After exceptionally strong growth for Portugal, a slowdown is looming

The Portuguese economy, driven by strong export dynamics in the first quarter, is expected to face a significant slowdown due to a weakening global economic context and rising financing costs. Although a further decline in inflation is expected, the inflation slowdown is hampered by increased wage growth

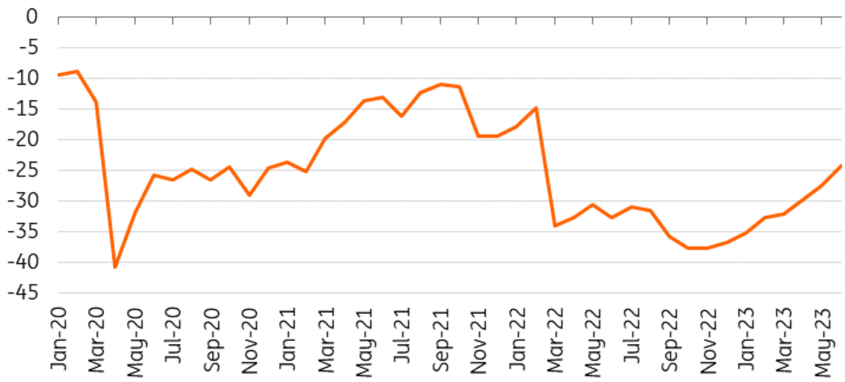
Portugal's tourism sector is thriving

Strong first-quarter growth will not be sustained

In the first quarter, the Portuguese economy experienced 1.6% quarter-on-quarter growth, primarily driven by robust export dynamics. However, this positive momentum will be increasingly challenged by the tightening of monetary policy. As households and companies become more cautious about taking on new loans, consumption and investment will slow down. The coordinated tightening of global monetary policy will also contribute to weaker global growth prospects, which will dampen Portuguese export dynamics –an essential driver of economic growth in the first quarter.

Despite numerous interest rate hikes, we maintain a positive growth scenario. For the second quarter, we still anticipate growth of 0.4% quarter-on-quarter, which is expected to decrease further to 0.2% in both the third and fourth quarters of this year. Positive factors such as favourable labour market developments, increased inflows of European funds, government measures to support income, and a thriving tourism sector partially mitigate the impact of higher interest rates. Additionally, consumer confidence has risen to its highest level since the start of the war in Ukraine, boosted by rising wages which have already risen more than 7% in certain sectors.

Cautious recovery in consumer confidence



Source: European Commission

Looking ahead to 2024, we expect full-year growth of 1.1%. With this forecast, we differentiate ourselves from other institutions that have a higher growth forecast for the Portuguese economy. Our projection takes into account a more pronounced influence of monetary policy on economic growth. This effect will already be felt in the second half of 2023, which also gives us a smaller spillover effect into 2024.

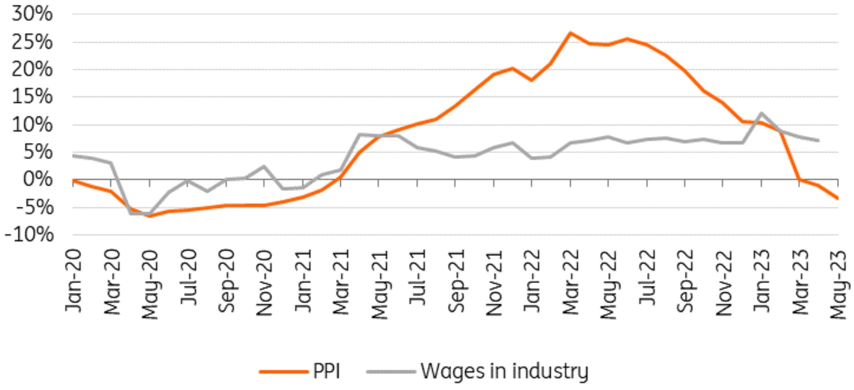
Moreover, the European Central Bank is expected to implement some additional interest rate hikes in July and September this year, the full impact of which will not be fully felt until 2024.

More signs that core inflation will fall further

Inflation has fallen significantly and is expected to remain on a downward path for the rest of the year. This decline can be attributed to the expected fall in energy and food prices, which gradually impact core inflation. Portugal's Producer Price Index (PPI), which measures the cost of inputs such as raw materials, intermediate goods and energy to businesses, is often considered an early indicator of inflationary pressures in the economy. The PPI in particular has fallen sharply: in May, producer prices fell 3.4% from a year earlier. These factors will contribute to further deflationary pressures on inflation.

However, wage growth will be the main driver of inflation, countering the downward pressure from lower energy and input costs. As companies pass on higher wages to consumers through higher prices, inflation will fall more slowly. For the rest of the year, the favourable base effect of energy will also gradually dissipate, which could push up overall inflation again. Our projections assume an average inflation rate of 5% for 2023 and 2.5% for 2024.

Falling producer prices, but wages rise



Source: INE

A significant growth slowdown in the pipeline

While we continue to expect continued economic growth for the rest of the year, we expect a significant slowdown after the strong start. Export dynamics, the major growth driver in the first months of the year, are likely to be affected by a deteriorating global economic environment and a significant rise in financing costs. While we expect a further decline in inflation, this downward trend will be tempered by upward pressure from rising wages.

Summary table

	2022	2023F	2024F	2025F
GDP	6.7	2.6	1.1	2.0
Private Consumption	5.8	1.0	1.1	1.5
Investment	3.0	2.6	3.4	4.4
Government consumption	1.7	1.4	1.0	0.8
Exports	16.7	7.0	2.9	3.7
Imports	11.1	4.2	3.9	3.5
Headline CPI	7.8	4.6	2.3	2.1
Unemployment rate (%)	6.0	6.9	6.8	6.6
Budget balance as a % of GDP	-0.4	-0.2	0	0.1
Government debt as a % of GDP	113.9	106.2	102.4	98.4

Source: Refinitiv, all forecasts ING estimates

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