Prepared with information available by January 8th , 2024

Portugal:
Macroeconomic and financial outlook

CaixaBank **Research**

January 2024

CaixaBank

Main messages

Activity

- **In Q3, GDP contracted 0.2%, driven by poorer than expected performance of G&S exports.** The shutdown on production in an important car factory (Auto Europa) during 2 weeks in Q3 and a volatile behavior of import and export deflators may have increased this negative performance; however, it also suggests that the slowdown of activity in the main trading partners has been weighing on activity. **More recent economic indicators point to a better performance in Q4**. Up to December 24th, the daily economic indicator increased around 6%, while in Q3 advanced by only 2%, supporting the expected rebound of activity in Q4 and suggesting that annual growth in 2023 may stay close to 2.2%, minus 0.2 p.p. than our forecast. For 2024, we see a more moderate pace of growth, reflecting the full impact of higher interest rates (internally and also on the activity of the main trading partners of Portugal) that will be mainly felt in H1 2024, restraining economic growth in this period. **The CPI flash estimate for December continues to signal deceleration, slowing to 1.4%, pushing annual inflation to 4.3%, slightly below our forecast.** This positive trend was also apparent in the core indicator, that moderated to 2.6% yoy from 2.9% in November.
- **Labor market remains robust.** The unemployment rate stood at 6.7% in November, with slight gains on employment and declines on unemployed. However, the number of workers in a layoff situation is increasing, signaling some risks for evolution in the months ahead.
- **Tourism continues to perform well.** Up to October, the number of tourists rose 13.7% yoy, with non-resident increasing 20%.
- **In housing market, our forecast for 2023 (7,1%) remains comfortable**, considering the available data regarding price dynamics in Q3 and first data for Q4. Overall, supply side tightness keeps supporting valuations.
- **Moody's upgraded Portugal's rating by two notches to A3, being the third agency pushing the Portugal's classification to the "A" class.** These revisions reflects the positive impact on country's credit conditions, coming from economic and fiscal reforms, reduction in the level of indebtedness in the private sector and the strengthening of the banking sector.
- **On March 10^{th}, there will be legislative elections;** last polls don't suggest a clear trend, but they also don't yet reflect the changes in the leadership of the socialist party or the agreement between the center-right parties.
- **Up to November, the fiscal balance registered a surplus equivalent to 2.7% of GDP** (cash basis and adjusted by the transfer of the Caixa Geral de Depósitos Employees Pension Fund to Caixa Geral de Aposentações, of about EUR 3.0 billion, an one-off that will have no impact on the official final figure). In the same month the public deficit fell to 102% of GDP and recent news about debt repurchases suggest that the ratio will end 2023 below the 100% mark, for the first time since 2009. Given the very positive performance up to November, we see the fiscal balance reaching a surplus of 0.7% of GDP in 2023 and of 0.4% in 2024. This performance will allow the consolidation of the public debt ratio below 100% of GDP in 2024. These forecasts are in line with the targets included in the proposal for the official budget 2024 (SB24), that the Government presented in mid-October.

Banking Sector

- **NPLs ratio declined in Q3 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 impact on credit quality might be 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	Forecasts 2023	Forecasts 2024
GDP	2,0	3,5	2,8	2,7	-8,3	5,7	6,8	2,4	1,8
Private Consumption	2,6	2,1	2,6	3,3	-7,0	4,7	5,6	0,9	0,7
Public Consumption	0,8	0,2	0,6	2,1	0,4	4,5	1,4	1,2	1,3
Gross Fixed Capital Formation (GFCF)	2,5	11,5	6,2	5,4	-2,2	8,1	3,0	1,3	5,0
Exports	4,4	8,4	4,1	4,1	-18,8	12,3	17,4	5,5	2,7
Imports	5,0	8,1	5,0	4,9	-11,8	12,3	11,1	1,6	2,5
Unemployment rate	11,4	9,2	7,2	6,6	7,0	6,7	6,2	6,6	6,5
CPI (average)	0,6	1,4	1,0	0,3	0,0	1,3	7,8	4,3	2,4
External current account balance (% GDP)	1,2	1,3	0,6	0,4	-1,2	-0,8	-1,4	1,2	1,2
General Government Balance (% GDP)	-1,9	-3,0	-0,3	0,1	-5,8	-2,9	-0,3	0,7	0,4
General government debt (% GDP)	131,5	126,1	121,5	116,6	134,9	125,5	112,4	103,0	98,6
Risk premium (PT-Bund) (average)	307	269	138	98	89	60	97	84	95

Source: *CaixaBank Research*

2023: ends recovering from the break in the Q3

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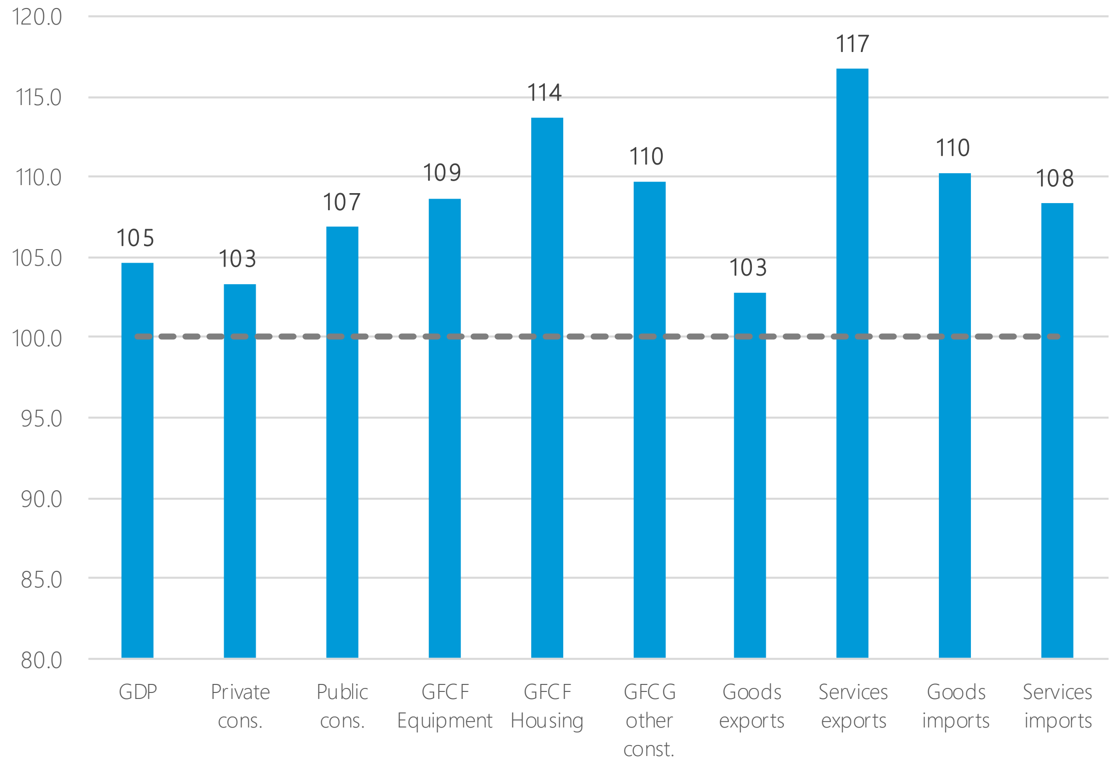
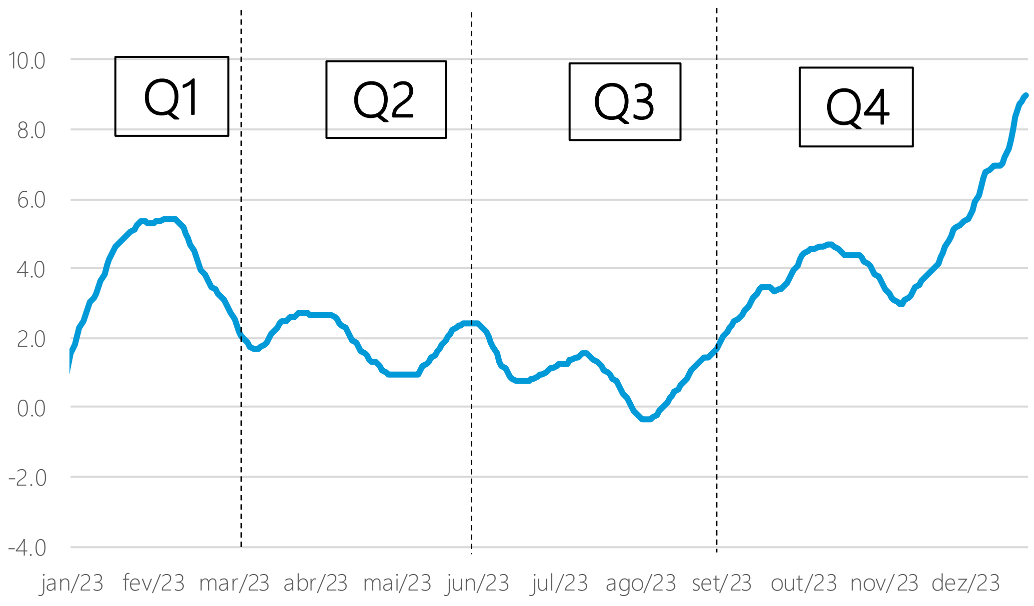
GDP components: Q3 2023 vs Q4 2019

Real Index (Q4 19 = 100)



Daily activity indicator

yoy montly moving average (%)



Source: CaixaBank Research, from Bank of Portugal, INE

- **GDP contracted by 0,2% qoq in Q3, driven by a poorer than expected performance of exports (G&S). But the behavior of the daily economic indicator suggests that activity accelerated again in Q4. Up to December 24th,** this indicator increased around 6%, while in Q3 advanced by only 2%. The number of flights accelerated in Oct-Nov to 9,7% in comparison to 2019, from 6,6% in Q3, but car sales, a proxy for durable goods consumption, slowed to 7,9%, from 12,2% in Q3.
- **Available detailed data up to Q3 shows that the economy recovered swiftly since the pandemic**. All components are above 2019 year end, and we highlight investment and exports as the best performers.

