Recession inevitable in Portugal, despite the good performance prior to the pandemic

The Portuguese economy was facing 2020 from a position of strength. In 2019, GDP grew by 2.2% (exceeding most forecasts) and the consumption and economic activity indicators for the beginning of 2020 suggested that economic activity remained healthy (in February, the coincident indices for private consumption and aggregate activity suggested growth rates of 2.7% and 2.3%, respectively). In addition, the public accounts ended 2019 with a surplus, the current account balance was close to equilibrium, and unemployment stood below 7%.

The COVID-19 changed completely the outlook. Although we do not yet have economic indicators that capture the impact of the COVID-19 pandemic on economic activity in Portugal (where the outbreak was not felt until early March), the entry into force on 18 March of the state of emergency (with the consequent social isolation measures, key to halting the spread of the pandemic) has resulted in a freeze of economic activity. There are sectors and companies which have reported declines in their activity of more than 70% in the second half of March (bakeries and restaurants), while motorway traffic fell by 75% in the third week of March.[1] These measures have a clear economic cost, albeit a temporary one, and activity can be expected to quickly recover following their withdrawal.

Portugal is facing a severe decline in economic activity, albeit a temporary one. Uncertainty surrounding the economic impact of the COVID-19 pandemic is high, but the sudden stagnation in the closing weeks of March will mean that this impact will already be evident in the economic activity figures for Q1. However, in Q2 we expect that economic activity will contract by around 15% compared to the previous quarter.[2] This figure assumes that sectors such as tourism, accommodation, catering or cultural activities, among others, will experience a complete shutdown or will be seriously affected (with a relative weight of around 20% of the GVA); others, such as industry, construction and real estate activities, will see their activity limited by the mitigation and isolation measures (together, accounting for around 40% of the GVA), while the remaining sectors are assumed to maintain a more normal level of activity, provided they can adapt to remote working.

If the pandemic in Portugal is brought under control as planned (between late April and early May), economic activity could recover substantially in Q3, undoing part of the losses suffered. In this scenario, we project a contraction of GDP for 2020 as a whole of –3.4% (compared to 1.7% growth previously forecast). In 2021, GDP growth would reach around 6%, primarily due to the base effects. Nevertheless, this crisis is likely to have lasting effects in some sectors, which will recover more gradually. They include tourism, which represents around 8% of GDP and 15% of household consumption (figures for 2018). The recovery in the labour market is also likely to be more gradual, and we estimate an unemployment rate of 8.2% for 2020 as a whole (previously 6.4%). As such, at the end of 2021 GDP would still stand 1.5% below our previous scenario.

1. According to data from the Ministry of Infrastructure and Housing.
2. Estimates based on the impact of a shutdown of around eight weeks on the GVA of the various sectors, which are classified as being in shutdown, being limited, operating normally and in overdrive.

Portugal: economic forecasts

	2019	2020		2021	
		Feb. 2020	Mar. 2020	Feb. 2020	Mar. 2020
GDP	2.2	1.7	–3.4	1.6	5.9
Inflation	0.3	0.7	0.1	1	0.9
Unemployment rate	6.5	6.4	8.2	6.3	6.8
Employment (YoY change)	1	0.5	–2.6	0.2	1.9
Fiscal balance (% of GDP)	0.2	–0.1	–3.6	0.2	–0.6
Public debt (% of GDP)	117.7	114.6	124.9	110.6	116.6
Housing prices (YoY change)	9.7	4.4	–0.4	3.7	3.2
Home sales (YoY change)	1.7	–5.7	–22.3	–5.4	5.8

***Source:** CaixaBank Research, based on data from the National Statistics Institute of Portugal and the Bank of Portugal.*

In addition, the turmoil caused by the COVID-19 pandemic will have a widespread effect across all the other main macroeconomic variables: in the external accounts, the public accounts and the real estate market. In the latter case, for instance, sale transactions could fall by more than 20% in 2020.

Exceptional measures to offset/mitigate the economic impact

The measures aimed at mitigating the economic impact of the COVID-19 pandemic in Portugal have not yet been fully defined, given that the outbreak emerged later. With the information available at the end of March, we estimate that the total value of the support measures – which include liquidity measures, deferrals of tax payments and direct support for households – amounts to around 12.5 billion euros, or 6.2% of GDP.

