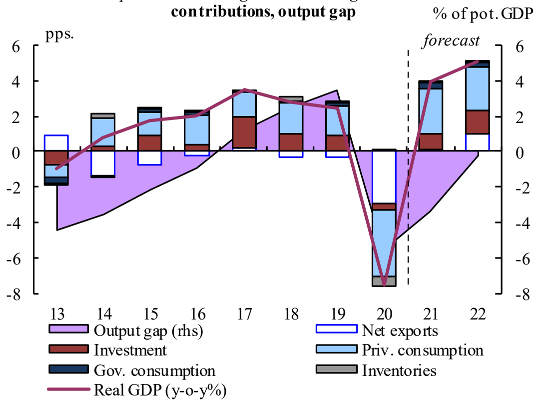
16. PORTUGAL

Portugal's economy is set to grow again from the second quarter of 2021 as measures to contain the COVID-19 pandemic are gradually relaxed. GDP is projected to reach its pre-pandemic level in mid-2022, also helped by the expected deployment of the RRF. After the public debt ratio reached an all-time high in 2020, public finances are set to gradually improve in 2021 and 2022, driven by the expected economic recovery and wind-down of fiscal support measures.

GDP to reach pre-pandemic level by mid-2022

Portugal's economy contracted by 3.3% (q-o-q) in the first quarter of 2021 as a result of the strict lockdown imposed in mid-January to contain a new spike in COVID-19 cases. While the scope of mobility restrictions was similar to the one in March-June 2020, the economic correction turned out much smaller. Businesses and consumers have since adapted to some degree to restrictions, helped by a new round of state support for jobs and incomes. Industrial supply chains have also remained largely resilient during the new lockdown. The country's large hospitality sector, in particular foreign tourism, was once again the most affected but its negative impact on growth was limited by the low base in the previous year.

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



With the gradual relaxation of mobility restrictions, the economy is expected to rebound in the second quarter of 2021 and to accelerate further in the third quarter. In full-year terms, GDP is projected to grow by 3.9% in 2021 and 5.1% in 2022. After the economic contraction of 7.6% in 2020, the current projections suggest that GDP should reach its pre-pandemic level in mid-2022. The forecast factors in strong growth in investment, helped by the deployment of the RRF. The recovery in tourism is assumed to gain speed in the third quarter of 2021 but the sector is not expected to have fully reached its pre-pandemic level by the end of the forecast period. Risks remain tilted to the downside due to Portugal's high reliance on foreign tourism where uncertainty on the path of its recovery remains high.

In the external sector, both exports and imports are projected to rise at high rates over the forecast period due mainly to base effects from the travel industry. The external sector is set to have a positive contribution to GDP growth in 2021 and 2022. The current-account balance is also projected to improve but to remain slightly negative as the net inflow of travel receipts is expected to remain below its pre-pandemic level.

Labour market remains resilient

The unemployment rate increased relatively mildly from 6.5% in 2019 to 6.9% in 2020 as government support to the labour market proved largely effective at protecting jobs and incomes. Unemployment remained at around 6.9% in the first quarter of 2021 when the new lockdown had a rather limited impact on the flow of newly-registered job seekers. The number of people employed shrank by 1.7%. The total number of hours worked, by contrast, showed a more significant decrease of 9.2%. This can be attributed to labour hoarding, which was very significant during the initial period of the pandemic. As the economy recovers both the rates of unemployment and employment are projected to return to their pre-pandemic levels in 2022.

Consumer prices (HICP) declined by 0.1% in 2020, mainly due to the steep drop in energy prices. Prices of industrial goods and services also contributed to the decline, while food prices, particularly those of unprocessed agricultural products, increased. Inflation picked up to 0.2% (y-o-y) in the first quarter of 2021 and is projected to increase further to 0.9% in 2021 and 1.1% in 2022. This reflects the rebound in crude oil prices in early 2021 and the gradual increase in service prices expected afterwards.

Public finances hit by the crisis

The general government balance was visibly impacted by the COVID-19 crisis, reaching a deficit of 5.7% of GDP in 2020. The package of crisis mitigation measures, with an estimated overall direct budgetary cost of about 3% of GDP, was the biggest driver of this deterioration. Spending increased across the board, with transfers and subsidies to firms and households – including through short-time work and furlough schemes – contributing the most. The decline in tax revenue by about 1¾% of GDP also pushed the deficit upwards, reflecting the operation of automatic stabilisers on the back of the sharp drop in output. The deficit was also affected by one-off measures in 2020, in particular the third activation of the Novo Banco contingent capital mechanism (0.5% of GDP). Excluding all one-off measures, the deficit would have been 5% of GDP in 2020.

