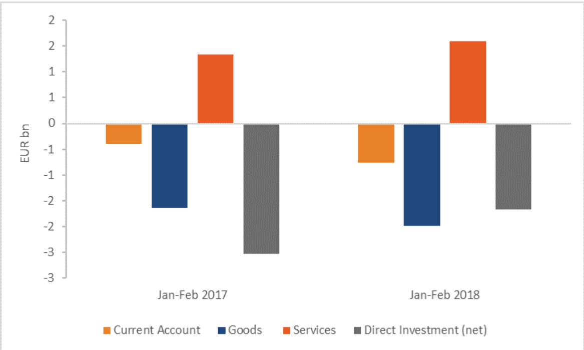
BiG BANCO DE INVESTIMENTO GLOBAL

Portugal continues sending comforting "consolidation efforts" to markets, real structural changes still not in sight

- Monthly macro data: deceleration in average wage growth in first two months, inflation 0.5 percentage points below Eurozone in March
- New reference point for the Portuguese sovereign curve has been created with the placement of a new 15-year maturity OT line
- Stability Program 2018-2022 underlines structural problems in government's fiscal policy stance
- Sovereign credit rating model: Portuguese 10 Y bonds currently expensive, Italy fairly valued, value found in Cyprus

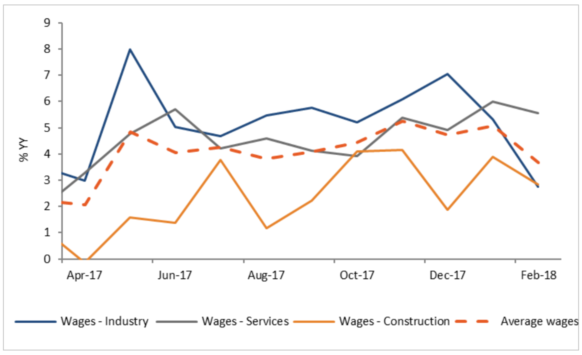
Macroeconomic Review – April



Source: Banco de Portugal

Current account deficit widens, direct investment gap narrows

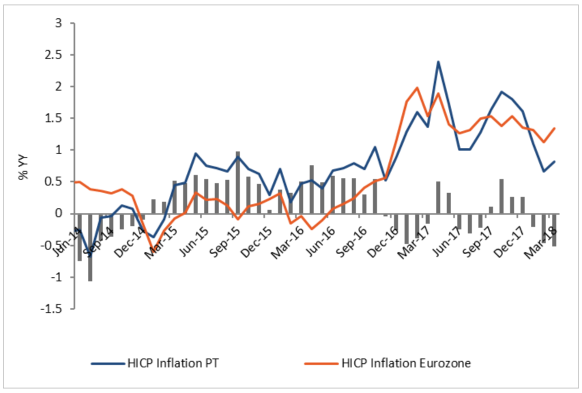
The current account balance accumulated to - EUR 766 mn within the first two month of the year, corresponding to a deficit widening of EUR 372 mn in comparison to the same period last year. As characteristic for last year, the increase in the service balance (+ EUR 259 mn) – and yet again primarily in form of service provision to the travel industry - was unable to offset the widening in goods deficit (- EUR 362 mn). Exports increased by 8.3% YY, imports by 9.0% YY. The deficit in direct investment narrowed by EUR 859 mn.



Source: INE, BiG Research

Deceleration in average wage levels

The unemployment rate for February was measured at 7.6%, 0.3 percentage points lower than in the previous month. The provisional unemployment rate for March stands at 7.4%. Government's estimates point to an unemployment rate of 7.6% for this year, consistently following the country's robust labour market recovery path (unemployment rate of 11.1% in 2016, 8.9% in 2017). While average wage levels have been recovering for the last two years, since beginning of this year we record a deceleration in wage increases, primarily in the industry sector. Given the ever-important and expanding tourism industry, wages in the service sector have continued growing robustly.



Source: Eurostat

Inflation 0.5 percentage points below Eurozone

CPI annual inflation has slightly increased to 0.7 % in March (0.6% in February), core inflation (excluding energy and unprocessed food products components) has picked up by 0.2 percentage points from the previous month to 0.8% YY. Largest price pressures emanated from *Hotels & Restaurants* (2.5% YY) and *Transport* (1.9% YY), prices in *Clothing & Footwear* actually retracted (-4.4% YY). Portugal's HICP inflation rate remains 0.5 percentage points below the Eurozone inflation rate of 1.3%. Portugal's flash CPI estimate for April was 0.4%.

