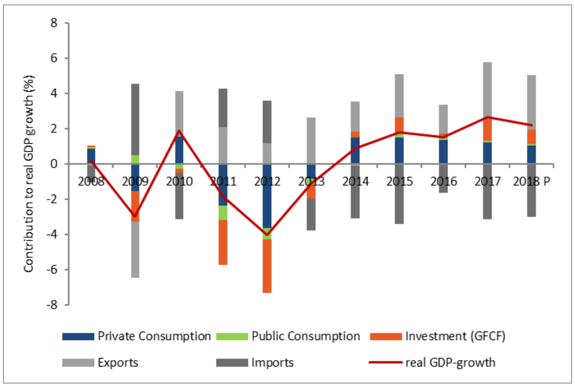
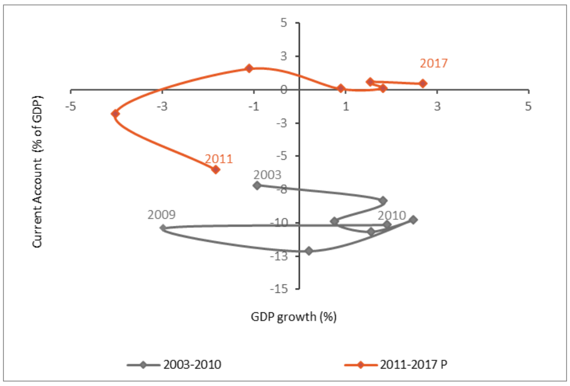
Annual GDP growth for 2017 surpasses forecast consensus - growth as strong as 17 years ago

- Portuguese economy solidifies its strong recovery path with an annual GDP growth rate of 2.7% in 2017
- First year's OT debt auctions characterized by sound demand, all-time lowest placement rate for 5-Y maturity bond achieved
- Novo Banco's capitalization stance remains precarious, state support through resolution fund likely to be necessary
- Monthly Spotlight: "*Ouro branco*" – Portugal's large reserves of Lithium as an increasing opportunity for economy

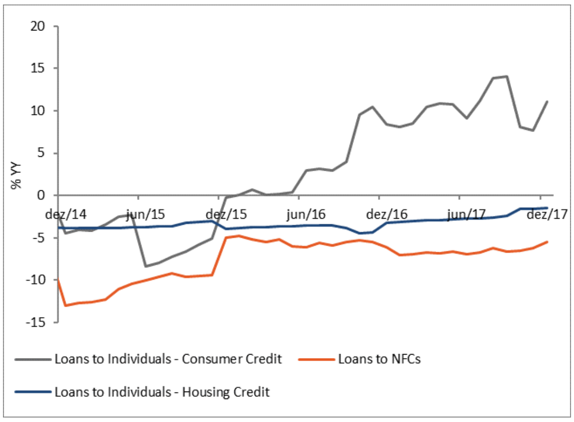
Macroeconomics – February



Source: INE



Source: Banco de Portugal, INE, BiG Research



Source: Banco de Portugal, BiG Research

Portugal's economy grew by 2.7% in 2017

Portugal's annual GDP growth rate of 2.7% for 2017 surpassed forecast consensus. Domestic demand has remained the backbone of the economic recovery process (2.8% YY), the strong surge in investment (8.4% YY) and exports have contributed decisive growth impulses along the year. Tourism has reaffirmed its importance as an economic growth pillar. Structural limitations on Portugal's growth potential however remain sizeable and real. Low productivity levels along with likely increasing wage costs imply potential future shortfalls in national competitivity. Investment levels (General Fixed Capital Formation) remain - despite its strong increase this year - 25 % below its pre-crisis level.

