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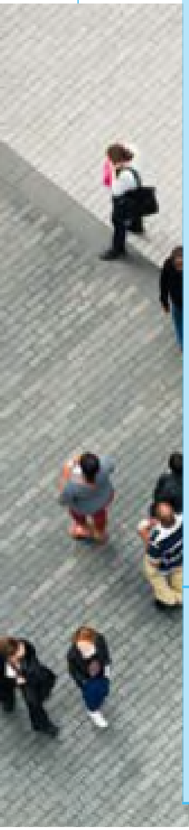
Portugal:
Macroeconomic and financial outlook

CaixaBank Research

May 2024

Main messages

CaixaBank



Activity

- **GDP advanced 0,7% qoq and 1,4% yoy in the Q1 24, above our predictions, putting upside risks to the current forecasts of a 1,6% annual growth rate in 2024**. For the rest of the year, we expect that Q2 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 RRP execution should also be key to growth dynamics in the next couple of years.
- **The global CPI stood at 2.2% in April** (2.3% in March) **and the core CPI at 2.0%** (2.5% in March). Nevertheless, looking ahead to the coming months, we can't rule out further rises in inflation: it's foreseeable that May will also see base effects in the unprocessed food and energy indices (in May 2023 they fell by -2.4% and -1.8%, respectively). Therefore, our vision continues to be one of a gradual reduction, dragged out over time, without the 2% target being reached by 2024.
- **Employment continues to evolve positively although with some less positive figures** (for example, job offers or the layoff numbers). That said, and given the more significant increase in employment and the labour force in Q1 than we had anticipated, we may have to slightly revise upwards our forecast for the unemployment rate this year.
- **Housing market fundamentals and the prospect of rate cuts set a good tone for prices at the beginning of 2024.** House prices should evolve more favourably in this first quarter than we anticipated previously (+0.5% qoq), which could lead to an upward revision of our forecast for average house price growth in 2024 (currently at 3.5%).
- **Portugal registered a surplus in the current account of 2,3% of GDP up to February, an important factor 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 external debt ratio declined 55 p.p.. In nominal terms, the external debt fell 48MM€ since 2015, to 142,7MM€ in 2023.
- **The fiscal balance registered a deficit of 0,4% of GDP in Q1** (cash basis), as expenses rose 15,1% while revenues advanced only 4,5%. In the same period **the public debt ratio rose to 100,5% of GDP,** +1,5 p.p. than in the end of 2023. The beginning of the year always brings greater complexity in the comparison with the previous year, given the different profiles for paying expenditure and/or receiving revenue, but the lack of clarity as to the main policy measures that the new government will implement (or be obliged to implement), the likely slowdown in economic activity and lower inflation in 2024 are risks for the public accounts.
- **The centre-right coalition (AD) won the elections with a low margin compared to the second largest party (PS);** hence**,** the political situation is one of the main factors of uncertainty in the internal field in the near future.
- **S&P upgraded Portugal's rating to A- last March, 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

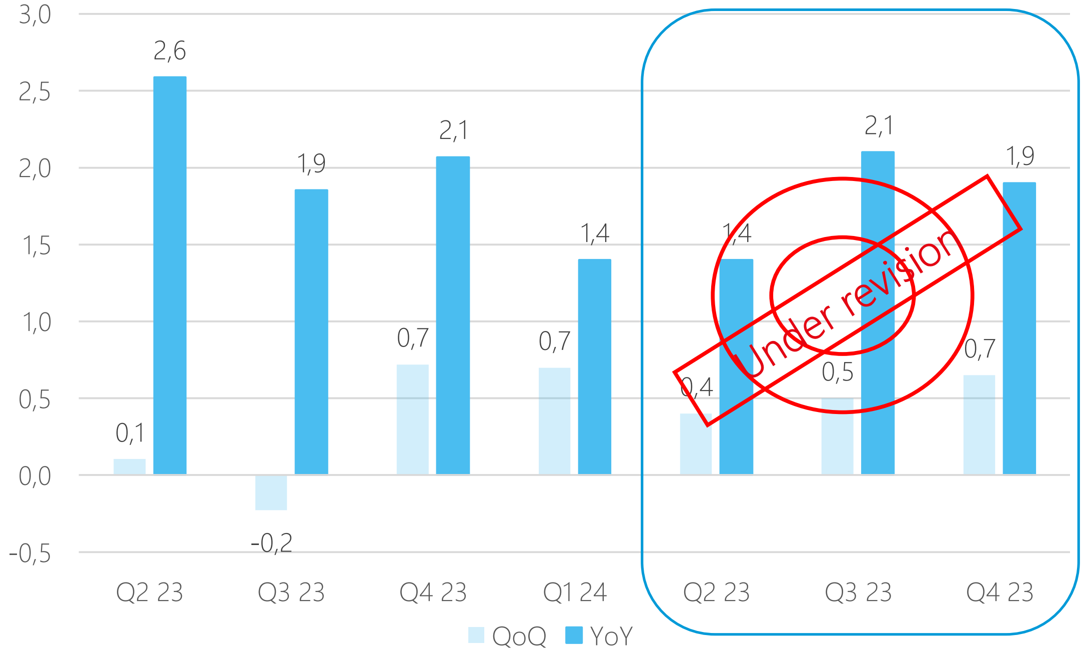
%, yoy	2016	2017	2018	2019	2020	2021	2022	2023	Forecasts 2024	Forecasts 2025
GDP	2,0	3,5	2,8	2,7	-8,3	5,7	6,8	2,3	1,6	2,3
Private Consumption	2,6	2,1	2,6	3,3	-7,0	4,7	5,6	1,7	1,0	1,7
Public Consumption	0,8	0,2	0,6	2,1	0,4	4,5	1,4	1,0	1,5	1,1
Gross Fixed Capital Formation (GFCF)	2,5	11,5	6,2	5,4	-2,2	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**: CaixaBank Research.*

Higher than expected growth in Q1

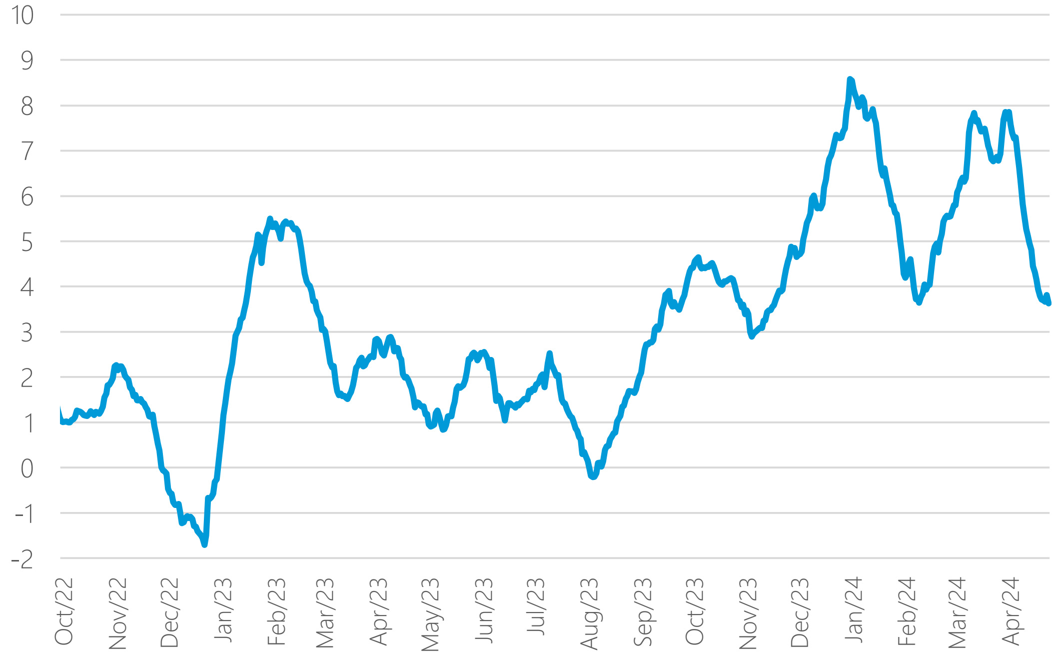
GDP: quarterly and homologous changes

%



Daily activity indicator

yoy monthly moving average (%)

