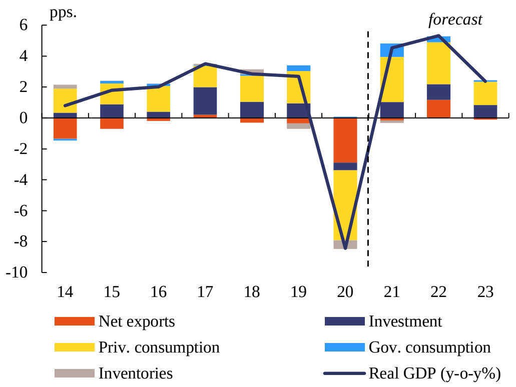
16. PORTUGAL

Portugal's economy is rebounding strongly, helped by a resurgence in demand and employment. The growth outlook remains favourable despite challenges related to global supply chains and uncertainty in foreign tourism. Public finances benefit from the recovery, amid a wind-down of fiscal support and revived momentum in public investment, helped by the financing from the RRF.

GDP rebounds helped by pent-up demand

Portugal's economy rebounded by 4.5% (quarter-on-quarter) in 2021-Q2, as the gradual relaxation of pandemic-related restrictions pushed up consumer demand. Sales of durable goods rose substantially against the backdrop of accumulated savings and pent-up demand. In the following months, retail trade with goods moderated but the service sector continued to increase at a strong pace. Domestic tourism performed particularly well, reaching historical highs in the summer. Foreign tourism also started to recover, but it remained significantly below its pre-pandemic level. Meanwhile, bottlenecks in global supply chains affected negatively the local automotive industry and, to a lesser extent construction.

Graph II.16.1: **Portugal - Real GDP growth and contributions**



As most of the COVID-19-related restrictions have been lifted since October, the economy is projected to continue its recovery and to reach its pre-pandemic level around the middle of 2022. In full-year terms, GDP growth is projected at 4.5% in 2021, 5.3% in 2022, and 2.4% in 2023. The growth is backed by the ongoing implementation of the Recovery and Resilience Plan. The hospitality sector is also set to support economic growth, although specific services related to foreign tourism are likely to remain below pre-pandemic levels until the end of the forecast period. The industrial sector is set to remain affected by supply constraints in the near term but to gradually pick up over the forecast horizon. In the external sector, the current-account balance is projected to improve somewhat over the forecast horizon, helped by the projected recovery in exports of services. However, the deficit in trade of goods is expected to rise against the backdrop of increased consumer demand and imports of investment goods.

The balance of risks appears slightly to the downside due to the large size of foreign tourism, where uncertainty remains high. Portugal's high vaccination rate reduces domestic risks related to the pandemic. At the same time, uncertainties related to the adoption of a budget for 2022 represent an additional risk factor.

Employment recovers to pre-pandemic level

After moving sideways until May 2021, labour market indicators started to improve along with the recovery in economic activity. As of August 2021, all labour indicators apart from hours worked reached pre-pandemic levels. Unemployment dropped to 6.4%, compared to 8.2% a year earlier, and to 6.5% in 2019, when tourism was at its peak. Employment and labour force participation rates performed equally well, reaching historical highs in the summer months. With the phasing-out of job retention schemes, labour indicators are set to improve at a much slower pace than GDP, with a gradual recovery in labour productivity. Therefore, the unemployment rate is projected to decline only marginally from 6.7% in 2021 to 6.4% in 2023.

Consumer price inflation (HICP) picked up from -0.1% (year-on-year) in 2021-Q2, to 1.2% in 2021-Q3. Apart from the steep acceleration in energy prices, industrial goods and base effects in tourism-related services contributed to the overall increase. Inflation is expected to rise further in the winter months in the context of higher energy prices, while services are set to turn into a major driver afterwards, including substantial base effects in the accommodation and airline services in 2022. In full-year terms, inflation is forecast to increase from 0.8% in 2021 to 1.7% in 2022, and to moderate to 1.2% in 2023.

Public finances to benefit from the recovery

The general government deficit is expected to narrow to 4.5% of GDP in 2021, down from 5.8% of GDP in 2020. In 2021, government revenue is set to rebound, with tax revenue being propelled by the projected economic recovery. The intake of EU funds is expected to be sizeable, including under REACT-EU (about ¾% of GDP). One-off revenue linked to the reimbursement of the pre-paid margin on the financial assistance loan by the European Financial Stability Facility (0.5% of GDP) should also contribute to roll back the deficit. However, these developments are set to be partly offset by continued growth in government expenditure in response to the crisis, on the back of spending on subsidies and social benefits, and the expansion of the public wage bill. Current spending is also expected to be compounded by pre-pandemic structural upward pressures. Fiscal support measures – mainly subsidies to firms and social transfers to households, namely linked to short-time work and furlough schemes, as well as health-related measures – are set to remain active in 2021. Their overall direct budgetary cost reached about 2.5% of GDP in August 2021, and it is set to increase further until the end of the year.

