ECONOMIC BULLETIN

OCT. 2020

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Lisboa, 2020 • www.bportugal.pt

Economic Bulletin | October 2020 • Banco de Portugal Av. Almirante Reis, 71 | 1150-012 Lisboa • www.bportugal.pt •
Edition Economics and Research Department • **Design** Communication and Museum Department | Design Unit •
Translation International Relations Department | Translation Unit • **ISSN (online)** 2182-035x

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1 Overview

The novel coronavirus epidemic, which began in China at the end of 2019, spread during the first months of 2020 and soon became a pandemic. The world economy suffered a negative exogenous shock, which was unprecedented both in terms of size and synchronisation. This situation has led several countries to adopt containment measures. In Portugal, the state of emergency, which lasted from 18 March to 2 May, led to the temporary closure of a number of activities and included a self-isolation duty for the general population, closed borders and strong restrictions on freedom of movement. When the state of emergency ended, containment measures were gradually eased, but several restrictions to activity remained in place.

This shock differs from previous economic crises in that it originated from a factor that was exogenous to the economy and affected most countries in a direct and abrupt manner. The pandemic and the containment measures adopted by the various governments have led to a sizeable and simultaneous decline in supply and demand. Against this background, global GDP declined in the first quarter of the year and then more sharply in the second quarter (1.6% and 8.7%, respectively, year on year). As usual, world trade decreased more than activity, largely reflecting the fact that the production process is fragmented across geographical locations and organised by global supply chains. Global imports declined by 20.5% year on year in the second quarter of 2020. This compares with a record decline of 15% year on year during the 2008-09 crisis.

The response of economic policy was swifter and on a larger scale and scope than in the past. In order to contain the negative effects of the pandemic on the financial situation of households, firms and the financial system, and to lay the ground for a swifter recovery, several monetary, fiscal, prudential and supervisory measures were implemented over a short period of time. In the European Union (EU), national measures were complemented by concerted measures in an unprecedented effort of cooperation.

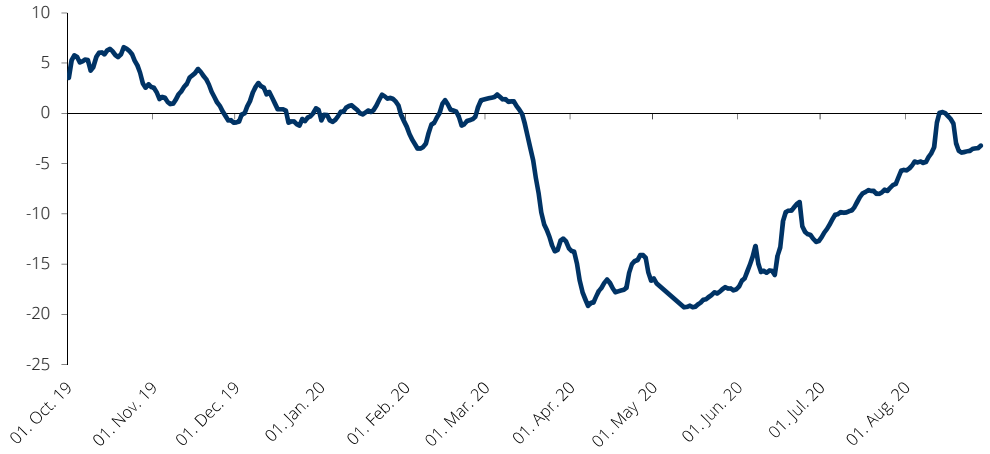
The ECB responded to the pandemic crisis from mid-March in order to ensure monetary policy transmission and favourable financing conditions for all euro area economies. An accommodative monetary policy was ensured by maintaining negative interest rates, strengthening forward guidance, substantially increasing asset purchases and through ample liquidity provision to the financial system. These measures have helped the non-financial private sector's financing conditions to remain favourable, especially when considering the unprecedented magnitude of the pandemic's effects and the increase in credit risk.

The combination of different economic policy tools has been important to respond to the pandemic shock. In Portugal, State-guaranteed credit lines were established to prevent the bankruptcy of firms that were viable before the pandemic and the subsequent capital and job destruction, leading to a more sustained recovery. These credit lines accounted for around half the loans granted by resident financial institutions to firms between March and June. The liquidity needs of firms and households were also mitigated by the implementation of public and private credit moratoria. Provided certain conditions were met, debtors were able to defer some of their obligations to the financial system without defaulting. At the end of the first half of the year, the moratoria covered approximately 15% of loans to households and 30% of loans to firms.

Fiscal policy mostly focused on the expenditure side to support labour income, preserve employment and increase social benefits. Particularly important among these measures was the "simplified layoff" scheme owing to its importance in preserving employment and reducing the liquidity needs of firms. The stimulus package implemented by the Portuguese government is a substantial fiscal effort (2.7% of GDP in 2020).

GDP, which had been increasing in Portugal since 2014, recorded a contraction of 3.9% and 13.9% quarter on quarter in the first and second quarters of 2020 respectively. The decline accumulated in the two quarters was larger than in the euro area (-17.2%, compared with -15.1%). These developments were the result of an unprecedented drop in activity over a short period of time. The contraction was particularly sharp from mid-March, when measures to contain the spread of the disease were imposed in several countries. From May, with the introduction of flexibility to these measures and the impact of the economic policy measures, economic activity has been gradually recovering (Chart I.1.1). At the end of the first half of the year, in most sectors, activity still remained considerably below the levels observed before the pandemic.

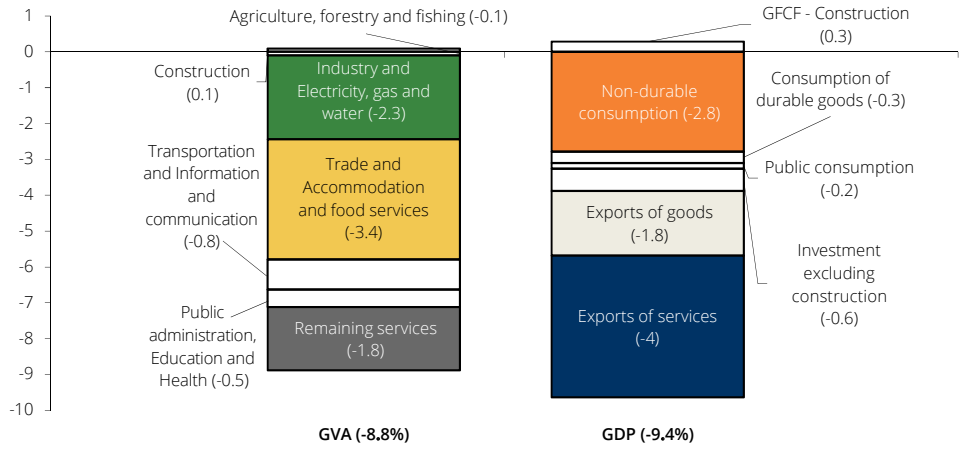
Chart I.1.1 • Daily economic indicator (DEI) | Year-on-year percentage change



Source: Lourenço and Rua (2020). | Notes: DEI is normalized so that its quarterly value has the same mean and standard deviation of the GDP quarterly year-on-year change over the last years. The data correspond to weekly moving averages.

The contraction was broadly based across main expenditure components. Private consumption declined more sharply than in previous recessions, with non-food non-durable consumption decreasing markedly (10.2% year on year in the first half of the year, compared with a 7.9% drop in total private consumption). Expenditure on durable goods also fell very significantly (by 16.1% year on year in the first half of the year), as is often the case in periods of uncertainty and of declines in household income. Constraints on productive activity, uncertainty surrounding the prospects of recovery for Portugal and its main trading partners and disruptions in global value chains have contributed to a decline of 6.4% in investment in the first half of the year. This decline was largely felt in investment in machinery and equipment, and transport equipment. In contrast, the construction component remained very buoyant (3.5%, year on year). The decline in global activity has also led to a weakening of external demand for Portuguese goods and services and a subsequent sharp drop in exports (21.9% year on year in the first half of the year). Services exports contracted more sharply than goods exports, reflecting a drastic fall in international tourism flows. Tourism exports remained low throughout the second quarter and the recovery is highly dependent on the evolution of the pandemic. Imports also dropped sharply, although to a lesser extent than exports (by 15.6% year on year). Taking into account the import content of the expenditure components, the largest contributions to the year-on-year decrease of 9.4% of GDP in the first half of the year came from services exports (4 p.p.) and non-durable private consumption (2.8 p.p.) (Chart I.1.2).

Chart I.1.2 • Decomposition of GVA and GDP in the first half of 2020 | Year-on-year percentage change and percentage point contributions



Source: Statistics Portugal – National Accounts (Banco de Portugal calculations). | Notes: The NACE sections presented are: A (Agriculture, forestry and fishing); F (Construction); B-E (Industry and Electricity, gas and water); G and I (Trade and Accommodation and food services); H and J (Transportation and Information and communication); O-Q (Public administration, Education and Health); and K-N and R-U (Remaining services). GDP contributions are net of imports.

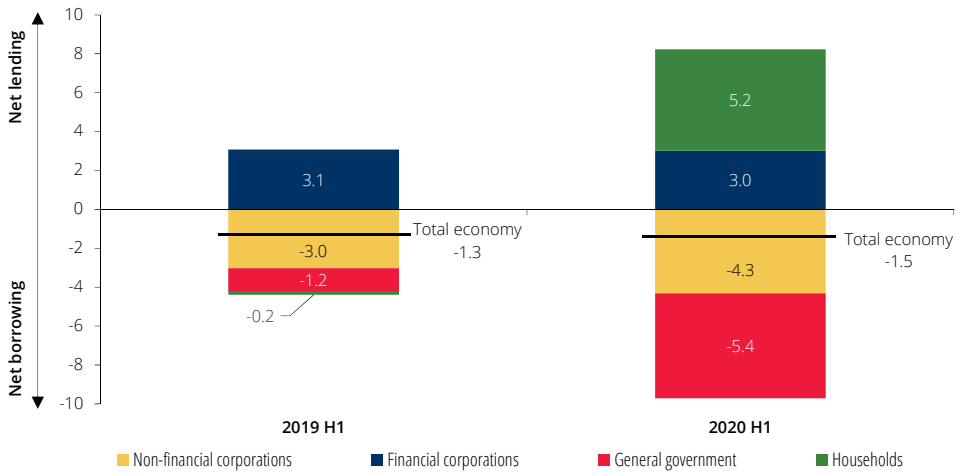
The common and exogenous origin of the crisis and the coordination and similarity of the responses have contributed to developments in Portugal and the other economies with similar features. Particularly relevant were, on the expenditure side, a sharp drop in exports and private consumption and, on the production side, a larger contribution from services to the decline in gross value added (Chart I.1.2). In Portugal, sectors strongly related to tourism, such as accommodation and food services, made the largest contribution to the decline in activity in the first half of the year.

The effects of the pandemic crisis have also been felt in the labour market. The contraction in activity has been accompanied by a drop in number of hours worked. The effect on employment has been mitigated by the measures adopted, more specifically the "simplified layoff" scheme and support to the self-employed. Despite these measures, and for the first time since the second half of 2013, employment recorded a year-on-year decline (2%) in the first half of the year. The drop in employment was larger for workers with temporary contracts, a lower level of education or who were younger. In contrast, employment increased for workers with open-ended contracts, aged 45 to 54 or with a higher level of education. Many individuals who lost their jobs or were already unemployed did not actively seek work, although they were available for work, and were classified as inactive rather than unemployed. Consequently, although there was a substantial increase in the slack of the economy, including in the labour market, the unemployment rate declined from 6.7% in the fourth quarter of 2019 to 5.6% in the second quarter of 2020.

Changes in the household consumption basket, constraints on production and a sharp fall in oil prices in international markets, arising from a drop in global demand, contributed to substantial changes in prices in several HICP items over the course of the first half of the year. Between the first and the second quarter, food prices accelerated year on year and energy industrial goods prices declined considerably. In the first half of the year, the rate of inflation stood at 0.2%, compared to -0.1% in the second half of 2019.

The current account recorded a larger deficit as a percentage of GDP than in the same period a year earlier (1.6% and 2% in the first half of 2019 and 2020 respectively). These developments resulted from a decline in the services account surplus arising from a deterioration in the balances of travel and tourism, and transports.

Chart I.1.3 • Decomposition of the net lending/borrowing of the economy by institutional sectors | Percentage of GDP



Source: Statistics Portugal. | Notes: The data presented correspond to semiannual values not seasonally adjusted. The household sector includes the non-profit institutions serving households.

Underlying the slight increase in the economy's financing needs in the first half of the year, compared with the same period a year earlier, is an increase in households' net lending (from -0.2% to 5.2% of GDP) and an increase in net borrowing of general government (from 1.2% to 5.4% of GDP) and, to a lesser extent, non-financial corporations (from 3% to 4.3% of GDP) (Chart I.1.3). These developments reflect considerable changes in the savings of a number of institutional sectors and, to a much lesser degree, investment.

In the first half of the year, total savings in the economy, 17.3% of GDP, remained virtually unchanged. Household savings increased (to 9% of GDP, from 3.3% in the same period a year earlier), savings of non-financial corporations declined and the general government recorded negative savings (-2.3% of GDP, compared with 1.4% in the same period a year earlier). During this period, the share of aggregate investment in GDP increased slightly (0.5 p.p.), given that the slight increase in investment by the general government and households more than offset the slight decline in investment by non-financial corporations.

The economic outlook is highly dependent on the evolution of the pandemic. The impact of this crisis on public and private sector debt, the drop in employment and increased credit risk pose challenges to economic growth over the next few years. Consumption and investment decisions in the coming half-years will be key to address the challenge of an economy that is more indebted overall. Policies should help the recovery in investment to mitigate these effects and promote an appropriate allocation of resources among the sectors of activity.

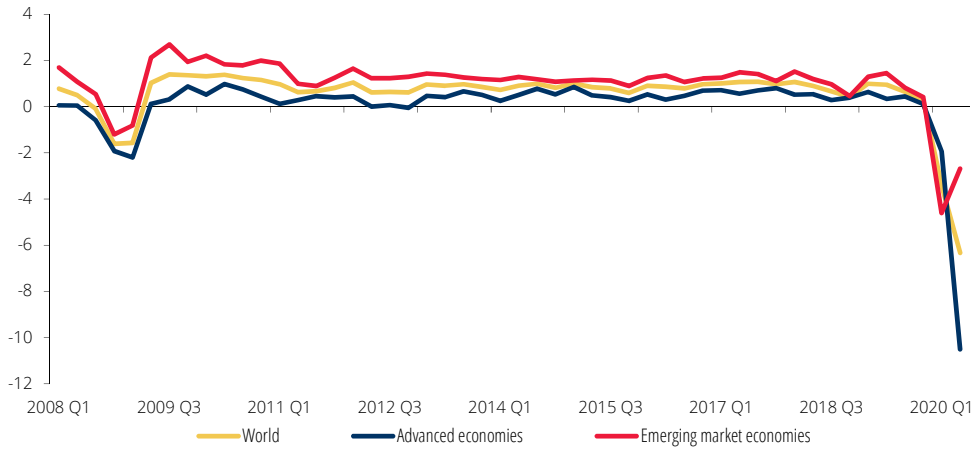
This issue of the *Economic Bulletin* is made up of three parts. Part I assesses the behaviour of the economy in the first half of 2020. Part II presents the projections for the year as a whole. Part III includes complementary analyses focused on the pandemic crisis.

2 External environment

The COVID-19 pandemic induced a marked, synchronised contraction in the world economy in the first half of 2020

The novel coronavirus pandemic generated an unprecedented global economic shock, with the world economy contracting, year on year, by 5.2% in the first half of the year (Chart I.2.1). In contrast to previous crises, this was an exogenous, broadly based shock and was associated with historically high levels of uncertainty. According to the International Monetary Fund (IMF), the contraction is likely to have hit 90% of economies.

Chart I.2.1 • World GDP | Quarter-on-quarter percentage change



Source: Refinitiv (Banco de Portugal calculations).

The fall in economic activity stemmed from fears of contagion and the uncertainty surrounding the pandemic, as well as the lockdown and social distancing measures imposed. The gradual lifting of lockdown measures after April contributed to a pick-up in activity, although mobility restrictions and social distancing recommendations remained in place.

The swift economic policy response contained the shock

Swift, comprehensive and wide-ranging monetary, fiscal, prudential and supervision policy measures made it possible to contain the shock on the economy and to pave the way for activity to recover. The different starting points, notably in terms of public debt and monetary accommodation, contributed to some diversity as regards the magnitude and policies across countries.

Monetary authorities took measures to stabilise financial conditions and provide monetary accommodation

Accommodative monetary policy prevented financial market disruptions through, for instance, interest rate cuts, asset purchase programmes, ample provision of liquidity and swap lines between central banks.

The Federal Reserve lowered the target for the federal funds rate by 150 basis points (b.p.) to the 0-0.25% range, reactivated the purchase of Treasury and agency debt, launched new facilities and established USD-denominated liquidity swap lines with other central banks. The facilities supported lending to the economy, reaching specific market segments – among which, commercial paper and riskier loans – and sustaining funding to small and medium-sized enterprises as well as local and state governments. Part of these programmes are backed by the Treasury under the Coronavirus Aid, Relief and Economy Security Act (CARES).

In the euro area, the ECB ensured an accommodative monetary policy stance, by maintaining negative interest rates, enhancing forward guidance, increasing asset purchases and sustaining ample liquidity provision.

In addition to raising the envelope of €120 billion under the existing asset purchase programme (APP), the Governing Council announced a new asset purchase programme – the pandemic emergency purchase programme (PEPP). Purchases under the PEPP may go up to €1,350 billion and will be conducted until the Governing Council judges that the coronavirus crisis is over and until at least the end of June 2021, in a flexible manner over time, across asset classes and jurisdictions. This flexibility has helped stave off risks to monetary policy transmission and maintain favourable financing conditions for all euro area economies.

To sustain increasing liquidity needs, the ECB conducted new liquidity-providing operations – in particular, non-targeted pandemic emergency longer-term refinancing operations (PELTROs), with an interest rate 25 b.p. below the rate applied in the main refinancing operations – expanded the list of assets eligible as collateral and eased funding conditions for targeted longer-term refinancing operations (TLTRO III). The TLTRO III cost of funding was cut by 50 b.p., particularly for the period between June 2020 and June 2021, and may go down to 50 b.p. below the deposit facility rate over the entire maturity of the operation for banks whose eligible net lending as at March 2021 stands at the same level as one year before. The very favourable conditions were behind the strong demand at the June TLTRO III, in which €1,308 billion was allotted, i.e. the largest amount allotted to date under any single Eurosystem's lending operation. Finally, to contribute to stability in international financial markets, the ECB established swap lines with other central banks.

Monetary policy measures proved effective in containing the effects of the pandemic crisis on financial markets and the fragmentation risks in the euro area, sustained lending to the economy and provided the necessary support to pursue the price stability objective (Section 2.1 in Part III).

Macroprudential and supervisory changes facilitated credit flows

At a time when liquidity needs increased, supervisory authorities eased the regulatory framework to guarantee lending to the economy.

US supervisors encouraged banks to use their additional capital and liquidity buffers to lend and eased the prudential treatment of loans. Leverage ratio rules were also eased.

The ECB Banking Supervision introduced flexibility to compliance with regulatory ratios, namely Pillar 2 requirements, the capital conservation buffer and the liquidity coverage ratio. The ECB temporarily eased the prudential and accounting treatment of credit exposures stemming from the implementation of moratoria. The European Council also implemented changes to capital requirements regulations, thereby introducing more flexibility to prudential and accounting rules.

Fiscal policy measures supported business continuity and household income

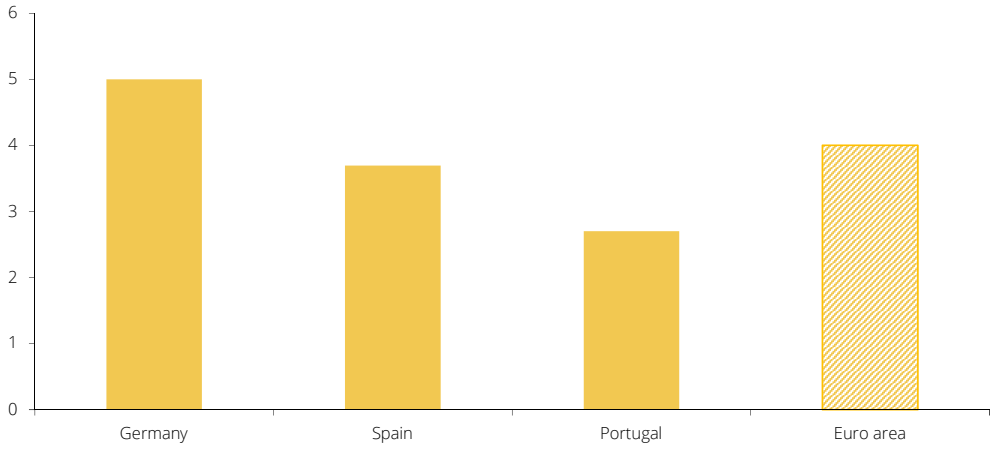
Most governments reacted immediately and strikingly, by providing support to health systems, firms and households. In particular, they strove to guarantee business continuity in light of liquidity constraints and to mitigate household income losses.

In the United States, the most prominent fiscal policy programme was CARES, which accounted for approximately 11% of GDP in tax cuts, unemployment benefits, social protection, health, assistance to local and state governments, international aid, loans and guarantees for small businesses and guarantees to Federal Reserve facilities. The US government approved two further legal acts to the amount of around 3.5% of GDP, mostly aimed at supporting small businesses, preserving employment, medical assistance and fighting the novel coronavirus.

At EU level, the European Council approved the Next Generation EU (NGEU) recovery fund in July, totalling €750 billion (approximately 5% of the EU's GDP). This amount will be broken down into loans (€360 billion) and non-refundable grants (€390 billion) and distributed between Member States from 2021 onwards. These resources will be obtained via debt to be issued by the European Commission. Moreover, the European Council approved, at the initiative of finance ministers in the Eurogroup, a €540 billion package (approximately 4% of the EU's GDP) to support health expenditure, guarantee fund on loans granted via the European Investment Bank, with a focus on SMEs, and temporary support to mitigate unemployment risks in an emergency (SURE).

European governments adopted measures to support the economy, even before the concerted European action and, more recently, they have expanded them. The size and composition of fiscal packages differ from country to country (Chart I.2.2). On average, discretionary measures taken by euro area countries have reached approximately 4% of GDP. The size of these packages is slightly smaller in a number of countries with limited fiscal room. Member States have also activated contingency measures. The potential amounts of these programmes also varied significantly across countries, ranging from around 8% of GDP in Spain to 30% in Italy.

Chart I.2.2 • Size of fiscal stimulus packages in response to the pandemic | Percentage of GDP

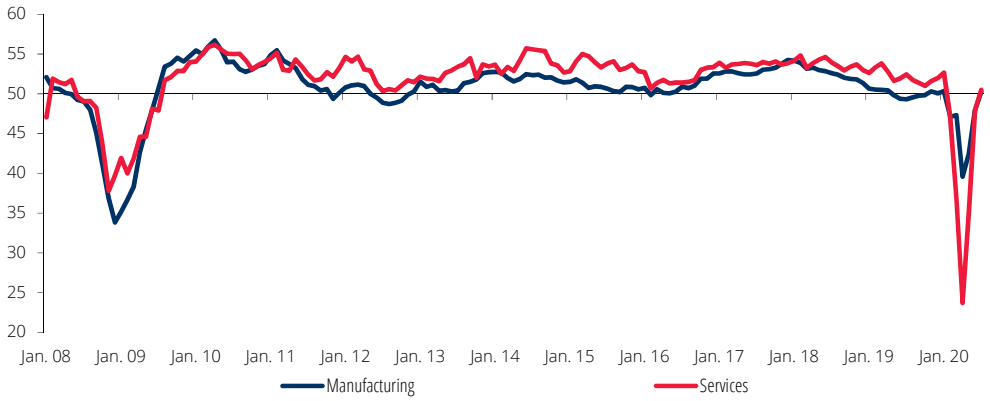


Sources: Bundesbank, European Fiscal Board, Eurostat, IMF, GEP/MTSSS and DGO/MF (Banco de Portugal calculations). | Note: Discretionary measures excluding contingent measures. Average of the measures of each government for the euro area.

Although synchronous, the pandemic shock affected economies and industries differently

Containment measures and their impact on activity were not the same in all economies. The impact varied according to productive structure, external openness, integration in global value chains and measures to support the economy. In sectoral terms, social distancing and mobility restrictions mostly affected services (Chart I.2.3). This contrasts with previous crises, in which services were one of the least affected sectors.

Chart I.2.3 • Global Purchasing Managers' Index | Index



Source: IHS Markit. | Notes: A value below 50 suggests a contraction in activity.

Marked contraction in private consumption

The containment measures adopted to limit the spread of the virus, the deterioration in the labour market situation and increased uncertainty impacted on expenditure components differently from previous recessions. Consumption decreased more than usual while household savings increased, reflecting the effects of the lockdown and precautionary motives amid consumer uncertainty and pessimism. Investment contracted in light of falls in activity and high uncertainty. The pandemic and containment measures have also implied a negative shock on supply, amplified by the organisation of production in global value chains.

Given that the pandemic started in China, Chinese GDP posted a 10% quarter-on-quarter drop in the first quarter. However, already in the second quarter, it rose by 11.5%, despite a reduction in consumption and a recovery in exports.

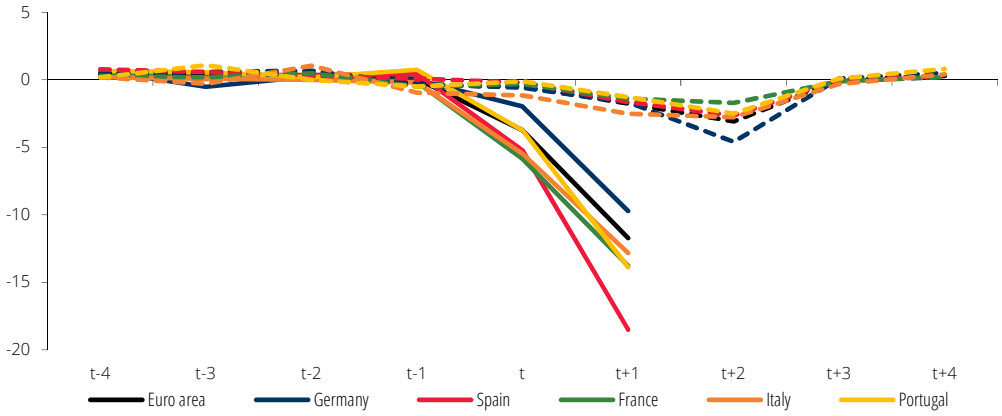
In the United States, GDP contracted, year-on-year, by 4.4% in the first half of the year (quarter-on-quarter rates of change of -1.3% and -9.1% in the first and second quarters respectively), with a fall across all expenditure components excluding public consumption. Unlike previous recessions, private consumption made a larger contribution to the reduction in GDP than investment.

In the euro area, GDP dropped, year-on-year, by 9% in the first half of the year (quarter-on-quarter rates of change of -3.7% and -11.8% in the first and second quarters respectively), which corresponded to an unprecedented fall, exceeding that seen during the global financial

crisis (Chart I.2.4). Similarly to other economies, private consumption fell more markedly than in previous recessions and was the main factor behind the reduction in GDP (in the first half of the year, year-on-year rate of change of -9.9% and -5.3 p.p. contribution to the rate of change in GDP). Consumption of durable goods fell considerably (Chart I.2.5). However, the most striking feature was the shift in consumption to the detriment of services. As a result of measures to support employment, disposable income remained relatively stable, which, together with consumption decisions, led to an increase in the savings rate to 17% in the first quarter (compared to a stable rate of around 13% since 1999).

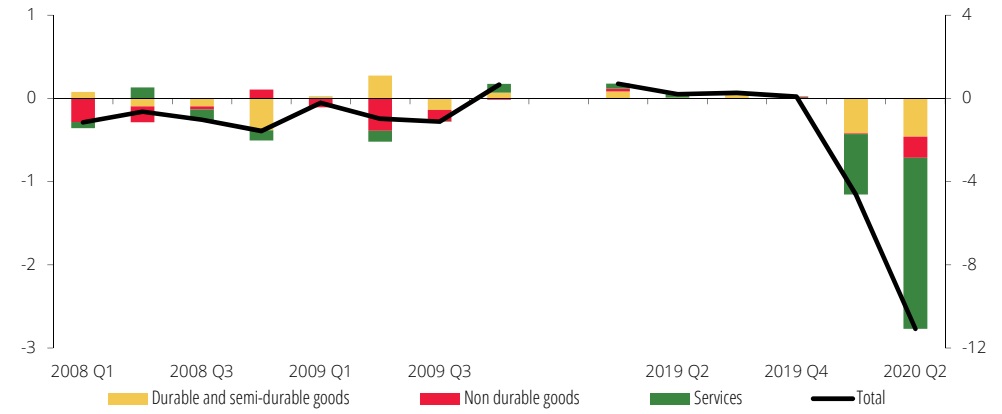
Despite the lower contribution to the reduction in GDP, the fall in investment exceeded that in private consumption (10.3%, year on year, in the first half of the year), reflecting GFCF decreases (19.5% in machinery and equipment and 8.2% in construction).

Chart I.2.4 • Euro area GDP growth – comparison with the global financial crisis | Quarter-on-quarter percentage change



Source: Eurostat. | Notes: Full line – pandemic crisis. Dashed line – global financial crisis. "t" refers to the quarter when the shock occurred : 2008 Q3 for the global financial crisis and 2020 Q1 for the pandemic crisis.

Chart I.2.5 • Private consumption in the euro area | Quarter-on-quarter percentage change and percentage point contributions



Source: Eurostat (Banco de Portugal calculations). | Notes: 2008 Q1-2009 Q4 reports to the left-hand scale, while 2019 Q1-2020Q2 reports to the right-hand scale.

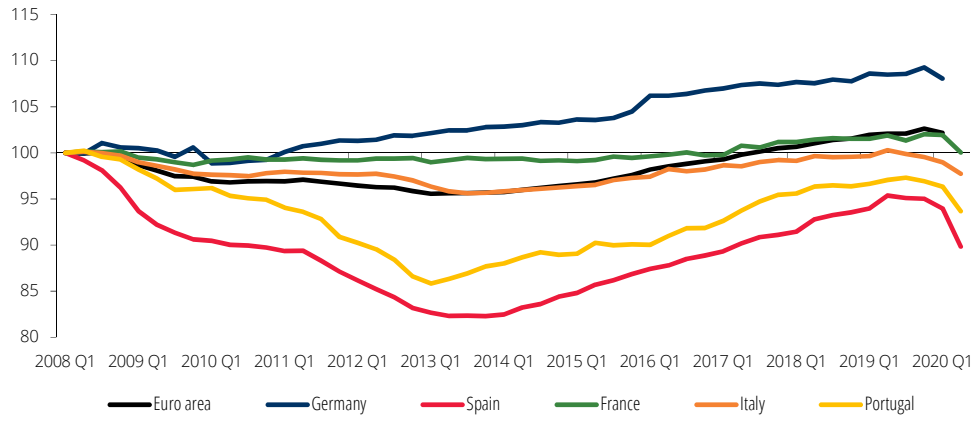
Economic activity in the first half of the year contracted in all euro area countries. In Germany, the contraction in GDP was more subdued than in the euro area (6.7%, year on year). In Spain, France and Italy, GDP contracted more markedly (13.1%, 12.3% and 11.7%, year on year), reflecting the local severity of the pandemic and the greater dependence on activities characterised by mobility and social interaction, such as those associated with tourism. In all countries, private consumption was the main element responsible for the decline in output.

Policy measures contained the effect of the crisis on the labour market

Containment measures led to a strong reduction in actual hours worked. According to the International Labour Organization (ILO), the estimated year-on-year fall in hours worked worldwide stood at 5.4% in the first quarter and 14% in the second quarter. To contain the effects that this could have on employment, governments adopted measures to support the labour market. The United States chose to preserve employment flexibility and reinforced the social protection network against unemployment. European countries mostly chose to implement furlough schemes (for instance, the "simplified layoff" scheme in Portugal) and to preserve the role of automatic stabilisers. Consequently, employment fell more markedly in the United States than in Europe. Conversely, developments in hours worked were similar in both regions and mirrored employment developments in the United States.

Despite the resilience in employment in the euro area, the impact was mixed across countries, depending on the percentage of employment in activities subject to forced closure and the structural characteristics of labour markets, notably the importance of temporary employment (Chart I.2.6).

