries

*(million of euros)*

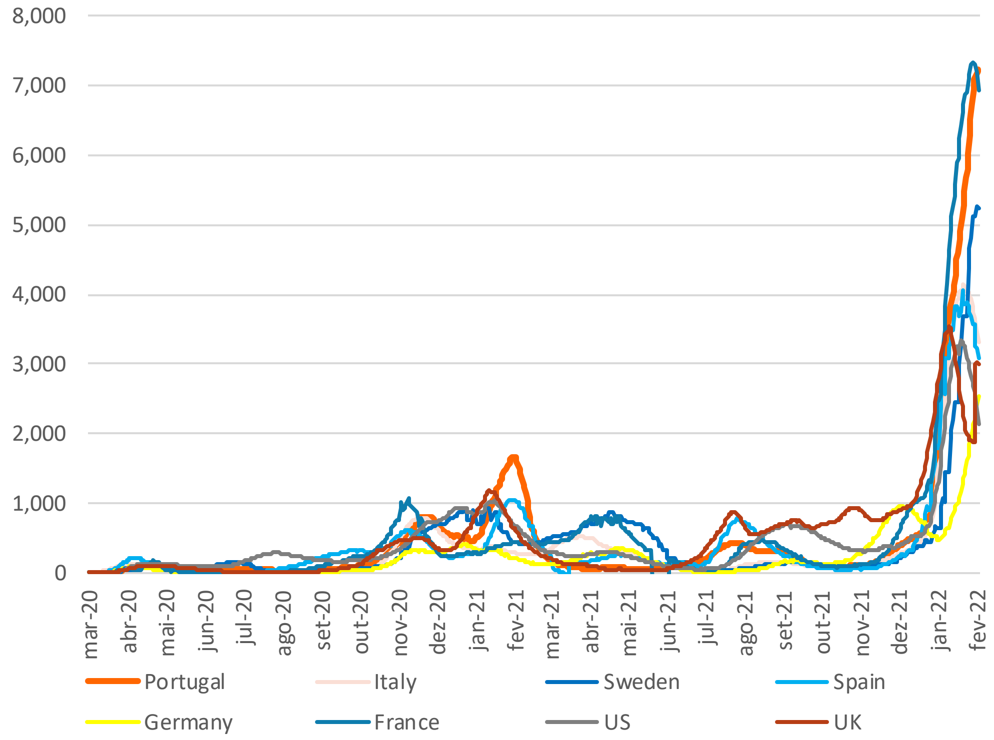
| Up to February 2nd | Amount approved | Amount payed |
|---|---|---|
| Families | 29 | 25 |
| Solidarity and Social Economy Institutions | 1 | 0 |
| Non-financial corps. | 0,1 | 0,1 |
| Institutions of the scientific and technological system | 0 | 0 |
| Higher education institutions | 0 | 0 |
| Schools | 228 | 30 |
| Municipalities and metropolitan areas | 290 | 32 |
| Public entities | 1.706 | 153 |
| Public enterprises | 1.627 | 155 |
| **Total** | **3.881 (24% of 16,4 MM)** | **396 (2% of 16,4 MM)** |

***Source***: *BPI Research, based on Government figures.*

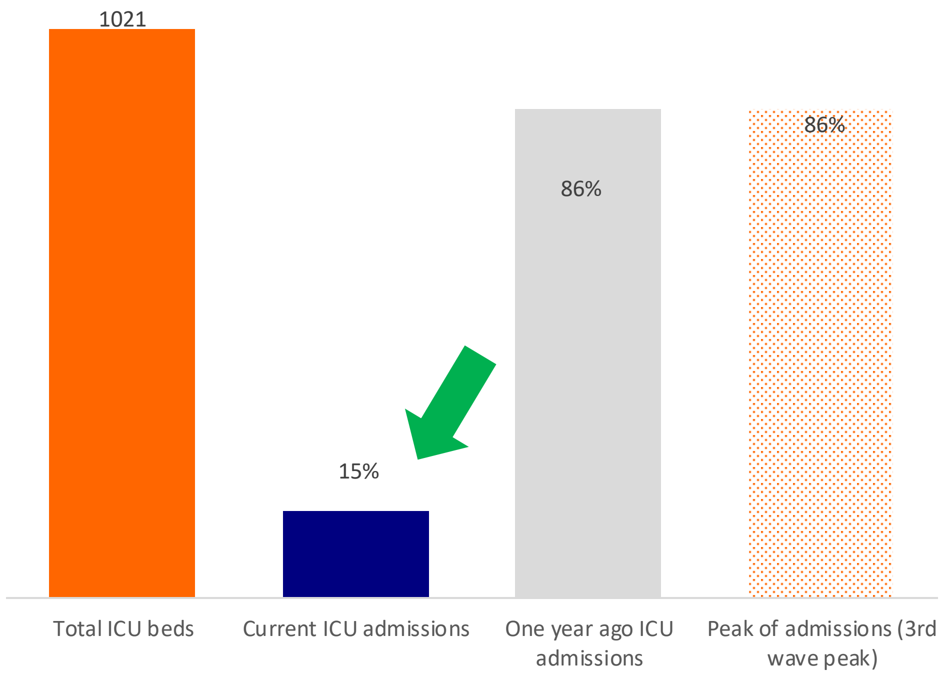
- **Portugal will receive €13,9 bn (≈6.5% of 2019 GDP) between 2021 and 2026** as subventions (+€2,7 bl as loans) from the European Recovery and Resilience Mechanism. **Portugal has already received the pre-financing amount: ≈€2,2 bln. Recently, the country requested the first payment at the beginning of 2022 (€1.162m).**
- **Macro impact:** We anticipate an execution rate of ~50% in 2021, with a growth contribution of ~0.2 p.p...In 2022, the impact on growth will be ≈0.6 p.p. Between 2021-26, funds will probably add to Portugal's annual GDP between 0.8 and 1.5 p.p., on average.
- **Main risk:** the main risk is probably related to the scarcity of resources to go ahead with investments (for example, shortage of labour force in some sectors).