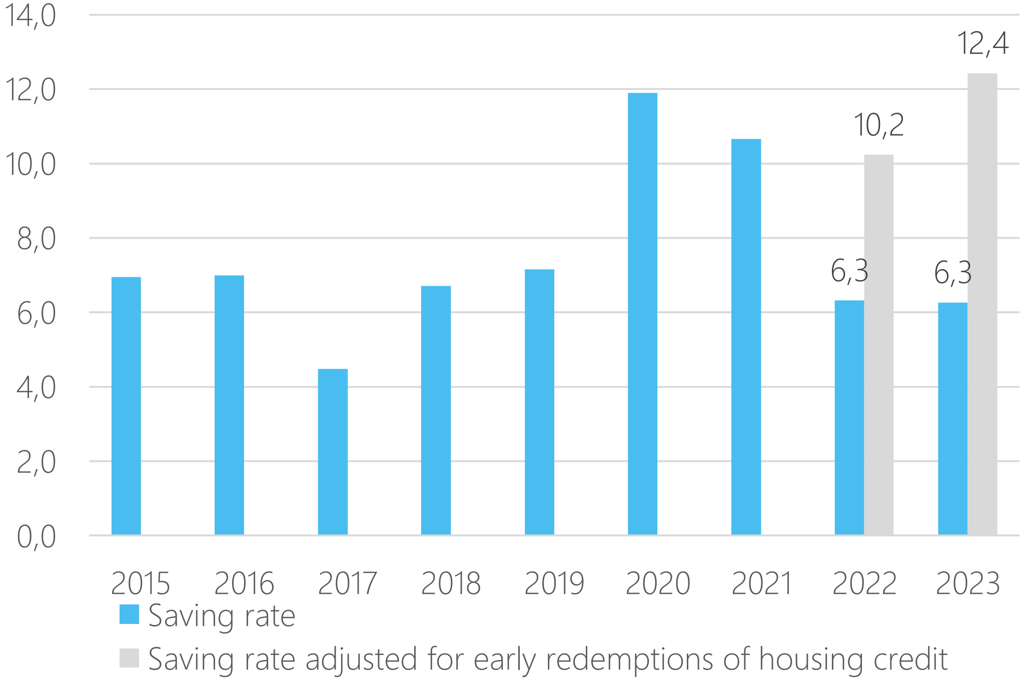


Source: CaixaBank Research, from Bank of Portugal, INE

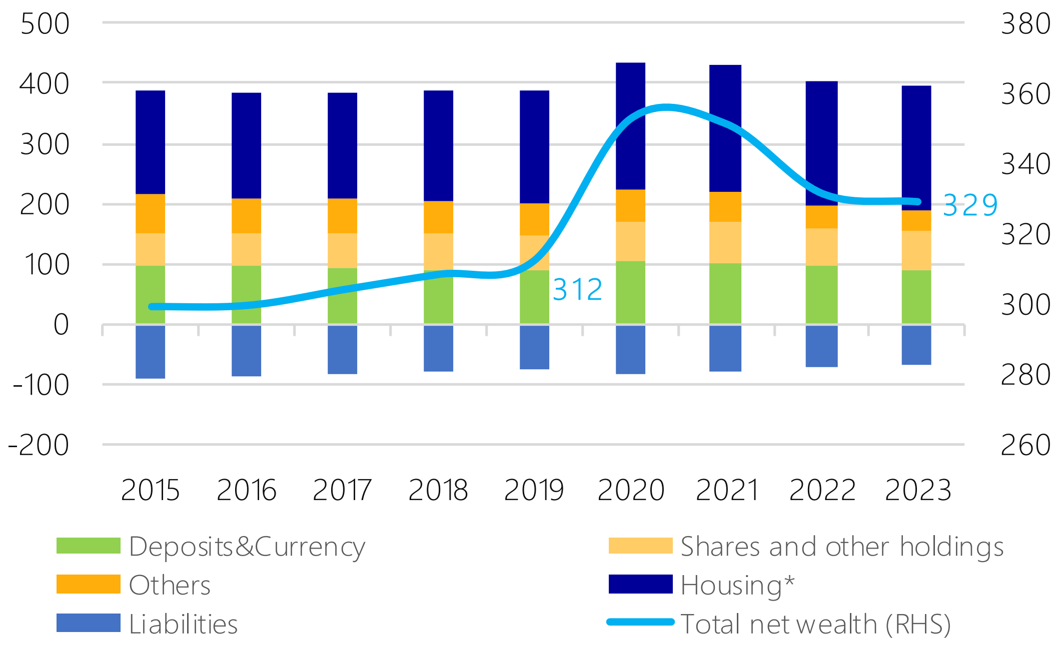
- **GDP rose 0,7% qoq (1,4% yoy), suggesting annual growth in 2024 may exceed our current forecast of 1,6%.** Preliminary data indicates that qoq growth was due to an increase of the contribution of the foreign demand, as exports decelerated less than imports. At the same time, private consumption remained resilient, but didn't growth enough to offset a qoq contraction of the investment.
- **Indicators for Q2 are still scarce,** but continue to suggest that activity continues to expand, even if at a slower pace. By one side, the daily activity indicator slowed in April to 2,2% yoy from 6,2% in Q1 and the economic climate indicator also slowed to 1,7% from 1,9% in March. But the economic sentiment indicator released by the EC accelerated again in April to 101,3 from 100,8 in March, and car sales continue to expand at robust pace: 7,9% yoy in April.

Private consumption is seen to continue to perform well

Families' saving rate
(% DI)



Families' wealth
% of GDP



*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.

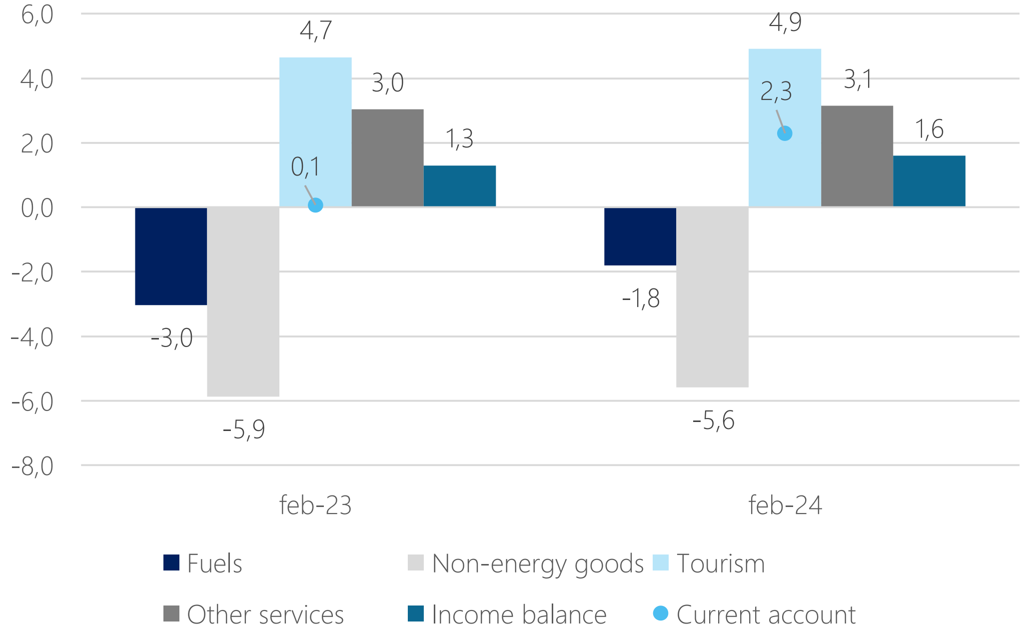
Source: *CaixaBank Research, from INE, BoP.*

- Household savings is slightly above the historical low (5.1% of DI in Q2 2008), but its recent evolution hides decisions to reduce household financial liabilities, namely through early repayment of mortgage loans. In 2023, households repaid around 11.7 billion euros of housing credit in advance, which, if it had been channelled into savings, would have brought the savings rate close to 13% in proportion of DI (disposable income). This will reduce families' future financial responsibilities, freeing up funds for consumption.
- Families' wealth improved from 305% of GDP in 2015-19 to 329% 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.
- Both savings and a better asset position should support families' sentiment and favour consumption.