In the last months of 2023, indicators showed a recovery trend

Economic indicators from + to -

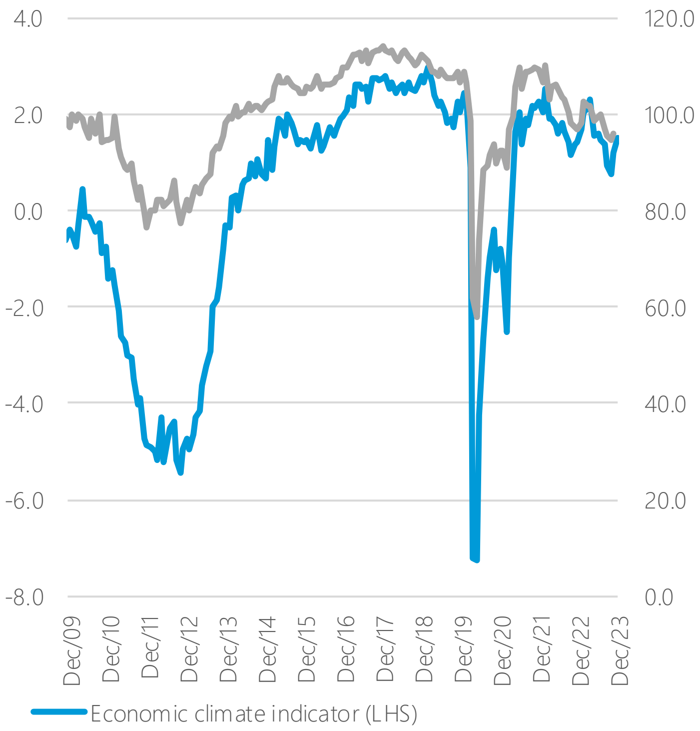
% annual growth

yoy, level		Q3 2023	Q4 2023	Last month available
Synthetic indicators	Economic climate indicator	1,3	1,0	October
	Economic sentiment indicator	97,6	95,4	October
	Daily economic indicator	2,0	5,8	November
Consumption	Consumer confidence	-22,9	-28,2	October
	Retail sales (yoy)	1,7	1,3	November
	Retail sales excl. fuels (yoy)	2,1	1,5	November
	Car sales (number)	14.400	15.038	December
	Car sales (yoy)	12,2	7,9	December
Investment	GFCF indicator	4,1	0,7	October
	Imports of capital goods (accum. year)	6,3	3,1	October
Suply	Cement sales	7,5	9,1	November
	Industrial production	-4,6	-1,1	November
Demand	Electricity consumption adjusted for temperature&working days	-0,7	3,7	December
	Non-resident tourists (yoy 2019)	9,8	15,1	October
	Number of flights (yoy 2019)	8,9	7,2	December
Trade	Exports G&S (accum. Year)	7,0	5,3	October
	Imports G&S (accum. Years)	-0,1	-1,3	October
Labour market	Change in regist. unemployment (thousand people)	10,8	14,2	October
	Change in employment (thousand people)	94,3	51,7	October

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

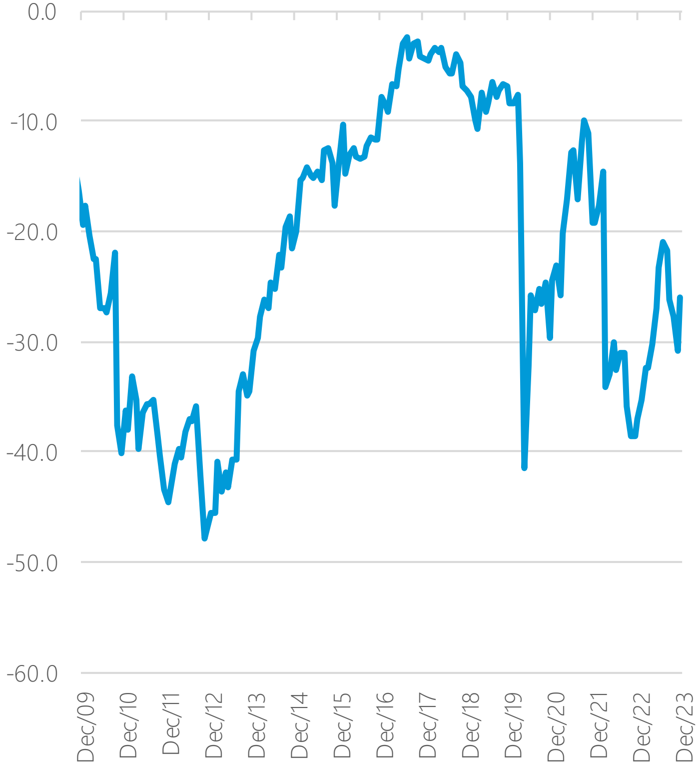
Synthetic sectoral sentiment indicators

% yoy, level



Consumer confidence

Level



- **Consumption indicators accelerated at the end of the year:** retail sales excluding fuel rose by 2.3% in November and car sales accelerated at the end of the year, contributing to a 7.9% yoy rise in Q4. This movement was followed by improved household sentiment, via a more benign inflation trend with a positive impact on income. The tourism sector, measured by the number of flights and purchases made with non-resident cards, showed favorable developments. The former grew by 7.2% yoy in Q4 and the latter accelerated in October and November compared to Q3. Finally, electricity consumption, adjusted for the effects of temperature and working days, accelerated in the last 3 months of the year**. This data supports an advance of GDP around 0.3% in Q4. If so, annual growth will be 2.2%, in line with our forecast of growth above 2%.**

2024: structural improvements will help to avoid a strong deceleration

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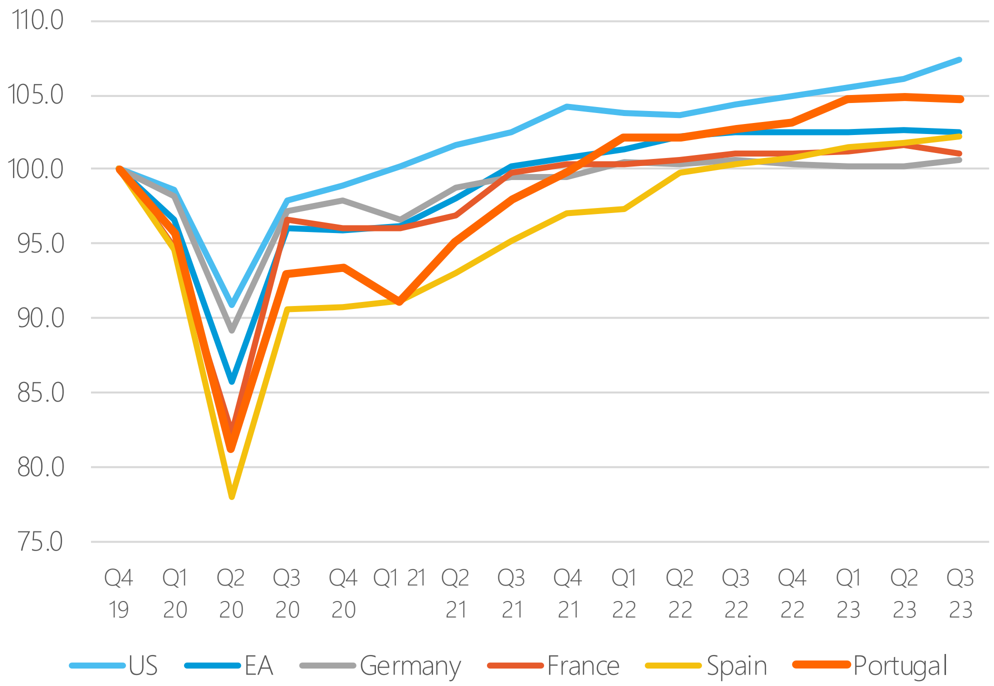
Portuguese recovery compares well with other economies