Chart I.2.6 • Euro area employment | Index 2008Q1=100



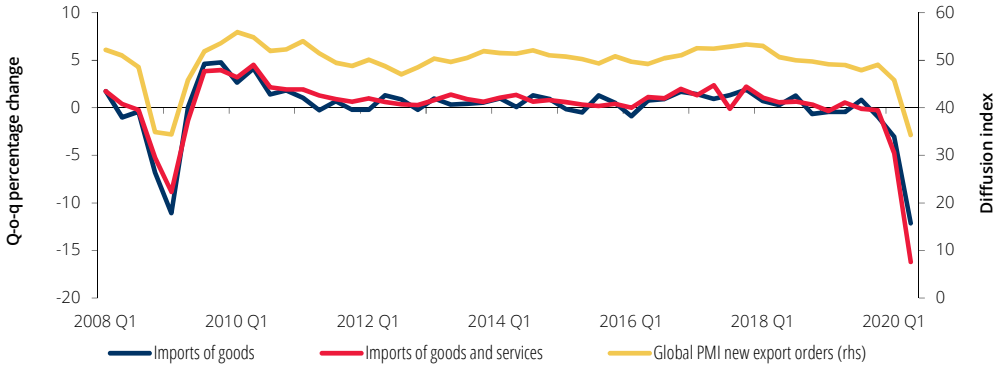
Source: Eurostat.

The pandemic crisis led to the largest fall in world trade

World trade collapsed in the first half of 2020, with a fall exceeding that seen during the 2008-09 global financial crisis (Chart I.2.7). Global imports of goods and services dropped by 12.5% in the first half of the year, compared to the same period one year earlier. World trade developments

were in line with the reduction in economic activity and were amplified by disruptions in global value chains. The fall in trade was also more marked in the services sector than in the goods sectors, in contrast to previous crises.

Chart I.2.7 • World trade



Sources: ECB, CPB and IHS Markit.

External demand for Portuguese goods and services fell by 15.1%

The abrupt, synchronised fall in the global economy implied a 15.1% decrease in external demand for Portuguese goods and services, year-on-year, during the first half of the year (Table I.2.1). Mobility restrictions particularly affected tourism-linked industries. The United Kingdom's contribution to the drop in external demand for Portuguese goods and services was sizeable given its weight in Portuguese exports – in particular, tourism – and the reduction by almost one-quarter in its imports of goods and services.

Table I.2.1 • External demand for Portuguese goods and services

	Weights [b]	Annual rate of change					Year-on-year percentage change		
		2015	2016	2017	2018	2019	2019		2020
							H1	H2	H1
External demand (ECB) [a]	100	4.0	2.9	5.0	3.4	1.6	2.0	1.2	-15.1
Intra-euro area external demand	57.1	6.0	3.2	5.7	2.8	1.9	1.9	2.0	-15.8
Imports:									
Spain	19.7	5.1	2.6	6.6	3.3	1.2	0.1	2.4	-19.4
Germany	10.8	5.4	4.4	5.8	3.8	2.6	4.1	1.1	-9.7
France	12.6	5.7	3.0	4.7	3.1	2.6	2.9	2.2	-13.7
Italy	3.2	6.3	4.1	6.5	2.8	-0.2	0.6	-1.0	-16.5
Extra euro area external demand	42.9	0.9	2.4	3.7	4.3	1.1	2.2	0.0	-14.0
Imports:	0.0								
United Kingdom	9.4	5.4	4.4	3.5	2.0	4.6	7.9	1.4	-23.0
United States	0.4	5.2	1.7	4.7	4.1	1.1	2.6	-0.4	-13.7
Brasil	0.7	-14.0	-10.4	7.2	7.4	1.1	3.2	-0.9	-14.1
China	0.3	-1.4	4.1	6.9	5.8	-1.2	-2.4	0.0	-12.5
World trade of goods and services (IMF)		2.8	2.3	5.7	3.8	0.9	–	–	–
World imports of goods (CPB)		1.7	1.5	5.3	3.8	-0.4	0.1	-0.9	-8.8

Sources: ECB, CPB, IMF and Refinitiv (Banco de Portugal calculations). | Notes: Each country year-on-year rates of change refers to imports of goods and services. (a) Computed by the ECB as the weighted average of imports volumes of the main trading partners of Portugal. Each country/region is weighted by its share in Portuguese exports. (b) Average weights over the period 2016-18.

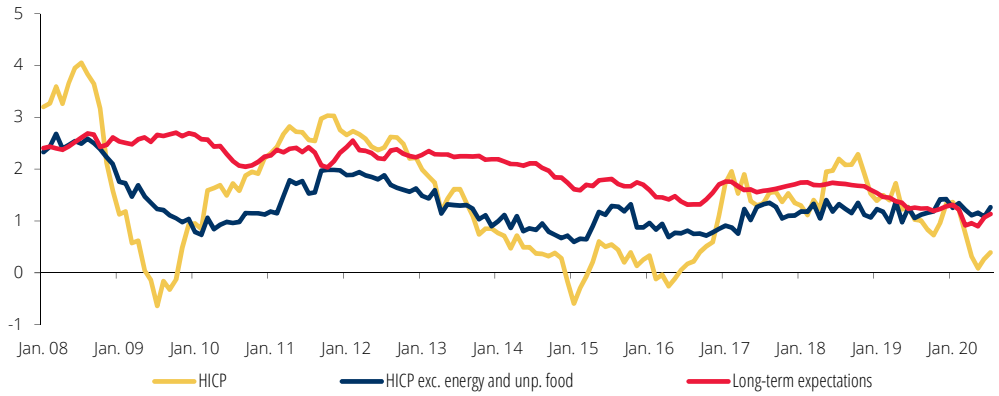
Euro area inflation decreased and expectations remained below the ECB's objective

The pandemic shock has had opposite effects on inflation. On the supply side, activity restrictions, interruptions in global value chains and the consideration of new costs associated with healthcare are likely to imply an increase in prices. In turn, the demand shock results in a decrease in prices. Available evidence so far suggests the predominance of a downward effect on prices.

In the euro area, the inflation rate dropped to 0.7% in the first half of 2020 (1% in the second half of 2019), amid difficulties in collecting the information needed to calculate it (Chart I.2.8). The decrease in inflation was largely due to the reduction in energy prices. The abrupt fall in economic activity and world trade in March and April led to excess oil supply and a price decrease to approximately USD 20 per barrel, compared to USD 60 at the beginning of the year. Its price subsequently recovered, to stand around USD 40 by mid-year.

Inflation expectations remained low during the first half of 2020. Inflation expectations in the long run implied in market instruments decreased between March and May (a 32 b.p. reduction in average five-year inflation expected five years ahead), in line with actual inflation, only to recover subsequently, but still remaining below the levels observed at the beginning of the year.

Chart I.2.8 • Euro area inflation | Year-on-year percentage change



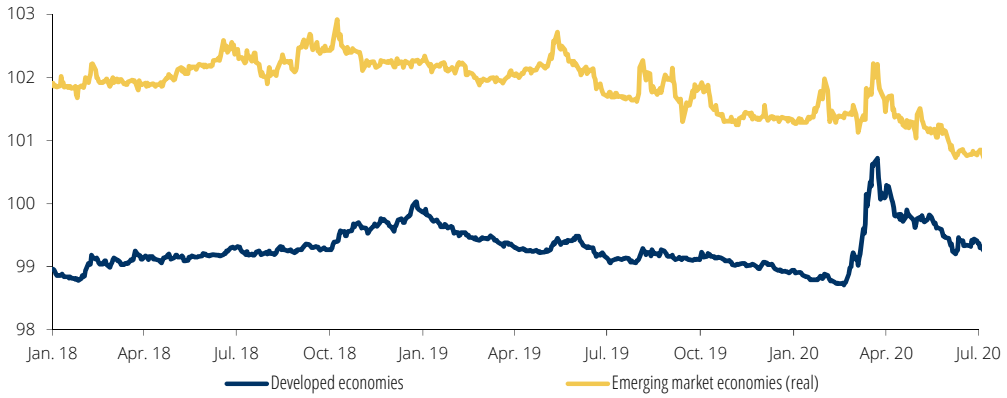
Sources: Eurostat and Refinitiv. | Notes: Long-term expectations – 5-year inflation rates 5-year forward implicit in inflation swaps.

Financial markets stabilised after a period of volatility

From end-February onwards, with the onset of the outbreak of the virus worldwide and in light of uncertainty associated therewith, as well as a strong increase in risk aversion among investors, global financial conditions deteriorated markedly in developed economies (Chart I.2.9). The swift economic policy response is likely to have contributed to containing financial market tensions from mid-March onwards. By mid-year, volatility indicators had already reached levels close to those seen at the beginning of the year. Equity market prices fell markedly, but subsequently recovered to levels close to those seen at the beginning of the year in several economies. Government debt yields decreased considerably, particularly in economies further away from the zero threshold, such as the United States. Interest rates in the major advanced economies are now close to 0%. The decrease in nominal interest rates went hand in hand with a reduction in real interest rates,

in line with a rise in savings, the decline in investment opportunities and the downward revision of the growth outlook. Foreign exchange markets reflected the effect of the pandemic on global risk sentiment. Despite the depreciation during the peak of the pandemic crisis, the euro appreciated in nominal effective terms in the first half of the year compared to the end of 2019.

Chart I.2.9 • Financial conditions indices | Index



Source: Goldman Sachs. | Notes: Financial Conditions Indices (FCI) are weighted averages of short- and long-term interest rates, corporate bond market spreads, stock prices and exchange rates, where the weights try to capture the effect of financial variables on GDP growth over a short horizon. An increase represents a tightening in financial conditions.

3 Monetary and financial conditions

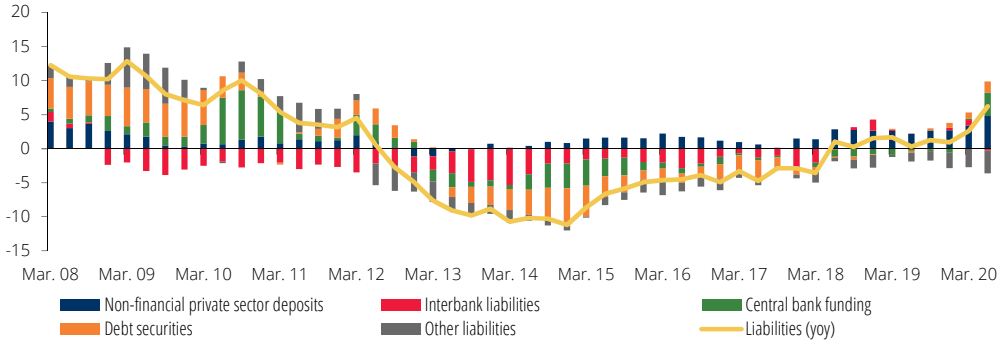
The shock of the COVID-19 pandemic has led to a deterioration of the financial situation of households and firms. Its immediate effects have resulted in increased liquidity needs. In order to mitigate this increase, the ECB and other central banks have adopted several monetary policy and regulatory measures to ensure an ample supply of liquidity to the economy, thus contributing to financial market stability and monetary policy transmission. Governments have complemented these policies with several measures, most notably furlough schemes (for instance, the "simplified layoff", in Portugal), credit moratoria and State-guaranteed credit lines. In Portugal, these measures have helped the financing conditions of the non-financial private sector to remain favourable, in particular considering the magnitude of this shock and the increase in credit risk.

The financing conditions of banks remained favourable

In the second quarter of 2020, the financing conditions of Portuguese banks remained favourable, largely reflecting the accommodative stance of the ECB's monetary policy. The liabilities of resident banks, covering deposits, debt securities and other liabilities, increased considerably, reaching a year-on-year rate of change of 6.2% in June, a figure that had not been recorded since the euro area sovereign debt crisis (Chart I.3.1).

In contrast to the previous crisis, non-financial private sector deposits were the main contributor to growth in bank liabilities, complemented by a strong contribution of central bank funding (Chart I.3.1). While the former reflected a change in depositor behaviour, the latter reflected banks' reaction to the measures adopted by the Eurosystem, against a background of increased demand for credit.

Chart I.3.1 • Contributions to the year-on-year rate of change in resident banks' liabilities
| Percentage and percentage points



Source: Banco de Portugal.

The deposits of households and firms accelerated in the months most affected by the pandemic (year-on-year rates of change of 6% in June for households, compared with 3.7% in December 2019, and 18.1% for firms, compared with 9.6% in December). The acceleration in household deposits, in a context of record low interest rates, is consistent with a considerable increase in household savings, high uncertainty and increased risk aversion. A share of this increase in deposits will be temporary, as it results from 'forced' savings by the lockdown and social distancing measures. For firms, a share of the increase in deposits likely results from loans received during this period.

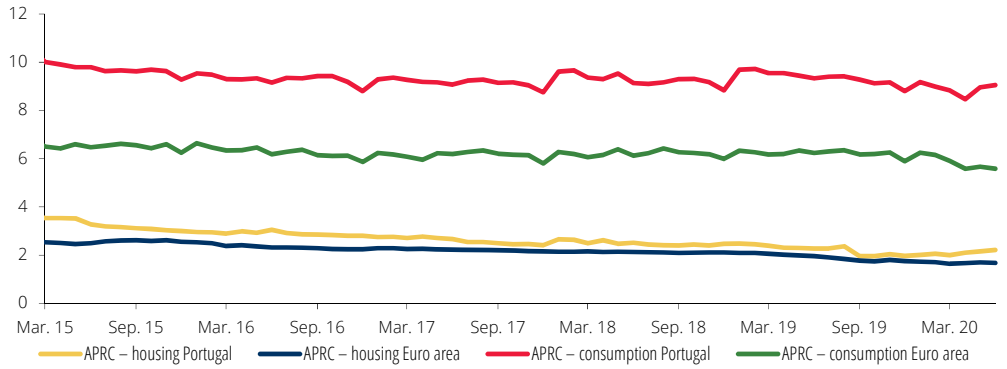
According to the euro area Bank Lending Survey (BLS), Portuguese banks were faced with a slight deterioration in the conditions for access to wholesale funding and their ability to securitise loans, in

the first quarter, and a stabilisation of these conditions in the second quarter. These developments took place amid worsening financial conditions in the euro area in the first quarter, which were largely reversed with the announcement of monetary policy measures by the ECB in mid-March (Section 2.1 of Part III). In the second quarter, banks also reported an improvement in access to short-term retail funding, in line with the observed increase in non-financial private sector deposits.

Interest rates on new loans to households remained low

From March to June 2020, interest rates on housing and consumer loans in Portugal remained low (Chart I.3.2). In June, the average annual percentage rate of charge (APRC) on new loans to households stood at 2.2% for house purchase and 9.1% for consumption (2% and 8.8%, respectively, in December 2019). In the euro area, these rates declined from 1.8% to 1.7% for housing loans and from 5.9% to 5.6% for consumer loans during the same period.

Chart I.3.2 • APRC on new loans to households for house purchase and consumption | Percentage



Sources: ECB and Banco de Portugal. | Notes: The APRC is the annual percentage rate of charge. This rate represents the total cost of the credit for the consumer, including interest and other (related) charges that the consumer has to pay for the credit.

However, in the July 2020 Bank Lending Survey, Portuguese banks reported a tightening of credit standards on loans to households in the second quarter (Chart I.3.3). According to the survey, banks rejected a higher share of loan applications in the second quarter than in the first quarter and tightened the loan-to-value ratio for housing loans. These changes resulted from an increase in risks related to the economic situation and outlook, a deterioration in borrowers' creditworthiness and a decline in risk tolerance. Together with a decrease in demand, this tightening likely had an impact on lending volumes (Charts I.3.3 and I.3.4).

In order to ensure liquidity to households in the short-run, Banco de Portugal introduced a temporary adjustment to the Macroprudential Recommendation issued in 2018, allowing banks to exceed the limits that had been previously recommended for the debt-service-to-income (DSTI) ratio, when granting personal credit with maturities of up to two years, provided the credit is intended to mitigate temporary household liquidity shortage situations.

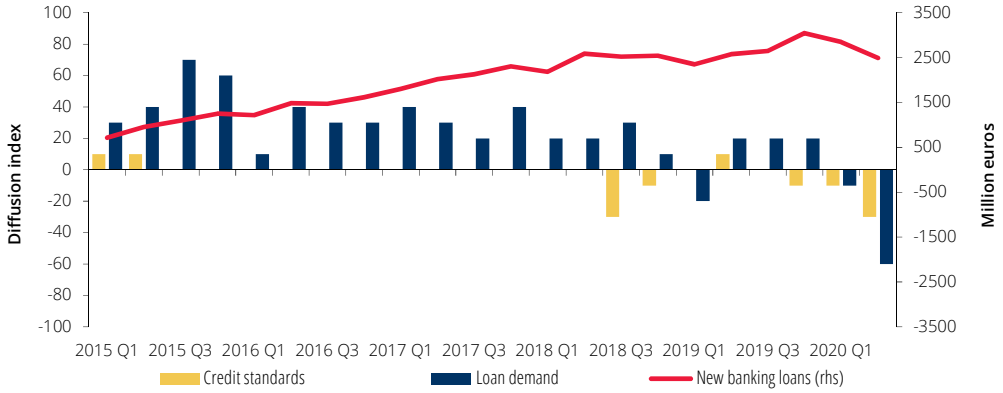
New housing loans and consumer credit have declined since the start of the pandemic

According to the BLS, since the start of the pandemic, credit demand has declined sharply, driven by lower consumer confidence, deteriorating housing market prospects, a decline in consumption spending on durable goods and restrictions to mobility and trade due to the pandemic.

The amount of new housing loans declined by 6.5% in the first quarter and by 12.5% in the second quarter, compared with the previous quarters, interrupting the upward trend observed in the recent past (Chart I.3.3). In the second quarter, the drop in the value of new loans took place amid an even sharper decline in the value of real estate transactions (the quarter-on-quarter rate of change in the value of transactions stood at -2.5% in the first quarter and -23.8% in the second) and a deceleration in prices (the year-on-year rate of change in the house price index declined from 10.3% in the first quarter to 7.8% in the second).

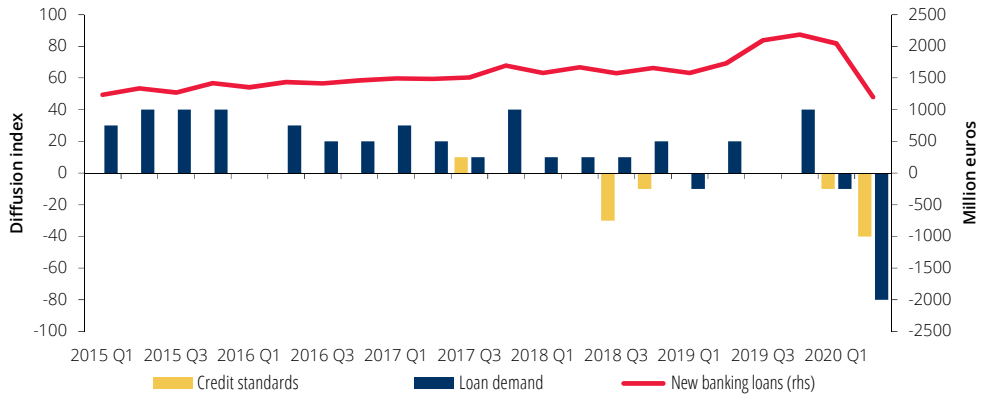
New consumer credit and other lending declined more sharply than housing credit, recording quarter-on-quarter rates of change of -6.3% in the first quarter and -41.4% in the second (Chart I.3.4). This decline was observed both in car loans and personal loans. In the second quarter, the decrease in new consumer credit was more pronounced than the decline in private consumption excluding food (the ratio of new credit, excluding credit cards, to private consumption, excluding food, decreased by 2.1 p.p. to 3.4%, compared with an average of 5.6% in 2019).

Chart I.3.3 • New loans and demand and supply of loans granted by resident banks to households for house purchase



Source: Banco de Portugal. | Notes: The diffusion index varies from -100 to 100, where 0 corresponds to the "unchanged" situation. In the case of the credit standards the chart includes the additive inverse of the diffusion index. Values higher (lower) than zero mean less (more) restrictive credit standards and represent an increase (decrease) in loan demand.

Chart I.3.4 • New loans and demand and supply of loans granted by resident banks to households for consumption and other purposes



Source: Banco de Portugal. | Notes: The diffusion index varies from -100 to 100, where 0 corresponds to the "unchanged" situation. In the case of the credit standards the chart includes the additive inverse of the diffusion index. Values higher (lower) than zero mean less (more) restrictive credit standards and represent an increase (decrease) in loan demand.

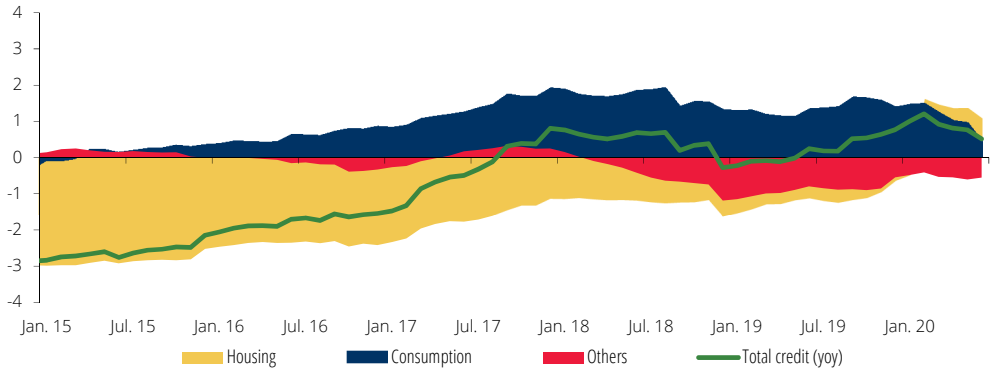
Stable household debt

The annual rate of change in total credit to households decreased in the course of the first half of the year, but remained positive (0.5% in June) (Chart I.3.5). The slight increase in credit was due to growth in new loans up to March 2020 and a decline in repayments in the second quarter. Credit moratoria, allowing those households most affected by the pandemic to defer principal and interest payments, contributed to the decrease in repayments. At the end of the first half of the year, 15.7% of lending to households was covered by a moratorium. Resort to this measure was more common among young people and the self-employed, groups that tend to have less stable work situations (Section 2.5 of Part III).

Since February 2020, housing loans have contributed positively to the annual rate of change in total credit, which had not been the case since June 2011. This contribution became more pronounced in the months affected by the pandemic. In contrast, consumer credit decelerated sharply in the second quarter, although it continued to make a positive contribution to total credit. The annual rate of change in this segment stood at 3.2% in June, the lowest since November 2015. The strong decrease in new consumer credit following the outbreak of the pandemic and the fact that resort to moratoria was lower for consumer credit than for housing loans are likely to have contributed to this situation.

In the euro area, developments in the annual rate of change in bank loans for house purchase were similar to those in Portugal, recording a slight increase compared with December 2019. In turn, consumer credit decelerated even more abruptly than in Portugal.

Chart I.3.5 • Contributions to the annual rate of change in total credit to households by credit purpose | Percentage and percentage points



Source: Banco de Portugal.

Corporate funding supported by State-guaranteed credit lines

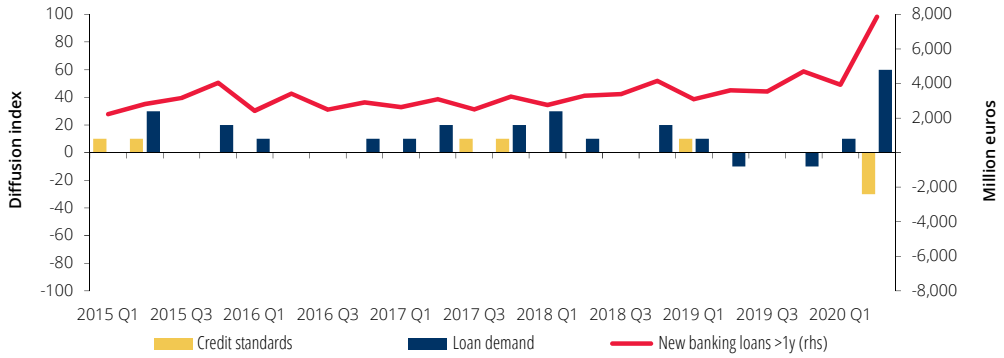
The decline in sales resulting from the pandemic led to a deterioration in the liquidity of a large share of Portuguese firms. In parallel, demand for loans by firms increased in the second quarter of the year (Chart I.3.6), mostly due to inventories and working capital financing needs. This increase in demand was channelled towards State-guaranteed credit lines, replacing demand for loans that are not covered by this support measure, which has in turn declined.

The tightening of credit standards (Chart I.3.6) as a result of the risk outlook was counterbalanced by the policy measures adopted. The provision of liquidity by the ECB, with explicit incentives for lending, and the establishment of State-guaranteed credit lines have helped firms access funding. Hence, the take up of new loans with a maturity of over one year increased by 27% in the second

quarter compared with the previous quarter, of which approximately 60% are guaranteed by the State (around half when shorter maturities are also considered). In the euro area, historically high flows of loans to non-financial corporations were also observed. According to the BLS, State loan guarantees were a key factor behind these developments.

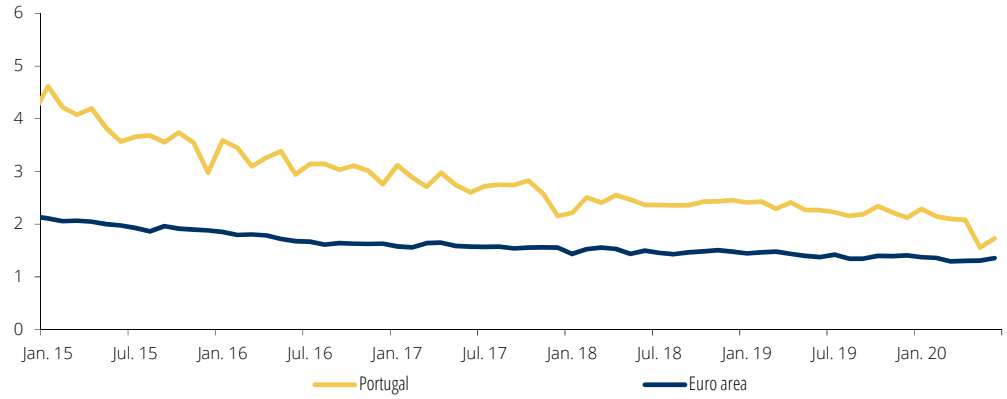
State-guaranteed credit lines allowed for more favourable conditions on new loans than those prevailing in the market, more specifically lower interest rates and longer maturities. Based on calculations using microdata from the Central Credit Register, the median interest rate on State-guaranteed loans granted from March to June stood at 1.3%, compared with 1.6% for loans without State guarantee and 1.7% for loans granted in the last quarter of 2019. Guaranteed loans therefore contributed to accentuate the downward trend in interest rates on corporate loans, which declined, on average, from 2.1% in December 2019 to 1.7% in June 2020, according to data from Monetary and Financial Statistics (Chart I.3.7). In the euro area, the average interest rate on new loans remained stable during the first half of the year at 1.4%.

Chart I.3.6 • New loans with a maturity greater than 1 year and demand and supply of loans granted by resident banks to non-financial corporations



Source: Banco de Portugal. | Notes: The diffusion index varies from -100 to 100, where 0 corresponds to the "unchanged" situation. In the case of the credit standards the chart includes the additive inverse of the diffusion index. Values higher (lower) than zero mean less (more) restrictive credit standards and represent an increase (decrease) in loan demand.

Chart I.3.7 • Interest rates (AAR) on new loans to non-financial corporations | Percentage



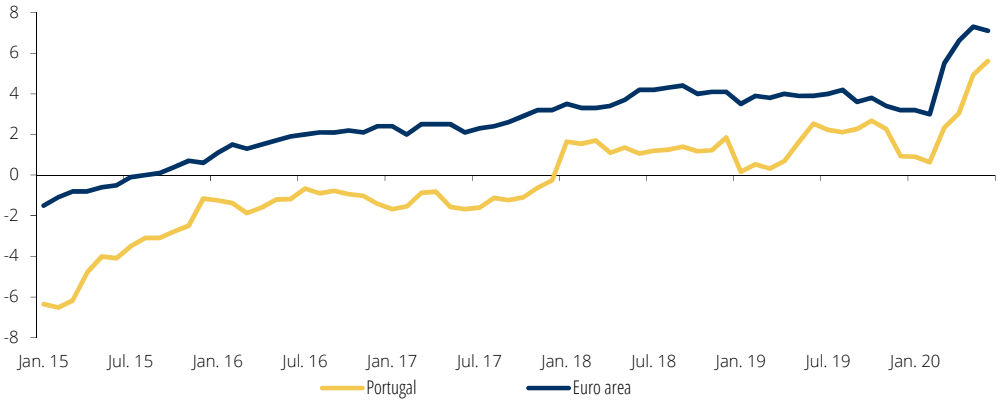
Source: ECB. | Note: The AAR is the annualised agreed rate.

Banks took a key role in the financing of firms

The annual rate of change in bank loans to non-financial corporations stood at 5.6% in June 2020, an increase of 4.7 p.p. from December 2019 (Chart I.3.8). This acceleration was also visible in the euro area.

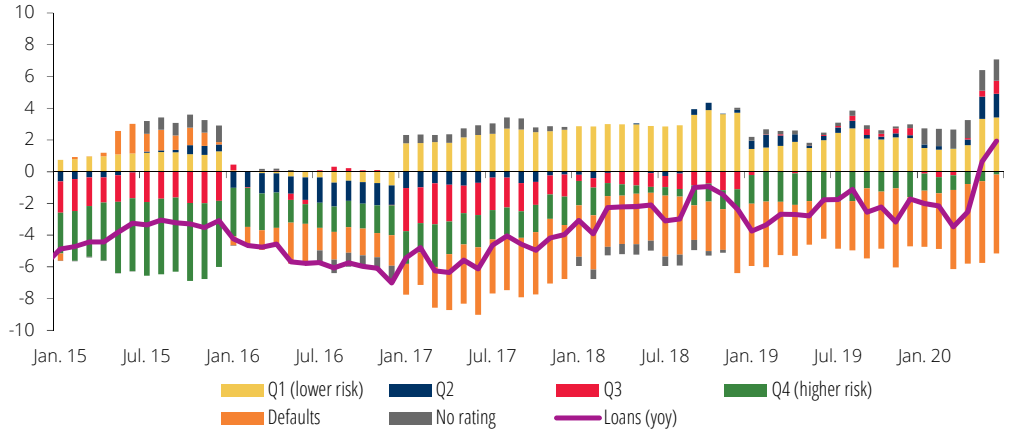
Increased funding by resident financial institutions mostly reflected the positive contribution of credit to firms in the two lower risk quartiles, in line with previous years (Chart I.3.9). An analysis by risk profile of the structure of new loans granted since the start of the pandemic shows that, as compared to the same period in 2019, the average risk of firms with new loans without a State guarantee is similar, while it is slightly lower in guaranteed loans (Section 2.4 of Part III). The eligibility criteria for access to the guarantees (tax and financial obligations duly fulfilled and positive equity for firms with over two years of activity) contributed to this dichotomy. The risk assessment used in this analysis is based on accounting information which does not yet reflect the pandemic period. Combining information on risk with the sectors of activity shows that a non-negligible share of low-risk firms with guaranteed loans belong to some of the sectors worst hit by the pandemic, such as accommodation and food services.

Chart I.3.8 • Annual rate of change in banking loans to non-financial corporations | Percentage



Source: ECB.

Chart I.3.9 • Contributions to the year-on-year rate of change in loans granted by resident financial institutions to private non-financial corporations by risk profile | Percentage and percentage points

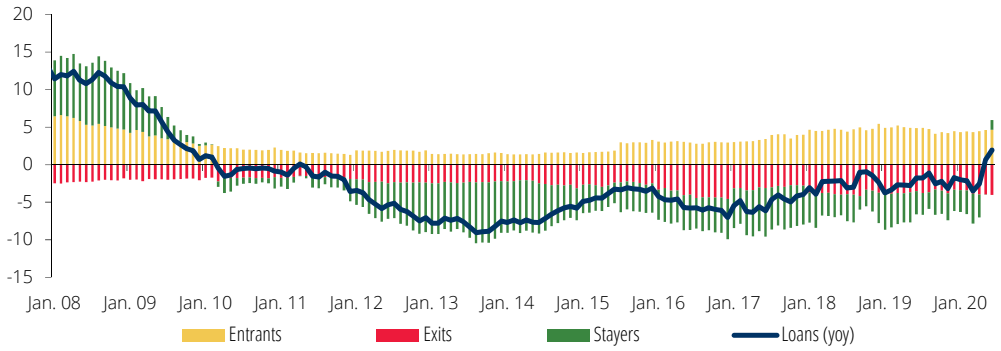


Source: Banco de Portugal. | Notes: The risk assesment is defined based on Antunes, Gonçalves and Prego (2016) "Firm default probabilities revisited", Banco de Portugal *Economic Studies*, Vol 2, No 2, April 2016. A firm is considered to be in default if the share of credit in default is larger than 2.5 per cent of the total of the credit. The "default event" occurs when the firm is past due for more than three consecutive months. Year-on-year rates of change are computed based on end-of-month outstanding amounts and no adjustments are made regarding sales, reclassifications, write-offs or exchange rate and price revaluations.

