



## Executive Summary

In the **third quarter of 2023**, the Portuguese economy is expected to have **contracted 0.3% quarter-over-quarter (qoq)**, which would correspond to a **year-on-year (yoy) growth of 1.7%**. Uncertainty is very high, namely, because inflation variability between quarters introduces additional difficulties in estimating real variations between consecutive quarters. The **Eurozone** is also expected to have **contracted by 0.3% qoq**, corresponding to a **drop of 0.2% yoy**, meaning that inflation and rising interest rates are beginning to penalize economic activity, although without an increase in unemployment yet.

In Portugal, **inflation** reached **3.5% on average** during the third quarter of 2023, but its yoy growth was greater in August and September. The annual average inflation is revised downwards to **4.6% in 2023**. Core inflation remains high with a year-on-year change of 5.9% in September.

The ECB's **monetary policy** should contribute to a reduction in inflation either in the Eurozone, or in Portugal, but inflation could persistently return to the 2% target only by 2025, noting that the interest rates are now in the interval between 4.0% and 4.75%. The instability of the American and European financial systems made it more difficult to anticipate the evolution of monetary policy. On the one hand, the Fed and the ECB will be faced with the temptation to tolerate inflation rates above 3% for longer to avoid causing excessive difficulties to the sustainability of the balance sheets of the banks they regulate. On the other hand, some think that rising interest rates could already be enough to cause a rapid drop in inflation. In short, a scenario of great uncertainty remains.

The midpoint estimate of the **Portuguese economic growth is revised downwards to 2.1% in 2023**, as a result of a greater level for 2022 (upward correction of national accounts data made by INE), rather than from a deterioration of the outlook. The trend growth remains fragile and there could be technical corrections that give rise to chain contractions, as envisaged for the third quarter. The most relevant factors continue to be high inflation and rising interest rates, coupled with a likely worsening of credit availability. Private consumption and investment appear to remain fragile.

For **2024 and 2025**, the new midpoints for annual growth are, respectively, **1.0% and 1.5%**, reflecting the probable adverse effects of the pandemic on the potential growth of the Portuguese economy, as well as the economic costs of high inflation and interest rates. Growth in 2024 is hampered by an unfavourable base effect resulting from unusually high growth in the first quarter of 2023, although INE may smooth this figure.

The **Eurozone economy** is expected to perform a little worse, with GDP growth midpoint at **0.4% in 2023**. Thus, the risk of a mild recession is still present. The difficulties of the financial system are a new risk that also changes the speed with which the ECB will be able to fight inflation without causing damage to that system. The sharp rise in interest rates implicit in medium and long-term sovereign debt is a challenge for the banking system and regulators. Unexpectedly, new **geopolitical risks** emerged with uncertain consequences in the current outlook.

In Portugal, the **unemployment rate** remains at historically low values with 6.0% in the third quarter and 6.4% in 2023, meaning that risks for the labour market envisioned at the end of the second quarter have not materialized.

The **Budgetary Plan 2024** foresees a GDP growth of 1.5% and a budget surplus of 0.2% after 0.8% in 2023. The debt ratio could leave the level of 100% of GDP.

### Forecasts from Católica Lisbon Forecasting Lab – NECEP

Region	Indicator	2023 Q2 <sup>a)</sup>	2023 Q3	2022	2023 scenarios (% change)		
					Downside	Central	Upside
Portugal	GDP (% change on previous quarter)	0.0	-0.3	-	-	-	-
	GDP (year on year/annual % change)	2.5	1.7	6.8	1.7	2.1	2.5
	Unemployment rate (%)	6.1	6.0	6.0	6.5	6.4	6.3
	Consumer prices (annual % change)	3.4 <sup>b)</sup>	3.6 <sup>b)</sup>	7.8	-	4.6	-
Euro Area	GDP (% change on previous quarter)	0.1	-0.3	-	-	-	-
	GDP (year on year/annual % change)	0.5	-0.2	3.5	0.1	0.4	0.7
	Consumer prices (annual % change)	5.5 <sup>b)</sup>	4.3 <sup>b)</sup>	8.4	5.7	5.5	5.3

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