The external surplus will allow the continuing reduction of external debt

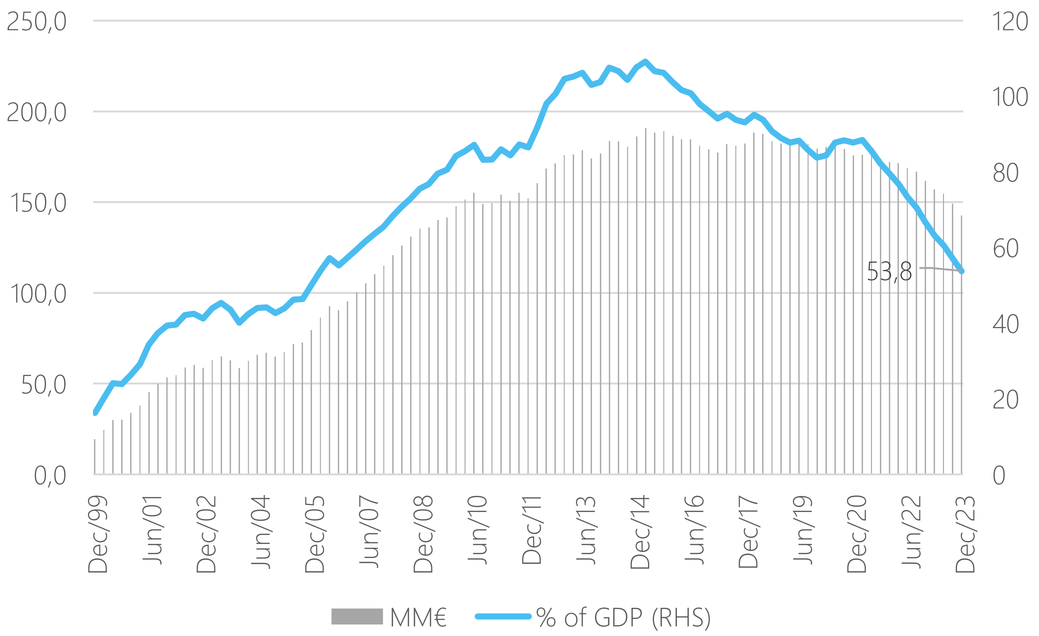
Current account up to February

% of GDP



Net external debt

MM € *% of GDP*



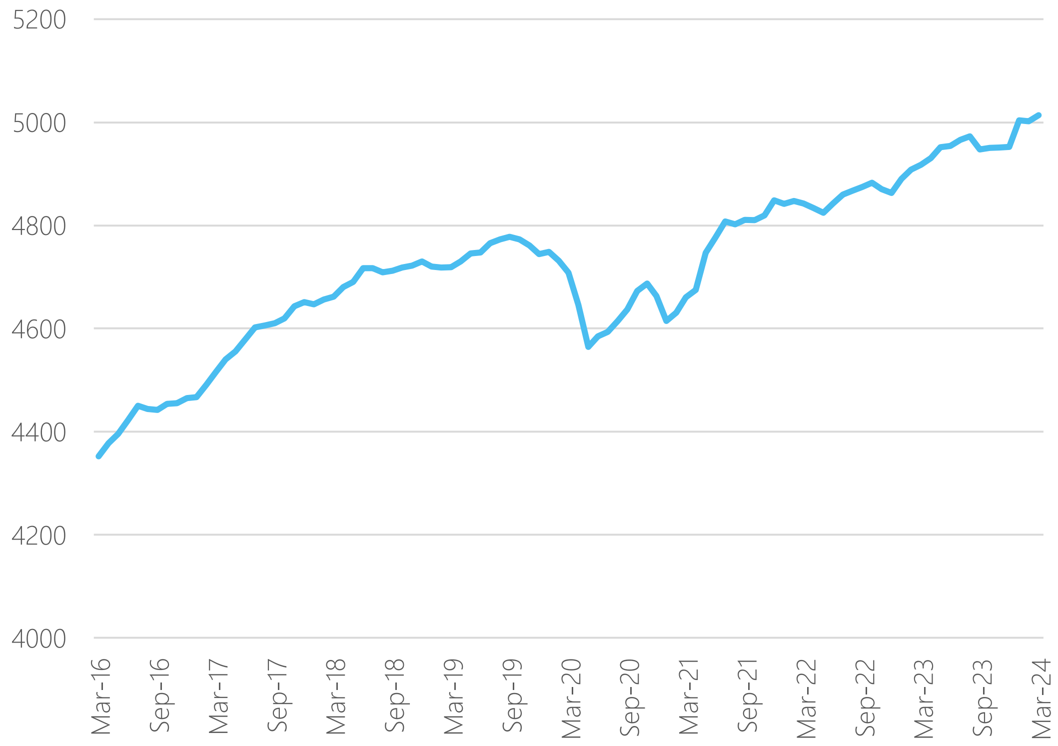
Source: CaixaBank Research, from BoP.

- **The current account started well 2024, reaching a surplus equivalent to 2,3% of the GDP in the first two months of the year.** This performance mainly reflects the decline of the deficit in the energy balance to 1,8% from 3% a year ago in line with the decline of the energy prices over the period.
- The surplus strengthened the fall in foreign debt to 53,8% of GDP in 2023 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

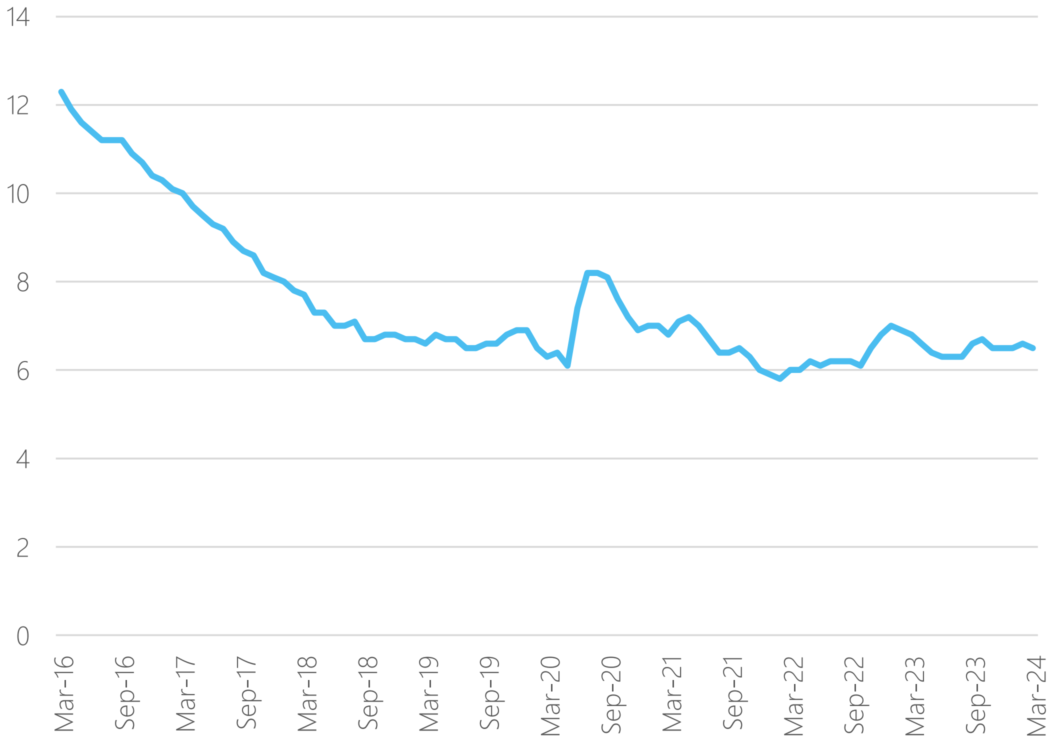
Employment

Number of individuals (thousands)