# Wave of contagions with Omicron still high, but without significant pressures on hospitalizations

### COVID-19 cumulative incidence
*Infections per 100k inhabitants accumulated in 14-day*




### UCI admissions vs. UCI installed capacity
*Unit, %*

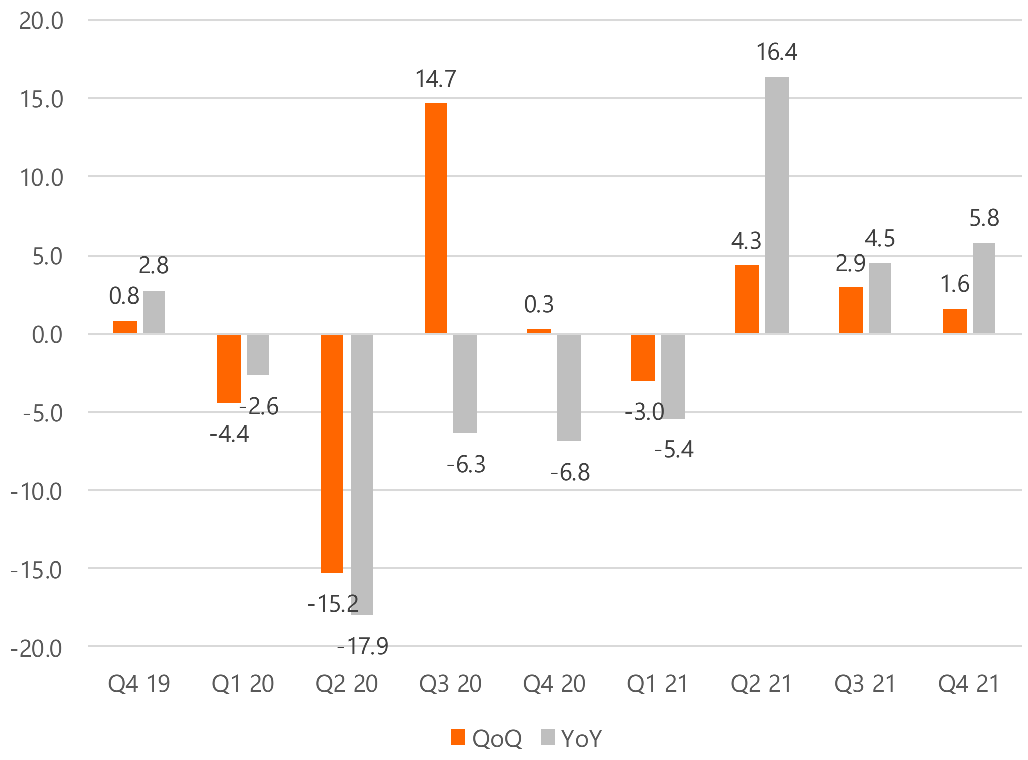



- **14-day cumulative incidence has been increasing and at the beginning of February is well above the threshold of 120 cases per 100k set by the Government (≈7.000/100k).** However, the **high rate of vaccination is avoiding the increase of serious cases**, allowing to keep UCI occupation low, circa 18% of levels seen one year ago. Hospitalizations and mortality continue contained and well below the levels registered at the beginning of 2021.
- In the current scenario of less severe effect related with infections, restrictions imposed in the end of 2021 are being lifted, which will allow the return to normality of the economic activity.

# Growth in Q4 surprised on the upside and push 2021 growth to near 5%

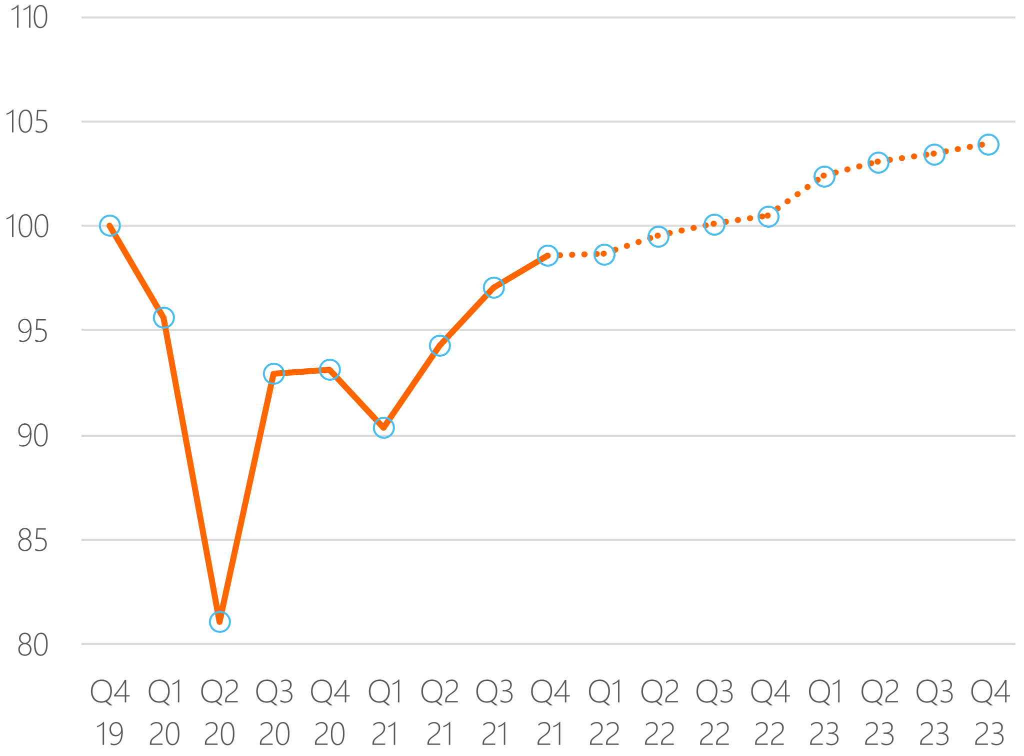
**GDP growth**

*Percentage change (%)*




**GDP: recovering trend**

*Q4 2019 = 100*




- **GDP posted an annual growth of 4,9% in 2021, taking advantage of a better than expected performance in Q4: 1,6% qoq and 5,8% yoy, supported by positive perfomance of domestic demand and exports (detail will be released on February 28th. The gap for the pre-covid level fell to 1,4%.**
- **Central scenario**: our main scenario sees GDP advancing around 5% this year and reaching the pre covid level by the end of the first semester. Uncertainty remains high and mainly related to the health situation, emergence of new variants, impact of bottlenecks on the supply side and higher inflation. However the tail winds – tourism, European funds and pent-up demand - should be stronger, helping GDP to reach pre-crisis levels by mid-2022.

# The recovery proceeds despite the pandemic

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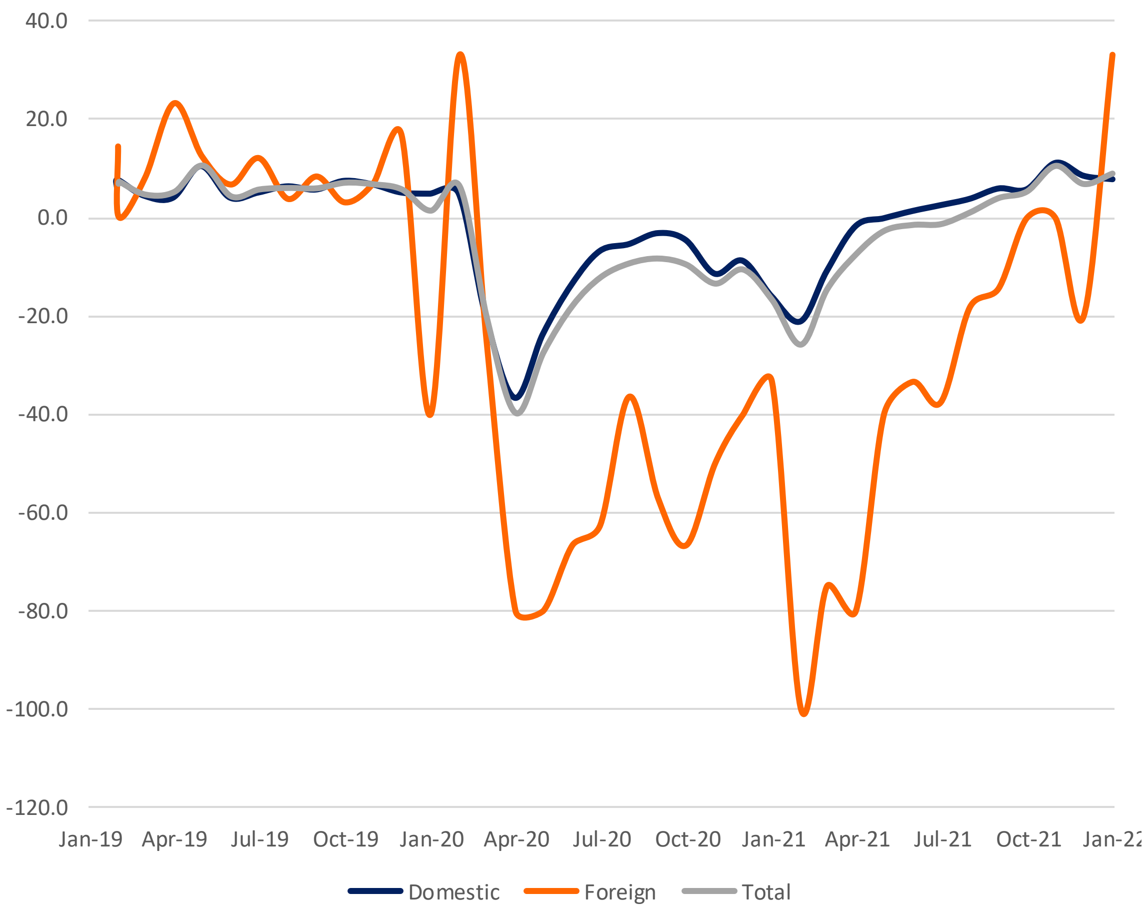
**Consumer confidence indicator: important purchases in the next 12 months**