The amount of loans in default continued to decline in year-on-year terms. However, these developments are influenced by the fact that the moratoria allow for the deferral of obligations to the financial system without giving rise to a default. Given the economic contraction and the temporary nature of these measures, the share of credit in default is expected to increase.

The acceleration in loans granted by resident financial institutions to firms in June was due to an increase in funding for firms that had already taken bank loans previously, and had been reducing their debt to these institutions since March 2010 (Chart I.3.10).

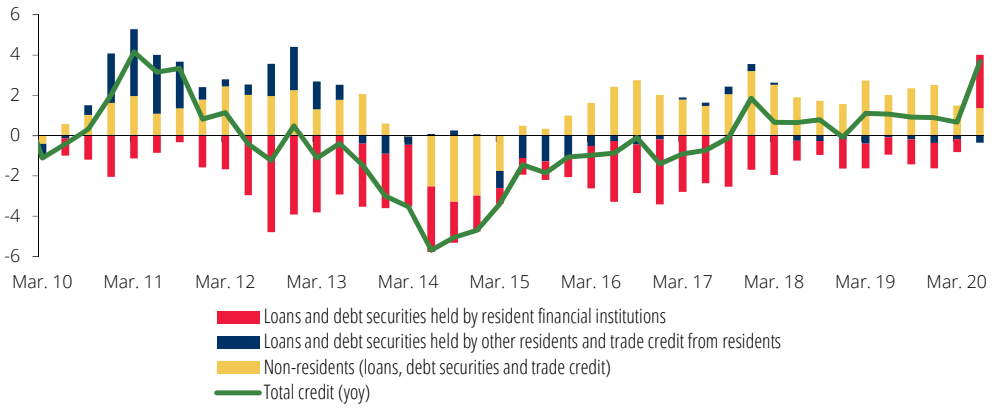
Chart I.3.10 • Contributions to the year-on-year rate of change in loans granted by resident financial institutions to private non-financial corporations by credit market participation | Percentage and percentage points



Source: Banco de Portugal. | Notes: Entrants refer to firms with credit in the reference period but without credit in the same period in the previous year, exits refer to firms without credit in the reference period but with credit in the same period in the previous year and stayers refer to firms with credit in the reference period as well as in the same period in the previous year. Year-on-year rates of change are computed based on end-of-month outstanding amounts and no adjustments are made regarding sales, reclassifications, write-offs or exchange rate and price revaluations.

Total credit to Portuguese firms, covering loans, debt securities and trade credits, granted by resident banks, other resident financial institutions and other resident and non-resident creditors, increased by 3.7% in June, year on year, compared with 0.9% in December 2019. For the first time since 2009, resident financial institutions made a positive contribution to this change (Chart I.3.11). These developments are also related to State-guaranteed loans and to the use of moratoria.

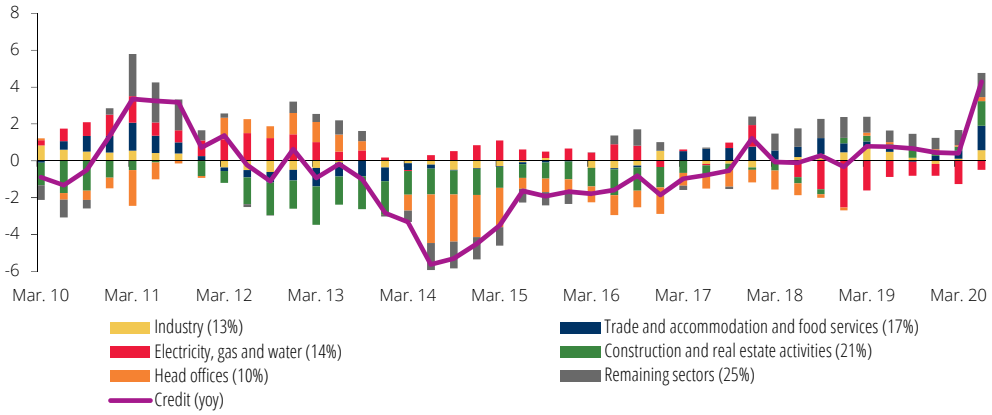
Chart I.3.11 • Contributions to the year-on-year rate of change in total credit to non-financial corporations by financing sector | Percentage and percentage points



Source: Banco de Portugal. | Notes: Total credit includes loans, debt securities and trade credit (trade credit between resident corporations is excluded). Year-on-year rates of change are computed based on end-of-month outstanding amounts and no adjustments are made regarding sales, reclassifications, write-offs or exchange rate and price revaluations.

All sectors of activity have made a positive contribution to the year-on-year rate of change in credit to non-financial corporations, with the exception of Electricity, gas and water (Chart I.3.12). The largest contributions were related to firms in Construction and real estate activities, which were funded outside the resident banking system, and firms in Trade and accommodation and food services. Firms in the Accommodation and food services sector made more use of State-guaranteed loans and moratoria than other firms.

Chart I.3.12 • Contributions to the year-on-year rate of change in credit to non-financial corporations by sector of activity | Percentage and percentage points



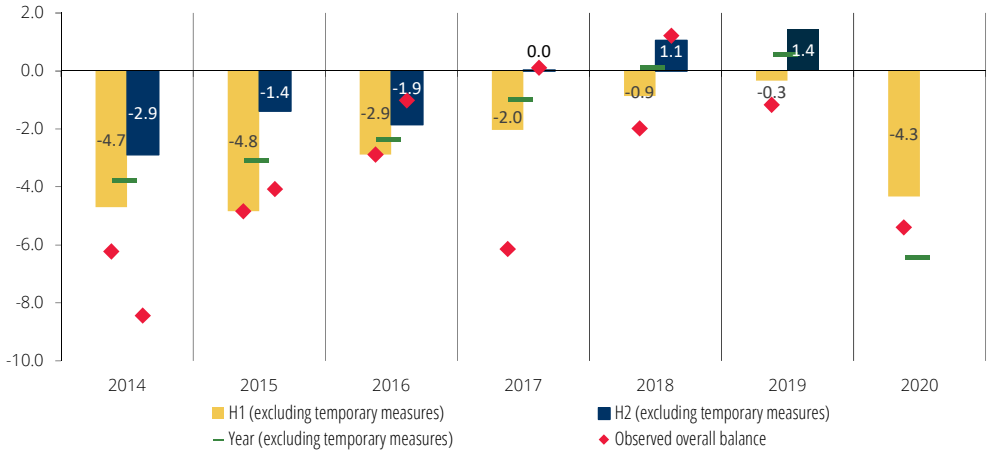
Source: Banco de Portugal. | Notes: Credit includes loans and debt securities (all trade credit is excluded and so it differs from Chart I.3.11). Year-on-year rates of change are computed based on end-of-month outstanding amounts and no adjustments are made regarding sales, reclassifications, write-offs or exchange rate and price revaluations. The NACE sections presented are: B and C (Industry), G and I (Trade and accommodation and food services), D and E (Electricity, gas and water), F and L (Construction and real estate activities), M, 70100 (Head offices) and A, H, J and M-S (Remaining sectors). In the legend to the chart, values in parentheses correspond to each sector's weight on total credit granted to non-financial corporations as of June 2020.

4 Public finances

The general government deficit stood at 5.4% of GDP in the first half, showing the sharp deterioration estimated for the year

In the first half of 2020, the general government sector posted a 5.4% deficit, recording a 4.2 p.p. increase compared with the same period one year earlier (Chart I.4.1). This deterioration was associated with an increase in expenditure of 5.1 p.p. of GDP with the implementation of fiscal policy measures to deal with the crisis (Section 2.2 of Part III) and was only partially offset by an increase in revenue ratio to GDP by 0.9 p.p.. Excluding the effect of temporary measures, the deficit stood at 4.3% of GDP, a deterioration of the same magnitude (4 p.p.).

Chart I.4.1 • General government budget balance: headline and excluding temporary measures | Percentage of GDP



Sources: Statistics Portugal and Banco de Portugal. | Notes: The overall balance excluding temporary measures for 2020 corresponds to the official target, excluding the impact from the capital injection in Novo Banco, a court decision regarding local government, and the recovery of the remaining BPP guarantee. The adjusted balance excludes the following one-off effects: between 2014 and 2018, the measures referred to in the *Economic Bulletin* of October 2019; for 2019, the capital injection in Novo Banco, a decision by the Supreme Court regarding the payment of an indemnity, a land sale by local administration and the partial recovery of the BPP guarantee.

The budget balance for the second half of the year will continue to be affected by the crisis and the measures taken to address it. These measures had an impact of 1.8% of GDP on the balance of the first half of the year, which compares with an estimated weight of around 3% of annual GDP for the year as a whole. In addition, the personal income tax (PIT) refund profile benefited the balance by about 0.7 p.p. of GDP in the first half of the year. Finally, expenditure growth, excluding measures, would contribute to the deterioration of the deficit. Despite the uncertainty surrounding budgetary developments, the 2020 budget deficit target of 7.0% of GDP seems feasible.

Revenue decreased with the contraction in economic activity

In the first half of the year, total revenue decreased by 4.8%, less than the decline observed in nominal GDP (6.8%), which justifies the positive contribution to the change in the budget balance to GDP ratio

(Table I.4.1). Underlying these developments is an additional time-adjustment made by Statistics Portugal with a positive impact on tax and contributory revenue of about €2 billion in order to reflect the measure of deferring the final settlement of corporate income tax (CIT) to July and the measures for instalment payments of taxes and contributions. Adjusting the effect of the PIT refund profile, year-on-year developments in total revenue were close to the fall in nominal GDP and identical to the change estimated in the official estimate for 2020 (6.3%). The impact of policy measures associated with the pandemic on revenue was focused on social contributions.

Table I.4.1 • General government accounts | EUR millions

	First half 2019	First half 2020	First half 2020 yoy (%)	Official yearly estimate yoy (%) [a]
Total revenue	40,938.1	38,988.8	-4.8	-6.3
Current revenue	40,708.9	38,673.8	-5.0	-7.2
Tax and contributory revenue	34,410.3	33,118.6	-3.8	-8.2
Taxes on income and wealth	7,159.1	7,607.9	6.3	-13.2
Taxes on production and imports	15,254.7	13,738.0	-9.9	-7.5
Social contributions	11,996.4	11,772.7	-1.9	-4.8
Other current revenue	6,298.7	5,555.2	-11.8	-0.9
Capital revenue	229.2	315.0	37.4	116.1
Total expenditure	42,159.8	44,229.1	4.9	9.3
Current expenditure	39,241.9	40,875.2	4.2	7.5
Social payments	17,258.8	17,723.4	2.7	5.0
in cash	15,376.9	15,809.0	2.8	5.3
in kind	1,881.9	1,914.4	1.7	2.4
Compensation of employees	11,009.3	11,434.9	3.9	3.2
Intermediate consumption	5,047.2	5,124.8	1.5	7.0
Subsidies	354.2	1,247.2	252.1	249.1
Interest	3,171.7	2,899.4	-8.6	-3.0
Other current expenditure	2,400.7	2,445.5	1.9	20.0
Capital expenditure	2,917.9	3,353.9	14.9	33.6
Gross fixed capital formation	1,600.1	1,858.1	16.1	23.9
Other capital expenditure	1,317.8	1,495.8	13.5	51.1
Overall balance	-1,221.8	-5,240.3	–	–
Overall balance (% of GDP)	-1.2	-5.4		-7.0
Memo:				
Primary current expenditure	36,070.3	37,975.8	5.3	8.3

Sources: Statistics Portugal and Banco de Portugal. | Nota: (1) Official estimate underlying the State Budget for 2020, including the changes approved by Parliament and considering, for 2019, the accounts updated by Statistics Portugal in the second notification of the Excessive Deficit Procedure, on the 23 of September 2020.

Revenue from taxes on income and wealth increased by 6.3% in the first half of the year, in contrast to the 13.2% reduction projected for the year as a whole. However, the expected decline in CIT in 2020 is likely to occur mainly in the second half of the year, namely because of the extension of the possibility of suspending prepayments. On the contrary, income from taxes on production and imports decreased by 9.9%, showing a more marked contraction than estimated in the supplementary

State budget for 2020 (7.5%). These developments mainly reflected VAT, which posted an 11.6% reduction that was higher than that of nominal private consumption (7%) which may be related to lower consumption of non-food goods and services, to which, on average, a higher tax rate applies. The 1.9% decrease in revenue from social contributions was lower than that underlying the budget (4.8%), and already included the impacts from the contribution exemption measures under the "simplified layoff" scheme and from the suspension of enforced arrears recovery.

Other current revenue decreased by 11.8% in the first half of the year, as a result of the reduction in the use of public services (through sales and fees charged) and, to a lesser extent, a decrease in dividends received. In the second half of the year, there may be a dilution of these effects, but complying with the supplementary state budget estimate (0.9%) seems difficult. Capital revenue increased by 37.4%, reflecting an acceleration in expenditure financed by European funds, albeit below the estimates.

Growth in primary spending has been affected by policy measures and, conversely, by restrictions to the functioning of public services

In the first half of the year, primary current expenditure increased by 5.3%, a lower figure than projected in the supplementary State budget (8.3%). Adjusting for the impact of policy measures associated with the pandemic crisis, growth in primary current expenditure was 1.7%.

For social benefits in cash, the rate of change for the first half of the year was 2.8%, which is below the projected rate (5.4%). Social security measures to fight the pandemic crisis with higher direct fiscal impact are classified in subsidies. In addition, it is important to consider that these measures, in particular the "simplified layoff" scheme, have probably avoided more significant increases in expenditure with unemployment benefits. During the first half of the year, social benefits in kind grew by 1.7%, but while growth was 8.7% in the first quarter, in the second quarter there was a 4.3% reduction associated with the lower provision of some services, particularly health services.

Compensation of employees grew by 3.9% in the first half of the year, a figure close to that projected for the year as a whole. Given that the average number of civil servants increased by 2.2%, expenditure growth also resulted from an increase in average wages. The effect of the gradual unfreezing of civil servants' careers in 2019 will contribute to a smaller growth of this item in the second half of the year.

Intermediate consumption grew by 1.5% in the first half of the year, despite the increased expenditure associated, in particular, with the purchase of personal protective equipment. There were probably some savings from the use of teleworking and the closure or limited operation of public services. In the second half of the year, some acceleration of this item is expected, which may still fall short of the budgeted amount.

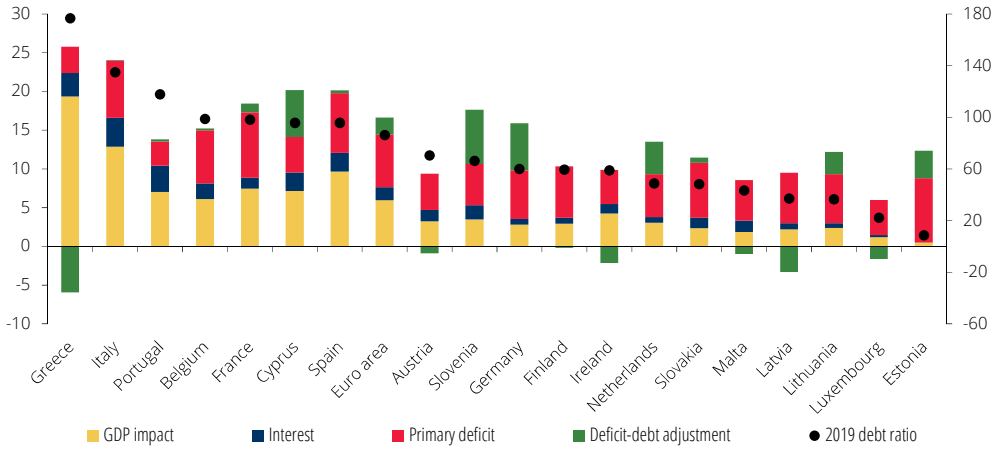
The implementation of the "simplified layoff" scheme, of measures to support self-employed workers and exceptional support to households significantly affected developments in subsidies. These measures represented about 228.6 p.p. of the 252.1% year-on-year increase in this item. The spending on subsidies by the end of the year may be lower than that estimated in the supplementary State budget, as the information available indicates that the cost of these measures is lower than that projected in the State budget.

In the first half of the year, public investment grew by 16.1% with an acceleration in the implementation of projects with European funding, and the rate is expected to remain high for the remainder of the year.

The downward trajectory of the public debt ratio was interrupted, but the financing conditions remain favourable

At the end of the first half of the year, the debt ratio stood at 126.1% of GDP for the year ending in that half year, accounting for an 8.9 p.p. increase from the end of last year. The GDP contraction (4.1 p.p. of GDP) and to a lesser extent, the budget deficit (2.5 p.p. of GDP) and deficit-debt adjustments (2.3 p.p. of GDP) – associated mainly with the accumulation of deposits (1.1 p.p. of GDP) and with the additional time-adjustment in tax and contributory revenue carried out by Statistics Portugal (1 p.p. of GDP) – have strongly contributed to these developments. Differences in the starting point of the debt ratio are expected to contribute via the denominator effect to an increase in the dispersion in debt levels as a percentage of the GDP of euro area countries in 2020, but may have the opposite effect in the medium term, when economic activity recovers (Chart I.4.2).

Chart I.4.2 • 2019 public debt ratio and contributions to the change projected by the European Commission in 2020 | Percentage of GDP



Source: European Commission Spring 2020 Economic Forecasts, published on 6 May 2020.

The Portuguese State's funding conditions remained favourable. Despite the rapid deterioration of the economic outlook and high uncertainty, the increase in financing costs was visible only for March and April issues. As regards short-term issues, the average rate of Treasury bill issues was of 0.3% in the first half of the year, a figure similar to that in 2019. Also in long-term issues, the average interest rate in 10 year Treasury bond auctions remained at its 2019 level (0.8%), although there was an increase from the average in the second half of 2019 (0.4%). In the first half of the year, interest expenditure kept the same GDP weight as in the previous year, posting an 8.6% decrease compared to the same period of the previous year, in comparison with a 3% decrease estimated in the supplementary State budget.

5 Supply

Economic activity in the first half of the year was severely affected by the COVID-19 pandemic. The decline in activity resulted in an unprecedented and abrupt fall in gross value added (GVA) and in the number of actual hours worked (in the first half of the year, year-on-year changes of -8.8% and -15.5% respectively). The negative impact on employment was mitigated by the implementation of business support measures to maintain jobs. These measures, together with an increase in the use of teleworking and an adaptation of the work carried out by companies, helped to contain the rise in unemployment. In addition, the pandemic and containment measures led to an increase in inactivity because jobless people could not take active steps to seek a job, given the restrictions on mobility and work stoppages in many activities. Thus, between the fourth quarter of 2019 and the second quarter of 2020 there was a significant reduction in the participation rate (from 51.2% to 48.7%) and an increase in the rate of labour underutilisation (from 12.5% to 14.0%), while the unemployment rate decreased (from 6.7% to 5.6%).

GVA fell 8.8% in the first half of 2020

In the first half of the year, GVA decreased by 8.8% year-on-year (9.3% compared with the previous half) (Table I.5.1). The pandemic crisis was already reflected in the first quarter, but its effects increased significantly in the second quarter, leading to year-on-year changes in GVA of -2.1% and -15.4% respectively. In the euro area, GVA also declined by 8.8% year-on-year in the first half.

Table I.5.1 • GVA by activity sector

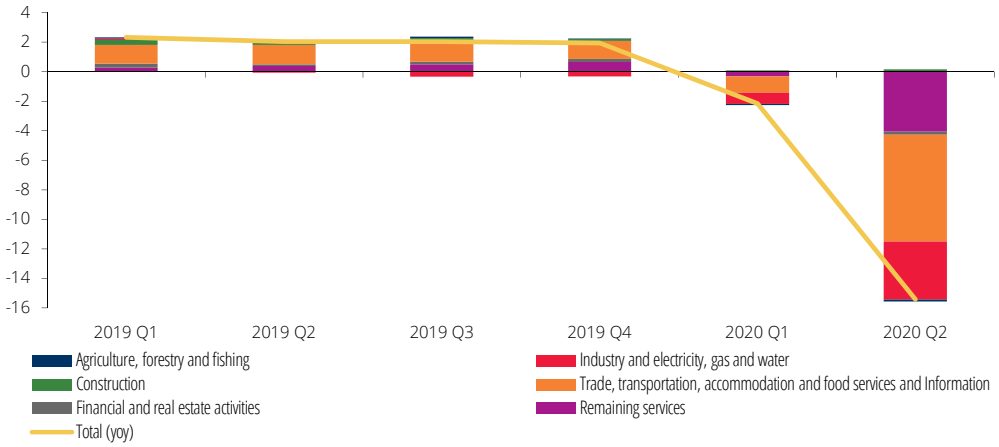
	% of GVA in 2019	Annual percentage change			Year-on-year percentage change					
		2017	2018	2019	2019 H1	2019 H2	2020 H1	2019 Q4	2020 Q1	2020 Q2
GVA	100.0	3.3	2.7	2.1	2.2	2.0	-8.8	1.9	-2.1	-15.4
Agriculture, forestry and fishing	2.4	2.0	-1.1	3.4	4.1	2.8	-4.4	1.5	-3.0	-5.7
Industry	14.2	5.9	3.5	0.0	0.7	-0.7	-13.8	-0.8	-3.6	-24.0
Electricity, gas and water	3.4	-3.6	8.6	-4.0	-2.1	-5.8	-8.6	-5.2	-5.8	-11.4
Construction	4.3	5.3	3.6	5.1	6.3	3.9	2.2	3.0	0.6	3.8
Services	75.8	3.1	2.3	2.6	2.4	2.8	-8.6	2.8	-1.8	-15.3
Trade and accommodation and food services	19.6	2.7	2.5	4.3	4.2	4.5	-16.7	4.3	-5.1	-28.3
Transportation and information and communication	8.6	5.6	4.0	5.3	5.6	5.0	-9.5	4.3	-1.1	-17.7
Financial and real estate activities	17.4	1.7	1.1	1.1	1.1	1.1	-0.3	1.2	0.4	-1.1
Remaining services	30.2	3.4	2.4	1.5	1.1	2.0	-7.5	2.2	-1.1	-13.9
Memo:										
Euro area	–	2.8	1.9	1.2	1.4	1.1	-8.8	0.9	-3.0	-14.6

Sources: Eurostat and Statistics Portugal – National Accounts (Banco de Portugal calculations). | Note: The NACE sections presented are: A (Agriculture, forestry and fishing); B and C (Industry); D and E (Electricity, gas and water); F (Construction); G and I (Trade and accommodation and food services); H and J (Transportation and information and communication); K and L (Financial and real estate activities); M to U (Remaining services).

The services sector, which had been growing since 2013, fell by 8.6% in the first half of the year (Table I.5.1), resulting in the most negative contribution to the change in GVA in that period (-1.4

p.p. in the first quarter and -11.5 p.p. in the second) (Chart I.5.1). In trade, accommodation and food services, which were heavily affected by the containment measures, GVA recorded a 16.7% year-on-year fall. Accommodation and food services represent a larger share in the Portuguese economy than in the euro area, implying greater vulnerability to the impact of the pandemic (Section 3.2 of Part III). Manufacturing fell by 13.8%. On the other hand, Construction contributed positively to GVA growth in the first half of 2020. The remarkable resilience of the Construction sector's activity to the pandemic crisis was in line with the momentum of investment in construction (Chapter 6). Construction recorded a year-on-year increase in GVA of 0.6% in the first quarter, which accelerated in the second quarter (3.8%).

Chart I.5.1 • Sectoral contributions to the GVA year-on-year rate of change | Percentage and percentage points



Sources: Statistics Portugal – National Accounts (Banco de Portugal calculations). | Note: The NACE sections presented are: A (Agriculture, forestry and fishing); B to E (Industry and electricity, gas and water); F (Construction); G to J (Trade, transportation, accommodation and food services and Information); K and L (Financial and real estate activities); M to U (Remaining services).

The contraction in activity was accompanied by a sharp decrease in actual hours worked

According to Statistics Portugal's Labour Force Survey, in the first half of 2020 actual hours worked fell by 15.5% year-on-year (Table I.5.2). To a large extent, this decline reflected the increase in the employed population absent from work, as a result of the measures implemented in response to the pandemic crisis.

Hours worked decreased across all employment situations, contract types and employment duration schemes. The largest reductions occurred among self-employed or family workers, fixed-term contracts or service providers and part-time workers. The fall in hours worked was higher for workers with lower schooling and for young people.

The "simplified layoff" scheme contributed to mitigate the decrease in employment

In the first half of 2020 employment in Portugal fell by 2.0% year-on-year (Table I.5.3). Negative employment developments were mitigated by support measures for firms, especially the "simplified

layoff" (Section 2.3 of Part III). Against this background, the reduction in employment was substantially more contained than the reduction in hours worked, which more closely correlates with the economic downturn.

Table I.5.2 • Actual hours of work

	Annual percentage change			Year-on-year percentage change					
	2017	2018	2019	2019 H1	2019 H2	2020 H1	2019 Q4	2020 Q1	2020 Q2
Total	3.5	2.1	1.3	1.2	1.5	-15.5	1.6	-5.1	-26.1
By situation in the profession									
Employees	4.2	2.7	0.6	-0.1	1.4	-14.0	2.0	-3.7	-24.4
Self-employed	0.7	-0.9	5.3	8.3	2.4	-22.7	-0.6	-11.4	-34.0
Family workers	-21.8	-12.1	-9.8	2.0	-21.5	-40.7	-7.4	-38.3	-43.2
By type of contract									
Open-ended contracts	4.4	2.7	2.0	1.0	3.0	-10.6	3.8	-1.2	-20.1
Fixed-term contracts	3.1	2.6	-3.6	-3.5	-3.7	-28.4	-1.9	-14.8	-41.9
Service providers	5.2	1.8	-10.8	-11.2	-10.4	-24.3	-23.4	-7.3	-43.7
By duration									
Full-time	3.8	2.4	1.3	1.2	1.4	-15.1	1.7	-4.9	-25.5
Part-time	-1.8	-5.4	2.0	1.3	2.7	-24.2	-1.0	-9.0	-39.1
By age group									
From 15 to 24 years old	8.5	5.8	1.1	0.6	1.5	-22.9	3.2	-9.0	-37.4
From 25 to 34 years old	1.7	0.5	0.2	0.9	-0.6	-19.2	0.3	-7.9	-30.5
From 35 to 44 years old	0.1	-0.4	-0.3	-0.9	0.4	-17.9	0.4	-8.0	-28.1
From 45 to 54 years old	4.6	2.1	1.5	0.6	2.4	-9.1	3.8	0.6	-18.8
More than 54 years old	8.1	6.4	4.6	5.4	3.8	-14.9	1.1	-4.5	-25.3
By schooling level									
None	-1.2	-8.3	-13.6	-3.6	-23.8	-25.3	-24.4	-5.6	-43.5
Basic education – 1st and 2nd cycles	1.3	-1.9	-7.7	-7.1	-8.3	-23.6	-7.5	-12.1	-35.5
Basic education – 3rd cycle	2.3	-0.9	2.4	1.6	3.3	-22.1	3.1	-8.6	-35.2
Secondary education	6.0	5.7	4.6	3.4	6.0	-12.1	5.6	1.6	-25.8
Tertiary education	4.2	4.8	5.3	5.9	4.7	-7.7	4.5	-3.9	-11.7

Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations).

Employment developments by employment situation, type of contract, employment duration scheme and individual characteristics were more heterogeneous than those of hours worked, although the groups most and least affected coincide. In the first half of 2020 the number of employees on fixed-term, part-time contracts, with educational attainment below lower-secondary and aged 15-24 showed significant year-on-year decreases (between 10% and 15%). These sharp reductions contrast with the slight year-on-year increase in the number of permanent workers, aged 45-54 and with secondary or higher education. The more favourable developments in employment for workers with higher levels of schooling were probably due to such workers having occupations more prone to teleworking (Section 3.1 of Part III).

Table I.5.3 • Employment

	Thousand individuals in 2019	Annual percentage change			Year-on-year percentage change					
		2017	2018	2019	2019 H1	2019 H2	2020 H1	2019 Q4	2020 Q1	2020 Q2
Total	4,913	3.3	2.3	1.0	1.2	0.7	-2.0	0.5	-0.3	-3.8
By situation in the profession										
Employees	4,085	4.3	2.7	0.7	0.6	0.8	-1.7	0.6	0.3	-3.6
Self-employed	810	-0.4	0.5	2.6	4.2	1.1	-3.2	0.3	-2.2	-4.2
Family workers	18	-23.9	-7.1	-12.9	-3.1	-22.3	-28.9	-12.3	-34.3	-22.0
By type of contract										
Open-ended contracts	3,236	4.7	2.8	2.2	1.6	2.9	2.1	2.6	3.1	1.2
Fixed-term contracts	719	3.3	2.2	-3.5	-2.0	-5.1	-16.1	-3.7	-11.2	-20.9
Service providers	130	0.8	4.8	-11.1	-7.2	-14.7	-14.9	-19.6	-4.7	-26.0
By duration										
Full-time	4,405	4.1	3.2	1.1	1.1	1.1	-1.1	0.9	0.6	-2.8
Part-time	509	-2.4	-4.7	-0.6	1.8	-3.0	-9.7	-3.1	-7.4	-12.1
By age group										
From 15 to 24 years old	305	7.7	4.9	3.0	4.8	1.4	-11.1	1.3	-3.8	-18.6
From 25 to 34 years old	936	1.1	0.7	-0.5	0.0	-0.9	-4.7	-1.7	-2.2	-7.1
From 35 to 44 years old	1,292	-0.1	-0.3	-0.8	-0.4	-1.3	-3.4	-1.8	-2.3	-4.5
From 45 to 54 years old	1,269	4.3	2.7	1.4	0.5	2.3	2.1	3.5	3.1	1.1
More than 54 years old	1,110	7.7	6.0	3.3	4.0	2.5	-0.4	1.6	0.9	-1.7
By schooling level										
None	57	24.1	-28.6	-17.8	-12.5	-23.3	-14.4	-21.4	-7.6	-21.4
Basic education – 1st and 2nd cycles	1,096	0.5	-1.9	-7.9	-7.5	-8.3	-9.6	-7.3	-6.5	-12.9
Basic education – 3rd cycle	981	3.4	0.1	0.7	0.2	1.2	-3.3	2.4	-0.4	-6.1
Secondary education	1,405	6.6	5.5	5.7	4.7	6.7	1.9	5.4	4.0	-0.3
Tertiary education	1,368	1.4	7.4	5.2	7.1	3.3	2.0	1.8	1.3	2.6

Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations).

Transitions from unemployment and employment to inactivity increased

Labour market dynamics were marked by the transitions from unemployment and employment to inactivity. Between the first quarter of 2020 and the second quarter of 2020 around 224,000 individuals shifted from employment to inactivity and 119,000 from unemployment to inactivity (Table I.5.4). In net terms, 76,000 individuals switched from unemployment to inactivity, contributing to a reduction in the number of unemployed in the second quarter of 2020. This decline occurred despite the net inflow of 21,500 individuals from employment to unemployment, which recorded a positive figure for the first time since the first quarter of 2014.

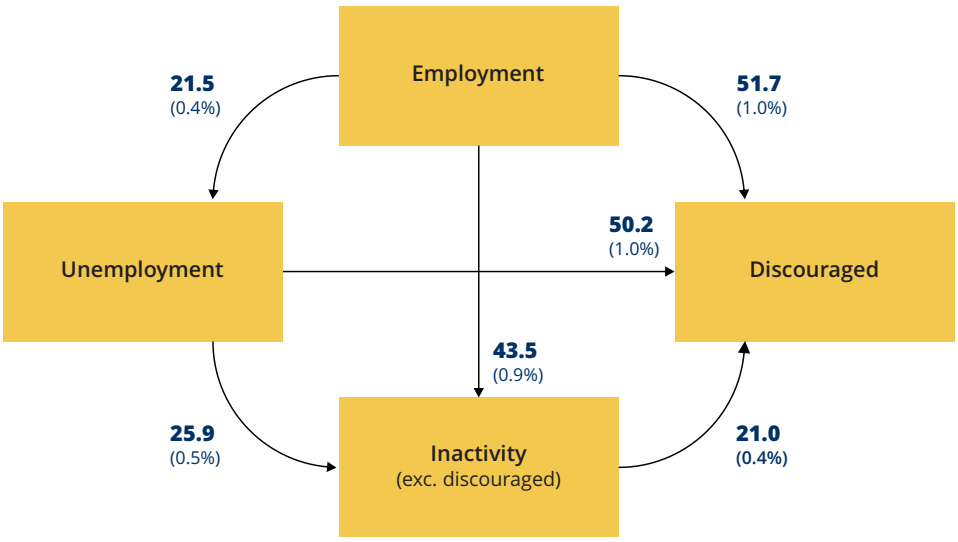
In the second quarter of 2020, 312,000 inactive individuals were classified as discouraged because they were available for work but did not report taking active steps to seek a job. This was the highest recorded figure for the number of discouraged individuals since this statistical series started being released by Statistics Portugal in 2011. In the second quarter, net flows into the discouraged group were higher than the net flows into the remaining inactivity situations (Figure I.5.1). The restrictions on travel imposed by the state of emergency and the interruption of information on job vacancies probably contributed to this unprecedented increase in discouraged individuals.