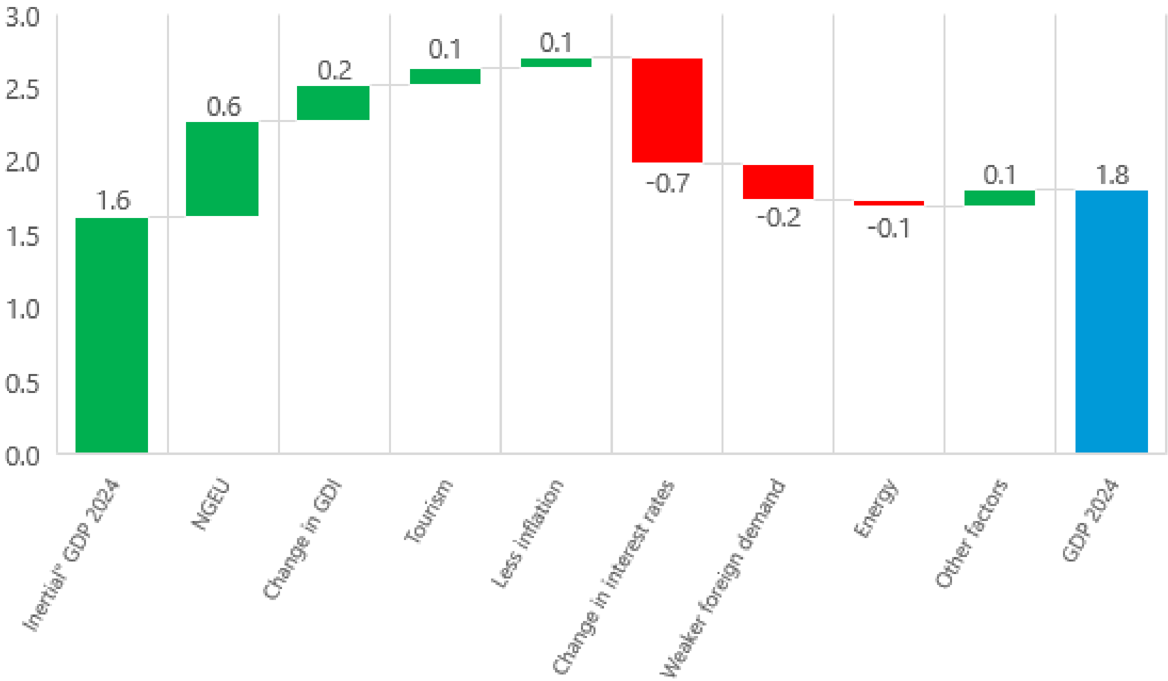
GDP Q4 19=100



Source: CaixaBank Research, from IMF, INE, BoP

GDP 2024: tail and headwinds

Percentage points



- **For 2024, we predict slower growth.** GDP is expected to advance 1,8%, -0,5 p.p. than in 2023, with the first half of the year being particularly penalized, reflecting the full impact of the increase in interest rates.
- **The headwinds and tailwinds seem almost balanced, but 2024 will begin dominated by great uncertainty which could lead to a deterioration in the headwinds.** The risk of an intensification of the Israeli-Palestinian conflict, with an impact on the price of energy commodities, would imply more inflation and probably more tightening by the ECB, with a considerable impact on growth. In this alternative scenario (whose probability looks contained, for now), the already negative impact of the expected increase in the price of oil would worsen; the positive contribution associated with a more benign scenario for inflation would disappear (or become more of a headwind...); and the negative impact associated with the slowdown in trading partners would be greater than estimated in the central scenario. In other words, our forecast of 1,8% growth would be compromised. **All in all, there are conditions for the Portuguese economy to remain resilient in 2024, but the risks and external factors are significant, once again generating high uncertainty in the scenario.**

Lower energy prices, more tourism and structural improvements brought external accounts to surplus again (and lower external debt)

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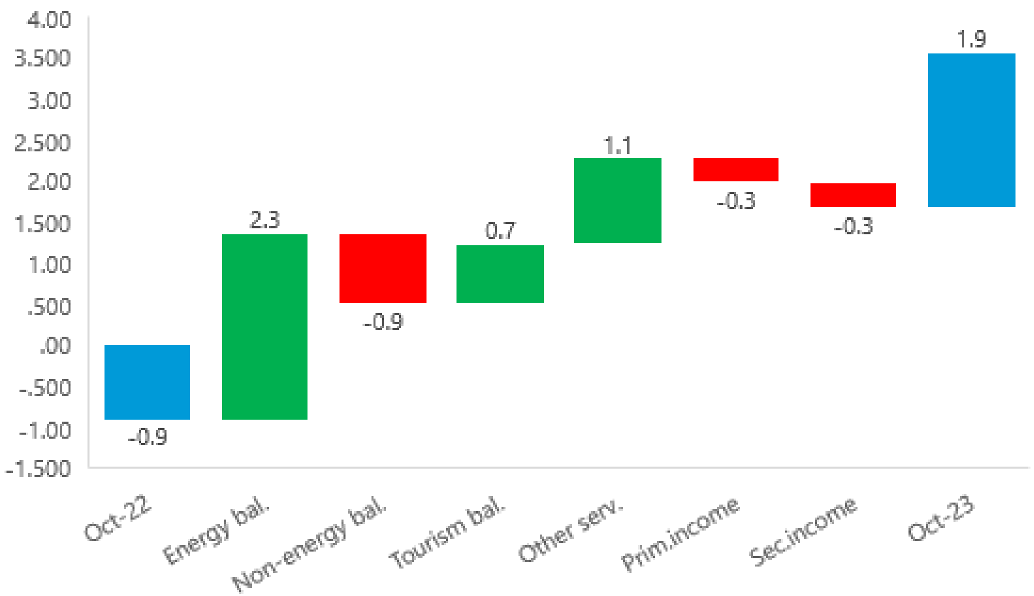
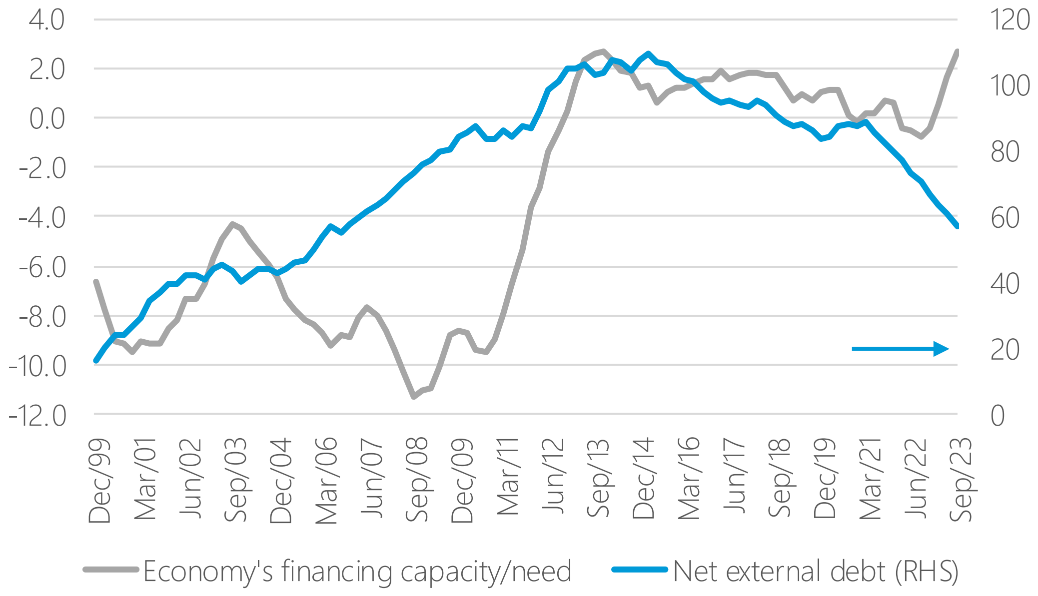
Current account evolution up to October 2023
% of GDP and p.p. changes



Economy financing capacity and external debt
% of GDP

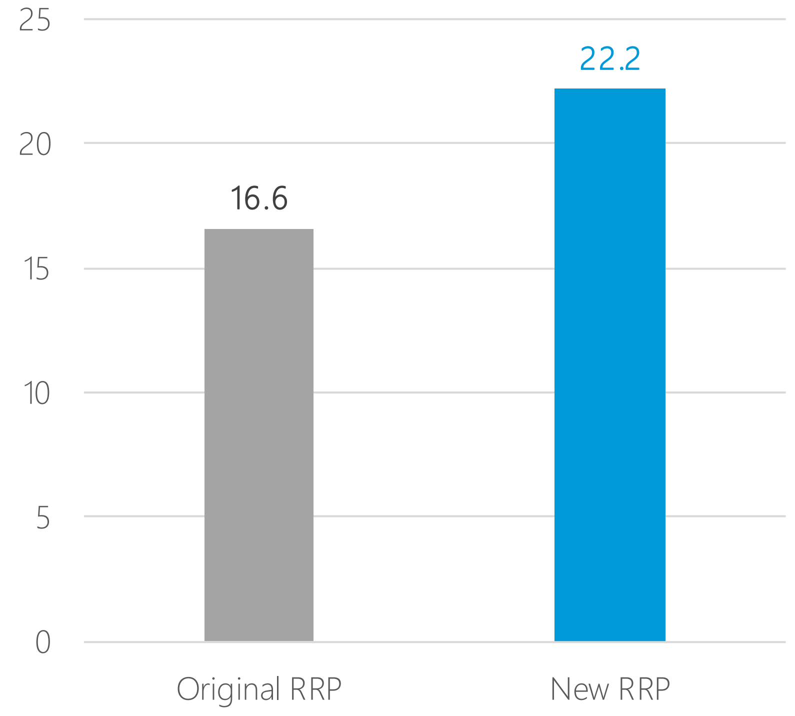


Source: CaixaBank Research, from INE

- **Up to October, current account posted a surplus equivalent to 1,9% of GDP.** Compared to the same period a year ago, the main contributions for this improvement came from the energetic balance and balance of services, both tourism and other services.
- **The return of the current balance to a surplus is an important boost for the rise of the financing capacity and foreign debt reduction. In Q3, economy registered an external financing capacity equivalent to 2,6% of GDP, the highest level in more than twenty years, contributing for the reduction of the net external debt to 57,3% of GDP, the lowest level since 2006 and minus 9 p.p. than in the end of 2022.** By the end of the year and in 2024, it is expected further declines in the external debt, as the current account is expected to be in surplus during the period. We are forecasting a surplus of 1,2% of GDP for the current account in both 2023 and 2024.

