Q3 2026

PORTUGAL

Relative Strength, Tightening Capacity Constraints

Macroeconomic Report

Executive Summary

BFF INSIGHTS

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The external environment in recent months has been dominated by energy price developments. These have shaped the path of euro-area inflation, that path drove the ECB's decision to raise rates and the decision reset financing conditions across the periphery.

Economic growth in Portugal has been strong. In Q2, real GDP increased by 0.8% from the previous quarter and by 2.5% year-on-year, double the euro-area average and faster than any of the four largest euro-area economies. Employment reached its highest level since the first quarter of 2011 and unemployment fell to 5.3%. Both are records within the current Labour Force Survey series, which begins in 2011 after a methodological break and is not comparable with earlier data. The Banco de Portugal continues to project 1.8% growth for 2026, a figure that predates the second-quarter statistics and would now require a pronounced second-half slowdown. Our own central path assumes quarterly growth of about 0.4% in the third quarter and 0.5% in the fourth, which delivers 2.3% for the year, with a range of 2.1% to 2.5%.

Table 1.1: PORTUGAL: KEY ECONOMIC INDICATORS 2025-2028

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

Indicator	2025	2026	2027	2028
Real GDP growth (%)	1.9	1.8	1.6	1.8
HICP inflation (%)	2.2	3.1	2.4	2.0
Budget balance (% of GDP)	+0.7	-0.2	-0.5	-0.5
Public debt (% of GDP)	89.7	85.7	82.5	79.5

Source: Banco de Portugal, Economic Bulletin, June 2026; INE for 2025 actuals. Growth and inflation are reproduced from Table 1.1 of the full report, the budget balance and public debt from Table 2.1.

Note: 2025 figures are actuals. BFF Insights forecasts growth of 2.3% in 2026 and 1.7% in 2027, above the central bank on the near term. HICP is the Harmonised Index of Consumer Prices.

The growth is genuine and so is its cost. The second quarter was carried by private consumption while investment contracted, falling 1.9% on the quarter on the full national accounts, in the quarter when Recovery and Resilience Plan execution should have been at its most intense. Public works tenders fell 39% year-on-year in the first half, and the Banco de Portugal projects investment growth falling from 4.5% this year to 1.1% in 2027. The plan closed on 31 August. As of late July, 283 of its 379 milestones and targets had been met, with the remainder due to be presented in the final month. The PTRR, the 22.6 billion euro programme that replaces it, became law on 2 June but has not yet produced replacement tender volume. The investment gap sits in 2027.

The labour market is the clearest sign of both the strength and the constraint. Employment rose 1.9% on the quarter and 2.9% on the year, participation increased and inactivity fell, so this was absorption of workers rather than a shrinking labour force. But labour underutilisation is also at a series low of 9.1%, labour costs are rising 5.4% against output per worker that the central bank projects at 0.8%, and shortages are already reported in construction, information technology and medical services. Construction, where the PTRR and the storm reconstruction both need capacity, has labour costs rising 7.1%. The remaining margin of spare labour has narrowed substantially, and slower migration inflows could make supply a binding constraint in 2027.

Consumer price inflation remained unchanged at 3.3% in August, the same level recorded in April. However, the stability of the headline rate reflected the sharp slowdown in unprocessed food inflation and masked a strengthening of underlying price pressures, with core inflation rising from 2.2% to 2.7%. Banco de Portugal raised its 2026 inflation projection to 3.1% in the June bulletin, up 0.3 percentage points from March, with 2.4% for 2027 and a return to 2.0% in 2028. Its core measure runs 2.4% in 2026 and 2.5% in 2027, so the central bank expects underlying inflation to peak a year after the headline.

The energy shock behind all of this is a condition of the baseline rather than a forward risk. The Strait of Hormuz has been closed or severely restricted since early March. Brent fell to about 73 dollars in early July after a framework agreement, traded back above 100 on 23 July when that agreement broke down, and stood at about 93 dollars on 31 August. European gas averaged about 62 euros per megawatt hour over August, against roughly 30 before the conflict. Portugal's exposure runs through liquid fuels rather than electricity, though that buffer has worn off. Portuguese wholesale power averaged 41 euros per megawatt hour between January and April against 96 in Germany, but 107 in July against 106, so the gap closed over the summer. This offers a plausible mechanism for Iberian outperformance rather than a demonstrated cause: a January to April price average cannot on its own account for a second-quarter outturn.

The housing market continues to exhibit strong price growth, underpinned by persistent supply constraints, although the most recent data suggest some modest signs of moderation. The mortgage stock grew 11.0% year-on-year in July, more than three and a half times the euro-area rate. The state guarantee for young buyers was present in 28.7% of all new own-home contracts in the second quarter and in more than half of those written by buyers under 35, and it closes to new contracts on 31 December 2026. The Banco de Portugal cut the debt-service-to-income ceiling to 45% from 1 August, though the same revision relaxed the maturity limit for borrowers aged 30 to 35.

The fiscal position is the strongest part of the picture. The 2025 surplus of 0.7% of GDP has been confirmed, debt closed the year at 89.7%, and the Banco de Portugal now projects 85.7% this year, 82.5% in 2027 and 79.5% in 2028. That path is roughly three and a half percentage points below the European Commission's for 2027. Our own view sits closer to the Banco de Portugal and the IMF, because our growth forecast is above all three institutions and the denominator does most of the work in a Portuguese debt projection. On either projection Portugal falls below the euro-area average during 2027, since the Commission has euro-area debt rising to 91.2% of GDP and European Union debt to 85.3% over the same period. Demand for Portuguese paper has been exceptional: the January ten-year syndication priced at the tightest spread to Germany since 2007, and the May twenty-year drew an order book of 56.5 billion euros against 3 billion placed. The sovereign trades inside Spain as well as France and Italy.

The Portuguese 10-year yield reached 3.67% on 31 August, up 30 basis points since the previous edition's cutoff of 7 May, while the spread to the German Bund narrowed slightly. Three of the four rating agencies moved Portugal to a positive outlook during 2026, and S&P affirmed A+ with that outlook on 28 August.

Table 1.2: TEN-YEAR GOVERNMENT BOND YIELDS, PORTUGAL AGAINST EURO-AREA PEERS

Country	7 May 2026 (%)	31 Aug 2026 (%)	Spread to Bund, 31 Aug (bps)
Germany (Bund)	3.00	3.32	-
Portugal	**3.37**	**3.67**	**35**
Spain	3.43	3.78	46
France	3.63	4.18	86
Italy	3.74	4.15	83

Source: Bloomberg, daily closing yields for 7 May and 31 August 2026.

Portugal is outperforming Europe on growth, employment, fiscal credibility and sovereign pricing, and that outperformance is consuming the capacity that would be needed to sustain it. Standard solvency indicators remain favourable, but they buy time rather than settle the question. Ageing-related spending, the defence trajectory, the investment transition, slower migration and weak productivity all press in the same direction over the next decade.

Four risks carry material weight. The first is a renewed escalation in the Strait of Hormuz. The Banco de Portugal's severe scenario puts inflation at 4.3% in 2027 while costing only half a point of growth, so the exposure is to the price level rather than to output. The second is second-round effects through the 2027 wage round, with labour costs already running above productivity. The third is an investment trough in 2027 if the PTRR and Portugal 2030 do not replace the Recovery and Resilience Plan in time. The fourth is a disorderly housing correction, on a market where mortgage growth is close to four times the euro-area rate and a government guarantee sits behind a rising share of new lending. On the other side, a durable settlement in the Middle East would reverse the energy shock faster than any instrument available to Portuguese policy.

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