Table I.5.4 • Flows between labour market states | Thousands of individuals

	2019 Q1	2019 Q2	2020 Q1	2020 Q2	2019 Q2-2019 Q1	2020 Q2-2020 Q1
1 – Net flow from employment to unemployment	-5.4	-36.5	-4.7	21.5	-31.1	26.2
From employment to unemployment	59.2	38.2	60.9	74.2	-21.0	13.3
From unemployment to employment	64.6	74.8	65.5	52.6	10.2	-12.9
2 – Net flow from employment to inactivity	8.4	-4.1	38.6	95.2	-12.5	56.6
From employment to inactivity	118.1	119.4	139.2	224.0	1.3	84.8
From inactivity to employment	109.7	123.4	100.5	128.8	13.7	28.3
3 – Net flow from unemployment to inactivity	0.0	-18.5	4.7	76.1	-18.5	71.4
From unemployment to inactivity	53.0	44.0	61.6	119.0	-9.0	57.4
From inactivity to unemployment	52.9	62.5	56.9	42.9	9.5	-14.0
Memo:						
Net flow to unemployment (1-3)	-5.4	-18.0	-9.4	-54.5	–	–
Sample effect	10.0	-7.1	5.1	-15.1	–	–
Change in unemployment	4.5	-25.2	-4.3	-69.6	–	–

Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations). | Notes: The values are based on constant sample quarterly flows (individuals that remain in the sample of the Labour Force Survey for two consecutive quarters). The sample effect represents the difference between constant and non-constant (whole sample) flows reflecting the impact of the quarterly refresh of the dataset (1/6 of total sample) and changes in the composition of individuals that are kept in the remaining 5/6 of the sample. The change in unemployment is given by the sum of the net flow to unemployment and the sample effect.

Figure I.5.1 • Net flows between labour market states in the second quarter of 2020 | Thousands of individuals and percentage of the labour force

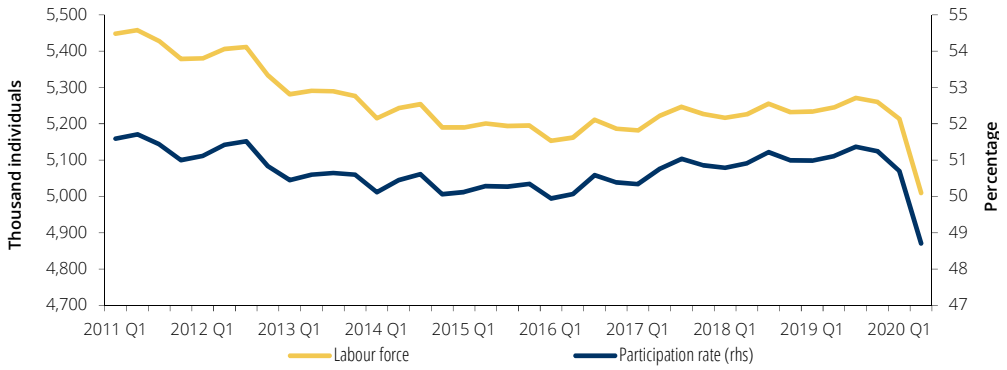


Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations). | Notes: The values are based on constant sample quarterly flows (individuals that remain in the sample of the Labour Force Survey for two consecutive quarters), in thousands of individuals and as a percentage of the labour force. The inactivity state is decomposed into two states: inactivity excluding discouraged individuals and discouraged individuals.

Historically low participation rate

Reflecting the simultaneous decline in employment and unemployment, the labour force declined by 3.9% in the second quarter of 2020 compared with the previous quarter (4.5% year-on-year), after a 0.9% fall in the first quarter (0.4% year-on-year). This development interrupted the recovery trend observed between the end of 2016 and 2019 and led Portugal's participation rate to fall by 2.5 p.p. to 48.7%, a historically low figure (Chart I.5.2).

Chart I.5.2 • Labour force and participation rate



Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations).

The increase in the inactive population contributed to widening the divergence between developments in the rates of unemployment and labour underutilisation

The increase in inactivity and in particular in the number of discouraged individuals contributed to the unemployment rate not behaving in the usual countercyclical manner. In the second quarter of 2020 the number of unemployed fell by 15.2% compared with the same quarter of the previous year and the unemployment rate declined by 1.1 p.p. compared with the first quarter of 2020, to stand at 5.6% (Table I.5.5). In contrast to the reduction in the number of unemployed (International Labour Organisation definition), unemployment registered with employment centres interrupted the downward trend observed over the course of 2019. Compared to the previous year, registered unemployment increased by 3.0% in the first quarter and 36.4% in the second quarter (an increase of around 63 thousand individuals compared with the first quarter).

Table I.5.5 • Unemployment and labour underutilisation | Percentage of labour force, unless otherwise stated

	Thousand individuals in 2019	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2
Unemployment (year-on-year percentage change)	339.5	-13.8	-6.6	-8.3	0.9	-1.6	-15.2
Unemployment rate	–	6.8	6.3	6.1	6.7	6.7	5.6
Unemployment registered in job centres (year-on-year percentage change)	310.9	-15.1	-10.3	-11.1	-8.4	3.0	36.4
Labour underutilisation (year-on-year percentage change)	690.0	-10.7	-5.9	-6.9	-5.0	-5.8	10.7
Labour underutilisation rate (1)	–	13.6	12.4	12.2	12.5	12.9	14.0
Discouraged individuals	167.5	3.4	3.2	3.4	2.8	3.2	6.2

Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations) and Employment and Professional Training Institute. | Notes: (1) The labour underutilisation rate aggregates the unemployed population, involuntary part-time workers, individuals seeking work but not immediately available and individuals available to work but not seeking. To compute labour underutilisation rate, the labour force also includes these inactive individuals.

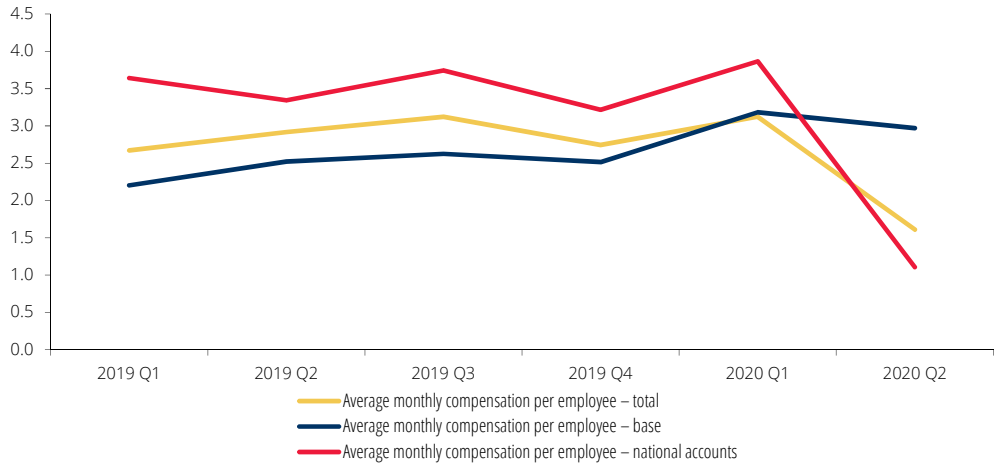
To assess labour underutilisation, more comprehensive measures than the unemployment rate must be considered. The concept of labour underutilisation includes not only the unemployed population, but also the discouraged individuals, individuals seeking work but not immediately available, and the underemployed, i.e. those who are working part-time but who would be willing and available to work longer hours. Labour underutilisation recorded a 10.7% increase year-on-year in the second quarter of 2020, which was reflected in a labour underutilisation rate of 14%, albeit still lower than the figure recorded in the previous crisis.

Compensation developments reflected *inter alia* the impact of the "simplified layoff"

In times of sharp contraction in economic activity, the decline in employment tends to have a greater impact on people with lower qualifications or those with temporary contracts, characteristics often associated with lower compensations per employee. Arithmetically, these changes in the composition of employment tend to lead to a higher average compensation per employee. In addition to this composition effect, the analysis of compensation developments entailed additional complexity arising from the implementation of employment and labour income support measures, including the "simplified layoff" and the "extraordinary support to the reduction of economic activity of self-employed workers", as well as from firms' own remuneration management options.

According to national accounts data, compensation per employee decelerated to 1.1% year-on-year in the second quarter of 2020, after several quarters of year-on-year growth close to 4.0% (Chart I.5.3). This was identical to that observed in terms of compensation per employee in the data from the Ministry of Labour, Solidarity and Social Security and compiled by Statistics Portugal. The year-on-year deceleration in total compensation per employee, from 3.1% in the first quarter of 2020 to 1.6% in the second quarter of 2020, contrasted with the relative stability in the year-on-year growth rate of base compensation per employee. The divergence between these two indicators may reflect the effect of the reduction in activity on non-contractual remuneration, as well as the impact of the support measures for households and firms on income, in particular that of the "simplified layoff" scheme.

Chart I.5.3 • Compensations per employee | Year-on-year percentage change



Sources: Statistics Portugal (Statslab) and Eurostat. | Note: The information compiled by Statistics Portugal (total and base compensations per employee) includes the individuals under the Social Security scheme and the Caixa Geral de Aposentações – CGA (public employees' pension system) scheme.

6 Demand

Strong fall in economic activity

The COVID-19 pandemic has caused an unprecedented drop in demand. In the first quarter of 2020, GDP fell by 2.3% year on year (3.9% compared to the previous quarter), reflecting the impact of sanitary measures and the environment of uncertainty (Table I.6.1). The decline in GDP was larger in the second quarter, with a drop of 16.3% year on year and 13.9% quarter on quarter.

Table I.6.1 • GDP and its main components | Year-on-year percentage change, unless otherwise stated

	% of GDP in 2019	Annual percentage change			Year-on-year percentage change					
		2017	2018	2019	2019 H1	2019 H2	2020 H1	2019 Q4	2020 Q1	2020 Q2
GDP	100.0	3.5	2.8	2.2	2.3	2.2	-9.4	2.3	-2.3	-16.3
Domestic demand	99.8	3.3	3.2	2.7	3.1	2.3	-6.6	1.2	-1.1	-12.0
Private consumption	63.9	2.1	2.6	2.4	2.4	2.5	-7.9	2.4	-1.1	-14.7
Public consumption	16.9	0.2	0.6	0.7	0.1	1.3	-1.4	1.7	0.5	-3.4
Investment	19.0	11.9	7.8	5.4	8.9	2.2	-6.4	-3.4	-2.6	-10.3
GFCF	18.2	11.5	6.2	5.4	7.4	3.5	-4.7	2.6	-0.3	-9.0
Change in inventories [a]	0.8	0.1	0.3	0.0	0.3	-0.2	-0.4	-1.1	-0.4	-0.3
Exports	43.5	8.4	4.1	3.5	2.9	4.2	-21.9	5.9	-4.8	-39.2
Imports	43.3	8.1	5.0	4.7	4.9	4.4	-15.6	3.2	-2.0	-29.4
Contribution to GDP growth, net of imports (in p.p.) [b]										
Domestic demand		1.6	1.8	1.5	1.6	1.3	-3.6	1.1	-0.7	-6.5
Exports		1.9	1.1	0.7	0.7	0.8	-5.8	1.1	-1.6	-9.8
GDP – change over the previous period					1.1	1.0	-10.3	0.7	-3.9	-13.9
GDP – euro area		2.8	1.8	1.3	1.4	1.2	-9.0	1.0	-3.2	-14.7

Sources: Statistics Portugal and Eurostat (Banco de Portugal calculations). | Notes: (a) Includes acquisitions less disposals of valuables and it is expressed in percentage point contributions to the annual percentage change of real GDP. (b) Percentage point contributions net of imports to the annual percentage change of real GDP. Demand aggregates net of imports are obtained by subtracting an estimate of imports needed to meet each component. The computation of the import content was based on data for 2017. For more information on the methodology, see Box 4 "Update of the import content of global demand for the Portuguese economy" in the March 2019 issue of the *Economic Bulletin*.

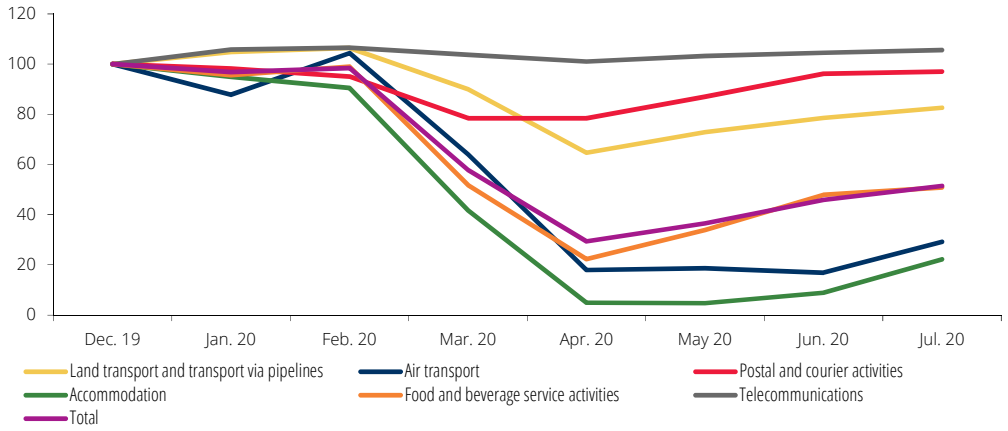
In monthly terms, economic activity began to decline in March – in contrast to the positive developments observed in the first two months of the year – and the fall deepened in April, reaching historical lows. In May there was an improvement, which continued in June, following the gradual easing of the restrictions imposed, but activity remained below levels observed in the same period last year. These developments are corroborated by other higher frequency indicators (Box 1).

The contribution of domestic demand to the rate of change of GDP became negative in the first half of the year (3.6 p.p.), reflecting a considerable drop in private consumption and, to a lesser extent, gross fixed capital formation (GFCF). Expenditure and investment decisions by households and enterprises have been affected by restrictions on mobility and activity, lower confidence and increased uncertainty. External trade flows of goods and services fell, especially in the case of exports, with a collapse in tourism exports (47.4% year on year in the first half of 2020). The contribution of exports (net of import content) to GDP growth was 5.8 p.p.

Contraction of private consumption, with changes in composition

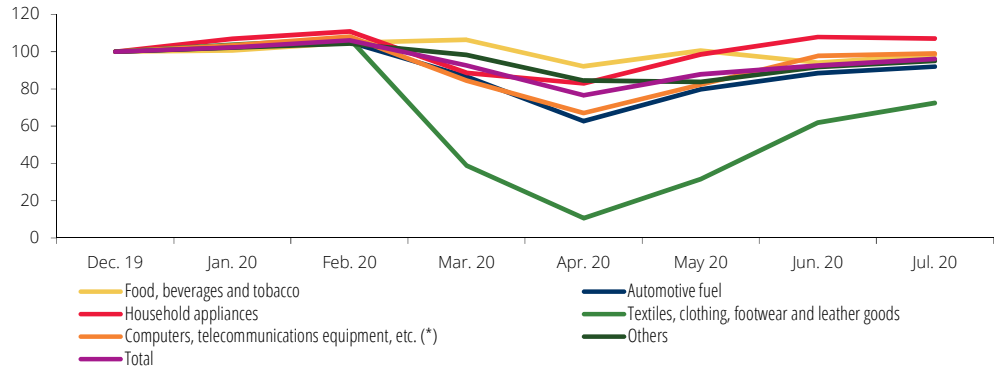
Private consumption fell by 7.9% in year-on-year terms in the first half of 2020, following growth of 2.5% in the second half of 2019. At the same time, there was a change in the composition of household consumption expenditure. The analysis of turnover indices in services intended for final consumption and in retail trade shows that a share of consumption was constrained by social distancing measures, in particular expenditure on hotels and restaurants, on transport and other leisure activities involving personal interaction, but also the acquisition of clothing and footwear and fuels (Chart I.6.1 and Chart I.6.2). In the second quarter, non-food non-durable consumption posted an unprecedented 18.7% year-on-year drop, following a 1.8% contraction in the first quarter (Chart I.6.3). In contrast, expenditure on food increased by 1.3 p.p. to 4.7% in the second quarter. Expenditure on durable goods, in particular cars, fell by 16.1% in the first half of the year, in line with the usual behaviour of this type of expenditure during crisis periods. In the second quarter, a recovery in private consumption was observed but differentiated by type of goods and services.

Chart I.6.1 • Services turnover – final consumption | Index Dec. 19 = 100



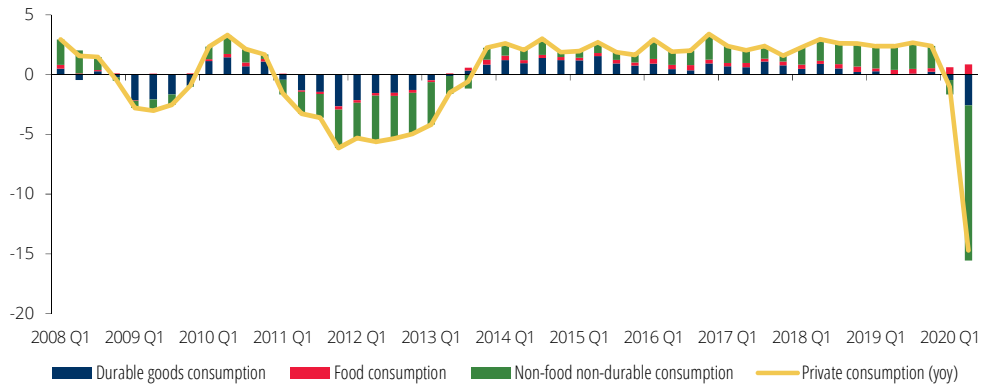
Source: Statistics Portugal (Banco de Portugal calculations). | Notes: Deflated figures, adjusted for calendar and seasonal effects. Postal and courier activities correspond to activities of receiving, processing, transporting and distributing national and international postal items by companies not related to universal obligations.

Chart I.6.2 • Retail trade turnover | Index Dec. 19 = 100



Source: Statistics Portugal (Banco de Portugal calculations). | Notes: (*) The full name of the item is Computers, peripheral units and software; telecommunications equipment, books and other products in specialised stores; The item Others includes retail sales in non-specialised stores other than food, beverages or tobacco predominating, retail sales of dispensing chemist, medical and orthopaedic goods, cosmetic and toilet articles in specialised stores and retail sales via mail order houses or via Internet; Deflated figures, adjusted for calendar and seasonal effects.

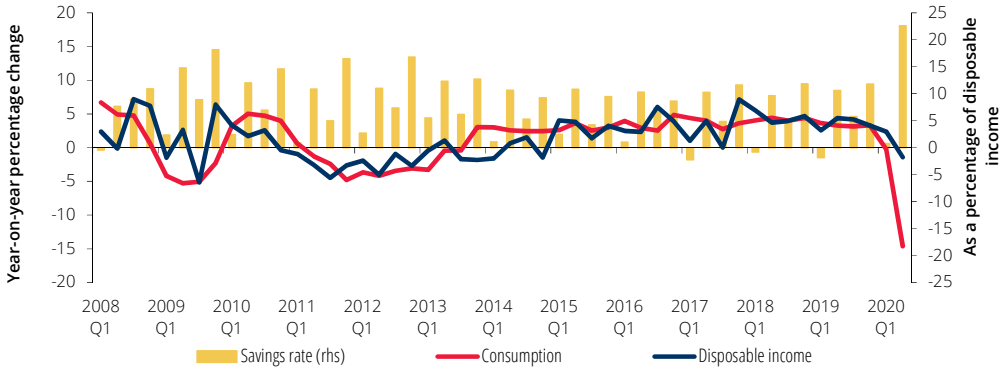
Chart I.6.3 • Decomposition of private consumption | Year-on-year percentage change and percentage point contributions



Source: Statistics Portugal. | Note: In the presented decomposition, current non-food consumption includes the final consumption expenses of Non-Profit Institutions Serving Households.

The fall in consumption in the first half of the year, together with a relative stabilisation of disposable income, was reflected in a very significant increase in the savings rate (Chart I.6.4). It also resulted in a marked increase in the balance of household deposits with resident banks, especially as from March (Chapter 3). The increase in savings is mainly explained by two factors. Social distancing measures hindered consumption of a large part of the usual household expenditure basket, leading to forced or involuntary savings. In addition, high uncertainty about the economic situation has also led to an increase in precautionary savings. In the second quarter, the reduction in disposable income was mitigated by measures to support employment and income, with emphasis on the impact of the 'simplified layoff' scheme (Section 2.3 of Part III).

Chart I.6.4 • Savings rate, nominal consumption and nominal disposable income

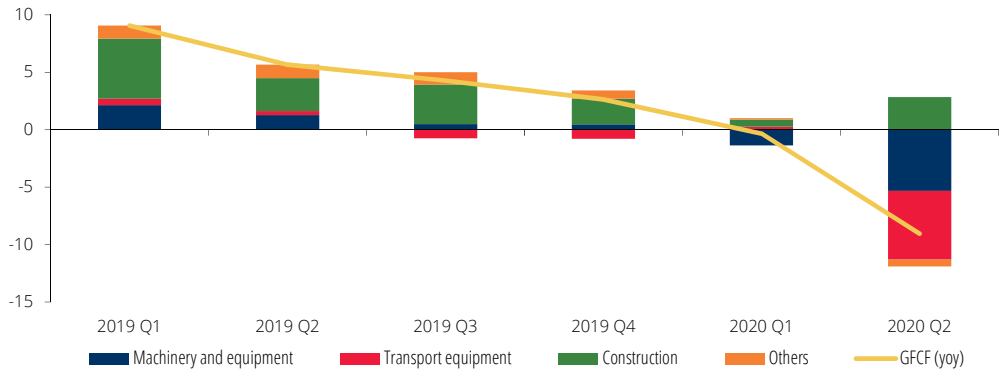


Source: Statistics Portugal. | Notes: Nominal data from the quarterly national sector accounts, not seasonally or calendar adjusted. For a better reading of the effect of the pandemic, actual quarterly values are considered, rather than annual values ending in the reference quarter. The payments of the holidays allowances (that might occur in the second or third quarters) and Christmas allowances (generally in the fourth quarter) influence to a great extent the behaviour of the savings rate. For this reason, the savings rate for the first quarter of each year is the lowest and can be even negative.

Investment fell, except in construction

Uncertainty and the decline in activity had a negative impact on investment, which fell by 6.4% year on year in the first half of 2020. However, the main components of GFCF posted different behaviours, with particular emphasis on the resilience of construction (Chart I.6.5).

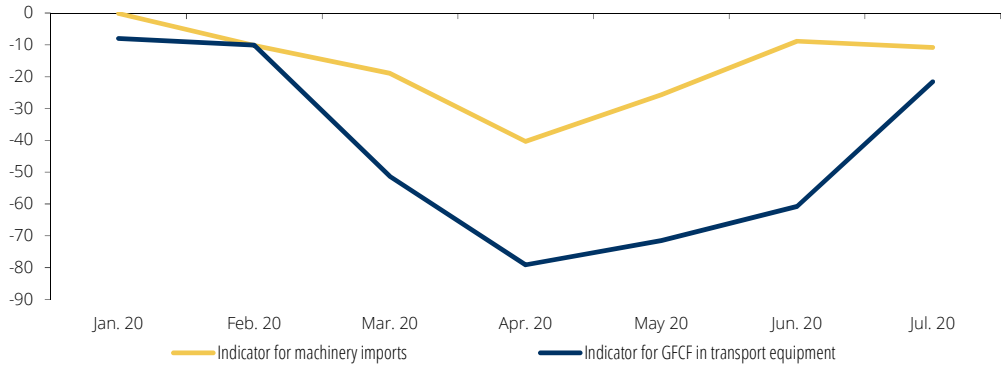
Chart I.6.5 • Decomposition of GFCF | Year-on-year percentage change and percentage point contributions



Source: Statistics Portugal.

GFCF in construction slowed down in the first half of the year but kept a remarkable dynamism (3.5% year-on-year growth, compared to 5.9% in the second half of 2019). In quarterly terms, there was even a 4.7 p.p. acceleration from the first to the second quarter. These developments contrast with those observed in several euro area countries, where the sector was greatly affected by the pandemic. The fact that the state of emergency measures adopted in Portugal did not suspend construction works contributed to these differentiated developments. Despite a decrease, confidence in the sector has remained at levels higher than the average of the last 10 years in the first half of the year. In contrast, GFCF in machinery and equipment and transport equipment dropped by 13.1% and 32.8% year on year respectively. However, monthly indicators suggest some recovery in this type of investment in the most recent period (Chart I.6.6).

Chart I.6.6 • Indicators of GFCF in machinery and equipment and transport equipment | Year-on-year percentage change



Sources: ACAP, ARAC and Statistics Portugal (Banco de Portugal calculations). | Note: The indicator for GFCF in transport equipment is not seasonal or calendar adjusted.

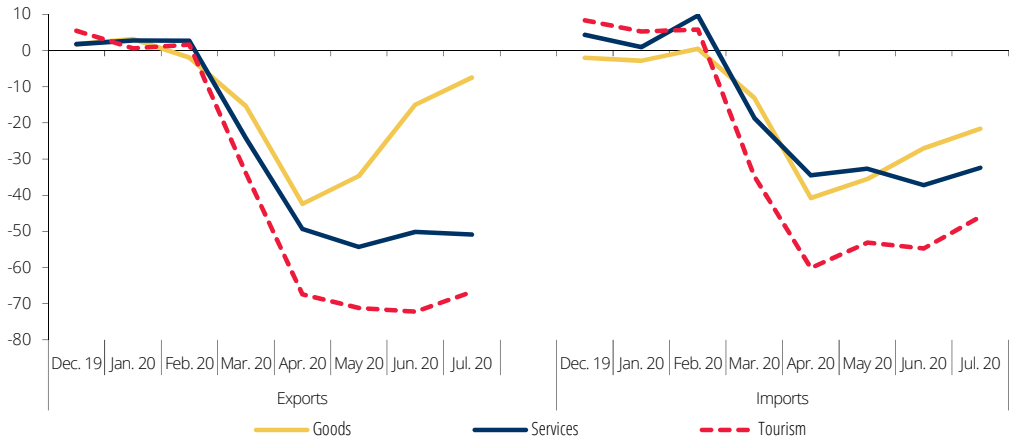
In terms of GFCF by institutional sector, the impact of the pandemic on household investment, notably in housing, was limited. Public investment has continued to show buoyant growth, partly benefiting from the increase in European funds received, associated with the end of the current programming period (Chapter 8). In contrast, corporate GFCF has declined, reflecting the postponement of investment projects amid uncertainty and reduced corporate sales, which had an impact on profitability and liquidity.

External trade flows fell, particularly exports

Exports fell by 21.9% year on year in the first half of 2020, compared to 4.2% growth in the second half of 2019. These developments reflect the weakening of external demand for Portuguese goods and services, associated with the reduction in global activity and disruptions in global supply chains (Chapter 2), as well as disturbances in domestic production caused by the restrictive measures. In addition, constraints on international travel have led to a drastic reduction in tourism exports (Section 3.3 of Part III).

Goods exports posted a 15.6% year-on-year fall, after a 3.5% increase in the second half of 2019. In services, the reduction was more marked, reflecting the 47.4% drop in the tourism exports component. Unlike goods exports, which posted a recovery during the second quarter, exports of services remained at very low levels (Chart I.6.7).

Chart I.6.7 • International trade flows | Year-on-year percentage change



Sources: Statistics Portugal and Banco de Portugal. | Note: Nominal data on international trade and the balance of services adjusted for calendar and seasonal effects.

Total imports also fell, although the fall was of a lower magnitude than that of exports, reflecting the growth differential in services and their different weight in both flows. In 2019 services accounted for 32% of exports and 17% of imports.

Imports of goods decreased by 14.2% year on year, while in services there was a 21.9% fall (increases of 3.3% and 9.2% respectively in the second half of 2019). The reduction in imports of goods and services reflected developments in global demand weighted by import content of the various components. However, the elasticity of imports to global demand was lower than the historical average, which tends to happen during economic downturns, pointing to the relative rigidity of imports.

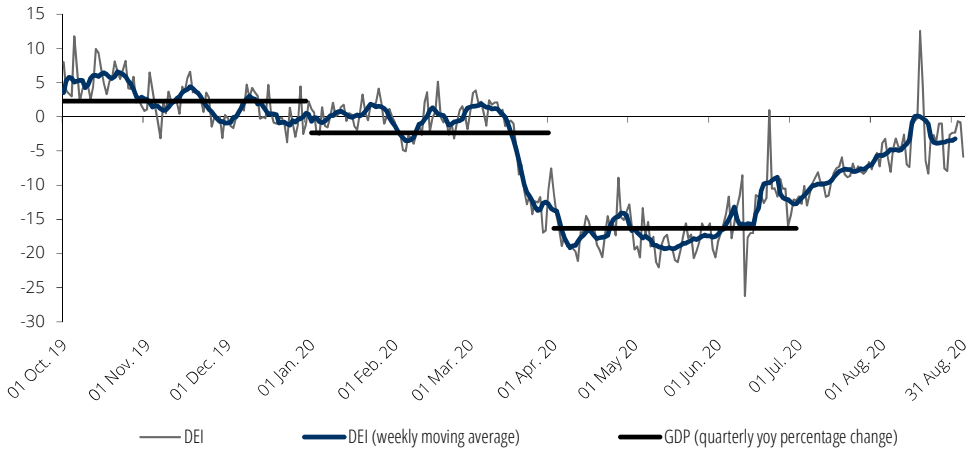
Box 1 • Developments in economic activity in Portugal during the pandemic on a daily frequency

The disruptions caused by the SARS-CoV-2 outbreak in the global economy made clear the need to use high-frequency data to inform economic policy responses. These data have the advantage of being disclosed with a short time lag *vis-à-vis* the reference period, enabling the identification of changes in economic activity in a timely manner.

This box illustrates developments in economic activity in Portugal since the onset of the pandemic using the recently presented daily economic indicator (DEI) in Lourenço and Rua (2020).[1] This indicator seeks to cover several dimensions of economic activity, summarising information on the following daily variables: road traffic of heavy commercial vehicles on motorways, electricity and natural gas consumption, cargo and mail landed at national airports and card-based payments in Portugal by residents and non-residents.

According to the DEI, economic activity registered a sharp drop on 12 March, when the level of alert was declared (Chart C1.1). This drop deepened further after the declaration of the State of Emergency on 18 March and the consequent imposition of restrictions to the normal functioning of various activities. Between the first half of April and the end of May, the indicator suggests a very marked fall in activity (on average, 17.4% year on year in April and May). As from the beginning of June, the DEI exhibits a globally upward trend.

Chart C1.1 • Economic activity during the pandemic on a daily frequency | Year-on-year percentage change



Source: Lourenço and Rua (2020). | Notes: The DEI is normalized so that its quarterly value has the same mean and standard deviation of the GDP quarterly year-on-year change over the last years. In the calculation of the indicator, data are considered up to August 31, 2020, with the exception of information regarding the cargo and mail landed, whose last observation is July 31, 2020.

1. See Lourenço and Rua (2020), "The DEI: tracking economic activity daily during the lockdown", *Working Paper* No. 13, Banco de Portugal.

7 Prices

The inflation rate remained low in the first half of 2020

The crisis triggered complex effects on consumer prices. Firstly, this crisis combined demand and supply shocks of opposite signs on prices that were also heterogeneous sector-wise. On the demand side, the lockdown, the fears of contagion, the deteriorating financial situation of households and the underlying uncertainty pushed prices downward. On the supply side, the pandemic caused production constraints and disruptions in distribution. In addition, producers faced costs associated with mandatory health measures. These factors pushed prices upward. Furthermore, the pandemic and all related containment measures contributed to changes in the household expenditure basket, possibly leading to changes in relative prices. Lastly, in the course of the second quarter there were constraints in collecting some prices that required imputing prices. This should be taken into account when reading inflation statistics.

