PORTUGAL

A LESS SEVERE ENERGY SHOCK THAN ELSEWHERE

With a relatively limited risk of energy shortages, Portugal should record some of the largest economic growth in the eurozone this year. A number of favourable factors are driving these growth levels. There has been substantial carry-over growth from 2021 and real GDP rose sharply in Q1 (+2.4% q/q), before stabilising in Q2. The recovery in tourism has also boosted business activity this summer. Despite the aid measures for households and businesses, which the government estimates are worth EUR 4 billion so far in 2022, there should be a slight surplus on the primary budgetary balance for this year. Since he came to power in 2015, and despite successive crises, Prime Minister António Costa has persistently keep a fiscal discipline, which has not greatly hindered the country's economic growth.

Portugal has not been able to escape the inflationary shock, which is unparalleled in recent times. With inflation standing at close to 10% in August (9.3% y/y), the measures taken by the government to control the spike in energy prices are not enough. The rise in energy prices has slowed slightly (with prices remaining very high at +24% y/y in August, however), thanks, in particular, to the impact of the electricity tariff shield, which was introduced last spring, and the drop in oil prices. However, the spread of inflation to all consumer items is increasing: the underlying measure (which excludes energy and food products) recorded its strongest growth in almost thirty years in August, standing at 6.5% y/y. The fall in purchasing power due to rising inflation, as well as the effects of rising interest rates on debt servicing, is causing a significant deterioration in Portuguese households' financial situations. As a matter of fact, their ability to save is at its lowest since 2008 (according to a European Commission survey).

However, this drop in household purchasing power should only be apparent in Q4 2022 growth figures. Business activity during Q3 should have benefitted from tourist numbers returning very close to their 2019 levels. However, the gap has not closed completely: the hotel occupancy rate hit 70% last July, compared with 71.1% in July 2019 (according to the INE, the Spanish National Statistics Institute). In addition, the labour market is holding up well against the shocks thus far: the unemployment rate was 5.9% in July, which is slightly lower than the rate in late 2019.

Developments on the real-estate market will be closely monitored due to the current tightening of credit conditions. For the time being, price dynamics have been remarkable. Apart from a slowdown during the health crisis, the rise in housing prices has been relentlessly accelerating since 2015, hitting a record 16% y/y last July. In order to curb demand, in early 2022, the government announced that foreign investors looking to benefit from Golden Visas can no longer buy residential properties in certain areas, restricting their access to the majority of coastal towns and cities, where the housing supply is stretched. However, the effects of this measure have not yet been felt on prices, with the housing shortage still having a major influence on prices.

A new budgetary package worth EUR 2.4 billion was made available in early September in order to support households trying to cope with the inflationary shock. It includes a VAT cut on electricity from 13% to 6% (which will be in effect from 1 October 2022 to 31 December 2023), upgrading pension rates and sending a EUR 125 cheque to almost 5.8 million citizens. The price of public transport passes will be frozen in 2023, while rent increases will be capped at 2%. In addition to this spending, more structural measures were announced, such as relaxing legal conditions for households and SMEs to move from the market rate to the regular rate for gas, which was announced this summer. With this final helping hand, the interventionalist package from

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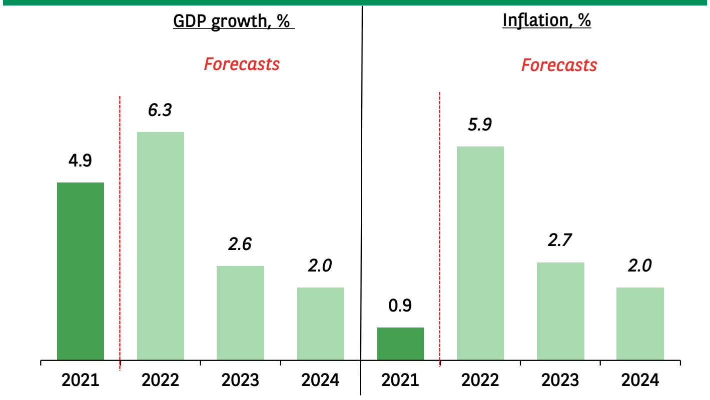

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

António Costa's government is in line with the eurozone average, with EUR 4 billion budgeted for all the "anti-inflation" measures announced so far in 2022. That is the equivalent of 1.9% of national GDP (2019).

In its stability programme, the government was expecting public debt to reduce gradually, to 100% of GDP by 2025 compared to 121% today (Q2 2022). Even though these forecasts are usually optimistic, and although they were made before the most recent budgetary package, the primary surplus expected by the government (0.3% of GDP in 2022, 1.6% in 2023) seems achievable as things stand: cumulatively over the first seven months of the year, the general government's primary balance recorded a surplus of EUR 4.4 billion. This figure is very close to 2019 levels (EUR 4.87 billion) and is much better than the same period in 2021 (a deficit of EUR -2.93 billion). In 2019, the primary balance registered a surplus of 3.1% of GDP. Therefore, all in all, despite the succession of recent crises, Prime Minister António Costa has persistently exercised fiscal discipline since he came to power in November 2015, which has not been detrimental to the country's business activity. For the past five years, growth in Portugal has been higher than the eurozone average.

Guillaume Derrien
guillaume.a.derrien@bnpparibas.com