Q2 2026

PORTUGAL

Energy Shock and Fiscal Resilience

Macroeconomic Report

Executive Summary

BFF INSIGHTS

Executive Summary

Portugal's economy performed well in 2025. Real GDP grew 1.9% (INE), comfortably above the Eurozone's 1.3%, and the country entered 2026 with momentum. That momentum has since run into trouble. Q1 2026 GDP still grew 2.3% year-on-year (INE flash estimate), well above the Eurozone's 0.8%, but on a quarter-on-quarter basis it stalled at 0.0%, down from a revised 0.9% in Q4 2025. The Banco de Portugal now projects 1.8% growth for 2026, down half a percentage point from its December estimate of 2.3%. The reasons: the Middle East conflict, an energy price shock, and weaker demand from the rest of Europe. Portugal is still outperforming. The question is how long that lasts with this many headwinds at once.

Table 1.1: PORTUGAL: KEY ECONOMIC INDICATORS 2025–2028

Banco de Portugal projections (March 2026), annual percentage change unless otherwise indicated

Indicator	2025	2026	2027	2028
Real GDP Growth (%)	1.9	1.8	1.6	1.8
Unemployment Rate (%)	6.0	5.9	6.1	6.1
HICP Inflation (%)	2.2	2.8	2.3	2.0
Budget Balance (% GDP)	+0.7	-0.4	-0.9	-1.0
Public Debt (% GDP)	89.7	87.0	83.5	~80

Source: Banco de Portugal, Economic Bulletin, March 2026; INE, PDE notification, March 2026.

Note: 2025 figures are actuals (INE). Projections subject to revision. HICP = Harmonized Index of Consumer Prices.

The short answer: the growth drivers have changed. Private consumption slowed in Q1 as the energy price shock ate into household purchasing power. CPI inflation went from 1.9% in January to 3.4% in April (INE), driven almost entirely by energy prices swinging from -2.4% to +13.0% year-on-year after the US/Israel strikes on Iran in late February. The Banco de Portugal now expects 2.8% inflation in 2026, up from 2.1% in its December forecast. Meanwhile, investment was the positive surprise: gross fixed capital formation picked up as EU fund execution accelerated ahead of the August 2026 RRP deadline. Growth has gone from being consumption-led to investment-supported. That is probably a healthier mix, but it depends on public investment flows holding up.

The labour market is arguably even stronger than the headline numbers suggest. Banco de Portugal revised its 2026 employment growth forecast up to 1.3% (from 1.1%) and cut the unemployment rate projection to 5.9% (from 6.3%). The minimum wage rose to €920 in January, heading toward €1,020 by 2028. In construction, which is tied to both RRP execution and storm rebuilding, employment grew 2.0%, and pay indices jumped 7.3% in January (INE). Youth unemployment stood at 18.1% in March 2026, the lowest reading since October 2022 (INE Labour Force Survey). Real wages are growing and supporting consumption, but they are also squeezing margins in labour-intensive export sectors. That tension is worth watching.

The external sector is where things look worst. Net exports dragged on growth in Q1, with imports outpacing exports. Winter storms, including Storm Kristin, knocked out industrial export capacity in the central region. Tourism kept growing but more slowly: overnight stays were up just 1.3–2.0% in early 2026, a marked step down from 2025. On trade policy, the US Supreme Court struck down IEEPA tariffs, which were replaced by a uniform 10% rate. That changes the risk profile but does not remove it. And Portugal's deeper competitiveness problem persists: unit labour costs have risen 29.9% since end-2019, versus 20.2% among its main trading partners (BdP).

Table 1.2: PORTUGAL: FISCAL FISCAL AND SOVEREIGN RISK INDICATORS

Indicator	Value	Trend
10-Year Bond Yield (Apr 2026)	3.33%	Rising (+22 bps)
Spread vs German Bund	35 bps	Stable
S&P Rating	A+	Stable
Moody's Rating	A3	Upgrade potential
Fitch Rating	A	Stable
ECB Deposit Rate	2.0%	Hikes priced Jun/Jul
Interest Expenditure (% GDP)	~2.5%	Stable

Source: Bloomberg; Banco de Portugal; S&P; Moody's; Fitch; ECB.