Unemployment rate

% of active population



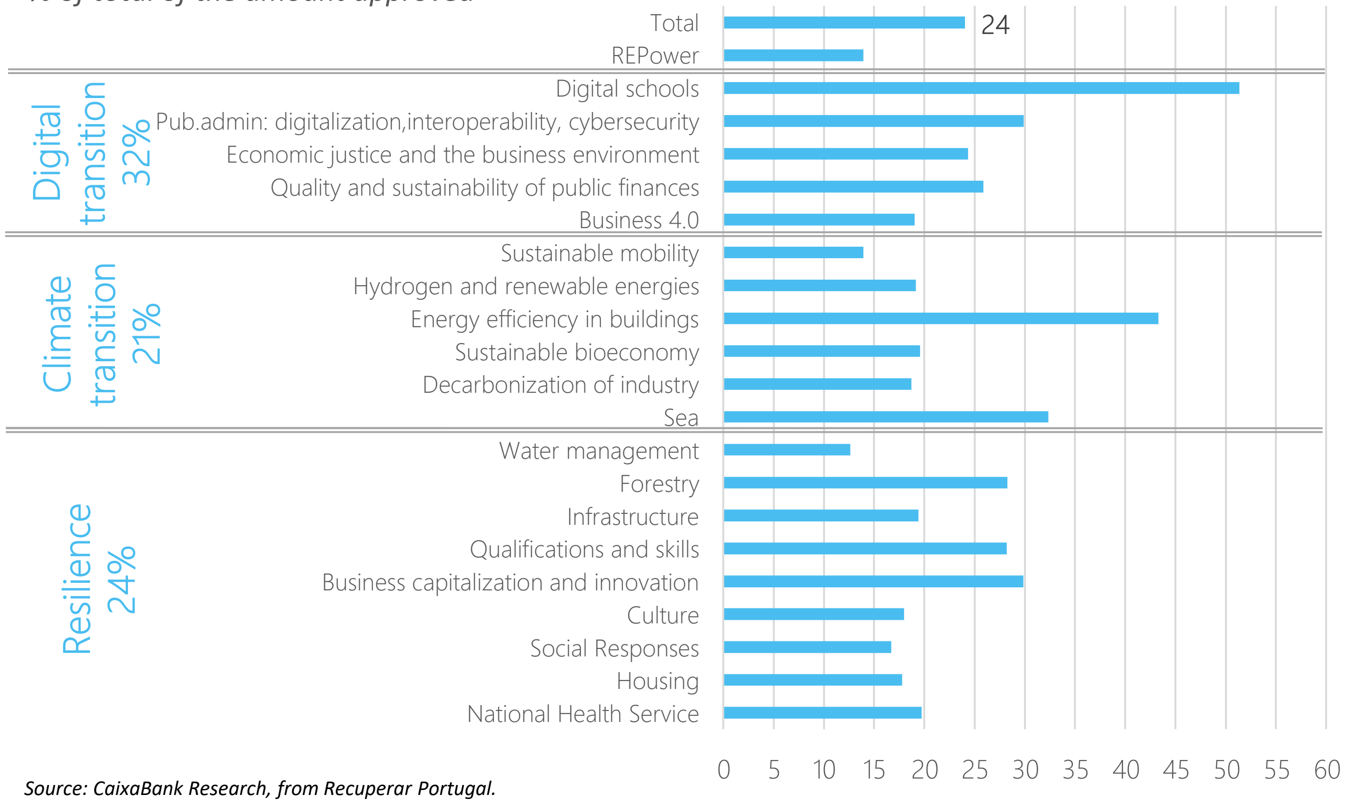
Source: CaixaBank Research, from INE.

- **Employment continues to evolve positively year-on-year.** In the first three months of the year, employment grew 2,1% on average, very similar to that recorded for the whole of the previous year (≈2%) and higher than in Q1 2023 (1,3%). With more than 5,0 million people employed, this is the highest figure in the historical monthly series.
- **The unemployment rate stabilized at 6,5% in March for the fifth consecutive month**, and continues to compare favorably with the same month last year and with the historical record (for example, the average unemployment rate recorded in the months of March of the 5 pre-pandemic years was 8,6%). Reinforcing these figures, unemployment registered at job centers fell for the second time month-on-month in march.

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

Payment rate up to March 27th

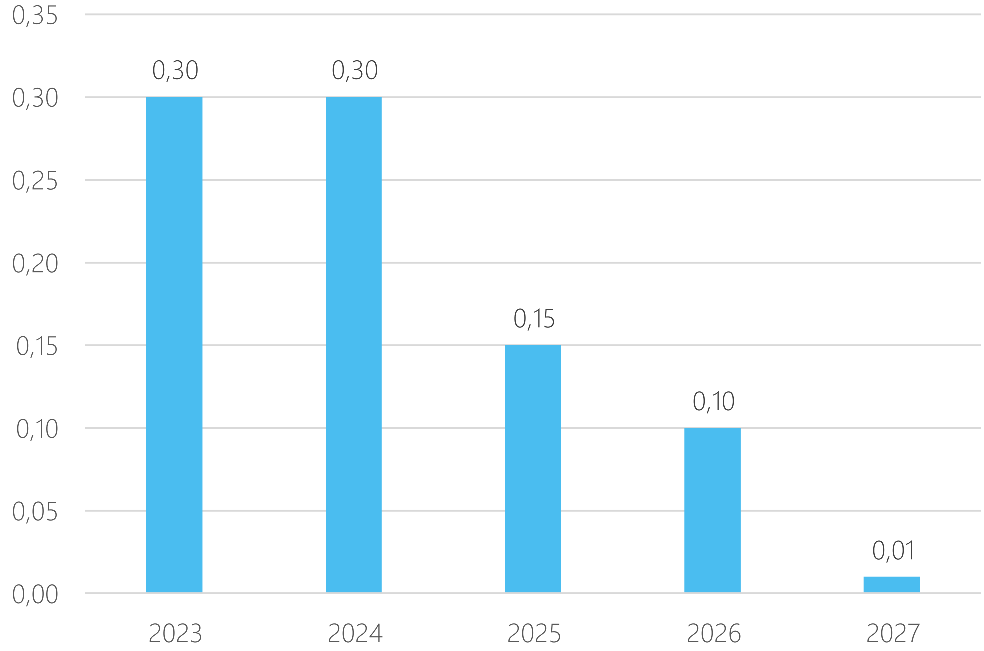
% of total of the amount approved



Source: CaixaBank Research, from Recuperar Portugal.

RRP: own estimates for contribution for real GDP growth

p.p.