In the first half of 2020 the inflation rate in Portugal, as measured by the year-on-year rate of change in the Harmonised Index of Consumer Prices (HICP), stood at 0.2%, 0.3 p.p. higher than in the previous half-year (Table I.7.1). The slight increase in inflation reflected the acceleration in food – in particular, in the unprocessed food component – and services prices, especially due to developments in the hotel services sub-component, which had declined year on year in the previous half. These developments were counterbalanced by the sharper fall in industrial goods prices, in particular energy prices, due to the sharp fall in oil prices in international markets (year-on-year change of -36.2%) (Chapter 2). Excluding food and energy, inflation remained unchanged at 0.1% in the first half of 2020.

Table I.7.1 • HICP – Main components | Growth rate, percentage

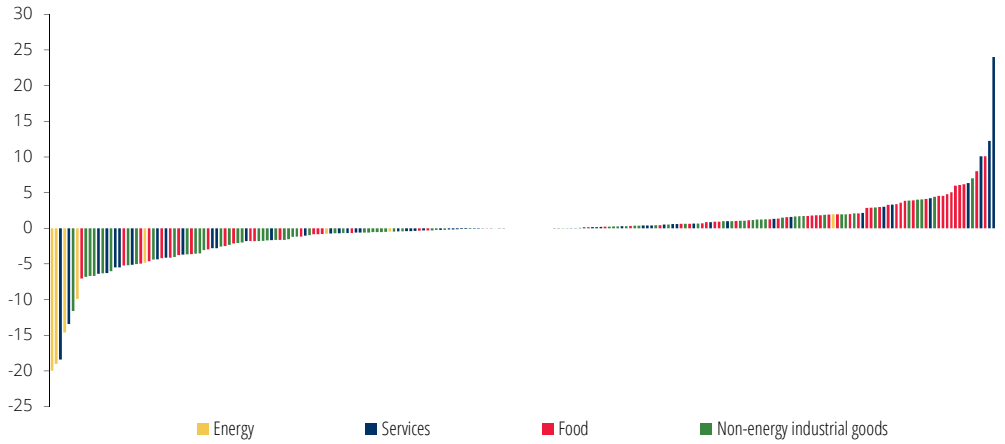
	Weights in 2019	Annual percentage change			Year-on-year percentage change					
		2017	2018	2019	2019 H1	2019 H2	2020 SH1	2019 Q4	2020 Q1	2020 Q2
Total	100.0	1.6	1.2	0.3	0.7	-0.1	0.2	0.2	0.5	-0.2
Goods	56.4	0.9	0.5	-0.3	0.1	-0.6	-0.8	-0.5	-0.1	-1.5
Food	22.6	1.7	1.0	0.6	0.8	0.4	1.8	0.5	1.0	2.6
Unprocessed food	6.2	2.2	1.3	0.2	0.5	-0.1	4.4	0.4	2.4	6.4
Processed food	16.3	1.6	0.8	0.7	0.9	0.6	0.9	0.5	0.5	1.2
Industrial	33.8	0.3	0.2	-0.9	-0.4	-1.3	-2.6	-1.2	-0.9	-4.2
Non-energy	26.3	-0.8	-1.1	-0.6	-0.4	-0.8	-1.9	-0.8	-1.2	-2.7
Energy	7.5	3.7	4.8	-1.7	-0.5	-2.9	-4.8	-2.5	0.2	-9.6
Services	43.6	2.5	2.1	1.1	1.5	0.6	1.4	1.1	1.3	1.5
Memo items:										
Total excluding energy	92.5	1.4	0.9	0.5	0.8	0.2	0.6	0.4	0.5	0.6
Total excluding food and energy	69.9	1.2	0.8	0.4	0.8	0.1	0.1	0.4	0.1	-0.1
Total excluding food, energy and volatile tourism-related items	64.7	0.6	0.4	0.5	0.8	0.3	-0.2	0.3	0.1	-0.4
Total excluding administered prices	89.7	1.6	1.1	0.3	0.7	-0.1	0.3	0.3	0.7	-0.1
CPI		1.4	1.0	0.3	0.6	0.0	0.1	0.3	0.4	-0.3
HICP – Euro area		1.5	1.8	1.2	1.4	1.0	0.7	1.0	1.1	0.2

Sources: Eurostat and Statistics Portugal. | Note: Volatile tourism-related items include package holidays and accommodation (weight of 4.4% in total HICP) and domestic and international flights (weight of 0.9%).

Over the first six months of 2020 the inflation rate declined from 0.5% in the first quarter to -0.2% in the second quarter. This decline was caused by developments in energy prices, but was partly offset by food price changes, particularly unprocessed food.

Significant changes in relative prices occurred in the second quarter and were more pronounced than usual. While at one end of the distribution there were drastic falls in the prices of goods such as fuel, at the opposite end there were goods allocated to food and transport services (Chart I.7.1). Rising food prices are likely to have been driven by demand rigidity and by a (temporary) increase in demand for this type of goods – partly due to restaurant visits being replaced by meals at home – as well as, by the increase in production and distribution costs because of several operational constraints. For transport services, these changes were associated with the substantial reduction in the prices of public transport travel cards in the second quarter of 2019.

Chart I.7.1 • Price changes of the HICP items: difference between the year-on-year percentage change in the second and first quarter of the year | Percentage points



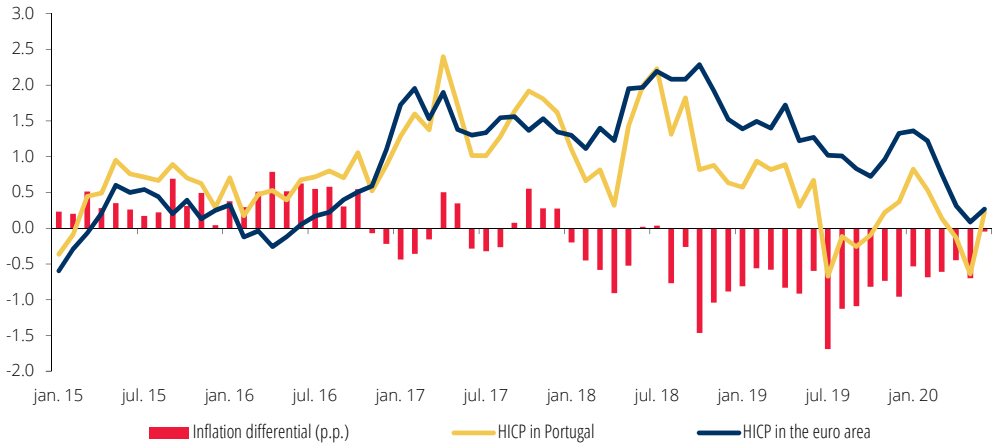
Source: Statistics Portugal (Banco de Portugal calculations). | Note: This analysis includes 224 items.

As mentioned, another effect of the pandemic was the additional difficulty concerning the collection of certain prices. These constraints have further affected developments in services prices in the second quarter, in particular for items related to tourism activity (weighing 11.9% in the services aggregate and 5.2% in the total HICP). Price collection was most affected in April, when the share of items with imputed prices in the total HICP was around 43%. Since May, there has been a gradual decrease in the number of items with imputed prices, and in June their share fell to around 15%.

Reduction of the negative inflation differential *vis-à-vis* the euro area

Over the first half of the year, both total and underlying inflation (excluding energy and food) displayed similar profiles in Portugal and in the euro area (Chart I.7.2). Over that period, the inflation rate in the euro area declined to 0.7% (1% in the second half of 2019). Thus, the negative inflation differential with the euro area decreased from -1.1 p.p. to -0.5 p.p.

Chart I.7.2 • Inflation in Portugal and in the euro area | Year-on-year percentage change and inflation differential in percentage points



Sources: Eurostat and Statistics Portugal.

Lower inflation expectations in the short and long-term

The Consensus Economics forecasts for inflation this year and for 2021 also decreased over the first half, from 0.8% in January to 0% in June 2020 and from 1.2% in January to 0.7% in June 2021. Similar revisions occurred in the euro area. The Consensus Economics forecasts for longer time horizons were also adjusted downwards for Portugal in the first half of 2020, in particular for the next three to five years. Ten-year forecasts remained relatively steady around the figures observed in recent years, which has also been observed in the euro area (Chapter 2).

8 Balance of payments

Deterioration of the current account balance associated with the fall in travel and tourism exports

The current and capital account balance deteriorated in the first half of 2020, reaching -2% of GDP, compared with -1.6% in the same period the previous year. This balance is seasonal, with lower values in the first half of the year, largely reflecting the behaviour of the travel and tourism balance.

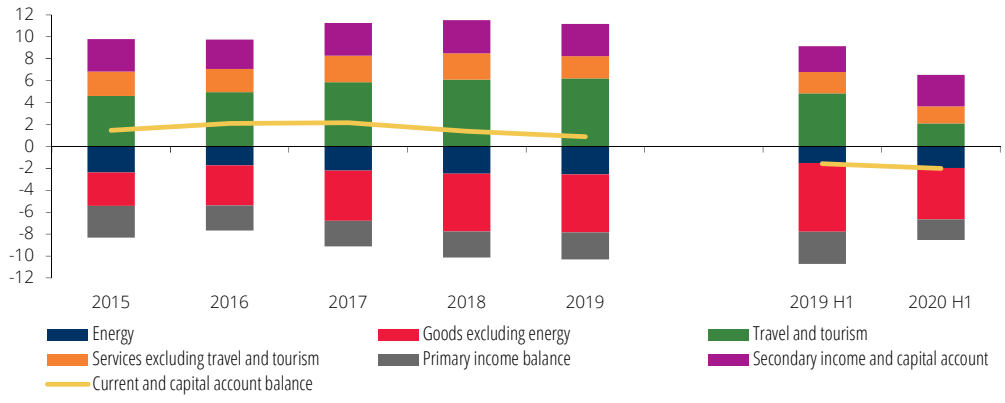
Table I.8.1 • Balance of payments | Percentage of GDP

	2017	2018	2019	2019 H1	2020 H1
Current and capital accounts	**2.2**	**1.4**	**0.9**	**-1.6**	**-2.0**
Current account	1.3	0.4	-0.1	-2.2	-3.1
Goods and services account	1.5	0.7	0.4	-1.0	-3.0
Goods	-6.8	-7.8	-7.8	-7.8	-6.7
Energy	-2.2	-2.5	-2.6	-1.5	-2.0
Goods excluding energy	-4.6	-5.3	-5.3	-6.3	-4.7
Services	8.3	8.5	8.2	6.8	3.7
Travel and tourism	5.9	6.1	6.2	4.8	2.1
Other services	2.4	2.4	2.1	2.0	1.5
Primary income account	-2.3	-2.4	-2.5	-3.0	-1.9
Secondary income account	2.1	2.0	2.0	1.7	1.8
Capital account	0.9	1.0	1.0	0.6	1.1
Financial account	**2.2**	**1.5**	**1.1**	**-1.8**	**-2.5**
Errors and omissions	0.0	0.2	0.2	-0.2	-0.5

Sources: Statistics Portugal and Banco de Portugal.

Developments in the current and capital account balance were caused by the sharp decline in the services balance surplus (Chart I.8.1), which contrasts with an improvement in the balances of the remaining components.

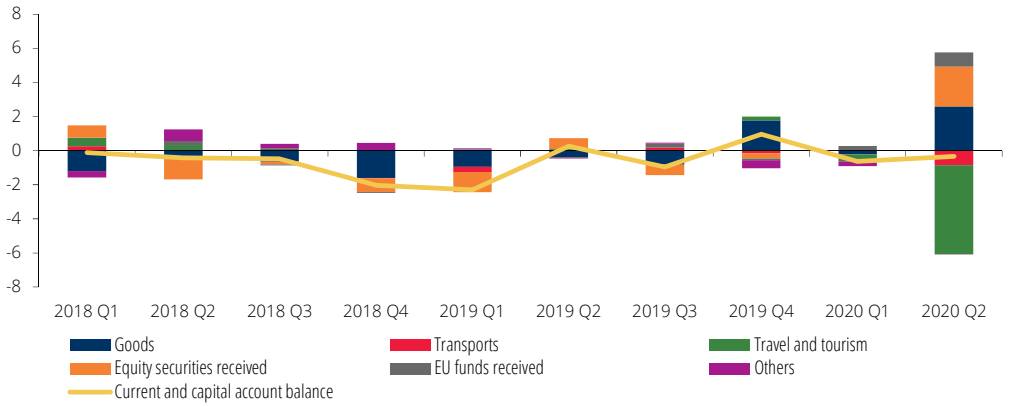
Chart I.8.1 • Breakdown of the current and capital account balance | Percentage of GDP



Sources: Statistics Portugal and Banco de Portugal. | Note: The breakdown of the goods account balance relies on nominal international trade data released by Statistics Portugal.

The pandemic is having an impact on global trade and international financial transactions (Chapter 2). The balance of payments reflected the sharp reductions in trade flows in goods and services and the increased volatility of financial flows. Against this background, in the second quarter of 2020 there were marked year-on-year changes in various components of the current and capital account (Chart I.8.2).

Chart I.8.2 • Year-on-year change in the current and capital account balance | Percentage of GDP



Sources: Statistics Portugal and Banco de Portugal.

The surplus for travel and tourism declined from 4.8% of GDP in the first half of 2019 to 2.1% of GDP, reflecting the collapse in tourism export revenues as of March (Part III, Section 3.3). In the other services account there was a reduction in the balance of transports from 1.4% to 1.0% of GDP.

The smaller deficit in the goods account in the first half of the year reflected a positive volume effect – due to a larger decrease in the volume of imports than exports and a significant gain in terms of trade, coupled with the marked fall in oil prices on international markets (Chart I.8.3). The strong decrease in overall economic activity implied a sharp drop in external demand for Portuguese exports (Chapter 2). However, the decline in domestic demand was also very marked – in particular for components with a high import content – which, combined with the fall in external supplies for exports and the disruption of global value chains, translated into a severe reduction in real imports of goods (Chapter 6).

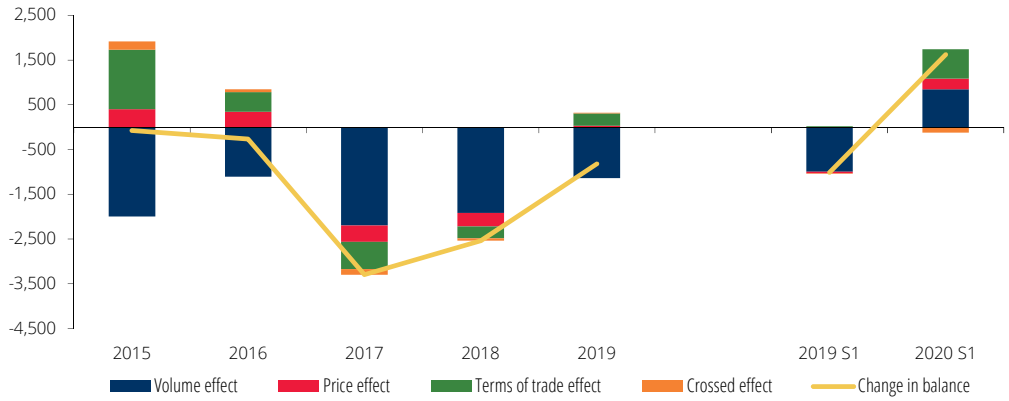
The primary income account deficit decreased and the surpluses in the secondary income and capital account balances increased

The deficit in the primary income account narrowed in the first half of 2020 as dividends paid by resident entities to non-residents declined significantly.

The secondary income account balance increased as a percentage of GDP by 0.1 p.p., to stand at 1.8% of GDP due to developments in private transfers, including in the balance of migrants' remittances.

The capital account balance as a percentage of GDP was 1.1%, 0.5 p.p. more than in the first half of 2019, mainly due to higher inflows of EU funds, essentially the ERDF and ESF, and a base effect from the purchase of carbon dioxide emission permits the year before.

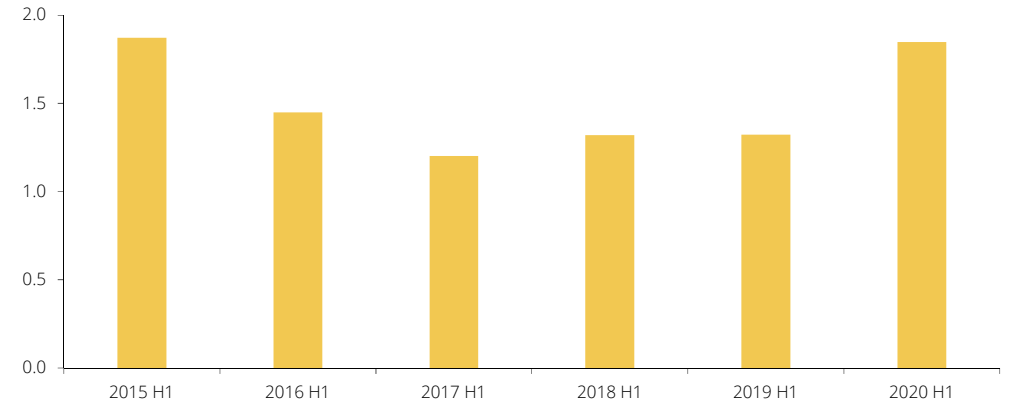
Chart I.8.3 • Decomposition of the change in goods account balance | Million of euros



Sources: Statistics Portugal and Banco de Portugal. | Note: A positive change (negative) implies an increase (decrease) in the overall balance of the goods account. The change in the overall balance of goods account can be decomposed in four effects: – volume effect – effect of the change in quantities imported and exported; $[X_{t-1} \times vx_t] - [M_{t-1} \times vm_t]$; (ii) price effect – effect of the average price growth of external trade; $[X_{t-1} \times p_t] - [M_{t-1} \times p_t]$; (iii) terms of trade effect – effect of the relative change in exports and imports prices; $[X_{t-1} \times (px_t - p_t)] - [M_{t-1} \times (pm_t - p_t)]$; (iv) crossed effect – effect of the interaction between the change in quantities and in prices of exports and imports; $[X_{t-1} \times vx_t \times px_t)] - [M_{t-1} \times vm_t \times pm_t)]$, where X_{t-1} and M_{t-1} are the exports and imports in year $t-1$ at current prices; vx_t e vm_t are the change rates in volume of exports and imports in t, respetivamente; px_t and pm_t and pmt are the change rates of exports and imports prices in t; p_t is the average change rate of the prices of external trade in year t $((px_t + pm_t)/2)$.

Overall, the balance of transfers with the EU – which are recorded in the primary and secondary income accounts and in the capital account – increased from 0.2% of GDP in the first half of the previous year to 0.7% in the first half of 2020, reflecting an increase in the pace of inflows compared with recent years, which is characteristic of the final phase of EU funds' programming periods (Graph I.8.4).[2]

Chart I.8.4 • European Union funds received | Percentage of GDP



Sources: Statistics Portugal and Banco de Portugal.

2. For further details on the impact of EU funds on the balance of payments, see Box 2 entitled "Impact of EU funds on the current and capital account: Portugal 2020 in perspective", in the March 2019 issue of the *Economic Bulletin*.

The Portuguese economy was a net receiver of funds in the first half of 2020

The economy's net borrowing in the first half of 2020 led to a net inflow of funds, i.e. a negative financial account balance in that period. External financing was higher than the acquisition of assets issued by non-residents, to a greater extent than in the same period of the previous year.

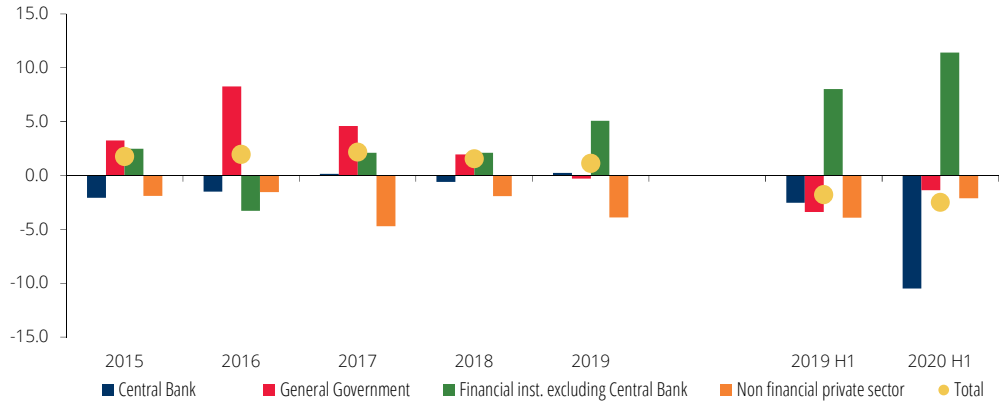
By institutional sector, the inflow of funds in the economy occurred through a larger increase in TARGET liabilities than in the same period the year before due to the increase in asset purchases as part of the implementation of the ECB's monetary policy.

General government also increased its net liabilities, mainly because of non-residents' investment in treasury bonds. Despite significant sales to the Banco de Portugal under the ECB's asset purchase programmes, treasury bills maintained a positive net investment.

Non-financial corporations were net recipients of funds in the first half of 2020, albeit to a lesser extent than in the same period a year earlier. This sector obtained a lower flow of financing in the first half of 2020 compared with the same period of 2019, namely with regard to direct investment, while the real estate investment component remains relevant. In other investment, there was a net repayment of loans and a decline in trade credits. Non-financial corporations' investment abroad was lower than that observed in the same period a year earlier.

Financial institutions (excluding the central bank) was the only sector that increased net investments abroad in this period, continuing to purchase foreign government bonds (Chart I.8.5).

Chart I.8.5 • Financial account balance, total and by institutional sector | Percentage of GDP

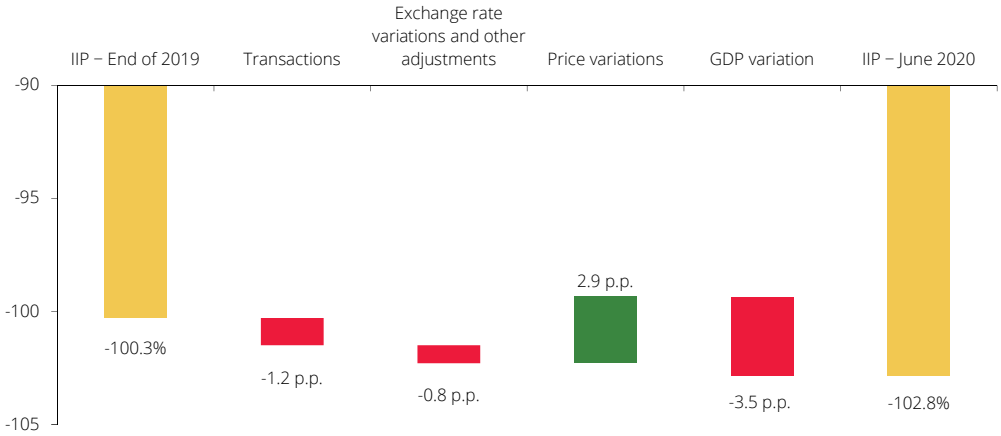


Sources: Statistics Portugal and Banco de Portugal. | Note: A positive (negative) signal corresponds to a net outflow (inflow) of funds in the Portuguese economy. The outflows of funds can occur by net acquisitions of external assets and redemptions in external liabilities. The inflows of funds correspond to sales of external assets or increase of liabilities held by non residents.

International investment position as a percentage of GDP deteriorates

The country's international investment position (IIP) deteriorated substantially from -100.3% of GDP at the end of 2019 to -102.8% in June 2020. This development was mainly due to the fall in GDP observed in the first half of the year and, to a lesser extent, to the net borrowing recorded in this period. These factors were partly offset by a positive effect associated with price changes, in particular the appreciation of monetary gold and depreciation of the equity of non-financial corporations held by non-residents (Chart I.8.6).

Chart I.8.6 • Portugal's international investment position | Percentage of GDP



Sources: Statistics Portugal and Banco de Portugal. | Note: The red bars represent contributions to a more negative IIP and the green bar represents a contribution to a less negative IIP.

II Projections for the Portuguese economy in 2020

Developments in the Portuguese economy in 2020 are dominated by the effects of the COVID-19 pandemic. The public health crisis and necessary containment measures have led to a year-on-year reduction in activity of 9.4% in the first half of the year. The fall was broadly based across economies worldwide. The contraction was mitigated by monetary and fiscal policy decisions in response to the crisis. Activity is expected to recover in the second half of 2020, translating into a year-on-year change of -6.8%, with sectoral heterogeneity, in the context of a gradual lifting of containment measures and of economic policy measures. This will be a partial recovery, as the slack in the economy is projected to increase, including in the labour market. Inflation is expected to remain contained at around 0%.

The unique features of the present crisis – exogenous shock triggered by the dissemination of a virus on a global scale, disruptions in domestic and foreign supply chains, unprecedented policy package to respond to the economic and public health crisis, changes in economic agents' behaviour and prevailing high uncertainty – render projection exercises difficult. The current projections have as their central assumption a relative control of the disease in Portugal and its trading partners, allowing for a continued gradual fading of the direct economic impact of the pandemic in the second half of 2020. However, projections have a higher than usual degree of uncertainty, which will remain high until a medical solution is found for the disease.

Table 1 • Projections of Banco de Portugal for 2020 | Year-on-year percentage change, unless otherwise stated

	Weights 2019	EB October 2020					EB June 2020		
		2018	2019	2020(p)	2020 H1	2020 H2(p)	2018	2019	2020(p)
Gross domestic product	100.0	2.8	2.2	-8.1	-9.4	-6.8	2.6	2.2	-9.5
Private consumption	63.9	2.6	2.4	-6.2	-7.9	-4.5	2.9	2.2	-8.9
Public consumption	16.9	0.6	0.7	1.2	-1.4	3.7	0.9	1.1	0.6
Gross fixed capital formation	18.2	6.2	5.4	-4.7	-4.7	-4.8	5.8	6.3	-11.1
Domestic demand	99.8	3.2	2.7	-5.0	-6.6	-3.4	3.1	2.8	-8.2
Exports	43.5	4.1	3.5	-19.5	-21.9	-17.1	4.5	3.7	-25.3
Imports	43.3	5.0	4.7	-12.4	-15.6	-9.3	5.7	5.2	-22.4
Contribution to GDP growth, net of imports (in p.p.) (a)									
Domestic demand		1.8	1.5	-2.6	-3.6	-1.6	1.6	1.5	-3.2
Exports		1.1	0.7	-5.5	-5.8	-5.2	1.0	0.7	-6.2
Employment (b)		2.3	0.8	-2.8			2.3	0.8	-4.5
Unemployment rate (%)		7.0	6.5	7.5			7.0	6.5	10.1
Current plus capital account (% of GDP)		1.4	0.9	-0.6			1.4	0.9	0.3
Trade balance (% of GDP)		0.7	0.4	-1.9			0.7	0.4	-0.5
Harmonised index of consumer prices		1.2	0.3	0.0			1.2	0.3	0.1

Sources: Banco de Portugal and Statistics Portugal. | Notes: (p) – projected, p.p. – percentage points. For each aggregate, this table shows the projection corresponding to the most likely value, conditional on the set of assumptions considered. (a) The demand aggregates net of imports are obtained by subtracting an estimate of the imports needed to meet each component. The import content calculations were based on 2017 data. For more information on the methodology underlying this calculation, see the Box "Update of the import content of global demand for the Portuguese economy" in the March 2019 issue of the *Economic Bulletin*. (b) Total employment, in number of persons according to the national accounts concept.

Marked drop in activity in 2020 and recovery in the second half of the year

Portuguese economic activity will drop markedly in 2020, with a reduction in GDP of 8.1%, which implies an upward revision from the June issue of the *Economic Bulletin*. The revision results from the incorporation of the quarterly national accounts, which showed that the fall in activity in the second quarter of 2020, albeit severe, was not as deep as anticipated.

According to the ECB's projections, euro area GDP is expected to decline by 8.0% in 2020, which corresponds to a reduction in activity that is also less marked than previously projected. This revision also reflects better than expected developments in activity in the second quarter of the year.

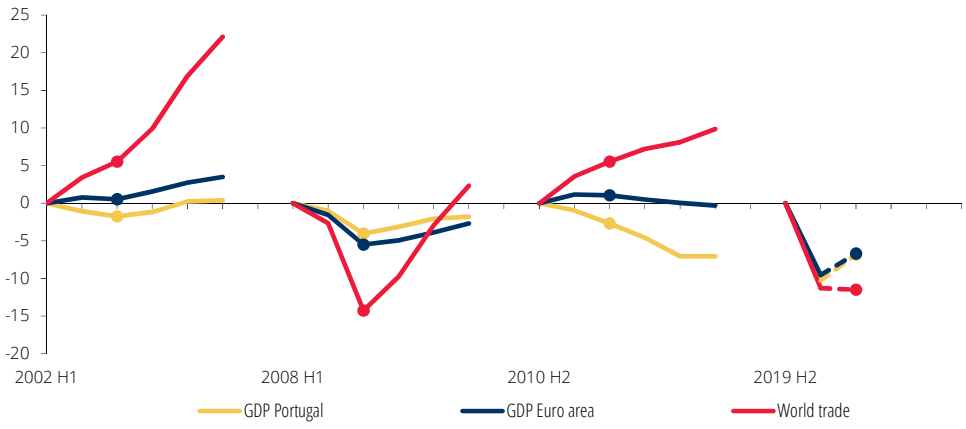
The reduction in GDP projected for 2020 reflects the strong fall seen in the first half, with an expected recovery in activity in the second half of the year. Most high-frequency indicators available up to 25 September suggest a gradual resumption of activity from May until the third quarter, which reflects the progressive lifting of pandemic containment measures and the monetary and fiscal policy response. In addition, this recovery scenario is projected to continue until the end of the year in Portugal and its trading partners, albeit at a gradually slower pace.

Output is expected to be lower at the end of this year than at the end of 2019. The partial recovery is the result of continued restrictions to activity in certain sectors, the reduction in productive capacity and the prevailing high uncertainty, which reinforces the adoption of risk-averse behaviours.

Strong decline in activity worldwide, with a recovery in the second half of the year

The COVID-19 pandemic triggered an unprecedented exogenous shock to world economic activity (Chart 1). In the first half of 2020 the global economy experienced a strong synchronised contraction, and there was a sudden fall in world trade. According to the external environment assumptions of the ECB's projection exercise (cut-off date for technical assumptions: 18 August), activity and global trade are assumed to recover partially and gradually in the second half of the year. External demand for Portuguese goods and services will move in line with the profile of world trade flows, although a 13.3% fall is projected for the year (Table 2).

Chart 1 • Evolution of Portuguese and euro area GDP and world trade over recessions
| Cumulated percentage changes



Sources: Banco de Portugal, ECB and Statistics Portugal. | Notes: In each of the four recession periods presented in the chart, the starting semester in the x-axis includes the highest quarterly level of activity in Portugal reached before the beginning of the crisis. Percentage changes are cumulated since the starting period, corresponding to the rate of change between the level in each semester and the starting period. Dotted lines denote projections. Circles denote the second semester after the beginning of the crisis in the different recession periods, which corresponds to the second half of 2020 in the current crisis.

In April oil prices dropped by almost 70% from the same period a year earlier, with an abrupt fall in economic activity and world trade, which led to high involuntary stockpiling at the end of March and early April. Oil prices have since recovered, despite remaining below those seen in 2019. The

fall in oil prices in euro is slightly larger due to the 1.7% appreciation of the euro against the dollar in annual average terms.

Sharp pandemic crisis

The current crisis has a sharp time profile, highly influenced by the fast propagation of the virus and the swiftness of policy decisions in response to the economic and public health crisis. The fall in the first half of 2020 was more marked than in the most recent recessions, and the partial recovery anticipated in the second half of the year is also more marked and faster than in previous crisis episodes (Chart 2).

