Portugal:
Macroeconomic and financial outlook

BPI Research

September 2021

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Prepared with information available by September 8th, 2021

BPI Grupo CaixaBank

Main messages

Activity

- **Strong rebound in Q2 GDP.** +4,9% qoq and +15,5% yoy, but still 4,6% below the pre-covid level. The strong recovery of private consumption (+8,5% qoq and +17,5% yoy) fueled by pent-up demand was the main drive of the rebound.
- **Fully vaccinated people aged over 50 exceeds 90%.** This will be key to ease hospital pressure and restrictions more generally, allowing economic activity to pick up substantially. The current pace of vaccination would allow to reach immunization (85% of population vaccinated in order to combat the Delta variant) in mid-September.
- **Tourist activity continues anemic (non-residents), but is expected to pick up.** Airplanes departures have been increasing around 90% qoq in Q3 and progress with vaccination is expected to contribute to a strong pick-up in tourism activity in the H2 and 2022.
- **GDP is expected to reach pre-crisis levels in mid 2022** –slightly later than the main European partners, given the prominent weight of the tourism sector (which will continue to operate well below potential for some time).

Banking sector

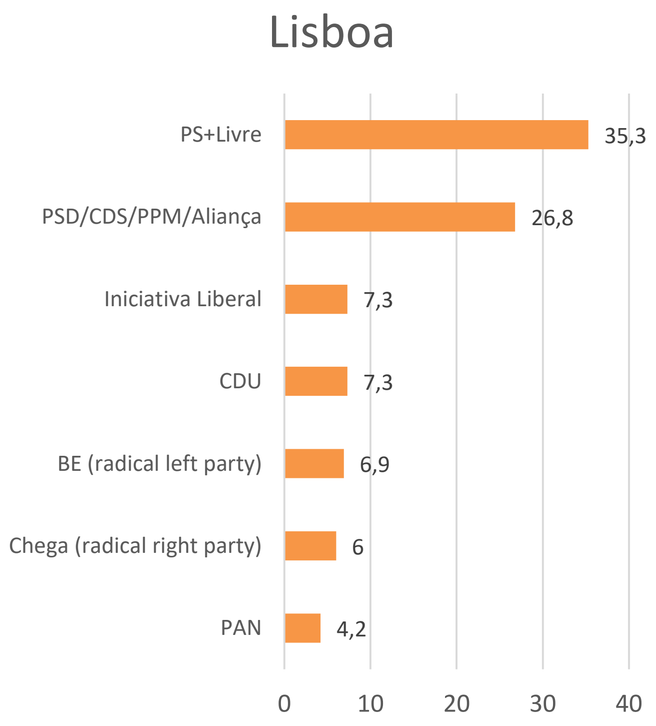
- **The Portuguese banking system has a relatively strong financial position to face the crisis and contribute to the recovery**. Credit quality improved significantly last years, but will probably return as a (moderate) constraint, specially after debt moratoria expire (September 2021) and guaranteed loans start maturing (mid 2022). However, official measures approved recently, namely the possibility of restructuring debt under moratoria, with state guarantee, a measure aimed at the most vulnerable sectors, will likely reduce the impact. So far, NPLs continue to decline and banks are building reserves to face future losses, with NPL coverage ratios at ~55%. Liquidity and solvency ratios have also been improving.

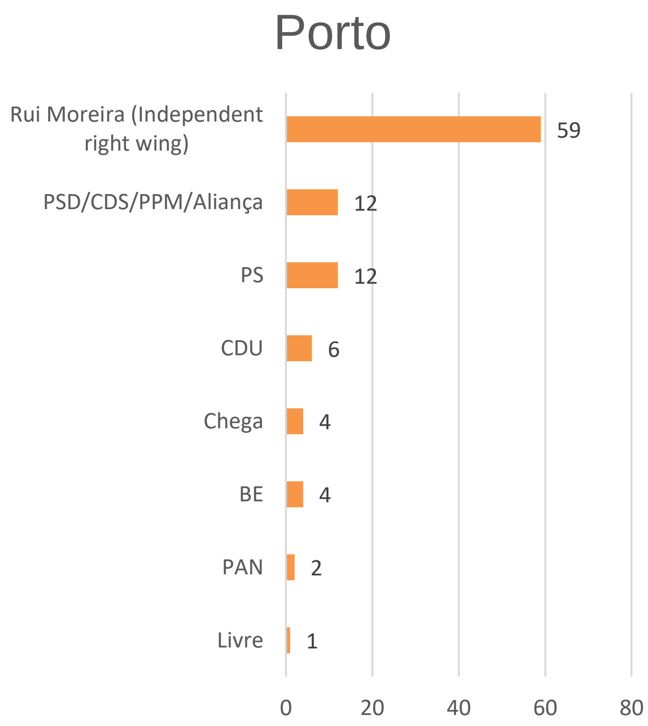
Policy

- **Domestic restrictions to mobility and activity have mostly been removed.** Since August 1st teleworking is no longer mandatory and commercial, cultural and sporting establishments start to operate according to the respective licensing hours, with the limit of 02:00am. From September 12th, the use of masks in outdoor spaces is no longer mandatory.
- **The policy response is offering a significant support to the economy** with a portfolio of direct measures, tax deferrals and public guarantees. Furlough schemes (which have been extended until end-2021) are proving very effective in cushioning the shock. These measures and the eventual need to prolong them or implement new ones (which we consider unlikely) should continue to put some pressure in the public accounts. Government estimates the fiscal deficit at 4,5% of GDP (5,7% in 2020), close to our own forecast (4,8% of GDP). In the next couple of years, the possible execution of guarantees related to the credit lines and the financial situation of state-owned enterprises could add additional pressure on public accounts. However, there is some room to accommodate potential slippage as public debt increased comparatively less in response to the Covid crises than in other European peers.
- **The Government funding needs are well covered**, helped by ECB purchases (expected to cover around 75% of financing needs in 2021), plenty of liquidity available and low interest rates. Public debt stands at 129.3% of GDP (35 pp is in ECB's balance-sheet).
- **Local elections will be on September 26th and are expected to confirm a comfortable position for the governing Socialist party.** The political outcome is unlikely to have any significant impact on political stability, as polls suggests that the Socialist party will remain the largest party in local government, continuing to control more municipal councils than any other political force.

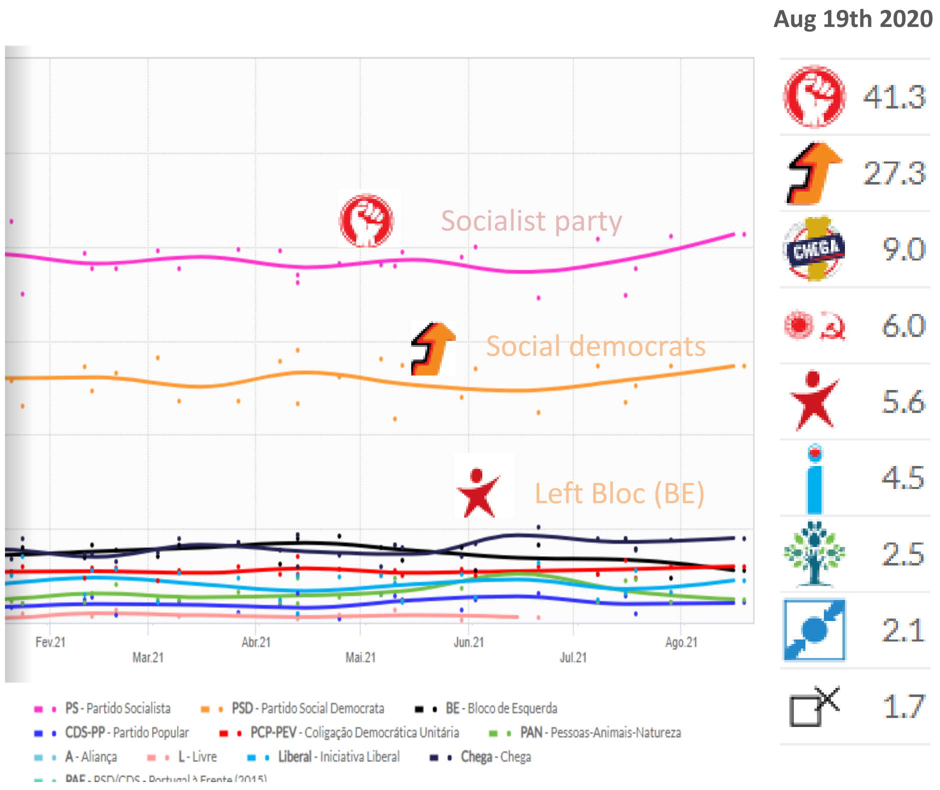
Elections for municipalities should not undermine political stability