*Points*


**Cards activity**

*Year-on-year (%)*




- **Consumption continues to perform well: families are confident and expenses paid with electronic cards in January surpassed by 9% the level of January 2021.**
- **Non-residentes expenses grew more than 30% from January 2021, reflecting the sentiment that current variants of the Covid 19 are less severe and anticipating a sustained recovery in tourism**

# Activity monitor – consumption and exports well anchored above 2019 levels

| Year-on-year change (%) | Daily Economic activity indicator | Credit cards | Cement | New registrations of passenger cars | Electricity consumption | Industrial production | Retail sales | Unemployment | Number of tourists | Exports of goods (ytd) | Imports of goods (ytd) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2019 | - | 6.5 | 15.1 | -2.0 | -0.1 | -2.3 | 4.3 | -6.4 | 7.9 | 3.5 | 6.0 |
| 2020 | -8.8 | -13.5 | 10.9 | -35.0 | -3.0 | -7.0 | -3.3 | 5.8 | -61.6 | -10.3 | -14.8 |
| 2021 | -2.9 | -2.2 | 17.0 | -34.4 | -2.1 | -4.3 | 0.7 | 22.9 | -46.4 | 3.9 | -2.2 |
| Q1 2021 | -4.2 | -12.8 | 10.2 | -31.5 | -1.7 | -4.5 | -8.9 | 2.6 | -78.7 | -10.3 | -17.6 |
| Q2 2021 | -2.0 | -3.8 | 21.9 | 157.6 | -3.6 | -5.8 | 1.9 | 30.2 | -64.5 | 3.8 | -6.1 |
| Q3 2021 | -1.1 | 1.4 | 15.3 | -23.8 | -1.3 | -5.4 | 1.8 | 21.4 | -31.6 | 2.9 | -4.3 |
| Q4 2021 | -1.9 | 7.7 | 16.2 | -14.2 | -2.1 | -4.0 | 4.7 | 14.1 | -20.2 | 5.1 | 1.2 |
| October | -3.1 | 5.4 | 0.6 | -32.4 | -3.3 | -5.0 | 4.0 | 17.2 | -14.8 | 4.2 | -0.6 |
| November | -1.4 | 10.7 | 27.8 | -33.4 | -1.2 | -2.8 | 5.7 | 13.0 | -17.0 | 5.3 | 1.2 |
| December | -1.2 | 7.0 | 20.4 | -28.9 | -1.9 | -4.2 | 4.5 | 12.1 | -28.9 | 6.0 | 3.2 |
| January | -8.5 | 9.1 | 10.8 | -31.9 | -4.2 | | | | | | |

Note: After March 2021 (inclusive), the comparisons are made with the respective month in 2019. January 2022 with January 2020
2021 as average of monthly 2019 yoy changes

Rate >= avg. prev. quarter

Rate < avg. prev. quarter

# Inflation continues to accelerate at the beginning of 2022

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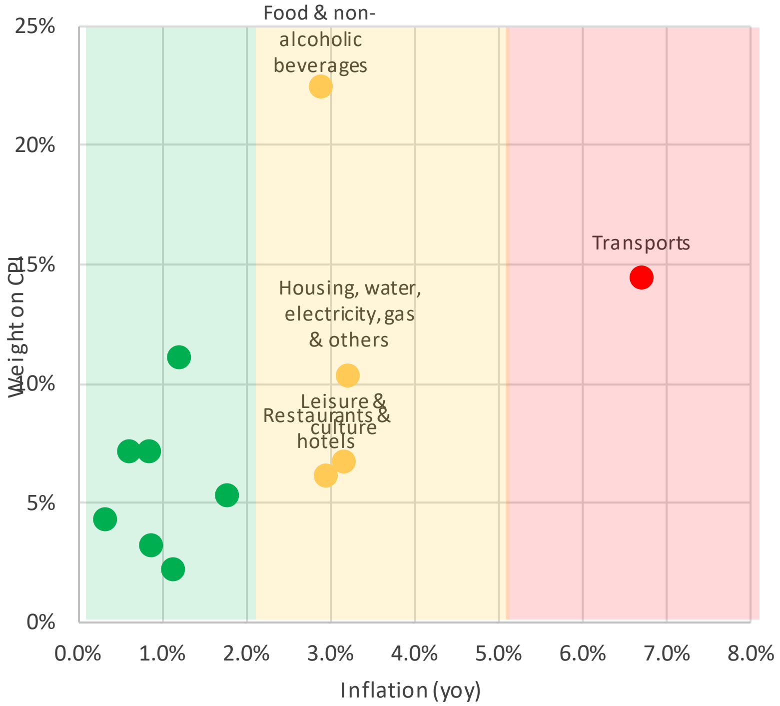
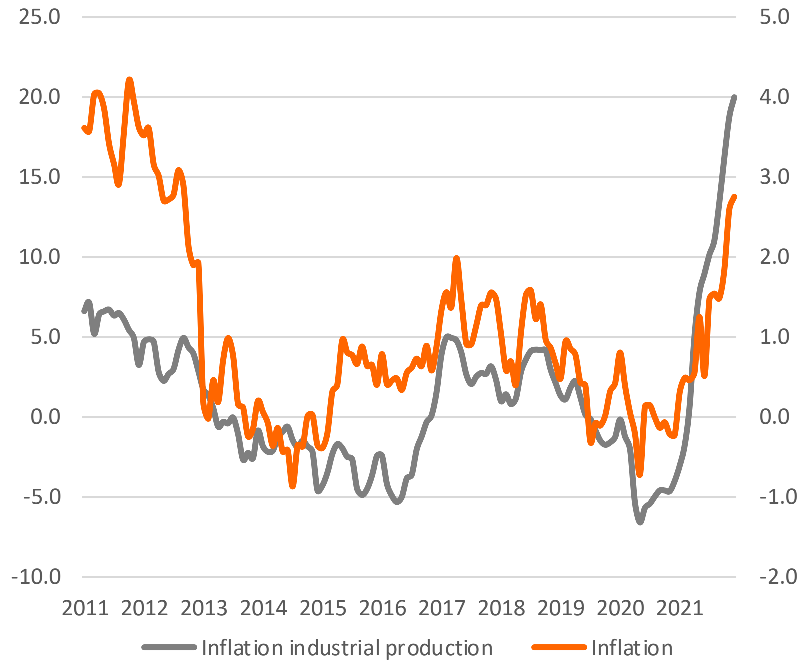
## Inflation December 2021 by components




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

## Inflation in industrial production and overall inflation rate

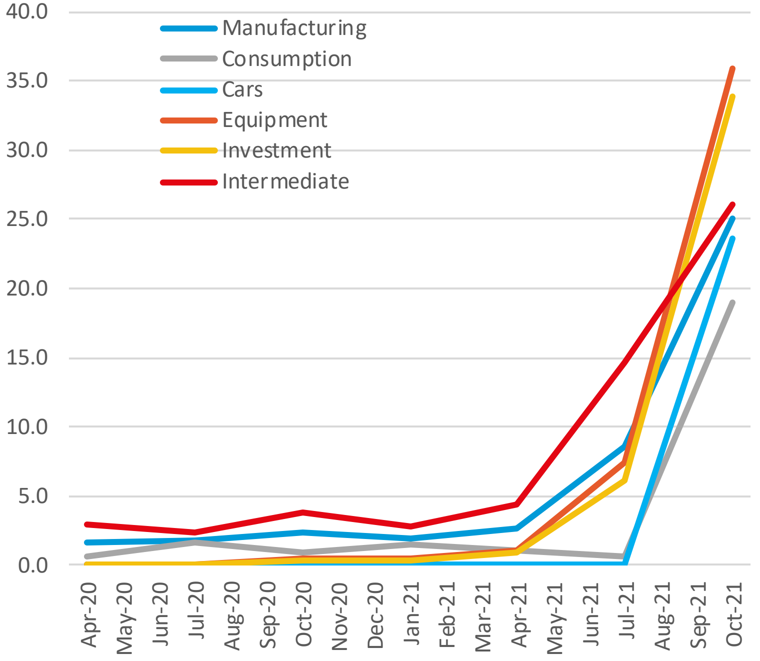
*Year-on-year (%)*




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

## Obstacles to production in Portugal

Report of Insufficiency of materials in the manufacturing industry (%)