Table 2 • Projection assumptions

		EB October 2020		EB June 2020	
		2019	2020	2019	2020
International environment					
World GDP	yoy	2.8	-4.2	2.8	-4.5
World trade	yoy	0.6	-11.4	0.7	-12.7
External demand	yoy	1.9	-13.3	1.6	-15.1
Oil price in dollars	aav	64.0	42.8	64.0	36.0
Oil price in euros	aav	57.2	37.6	57.2	33.1
Monetary and financial conditions					
Short-term interest rate (3-month EURIBOR)	%	-0.4	-0.4	-0.4	-0.4
Implicit interest rate in public debt	%	2.6	2.6	2.6	2.6
Euro effective exchange rate index	yoy	-1.5	3.4	-1.6	-0.3
Euro-dollar exchange rate	aav	1.12	1.14	1.12	1.09

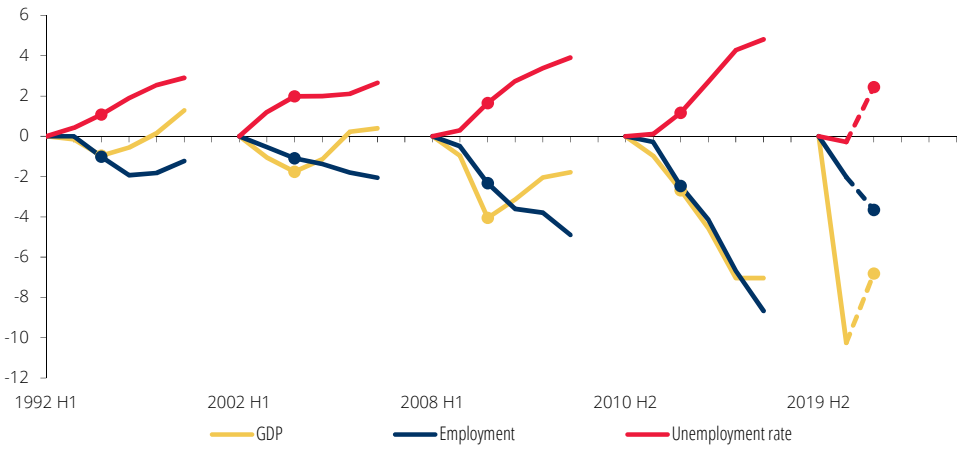
Source: Eurosystem (Banco de Portugal calculations). | Notes: yoy - year-on-year rate of change, % - per cent, aav - annual average value. The technical assumption for oil prices is based on futures markets. Developments in the 3-month Euribor rate are based on expectations implied in futures contracts. The implicit interest rate on public debt is computed as the ratio of interest expenditure for the year to the simple average of the stock of debt at the end of the same year and at the end of the preceding year. The projection for the implicit interest rate in public debt is based on an estimate that includes assumptions for the interest rate associated with new issuances. An increase in the exchange rate corresponds to an appreciation of the euro. From the current publication onwards, euro effective exchange rate is computed against a group of 42 partner countries. The technical assumption for bilateral exchange rates assumes that the average levels observed in the two weeks prior to the cut-off date will remain stable over the projection horizon.

Crisis and recovery marked by sectoral heterogeneity

The reduction in output in the first half of 2020 varied across sectors. In the recovery phase, sectoral heterogeneity is likely to persist. Sectors related to tourism and those services that are more exposed to person-to-person contact were more affected by the initial pandemic restrictions and are expected to recover particularly slowly, due to the uncertainty surrounding the solving of the health problem. Conversely, the construction sector has evolved positively, remaining decoupled from the strong negative impact of the pandemic crisis on other sectors. GVA in the sector grew by 2.2% in the first half of 2020 and is expected to decelerate somewhat over the course of the year. Overall, the comparatively higher weight in the Portuguese economy of the sectors most affected by the crisis contributes to a slower recovery than in the euro area average.

As a result of crisis response measures, public consumption is projected to rise by 1.2% in 2020, being the only main expenditure component with real growth in the current year.

Chart 2 • Evolution of GDP, employment and unemployment rate over recessions | Cumulated percentage changes



Sources: Banco de Portugal and Statistics Portugal. | Notes: In each of the five recession periods presented in the chart, the starting semester in the x-axis includes the highest quarterly level of activity in Portugal reached before the beginning of the crisis. Percentage changes are cumulated since the starting period, corresponding to the rate of change between the level in each semester and the starting period. Percentage point changes are presented in the case of the unemployment rate. Dotted lines denote projections. Circles denote the second semester after the beginning of the crisis in the different recession periods, which corresponds to the second half of 2020 in the current crisis.

Policy measures mitigated the negative impact on the labour market

The strong contraction in activity in 2020 will be associated with a pronounced fall in hours worked and a reduction in employment of 2.8%. Employment falls less than would be expected against previous recession periods and is revised upwards from projections in the previous *Economic Bulletin* (Chart 2). Recruitment costs and firm-specific human capital lead enterprises to prefer to adjust labour less sharply, especially when a shock is understood as temporary. This less sharp reaction of employment is owed not least to extraordinary and temporary employment protection policies, in particular the "simplified layoff" and subsequent measures presented in the Economic and Social Stabilisation Programme. Nevertheless, enterprises' hiring decisions will continue to be impacted by the existence of underutilised resources and the uncertainty regarding demand prospects.

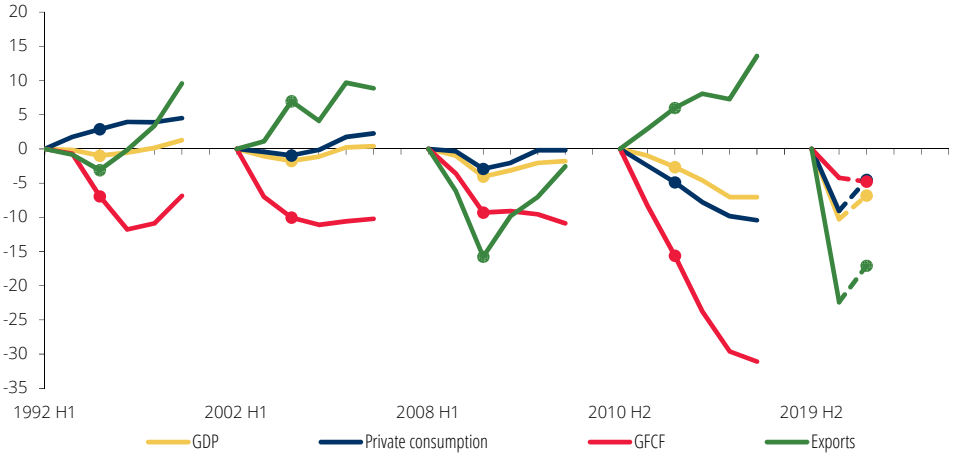
In 2020 the unemployment rate is projected to increase to 7.5% in annual average terms (Chart 2), which is a downward revision compared to that released in the June issue of the *Economic Bulletin*. The particular features of the pandemic crisis implied a decline in the unemployment rate in the first half of 2020, amid a significant reduction in the labour force. With the gradual normalisation of pandemic-related circumstances, the unemployment rate and the labour force are projected to increase in the second half of the year.

Change in the composition of consumption, with a partial recovery in the second half of 2020

The current crisis changed the composition of household consumption. In a context of a rather mitigated impact on disposable income, the propagation of the disease and the containment measures implemented led households to significantly restrain their expenditure and increase

savings. The strong decline in consumption contrasts with its usual smoother developments (Chart 3), even in terms of its non-durable component, which is typically less volatile. Expenditure on leisure activities, hotels, restaurants, transport, clothing and footwear fell considerably. The only exceptions are expenses on essential goods, namely food.

Chart 3 • Evolution of GDP, private consumption, GFCF and exports over recessions | Cumulated percentage changes



Sources: Banco de Portugal and Statistics Portugal. | Notes: In each of the five recession periods presented in the chart, the starting semester in the x-axis includes the highest quarterly level of activity in Portugal reached before the beginning of the crisis. Percentage changes are cumulated since the starting period, corresponding to the rate of change between the level in each semester and the starting period. Dotted lines denote projections. Circles denote the second semester after the beginning of the crisis in the different recession periods, which corresponds to the second half of 2020 in the current crisis.

As of May consumption recovered. This recovery is expected to extend until the end of 2020, which will translate into a year-on-year change of -4.5% in the second half of the year. The recovery will differ depending on the type of product, in the context of the gradual lifting of containment measures, the maintenance of policies to support income and high uncertainty, which should continue to limit consumer confidence. The increase in savings in the first half of 2020 may also contribute to the recovery in private consumption in the second half of the year. However, the prevailing uncertainty should continue to encourage precautionary savings.

In this context, consumption of durable goods other than cars is projected to recover comparatively more quickly, reflecting pent-up demand and the maintenance of high levels of teleworking and home-schooling. In turn, some expenses, for example related to leisure, tourism and restaurants, should recover more slowly.

Investment is expected to fall by 4.7% in 2020. This is a less negative change than those observed in previous recessive periods, not least owing to the crisis' temporary nature (Chart 3). Public investment growth should remain dynamic, benefiting from an increase in European funds received. Private investment is likely to drop in 2020, reflecting developments in the business component, affected by a decline in the capacity utilisation rate and the uncertainty surrounding domestic and external demand. Developments in business investment are also impacted by the deterioration of the financial situation of enterprises, albeit with heterogeneity by sector of activity and size. Against this background, the following play a particularly important role in investment decisions: (i) government measures on State-guaranteed credit lines and credit moratoria in force until September 2021,

(ii) monetary policy measures that should ensure that credit conditions for enterprises remain favourable, and (iii) European funds received and (iv) public investment, both acting as catalysts.

Strong disruptions in trade flows

In a context of global crisis, export and import flows have been considerably affected in 2020. Exports show a fall of 19.5%, a more negative evolution than external demand for Portuguese goods and services due to developments in exports of tourism and tourism-related services. The reduction in import elasticity *vis-à-vis* overall demand weighted by import content, which tends to occur in periods of contraction, will result in greater import rigidity.

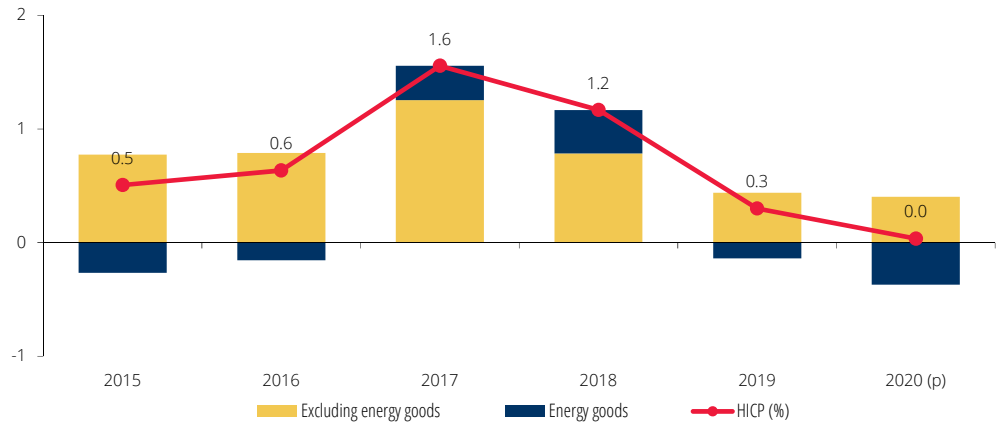
Hence, taking into account that Portugal is a net tourism exporter, the goods and services account balance is expected to decline considerably, reflecting a strong negative volume effect, partly offset by a positive terms of trade effect associated with a marked fall in oil prices. The goods and services account is expected to record a deficit, which will determine the worsening of the current and capital account balance to -0.6% of GDP. In 2020 the Portuguese economy should register net borrowing flows against the rest of the world, interrupting the sequence of external surpluses recorded since the previous crisis.

Maintenance of low inflation scenario

The projection for inflation, as measured by the annual average rate of change in the HICP, is 0% in 2020, after 0.3% in 2019, remaining virtually unchanged from the June *Economic Bulletin*.

The current crisis differs from previous ones by the interaction of supply and demand shocks that are mutually reinforcing but have opposite sign impacts on prices. The reduction in activity in 2020 reflects a decline in supply and a decrease in demand for goods and services. For example, in some sectors the increase in operational costs as a result of virus containment measures is reflected on increases in final prices. In contrast, prices undergo downward pressures in sectors with a strong contraction in demand. Energy prices are projected to decrease by about 5%, reflecting the pronounced fall in oil prices (Chart 4). Overall, inflation is expected to remain contained, in a context of increased spare capacity and expectations remaining at low levels.

Chart 4 • Harmonised index of consumer prices | Percentage point contributions to the annual rate of change



Sources: Banco de Portugal and Statistics Portugal. | Note: (p) – projected.

Continued uncertainty

The short-term outlook for the Portuguese economy remains surrounded by uncertainty about the evolution of the pandemic and its impact on economic agents' behaviour. A persistence of the pandemic crisis may cause a retraction in demand and supply. In this context, the scope for action of national and supranational economic policies should be preserved, given that these policies will continue to play a fundamental role in the recovery process.

III Policies and consequences of the pandemic

1 Introduction

The ongoing pandemic crisis is unique in many aspects. The exogenous origin of the initial shock, the widespread response of policymakers and the radical change in incentives influencing the actions of economic agents form an unprecedented set of circumstances in recent economic history. The analysis of this crisis is very important in order to interpret and frame developments in the Portuguese economy. Available data already make it possible to understand some implications of the pandemic and to analyse the policies implemented by the authorities.

Part III is designed to promote understanding of the immediate implications of the pandemic. It is composed of several texts, providing complementary views of developments in the Portuguese economy. This Part comprises 8 sections, grouped into two chapters. Chapter 2 addresses the policy responses taken by authorities, in terms of both macroeconomic measures and those directed towards households and firms. Chapter 3 covers more structural aspects, associated with the sectoral structure of the economy and the response taken by firms to the challenges posed by the pandemic. These contributions should be read in conjunction with Part I of this Bulletin, in which the main developments in the first half of 2020 are presented.

Section 2.1 starts with an analysis of the ECB's monetary policy response to the crisis. This response was crucial to guarantee monetary policy transmission to the euro area as a whole and to preserve favourable financing conditions. In the current crisis, supranational policies – monetary, prudential, regulatory and fiscal – complemented country-level policies. Portugal adopted fiscal measures whose impact on public accounts is presented in Section 2.2. This direct fiscal impact does not take into account second-round effects materialising via automatic stabilisers. The measure with the largest direct fiscal impact was the "simplified layoff" scheme. This made it possible to share costs and risks among firms, households and the State. An assessment of the impact of this policy is presented in Section 2.3. The analysis concluded that the "simplified layoff" scheme was key to safeguarding firms' liquidity and mitigating the fall in employment. Several additional measures contributed to supporting liquidity and income of both households and firms. Moratoria on loans and State-guaranteed credit lines are analysed in Section 2.4. These measures also helped sustain the necessary growth in lending to firms. Similarly, Section 2.5 characterises the moratoria on loans to households. These moratoria mitigated the impact of the reduction in disposable income, in particular among households in a more fragile situation, which typically have a higher propensity to consume.

The pandemic crisis interacts markedly with each country's sectoral heterogeneity, calling for high adaptability among firms. The third chapter looks into these aspects. Increased use of teleworking was one of the strategies employed by firms as a response to the impossibility of working on-site. Section 3.1 demonstrates the heterogeneity of teleworking across sectors of activity, occupations and education levels of the workers. The effects of the crisis have been more marked in service sectors that require person-to-person contact. As analysed in Section 3.2, Portugal is highly specialised in tourism-exposed sectors. This specialisation is a vulnerability in the current environment. The international bodies following up on the tourism sector point to a slow, incomplete recovery in the near future, as described in Section 3.3.

The complexity of the issues discussed here makes it impossible to conduct a thorough analysis. A more comprehensive assessment of the crisis and its consequences will only be possible by benefiting from a longer perspective and by examining microeconomic information, which is typically released with a slight lag. This will continue to be a reason for concern for the Banco de Portugal going forward.

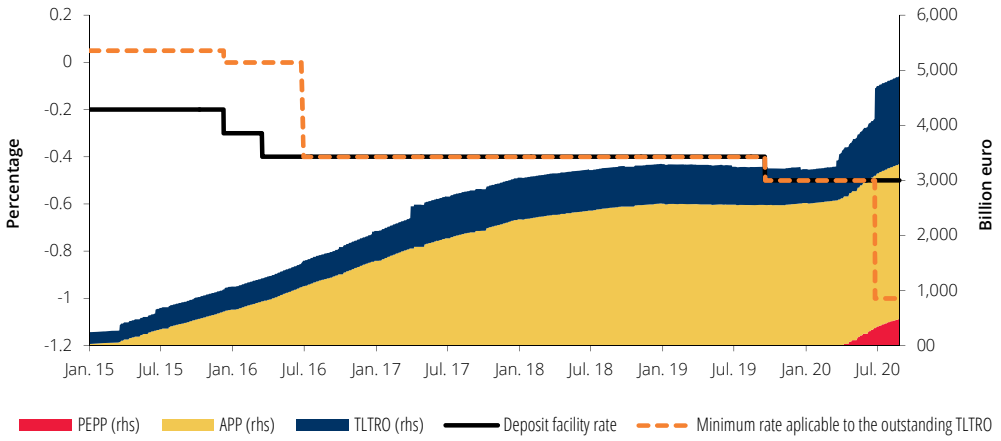
2 Policy responses by authorities

2.1 Monetary policy measures during the pandemic crisis and their impacts

The magnitude of the pandemic crisis required an unprecedented intervention via monetary and fiscal policies to mitigate the impacts on economic agents. The various actions taken by the ECB from mid-March onwards are mutually reinforcing, with a view to ensuring the necessary monetary accommodation, guaranteeing ample primary liquidity provision and contributing to financial market stability so as to safeguard monetary policy transmission (Chapter 3 of Part I).

The pandemic led to a downward revision of the outlook for inflation (from 1.6% in 2022 according to the December 2019 Eurosystem staff projections to 1.3% according to the June 2020 projections) and economic activity in the euro area (from 1.1% in 2020 according to the December 2019 Eurosystem staff projections to -8.7% according to the June 2020 projections) (Chapter 2 of Part I). The ECB endeavoured to ensure an accommodative monetary policy stance, by maintaining negative interest rates, strengthening forward guidance, increasing asset purchases (and their duration) and sustaining ample liquidity provision (Chart III.2.1).

Chart III.2.1 • ECB monetary policy: interest rates, TLTRO and asset purchases



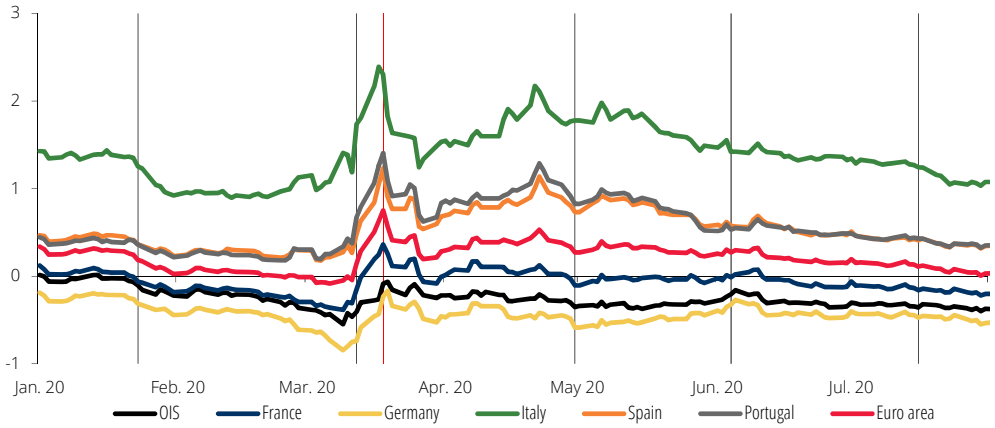
Source: ECB.

The accommodative monetary policy stance adopted has made it possible to maintain the euro area risk-free yield curve at low levels, which is a benchmark for financial conditions in the rest of the economy, in particular the government yield curve. However, in March, fragmentation and segmentation risks rose in euro area markets, linked to different risk perceptions and investors' 'run' towards financial assets deemed safer and more liquid. The marked increase in government bond yields and their differentials among euro area countries could have an adverse effect on monetary policy transmission in the euro area (Chart III.2.2).

Against this background, the ECB substantially scaled up financial asset purchases, resulting in considerable mitigation of fragmentation risks in the euro area. In addition to raising the envelope of €120 billion under the existing asset purchase programme (APP), the Governing Council announced

a new asset purchase programme: the pandemic emergency purchase programme (PEPP). The PEPP was announced on 18 March, with an overall envelope of €750 billion, scaled up to €1,350 billion at the Council meeting of 4 June. Purchases under the PEPP will be conducted until the Governing Council judges that the coronavirus crisis is over and at least until the end of June 2021 (reinvesting maturing principal payments until at least the end of 2022), in a flexible manner over time, across asset classes and among jurisdictions. This flexibility helped stave off risks to monetary policy transmission and maintain favourable financing conditions for all euro area economies. Moreover, given the tighter financing conditions, commercial paper with a maturity of one to six months became eligible for purchase by the ECB, thereby supporting a market segment of importance to cover the short-term financing needs of firms in the euro area.

Chart III.2.2 • 10-year risk free interest rates (OIS) and sovereign bond yields for Portugal and the four largest economies | Percentage



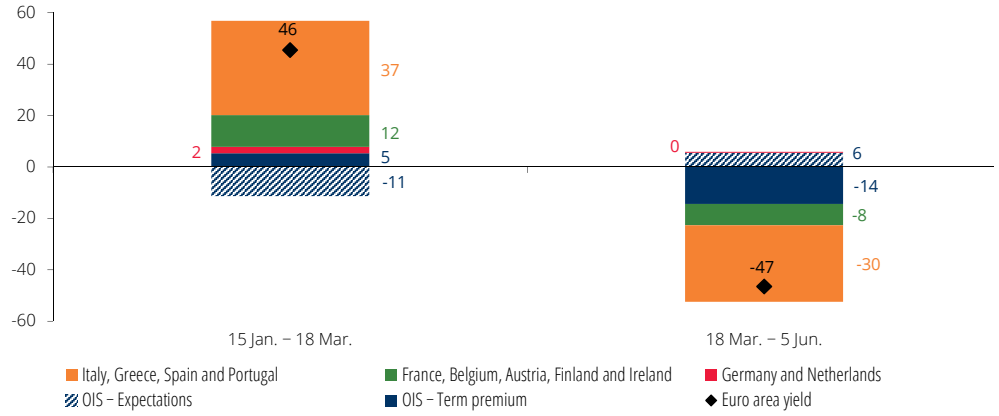
Source: Refinitiv. | Notes: Euro area long-term sovereign bond yield is an average of the 10-year yields of 11 countries (Germany, France, Italy, Spain, Netherlands, Belgium, Austria, Greece, Portugal, Finland and Ireland) weighted by capital key. Black vertical lines point Governing Council meetings and the red line points to PEPP announcement.

Euro area government bond yields decreased after the announcement of the PEPP, to stand in mid-June at levels below those seen at the beginning of the year. This reduction was partly due to a fall in the risk-free interest rate, which was chiefly the result of the lower term premium (Chart III.2.3). The fall in term premium is directly associated with asset purchase programmes such as the PEPP, that make it possible to mitigate the aggregate duration risk which investors must take. The effect of net purchases associated with these programmes on ten-year government bond rates in euro area countries may have amounted to 1 p.p., and was probably more substantial in jurisdictions deemed more vulnerable. Other factors, such as the increase in public debt issues, including the expected heterogeneity among jurisdictions, may justify the maintenance of higher rates. On the other hand, the flexibility in implementing the PEPP, by minimising the negative effects of investors' reallocation in public debt markets, contributed to the reduction in government bond yields and spreads in the euro area, although these remain, on average, 10 b.p. above the levels seen at the beginning of the year.

The pandemic crisis increased the liquidity needs of households and firms, as well as default risk. Banks could have lowered their willingness to lend. The ECB took action to meet liquidity needs, including new liquidity-providing operations, the expansion of the list of assets eligible as collateral and an easing in financing conditions. Government credit guarantees and easing compliance with prudential ratios were

also aimed at preserving the necessary flow of bank lending to the economy. At the March Governing Council meeting, additional longer-term refinancing operations (LTROs) were announced to provide immediate liquidity support to the financial system to minimise potential money market disruptions. The easing of conditions for the TLTRO III was also announced at that time and were revised again in April. The TLTRO III was cut by 50 b.p., particularly for the period between June 2020 and June 2021, and may go down to 50 b.p. below the deposit facility rate over the entire maturity of the operation for banks whose eligible net lending as at March 2021 stands at the same level as one year earlier. Given that the deposit facility rate is currently -0.5%, banks can, at most, benefit from a -1% rate on lending over a three-year period should monetary policy interest rates remain unchanged. At the Governing Council meeting of 30 April, non-targeted pandemic emergency longer-term refinancing operations (PELTROs) were introduced as an additional instrument to support liquidity at more favourable terms. The interest rate will be 25 b.p. below the main refinancing operations rate (currently 0%). To ensure that euro area banks were able to obtain the necessary liquidity through these operations, the ECB temporarily introduced collateral easing measures for refinancing operations. These are comprised of an expansion of additional credit claims (ACC, eligible credit claims set somewhat at the discretion of national central banks), the waiver to accept Greek sovereign debt instruments that do not meet minimum credit quality requirements, the reduction of collateral valuation haircuts, and the eligibility of marketable assets that fulfilled minimum credit quality requirements on 7 April 2020 even if they stop meeting credit quality requirements in the meantime.

Chart III.2.3 • Decompositions of the changes in the long-term sovereign bond yield of the euro area | Basis points

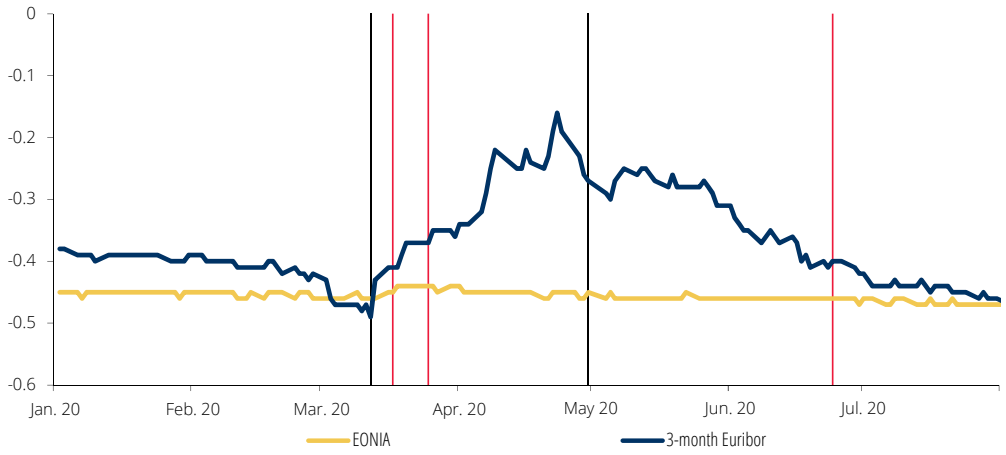


Source: Refinitiv (Banco de Portugal calculations). | Notes: Decomposition of the changes between the mentioned dates. The euro area long-term sovereign bond yield if is the average of the 10-year yields of the shown countries weighted by capital key. Decomposition of 10-year overnight indexed swaps (OIS) rates based on Joslin, Singleton and Zhu (2011) "A New Perspective on Gaussian Dynamic Term Structure Models." *Review of Financial Studies*.

These measures helped maintain the necessary flow of credit to the economy and contain some money market tension associated with flight-to-safety movements which emerged between mid-March and end-April (Chart III.2.4). This increase was associated with a number of factors which faded gradually over time and as financial markets stabilised.

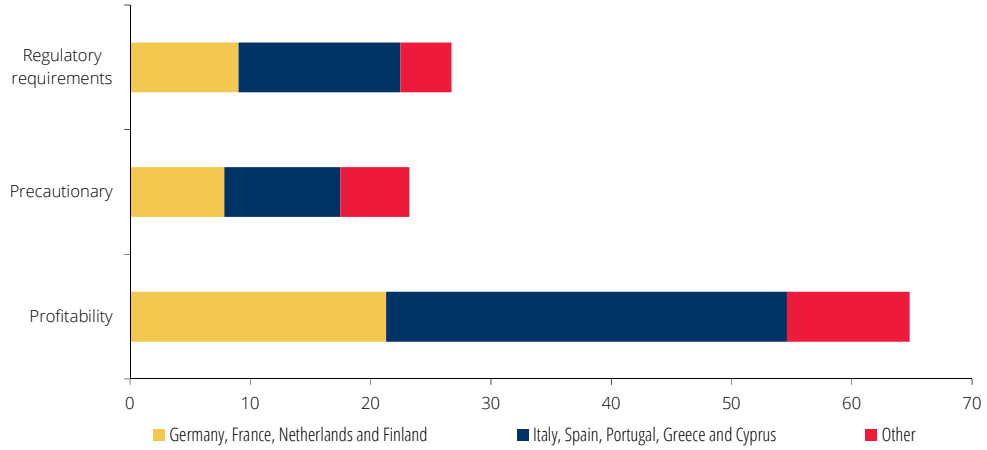
These very favourable conditions were behind the strong demand at the June TLTRO III, in which the largest amount to date under any single Eurosystem lending operation was allotted (€1,308 billion). Demand was closer to the maximum allowed ceiling in countries deemed more vulnerable. According to the Bank Lending Survey, the operation's attractive terms were the main reason behind participation (Chart III.2.5), particularly for banks in those countries, for which alternative financing costs would be even greater.

Chart III.2.4 • Money market interest rates | Percentage



Source: Refinitiv. | Notes: Black vertical lines point to announcements of new operations or changes in TLTRO-III conditions, while red lines point to TLTRO-III and the first bridge-LTRO allotments (bridge-LTRO were allotted between 17 March and 9 June).

Chart III.2.5 • Reasons for participating in the June TLTRO-III | Frequency of responses



Source: ECB (Banco de Portugal calculations). | Notes: Based on prospects for participation in future TLTRO-III at the end of the first quarter. Frequency of responses "will contribute somewhat" and "will contribute considerably" by country weighted by outstanding private non-financial loans.

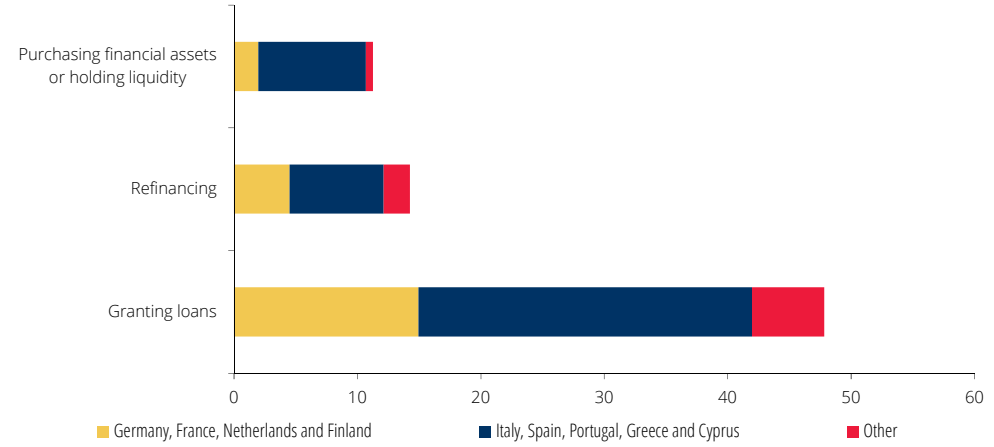
Banks indicated that they intended to use funds obtained through the TLTRO III mainly to lend (Chart III.2.6). This is in line with the flow of credit to euro area firms observed since March, to which government credit guarantees seem to also have contributed.

Finally, the ECB entered into swap line agreements with other central banks to safeguard stability in international financial markets. The agreement with the US Federal Reserve made it possible to provided US dollar-denominated liquidity to euro area institutions right from the onset of the pandemic crisis. The swap and repo lines with other central banks and the establishment of the Eurosystem repo facility for central banks (EUREP) helped support euro-denominated funding to non-euro area institutions.

Monetary policy measures proved effective in containing the effects of the pandemic crisis and, in conjunction with fiscal, macroprudential and prudential supervisory measures, contributed to interrupt

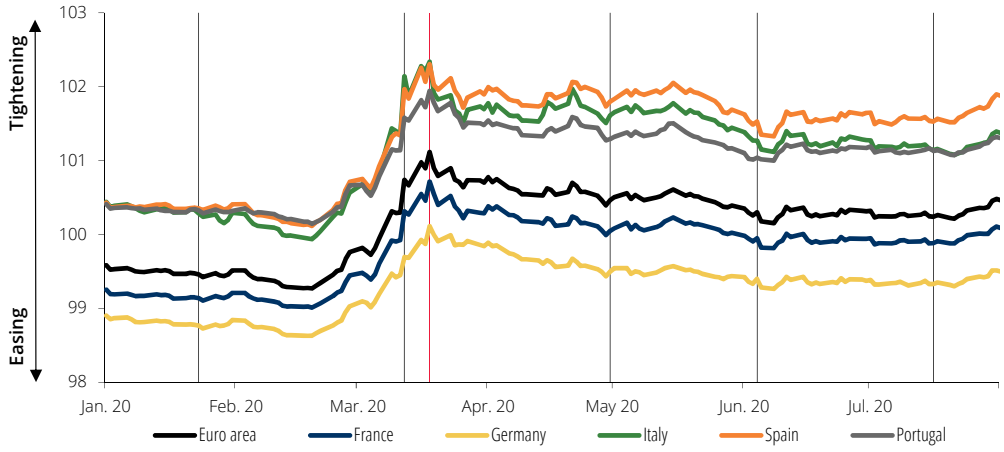
the tightening trend in euro area financial conditions observed since mid-February (Chart III.2.7). Financial conditions have improved since mid-March, although they remain at less favourable levels than at the beginning of the year. More recently, financial conditions have deteriorated somewhat, chiefly due to foreign exchange market developments. Prevailing risks to economic developments in the euro area stress the importance of the ECB's current monetary policy stance.