Municipal polls major cities
Polls from end of August





Socialist Party firmly ahead in polls



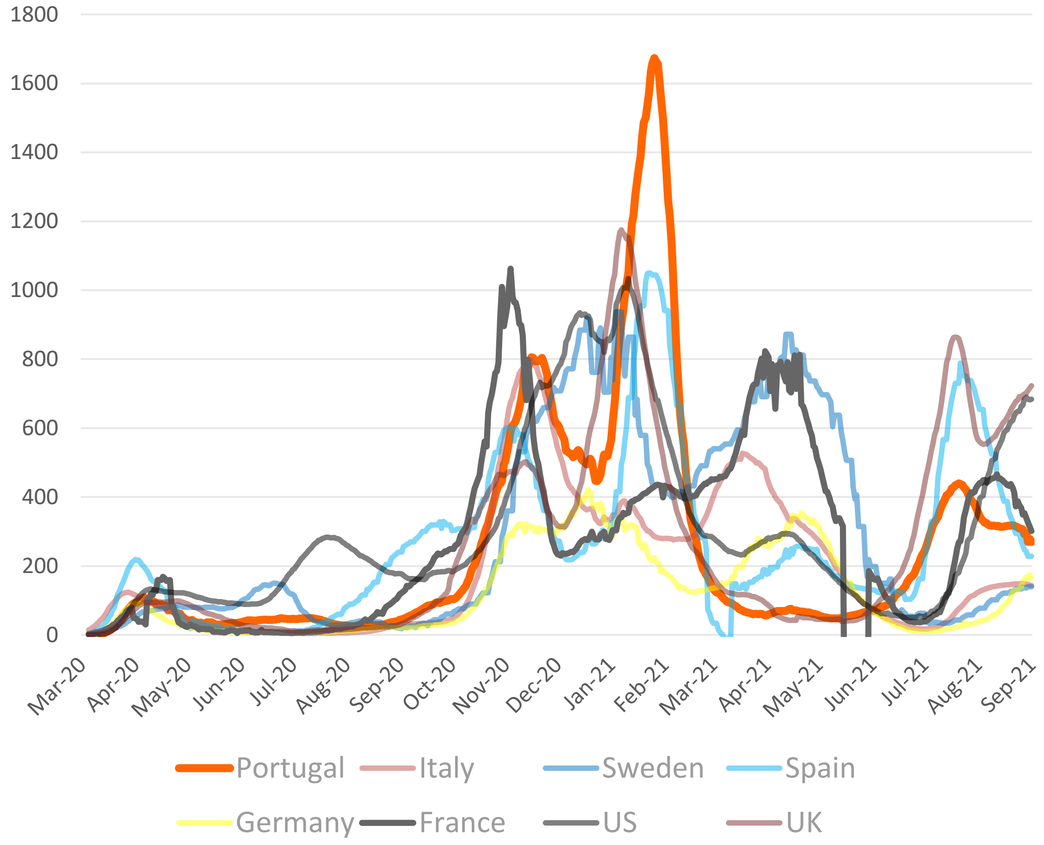
***Source**: Marktest*

- **Local elections will be on September 26th and are expected to confirm a comfortable position for the governing Socialist party**. The political outcome is unlikely to have any significant impact on political stability, as polls suggests that the Socialist party will remain the largest party in local government, continuing to control more municipal councils than any other political force. In Lisbon (capital) the Socialist candidate is expected to win with the current mayor continuing in charge. The same will happen in Porto (2nd biggest city), where the current mayor is an independent from the right wing.

Delta variant is pressuring incidence but not casualties and hospitalizations remain low