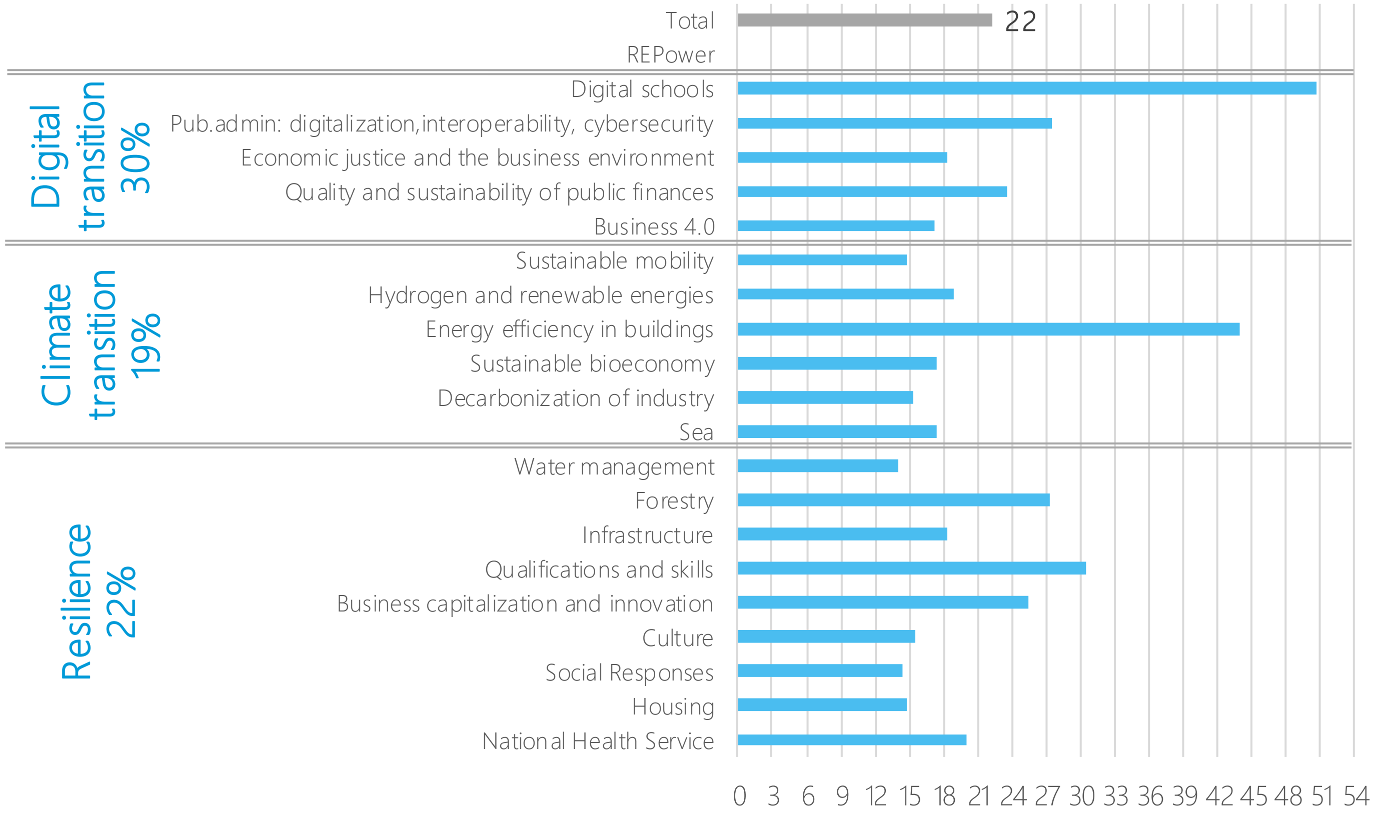
NGEU: high rate of approved projects (71% of the amount), but payments are still low

RRP amount after the rescheduling
EUR billion



Source: CaixaBank Research, from Recuperar Portugal.

Payment rate up to December 27th
% of total of the amount approved

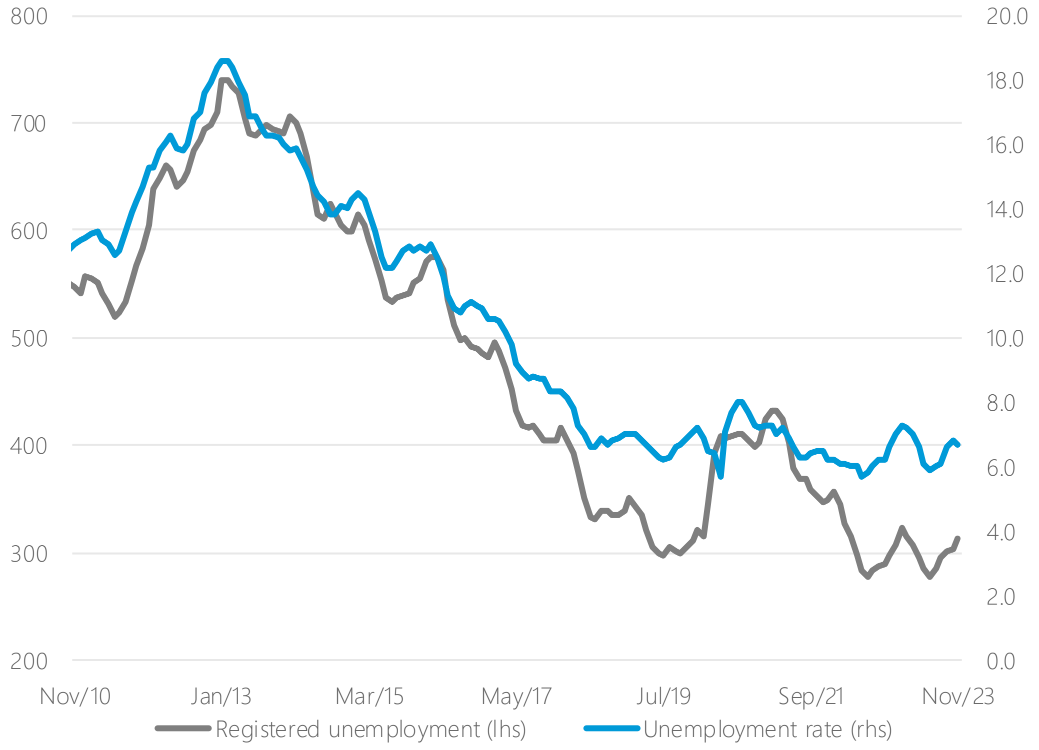


- The Regulation of the Resilience and Recovery Mechanism foresees adjustments in the distribution of NGEU funds among the various countries according to the accumulated growth of real GDP in 2020-21, which **in the case of Portugal led to an increase of the funds to be received from 16,6 billion euros to 22,2 billion euros (2,4 billion grants and 3,2 billion loans).** Some priorities for these additional grants and loans are the increase of the amounts available for companies, for the STEAM program (intended to strengthen labor force skills) and for the reinforcement of social equipment's. **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. The new amount is equivalent to 8,5% of GDP (2023), + 2,5 p.p. than the original amount.**
- **In the last days of 2023, Portugal received both tranches scheduled for 2023 in a total of 2.46 billion, reenforcing the ability to the execution of the RRP. In total, Portugal has already received 34% of the total amount of the RRP. Projects already approved amount to 15,7 billion euros, but the rate of payments fulfilled is only 22%.**

Labor market continues robust but it's losing momentum

Registered unemployment* and unemployment rate

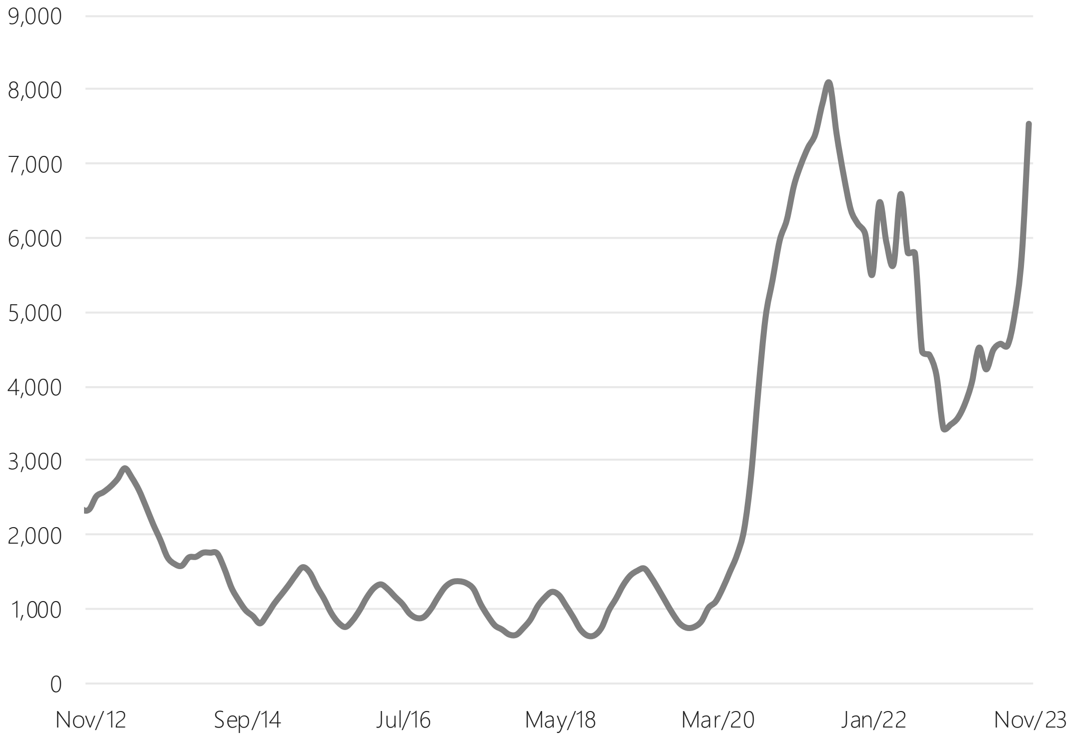
Thousand people *(%)*



Notes: (*) not seasonally adjusted.
Source: CaixaBank Research, from INE and IEFP.