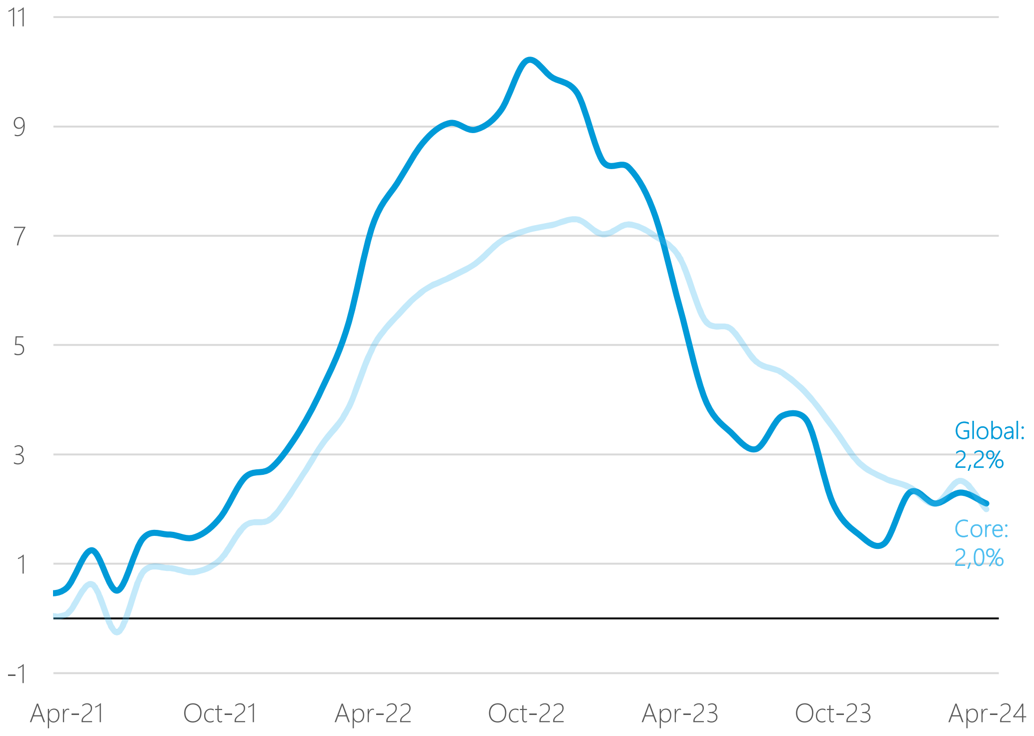


- **Up to the end of 2023, Portugal received 7,7 billion euros, equivalent to 35% of the total amount of the RRP**. In 2024, it should be received an additional 4,8 billion euros, that may suffer delays due to the Government transition.
- **Projects already approved amount to 17,7 billion euros (80% of the total amount) and payments reached 4,2 billion,** representing 24% of the approvals and circa 55% 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.**

Core inflation resumes downward trajectory in April

Portugal CPI: Global & Core

Year-on-year (%)



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

Energy CPI

Year-on-year (%)

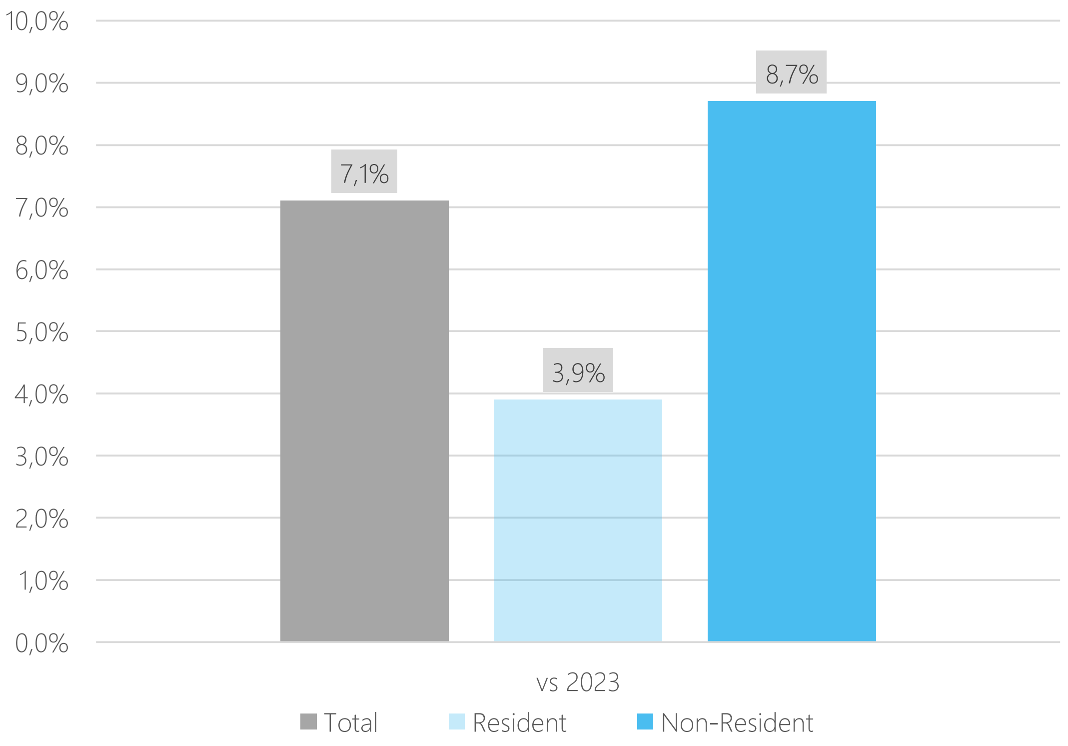
***Source**: CaixaBank Research, using data from INE.*

- **Last April, global CPI stood at 2,2% (2,3% in March) and the core CPI at 2,0% (2,5% in March).** This is a very slight drop and reinforces the dragging nature of the disinflationary process. The most favorable news for the index in April stems from the return to a downward trend in underlying inflation after the halt in March (which interrupted twelve consecutive months of decline).
- **April inflation dynamics was also affected by the base effect in energy products (there had been a significant reduction in prices in April 2023, specifically a month-on-month change of -3,2%).** It was already expected that energy would not support the fall in inflation in 2024, but the behavior, especially of Brent, has been more unfavorable than expected by the end of 2023.

Tourism: overall positive Q1 supported by the Easter season

Overnight stays

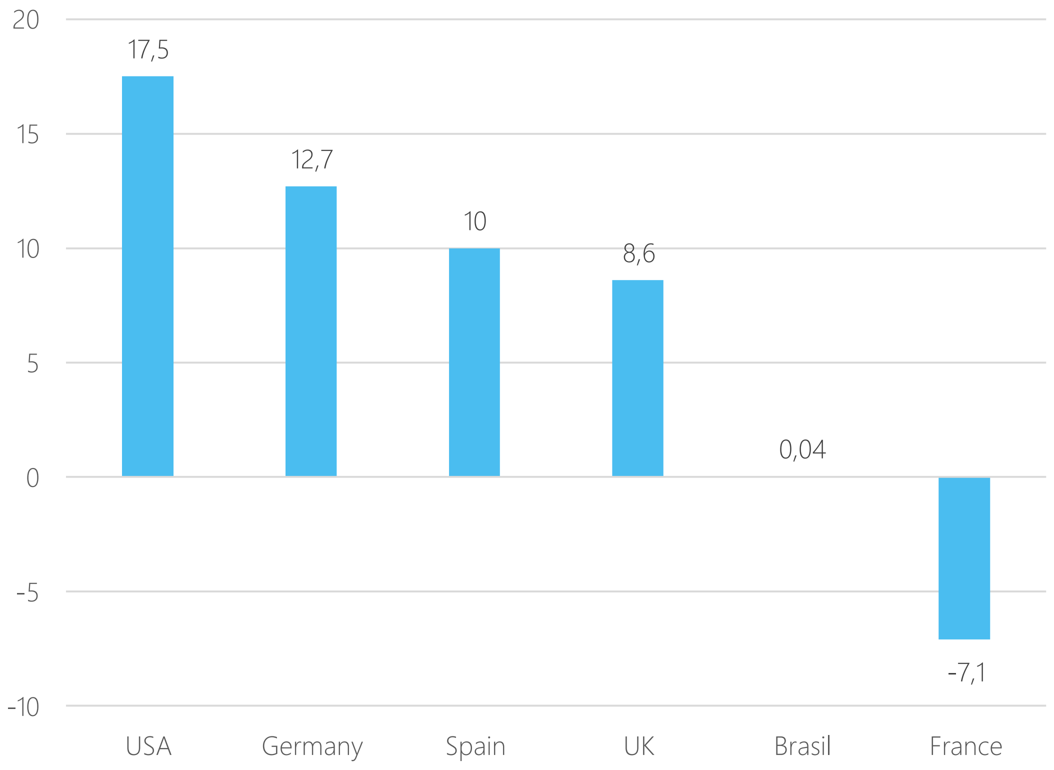
Change in Q1 2024 versus Q1 2023 (%)



