PORTUGAL

A STUNNING IMPROVEMENT IN PUBLIC FINANCES

After eight years of socialist government, the centre-right Democratic Alliance coalition won the snap general election held on 10 March. This shift in the political landscape, where no party now has an absolute majority in Portugal's Parliament, could be a source of instability in the country. Nevertheless, the sweeping consolidation of public finances during António Costa's term, as well as sound macroeconomic fundamentals, give the future government considerable economic and fiscal leeway. Portuguese growth is expected to remain well above Eurozone growth in 2024 (standing at 1.2%, according to the European Commission, compared to 0.7% for the Eurozone).

A SHIFT IN THE POLITICAL LANDSCAPE IS CREATING INSTABILITY

The surprise resignation last November of Portuguese Prime Minister António Costa, due to a corruption and influence-peddling scandal within his inner circle, forced the President of the Republic to dissolve Portugal's Parliament and call a snap general election, which took place on 10 March 2024. After eight years of socialist government, the centre-right Democratic Alliance (DA) party won the highest number of seats in the Portuguese Parliament (80 out of a total of 230), and its leader, Luís Montenegro, became Prime Minister. The Socialist Party (SP) came second, with 78 seats. Finally, the far-right Chega party became the country's third-largest political force. Having made an astonishing breakthrough by increasing its number of parliamentary seats from 12 to 50 in two years, it is seen as the big winner of this election.

However, with these results, Luís Montenegro cannot form an absolute-majority government in Parliament. As there is seemingly no alliance between the DA and Chega, or the DA and the SP, in the pipeline, the DA will most likely rule as a minority government, with opposition parties rejecting its future bills and voting down its proposed budgets, as is currently happening in Spain. However, this is not the first time in the history of Portuguese democracy that there has been a minority government[1]; therefore, the SP and DA are used to cooperating if a government does not have an absolute majority. Even though the SP leader insisted that his party would vote down the proposed budget in the autumn, in the current circumstances, both parties seemingly have an additional interest in cooperating, as they both would want to avoid another snap general election, which could give Chega another opportunity to increase its number of seats.

SOUND MACROECONOMIC FUNDAMENTALS

However, this shift in the political landscape is occurring at a time when Portugal's macroeconomic fundamentals are sound, which should reduce the potential risks resulting from a new party taking power and the minority government set-up. Portugal's annual average growth rate for 2023 was 2.3%, which is similar to Spain's (2.5%) and well above the Eurozone's (0.5%). It is expected to remain high in 2024 (standing at 1.2%, according to the European Commission), driven mainly by the strong performances in terms of household consumption and exports.

Over 2023 as a whole, inflation (harmonised measurement) slowed by 2.8 percentage points (from an annual average of 8.1% in 2022 to 5.3% in 2023) and looks to have stood at 2.6% y/y in March, according to the preliminary estimate from the Portuguese National Institute for Statistics. This drop in inflation, which will continue in 2024, combined with strong wage growth (+5.5% y/y in Q4 2023, according to Eurostat), should continue to boost household purchasing power. The strong labour market performance is also good news for household consumption. Although the unemployment rate has been relatively stable over the past five years (6.5% in January 2024), the employment rate (15-74-year-olds) reached an all-time high in Q3 2023, standing at 63.9%, almost three percentage points above the Eurozone average.

GROWTH & INFLATION

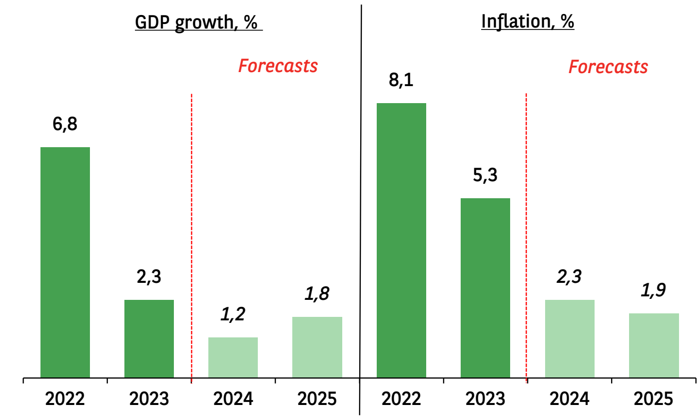

CHART 1 SOURCE: EUROPEAN COMMISSION (FEBRUARY 2024), BNP PARIBAS

Tourism should also continue to bolster exports. After the record tourism figures seen in 2023, with more than 18 million foreign tourists (+19% compared to 2022 and +11% compared to 2019), activity continued apace at the start of the year, with the number of foreign visitors hitting 964,700 in February (+10.4% y/y).

The broader roll-out of the EU's Recovery and Resilience Facility, from which Portugal is expected to receive EUR 16.3 billion in subsidies and EUR 5.9 billion in loans between 2021 and 2026, will sustain investment in 2024 and beyond. However, Portugal's political instability could affect future disbursements by Brussels, delaying the timeframes for investments and reforms associated with the country's recovery plan.

LARGELY HEALTHY PUBLIC FINANCES IN 2023

Throughout his term, the government of António Costa committed to restoring fiscal discipline. Recently, strong nominal growth in economic activity and rising tax revenues (+9% y/y in 2023) have helped public finances to improve. With a budget surplus of 1.2% of GDP this year, Portugal is enjoying its highest positive balance in its fifty years of democracy. Better still, the primary balance (excluding interest on debt) rose from a deficit of 8.5% of GDP in 2010 to a surplus of more than 3% in 2023, and the debt-to-GDP ratio fell below 100% in Q4 2023 (98.7%).

As a result, although the change of government may create uncertainty as to whether the pursuit of budgetary discipline started by the SP will continue, the country has some room for manoeuvre, with the 2024 budget still projecting a surplus of 0.2% of GDP for 2024.

Lucie Barette
lucie.barette@bnpparibas.com

1 Particularly between 2019 and 2022.