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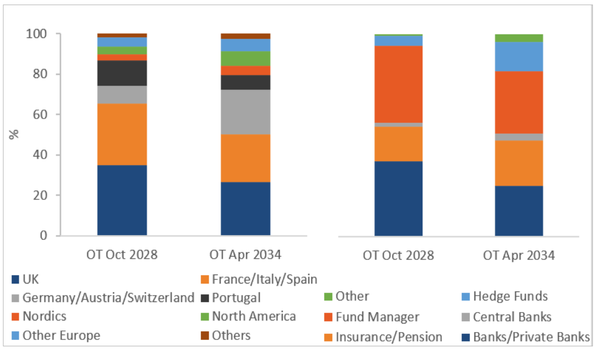
Primary Market - April



Source: IGCP, BiG Research

New 15-year benchmark OT line issued

A new reference point for the Portuguese sovereign curve has been created in April. Portugal has placed a new 15-year maturity OT line *Apr 2034* through a EUR 3 bn syndicated issuance with a coupon of 2.250% and a re-offer yield of 2.325%. Largest investor demand emanated from the UK (26.5%), followed by France/Italy and Spain (23.6%). The domestic investor share stood at 7.2% (vs. 12.4% in this year's first syndicated issuance of a new 10- year maturity OT line in January). Further, the issuance yields of a treasury bill auction (3 & 11 months maturity) have again remained largely unchanged in negative territory (-0.430% and -0.389% respectively).

Secondary Market - April

Source: Reuters, BiG Research
Data retrieved on 30.04.2018

Italian 2s10s spread flattened

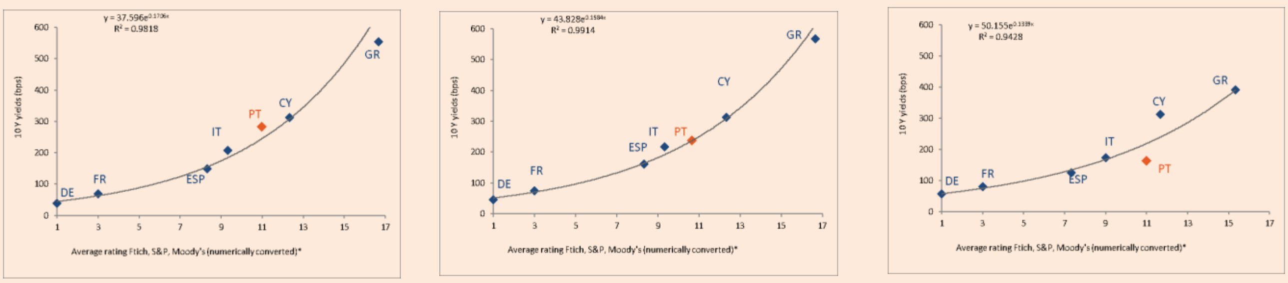
The Portuguese 10 Y yields remained relatively unchanged along April, increased by less than 5bps to 165 bps by the end of the month. Vis-à-vis the Bund, Portuguese 10 Y yields compressed by less than 5 bps, Italian by more than 10 bps, the Spanish widened by 2 bps. Italy continued holding the widest 2s10s spread of around 200 bps (German 2s10s spread of 116 bps), yet also the only one flattening its spread in April. The Spanish 2s10s spread steepened strongest, primarily due to the strong upward pressure on its 10 Y yields. The 10s30s spread steepened for all three periphery states, strongest in Spain due to an almost 20 bps increase in its 30 Y yields.

Sovereign Credit Rating: Valuation of Peripheral debt market

Sovereign credit rating as proxy for peripheral funding costs*

- Portuguese 10 Y bonds currently expensive, Italy fairly valued, value found in Cyprus.

a) 01. September 2017 b) 01. October 2017 c) 30. April 2018



Source: Reuters, BiG Research
Average value of numerically converted credit rating grades, "*AAA*"= 1,"*D*" =24. *Model-implied fair market pricing based on simple OLS-regression, serves as reference but not quantitative robust analysis output, and thus shall not be used as basis for investment decisions

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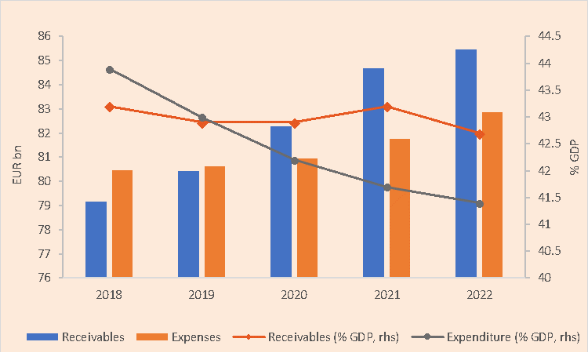
a) Beginning of September 2017, the **Portuguese 10 Y yields held an estimated value of almost 40 bps.** While the market demanded 2.8%, the model predicted fair yield levels of around 245 bps. Italy had an estimated value of around 20 bps.

b) **Portugal reached fair market pricing of its 10 Y yields at around 240 bps in October.** The unexpected S&P rating upgrade to "investment-grade" on Sept 18th 2017 triggered a considerable drop of around 40 bps, materializing the outstanding value as estimated beginning of September.

c) **Portugal's current fair value is predicted at slightly above 200 bps**, above its current 10 Y yield levels of 165 bps**.** While Italian 10 Y yields remained above model-predicted yield levels over the past months (primarily due to political noise), its current yield levels of around 170 bps are almost fairly valued in line with model projections (remaining value less than 5 bps).