Among these measures, those with a direct impact on public spending and that have already been announced (bolstering the national health system and subsidies for

Portugal: economic measures to tackle the COVID-19 pandemic

Measure	Amount (EUR millions)	% of GDP
Total of the measures	**12,860**	**6.2**
Measures affecting public spending	**2,300**	**1.1**
Support for employment (temporary lay-offs*)	2,000	1.0
Bolstering the health system with 1,800 doctors and 900 nurses Subsidies for households due to preventative isolation and caring for children (due to school closures)	300	0.1
Measures to guarantee companies' liquidity	**10,560**	**5.1**
Lines of credit for the tourism, textile, clothing and footwear sectors, and the mining and logging industries	3,060	1.5
Lines of credit for other sectors	200	0.1
Flexibility in the payment of tax obligations and social security contributions	6,200	3.0
Credit guarantees, with state support, for export companies (especially those exporting to outside the EU)	700	0.3
Deferral of bank loan repayment instalments and elimination of minimum charges in electronic payments	400	0.2

Note: ** According to statements by the prime minister, the monthly cost of these measures is estimated at 1 billion euros and they could remain in force for two months.*
Source: *CaixaBank Research, based on information from the Government of Portugal.*

households) represent 1.1% of GDP. In this group, of particular note are the subsidies for households and the simplified scheme for the temporary suspension of labour contracts, under which around 50% of the gross remuneration is ensured by Social Security, up to a maximum of 1,905 euros. If, as we estimate, these measures are in force for two months, then the total cost of the support measures for temporary lay-offs will amount to 2 billion euros (1% of GDP).[3]

The measures aimed at tackling companies' liquidity problems amount to 10.6 billion euros (5.1% of GDP) and are mainly focused on:

i) Deferring tax payments and making them more flexible.[4] The government estimates the sum of these deferrals to be 5.2 billion euros (2.5% of GDP). Payments of contributory taxes are also being made more flexible, and this is expected to affect payments amounting to 1 billion euros (0.5% of GDP). As an example, Social Security contributions for the months of April, May and June will be paid in the second half of 2020. In addition, payments of personal income tax withholdings and VAT can be postponed by between 3 and 6 months from April.

(ii) Lines of credit for companies[5] amounting to 3 billion euros (1.5% of GDP). These are channelled through the banking sector and offer more favourable financing conditions than ordinary lines of credit: lower interest rates, interest payment grace periods and longer maturities, among others.

(iii) Lines of credit with a state guarantee, aimed especially at the export sector with 700 billion euros (250 billion more than before).

iv) Faster deliveries (or deferrals of reimbursements) with respect to EU funds pledged as part of the Portugal 2020 programme.[6] This includes the almost immediate payment of expenses already incurred and of payments to suppliers, as well as the automatic deferral of reimbursements for a period of 12 months. Both of these measures will make it possible to inject funding resources into the underlying recipient firms, amounting to 400 billion euros.

Beyond these measures, there are others aimed at supporting households and firms, which include the elimination of minimum charges on electronic payments in shops and the deferral of loan repayment instalments. In addition, the Bank of Portugal has suggested a relaxation of the conditions for access to personal credit.[7] Finally, various financial institutions have announced measures to support businesses and households, such as making the conditions required to access moratoriums on credit repayments more flexible.

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3. According to public statements, the monthly cost is 1 billion euros.
4. The exact details are specified at https://covid19estamoson.gov.pt/medidas-de-apoio-emprego-empresas/
5. Lines of credit amounting to 3,260 million euros, aimed at SMEs and micro-enterprises in all sectors, but with a higher incidence in the tourism, textile, clothing and footwear sectors, and in the mining and logging industries. They are available to companies that have experienced a drop in their sales of 20% or more in the last 30 days compared to the immediately preceding 30 days. This drop in sales must be verified on the date the line of credit is contracted. This line of credit operates in the form of a mutual guarantee scheme (80% guaranteed by a public entity), such that the financing conditions will be quite favourable for the corporate sector. According to data from IAPMEI and eGOV.
6. Cabinet Note of 30 March 2020 – Extraordinary measures to support the economy and maintain jobs as part of Portugal 2020.
7. Statement from the Bank of Portugal on the implementation of the macro-prudential recommendation in force in the field of consumer credit.