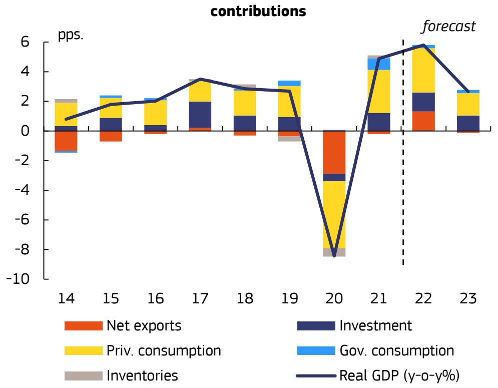
16. PORTUGAL

Portugal's economy grew by 4.9% in 2021, recovering slightly more than half of the level lost in 2020. The growth outlook remains favourable despite challenges related to commodity prices, global supply chains, and higher uncertainty in external demand. The public deficit is set to ease to 1.9% of GDP in 2022 and 1% in 2023, on the back of economic growth and the inflow of EU funds, amid a wind-down of crisis-related measures and strong momentum in public investment.

GDP keeps growing amid higher external risks

Portugal's GDP grew by 4.9% in 2021 after a steep contraction of 8.4% in 2020 caused by the outbreak of the COVID-19 pandemic. Investment and exports of goods rebounded to above pre-pandemic levels in 2021. However, private consumption recovered at a somewhat slower pace as contact-intensive services faced continuous restrictions. In quarterly terms, growth peaked in the second quarter of 2021 and moderated afterwards as pent-up demand gradually waned and services faced a new round of restrictions towards the end of the year. Growth picked up again to 2.6% (q-o-q) in the first quarter of 2022 as most of the containment measures were lifted in mid-January.

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



After the strong start of the year, Portugal's GDP is projected to rise by 5.8% in 2022 as the services sector, particularly foreign tourism, is set to rebound strongly from a low base. Economic growth is expected to moderate to 2.7% in 2023. Domestic demand is set to contribute substantially to growth in both years with investments rising faster than private consumption thanks to the ongoing implementation of the RRP. The external sector is forecast to have a positive net contribution to growth in 2022, reflecting the recovery in tourism, followed by a broadly neutral impact in 2023. However, the current-account balance is expected to worsen in 2022, due to high prices of energy imports, and to only improve in 2023 when energy prices are assumed to move downwards to some extent.

Risks to the growth outlook have moved to the downside as a result of Russia's war of aggression against Ukraine. In the light of Portugal's low direct exposure to the affected region, these risks are mostly indirect, stemming from commodity prices, security of supplies and uncertainty in global demand.

Unemployment drops to 20-year low

Helped by continued government support schemes and the economic recovery, the unemployment rate dropped to 6.6% in 2021. The rate improved further to 5.6% in February 2022, reaching a 20-year low. In addition, the employment rate rose to a historic high at the end of 2021 and early 2022. However, hours worked remained well below their pre-pandemic level. As job support schemes are set to expire in the second quarter of 2022, the unemployment rate is projected to improve at a much slower pace over the forecast horizon. The rebound in foreign tourism is set to more visibly impact hours worked than employment.

Consumer price inflation (HICP) averaged 0.9% in 2021 amid a substantial increase towards the end of the year. In quarterly terms, HICP inflation reached 2.4% (y-o-y) in the last quarter of 2021 and rose further to 4.4% (y-o-y) in the first quarter of 2022 as prices of energy and other commodities, including metals, construction materials and agricultural products, kept growing. Inflation is forecast to peak in the second quarter of 2022 and to gradually moderate thereafter at year-average rates of 4.4% in 2022 and 1.9% in 2023. Core inflation is projected at 3.7% and 2.2%, respectively, moving at a somewhat slower pace than the expected average wage growth.

Public finances benefit from the economic recovery

The budget balance reached a deficit of 2.8% of GDP in 2021, below the 5.8% observed in 2020. Public revenue drove the deficit reduction, thanks to the stronger intake of tax and social contributions' revenue (by 2.5% of GDP) and the higher inflow of EU funds (by more than 1% of GDP), compared to 2020. In particular, the revenue from taxes on production and imports grew buoyantly (by 10.6% y-o-y), on the back of stronger domestic demand. Public finances also benefited from one-off revenue linked to the repayment of the pre-paid margin of the European Financial Stability Facility financial assistance loan (of 0.5% of GDP). However, these favourable developments were partly offset by continued growth in public expenditure, where pre-pandemic upward pressures on current spending, especially on social benefits and the public wage bill, were amplified by the need to persist in responding to the pandemic. At the same time, there was revived momentum in public investment (by 19% y-o-y), after a protracted period of subdued growth.