Inflation is the story that changed most since Q1. The disinflation of 2025 is over. The Middle East conflict pushed oil prices up 47% relative to pre-war values, and European natural gas prices surged to roughly 38% above pre-conflict levels. Headline CPI went from 1.9% in January to 3.4% in April, with energy at +13.0%, above the Eurozone average of +10.9% (Eurostat). Core inflation has stayed around 2.0-2.2%, which is less alarming, but INE confidence surveys for March show selling price expectations rising across all business sectors, with manufacturing at its highest since October 2022. That is the channel through which this could get worse. The ECB held rates at 2.0% through April but discussed raising them at length; markets now price two 25-basis-point hikes in June and July, which would take the deposit rate to 2.50%. In Q1, the assumption was rates would stay flat all year. That assumption is gone.

The fiscal picture, on the other hand, is better than anyone expected. The general government posted a surplus of 0.7% of GDP in 2025 (EUR 2.059 billion, INE), beating both the Banco de Portugal's near-equilibrium forecast and the European Commission's projection of a 0.5% deficit. Public debt fell to 89.7% of GDP, the lowest since June 2010 and well below the Commission's own estimate of 93.5%. If the current trajectory holds, debt would reach 83–84% by 2027, putting Portugal below the EU average for the first time since it joined the euro.

In the Eurozone peer group, Portugal stands alone: it is the only major economy combining growth above the bloc average, a near-balanced budget, and debt below 90% and falling. France carries a deficit of 4.9% of GDP and debt past 118%, while Italy's debt stands at 137.9%. That 2025 surplus gives the government more room to absorb the moderate deficits expected in 2026–2027. Markets have taken note: Portuguese 10-year yields rose to about 3.33% in line with the broader Eurozone repricing, but the spread to Bunds at roughly 35 bps is still tighter than France at around 62 bps. The fiscal credibility gap has, for now, widened in Portugal's favour.

In conclusion, the risks have shifted to the downside since Q1, but Portugal's underlying position is stronger than the headlines suggest. The biggest unknown is how long the energy shock lasts. If the Middle East conflict drags on, inflation stays elevated, the ECB tightens more aggressively, and the combination weighs on growth and debt dynamics simultaneously. The Government has responded with the PTRR (Portugal Transformação, Recuperação e Resiliência), a EUR 22.6 billion programme running through 2034 that folds the Storm Kristin emergency response into a wider investment framework of 96 measures across 15 policy areas. Combined with the RRP execution push through August 2026, this gives Portugal an investment pipeline that extends well beyond the RRP horizon.

What could go wrong? A prolonged energy shock that forces ECB rate hikes beyond what is currently priced, eroding the interest-growth differential that has made the debt path look so favourable. Housing prices that keep accelerating (existing dwellings were up 20.9% YoY in Q4 2025) and eventually correct in a disorderly way; the share of new mortgages classified as high-risk jumped from 3% in 2024 to 21% in 2025 under the public-guarantee programme (Banco de Portugal), a trend the BdP is actively reviewing. Failure to absorb remaining RRP funds before August, given that only 47% of milestones were completed as of January (OECD). And the slow grind of competitiveness erosion from rising unit labour costs and euro appreciation, now with higher energy costs layered on top. On the other side: a resolution of the conflict and an energy price reversal would change the outlook quickly. The 2025 fiscal surplus has bought time. And the PTRR, if it delivers, extends the public investment runway to 2034.

For a detailed analysis of the energy shock, the ECB's potential policy turn, the PTRR's ambitions, and what these mean for Portugal over the medium term, we invite you to read the full Q2 2026 report.

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