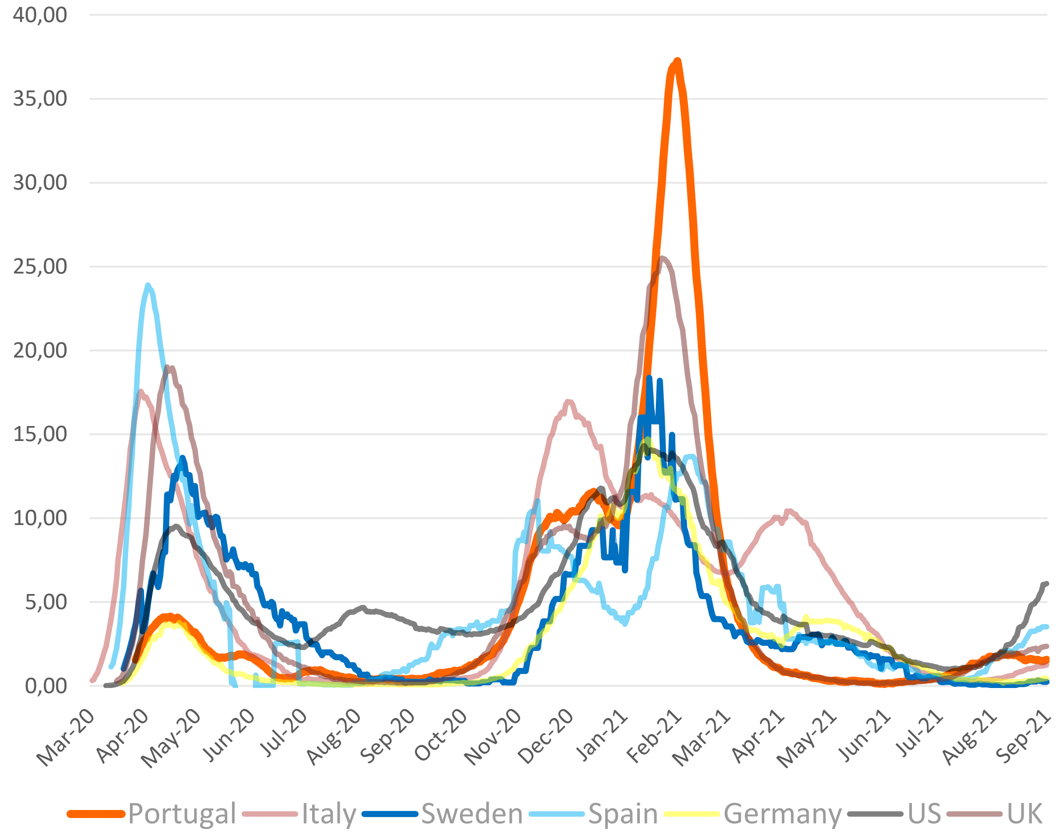
COVID-19 cumulative incidence

Infections per 100k inhabitants accumulated in 14-day



Mortality per 100,000 inhabitants

14-day moving average

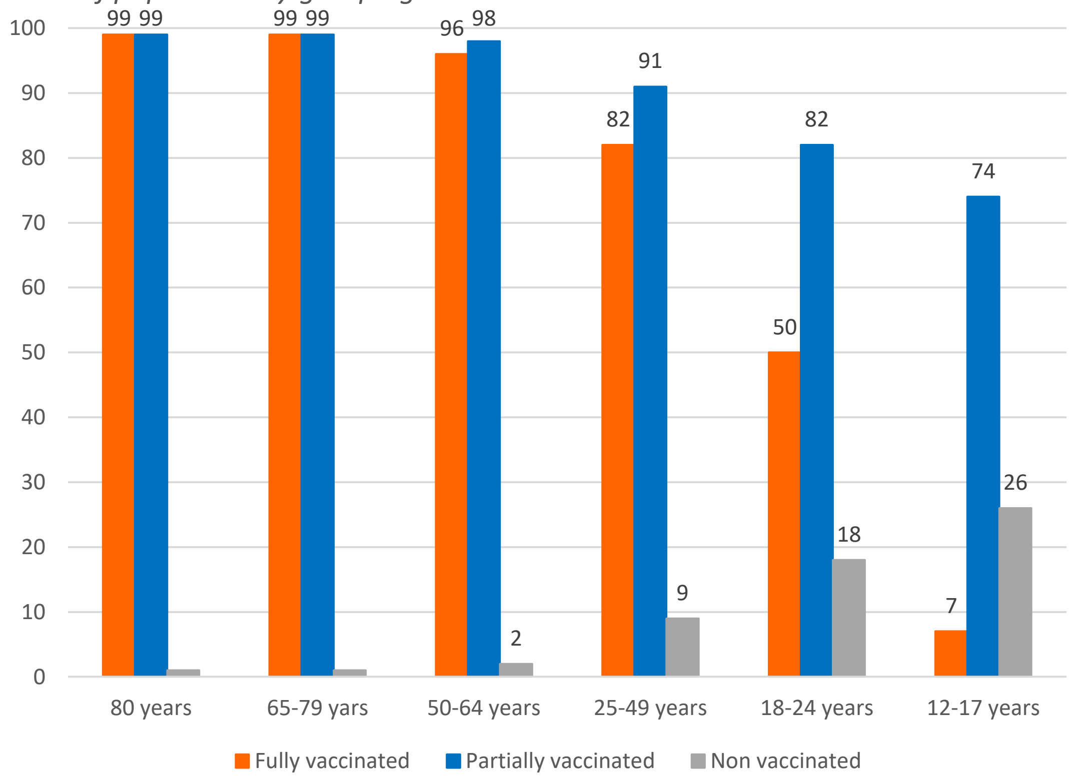


- **14-day cumulative incidence has been declining, but remains above the threshold of 120 cases per 100k set by the Government (269/100k in the beginning of September).** New infections are concentrated in the North region and the region of Lisbon (both with more than 60% of new cases).
- **Given the spreading of the Delta variant, the pace of vaccination and recent decrease in new cases, the Government continues to lift restrictions.** Since August 1st, teleworking is no longer mandatory and commercial, cultural and sports establishments start to operate according to the respective licensing hours, with the limit of 02:00. From September 12th, the use of masks in outdoor spaces is no longer mandatory.

Vaccination of high-risk groups near 100%

Vaccinated population by age

% of population by group age

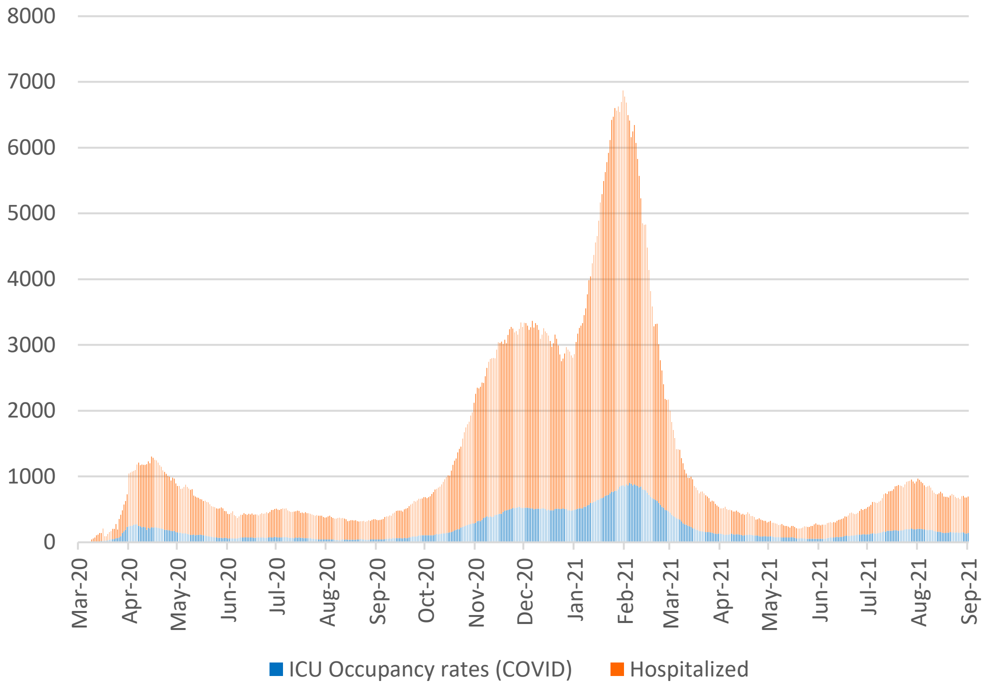


***Notes**: as of August 29th.*

Key take-away: Risk groups have already been vaccinated and inoculations are progressing fast among people below 25 years old.

Number of admissions to wards and ICE occupancy

Unit



Key take-away: The current pace of vaccination is reducing hospital pressure.

The recovery proceeds its way

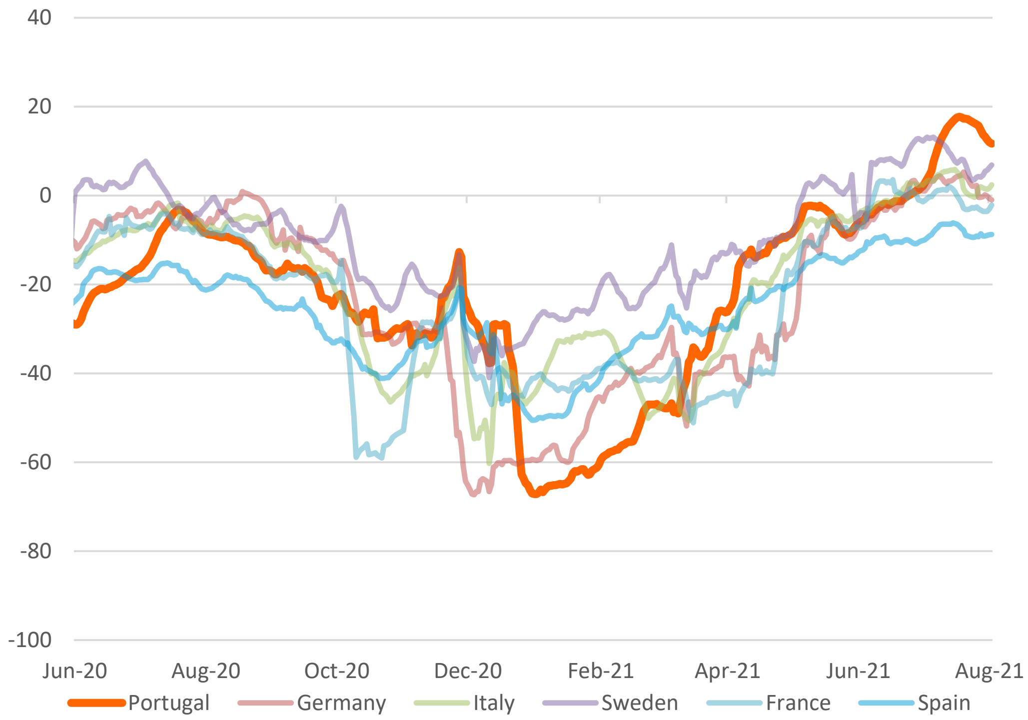
Card activity (Electronic payments + Cash operations)

Year-on-year change (%)

***Notes**: From March onwards, the yoy rate is computed using the level of the same month of 2019.*

Population mobility: to retail and recreation

Deviation from base level (%)



- The increased pace of vaccination, the favorable evolution of epidemiological data and the withdrawal of the state of alarm have had a positive impact on confidence which is already showing on a broad range of economic indicators.
- **Since May, card data has been exceeding the 2019 levels.** In July 2021, card and ATM payments exceeded in 6,7% the level of July 2019.
- **The recovery is broad-based**. The manufacturing and services turnover is improving. The manufacturing sector is already above the 2019 levels and services are seeing a strong recovery (in June it stood 6,5% below the level in June 2019, while in April and May was -11,5%). Retail sales are also above the 2019 level.

Activity monitor – several indicators are already 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
2019	-	6,5	15,1	-0,6	-0,2	-2,2	4,5	-6,1	7,9	3,5
2020	-7,7	-9,5	10,9	-30,2	-3,5	-6,9	-2,8	5,8	-61,6	-10,2
Q3 2020	-5,6	-6,2	11,8	-9,0	-0,7	-0,5	-3,0	21,2	-53,1	-3,0
Q4 2020	-5,3	-6,8	12,0	-20,0	-2,3	-2,1	-0,5	6,3	-68,5	-3,3
Q1 2021	-3,7	-11,3	10,2	-23,2	-1,4	-0,8	-8,9	2,6	-78,7	6,9
Q2 2021	-2,5	0,8	21,9	-27,2	-3,6	-5,8	2,0	4,4	-64,5	3,3
April	-3,1	-2,9	28,8	-29,8	-5,8	-3,5	0,5	4,1	-80,6	6,7
May	-2,2	1,3	11,3	-26,6	-3,9	-8,5	3,0	5,6	-62,7	-5,1
June	-2,1	4,1	25,5	-25,1	-1,0	-5,5	2,6	3,5	-50,2	8,4
July	-2,6	3,6	9,8	-33,1	-3,2	-7,5	1,1	1,6	-42,5	
August	-1,6			-35,9	-0,2					

Note: After March 2021 (inclusive), the comparisons are made with the respective month in 2019.
Q1 2021 as average of monthly 2019 yoy changes