Layoff*

6-months moving average (Number of individuals)



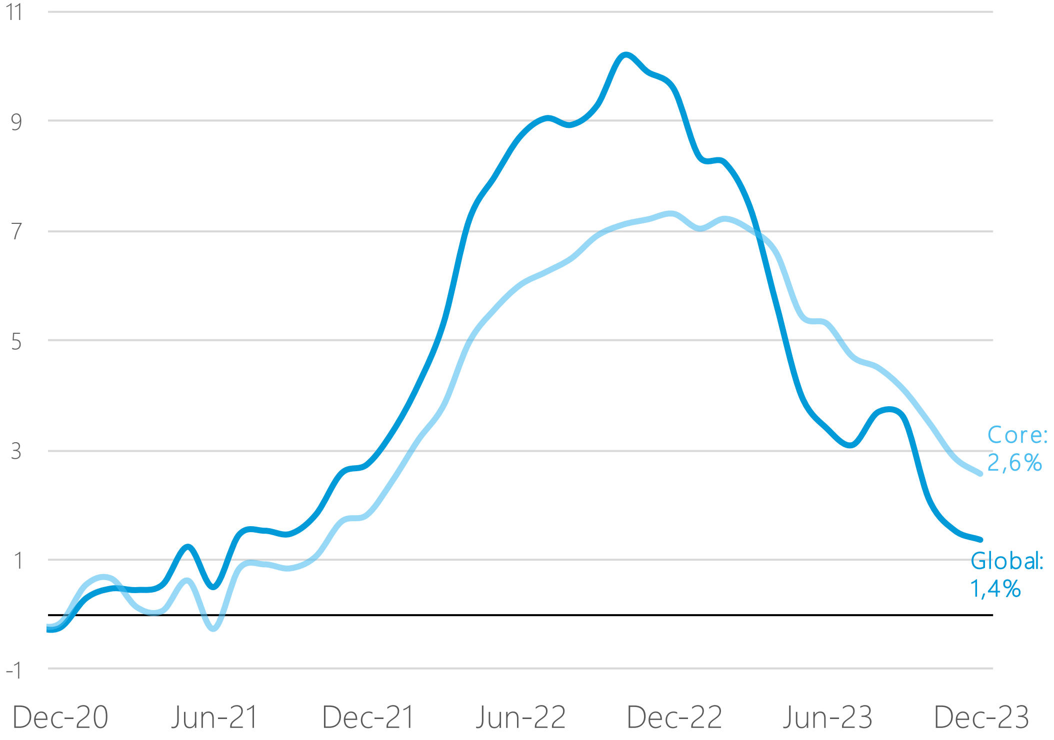
Note (*): Labor code regime.
Source: CaixaBank Research, from Social Security data.

- **The labor market appears to have reached a plateau.** The unemployment rate fell to 6,7% in November (-0,1 pp than in October) and the employed population rose 0,2% mom; 1,8% above the level of November 2022. In the same month, the number of registered unemployed people declined on a monthly basis and on an year on year basis, the pace of growth improved; however, the number of workers in layoff is considerably above the long-term average and very near the maximum registered in 2021, representing a limited, but not negligible, risk for unemployment in the months ahead, as it continues to represent a small portion of employed (0,3%).

Inflation slides further in December

Portugal CPI: Global & Core

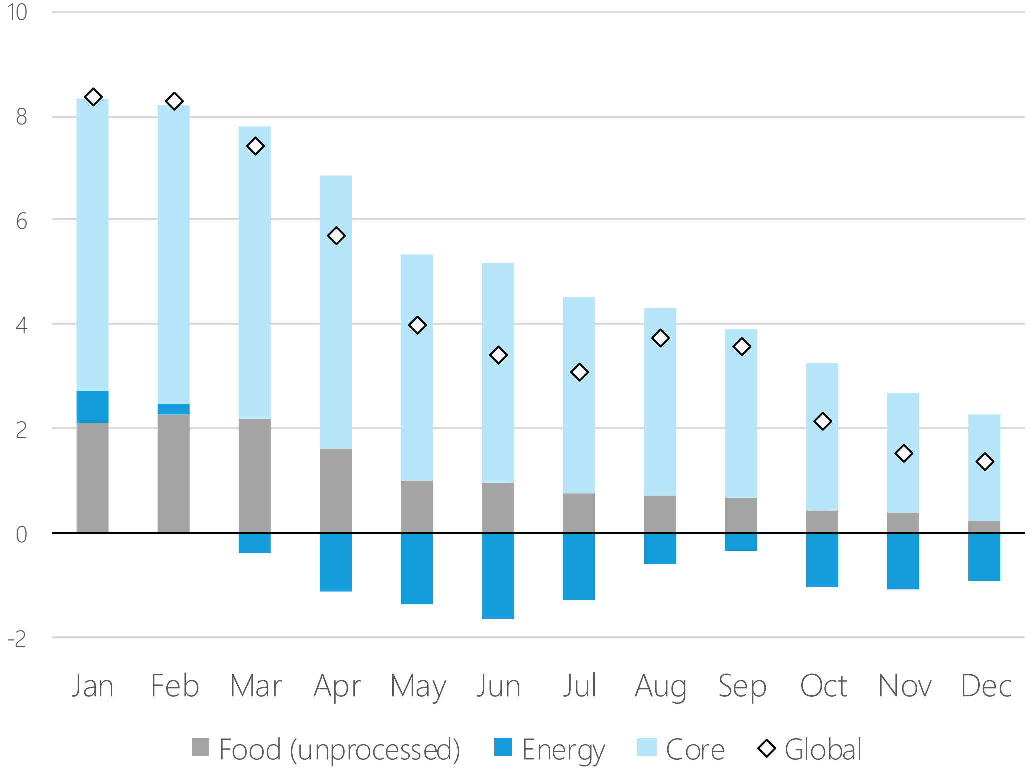
Year-on-year (%)



Source: CaixaBank Research, using data from INE.

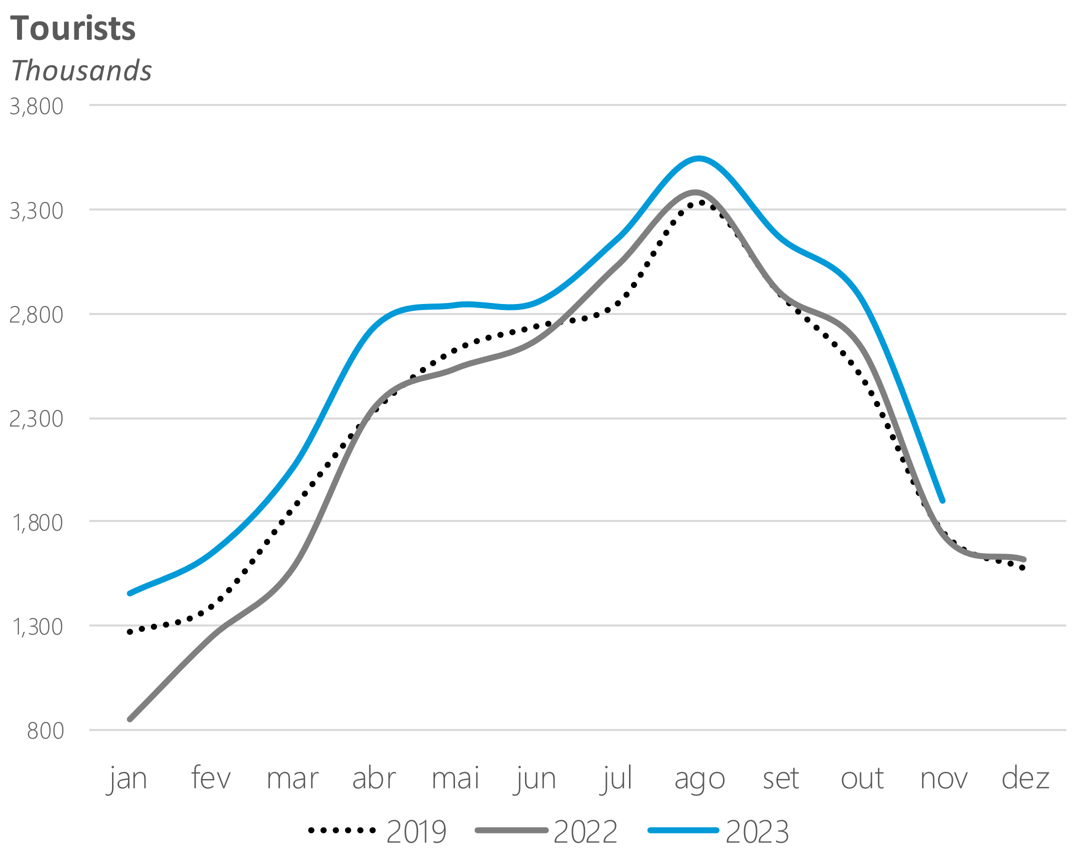
CPI: contribution to year-on-year change