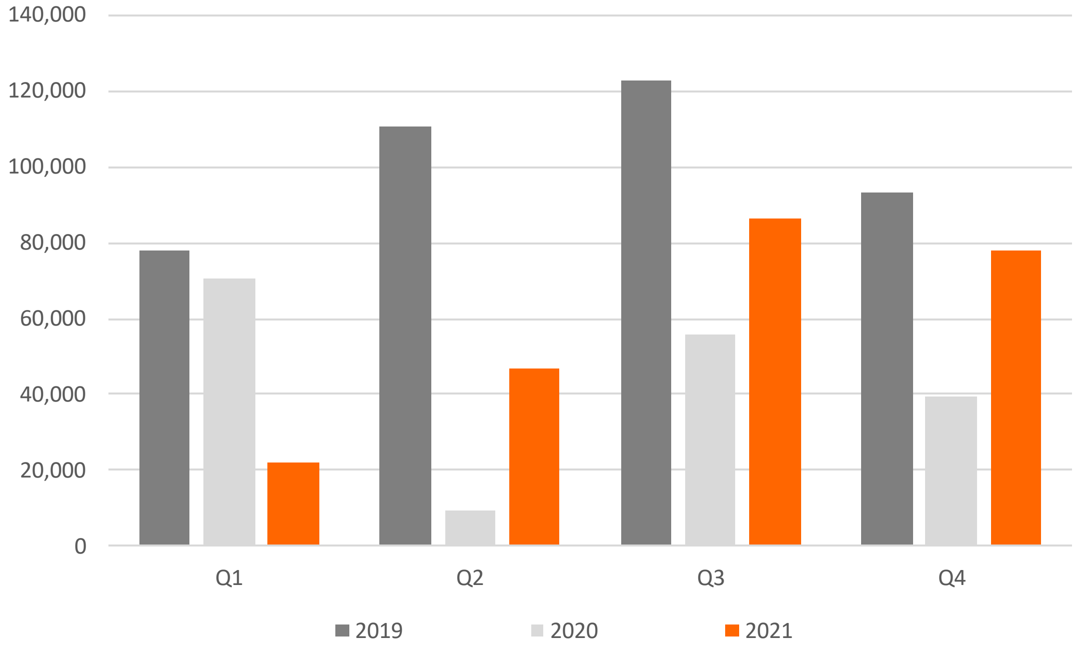



- **Inflation accelerated in January** to 3,3% (2,7% in Dec.), driven by higher prices on energy component. Additionally, high energy prices have started to spread to other components (food for example). driven by the impact of scarcity of inputs in a period of higher demand. Core inflation accelerated to 2,5%, from 1,8% in December. **Inflation should moderate in the second half of the year**: drop in energy prices and supply bottlenecks should ease during the last part of the year.
- Portuguese inflation is lower than the European one in almost all the items considered in the CPI basket. This difference is more apparent in classes related to energy – fuels, gas, electricity – and to activities within the Tourism sector – namely Restaurants and Hotels. The behavior of this last sub-group reflects the higher weight of tourism in the Portuguese economy, sector whose activity is still far below pre-covid levels. As for energy prices, the smoother behavior is related to some internal price-setting mechanisms, which accommodate greater price volatility in international markets. This is the case of electricity prices, given the price setting components and the frequency of updating by the regulator, in Portugal only once a year.
- **Central scenario**: our main scenario sees annual inflation reaching 2,2% in 2022 (1,3% in 2021), decelerating to 1,7% in 2023. **Risks are tilted to the upside**.

# Tourism should recover as vaccines demonstrate their effectiveness

## Number of flights, by quarter

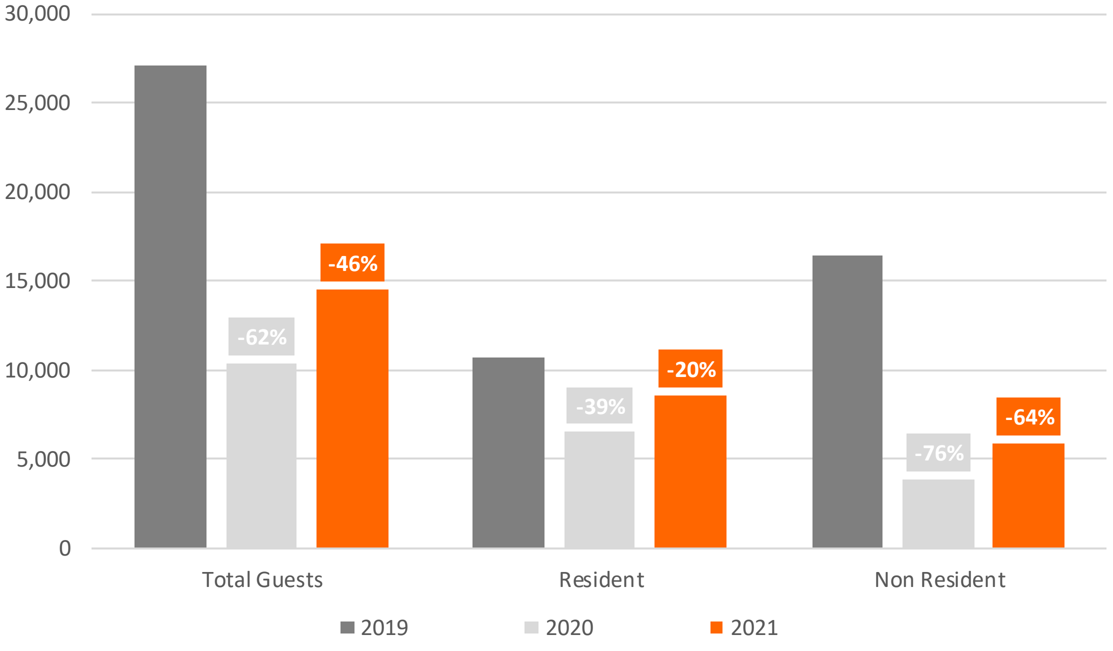
*Number*




***Source***: *BPI Research, based on EUROCONTROL data.*

## Number of guests (foreign and national)

*Accumulated in the year (Thousand)*




***Source***: *BPI Research, based on INE data.*

- **Tourism has been the sector hardest hit by the pandemic:** in 2021, the number of tourists reached 14.5 million, 39% more than in 2020, but still 46% below 2019. In the last months, the number of international tourists visiting Portugal has been increasing at a strong pace, but the total number of foreign guests is still 64% below the 2019 level. Domestic tourism (40% of total tourism demand in pre-covid era) remains 20% below the accumulated level of 2019.
- **Fundamentals remain strong and are complemented by the well succeeded vaccination process.** The Portuguese tourism industry is the 12th most competitive in the world and "safety & security" is viewed as one of its biggest assets. Hence, recovery should be supported by the successful vaccination process with circa 90% of the population already fully vaccinated and the effectiveness of vaccines to minimize the pressure on health sector. However, the revival is subject to some uncertainty as confidence is one of the main constraints and also some headwinds can arise associated with a slower than expected recovery of the European airline business.