Chart III.2.6 • Uses of TLTRO-III funding | Frequency of responses



Source: ECB (Banco de Portugal calculations). | Notes: Frequency of responses "will contribute somewhat" and "will contribute considerably", over the next 6 months answered at the end of the first quarter, by country weighted by outstanding private non-financial loans. "Refinancing" – average of frequency of responses to: substitute for deposit shortfalls, maturing debt securities, interbank lending, TLTRO II funding or other Eurosystem liquidity operations. "Purchasing financial assets or holding liquidity" – average of frequency of responses to: purchasing domestic sovereign bonds or other financial assets and holding liquidity with the Eurosystem.

Chart III.2.7 • Financial conditions in the euro area, Portugal and the four largest economies | Index



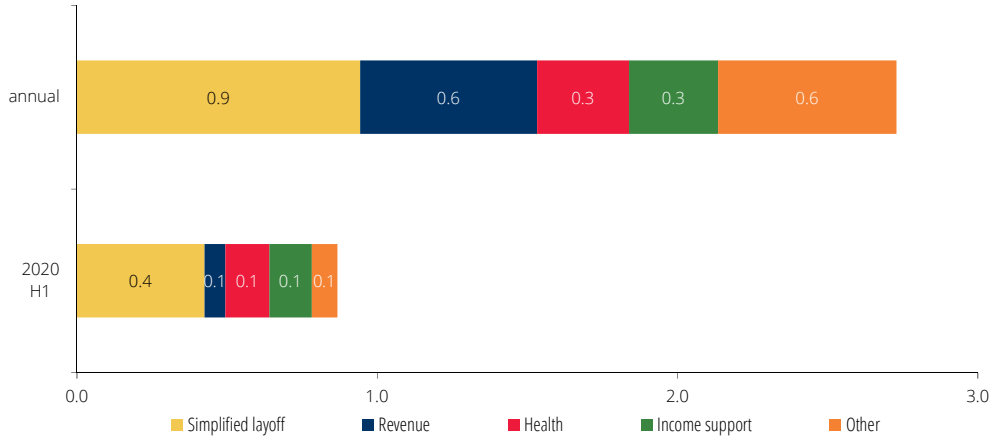
Source: Goldman Sachs | Notes: Each country Financial Conditions Index (FCI) is a weighted average of 3-month overnight indexed swap (OIS) rate, 10-year German sovereign bond yield, sovereign bond yield spread relative to Germany, corporate bond spread relative to the sovereign, stock index and the Goldman Sachs trade-weighted index. Weights reflect the effect of these variables on real GDP growth over a 1-year horizon coming from vector autoregressive (VAR) model. The euro area FCI is the aggregate of the countries FCI. Black vertical lines point to Governing Council meetings and the red line points to PEPP annoucement.

2.2 Budgetary measures in Portugal in the pandemic crisis

In the wake of the pandemic crisis, in addition to monetary policy interventions, the Portuguese government has adopted fiscal policy measures to support firms and households. The first measures were announced in March and were gradually reinforced in June, with the Economic and Social Stabilisation Programme and the Amending State Budget. The impacts of the measures reviewed in this section refer to direct effects on public accounts, excluding second-round effects. Quantifications have a higher degree of uncertainty than usual. Economic policy measures without direct budgetary effects, such as moratoria and State-guaranteed credit lines are analysed in Sections 2.4 and 2.5.

In the first half of the year, the impact of measures taken on the fiscal deficit stood at 0.9% of GDP projected by the Banco de Portugal for 2020, which will be used as a benchmark in this section (Chart III.2.8). The suspension of tax and contributory enforcement proceedings, in force between April and June, while maintaining the possibility of voluntary payment, had an impact of 0.1% of GDP. Compared to total enforced collection in 2019, the suspended figure reached 6.7% for tax revenues and 14.9% for social contributions. The deferral of tax payments, important to ensure the liquidity of firms in the second quarter of the year, has no impact on the budget balance in national accounts. However, a likely rise in non-compliance associated with this measure and the adoption of other measures after the Amending Budget approval pose a risk to the budgetary execution for the remainder of the year.

Chart III.2.8 • Impact from policy measures related to the pandemic | Percentage of GDP



Sources: GEP/MTSSS, DGO/MF and Banco de Portugal.

On the expenditure side, the "simplified layoff" is the measure with the higher budgetary impact. The sum of the subsidy paid to firms and social contribution exemptions had a budgetary impact of 0.4% of GDP in the first half of 2020 (Section 2.3). Income support measures, such as the creation of extraordinary support for self-employed workers with a reduction in economic activity, the exceptional support to households associated with school breaks and applicable when neither parent could work from home, and the allowance for people in quarantine covered an average of 120,000, 100,000 and 30,000 people between March and June. Exceptionally, unemployment benefits and social integration income with a granting period ending until 30 June were extended. Expenditure on these measures was 0.1% of GDP in the first half of 2020.

National Health Service (NHS) expenditure on personal protective equipment, medication and ventilators had an effect of 0.1% of GDP. Finally, other measures associated with the pandemic, including the purchase of personal protective equipment and the adaptation of workplaces in the general government, as well as regional or local measures, including €50 million of the €132 million loan to SATA Air Azores, had an impact of 0.1% of GDP on the deficit, in the first half of the year.

Information on the implementation of measures points to a slowdown in the budgetary impact in July. However, during the second half of the year, many of these measures will be in place and the impact of new measures will have yet to materialise. These include changes to the rules on Corporate Income Tax (CIT) prepayments, the instruments to support firms following the "simplified layoff" and the strengthening of measures supporting income and the aviation sector.

The suspension of the first and second CIT prepayments may be total for micro, small and medium-sized enterprises, cooperatives, firms in the Accommodation and food services sectors, and firms experiencing falls in turnover of more than 40%. The remaining firms may suspend 50% of these payments if their turnover falls more than 20%. The third prepayment must be settled in order to ensure that unpaid amounts do not exceed 20% of what would have been paid under normal circumstances. The quantification of this measure is uncertain, as it takes place concurrently with the impact on the collection of CIT that would result from the fall in corporate profits in 2020, in the absence of this legislation. Other less impacting measures include the additional solidarity surcharge on the banking sector, with a positive effect on the budget balance. The impact of the measures on the revenue side, excluding the exemption from contributions under the "simplified layoff", will be around 0.6% of GDP in 2020.

The "simplified layoff" scheme was still in place in July and, from then onwards, was valid only for a small number of firms. Thus, the support for progressive resumption was created, which allows workers to be furloughed until December. This measure, however, establishes a maximum reduction in working hours below that which could be set under the "simplified layoff" and, therefore, warrants lower compensation from social security. Firms benefiting from the "simplified layoff" scheme and not making use of the support for progressive resumption may have access to the extraordinary incentive to support the normalisation of the economic activity. In this case, firms may opt to receive a one-off cash transfer or two six-month deferred transfers, of an amount based on the number of workers in "simplified layoff" and its duration. The option into either of these supports gives rise to a 60-day extension of the period of restrictions on dismissals after expiry of the new incentive. These measures will amount to 0.9% of GDP.

Also in the social security context, new benefits have been created, in particular the stabilisation supplement for workers covered by the "simplified layoff" scheme, with income of up to twice the national minimum wage (equivalent to wage loss from one month on furlough), an extraordinary family allowance benefit for households up to the third income bracket and support for self-employed and informal workers, amounting to €438.81, between July and December, subject to the maintenance of social security contributions for two years. In addition to these new supports, access to social unemployment benefit was extended until the end of 2020. The estimated impact of these measures, together with those implemented in the first half of the year, will amount to 0.3% of GDP.

Furthermore, health expenditure is expected to continue to materialise, with the purchase of medication and personal protective equipment, the hiring of human resources and the payment of the bonus for NHS workers involved in the fight against the pandemic. These measures are

estimated to amount to 0.3% of GDP. Finally, the amount foreseen for State aid to TAP and SATA Air Azores in 2020, together with other smaller measures, have an impact on the budget balance of 0.6% of GDP.

The fiscal stimulus package for 2020 amounts to 2.7% of GDP. Part of this effort may be funded by European initiatives. This impact is higher than the fiscal stimulus, of about 1.2%, posted in 2008 and 2009 as a response to the financial crisis, which was, however, essentially different from the current one. For the euro area, the European Fiscal Board estimated, in early July, that budgetary measures taken in the context of the pandemic crisis would reach around 4% of GDP. In the near future, the balance between the need to adopt additional measures to boost the economy, while benefiting from European funds, and the maintenance of sustainable public finances in the medium term will be challenging, in particular in countries with high public debt, as is the case of Portugal.

2.3 The "simplified layoff": impact on firms' liquidity and employment

At a time when firms have experienced sharp falls in their revenue, the simplified scheme for temporary reduction of normal working hours or suspension of employment, commonly known as "simplified layoff", has made it possible to cut labour costs and sustain employment.

The possibility of benefiting from the "simplified layoff" was restricted to firms with all their tax and social security obligations duly fulfilled, having: (i) recorded a drop of at least 40% in turnover in the 30-day period prior to the submission of the application; or (ii) closed completely or partially due to the enforced closure of facilities (either by legislative or administrative ruling); or (iii) closed completely or partially due to the interruption of global supply chains or suspension or cancellation of orders.

In the case of a "layoff" with full reduction of working hours, the State aid corresponded to 70% of two-thirds of normal gross wage, with a minimum of €444.50 per worker and a maximum of €1,333.50. In addition, firms were exempted from paying employers' social security contributions for furloughed workers. In turn, the beneficiary firms were prevented from terminating employment contracts (through collective dismissal, redundancy, or worker unsuitability) during the period in which they benefited from this support and the following 60 days. This restriction applied to all workers, whether or not under the "simplified layoff".

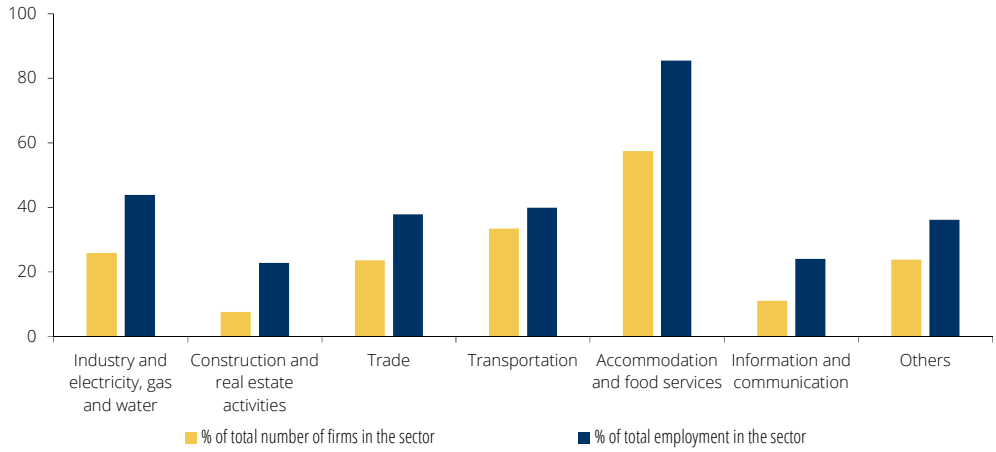
Firms were able to access the "simplified layoff" between April and June, with the possibility of extending this mechanism for three months. Subsequently, the possibility to extend the deadline was protracted until the end of July. After July, the "simplified layoff" remained in place for firms and establishments under the obligation to close facilities and for firms that, by the end of July, had not yet used this mechanism for three consecutive months. Measures to ensure a monitored phasing-out of this mechanism were also announced. In particular, firms that have resorted to "simplified layoff" may benefit from the extraordinary incentive for the normalisation of activity or keep workers partially on furlough until December 2020 at the latest, by using the support for progressive resumption. In the latter case, eligibility criteria are more restrictive than before, and social security support is lower (Section 2.2). This section does not address these new announced measures, with more information on their use being required.

According to Social Security information, about 115,000 employers had submitted "simplified layoff" applications until the end of July, corresponding to a potential universe of 1,367,000 workers.

Of these, around 900,000 workers had been supported, the equivalent of about 25 per cent of the employment recorded with the Social Security. The percentage of firms benefiting from this measure was higher in the Accommodation and food services sector (57.5%) and, to a lesser extent, in the Transportation sector (33.5%) (Chart III.2.9). The Accommodation and food services sector also stands out due to the percentage of workers potentially covered (85.5%).

Expenditure on subsidies paid to firms and the exemption from social contributions relating to the "simplified layoff" in the second quarter is estimated to have amounted to €1 billion, i.e. about 6% of the private sector wage bill.

Chart III.2.9 • "Simplified layoff" scheme – Beneficiary firms and potentially covered workers, by sector of activity | Percentage



Sources: Statistics Portugal, MTSSS and Banco de Portugal. | Notes: Data regarding "simplified layoff" scheme applications released by the MTSSS on August 13th. The share of potentially covered workers corresponds to the number of employees in firms that applied for the "simplified layoff" scheme as a percentage of total employment, implying an upper bound to the real impact. The information refers to submitted applications (not the accepted ones). The shares were calculated using data for the number of firms from the Central Balance Sheet Database (2018) and the total number of employees from Social Security (2019). In the Social Security data, there is only information for the O-Q NACE sections. To exclude the O section, the employment weight of this section in the O-Q sector in National Accounts was considered. The NACE sections presented are: B-E (Industry and electricity, gas and water); F and L (Construction and real estate activities); G (Trade); H (Transportation); I (Accommodation and food services); J (Information and communication); A, M-N and P-S (Others).

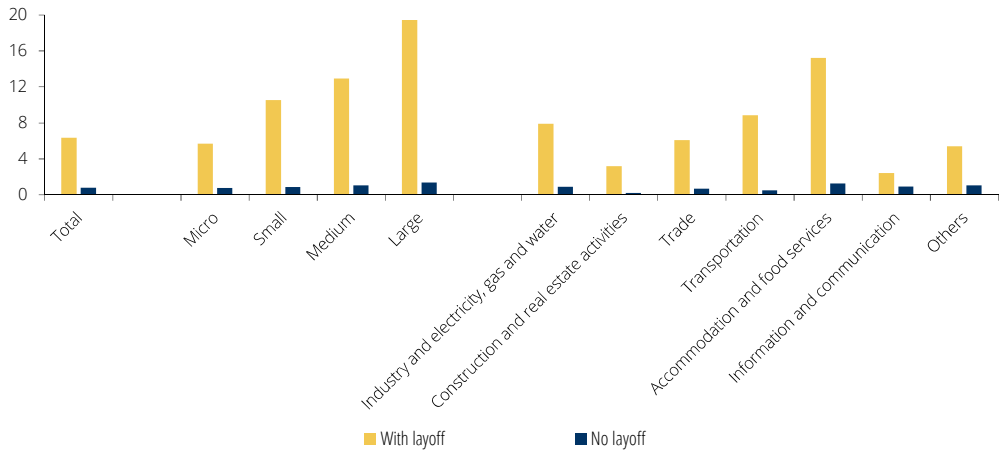
Based on a simulation exercise for the March-June 2020 period, it is possible to estimate the percentage of firms that, in the context of reduced activity, are unable to pay their fixed costs after depleting cash reserves and deposits, as well as credit lines already taken out. This exercise follows the methodology applied in the simulation exercise developed for the May 2020 Special issue of the *Economic Bulletin*.

The exercise is based around a scenario where fixed costs remain unchanged and resorting to "layoff" is not possible ("no layoff") and a scenario where firms with a turnover shock above 40% apply for "layoff" ("with layoff"). The exercise is based on common assumptions regarding the impact of the pandemic on the activity of firms in each sector and uses microdata that allows for heterogeneity across sectors to be considered. These assumptions reflect the outcome of the COVID-IREE survey. It is also assumed that all existing credits are renewed under the prevailing terms.

Chart III.2.10 illustrates the share of firms that are unable to pay their fixed costs after using their cash reserves, deposits, or credit lines in the two scenarios (firms with a liquidity shortfall at the outset are excluded from these calculations). In the "no-layoff" scenario, around 6% of the firms have liquidity shortfalls. This percentage drops to 1% in the scenario where firms can apply for

the measure, showing that the "simplified layoff" allows the impact of the shock on firms' liquidity to be almost entirely cancelled.

Chart III.2.10 • Firms with a liquidity shortfall by firm size and sector of activity | Percentage



Source: Banco de Portugal. | Notes: The chart shows the percentage of firms with a liquidity shortfall in June 2020, considering the accumulation of activity results for each firm between March and June 2020 and after the firm has exhausted its cash reserves, deposits and credit lines. The NACE sections presented are: B-E (Industry and Electricity, gas and water); F and L (Construction and real estate activities); G (Trade); H (Transportation); I (Accommodation and food services); J (Information and communication); A, K, M-S (Others).

The outcome of the exercise shows a considerable heterogeneity. The Accommodation and food services is the sector with the highest share of firms with liquidity shortfalls, with 15% and 1% of firms in "no-layoff' and with "layoff" scenarios, respectively. The difference between the two scenarios is also significant in Transportation and Manufacturing sectors (8 and 7 pp respectively). The impact of the "simplified layoff" is greater on large enterprises, cutting the percentage of enterprises with liquidity shortfall from 19% to only 1%. The high share of large enterprises with liquidity shortfall in a "no-layoff" scenario reflects, in part, an easier access to credit to meet cash needs in normal periods.

The "simplified layoff" has thus insulated the liquidity situation of a significant number of firms from the impact of the pandemic. This is one of the channels through which the "simplified layoff" measure has helped mitigate the decline in employment (Chapter 5 of Part I).

The quantification of the role played by the "simplified layoff" in preserving employment is complex and would require the computation of a counterfactual describing labour decisions in a no-policy scenario. A proxy of this impact can be obtained through firms' responses to the July edition of COVID-IREE.

A first question focused on observed employment developments. Among the firms that benefited from the "simplified layoff", 30% reported having cut jobs since the onset of the pandemic. Taking into account the magnitude of the falls reported by different firms, employment is estimated to have fallen by almost 7% in these firms (Chart III.2.11).[1] Since these firms were prevented from

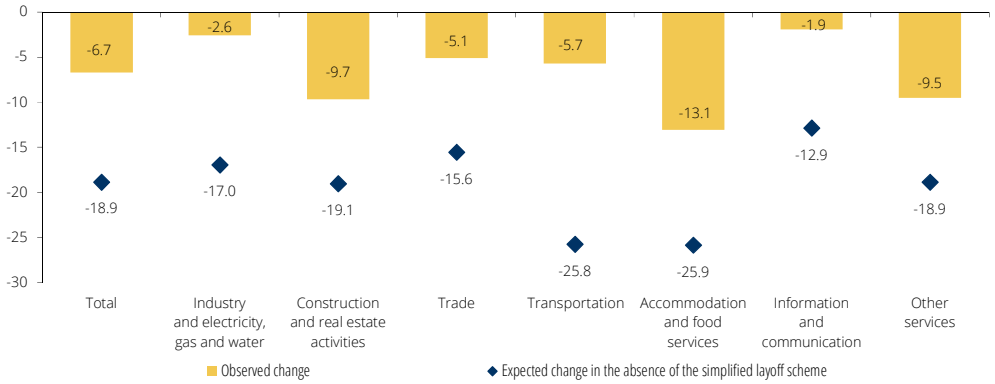
1. This quantification is obtained by taking the midpoint of the bracket reported for changes in employment by each firm, weighted by its workforce. In addition to uncertainties associated with these calculations, the last response bracket in the question regarding employment trends includes all changes greater than 20%. After a sensitivity analysis of the results and considering Labour Force Survey estimates for the second quarter of 2020, it was decided that a 40% change should be allocated to the last distribution bracket.

making dismissals, they must have opted for the non-renewal of fixed-term contracts and the non-replacement of voluntary or programmed redundancies. Considering the survey responses of all firms, the total estimated fall in employment for the second quarter is 3.6%.

In a second question, firms were asked to estimate employment developments that would have taken place in the absence of the "simplified layoff". In this scenario, 77% of the firms benefiting from the measure reported that they would have cut jobs, thereby reducing employment by around 19%. Considering the responses of all firms participating in the survey, the total fall in employment in this counterfactual scenario would amount to 8%.

In sectoral terms, the effect of the measure on job preservation is especially remarkable in Transportation and in Industry and Electricity, gas and water, where the difference between the actual and the expected job reduction, in the absence of the "simplified layoff", is 20 p.p. and 14 p.p., respectively (Chart III.2.11). This difference is also significant in the Accommodation and food services sector (13 p.p.), where the sharpest fall in employment was observed. Despite some degree of uncertainty, these estimates point to the success of the measure in preserving jobs.

Chart III.2.11 • Employment in beneficiary firms – observed change and expected change in the absence of the "simplified layoff" scheme, by sector of activity | Percentage



Sources: Statistics Portugal and Banco de Portugal (COVID-IREE). | Notes: The results are based on the COVID-IREE answers to the questions about the observed change in employment and the expected change in the absence of the "simplified layoff" scheme, from the beginning of the pandemic until the first half of July. The Total covers only the NACE sections presented: B-E (Industry and electricity, gas and water); F and L (Construction and real estate activities); G (Trade); H (Transportation); I (Accommodation and food services); J (Information and communication); M-N and P-S (Other services).

The results presented point to an important role of the "simplified layoff" measure in preserving firms' liquidity and mitigating the fall in employment in the short term, thus helping to support the recovery of the economy. However, against a background of a gradual and incomplete recovery of economic activity, the longer term effects of the pandemic on the financial situation of firms and the labour market remain uncertain.

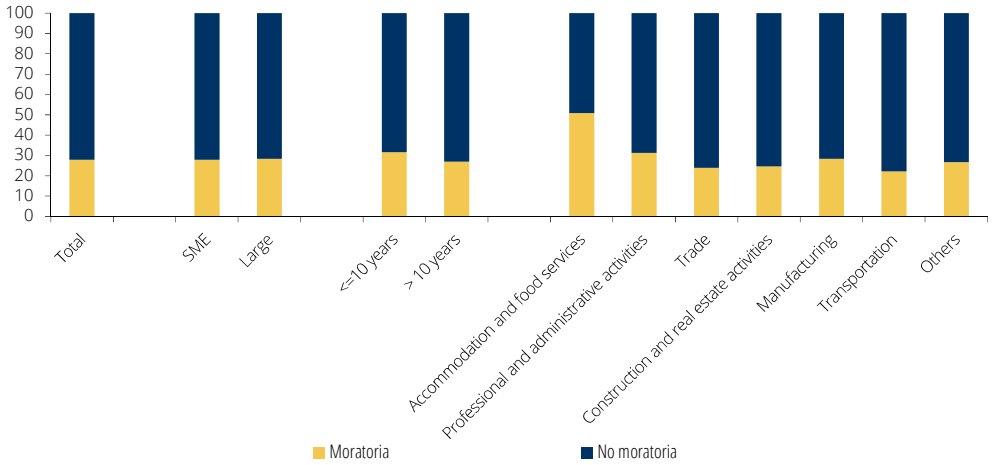
2.4 Measures to support corporate financing

By the end of June, about 38% of private non-financial corporations with access to credit before the pandemic had applied for moratoria on bank loans and/or State-guaranteed credit lines; 11% had applied to moratoria only, 15% to State-guaranteed credit lines only; and about 11% had applied for both measures.

Under the public moratorium established in Decree-Law No 10-J/2020, firms could apply until 30 September 2020 for an extension or suspension of the payment of principal, interest and guarantees scheduled until 27 March 2020. The measure will be in force until the end of September 2021 and applies to all firms with their tax and financial obligations fulfilled in accordance with the established rules.

According to information reported to the Central Credit Register, 18% of the loans benefited from a moratorium in June 2020. The use of moratoria was more significant in large enterprises (28% for the loans of these enterprises and 18% for micro, small and medium-sized enterprises – SMEs). However, the amounts subject to moratoria represent, in both cases, 28% of total outstanding amounts (Chart III.2.12). In the case of firms established for more than ten years, the percentage of outstanding loans subject to moratoria, 27%, is lower than in younger enterprises, 32%. Firms in the Accommodation and food services sector stand out significantly in the use of moratoria. More than half of the amount of loans in this sector are subject to moratoria. In firms in the Professional, scientific, technical and administrative activities and Manufacturing sectors, the percentage of outstanding balances of loans subject to moratoria is close to 30%. Applications for moratoria were less significant in the Transportation, Trade and Construction and real estate activities sectors (22%, 24% and 25% respectively).

Chart III.2.12 • Use of debt moratoria by firm size, age and sector of activity | Percentage of total outstanding amount of loans in June 2020



Source: Banco de Portugal. | Notes: Data based on the Central Credit Register referring to outstanding balances on loans to private non-financial corporations in June 2020. The NACE sections presented are: I (Accommodation and food services); M and N (Administrative, professional, scientific and technical activities); G (Trade); F and L (Construction and real estate activities); C (Manufacturing); H (Transportation); A, B, D, E, J, K, O, P, Q, R, S, T and U (Others).

The creation of State-guaranteed credit lines is intended to meet liquidity needs arising from the impact of the pandemic. Financing is granted by banks, with a State guarantee of up to 90% of the loan amount for micro and small-sized enterprises (for medium enterprises, small caps and mid caps[2], the guarantee is up to 80%). To ensure that guarantees are provided only to firms that were financially viable before the outbreak of the pandemic, firms are eligible if they have a regular tax and financial situation and positive equity capital (if they have been established for more than two years). These loans can have a maturity of up to six years and a grace period of up to 18 months, with maximum spreads and fixed mutual guarantee fees, depending on the maturity of the operation.

2. Small mid cap are large firms with less than 500 employees and mid cap are large firms with less than 3000 employees, according to the recommendations of the European Investment Bank.

These conditions are more favourable than market conditions, contributing to explain why 47% of the amount of loans granted from March to June 2020 was channelled through these credit lines. For loans with a maturity of more than 1 year, this percentage rises to 62% of new loans. In the applications to these credit lines, firms established for more than 10 years and firms in the Accommodation and food services sector stand out (Table III.2.1).

Financing through these credit lines allowed for longer maturities. In June 2020, around 67% of State-guaranteed loans had maturities of more than 5 years, compared to 29% for other new loans over the same period and 26% in the same period of the previous year. The interest rate (AAR annualised agreed rate) on these operations is also lower, 1.3% in average. For new loans without a State guarantee, the median interest rate is 1.6%, showing greater variability. This compares with a median interest rate of 1.7% in the last quarter of 2019.

In addition to the eligibility criteria, the participation of banks in the approval process for State-guaranteed is intended to ensure that they use their risk assessment capacity to avoid distortions in the allocation of resources. However, this is not a trivial task, warranting assessments that go beyond the use of financial information on the firms' past.

Table III.2.1 • Use of State guarantee loans by firm age and sector of activity | Percentage of amount of loans granted between March and June 2020

	No state guarantee	State guarantee
Total	52.7	47.3
<= 10 years	57.7	42.3
>10 years	51.1	48.9
Accommodation and food services	27.0	73.0
Professional and administrative activities	63.5	36.5
Trade	52.9	47.1
Construction and real estate activities	68.3	31.7
Manufacturing	46.9	53.1
Transportation	41.3	58.7
Others	64.5	35.5

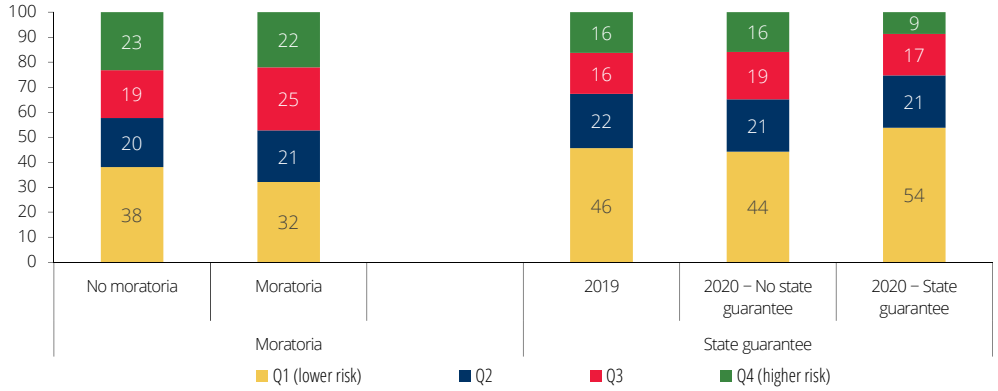
Source: Banco de Portugal. | Notes: Data based on the Central Credit Register referring to loans granted to private non-financial corporations between March and June 2020. The NACE sections presented are: I (Accommodation and food services); M and N (Administrative, professional, scientific and technical activities); G (Trade); F and L (Construction and real estate activities); C (Manufacturing); H (Transportation); A, B, D, E, J, K, O, P, Q, R, S, T and U (Others).

Using a credit risk model, also limited by the use of financial information on the firms' recent past, loans that benefited from moratoria were granted to firms with risks close to that of other loans, although slightly higher (Chart III.2.13). The opposite is true for State-guaranteed loans, the risks being slightly lower than for firms with unsecured loans granted in the same period or in the same period of the previous year.

Nevertheless, a significant part of the loans granted to firms in the Accommodation and food services sector is ranked at the lowest risk levels. Therefore, it is important to assess both the risk of firms estimated on the basis of financial information from recent years and the way in which firms have been affected by the shock. The combination of these two dimensions allows for a better evaluation of the firm's current risk. By combining not only the immediate impact of the shock but also the expected impact up to the end of 2020, an approximate assessment of the short-term viability of firms is possible. Chart III.2.14 breaks down lending, with and without a State guarantee, considering the risk observed in firms and the estimated impact on their sector of activity. The impact on each sector

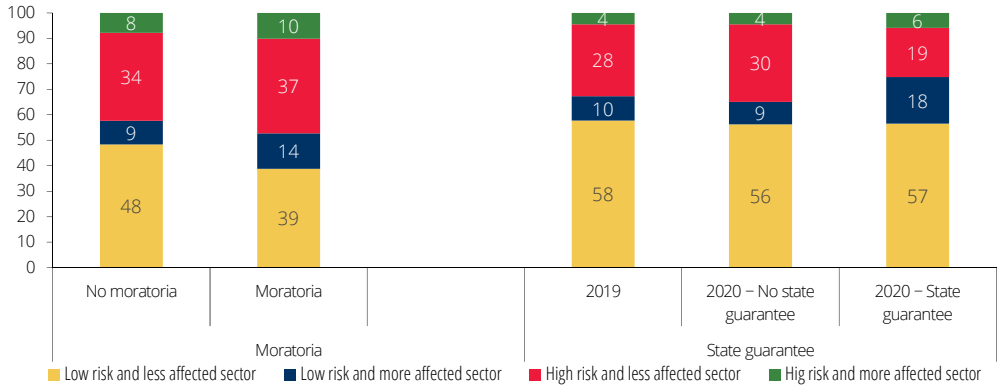
of activity is based on the results of the Fast and Exceptional Enterprise Survey COVID-19 (COVID-IREE) for the initial shock (in the April-July 2020 period) and on assumptions for the recovery profile in the subsequent period, anchored in expectations reported by firms. Firms with low credit risk before the pandemic but in more adversely affected sectors obtained a larger amount of secured loans. In contrast, higher-risk firms, whose viability could be more easily threatened by any shock, obtained a smaller amount of loans through State-guaranteed credit lines. As regards the moratorium, there is also a more significant number of applications from the most affected sectors, compared to the overall composition of banks' loan portfolios. In this case, however, the number of applications is slightly higher in high-risk firms than in low-risk firms.

Chart III.2.13 • Use of support measures by firms' credit risk | Percentage of amount of loans



Source: Banco de Portugal. | Notes: Data based on the Central Credit Register. In the analysis of the use of debt moratoria, data refer to outstanding balances on loans to private non-financial corporations in June 2020. In the analysis of the use of State guarantee loans, data refer to loans granted to private non-financial corporations between March and June 2020 (and in the same period of 2019). Credit risk assessment based on the Z-score, estimated in accordance with the methodology presented in the article by Antunes, Gonçalves and Prego (2016), "Firm default probabilities revisited", *Banco de Portugal Economic Studies*, vol. II, No 2, April.