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

Growth in the number of non-resident tourists (main markets)

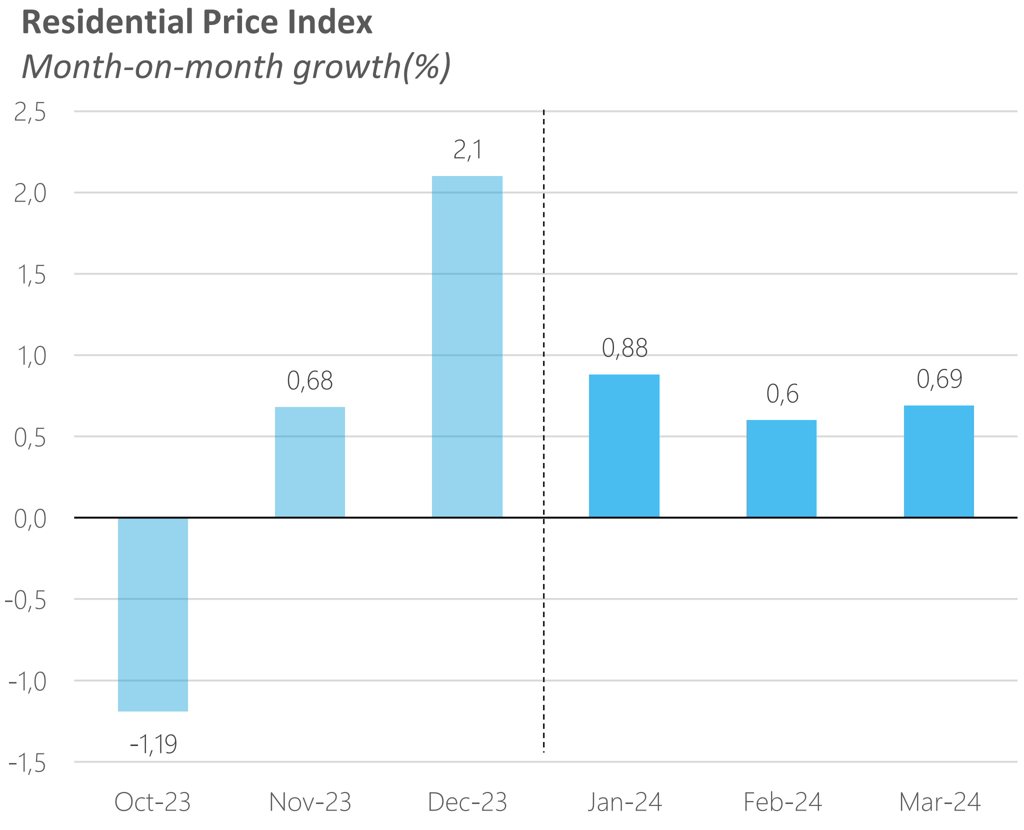
Change in Q1 2024 versus Q1 2023 (%)



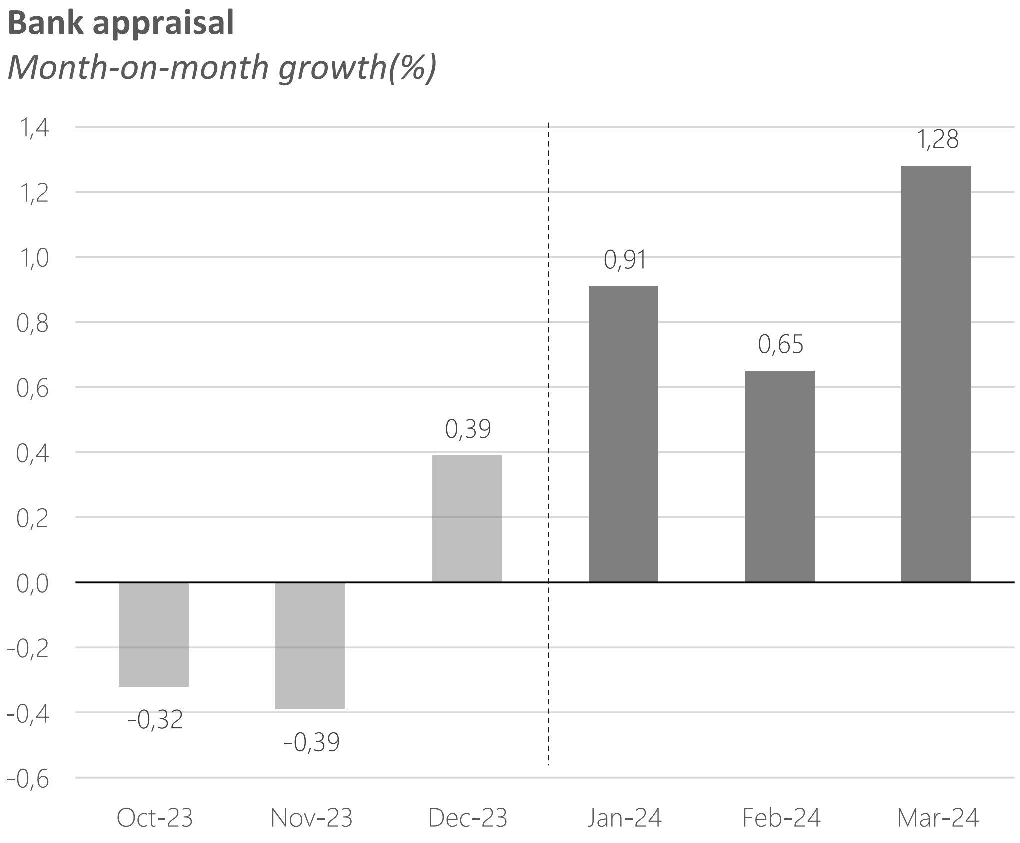
***Source**: CaixaBank Research, using data from INE.*

- **In the first three months of the year, there were 5,5 million guests and 13,4 million overnight stays in tourist accommodation establishments.** In part, this good performance was influenced by the moving structure of the calendar, i.e. the effect of the holiday period associated with Easter (this was spread between March and April and in 2023 it only took place in April).
- **Growth was stronger among non-residents (+8,7% of overnight stays) compared to residents (+3,9% of overnight stays).** With regard to the nationality of non-resident tourists (from the main source markets), those from the USA continue to stand out (an increase of 17,5 %) and kept the trend of recent years. The German market performed well, the Brazilian remained stable and the French market declined. Outside the main inbound markets, tourists from Canada stood out (up 29,6%).