# The real estate sector: resilience and solid fundamentals

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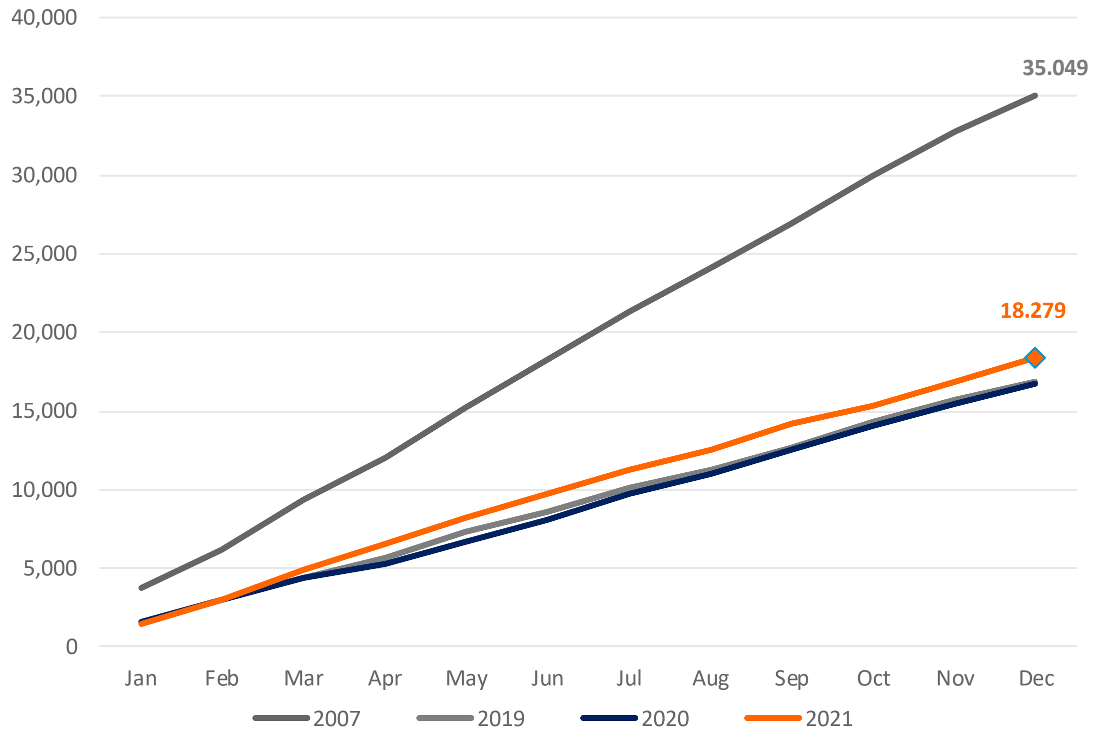
## Licenses to build new dwellings