Chart III.2.14 • Use of support measures by firms' credit risk and impact on sector of activity | Percentage of amount of loans



Source: Banco de Portugal. | Notes: Data based on the Central Credit Register. In the analysis of the use of debt moratoria, data refer to outstanding balances on loans to private non-financial corporations in June 2020. In the analysis of the use of State guarantee loans, data refer to loans granted to private non-financial corporations between March and June 2020 (and in the same period of 2019). Credit risk assessment based on the z-score, estimated in accordance with the methodology presented in the article by Antunes, Gonçalves and Prego (2016), "Firm default probabilities revisited", *Banco de Portugal Economic Studies*, vol. II, No 2, April. Firms are classified as having high risk if they have a z-score above the median. The firms most affected by the pandemic are essentially firms in the sectors of Accommodation and food services, Transportation and Arts, entertainment and recreation activities.

The timely implementation of moratoria and State guarantees have been key to mitigate the effects

of the pandemic on the liquidity of Portuguese firms. However, while for some firms the effects may have been temporary, for others the shocks may be more protracted, threatening their viability. The assessment of this viability is difficult but crucial for an efficient allocation of limited resources promoting a sustained recovery of the Portuguese economy.

2.5 Moratoria on credit to households

The Portuguese government approved a credit moratorium scheme for households, while not giving rise to defaults or credit restructuring. This measure was complemented by moratoria at the initiative of associations representing credit institutions.[3] In the short term, the moratoria reduce the liquidity needs of households and mitigate the worsening of banks' credit quality indicators.

The public moratorium will be in place until 30 September 2021, while the deadline for submission ended on 30 September 2020. The measure applies to households adversely affected by the pandemic but with their tax and financial obligations duly fulfilled, and covers mortgage loans, residential property finance lease and credit for educational purposes. Private moratoria comprise loan agreements that do not benefit from the public moratorium, namely personal loan agreements, car loans and credit cards.

In June 2020, 296,000 individual borrowers benefited from a credit moratorium (considering only the first borrower of the loans), corresponding to 7% of borrowers with actual credit recorded in the Central Credit Register. This percentage is more significant in housing credit and personal loans, where 13% and 10% of the borrowers benefited from a moratorium, than in car loans, where only 4.5% of the borrowers have benefited from it (Table III.2.2.).

Table III.2.2 • Number of debtors under moratoria | Percentage of total debtors of each type

	Housing loans	Personal loans	Car loans
All debtors	13.2	10.3	4.5
Age of debtor			
Less than 35 years old	15.8	11.1	5.5
35 to 44 years old	15.8	13.2	5.6
45 to 54 years old	13.4	11.7	4.3
55 to 64 years old	10.0	8.3	2.7
More than 64 years old	5.2	3.2	1.4
Labour situation of debtor			
Employee	12.9	11.6	4.7
Self-employed	21.9	18.9	9.4
Unemployed	14.8	14.0	5.9
Retired	5.6	4.2	1.7
Student	11.1	11.9	4.9
Other not working	13.0	13.1	5.2
Schooling level of debtor			
Tertiary	13.0	13.7	5.0
Secondary	16.2	13.9	6.1
Basic or no education	10.9	9.4	4.2

Source: Banco de Portugal | Note: Data based on the Central Credit Register referring to households with credit in June 2020.

Borrowers aged 65 and over and retired borrowers, whose income was less affected by the crisis, applied less frequently for moratoria in any of the types of credit analysed. In the highest age bracket, 5.2%, 3.2% and 1.4% of the borrowers benefited from a moratorium on housing credit, personal and car loans, respectively (5.6%, 4.2% and 1.7% in the case of retired people). The number of beneficiaries of moratoria is less differentiated by schooling level.

3. The Banking Customer Website provides detailed information on the application of public and private moratoria. Box 1 "The importance of credit moratoria in the context of the COVID-19 pandemic" of the June 2020 *Financial Stability Report* presents a systematization of moratoria regimes.

The highest number of applications to moratoria occurs with borrowers aged less than 45 or self-employed, which may be explained by their incomes being more sensitive to shocks. In addition, for households where the reference person is aged between 35 and 45 or is self-employed, the ratio between loan instalments and disposable income is relatively high (median values of 19.2% and 19.3% respectively, compared to 17.5% for households as a whole, according to the Portuguese Household Finance and Consumption Survey 2017). The importance of moratoria for younger households in the context of the pandemic shock is in line with the results of a simulation exercise of the short-term effect of the pandemic on the financial situation of households.[4]

An estimate of the total amount of instalments subject to moratoria, based on credit register data, points to a figure of around €2.2 billion, which represents about 12% of the approximate value of instalments accumulated up to September 2021. The amount of credit subject to moratoria was €20.7 billion in June 2020, or 15.7% of total loans to households recorded in the credit register. Of this amount, €16.7 billion corresponded to housing credit, 1.8 billion to personal loans and 0.5 billion to car loans (17.0%, 17.6% and 6.0% of total loans in these segments) (Table III.2.3).

The share of loans subject to moratoria in total credit to households is low for households that typically have more vulnerable labour situations such as the youngest, the least educated and the self-employed. Credit under a moratorium for borrowers aged under 35, for those with an education level equal to or less than basic schooling and for the self-employed represents, respectively, 2.0%, 1.5% and 1.9% in housing credit, 3.1%, 2.2%, and 1.8% in personal loans and even less in car loans. Most of the amount of loans benefiting from moratoria is concentrated, as is total credit, on borrowers from middle age classes, with secondary or higher schooling, and on employees. In addition, more than 80% of credit under moratoria is housing credit, which is guaranteed by a real estate property and has low default rates. These situations mitigate the potential loss to the financial system arising from the materialisation of credit risk after the moratoria expire.

Table III.2.3 • Distribution of credit by type of debtor | Percentage of total do credit in each segment

	Under moratoria			Total		
	Housing loans	Personal loans	Car loans	Housing loans	Personal loans	Car loans
All debtors	17.0	17.6	6.0	100.0	100.0	100.0
Age of debtor						
Less than 35 years old	2.0	3.1	1.9	12.1	16.5	27.4
35 to 44 years old	7.1	5.5	2.0	39.7	24.7	26.3
45 to 54 years old	5.9	5.3	1.4	34.1	27.0	24.4
55 to 64 years old	1.8	2.9	0.6	11.8	19.7	14.5
More than 64 years old	0.2	0.8	0.2	2.3	12.1	7.3
Labour situation of debtor						
Employee	13.8	14.0	4.7	85.0	77.4	81.4
Self-employed	1.9	1.8	0.9	7.0	7.1	7.7
Unemployed	0.7	0.5	0.2	3.2	2.5	2.4
Retired	0.2	0.7	0.2	2.0	9.3	6.9
Student	0.1	0.2	0.0	0.7	1.3	0.8
Other not working	0.4	0.4	0.1	2.1	2.4	1.0
Schooling level of debtor						
Tertiary	7.9	6.3	1.7	50.5	35.7	30.3
Secondary	7.5	9.0	3.4	38.9	48.0	50.8
Basic or no education	1.5	2.2	0.9	10.6	16.3	18.9

Source: Banco de Portugal. | Notes: Data based on the Central Credit Register referring to outstanding amounts of credit to households in June 2020. Credit of debtors for whom the labour situation and the schooling level was not reported was distributed among the different groups according to the distribution of credit for debtors with a known situation.

4. See Special issue "The economic impact of the pandemic crisis" of the May 2020 *Economic Bulletin*.

3 Sectoral structure and firms' responses

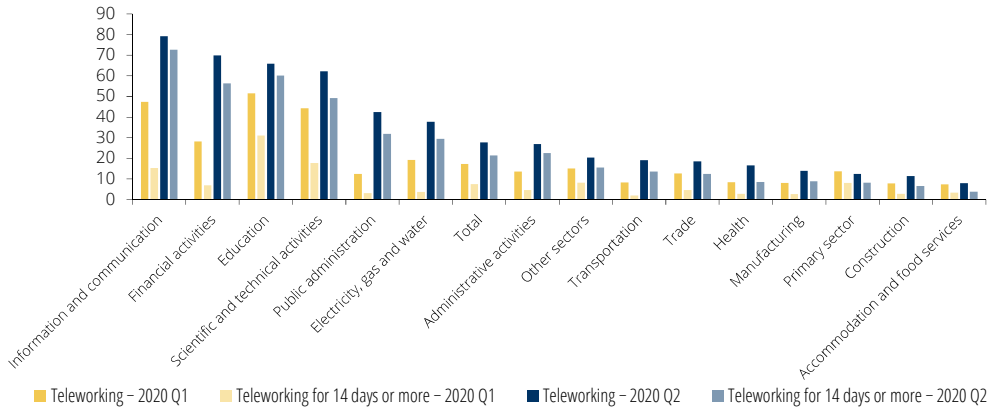
3.1 Teleworking in Portugal

The pandemic crisis and the need for social distancing gave rise to labour adjustments. The results of the Fast and Exceptional Enterprise Survey - COVID-19 (COVID-IREE) indicate that teleworking was a strategy that made it possible for firms to keep staff actually working in the second quarter of the year. In all sectors included in the COVID-IREE, the teleworking scheme was applied by about half of the firms throughout the second quarter, covering approximately 21% of workers.

This section describes teleworking in Portugal in the first half of 2020 using microdata from Statistics Portugal's Labour Force Survey. For the analysis, the questions on whether the worker has performed his/her duties at home in the reference period and for how many days are used as proxy for teleworking by the employed population. This information points to a strong increase in teleworking. In the second quarter of 2020, 27.8% of the employed population was teleworking for some period of time (approximately 1.316 million people), 10.6 p.p. more than in the previous quarter and 11.9 p.p. more than in the same quarter one year earlier. Furthermore, the share of individuals teleworking for 14 or more days rose to 21.4% (around 1.010 million people), from around 7.0% in the quarters one year earlier. These results show increases not only in teleworking but also in the intensity of its use.

The use of teleworking depends on the characteristics of the functions to be carried out and is therefore very heterogeneous in terms of occupations and sectors of activity. The Accommodation and food services, Construction, Primary sector, Manufacturing and Health sectors recorded the lowest percentages of teleworking relative to total employment in the sector (Chart III.3.1). By contrast, the sectors of Information and communication activities, Financial activities, Education, and Professional, scientific and technical activities registered teleworking percentages over 60% in the second quarter of 2020.

Chart III.3.1 • Use of teleworking, total and by sector of activity | Percentage of employment

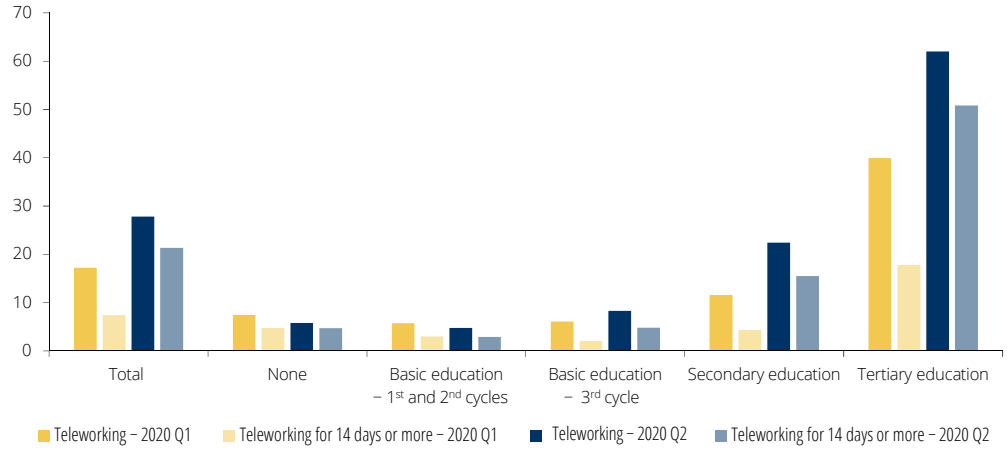


Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations). | Notes: The sectors in the graph are defined according to the sections of CAE-Rev.3 and are arranged in descending order of teleworking in the second quarter of 2020. The Primary sector comprises sections A (Agriculture, forestry and fishing) and B (Mining and quarrying) of CAE. The sector of Electricity, gas and water includes sections D and E of CAE. Scientific and technical activities include Real estate activities (section L) and Professional, scientific and technical activities (section M). Other sectors encompass sections R (Arts, entertainment and recreation), S (Other service activities), T (Activities of households) and U (Activities of extraterritorial organisations).

Chart III.3.2 illustrates the strong positive relationship between the workers' schooling level and teleworking. For individuals with less than secondary education, the share of teleworking was 6.5% in the second quarter of the year. This share rises to 22.4% for those with secondary education and to 62.0% for those with tertiary education (11.6% and 39.9% in the first quarter, respectively). This disparity is also visible in the intensity of teleworking use, with about half of all workers with tertiary education working remotely for 14 days or more.

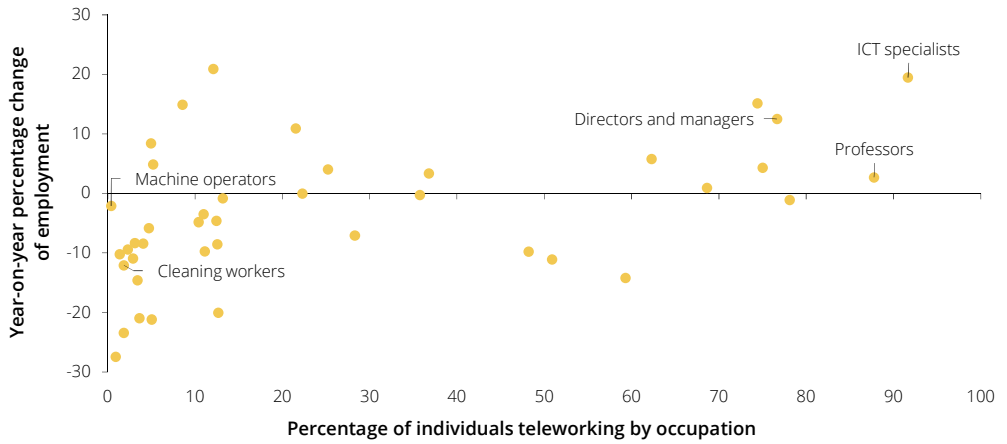
Chart III.3.3 presents the year-on-year rate of change in employment by occupation in relation to the share of individuals working remotely in each occupation. As would be expected in a situation of lockdown and social distancing, the largest reductions in employment were recorded in occupations with lower teleworking use. The possibility of working remotely has helped to minimise job losses. This, together with the fact that occupations with lower-skills and consequently lower incomes are less prone to work remotely, suggests that the pandemic crisis may exacerbate inequality, albeit mitigated by the exceptional household income support measures.

Chart III.3.2 • Use of teleworking, total and by schooling level | Percentage of employment



Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations).

Chart III.3.3 • Use of teleworking and year-on-year change of employment by occupation in the second quarter of 2020



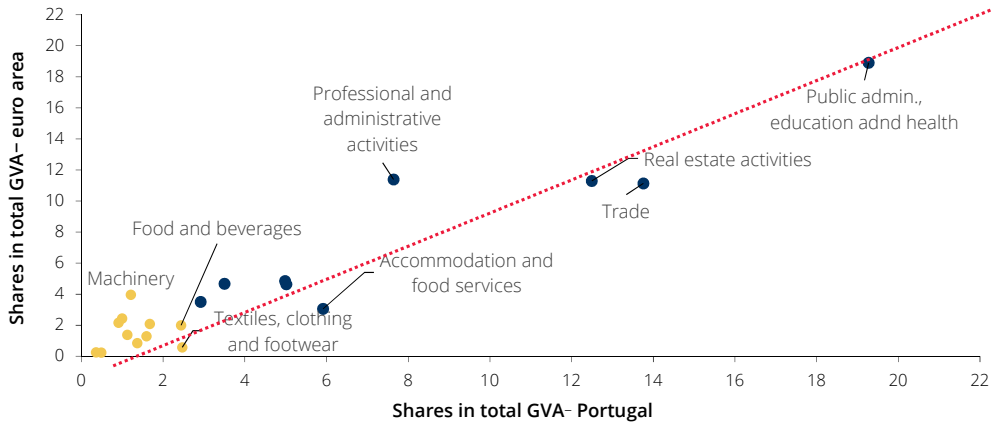
Source: Statistics Portugal – Labour Force Survey (Banco de Portugal calculations). | Note: The occupations in the Chart III.3.3 correspond to the 2-digit occupations of the National Classification of Occupations (2010 version), with the exception of the armed forces that are aggregated to 1-digit.

3.2 The productive structure in Portugal and the impact of the pandemic

The COVID-19 pandemic and the social distancing measures adopted to contain the health crisis led to a significant drop in global economic activity in the first half of 2020. However, the impact on the various countries was differentiated, in line with their productive structure. This section analyses the productive structure in Portugal and its impact on exposure to the pandemic shock. The analysis for Portugal is compared to that for the euro area and is based on GVA data from annual national accounts, with a breakdown of 38 sectors of activity.

The productive structure in Portugal is close to that of the euro area. In 2017, services had a slightly higher share in GVA in Portugal compared to the euro area (75.5% against 73.4%) and, in contrast, industry GVA had a lower share (14.6%, compared to 17.2%). Chart III.3.4 shows that structures by subsectors are not substantially different between Portugal and the euro area, but some particular cases stand out. In the GVA structure of industry in Portugal the main sectors are Textiles, clothing and footwear and Food and beverages. These sectors, and in particular Textiles, clothing, and footwear, have a larger share in the total economy in Portugal (2.5%) than in the euro area (0.6%). In the euro area, the main industry sectors are the Machinery, Transport equipment and Chemicals sectors, which have a higher share than in Portugal, with a particular emphasis on the differential recorded in the Machinery sector (with a weight in total GVA of 1.2% in Portugal and 4.0% in the euro area). As regards services, Portugal has a higher share in Trade (13.8% compared to 11.1%) and in Accommodation and food services (5.9% compared to 3.0%) and a lower share in Professional, scientific and technical activities (2.9% compared to 3.5%).

Chart III.3.4 • Shares of industry and services subsectors GVA in Portugal and in euro area in 2017

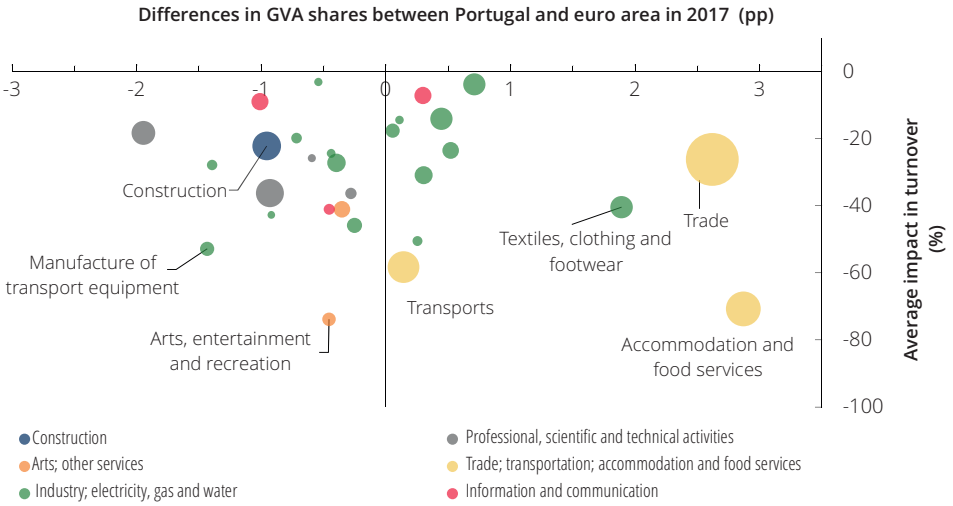


Sources: Eurostat and Statistics Portugal (Banco de Portugal calculations). | Note: The red dotted line corresponds to the quadrant bisector.

Against this backdrop, it is interesting to note to what extent the differences in the productive structure relate to the exposure of the economy to the effects of the recent COVID-19 pandemic. According to the Fast and Exceptional Enterprise Survey COVID-19 (COVID-IREE), the negative impact on firms' turnover was widespread, but presented different intensities by sector. The impact between April and June was more negative in services, particularly in Accommodation and food services, Transportation and Arts, entertainment and recreation activities. Based on the

COVID-IREE, an average negative impact of around 70% on turnover is estimated in these three months for Accommodation and food services, and Arts, entertainment and recreation activities, and around 60% in Transportation (much more negative, around 85%, in the Air transport sub-sector). These sectors, and in particular the Accommodation and food services and Transportation sectors, have increased their share in total GVA over the recent years. Furthermore, Portugal's higher specialisation *vis-à-vis* the euro area in the Accommodation and food services sector translates into a higher vulnerability of the Portuguese economy to the impact of the pandemic (Chart III.3.5). It should be noted that productive specialisation also determines the cross-sectoral relations, with these links playing a relevant role in the transmission of shocks along the production chain, which is not considered in the analysis presented.

Chart III.3.5 • Impact of the pandemic on April-June turnover by sector and difference in sector GVA shares between Portugal and the euro area in 2017

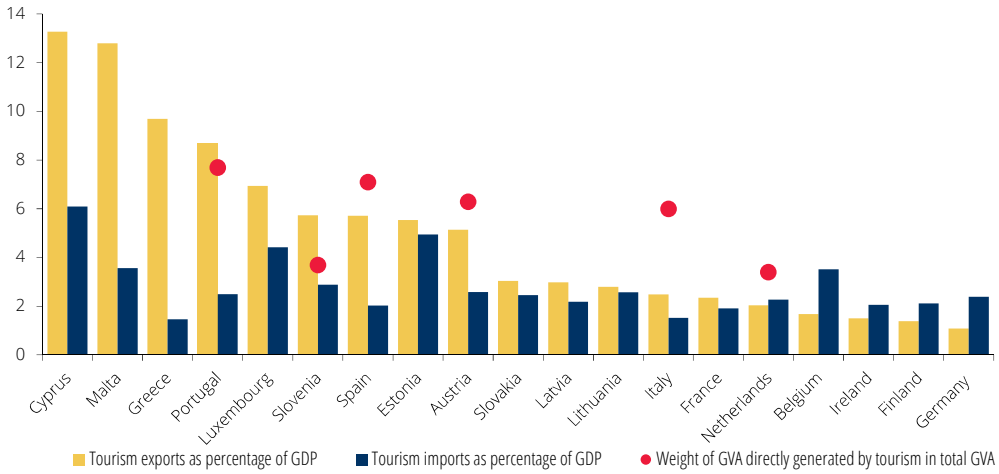


Sources: Eurostat, Statistics Portugal, and Banco de Portugal. | Notes: For each sector it was considered a breakdown by industry A38 (colours correspond to aggregation in A10 nomenclature). The size of the circles represents the weight of each sector in the total 2017 GVA in Portugal. The results of the pandemic impact are based on answers to questions about the impact on the turnover from COVID-IREE. The results correspond to the average of the months of April, May and June, each one corresponds to the simple average of the answers in the several weeks that compose the month. The following branches of activity are not included: A (Agriculture, forestry and fishing); K (Financial activities); L (Real estate activities); and branches O-Q (Public administration, education and health).

3.3 The impact of the pandemic on the tourism sector

In 2019, the share of tourism exports in Portugal was 8.7% of GDP, the fourth highest in the euro area (Chart III.3.6). The average growth rate of this aggregate over the past five years was 12.5%, the highest in the euro area. In total GVA of the economy, the tourism sector had a weight of 8% in 2018, rising to 11% if the indirect impact on economic activity is also considered. The non-resident component determines two-thirds of the GVA of tourism. Against a background of mobility restrictions, the domestic market is an important factor for the resilience of the sector. However, in the case of Portugal, this potential is limited, given that the ratio of tourism exports to imports was 28.8% in 2019 — with a weight of imports on GDP of about 2.5% — which is rather low by European standards. Consequently, the main tourism determinant should continue to be the international component.

Chart III.3.6 • Weight of tourism international flows in GDP and weight of GVA directly generated by tourism in total GVA | Percentage

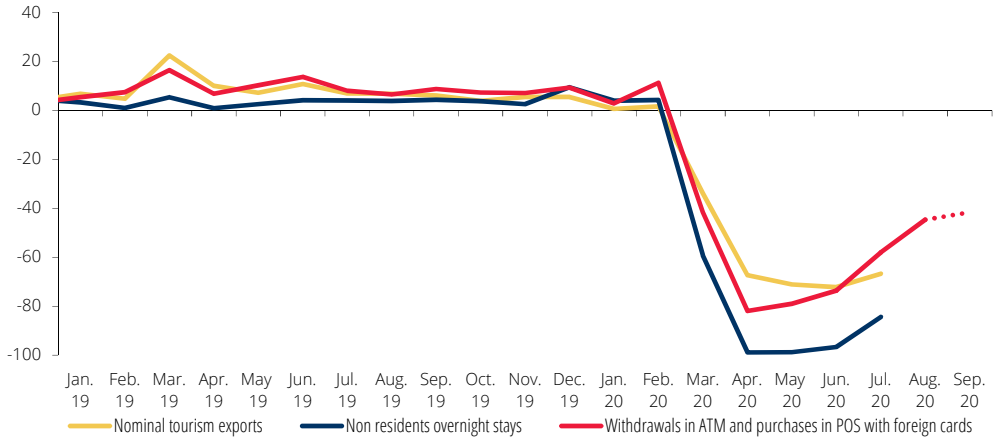


Sources: Statistics Portugal, UNWTO and Banco de Portugal. | Notes: In the case of the international flows of tourism, data corresponds to 2019. For the weight of tourism GVA, the data corresponds to the period between 2014 and 2017, depending on the country, and are only considered the countries with data available in the tourism satellite account with a comparable and consistent methodology.

In the first half of 2020, tourism in Portugal was particularly hit by mobility restrictions both on domestic and origin markets, including the suspension of flights and closure of borders worldwide. These restrictions, together with fears of contagion, mean that the negative impact of the pandemic is estimated to be particularly persistent in this sector.

The drop in tourism exports was felt from March onwards, with unprecedented falls of around 70% in the April-June period (Chart III.3.7). Other tourism indicators, such as overnight stays by non-residents and cash withdrawals and purchases with foreign bank cards, also reached historic lows in April. Since then, there has been a very slight recovery in this market segment. Domestic tourism started to recover earlier. In June and July, the number of overnight stays by residents still declined by 60.3% and 32.7% respectively, but less than the falls of 95.6% and 82.8% by non-residents.

Chart III.3.7 • Indicators of non-residents touristic activity | Year-on-year percentage change

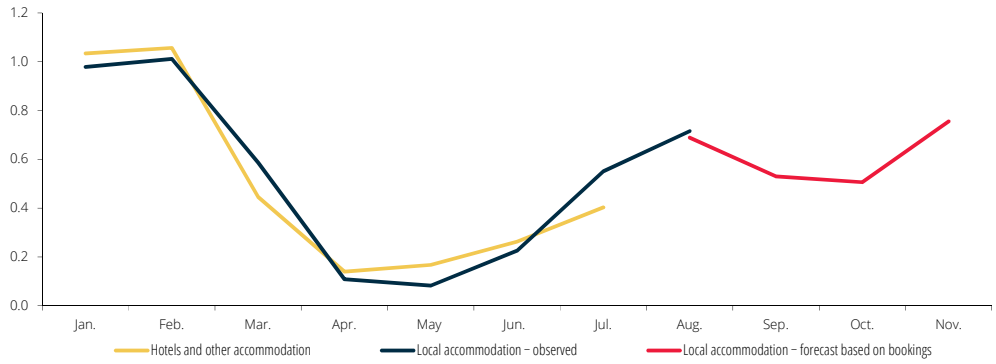


Sources: SIBS, Statistics Portugal and Banco de Portugal. | Note: Seasonally and calendar adjusted data, except in the case of the estimate for the operations in ATM/POS for the last available month, which is obtained based on the year-on-year change of the figures for the available days in the month.

The main origin countries of Portuguese tourism are concentrated in Europe. Spain, the United Kingdom, France and Germany together account for 51.3% of overnight stays, 61.4% of tourist arrivals and 54% of tourism exports in nominal terms. The geographical proximity of these countries may be a favourable aspect for the sector's prospects, as long as the pandemic remains under control in the origin markets and in Portugal.

Forward-looking indicators of tourism point to a slight recovery during summer and early autumn months. According to Statistics Portugal's Tourism Activity Press Release of June, most tourist accommodation establishments expected occupancy rates of less than 50% from June to October. Information on bookings in local accommodation establishments with 10 or more beds points to occupancy rates between August and October of around 60% of the figures for the same period of the previous year, with a moderate increase in November (Chart III.3.8). However, because of its more individualised nature, this accommodation segment may be less affected by the decline in demand than hotels. In the survey, establishments reporting booking cancellations from June to October accounted for 63.4% of the available capacity of this segment, compared to 85.3% for the hotels segment.

Chart III.3.8 • Tourist accommodation | Ratio of 2019 and 2020 occupancy rates



Sources: Statistics Portugal, Airdna and seetransparent.com (Banco de Portugal calculations). | Notes: Data for hotels and other accommodation correspond to the net occupancy rate. The proxy for the national average occupancy rate observed in local accommodation is obtained as the weighted average of the occupancy rates in Lisbon, Porto and Albufeira, considering the relative weights in the number of beds in local accommodation with more than 10 beds for the Lisbon Metropolitan Area, North and Algarve in 2019. The background information concerns Airbnb, Booking and Vrnbo. The forecast for the occupancy rate of local accommodation is obtained based on booking information from Airbnb and Vrnbo. The latter information was updated on 1 September, so the data for August are observed.

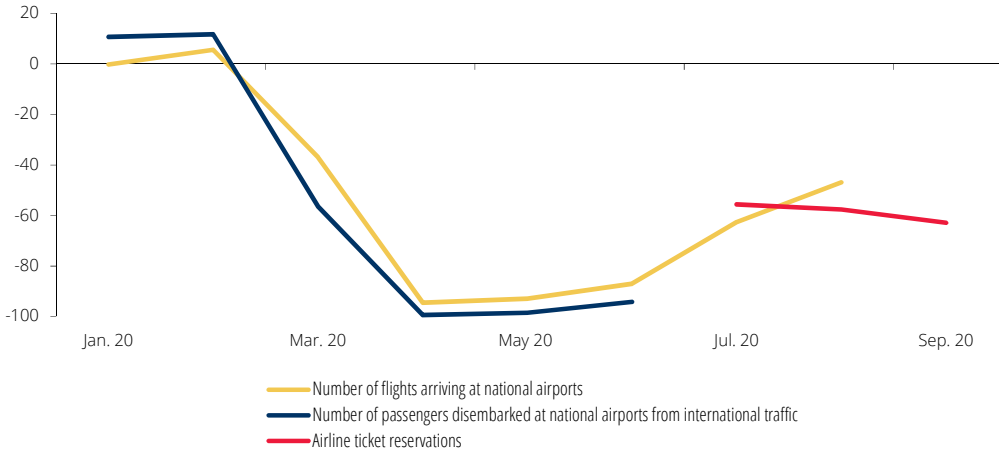
Information on airline ticket bookings to Portugal also points to year-on-year declines in demand of approximately 50% in July-September. Nonetheless, this represents a recovery from falls of around 90% to 100% from April to June (Chart III.3.9). This indicator may underestimate the recovery in tourism exports, should the importance of road travel increase. The bookings reductions from non-European countries are more significant, which reflects greater restrictions on travelling outside the Schengen area, but also illustrates the expected trend of decline on average travel distance.

From a global perspective, forecasts and scenarios about world tourism developments drawn up by several international institutions, although diverse in the variables and approaches considered, point to falls of about 55-70% in tourism-related indicators in 2020.[5] A gradual recovery is expected in the

5. These forecasts include those of the European Travel Commission (ETC)/Tourism Economics (Oxford Economics), Airports Council International and International Air Transport Association (IATA)/Tourism Economics (Oxford Economics), released in July 2020, as well as the optimistic scenarios (corresponding to the recovery of international tourism in July) of the OECD and UNWTO.

coming years but, according to the ETC/Tourism Economics forecast, the number of international arrivals in 2019 is not expected to be reached until 2023. According to IATA forecasts, air traffic indicators are not expected to resume the figures recorded in 2019 until 2024.[6]

Chart III.3.9 • Passenger air transport | Year-on-year percentage change



Sources: Statistics Portugal, Eurocontrol and Turismo de Portugal (Banco de Portugal calculations). | Note: Booking information relates to air tickets to Portugal sold by travel agencies and airlines in countries that total about 75% of tourism exports in 2019.

The uncertainty surrounding these projections is high. The evolution of the pandemic itself (most of these forecasts and scenarios do not consider the possibility of a second wave of infections in the second half of 2020) and the corresponding containment measures will affect travel and supply capacity. The impact of the pandemic on household income — in particular, given the high demand-income elasticity of this type of services — as well as confidence and changes in consumer preferences are also relevant.

A coordinated approach between countries is also key for a successful recovery of the tourism activity, as suggested by the recovery of flights in Europe from mid-June. The weight of tourism in the economy makes Portugal more vulnerable to the crisis in the sector, a challenge that will remain even beyond the public health crisis.

6. "COVID 19 June data and revised air travel outlook", IATA, 28 July 2020.