Resilient housing prices in early 2024



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



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

- **In the bank appraisal released by INE, March saw the most significant monthly increase in the median value/m2 since January 2023 (+1,28%, which corresponds to +20 eur/m2, to 1.580 euros).** Compared to the end of last year, the median value of bank appraisal increased by 2,9%. Confidencial Imobiliário's residential price index also signals increases: despite more contained monthly variations, the index rose by 2,2% compared to the end of 2023.
- **Sales and prices expectations in a 3-month horizon, as published by Confidencial Imobiliário, have also been recovering in the first few months of 2024**. The fact that rates on new mortgage loans for housing have been falling for five months and that the ECB is likely to cut official rates in the middle of this year are setting the tone.

Fiscal balance entered in a small deficit in Q1

Key items in the public accounts

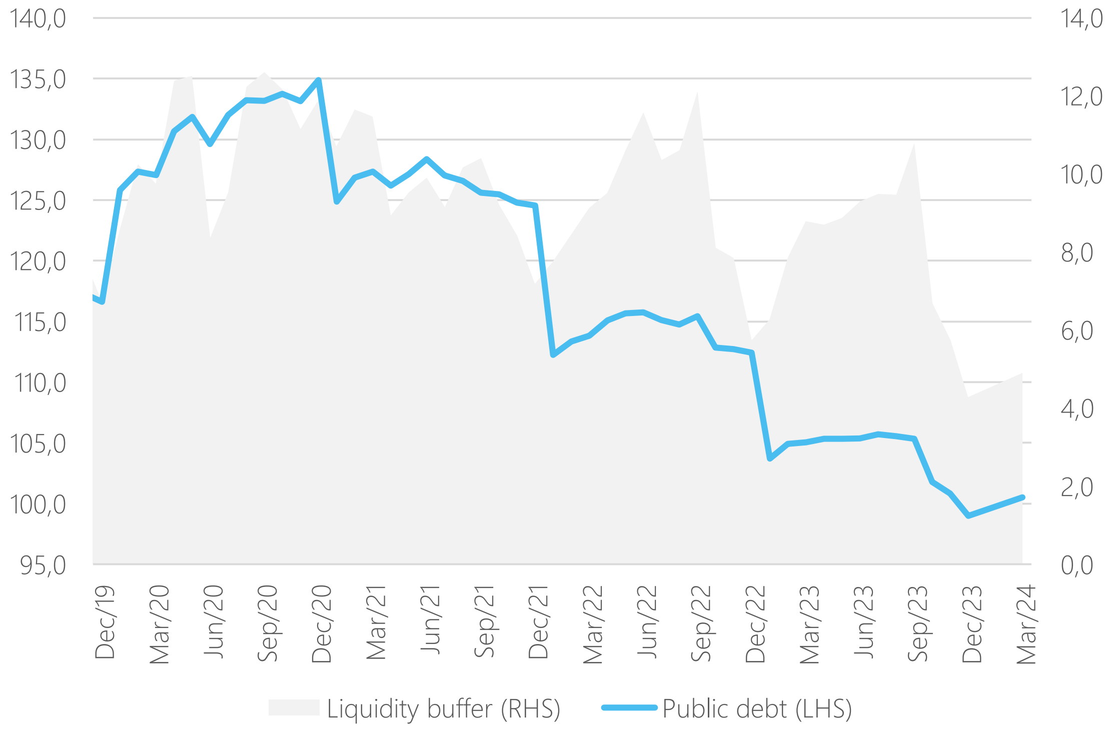
% of GDP

January - March	2023	2024	yoy change p.p.	yoy change million euros
Current revenue	35.2	36.7	1.5	976
Tax and contributory revenue	30.1	31.0	0.9	606
Capital revenue	1.0	1.1	0.1	47
Total revenue	**36.2**	**37.8**	**1.5**	**1,023**
Personnel costs	8.3	9.0	0.6	430
Current Transfers	15.0	18.4	3.4	2,268
Acquisitions of Goods and Service	4.7	5.1	0.3	227
Interest	2.0	2.1	0.1	78
Investment	1.9	2.0	0.1	64
Total expenditure	**33.2**	**38.2**	**5.0**	**3,322**
Primary Current Expenditure	**31.2**	**36.0**	**4.9**	**3,244**
Overall Balance	**3.1**	**-0.4**	**-3.5**	**-2,299**

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

Public debt ratio and the liquidity buffer

% of GDP; bln EUR

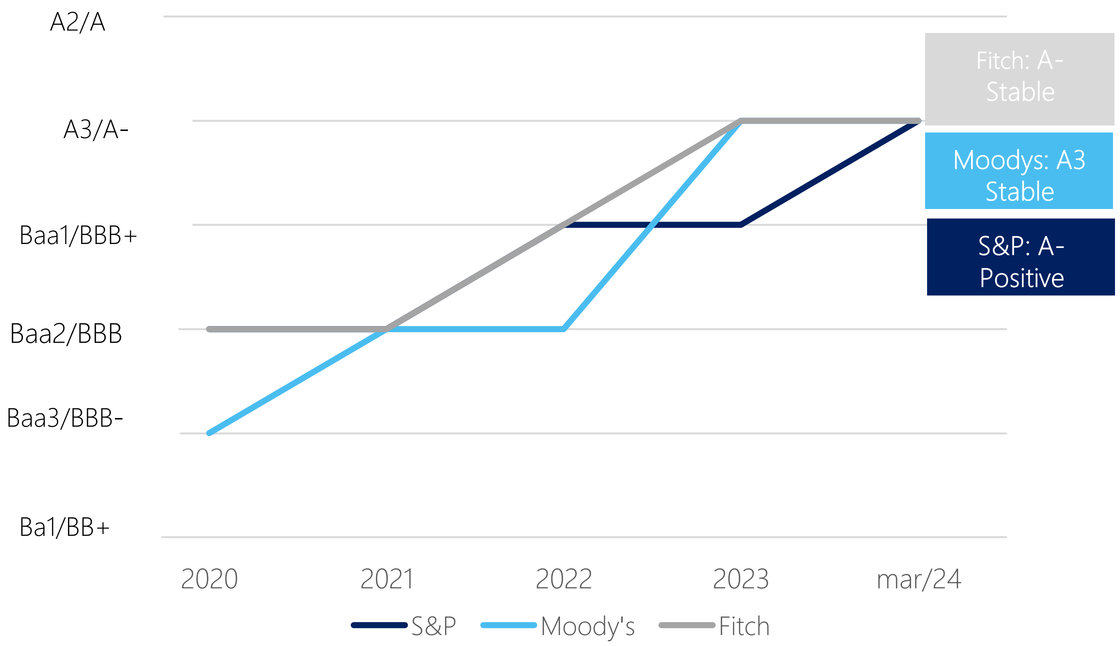


- **On a cash basis, the public sector reached a deficit of 0,4% of GDP in Q1,** with revenues advancing 4,5% and expenses 15,1%. The beginning of the year always brings greater complexity in the comparison with the previous year, given the different profiles for paying expenditure and/or receiving revenue. Added to this is the lack of clarity as to the main policy measures that the new government will implement or be obliged to implement. In this context, it is important have in mind that the likely slowdown in economic activity and lower inflation in 2024, together with other pressure factors (such as the maintenance of financing costs at still high levels) are risks for the public accounts.
- In Q1, public debt increased to 100,5% of GDP, plus 1,5 p.p. than in the end of 2023.

