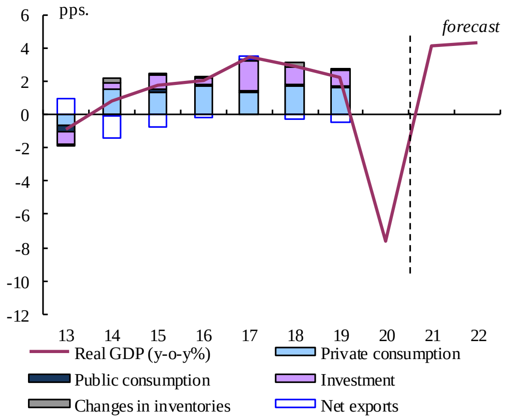
2.16. PORTUGAL

Portugal's economy contracted sharply in 2020 as the spread of the COVID-19 pandemic took a heavy toll on all aspects of social and business activities, with a particularly strong impact on the country's large hospitality sector. Portugal's GDP is estimated to have fallen by 7.6% in 2020. Quarterly rates closely followed the evolution of the pandemic and the consequent introduction of restrictions. After a cumulative drop of around 17% in the first half of 2020, GDP rebounded by 13.3% in 2020-Q3. However, the resurgence of infections brought new restrictions towards the end of the year and GDP growth weakened to 0.4% in the last quarter. With the introduction of a more stringent lockdown in mid-January 2021, GDP is projected to fall again in the first quarter of 2021, before starting to recover as of the second quarter of the year, with a major rebound in the summer months. This entails expectations for a notable rebound in tourism in the summer, particularly in intra-EU travel, and a more gradual recovery thereafter. However, the tourism sector is projected to remain somewhat below its pre-crisis level until the end of the forecast period.

In full-year terms, GDP is projected to grow by 4.1% in 2021 and 4.3% in 2022. A full return to pre-pandemic levels is expected towards the end of 2022 but risks remain significant due to the country's large dependence on foreign tourism, which continues to face uncertainties related to the evolution of the pandemic. On the other hand, measures specified in Portugal's draft Recovery and Resilience Plan, beyond those planned in the budget for 2021 (¼% of GDP), are not factored in the forecast and constitute an upside risk.

Service exports and equipment investment recorded the largest drops in 2020 but private consumption also fell significantly amid a steep rise in savings. On the other hand, investment in construction continued to grow, helped by the cycle of EU-funded projects. After the initial shock, manufacturing also performed relatively well, recovering to near pre-crisis levels. Pent-up consumer demand and the expected surge in business sentiment are projected to drive the economic recovery. Private consumption is also expected to benefit from a relatively resilient labour market, where the drop in employment compared favourably with that of output and government social transfers provide further support to incomes.

Graph 2.16: **Portugal - Real GDP growth and contributions**



Consumer prices (HICP) dropped marginally by 0.1% in 2020 and are set to increase by 0.9% in 2021 and 1.2% in 2022. The projected increase in energy prices is expected to be the main driver of inflation in the first half of 2021, followed by a gradual pickup in service prices as of the third quarter of this year.