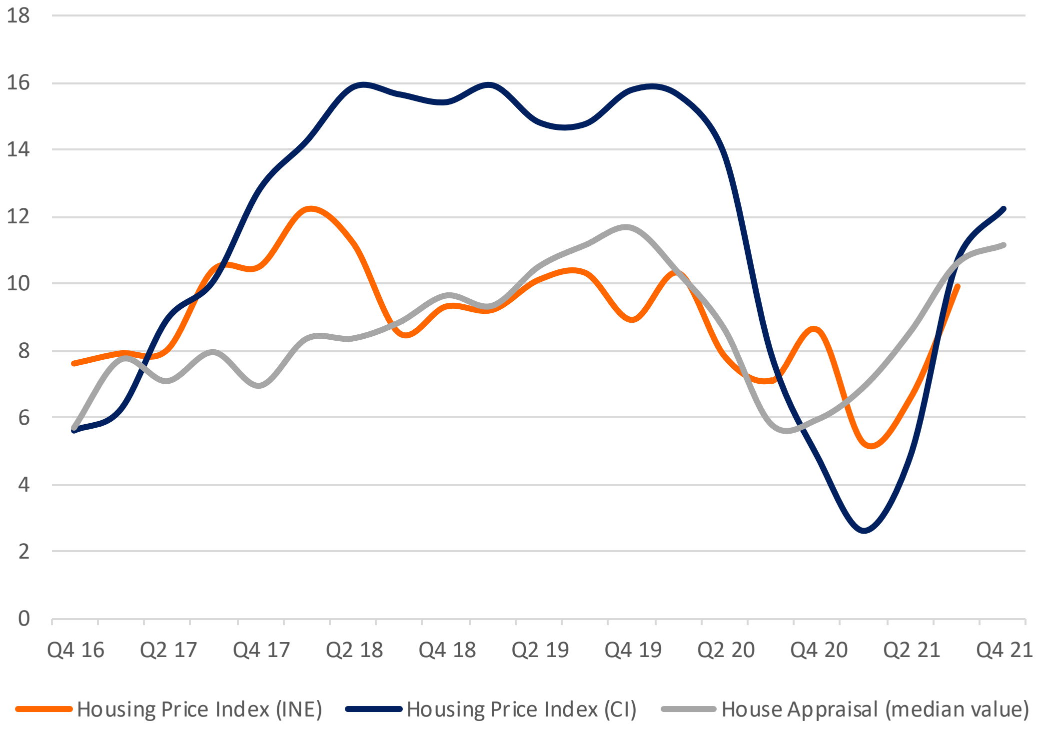
*Units accumulated in the year*




***Source**: BPI Research, based on INE data.*

## Housing prices

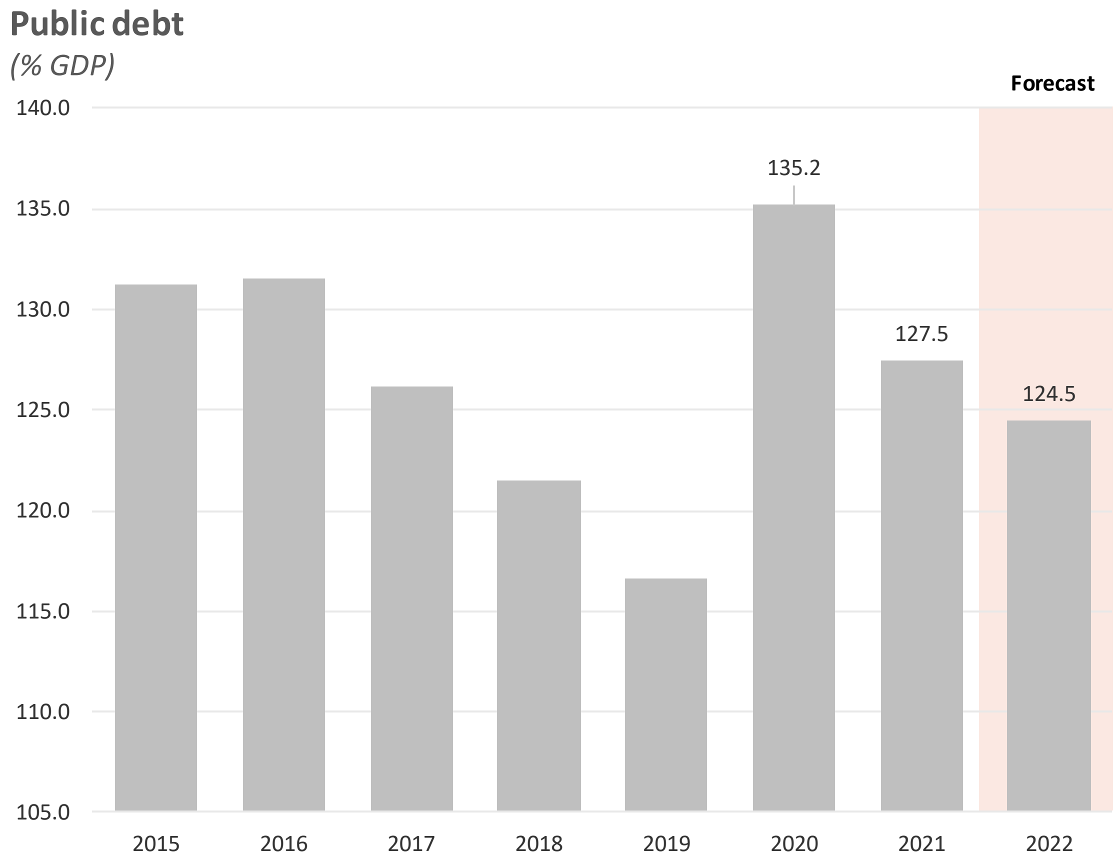
*Year on year (%)*



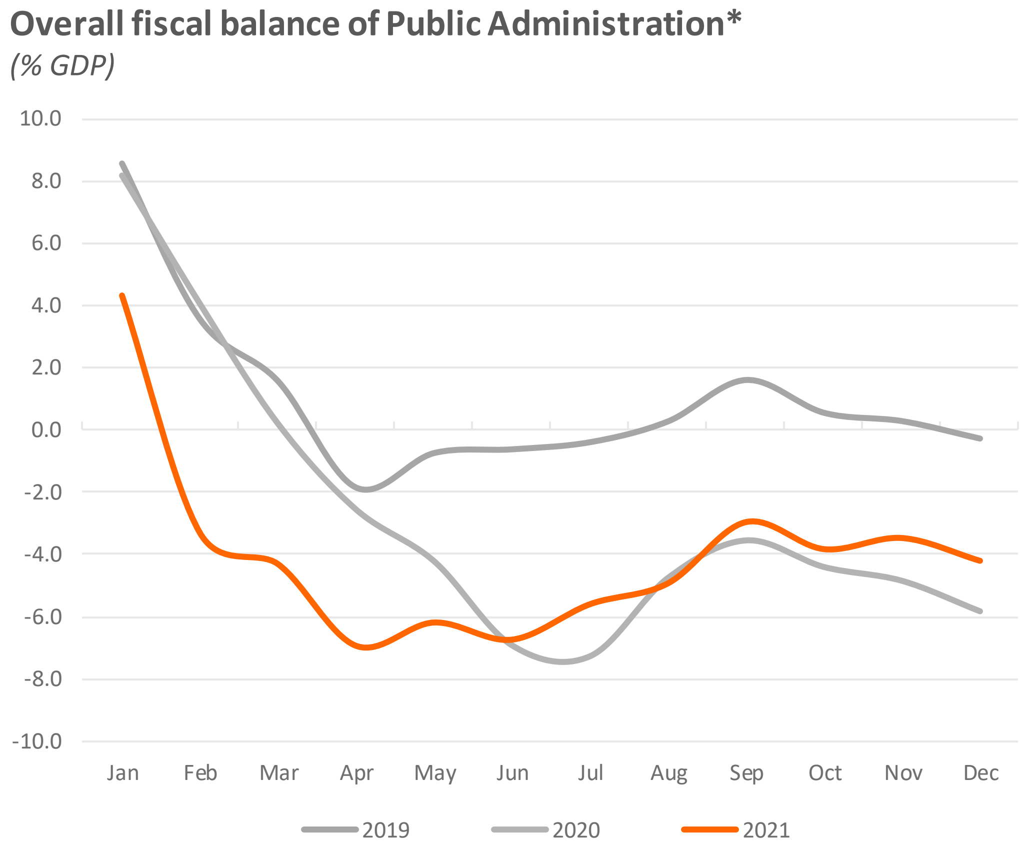

***Source**: BPI Research, based on INE and Confidencial Imobiliário data.*

- Both **new licenses and new construction are expanding, but they are still well below 2007 level**, suggesting a moderate pace of new homes entering the market, continuing to support prices. Additionally, prices continued to increase in last months of 2021 and confidence keeps strong in the sector.
- Going forward, **the market should continue resilient: no signals of oversupply, but the prices should decelerate in the coming years**, in line with the end of Vistos Gold in main cities as well as some cooling down expected from domestic buyers due to the end of some Covid-related supporting measures (namely moratoriums) and also due to the upward trend in interest rates. Housing prices may have increased 6,4% in 2021 and should decelerate to 4,0% in 2022, with upside risks to our scenario.

# Fiscal deficit: positive surprise in 2021?




***Source**: BPI Research, based on Bank of Portugal.*



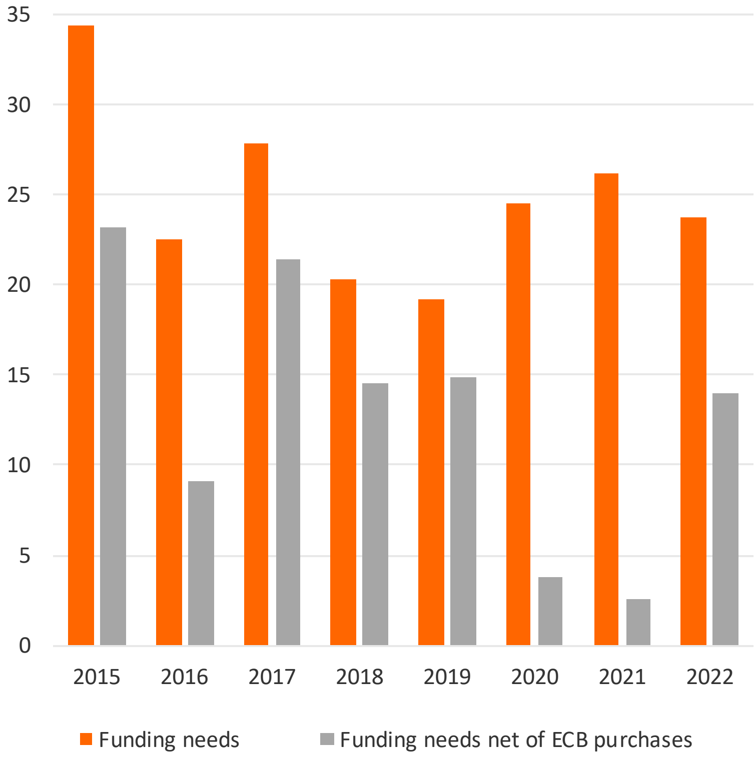

***Note (*)**: Budget execution according to the cash basis. **Source**: BPI Research based on DGO.*

- **Public debt (% of GDP) increased by 18,6 p.p. in 2020,** reflecting the supportive measures to companies, families and the health system due to the Covid-19 pandemic. Despite large, this increase was smaller than the evolution seen in other European countries (such as France, Spain, Italy), where supporting measures were larger. **In 2021, the public debt ratio decreased by 7,7 p.p. to 127,5% of GPD and should reach 2019 levels only in 2025** (Government's estimates)**. Going forward, keeping a sustained pace of economic growth, a moderate fiscal stance and low financing costs will be key for the achievement of these goals.**
- Probably, **the fiscal deficit in 2021 stood below the forecasts**; deficit may have stood below 4,0% of GDP, explained by the substantial increase in revenues (fiscal and contributory revenues, as well as Europeans funds).