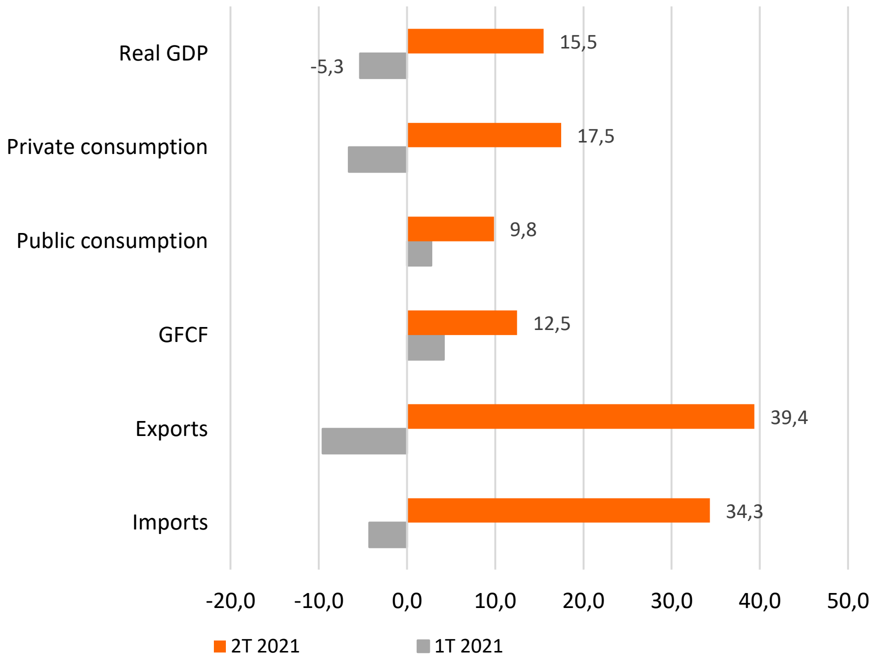
Rate >= avg. prev. quarter

Rate < avg. prev. quarter

GDP recovered strongly in Q2 and prospects remain positive

Portugal: GDP and demand components

yoy (%)



Source: BPI Research from Datastream data

Analysts' forecasts

GDP (Δ %)

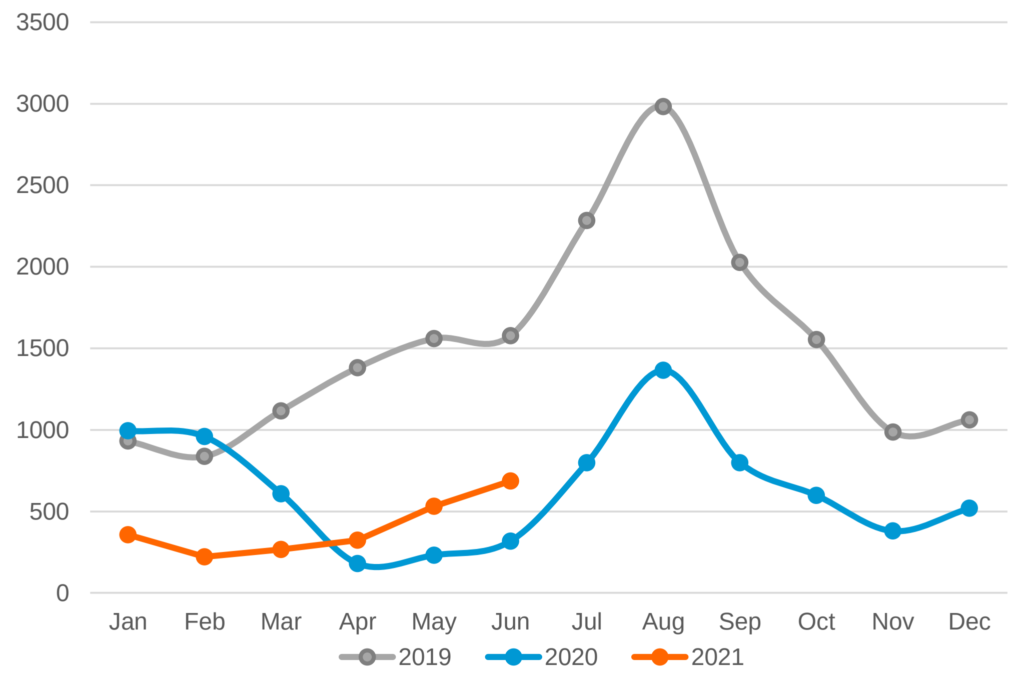
GDP (Δ %)	2020	2021	2022	Acum. 20-21	Acum. 20-22
Commerzbank (August)	-7,6	5,4	5,7	-2,6	2,9
Banco de Portugal (June)	-7,6	4,8	5,6	-3,2	2,3
Citigroup (August)	-7,6	4,1	5,9	-3,8	1,9
Oxford Economics (June)	-7,6	3,5	6,2	-4,4	1,6
EIU (August)	-7,6	4,1	5,1	-3,8	1,1
BPI Research (July)	-7,6	4,0	5,1	-3,9	1,0
Comissão Europeia (July)	-7,6	3,9	5,1	-4,0	0,9
Bank of America Merril Lynch (August)	-7,6	3,3	5,7	-4,6	0,9
Governo (April)	-7,6	4,0	4,9	-3,9	0,8
Focus Economics (September)	-7,6	4,0	4,9	-3,9	0,8
FMI (April)	-7,6	3,9	4,8	-4,0	0,6
OCDE (May)	-7,6	3,7	4,9	-4,2	0,5
Católica (July)	-7,6	3,5	4,5	-4,4	-0,1
Fitch Solutions (August)	-7,6	4,9	3	-3,1	-0,2
Capital Economics (June)	-7,6	2,5	4,5	-5,3	-1,0

- **The reduction of restrictions supported the recovery of activity in Q2 2021 and the rapid distribution of vaccines will permit the consolidation of the positive trend in the next quarters.** In addition to improvements in health situation and high accumulated savings by households, economic activity will also be supported in H2 by the start of the execution of the European recovery plan.
- Our forecasts assume that new bouts of contagion may continue to take place in the coming months, but the stress induced on the health system will be greatly diminished as the high-risk groups of population are already vaccinated. As a result, the need for more stringent restrictions will be diminished.
- GDP is expected to reach pre-crisis levels by mid 2022 –slightly later than the main European partners, given the important weight of the tourism sector.
- **Central scenario**: our main scenario sees GDP to advance 4% this year and 5,1% in the next. Uncertainty is still high and mainly related to the health situation and possibility that new more aggressive variants might emerge, but risks seem to be more balanced.

Tourism could recover swiftly as vaccination progresses

Expenditure by foreign tourists

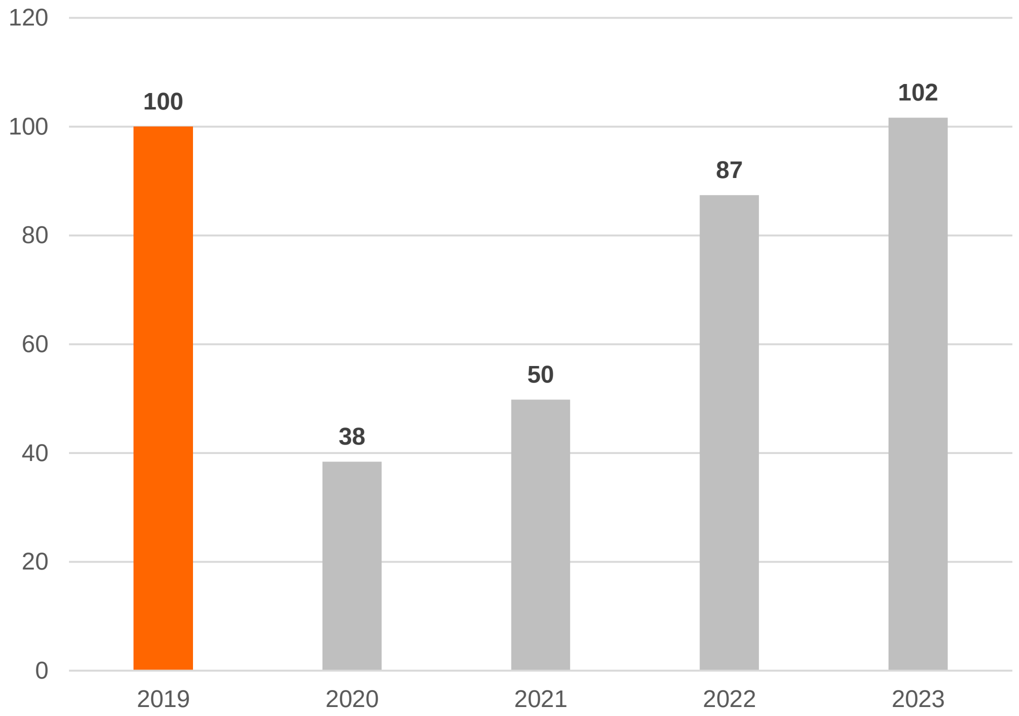
€ million



Source: INE and BPI Research forecasts..