Public finances are projected to continue to improve over the forecast horizon, supported by broad-based economic growth. Against that background, the deficit is projected to narrow to 1.9% of GDP in 2022, and to 1% in 2023. On the one hand, the gradual wind-down of the temporary measures taken in response to the pandemic is expected to contribute to roll back the deficit, despite possibly lasting effects on health-related intermediate consumption and the public wage bill. On the other hand, Portugal is also implementing additional measures to mitigate the impact of high energy prices in 2022, which include a combination of tax breaks and new subsidies to firms and households. The forecast also incorporates expenditure financed by RRF grants, which are expected to gradually increase to 1.3% of GDP in 2022, and to 1.6% in 2023. Prompted by the ongoing implementation of the RRP, public investment is projected to accelerate to above 3% of GDP in 2022, and to remain at a historically high level in 2023.

Reflecting the improving economic conditions and a reduction of the cash buffer, the public debt-to-GDP ratio declined to 127.4% in 2021, after its peak of 135.2% in 2020. Driven by favourable nominal growth-interest rate differentials, it is set to remain on a steadily declining path over the forecast horizon, moderating to 119.9% of GDP in 2022, and to 115.3% in 2023, when it would therefore fall below its pre-pandemic level.

Table II.16.1:

Main features of country forecast - PORTUGAL

		2021		Annual percentage change						
	bn EUR	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP		211.3	100.0	0.4	2.8	2.7	-8.4	**4.9**	**5.8**	**2.7**
Private Consumption		135.9	64.3	0.6	2.6	3.3	-7.1	**4.5**	**4.6**	**2.3**
Public Consumption		40.1	19.0	0.2	0.6	2.1	0.4	**4.1**	**1.2**	**1.3**
Gross fixed capital formation		41.8	19.8	-2.0	6.2	5.4	-2.7	**6.4**	**6.5**	**5.2**
Exports (goods and services)		88.8	42.0	4.3	4.1	4.1	-18.6	**13.1**	**12.3**	**4.1**
Imports (goods and services)		95.1	45.0	2.6	5.0	4.9	-12.1	**12.9**	**8.6**	**4.1**
GNI (GDP deflator)		208.8	98.8	0.4	2.7	2.5	-7.5	**5.3**	**5.2**	**2.8**
Contribution to GDP growth:	Domestic demand			0.0	2.8	3.4	-5.0	**4.9**	**4.5**	**2.8**
	Inventories			0.0	0.3	-0.3	-0.6	**0.2**	**0.0**	**0.0**
	Net exports			0.4	-0.3	-0.4	-2.9	**-0.2**	**1.3**	**-0.1**
Employment				-0.4	2.3	0.8	-1.9	**2.1**	**1.0**	**0.9**
Unemployment rate (a)				11.1	7.2	6.7	7.0	**6.6**	**5.7**	**5.5**
Compensation of employees / head				1.7	3.9	4.8	2.0	**3.8**	**4.2**	**2.6**
Unit labour costs whole economy				0.9	3.4	2.8	9.3	**1.0**	**-0.6**	**0.8**
Saving rate of households (b)				9.1	6.8	7.2	12.6	**10.9**	**7.7**	**7.2**
GDP deflator				1.9	1.8	1.7	1.9	**0.7**	**2.9**	**3.1**
Harmonised index of consumer prices				1.8	1.2	0.3	-0.1	**0.9**	**4.4**	**1.9**
Terms of trade goods				0.3	-0.8	0.4	1.6	**0.8**	**-2.6**	**2.5**
Trade balance (goods) (c)				-9.0	-7.8	-7.8	-6.4	**-7.4**	**-9.9**	**-9.1**
Current-account balance (c)				-5.6	0.3	0.1	-1.2	**-1.1**	**-1.7**	**-0.7**
General government balance (c)				-5.6	-0.3	0.1	-5.8	**-2.8**	**-1.9**	**-1.0**
Structural budget balance (d)				-1.9	-1.0	-1.2	-1.8	**-1.3**	**-1.9**	**-1.5**
General government gross debt (c)				98.1	121.5	116.6	135.2	**127.4**	**119.9**	**115.3**

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