# Funding needs are well covered

## Portugal: Funding needs

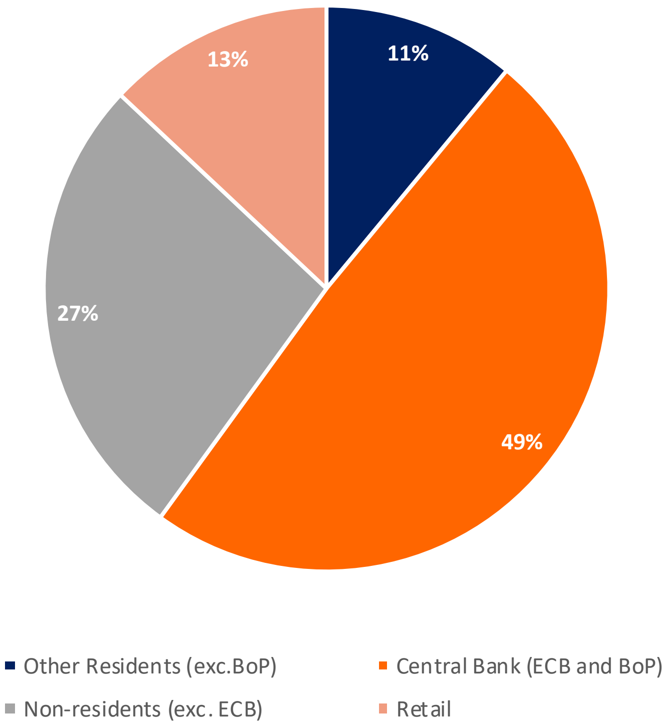
*(Billion euros)*




***Source**: BPI Research, based on IGCP, BoP.*

## Government debt by holders (exc. non-tradable debt)

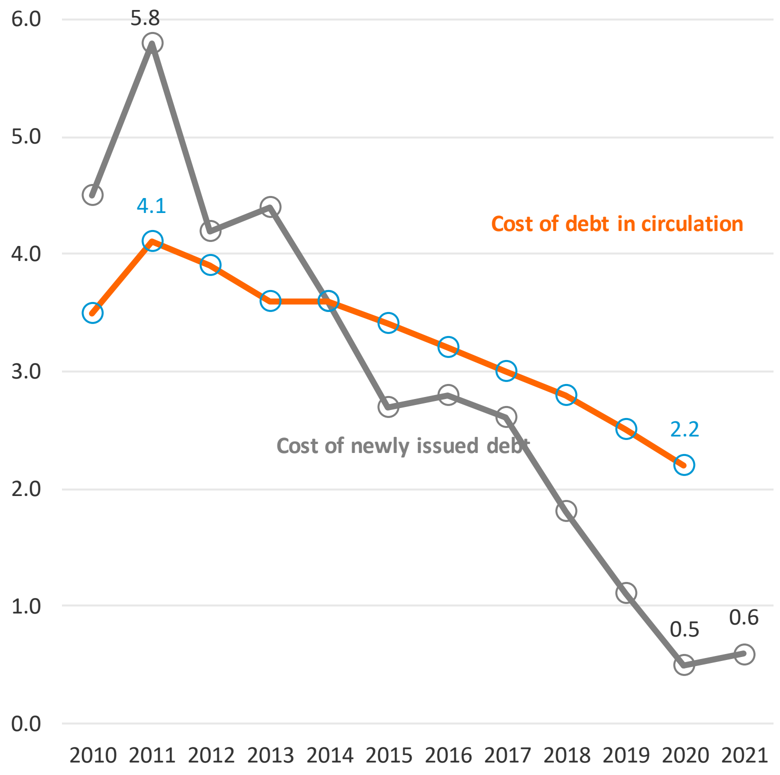
*(% of total; up to November)*




***Source**: BPI Research, based on IGCP.*

## Cost of debt

*(%)*



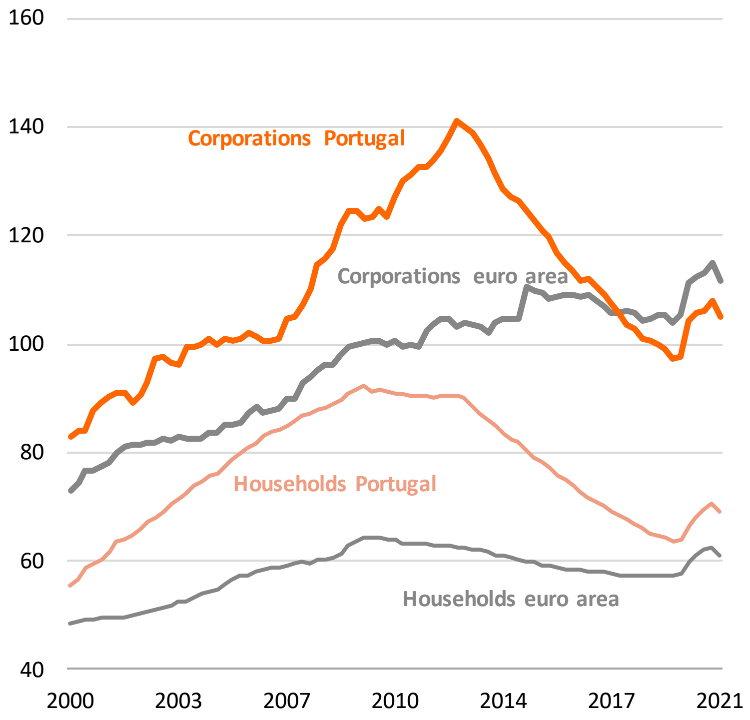

***Source**: BPI Research, based on IGCP.*

- Funding needs not covered by the ECB in 2022 will be above those of 2020 and 2021, but still below the levels seen in 2018 and 2019.
- **However, public funding needs continue well covered, helped by ECB purchases** (expected to cover around 40% in 2022), plenty of liquidity available and low interest rates. 18% of total debt are EU loans linked to the Economic and Financial Assistance Program (PAEF). **Currently, the Treasury liquidity cushion amounts to €16 bln (≈7% of GDP).**

# The Portuguese banking system: resilient and supporting the economy (1)

## Gross private debt

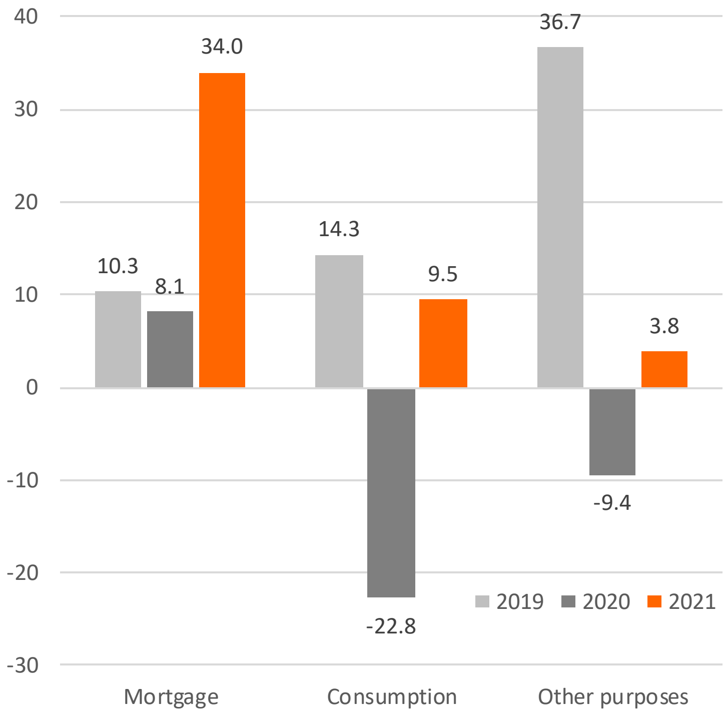
*% of GDP, non consolidated debt.*




***Source**: BPI Research, based on Eurostat data.*

## Households: New lending activity

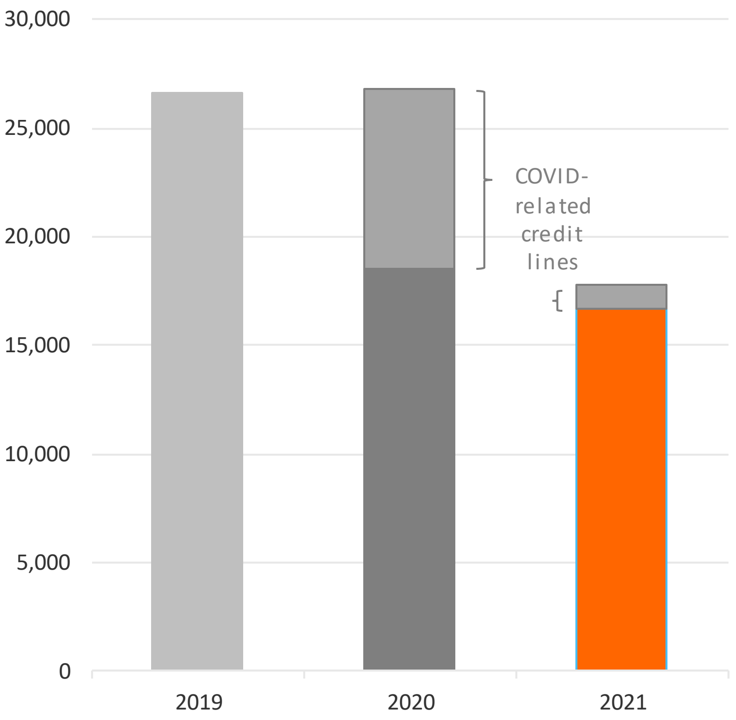
*YoY variation accumulated in the year (%)*