As the economic recovery takes hold, the budgetary outlook is expected to continue to improve. Based on the Draft Budgetary Plan of 15 October 2021, which constituted the relevant budgetary plan at the forecast cut-off date, the general government deficit is projected to ease to 3.4% in 2022, and to further decline to 2.8% of GDP in 2023. The phasing-out of crisis mitigation measures and growing tax revenue are set to drive the deficit reduction. Portugal's track record of low public investment is projected to be reversed over the forecast horizon, prompted by the new projects foreseen in the RRP. The forecast incorporates expenditure financed by RRF grants, which are set to gradually increase from 0.3% of GDP in 2021, to 1.5% of GDP in 2023. The forecast is surrounded by uncertainty linked to the adoption of a budget for 2022. Risks remain tilted to the downside, owing to the build-up of contingent liabilities from crisis-related public guarantees – whose calling may exceed current expectations – thereby adding to pre-pandemic vulnerabilities.

After its peak at 135.2% in 2020, the general government debt-to-GDP ratio is set to decline to 128.1% in 2021, driven by a favourable growth-interest rate differential and a debt-reducing stock-flow adjustment. It is projected to moderate further to 123.9% in 2022, and to 122.7% in 2023.

Table II.16.1:

Main features of country forecast - PORTUGAL

		2020			Annual percentage change					
		bn EUR Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP		200.1	100.0	0.4	2.8	2.7	-8.4	**4.5**	**5.3**	**2.4**
Private Consumption		128.5	64.2	0.6	2.6	3.3	-7.1	**4.6**	**4.2**	**2.4**
Public Consumption		38.3	19.1	0.2	0.6	2.1	0.4	**4.5**	**2.0**	**0.5**
Gross fixed capital formation		38.2	19.1	-2.0	6.2	5.4	-2.7	**5.4**	**5.2**	**4.3**
of which: equipment		10.3	5.2	0.4	8.9	1.8	-12.0	**7.7**	**9.2**	**5.8**
Exports (goods and services)		74.1	37.0	4.3	4.1	4.1	-18.6	**11.1**	**9.5**	**4.0**
Imports (goods and services)		78.3	39.1	2.6	5.0	4.9	-12.1	**10.9**	**6.2**	**4.1**
GNI (GDP deflator)		196.9	98.4	0.4	2.7	2.5	-7.5	**5.0**	**4.7**	**2.4**
Contribution to GDP growth:	Domestic demand			0.0	2.8	3.4	-5.0	**4.8**	**4.1**	**2.4**
	Inventories			0.0	0.3	-0.3	-0.6	**-0.1**	**0.0**	**0.0**
	Net exports			0.4	-0.3	-0.4	-2.9	**-0.2**	**1.2**	**-0.1**
Employment				-0.4	2.3	0.8	-1.9	**1.8**	**0.8**	**0.5**
Unemployment rate (a)				10.1	7.1	6.5	6.9	**6.7**	**6.5**	**6.4**
Compensation of employees / head				1.7	3.9	4.8	2.0	**2.2**	**3.0**	**3.0**
Unit labour costs whole economy				0.9	3.4	2.8	9.3	**-0.5**	**-1.4**	**1.1**
Real unit labour cost				-1.0	1.5	1.1	7.2	**-1.6**	**-3.1**	**-0.3**
Saving rate of households (b)				9.1	6.8	7.2	12.8	**9.0**	**7.8**	**8.0**
GDP deflator				1.9	1.8	1.7	1.9	**1.0**	**1.8**	**1.4**
Harmonised index of consumer prices				1.8	1.2	0.3	-0.1	**0.8**	**1.7**	**1.2**
Terms of trade goods				0.3	-0.8	0.4	1.6	**-0.3**	**0.0**	**0.0**
Trade balance (goods) (c)				-9.0	-7.8	-7.8	-6.4	**-7.5**	**-7.8**	**-8.1**
Current-account balance (c)				-5.6	0.3	0.1	-1.2	**-0.9**	**-0.4**	**-0.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-4.2	1.2	1.0	-0.1	**0.3**	**1.0**	**1.2**
General government balance (c)				-5.6	-0.3	0.1	-5.8	**-4.5**	**-3.4**	**-2.8**
Cyclically-adjusted budget balance (d)				-5.0	-1.8	-2.0	-2.6	**-2.7**	**-3.4**	**-3.1**
Structural budget balance (d)				-1.8	-1.1	-1.4	-1.9	**-3.0**	**-3.2**	**-3.1**
General government gross debt (c)				98.1	121.5	116.6	135.2	**128.1**	**123.9**	**122.7**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.