Tourists (foreign and national)

Index (2019 = 100)

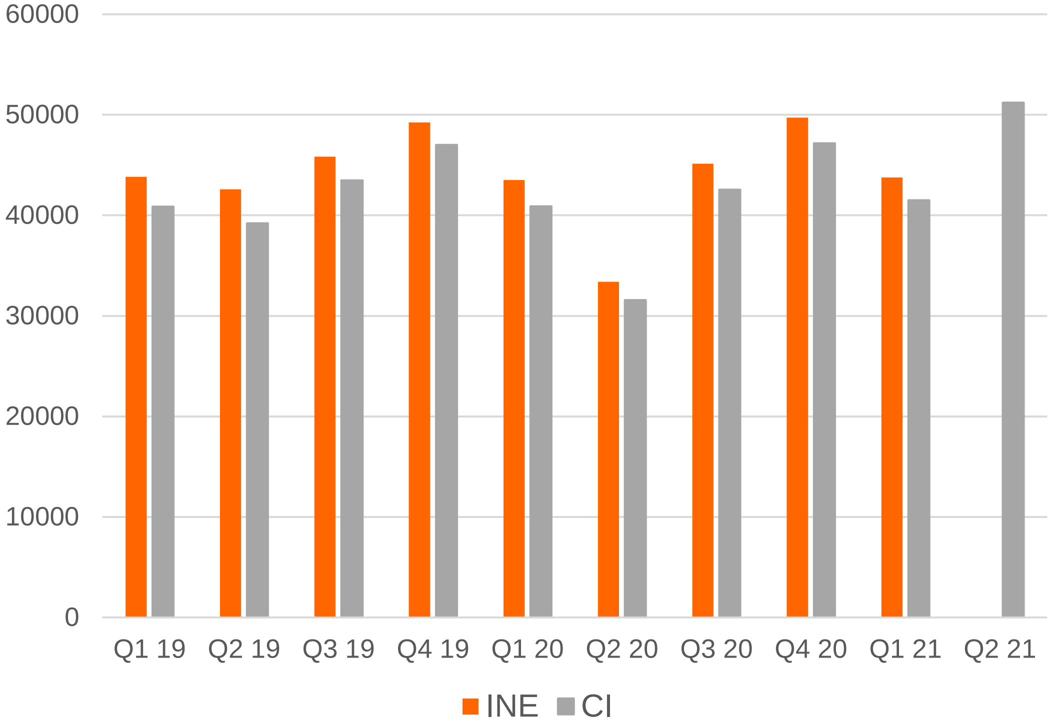


- **Tourism has been the hardest hit sector by the pandemic:** In July 2021, only 594k international tourists came to Portugal (-67% with respect to July-19). On the other hand, domestic tourism (40% of total tourism demand in pre-covid world) is showing a remarkable recovery – in July 2021 the number of stays by domestic tourists surpassed the July 2019 level. In this matter, the highlight goes to the region of Madeira where the number of resident tourist stays was 160% compared to July 2019.
- **The number of tourists is expected to increase by around 30% in 2021 from year ago levels** thanks to a significant improvement in tourism activity expected during the second half of the year.
- **Fundamentals remain strong and are followed 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 around 80% of the population already fully vaccinated. 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 European airline business.

The real estate sector: resilience and solid fundamentals

Housing Transactions

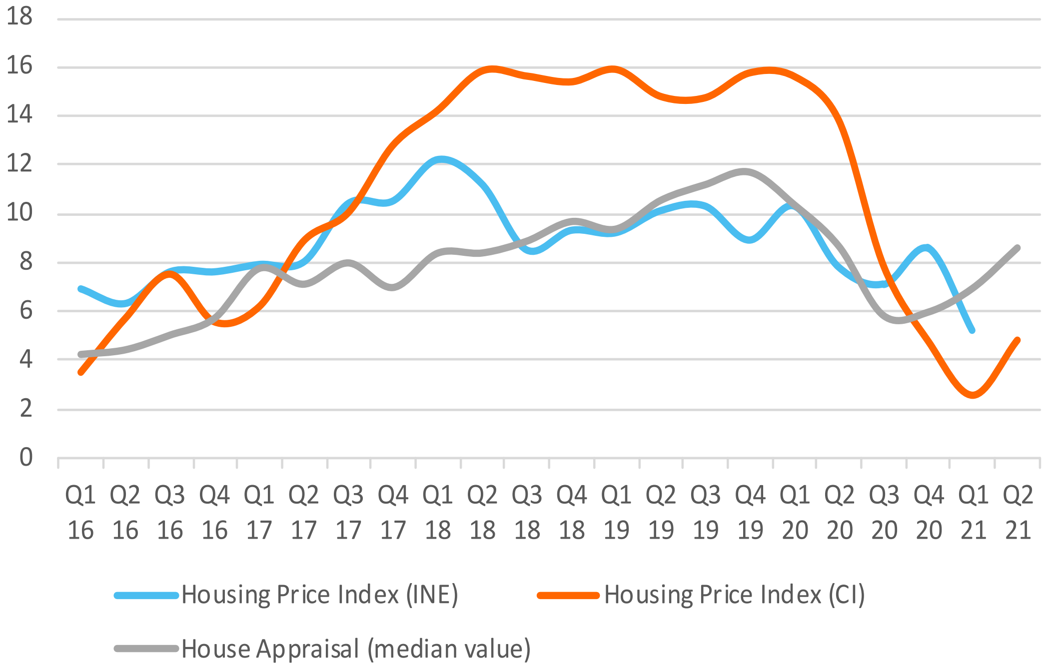
Units



Source: INE and Confidencial Imobiliário data.

Housing prices

Year on year (%)

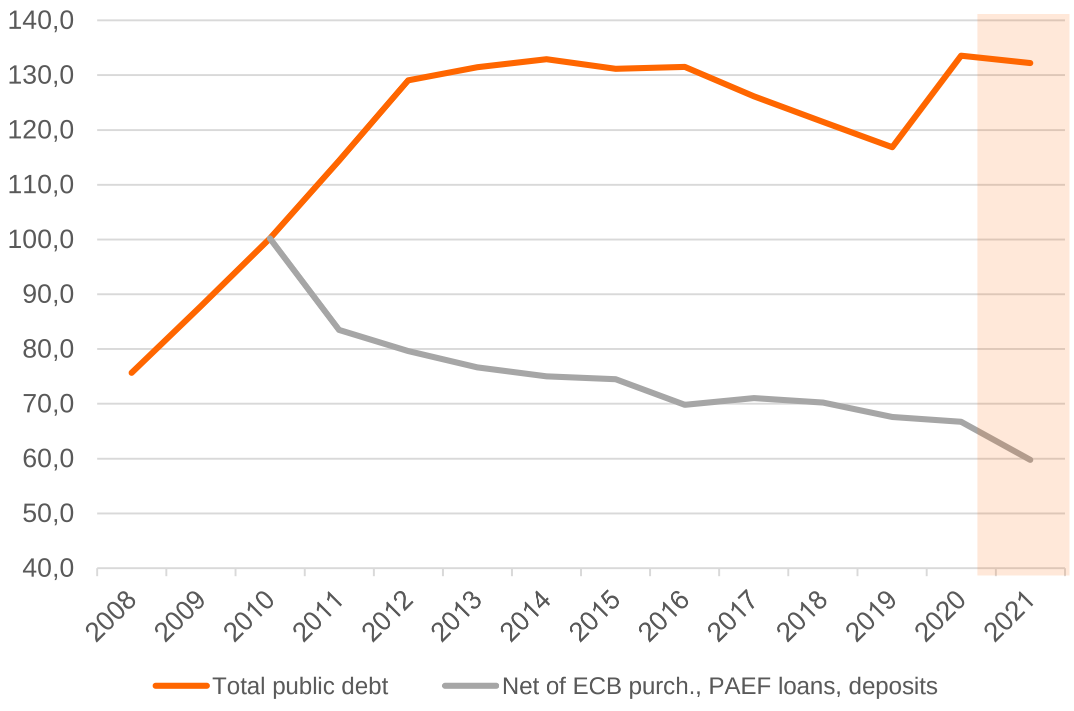


Source: INE and Confidencial Imobiliário data. *Note: Q2 2021 data refers to May*