%

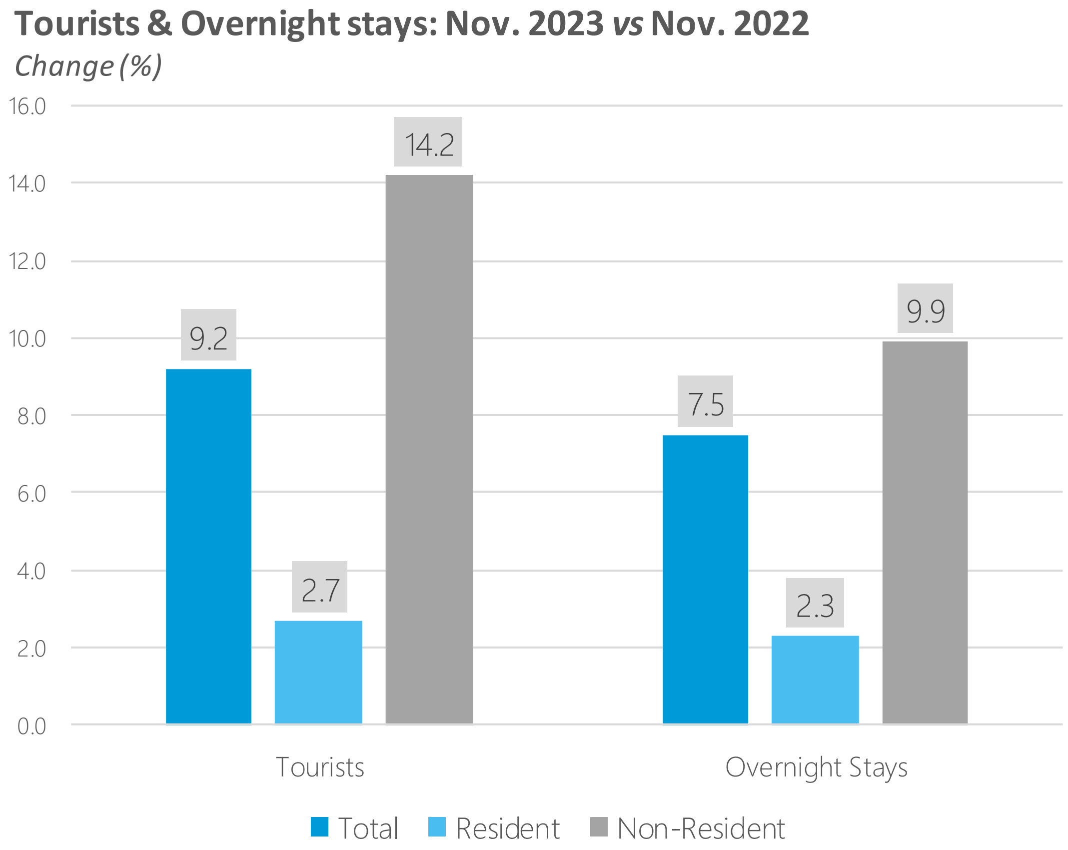


- **Inflation down again in December, to 1,4%** (1,5% in November). It's the second month with inflation below the 2 per cent benchmark. The core CPI also followed the trend, moderating to 2,6% (2,9% in November). Following December data, average inflation in 2023 stood at 4,3%, 0.3 p.p. less than our forecast (4.6%).
- **In December, the price drops in monthly terms were widespread across the main basket aggregates**: energy products (-2,17 per cent); unprocessed food products (-0,93 per cent); processed food products (-0,26 per cent); underlying (-0,23 per cent).

Tourism: pre-pandemic levels set to be surpassed in 2023



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

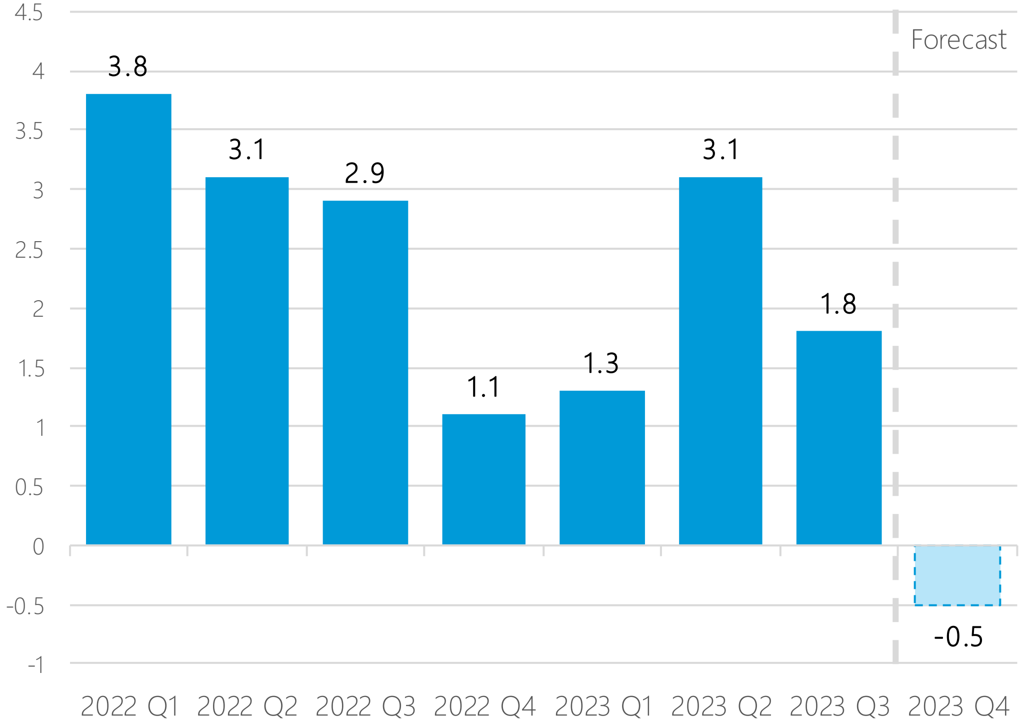


***Source**: CaixaBank Research, using data from INE.*

- **Up to November, the number of guests in tourist accommodation reached a total of 28,2 million.** Hence, the 2023 touristic year is expected to close in line with what we had forecasted: a total number of guests of 29,8 million, which is 12% above the pre-pandemic level and 13% above what was experienced in 2022.
- **In the first three quarters of the year, revenue in accommodation units increased by an average of 29% (in real terms) compared to the pre-pandemic**. Revenue grew more than guests, signaling an increase in added value.

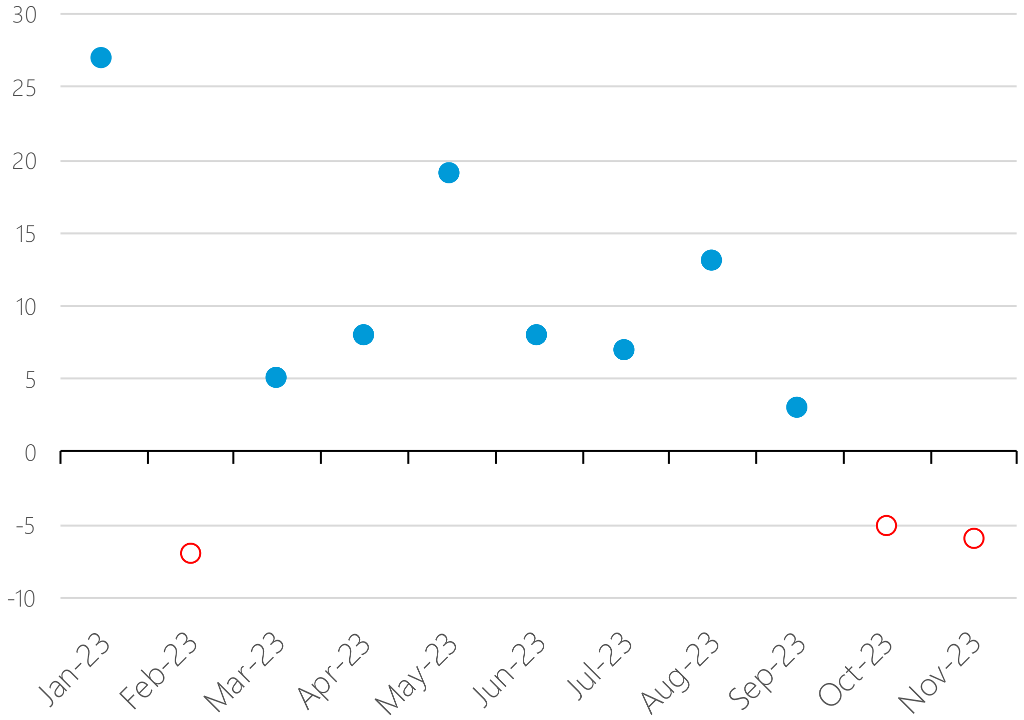
Housing market: Q3 data confirms another price increase

House Price Index
qoq change (%)



Source: *CaixaBank Research from data of INE.*

House appraisal
mom change (eur per square metre)



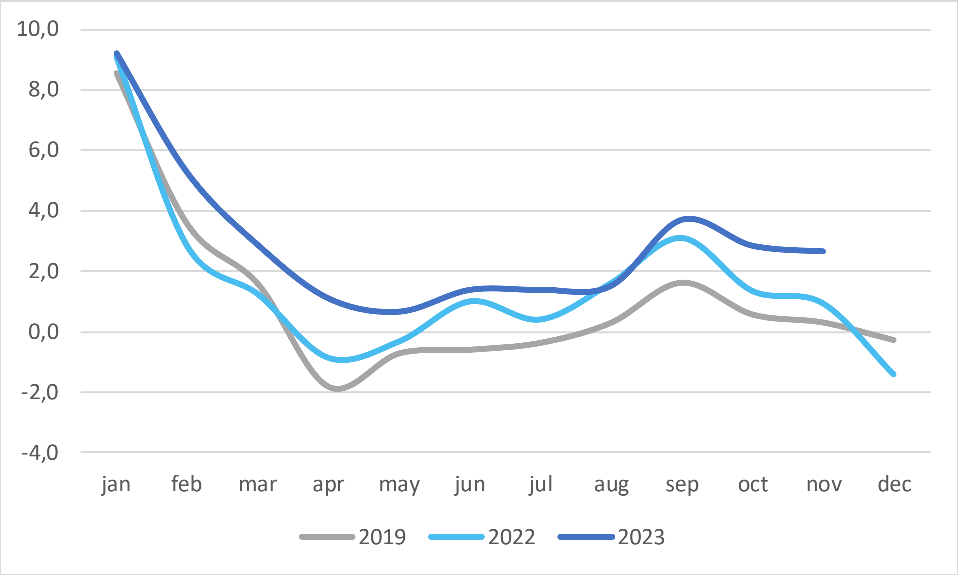
Source: *CaixaBank Research from data of INE.*

- **In quarter-on-quarter terms, the house price index grew by 1.8% in Q3 2023, 1.3 p.p. less than in the previous quarter.** In the same period, 34.256 homes were sold, 18,9% less yoy but growing quarterly (+2%).
- **House appraisal made by banks went down for the second consecutive month in November.** The last time something similar happened was at the end of 2014 and this was coincident with a drop in the HPI (-0,3 qoq).

