CATÓLICA-LISBON Forecasting Lab | NECEP

January 18th, 2023

Executive Summary

In the **fourth quarter** of 2022, the Portuguese economy may have operated at around **101.9% of the pre-pandemic level**, relative to the fourth quarter of 2019. The information available is still contradictory, but the best estimate is that the Portuguese economy has **contracted around 0.5% over the third quarter**, which corresponds to a **year-on-year change of 2.4%**. For the whole of **2022**, the change should have been **6.5%**, although the Government has announced a figure of 6.8%, which would require a quarter-over-quarter growth of 0.4% in the last period.

The **euro zone** may have grown **0.1% quarter-over-quarter**, which is surprising given that, until recently, a slight contraction seemed inevitable. In **2022**, the euro zone might have grown by **3.4%**, still under the effect of the post-pandemic rebound that was stopped by the war in Ukraine, by the rise in energy prices and by an abnormally high inflation rate (8.4%).

Inflation in Portugal reached **7.8% in 2022** (with a year-on-year change of 9.6% in December), although it is reasonable to expect it to drop to around **6.0% in 2023**, following the recent deceleration. The ECB's monetary policy should contribute to a reduction in inflation either in the euro area or in Portugal, but only by 2024, noting that the interest rates are still in the interval between 2.0% and 2.75%. Thus, the ECB may raise benchmark **interest rates** over the next few months, following the lead of the US Federal Reserve until interest rates approach levels that are neutral in terms of favouring the economic activity and to ensure that inflation returns to its 2% target over the medium term.

The Portuguese economy is expected to have a fragile performance in **2023**, with a forecast interval ranging from a 1% contraction to a 2% expansion, with a **central point of 0.5%**. Investment shows a weak dynamic – it should have advanced only 2.1% in 2022 – despite the Recovery and Resilience Plan (PRR). Other factors to track are the evolution of inflation and interest rates, as well as the limits to tourism growth. Private consumption may suffer due to the real reduction in disposable income, which may be partially mitigated by the reduction of savings.

The **eurozone economy** should behave similarly, with the GDP growth central point at **0.7%** and a range between a 0.6% contraction and a 2.0% expansion. There is a risk of a mild recession, but this still does not seem to be the most likely scenario. The main risk factors are the evolution of the world economy, namely, the developments in the US and China, which has abandoned its Covid-zero policy. Energy prices, inflation and rising interest rates remain the main economic constraints, at a time when the war in Ukraine, a tragical development, does not seem to be an additional factor of pressure on the European economy.

In Portugal, the **structural balance** could improve by around one percentage point compared to 2022, as a result of the reduction in pensioners' disposable income in real terms, the main budgetary adjustment measure for 2023. The primary balance and the evolution of inflation could reduce the ratio of **public debt**, but the rise in interest rates would entail additional risks for the headline deficit and for the long-term debt sustainability.

Forecasts from Católica Lisbon Forecasting Lab – NECEP

Region	Indicator	2022 Q3 a)	2022 Q4	2022	2023 scenarios (% change)		
					Downside	Central	Upside
Portugal	GDP (% change on previous quarter)	0.4	-0.5	-	-	-	-
	GDP (year on year/annual % change)	4.9	2.4	6.5	-1.0	0.5	2.0
	Unemployment rate (%)	5.8	6.4	6.0	6.4	6.2	6.0
	Consumer prices (annual % change)	9.3 b)	9.6 b)	7.8	7.5	6.0	4.5
Euro Area	GDP (% change on previous quarter)	0.3	0.1	-	-	-	-
	GDP (year on year/annual % change)	2.3	1.8	3.4	-0.6	0.7	2.0

a) Official values (Statistics Portugal – INE/Eurostat); b) year-on-year change at the end of the quarter.

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