Stability Program 2018 - 2022



Source: Portuguese Ministry of Finance, "Programa da Estabilidade 2018 – 2022", BiG Research

Improvements in fiscal performance, primarily due to denominator effect

The recently adopted Stability Program 2018 - 2022 is characteristic for the government's longer-term budget planning limitations. Portugal continues to base its fiscal policy stance on the support of robust GDP growth numbers (denominator effect). The ongoing positive economic development allows the government to meet EU fiscal targets and to send "fiscal consolidation efforts" to its debtors - without having to address structural changes on the expenditure side, yet. The state budget deficit projection for 2018 has been lowered by 0.4 percentage points to 0.7%, even estimated to turn into budget surplus by 2020 (0.7% of GDP).

However, when taking state income and expenses projections from 2018 until 2022 (given in % of GDP) and translating them into their nominal values (given the projected annual GDP growth rates along the entire forecast horizon), state expenses are estimated to continuously increase until 2022. Further, the fiscal burden (% of GDP) is projected to decrease only marginally by 0.1 percentage points to 34.4% of GDP until 2022.

The rating agency Moody's appears to be the only market participant capturing and identifying the ongoing, unresolved sovereign risk factors for the Portuguese economy, justifying its recent postponement of an upcoming rating revision with the country's unaltered high public debt levels and weak banking sector. Should Portugal fail to find a long-term, structural solution to its indebtedness levels - even at the cost of lower GDP growth rates – the country will likely be facing considerable GDP growth constraints in the medium to long term.

Outlook – April

Portuguese Treasury and Debt Management IGCP:

- May 16th: Auction of 6-month (reopen) and 12-month (launch) treasury bill lines, indicative amount set between EUR 1.5 bn and EUR 1.75 bn. A further treasury bill issuance for the second quarter has been scheduled for June 20th, with an indicative amount between EUR 1 bn and 1.25 bn.
- May 18th: Treasury bill amortization of EUR 2.86.

  Outstanding amount of treasury bill amortization in 2018: EUR 6.3 bn. Outstanding amount of bond amortization in 2018: EUR 6.6 bn

Event Outlook - May

Date	Event
10-May	Global trade balance (March)
11-May	CPI inflation (April)
16-May	BT auction: 6 & 12 months
16-18 May	GDP, preliminary (Q1)
21-May	Current account balance (March)
29-May	Business Confidence (May)
29-May	Consumer Confidence (May)
30-May	CPI inflation flash (May)
30-May	Unemployment ate (April)
30-May	GDP, final (Q1)

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Appendix

MACROECONOMIC DEVELOPMENT				BiG Research	Forecasts 2018	
					IMF**	Ministry of Finance
	2015	2016	2017	Development 2018	2018 P	2018 P
Real Economy (YoY, % change)						
GDP	1.8	1.6	2.7	→	2.2	2.3
Private Consumption	2.1	2.1	2.3	→	2.0	2.0
Public Consumption	1.3	0.6	0.1	→	0.2	0.7
Investment (GFCF)	6.4	0.8	8.5	→	8.1	6.2
Imports	6.1	4.4	7.8	→	6.6	6.3
Exports	8.5	4.2	7.9	→	7.0	6.3
Fiscal Account (%GDP)						
Primary balance	0.2	2.2	0.9	↑	2.6	2.8
Budget balance	-4.4	-2.0	-3.0	↑	-1.1	-0.7
Public debt	128.8	130.0	125.7	↑	121.7	122.2
External Accounts (%GDP)						
Current Account	0.1	0.6	0.5	→	0.5	0.7
NIIP	-113.2	-106.1	-105.7	→		
Gross External Debt	222.0	215.3	211.1	→		
Labour market (YoY, %change)						
Unemployment Rate	12.4	11.1	8.9	↑	7.8	7.6
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	15.0	↑		
Monetary/FX						
Inflation, HICP (YoY, % change)	0.50	0.64	1.55	→		
PGB 10Y-Bund Spread (Bps)	180.3	322.8	241.9	→		
EUR/USD	1.11	1.10	1.15	→		
Real effective exchange rate (1999=100)	87.0	89.2	90.5	→		

Source: INE, Banco de Portugal, ECB, Reuters, DG ECFIN, OECD

**IMF Article IV country report projections, ***Ministry of Finance projections as accounted for/published in stability Program 2018-2022

Cross-Country Bund Spreads

Bps	France	Spain	Italy	Portugal	Greece
2y	9.6	29	38.5	40.1	201.2
5y	6.5	27.5	66.1	60.9	304.8
10y	22.7	68.9	116.8	107.4	334.7
30y	39.1	109.8	159.5	141.5	669.5
Δ 1M					
2y	-2.4	5.5	5.6	0.1	-2.7
5y	-2.6	4.4	-9	-4.5	-48.9
10y	-0.8	2.1	-12.5	-4	-47.2
30y	-2.9	8.7	-11.1	-1.7	-8

Source: Reuters, data retrieved on 30.04.2018

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