Trade balance deficit widened by € 2.6 bn in 2017

The surge in exports contributed significantly to the unanticipated strong growth development along 2017. Exports grew by 10.1% YY, imports increased by 12.5%. The trade balance deficit widened by € 2.6 bn to € 13.8 bn, the increase in service balance, primarily in form of service provision to the travel industry, was unable to offset the reduction in the goods balance. Irrespective the moderate narrowing in current account surplus this year (0.5 % of GDP vs 0.6% of GDP in 2016), the overall recovery path from its pre-crisis levels (current account balances as negative as -10% of GDP in 2009/2010) is noteworthy.

Financial intermediation continued receding along 2017

Loan provision to non-financial corporations have continued receding by -5.5% in 2017 (-6.1% in 2016) - due to restrictions on both ends: a) banks risk aversion to lend to highly-indebted corporations and b) low credit demand from viable corporations given their preference of self-financing (due to currently still large corporate profit margins and prevailing beneficiary financing conditions). Aggregate loan provision to households (consumption, housing, others) further continued receding in 2017 (-1%), however following a gradual recovery path since 2013 – led by the robust expansion in consumer loans since 2016 (increased by 11.1% in 2017)

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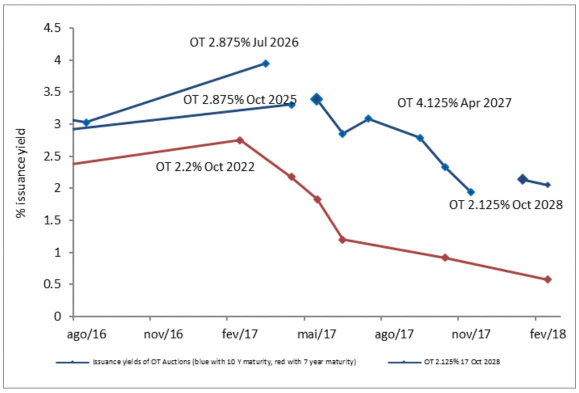
Primary Market - February

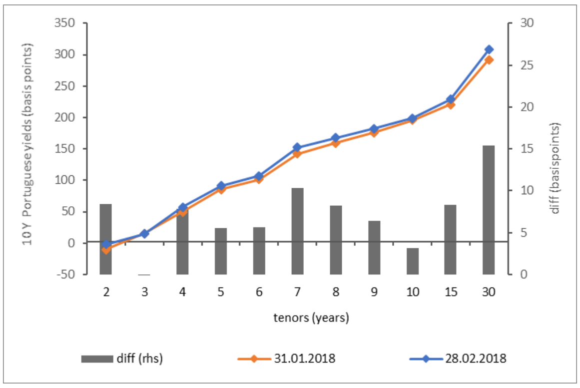


Source: IGCP, BiG Research

Lowest all-time issuance yield for 5-year maturity bond reached

Portugal has conducted its first regular debt auction in February, issuing total € 1.25 bn of its 5-year and 10-year maturity OT lines. The 10-year maturity line *Oct 2028* was placed at an issuance rate of 2.046%, slightly lower than at its syndicated issue in January (2.137%). The 5-year maturity line *Oct 2022* was issued at 0.577% - the lowest placement rate ever achieved for this maturity (and last auctioned in October 2017 at 0.916%). Portugal further sold total € 1.1 bn of its 3-month and 11-month treasury bills (both reopened) – issuance yields changed little and remained in negative territory (-0.417% respectively -0.393%).

