PORTUGAL

A MORE CONTAINED INFLATIONARY SHOCK

The large victory of António Costa's Socialist party in February's legislative elections provides some welcome political stability in the current economic environment. Even though the inflationary shock in Portugal is not as strong as in most of the European countries, and despite support measures introduced by the government, confidence surveys declined sharply in March. It remains to be seen how much this deterioration will alter hiring dynamics. So far, the job market is still on a positive trajectory, with an unemployment rate this winter close to the levels reported in the early 2000s.

The economic repercussions of the war in Ukraine – and foremost the surge in producer prices (20.7% y/y in February) and consumer prices (5.3% y/y in March) – triggered a sharp drop in business sentiment and household confidence in March. Although energy prices have not risen as dramatically as for its close neighbours (the harmonised CPI for energy was up 10.6% y/y against an eurozone average of 18.9% y/y), the country has been hit by major price increases for food as well as for hotel and restaurant services. It remains to be seen how much these price increases will carry over to economic activity and the labour market. The rebound in employment was better than expected in 2021, and the recovery continued into this winter. In February, the unemployment rate dropped to the lowest level in twenty years (5.8%). At 19.9%, the youth unemployment rate has also declined, but it is still higher than the 2019 level. Employment is approaching the peak level of 2008, although there is still a shortfall of 2%.

The government announced several support measures to offset the impact of higher energy prices on households and companies: fuel subsidies were extended through the end of April (AUTOvoucher programme); new lines of financing were made available (EUR 400 million) to help industrial and transport companies impacted by the war in Ukraine; and it used part of the surplus of the Environmental Fund (EUR 150 million), whose revenues are derived essentially from auctioning carbon issue permits.

PUBLIC DEBT IS NO REAL CONCERN IN THE SHORT TERM

In September 2021, the lifting of moratorium measures introduced during the pandemic does not seem to have created a corporate solvency shock. The government also set up the Retomar programme to serve as a buffer during this transition period. Portugal is one of the European countries that resorted to moratoriums the most during the Covid-19 crisis, and at their peak, a third of corporate loans were covered by the mechanism. The current surge in production costs, however, increases the risk of corporate defaults and weakens the Portuguese banking system. The banks have continued to clean up their balance sheets and seem to be in a better position to absorb any difficulties in the future. The non-performing loan ratio dropped to 2.3% in February, which is the same level as in year-end 2008.

The public deficit shrank below the 3% threshold to 2.8% of GDP in 2021. Thanks to the rebound in growth, the public debt ratio declined sharply to 127.4% of GDP in 2021, from 135.2% in 2020, but Portugal is still the third most heavily indebted country in the Eurozone. In the short term, the country's sovereign risk will be largely contained. Portugal benefits from fiscal support provided by the new European mechanisms (SURE job support programme, European Recovery and Resilience Facility). The government also has major cash reserves (EUR15.6 bn or 7.2% of GDP in Q4 2021) that it can use to meet any future repayment deadlines.

GROWTH & INFLATION

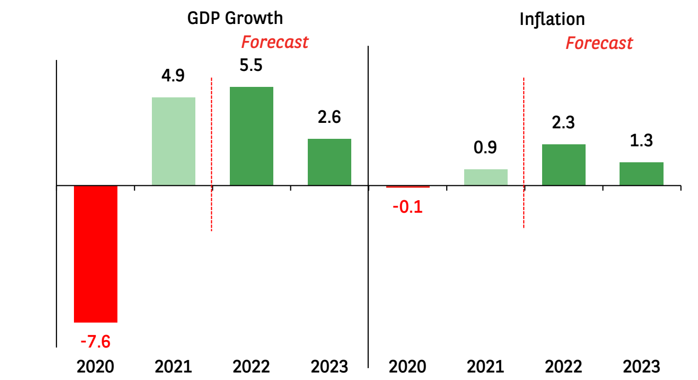

CHART 1 SOURCES: EUROPEAN COMMISSION, BNP PARIBAS

February's legislative election strengthened the position of the Socialist Prime Minister António Costa. Unlike the 2019 election, the Socialist party won a majority in parliament with 120 seats out of a total of 230 (up from 108 previously) to the detriment of the Social-Democrats, which lost 12 seats, and the leftist block, which lost 14 seats, bringing their total to 77 and 5, respectively. The election was also marked by the breakthrough of the far-right party Chega, which gained 11 seats, bringing its total to 12.

4 April 2022

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