Portuguese rating performance emphasizing improvement in external liquidity risks

Rating evolution

level



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

Macroeconomic scenario S&P vs BPI

%

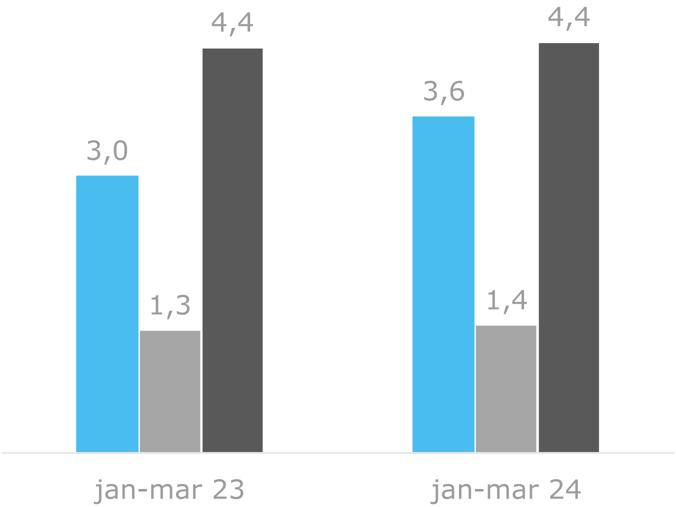
	2023	2024	2025	2026	Acum. 2024-26
GDP					
BdP (Mar 24)	2.3	2.0	2.3	2.2	6.6
BPI (Feb 24)		1.6	2.3	2.5	6.6
S&P (Mar 24)		1.4	1.8	1.8	5.1
Inflation rate					
BdP (HCPI)	5.3	2.4	2.0	1.9	6.4
BPI (CPI)	4.3	2.3	2.0	2.0	6.5
S&P (HCPI)	5.3	3.5	2.1	2.0	7.8
Unemployment rate					
BdP	6.5	6.5	6.5	6.5	0.0
BPI		6.7	6.5	6.5	0.0
S&P		6.7	6.5	6.5	0.0
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- last March, 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)

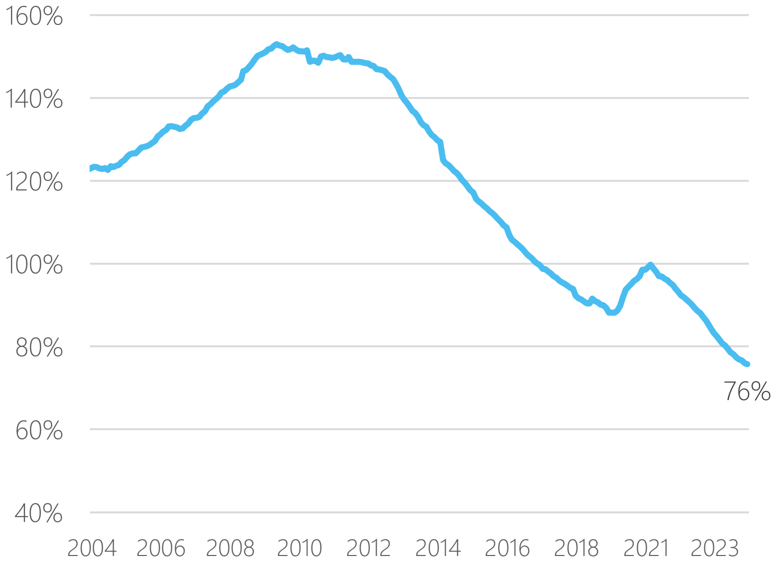
CaixaBank

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



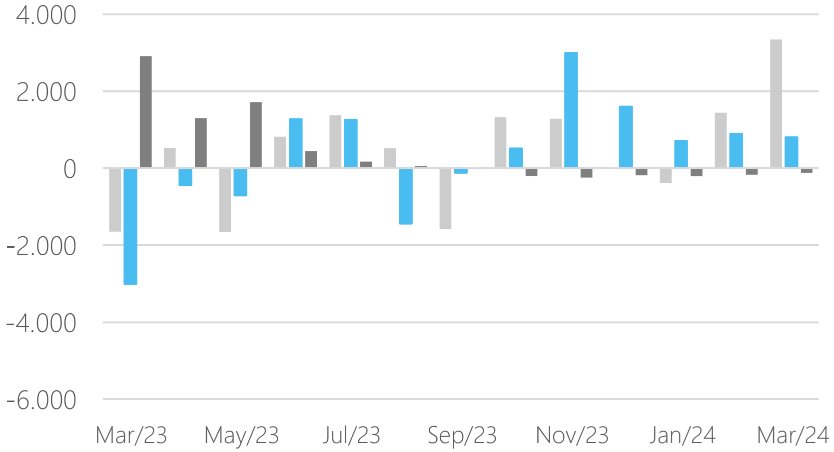
Source: CaixaBank Research, base on data from Bank of Portugal and ECB.

Bank credit to the private non-financial sector
% GDP



Source: CaixaBank 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: CaixaBank Research, base on data from Bank of Portugal and IGCP.

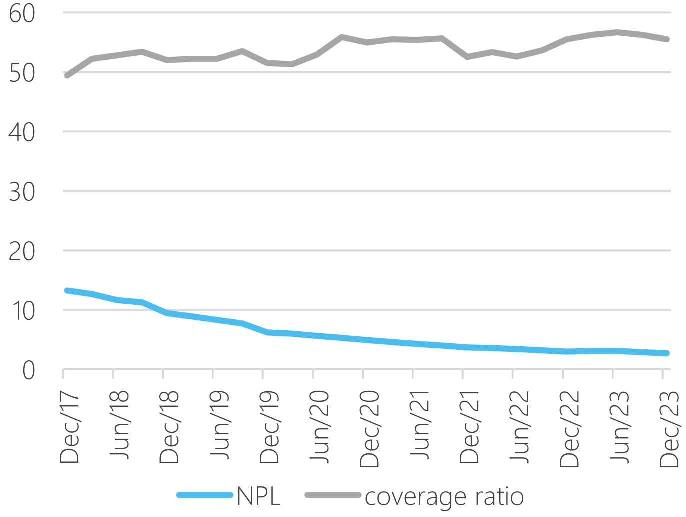
- **The stock of credit is decelerating since mid-2022, but the pace is slowing:**
  - **Mortgage credit:** the pace of decline continue to reduce and in March the stock declined 0,8%, but new operations accelerated in the same period by 21,4% indicating that the declining path seen since July 2023 is changing. First signs that the peak on interest rates may 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, lower investment, favorable level of deposits and continuing weak new credit operations. In March 2024 it fell 1,9%; new loans increased by 1%.
- **Deposits of the private sector rose 2,7% in March**. Households' deposits rose 4,2% yoy, as interest rates for new deposits continue to be higher (2,78% in March) 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

NPL ratio[1]
In % of gross loans

Coverage ratio
In % of NPLs



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

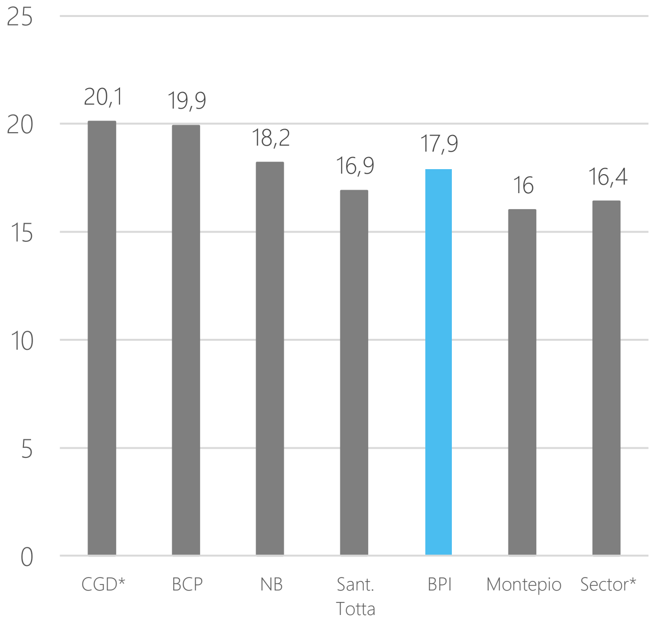
In % of average total assets (2023; trailing 12M)

	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 credit rose to 1,3%, +0,2 p.p. 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 the 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.**