Public debt ratio below 100% in 2023?

Overall fiscal balance*

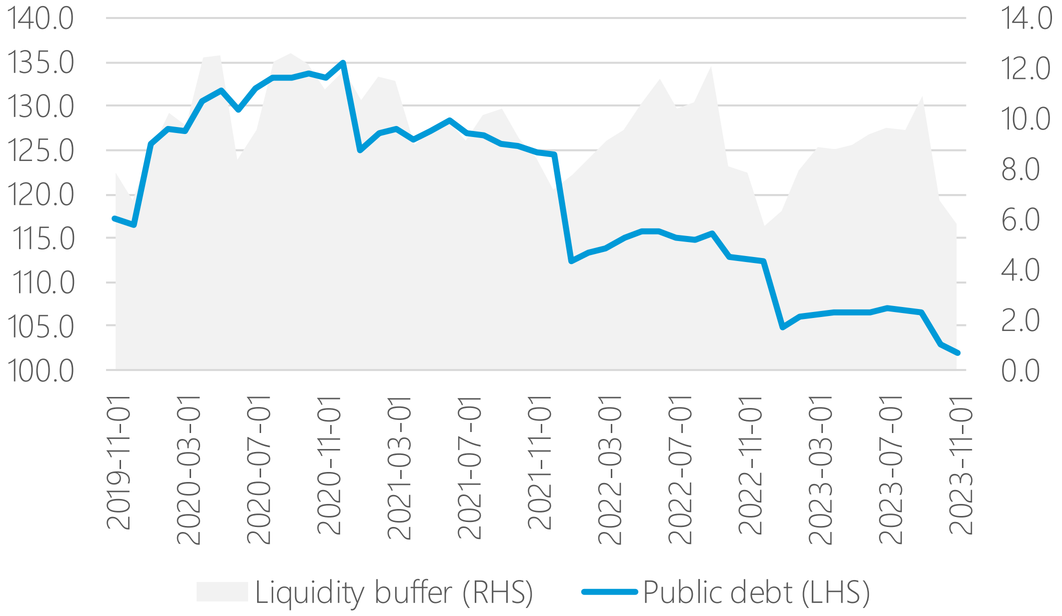
% of GDP



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

Public debt ratio and the liquidity buffer

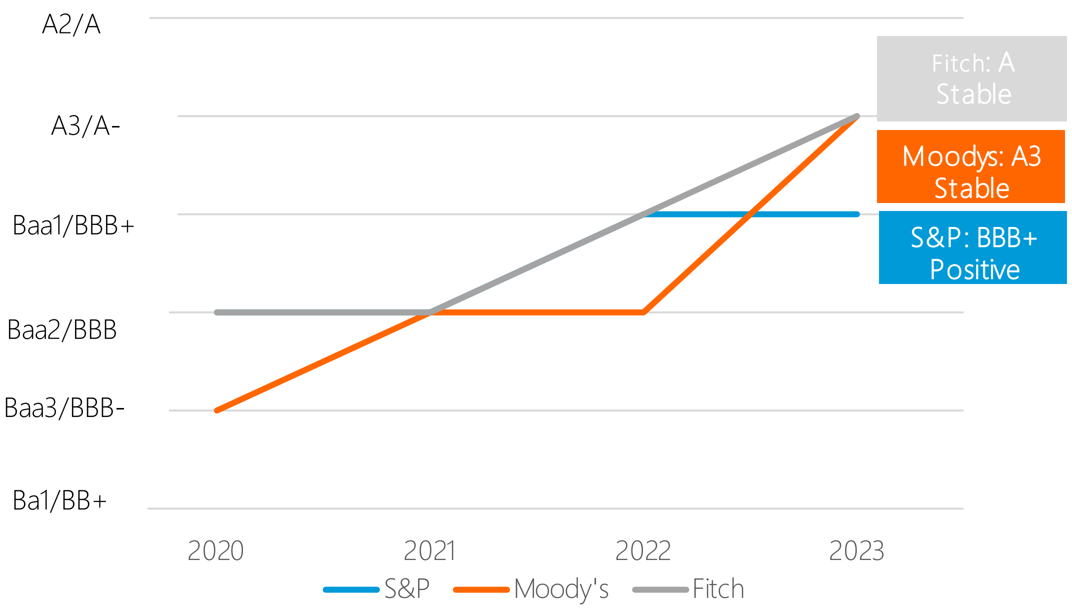
% of GDP; bln EUR



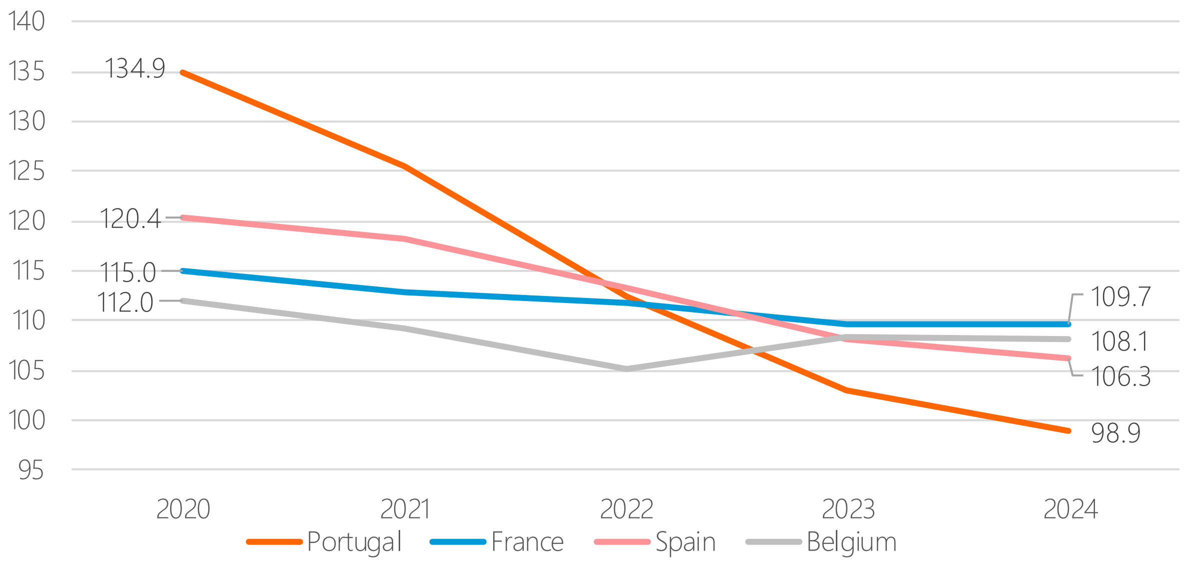
- **Up to November the fiscal balance registered a surplus equivalent to 2,7% of GDP** (cash basis and adjusted by the transfer of the Caixa Geral de Depósitos Employees Pension Fund to Caixa Geral de Aposentações, of about EUR 3,0 billion, an one-off that will have no impact on the official final figure). Given this very positive performance, we see the fiscal balance reaching a surplus of 0,7% of GDP in 2023 and of 0,4% in 2024, scenario that may turn conservative. This performance will allow the decline of the public debt ratio to below 100% of GDP for the first time since 2009 in 2024. These forecasts are in line with the targets included in the proposal for the official budget 2024 (SB24), that the Government presented in mid-October.
- **Public debt fell to 102% of GDP in November, suggesting that it may end the 2023 year near or below the 100% mark, better than forecasted.**
- **Upcoming elections may alter the implicit scenario for public accounts**, depending on the new Government political composition. However, **we do not expect major changes to the path projected** although we should only have more visibility on this premise after the elections.

Commitment with fiscal consolidation continues to push up the sovereign rating of Portugal, despite the political crisis

Rating evolution
level



Forecasts for the public debt ratio in SB 2024 (draft)
% of GDP

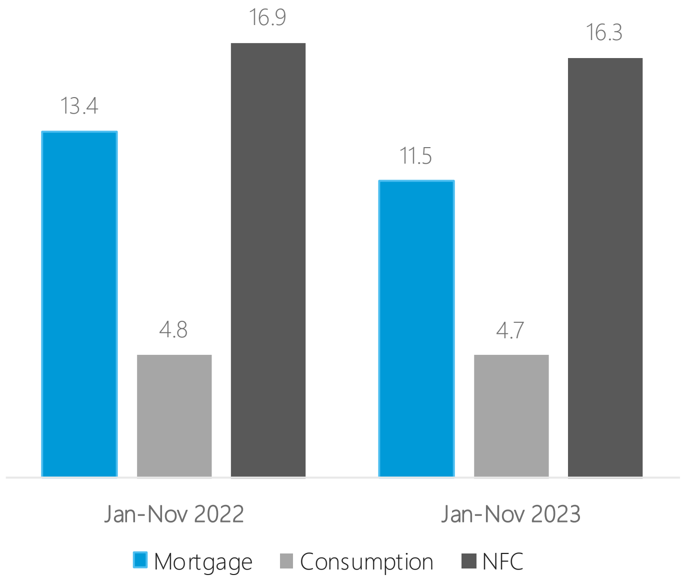


Source: CixaBank Research, from Fitch Ratings and Ministry of Finance

- **Moody's upgraded Portugal's rating by two notches to A3.** The revision reflects the positive impact on country's credit conditions, coming from economic and fiscal reforms, reduction in the level of indebtedness in the private sector and the strengthening of the banking sector.
- **Outlook for growth in the medium-term is positive,** supported by the impact of the RRP (increased investment and implementation of the reforms needed to obtain the funds), also contributed to the improvement in Portugal's credit rating.
- **Moody's sees economy to grow c. 2% annually in the next 5 years,** in line with improvements in Portugal's growth potential. GDP is seen to grow 2,1% in 2023, 1,6% in 2024 and 1,9% in 2025.
- **Drivers to growth:** FDI & domestic investment, further economic and administrative reforms (needed to disbursement of NG funds), further improvements in labor market and on productivity
- **Negative trend on demography is seen to be mitigated by migration.**
- **In the wake of alleged corruption cases targeting members of the Government, the Prime Minister resigned in Nov 7th. The President of the Republic has announced that legislative elections will be held on 10th March 2024** and the Government was dismissed in December 7th ; the 2024 State Budget was approved by end November, reducing uncertainty on fiscal policy up to the nomination of the new Government. With the approval of the 2024 budget, the Executive will remain in temporary administration until the March elections. **The latest polls do not show yet any visibility to the possible Government solutions that will emerge from the elections.**