Secondary Market - February

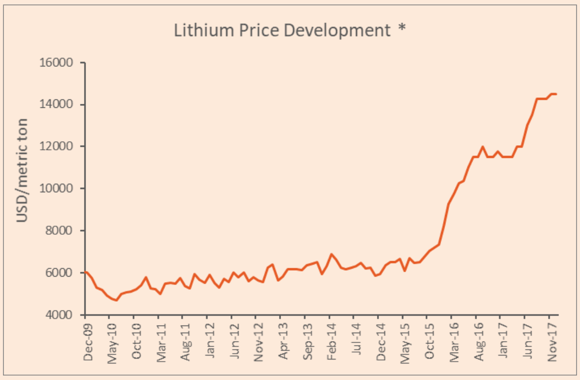


Source: Reuters

Portuguese 10s30s spread widens

Portuguese 10 Y yields have closed the second month of the year at the 2% mark, its Bund spread has widened by 10 basis points to around 134 bps. The Portuguese 2s10s spread remained largely unchanged, the 10s30s spread increased by 10 bps – partially reversing its compression movement of more than 25 bps in January along the broadening of Portugal's investor base in the course of regained investment-grade. As already stated in last month's montly bulletin, the forthcoming end of the ultra-loose ECB monetary policy is already being reflected in higher Bund yield levels, has however not translated into perceived higher periphery risk - yet.

Monthly Spotlight: "*Ouro branco*"



Source: Bloomberg, *measured as Europe Lithium Carbonate CIF Swap

Lithium exploration - opportunity for national economy

Portugal is estimated to hold the sixth largest reserves of lithium worldwide. Given the ever-increasing importance of the metal (among necessary for the use of electric car batteries), Lithium has become a promising natural resource for the country. In 2014, Portugal was estimated to hold 17.5 thousand metric tons of "*ouro branco*", by 2016 reserves were estimated at 60 thousand metric tons.[1] The price for Lithium has tripled in the last four years, the value of world market for lithium batteries is estimated at around € 37 bn by 2022.[2] Given the growing attention in domestic lithium exploration, public tenders are expected to be launched along this year.

[1]United States Geological Survey, last available estimates from 2014, [2]Allied Market Research

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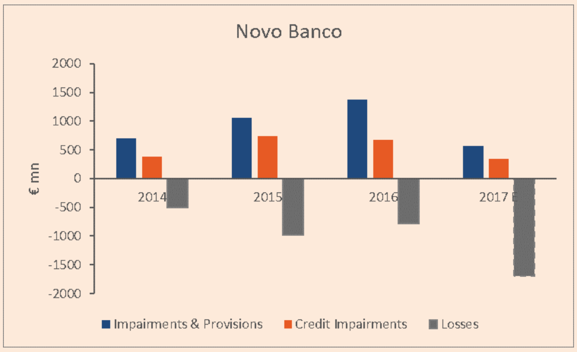
Novo Banco – State likely to inject more capital through Resolution Fund



Source: Negócios, BCP

Novo Banco´s capitalization remains precarious

Novo Banco' net losses for 2017 are reported by media to amount between € 1.6 to € 1.8 bn – making the institution generate losses for the fourth consecutive year since its existence. Total net losses over the past four years would therefore surpass € 4 bn. Should incurred losses for 2017 actually materialize that high and trigger Novo Banco's capital ratio CET1 to fall below 12%, the state will likely have to inject capital through a loan provision to the Resolution Fund – following state sources a maximum of € 850 mn as foreseen in this year's financing plan, and therefore expected not to increase public debt further.

Outlook – March

Event Outlook - March	
Date	**Event**
4-Mar	Italian general elections
8-Mar	ECB Governing Council Meeting
12-Mar	CPI (Feb)
12-Mar	Global trade balance (Jan)
16-Mar	S&P rating revision on Portugal
20-Mar	Current account balance (Jan)
21-Mar	BT Auction: 6m reopening & 12 m launch
20/21 mar	FED FOMC Meeting
27-Mar	Business confidenc incidator (Mar)
27-Mar	Consumer confidence indicator (Mar)

Italian elections – March 4th:

The upcoming election in Italy represent a considerable political risk event for Europe this year. Election results in Germany and France last year were however anticipated to be larger market-moving events than it is the case for Italy - largest risk would be a Five-star-led government implying severe shifts in the Eurozone policy. Our base scenario is however a hung parliament, with a "care-taker" government likely to rule the country for a considerable period of time - given Italy's history of frequent political crises nothing necessarily new. Further, both scenarios of a grand coalition building between Berlusconi's Forza Italia and the incumbent Democratic Party (PD) or a centre-right coalition (Forza Italia, Northern League, Brothers of Italy) would likely come along with reform-deadlocks and less stringent fiscal discipline. Should election results imply a government participation of a Euro-sceptic/anti-immigration party (Five Star, Northern League parties), we do assess – given its restraining effect on a deeper European integration process - a direct translation into higher risk premium for the periphery debt markets.