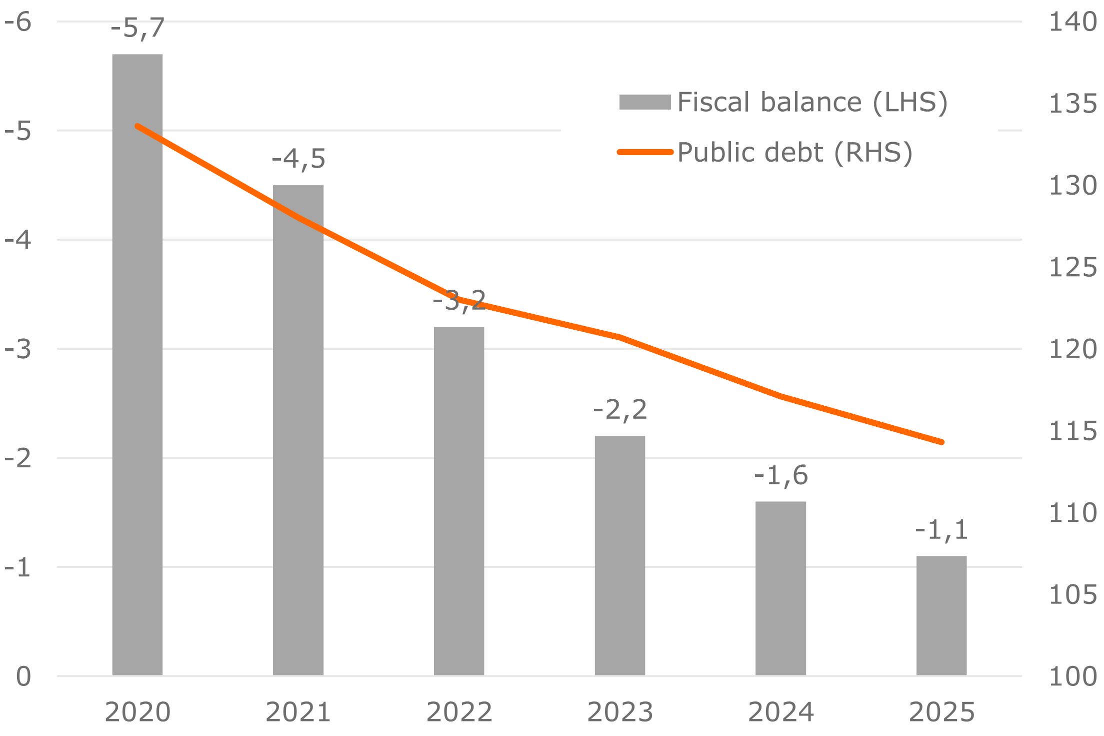
- **Housing prices continue to accelerate: according to Confidencial Imobiliário prices advanced** +0,6% mom and 5,7% yoy in July after 1,1% mom and 4,8% yoy in June. Going forward we see prices increasing on a more moderate pace, as the end of the moratoriums in September may increase supply, diminishing pressures on prices, but declines seem unlikely. Given the buoyant market we revised upwards our forecasts for housing prices to 5,7% this year from 4,3% and to 3,7% in 2022 from 3%.
- **According to Confidencial Imobiliário, 51.210 houses were sold in Q2 , the highest value since 2019.** We expect that housing demand will continue its positive trend in the coming months.
- Building permits continue well below the levels seen before the 2008 crisis (7005 in Jan-Jun 2021 vs 23.745 in Jan-Jun 2007), but are growing at a strong pace: +14% from June 2019, suggesting that pressures on prices will continue to fade away, albeit slowly.

In spite of a strong increase in public debt, funding needs are well covered

Public debt
(% GDP)



Overall fiscal balance and public debt ratio
(% GDP)

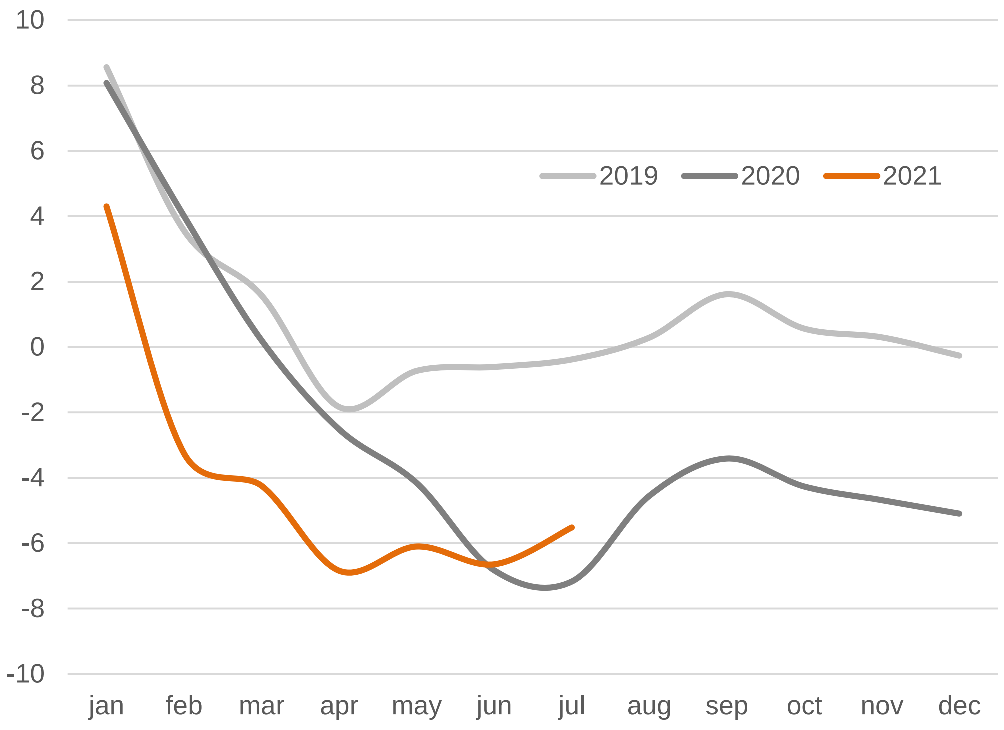


Source: ECB, Bank of Portugal, Government's Stability Report 2021-2025

- **Public debt (% of GDP) increased by 17 p.p. in 2020,** reflecting the fiscal support given to companies, families and health system. A smaller increase than in other European countries – France, Spain, Italy… - where support measures were stronger. **According to Government's forecasts, the public debt ratio will be below 2019 level only in 2025. Sustained pace of economic growth and low financing costs will be key for the achievement of these goals.**
- **The Government funding needs are well covered, helped by ECB purchases** (expected to cover around 75% of financing needs in 2021), plenty of liquidity available and low interest rates. The 2021 Government's forecast point to a 4.5% fiscal deficit (close to our own: 4.8%) and revenues from the NGEU of around 700 m€ (lower than 10% of total). 18% of total debt are EU loans linked to the Economic and Financial Assistance Program (PAEF). **Excluding deposits, EU loans and ECB purchases, public debt stood at ~59% in May 2021.**
- **Considering the impact of the lockdown period on economic activity and public accounts, the Executive revised slightly upwards the forecast for public deficit, to -4.5% of GDP, from -4.3% in State Budget 2021. According to the official scenario, the fiscal deficit will be lower than 3% in 2023, probably the year when the European fiscal rules will be again in place.**