***Note:** excluding renegotiations. **Source**: BPI Research, based on BoP data.*

## Non-financial corporations: New lending activity

*Accumulated in the year (Million euros)*



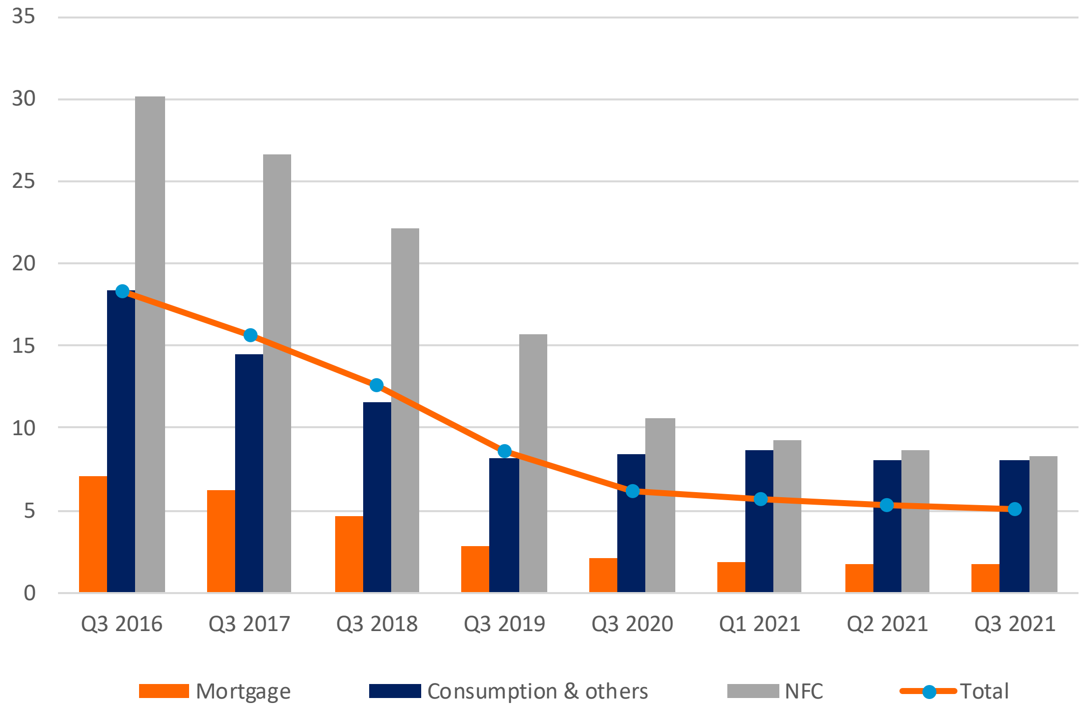

***Note:** excluding renegotiations. **Source**: BPI Research, based on BoP data.*

- **Corporate debt levels** remain below euro area average despite the recent pick-up in credit outstanding (mostly due to state guaranteed credit lines, issued back in 2020, and moratoria to companies). **Household debt** has increased, reflecting expanding mortgage lending, as well as the effect of moratoria. We expect the deleveraging trend to return to private sector credit after the COVID crisis and with the end of moratoria.
- **In 2021, new lending for the non-financial private sector contracted 11,4% yoy**, reflecting the fall of new credit to NFC (-33,5%). However, when excluding Covid-related credit lines, credit to companies decreased less (-9,9% yoy). **Data for households shows also a strong performance: new lending in 2021 increased 24,5%, due to the rise of 34% on mortgages**. The strength seen on the housing market, favorable financing conditions, the employment-supporting measures and the past households' balance-sheet improvements (deleveraging) explain this performance, although new mortgage credit (in volume) is still below the highs of the years 2006-07.

# The Portuguese banking system: resilient and supporting the economy (2)

## Non financial private sector: Non-performing loans

*(%)*




## Private domestic credit

*Year on year (%)*

| | Dec 2020<br>% yoy | Dec-2021<br>% yoy | 2022 (For.)<br>% yoy |
|---|---|---|---|
| **Credit to the non-financial private sector** | **4.6%** | **2.9%** | **0.5%** |
| Households | **1.4%** | **3.3%** | **2.1%** |
| Housing mortgages | **2.1%** | **3.3%** | **3.0%** |
| Other purposes | **-1.1%** | **3.1%** | **-1.0%** |
| Consumer lending | **-0.3%** | **0.2%** | **1.9%** |
| Non-financial corporations | **10.5%** | **2.2%** | **-2.2%** |

***Source**: BPI Research, based on BoP data.*

- **Moratorium was an important supporting measure for both households and firms in this current uncertain context.** This measure was especially important to firms: **between August and October 2020, credit under moratorium reached a maximum of 34,1% of total credit for NFC. Moratorium ended at the end of 2021** for those who applied until March 2021.
- Considering the importance of this measure and the potentially negative impacts on the firms' solvency after its end, the Government decided to give a public guarantee (maximum of 25% of credit) directed towards the most affected sectors (with revenue drop of at least 15% in 2020 in comparison to 2019; firms that did not achieve the 2019 revenues level yet) and those who previously renegotiate with banks their credits (extending the grace period – without capital reimbursements - and enlarging the maturity). **Given the ample cushions in the banking system and the healthy balance sheet of households and companies compared with past situations, we don't expect a significant deterioration in NPL's due to the end of moratoria.**

# Main economic forecasts

| %, yoy | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Forecasts 2021 | Forecasts 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| GDP | -0.9 | 0.8 | 1.8 | 2.0 | 3.5 | 2.8 | 2.7 | -8.4 | 4.9 | 4.9 |
| Private Consumption | -1.1 | 2.5 | 1.9 | 2.6 | 2.1 | 2.6 | 3.4 | -7.3 | 5.0 | 4.8 |
| Public Consumption | -2.0 | -0.5 | 0.8 | 0.8 | 0.2 | 0.6 | 2.1 | 0.4 | 4.6 | 0.8 |
| Gross Fixed Capital Formation (GFCF) | -4.8 | 2.3 | 5.9 | 2.5 | 11.5 | 6.2 | 5.4 | -2.7 | 4.4 | 6.2 |
| Exports | 7.2 | 4.3 | 6.2 | 4.4 | 8.4 | 4.1 | 4.1 | -18.6 | 9.4 | 10.4 |
| Imports | 4.7 | 8.1 | 8.1 | 5.0 | 8.1 | 5.0 | 4.9 | -12.1 | 11.0 | 8.7 |
| Unemployment rate | 17.1 | 14.5 | 13.0 | 11.4 | 9.2 | 7.2 | 6.6 | 7.0 | 6.6 | 6.1 |
| CPI (average) | 0.3 | -0.3 | 0.5 | 0.6 | 1.4 | 1.0 | 0.3 | 0.0 | 1.3 | 2.2 |
| External current account balance (% GDP) | 1.6 | 0.2 | 0.2 | 1.2 | 1.3 | 0.6 | 0.4 | -1.2 | -1.1 | -1.0 |
| General Government Balance (% GDP) | -5.1 | -7.4 | -4.4 | -1.9 | -3.0 | -0.3 | 0.1 | -5.8 | -4.3 | -2.9 |
| General government debt (% GDP) | 131.4 | 132.9 | 131.2 | 131.5 | 126.1 | 121.5 | 116.6 | 135.2 | 127.5 | 123.5 |
| Risk premium (PT-Bund) (average) | 464 | 252 | 189 | 307 | 269 | 138 | 98 | 89 | 60 | 65 |

***Source***: *CaixaBank Research.*

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