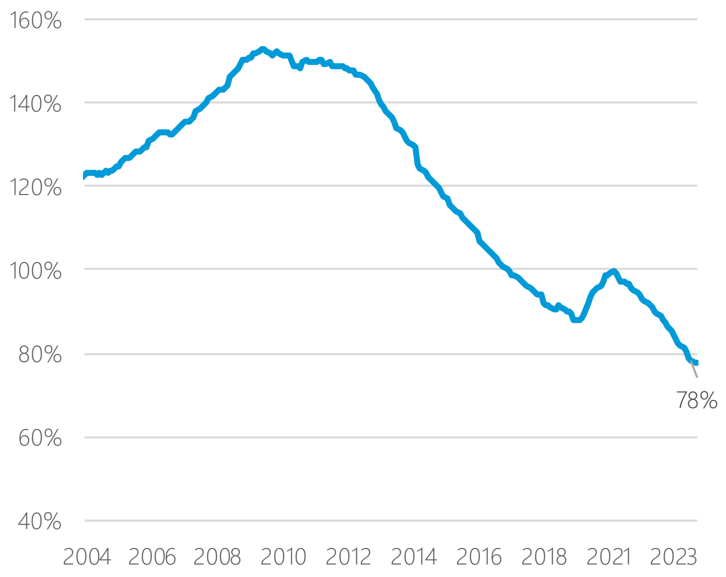
Banking system: a solid position to face the economic slowdown (1)

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



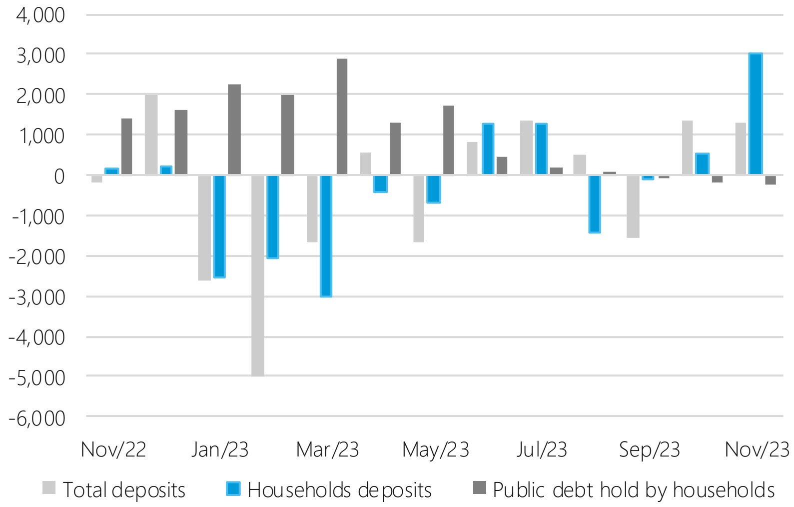
Source: CaixaBank Research, base on data from Bank of Portugal and ECB.

Bank credit to the private non-financial sector
% GDP



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

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

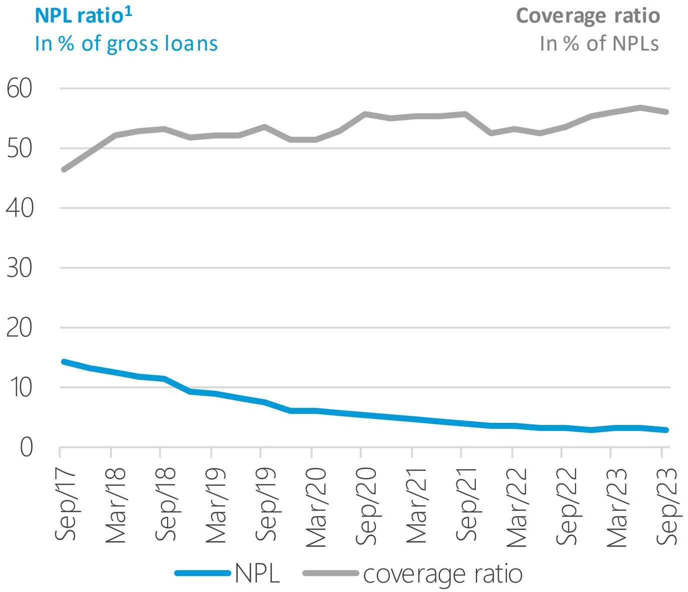


Notes (*): Public debt by households includes Certificados de Aforro and Certificados do Tesouro, which can only be subscribed by resident households. The maximum amount that Government can issue for these retail instruments (CA and CT) is 16.5 bn Eur in 2023.
Source: CaixaBank Research, base on data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

- **The stock of credit is decelerating since mid-2022:**
  - **Mortgage credit:** declined 1,2% yoy in November, in line with the drop in new operations (-14,4% yoy accumulated up to November) and the amount of early redemptions. High levels of interest rates, inflation and housing prices explain this decline, which should continue next months. However, the absolute amount of new mortgage operations remains high by historical standards and are showing some monthly increases since August.
  - **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.
- Deposits of the private sector continued to decrease in November (-1,9% yoy), but at a slower pace than in the previous months. Households' deposits declined -2,2% yoy, but meanwhile, interest rates for new deposits have been increasing (last October, household's deposit interest rate reached 2,98%, the highest rate since August 2012), which, together with the recent change in CA's new subscription conditions (maximum interest rate of 2,5%), should sustain the recovery of banking deposits.

Banking system: a solid position to face the economic slowdown (2)

NPLs and coverage ratios



Cost of risk[1]
0.5% in 2019
0.5% in Q3 2023

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

Banks' profitability

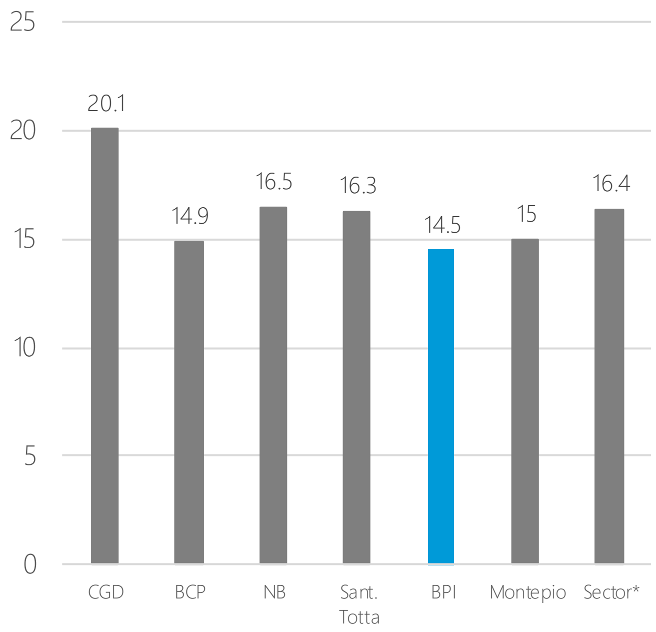
In % of average total assets (H1 23; trailing 12M)

	BPI	BCP	San Totta	CGD	NB	Montepio
Net Interest Income	**2.2%**	**2.2%**	**2.0%**	**2.6%**	**2.3%**	**2.0%**
Net fees	0.7%	0.9%	0.8%	0.6%	0.6%	0.7%
Gains on financial assets	0.1%	0.0%	0.0%	0.3%	0.2%	-0.2%
Other net profits	-0.2%	-0.2%	0.0%	-0.1%	-0.3%	-0.2%
Gross income	2.8%	2.9%	2.8%	3.4%	2.9%	2.4%
Operating expenses	-1.2%	-0.9%	-0.9%	-1.1%	-1.0%	-1.3%
Operational result	**1.6%**	**2.0%**	**1.9%**	**2.3%**	**1.9%**	**1.1%**
Impairement losses, taxes and others	-0.1%	-0.5%	-0.2%	-0.5%	-0.2%	-0.2%
Profit	1.0%	1.1%	1.1%	1.2%	1.6%	0.7%
ROTE[1]	11.6%	16.8%	17.6%	13.5%	ver nota	nd

Notes: 1) the values for BCP and CGD refer to ROE; calculation methodologies differ between banks. In the case of CGD and NB indicators refer to consolidated activity

Banks' solvency and liquidity position

*In % (q3 23)**



Source: Banks publications, BoP
*Note: *Q2 for the whole sector*

- **NPLs ratio fell 2 decimal in Q3.** The total NPL ratio stood at 2,9% in Q3 2023, due to an improvement on the NPL ratio in the case of credit to consumption and to NFC. The ratio related to mortgage operations remained in 1,2%. For NFC, the ratio continued to decrease (-0,3 p.p., to 5,9%). 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.** In Q2, it decreased by 0,2 p.p., to 13,7% (ROE). Profitability is expected to keep benefitting from high interest rates.
- **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.**