ECB Governing Council Meeting – March 8th:

Eurozone inflation slowed down to 1.2% in February (1.3% in January), remaining well below the price stability target of 2%. With the strong economic recovery in the Eurozone to move forward, we do not expect any change in the ECB forward guidance- unalteredly subject to the close screening of price level and currency developments.

Portuguese Treasury and Debt Management Agency (IGCP):

- March 21st: BT-Auction of 6 months (re-open) and 12 months (launch), indicative amount set between € 1.25 bn and € 1.5 bn

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MACROECONOMIC DEVELOPMENT				BiG Research	Forecasts 2018	
					IMF**	Ministry of Finance
	2015	2016	2017	Development 2018	2018 P	2018 P
Real Economy (YoY, % change)						
GDP	0.0	1.6	2.7	→	2.0	2.2
Private Consumption	2.1	2.1	2.2	→	1.8	1.9
Public Consumption	1.3	0.6	0.1	↓	0.5	-0.6
Investment (GFCF)	6.4	0.8	8.4	↑	5.7	5.9
Imports	6.1	4.4	7.9	→	5.2	5.2
Exports	8.5	4.2	7.9	→	5.1	5.4
Fiscal Account (%GDP)						
Primary balance	0.2	2.2		↑	2.7	2.7
Budget balance	-4.4	-2.0		↑	-1.4	-1.0
Public debt	128.8	130.0		↑	122.5	123.5
External Accounts (%GDP)						
Current Account	0.1	0.6	0.5	→	0.5	0.1
NIIP	-113.2	-106.1	-105.7	→		
Gross External Debt	222.0	215.3	211.0	→		
Labour market (YoY, %change)						
Unemployment Rate	12.4	11.1	8.9	→	9.0	8.6
ULC	0.9	2.6	1.4	↓		
Labor Productivity	0.4	-0.1	-0.4	↓		
Sentiment Indicators						
Consumer Confidence Indicator	-12.6	-11.7	-0.1	↑		
Industrial Confidence Indicator	-1.2	-0.9	2.3	↑		
Financial Sector						
Tier 1 Ratio	11.3	11.5		↑		
Return on Equity	0.5	-3.2		↑		
Share of NPLs (NFC; % of total loans)	16.0	16.1		→		
Monetary/FX						
Inflation, HICP (YoY, % change)	0.50	0.64	1.55	→		
PGB 10Y-Bund Spread (Bps)	186.6	306.7	257.3	↑		
EUR/USD	1.10	1.10	1.14	→		
Real effective exchange rate (1999=100)	87.0	89.2	90.5	→		

Source: INE, Banco de Portugal, ECB, Reuters, DG ECFIN, OECD
*Full-year data 2017 already available, no projection
**IMF Article IV country report projections, ***Ministry of Finance projections as accounted for/published in the State Budget 2018

Cross-Country Bund Spreads					
Bps	France	Spain	Italy	Portugal	Greece
2y	11.3	32.4	43.5	52.8	197.6
5y	10.4	42.1	88.6	87.2	356.8
10y	27.3	88.1	141.4	133.3	370.3
30y	44.1	125.6	178.3	178.9	692.9
Δ - 1M					
2y	-5.9	-0.3	10.5	7.3	3.1
5y	-9.1	-5	13.9	3.7	79.3
10y	-1.1	10.9	3.5	1.7	65.7
30y	-2.8	-3.2	0.6	16.5	28.8

Source: Reuters, retrieved on February 28th, 2018

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