PORTUGAL

THE VACCINATION CAMPAIGN IS PAYING OFF

Portugal's vaccination campaign seems to be paying off. It is the country that has vaccinated the most people in Europe – and one of the most advanced in the world – with nearly 85% of the population fully vaccinated at the end of September. The number of Covid-19 cases has fallen sharply after a surge in June-July due to the spread of the Delta variant. Portugal's economic recovery was slower than in most of the other European countries through Q2 2021, in part because it was hit by a more severe wave of the pandemic last winter. However, employment and housing activity have picked up strongly. As in several European countries, new risks have arisen as the pandemic wanes. Banking system risks must not be neglected: with a large share of loans currently under moratorium, the end of the Covid-19 crisis could be bumpy.

The contraction of Portugal's economy was sharper than previously thought last year. After revision from the National Statistical Institute (INE), real GDP fell 8.4% in 2020, compared to an initial figure of 7.6% (2019 growth was revised upwards by 0.2 percentage points to 2.7%). The downward revision in 2020 is mainly due to a bigger-than-expected contraction of activity in the hospitality and transport sectors, which were especially hard hit by lockdown measures. With the denominator effect coming into play, the public debt ratio rose to 135.2% of GDP in 2020.

At the end of Q2 2021, the Portuguese economy was still operating nearly 4% below the pre-pandemic level of Q4 2019. This major shortfall places Portugal among the laggards of the European economies. Even so, there are notable differences in the economic recoveries between sectors, with some that have returned to levels that are comparable with pre-Covid levels or very nearly so. This is the case for the construction, manufacturing, finance and insurance sectors. By contrast, other sectors have been slow to recover, notably the energy, retail and hotel & restaurant sectors harder hit by health restrictions.

Despite the mixed GDP data, employment rebounded by 2.8% in Q2 2021 and is now higher than the pre-pandemic level. The unemployment rate fell more moderately (6.6% in July) due to an increase in the active population, which is a positive trend. The labour market participation rate reached a new cyclical high of 59.3% in Q2 2021. Consumer confidence has also picked up, bolstered by the improvement in the labour market.

The housing market has also regained momentum with the easing of restrictive health measures. It did not slow much this winter, despite the wave of the pandemic that swept the country. House sales increased in Q2 2021 to the highest level in more than a decade, while real estate prices rose 8.3% y/y in July. Low interest rates fuelled demand. Indeed, borrowing rates continued to decline in 2021, dropping below 0.7% last April, according to the INE.

Though in decline, government subsidies aiming to limit the Covid-19 shock on the economy continue to weigh heavily on public finances. Portugal will report another large public deficit in 2021 (-5.0% according to the European Commission) and the stock of public debt could hold close to the level of 130% of GDP, despite the expected economic rebound in 2021. Yet the country entered the Covid crisis with healthy public finances: the General Government balance recorded a surplus of 0.1% of GDP in 2019 and it could report another primary surplus in 2022. Given its large debt stock, however, Portugal would be more vulnerable to an upturn in sovereign interest rates, which could occur if the European Central Bank decided to tighten monetary policy.

GROWTH AND INFLATION (%)

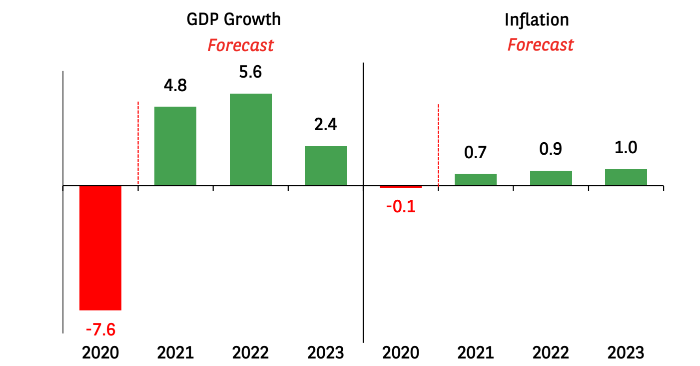

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

Banking system risks also must be monitored closely. Temporary measures set up to buffer the Covid-19 shock helped lower the volume of non-performing loans (NPL). As a result, the NPL ratio fell to 2.9% for loans to non-financial companies (NFC) and to 1.6% for household loans in August 2021. Yet this trend could reverse itself following the expiration of the loan moratorium on credit to businesses and families, that became effective at the end of September. Portugal is one of the European countries with the highest share of loans currently under moratorium. In July 2021, they were estimated at 11.3% of total household loans and 28.8% of total NFC loans outstanding according to the Bank of Portugal.

Completed on 23 September 2021

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