Economic activity in Portugal reversed sharply in March as the COVID-19 pandemic brought significant disruptions, particularly to the country’s large hospitality industry. Consequently, GDP fell by 3.8% quarter-on-quarter and 2.3% year-on-year in 2020-Q1 despite very positive data in the first two months of the year. Economic performance is expected to deteriorate at a much steeper pace of about 14% (quarter-on-quarter) in 2020-Q2 reflecting dramatic contractions in most of economic indicators. Tourism has been the most dramatically affected, with visits collapsing by almost 100% in April relative to a year earlier. The Commission’s Economic Sentiment Indicator also dropped abruptly from 105.7 points in February to 63.0 points in May before a partial recovery to 74.1 points in June. On the positive side, unemployment remained broadly stable in the range of 6.2-6.3% in March and April as temporary dismissals did not have an immediate statistical impact and government short-term work schemes also helped offset the shock.

With the confinement starting to ease in May, economic activity is slowly picking up but for many businesses, such as airlines and hotels, it is expected to remain well below its pre-pandemic level over a longer period. GDP is thus projected to drop by around 9.3% in 2020 before rebounding by about 6% in 2021. The risks are still tilted to the downside due to the large impact of foreign tourism, where the uncertainties over the medium term remain significant.

The effects of the pandemic on consumer prices are already visible. During the first half of 2020, the Harmonised Index of Consumer Prices (HICP) dropped below zero, reflecting a significant fall in energy prices, which more than offset a rise in food prices. Despite the fact that the crisis has created a combination of supply and demand shocks with opposite effects on prices, downward pressures due to weak aggregate demand are projected to prevail. Consequently, headline inflation is forecast to remain subdued in 2020 and rise gradually in 2021 in line with the expected economic recovery.