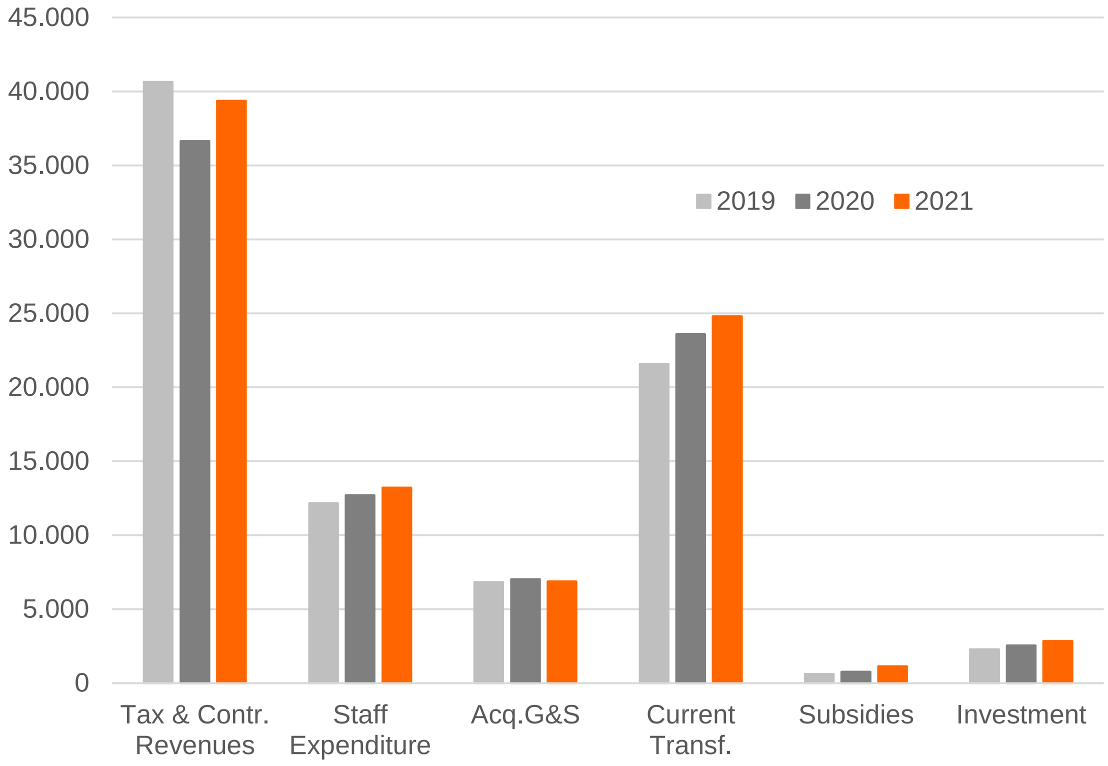
Pressure on public accounts is declining with economic revival

Public net borrowing needs (-) or capacity (+)
(% GDP)



Note: cash basis. Source: BPI Research, based on DGO figures.

Public accounts: main items
(Accumulated until July of each year)



Source: BPI Research, based on DGO figures.

- **Public deficit reached 5.5% of GDP in the first seven months of 2021**, in comparison to -7.2% in the same period of 2020. **Public accounts remain affected by the pandemic**, in particular due to **the impact of COVID measures on expenditure** (measures in the health system, measures to help firms and employment support); in 2021 **until July, these measures** (with impact on overall balance) **stood at around 2.9% of GDP.**
- **The COVID measures have impact on current transfers, which explained the majority of the increase in expenditure.** We highlight (considering the huge amount) the expenditure related to the layoff schemes, the program “apoio extraordinário à retoma progressiva da atividade” and “Apoio extraordinário ao rendimento dos trabalhadores”.

The Recovery and Resilience Plan

	Components and investments	
• **Total (8.2% of GDP 2020):** **Grants: 13,944 M€** (6.9% of GDP) **Loans: 2,699 M€** (1.3% of GDP)	**Direct to corporates: 5,000 M€ (30% of total)** • Innovation: 1,364 M€ • Industry decarbonisation: 715 M€ • Human Resources qualification: 630 M€ • Digital transition: Business 4.0: 650 M€ • Capitalization measures, Banco de Fomento: 1,550 M€ • Bio-economy: 145 M€	
• **Resilience** **11,125 M€**	• National Health Service (1,383 M€) • Housing (2,733 M€) • Social area (833 M €) • Culture (243 M€) • Corporates capitalization and innovation (2,914 M€ M€)	• Qualifications and skills (1,324 M€) • Infrastructures (690 M€) • Forest (615 M€) • Water sector (390 M €)
• **Climate transition** **3,059 M€**	• Sea (242 M€) • Sustainable mobility (967 M€) • Industry de-carbonization (715 M€)	• Sustainable bio economy (145 M€) • Energy efficiency in buildings (610 M€) • Hydrogen and Renewables (370 M€)
• **Digital transition** **2,460 M€**	• Digital school (559 M€) • Industry 4.0 (650 M€) • Efficiency of Public Finances (578 M€) • Justice, economy, business environment (267 M€) • Public administration quality (406 M€)	

Key economic measures

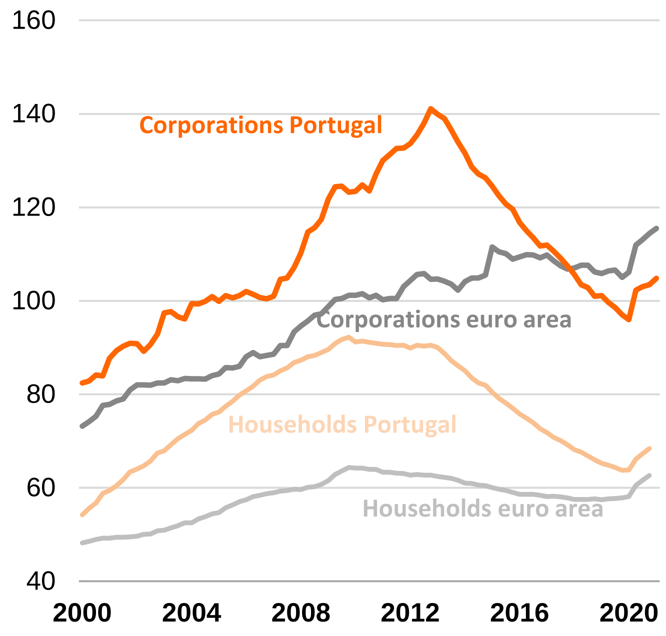
	Main measures
• Direct fiscal measures	• **Allowance of 100% of the remuneration** in case of prophylactic isolation (14 days). • **For self-employed without dependent workers,** financial support was provided if the turnover fell more than 40%**; for those with dependent workers,** the financial support was provided only if they applied for the layoff regime – minimum wage held. • **Extraordinary financial incentive** to support the normalization of the company's activity**.** • **Financial support from Social Security to pay remuneration** in cases of assistance to children under 12 years old. • **Simplified layoff**
• Deferrals	• **Mortgage and consumer credit moratoria** for families directly or indirectly affected by the pandemic. • **Exceptional and temporary scheme for the payment of housing** rent for families that have been affected by a cut in their monthly income. • **Deferral of the payment of contributions by workers.** • **For companies:** flexibility in the payment of tax obligations and reduction of social contributions; exceptional and temporary regime for the payment of non-housing rent.

• Credit guarantees and capital injections	• **Credit lines available to all sectors, especially for the most affected. The most recent lines:**
	  • **Apoiar.PT:** 750 million euros (non-repayable - grants) if jobs are kept during the period of the support, for micro and SME.
	  • **Exporting firms**: 1,050 million with state guarantee; 20% of this line may be converted in non-repayable funds, if jobs are maintained.
	  • **Cash reserve for the micro and small firms**: 750 million euros
	  • **Large companies most affected sectors**: 750 million euros
	  • **Extension of Turismo de Portugal microcredit to small companies**: 100 million euros
	  • **Credit lines reopened**: 400 million euros

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

Gross private debt

% of GDP, non consolidated debt.



Source: Eurostat

Private domestic credit

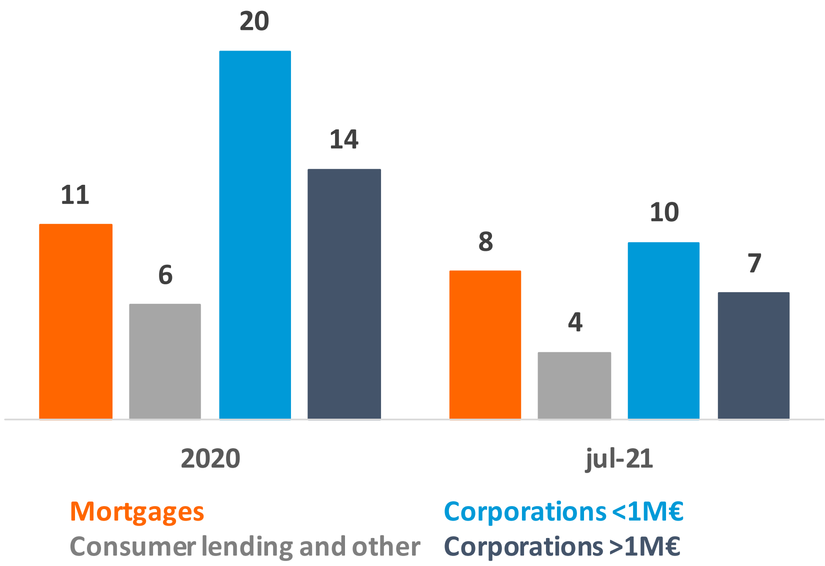
Year on year (%)