The profile of fiscal support is set to shape the budgetary outlook over the forecast horizon. The deficit is projected to ease to 4.7% of GDP in 2021, on the back of the gradual economic recovery. However, in the light of the renewed lockdown restrictions in the first quarter of 2021, the crisis mitigation measures were prolonged and expanded. Consequently, the size of this year's policy package is now projected to be somewhat similar to that of 2020. At the same time, EU transfers under REACT-EU (close to 1% of GDP) and one-off revenue linked to the reimbursement of the pre-paid margin on the financial assistance loan granted by the European Financial Stability Facility (0.5% of GDP) should contribute to reducing the deficit. Looking ahead, the improvement in public finances is projected to gain momentum in 2022, amid a phasing-out of fiscal support and the economic rebound. This forecast takes into account the spending under the RFF according to the 2021 Stability Programme, as well as the associated grants. Risks to the budgetary outlook are tilted to the downside, linked to the build-up of contingent liabilities stemming from crisis-related public guarantees, which add to non-negligible pre-pandemic levels.

The general government debt-to-GDP ratio spiked at 133.6% in 2020, driven by the primary deficit, an unfavourable denominator effect and an increasing cash buffer. It is set to resume a downward path within the forecast horizon, declining to 127¼% in 2021 and 122¼% in 2022, mainly thanks to favourable growth-interest rate differentials due to improved economic conditions.

Table II.16.1:

Main features of country forecast - PORTUGAL

		2019			Annual percentage change					
		bn EUR Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP		213.9	100.0	0.3	3.5	2.8	2.5	**-7.6**	**3.9**	**5.1**
Private Consumption		136.6	63.8	0.5	2.1	2.6	2.6	**-5.9**	**4.0**	**3.8**
Public Consumption		36.0	16.8	0.4	0.2	0.6	0.7	**0.4**	**2.0**	**1.7**
Gross fixed capital formation		38.8	18.2	-2.6	11.5	6.2	5.4	**-1.9**	**4.6**	**6.9**
of which: equipment		12.2	5.7	-0.6	12.4	8.9	2.7	**-12.0**	**4.9**	**15.4**
Exports (goods and services)		93.2	43.5	3.9	8.4	4.1	3.9	**-18.6**	**10.3**	**8.9**
Imports (goods and services)		92.3	43.2	2.2	8.1	5.0	4.7	**-12.0**	**9.5**	**6.0**
GNI (GDP deflator)		208.6	97.5	0.3	3.6	2.7	2.4	**-6.6**	**4.4**	**4.6**
Contribution to GDP growth:	Domestic demand			-0.1	3.2	2.8	2.7	**-4.1**	**3.8**	**4.1**
	Inventories			0.0	0.1	0.3	0.1	**-0.6**	**0.0**	**0.0**
	Net exports			0.4	0.2	-0.3	-0.3	**-2.9**	**0.1**	**1.0**
Employment				-0.5	3.3	2.3	0.8	**-1.7**	**1.0**	**1.2**
Unemployment rate (a)				9.8	9.0	7.1	6.5	**6.9**	**6.8**	**6.5**
Compensation of employees / head				1.8	2.3	3.9	3.5	**2.9**	**2.8**	**2.8**
Unit labour costs whole economy				1.0	2.1	3.4	1.8	**9.3**	**-0.1**	**-1.0**
Real unit labour cost				-1.0	0.6	1.5	0.0	**6.8**	**-1.5**	**-2.5**
Saving rate of households (b)				9.5	6.6	6.8	7.1	**12.8**	**9.3**	**7.7**
GDP deflator				2.0	1.5	1.8	1.7	**2.4**	**1.4**	**1.5**
Harmonised index of consumer prices				2.0	1.6	1.2	0.3	**-0.1**	**0.9**	**1.1**
Terms of trade goods				0.4	-1.1	-0.8	0.5	**2.1**	**-0.9**	**0.2**
Trade balance (goods) (c)				-9.3	-7.0	-7.8	-7.9	**-6.2**	**-7.1**	**-7.2**
Current-account balance (c)				-6.3	1.0	0.3	0.2	**-1.1**	**-0.8**	**-0.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-4.8	1.8	1.2	1.0	**0.1**	**0.5**	**1.1**
General government balance (c)				-5.7	-3.0	-0.3	0.1	**-5.7**	**-4.7**	**-3.4**
Cyclically-adjusted budget balance (d)				-5.2	-3.6	-1.7	-1.8	**-2.7**	**-2.9**	**-3.3**
Structural budget balance (d)				-1.8	-1.5	-1.0	-1.2	**-2.0**	**-3.2**	**-3.2**
General government gross debt (c)				93.8	126.1	121.5	116.8	**133.6**	**127.2**	**122.3**

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