	Dec 2020 % yoy	Jul-2021 % yoy	2021 (For.) % yoy
Credit to the non-financial private sector	**4.6%**	**4.4%**	**3.6%**
Households	**1.4%**	**3.0%**	**3.9%**
Housing mortgages	**2.1%**	**1.2%**	**4.3%**
Other purposes	**-1.2%**	**9.7%**	**2.2%**
Consumer lending	**-0.3%**	**0.4%**	**2.5%**
Non-financial corporations	**10.5%**	**6.9%**	**3.1%**

Source: Bank of Portugal

New lending activity by sector

Accumulated in the year, Bn euros



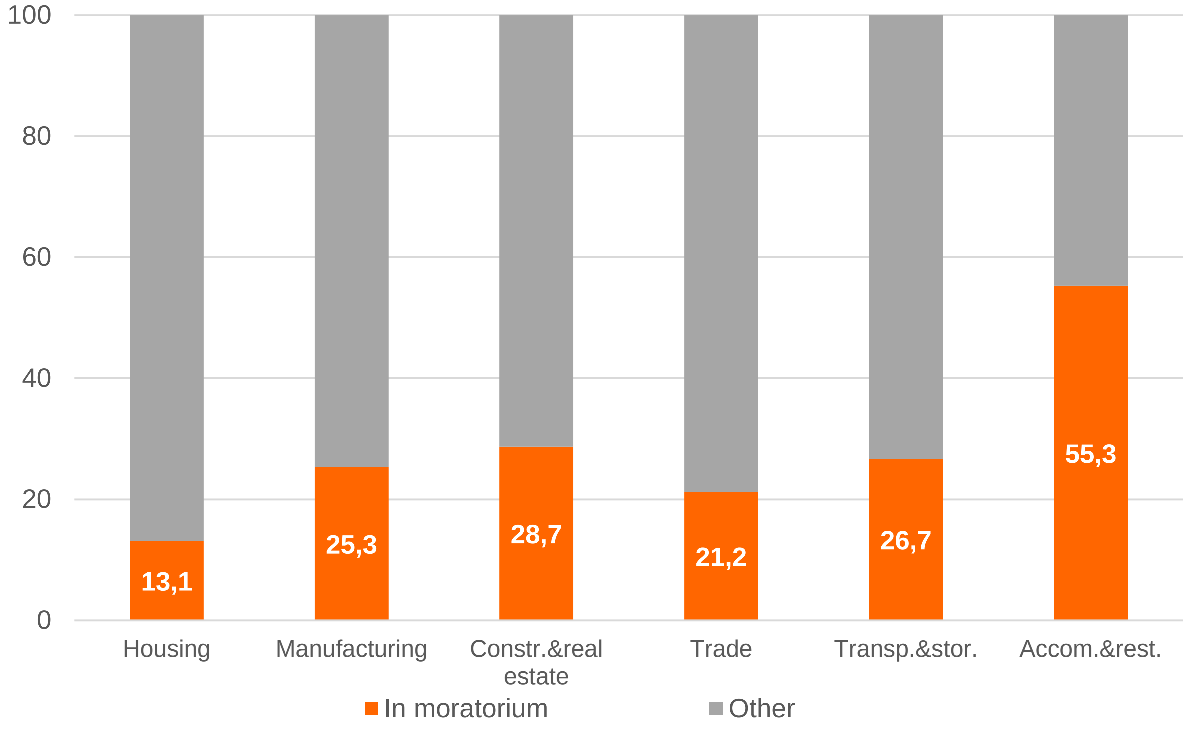
Source: Bank of Portugal

- **Corporate debt levels** remain below euro area average despite the recent pick-up in credit outstanding (mostly due to state guaranteed credit lines back in 2020). **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.
- **Up to July, new lending contracted 9.3% yoy**, reflecting the fall of new credit to NFC (-27%). The impact of state credit lines granted in 2020, which inflated new credit to companies a year ago, but also the persistence of some uncertainty related with the pandemic and the adoption of a more cautious stance by both banks and companies explain the credit decline to NFC in the first months of the year. **Data for households shows a different story: new lending in the first 7 months of 2021 increased 24.8%, due to the rise of 40.2% on mortgages**. The resilience of the housing market, favorable financing conditions, the employment-support measures and the past households deleveraging explain this performance, although new mortgage credit (in volume) is still far distant from the highs of the years 2006-07.

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

Loans in moratorium (July)

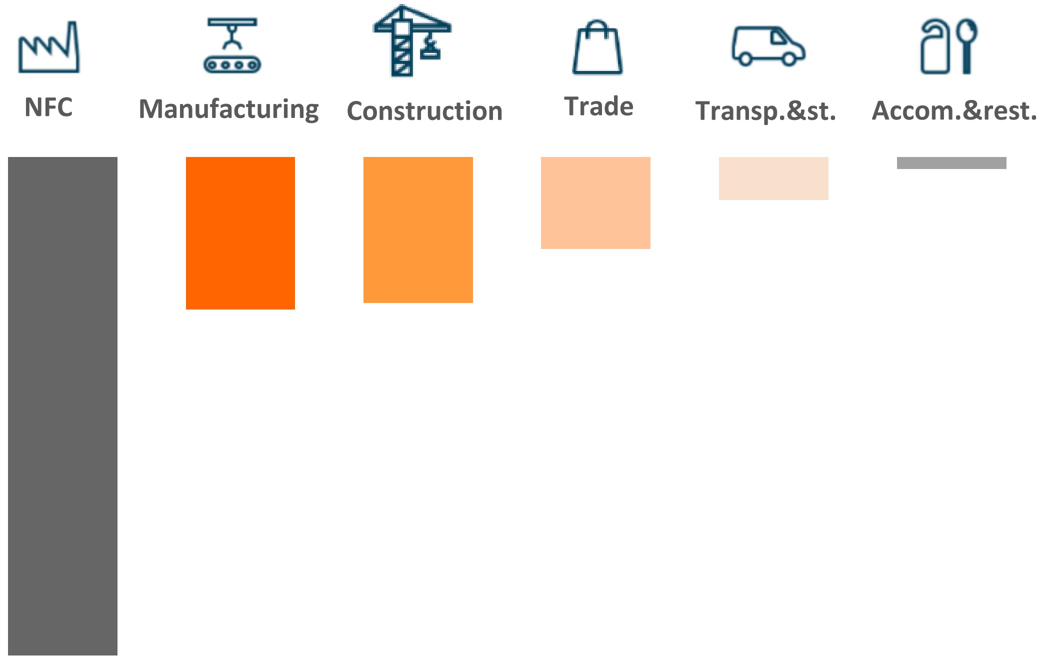
In % of stock of credit in each segment



Source: Bank of Portugal

NFC: credit moratorium, by sector (July)

Variation in comparison to the maximum (Million euros)



- **Moratorium has been an important supporting measure for both households and firms in this current uncertainty context.** This measure was especially important to firms: in July, credit under moratorium represented 28.8% of total credit for NFC (in comparison to 34.1% in August-October 2020).
- By sector, **this measure was particularly relevant for accommodation & restaurants**, one of the most affected sectors. Last July, the credit under moratorium represented more than 55% of the credit stock.
- Considering the importance of this measure and the potentially negative impacts on the firms' solvency after its end (September 2021), 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; shall not have achieved 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)

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	2,5	-7,6	4,0	5,1
Private Consumption	-1,0	2,4	2,0	2,6	2,1	2,9	2,6	-5,8	4,6	4,1
Public Consumption	-2,0	-0,5	0,8	0,8	0,2	0,6	0,7	0,4	4,6	0,5
Gross Fixed Capital Formation (GFCF)	-4,8	2,3	5,9	2,5	11,5	6,2	5,4	-1,8	5,4	7,3
Exports	7,2	4,3	6,2	4,4	8,4	4,1	3,5	-18,6	5,8	9,6
Imports	4,7	8,1	8,1	5,0	8,1	5,0	4,7	-11,9	7,5	6,7
Unemployment rate	17,1	14,5	13,0	11,4	9,2	7,2	6,6	7,0	7,0	6,9
CPI (average)	0,3	-0,3	0,5	0,6	1,4	1,0	0,3	0,0	0,9	1,3
External current account balance (% GDP)	1,6	0,2	0,2	1,2	1,3	0,6	0,4	-1,2	-0,9	-0,4
General Government Balance (% GDP)	-5,1	-7,4	-4,4	-1,9	-3,0	-0,3	0,1	-5,7	-4,8	-3,0
General government debt (% GDP)	131,4	132,9	131,2	131,5	126,1	121,5	116,8	133,6	132,2	128,0
Risk premium (PT-Bund) (average)	464	252	189	307	269	138	98	89	60	63

Source: BPI Research.