# Portuguese Republic
## Rating Report

A- STABLE OUTLOOK

### Credit strengths

- Status as a euro area member
- Prudent fiscal policy and good record of implementing structural reforms
- Favourable debt profile

### Credit challenges

- Elevated stock of public debt
- Moderate growth potential
- Vulnerability to shocks as a small open economy

## Rating rationale:

**Core euro area member:** Portugal's euro area membership provides access to a large and integrated market and contributes to the country's resilience to global shocks.

**Good record of fiscal consolidation and structural reform:** The Portuguese government has implemented a robust path of fiscal consolidation. Structural reforms have improved the business environment, and incoming EU funds support long-term growth prospects.

**Debt profile and market access:** The Portuguese treasury benefits from strong market access, supported by a favourable debt profile and a comfortable cash buffer.

**Rating challenges include:** i) an elevated stock of public debt; ii) moderate growth potential reflecting adverse demographic trends, impacting the labour force and public spending; and iii) the small, low-diversified open economy's vulnerability to shocks.

**Portugal's sovereign rating drivers**

| Risk pillars | | Quantitative | | Reserve currency | Qualitative* | Final rating |
|---|---|---|---|---|---|---|
| | | Weight | Indicative rating | Notches | Notches | |
| Domestic Economic Risk | | 35% | a+ | EUR [+1] | -2/3 | A- |
| Public Finance Risk | | 20% | a- | | +1/3 | |
| External Economic Risk | | 10% | ccc | | -1/3 | |
| Financial Stability Risk | | 10% | aaa | | 0 | |
| ESG Risk | Environmental Factors | 5% | a+ | | 0 | |
| | Social Factors | 7.5% | b- | | -1/3 | |
| | Governance Factors | 12.5% | a+ | | 0 | |
| **Indicative outcome** | | **a** | | | **-1** | |
| **Additional considerations** | | | | | **0** | |

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

## Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced over the next 12 to 18 months.

### Positive rating-change drivers

- Sustained fiscal consolidation is achieved, resulting in a material decline in public debt levels and additional improvement in the external position, particularly through a reduction in the requirement for external financing
- Improved medium-term growth prospects, supported by the implementation of growth-enhancing structural reforms

### Negative rating-change drivers

- Protracted fiscal deterioration results in weaker debt sustainability
- Fading commitment to or a reversal of structural reforms, leading to a markedly lower GDP growth

### Ratings and Outlook

**Foreign currency**

| | |
|---|---|
| Long-term issuer rating | A-/Stable |
| Senior unsecured debt | A-/Stable |
| Short-term issuer rating | S-1/Stable |

**Local currency**

| | |
|---|---|
| Long-term issuer rating | A-/Stable |
| Senior unsecured debt | A-/Stable |
| Short-term issuer rating | S-1/Stable |


### Lead Analyst

Jakob Suwalski
+49 69 6677389-45
j.suwalski@scoperatings.com

### Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

### Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

### Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

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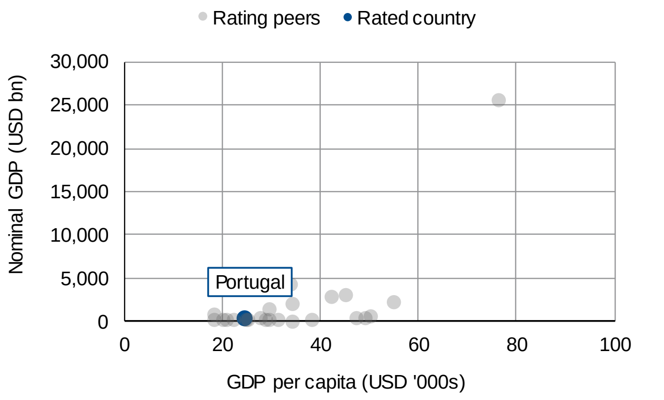
## Domestic Economic Risks

- **Growth outlook:** Portugal's economy expanded robustly at 6.7% in 2022, surpassing the Euro Area average of 3.3%. This growth was supported by private consumption and external demand, particularly from a vibrant tourism sector. Q1 2023 maintained this momentum, registering 1.6% quarter-on-quarter growth, largely driven by strong exports. However, we anticipate a moderation in real GDP growth to 2.6% in 2023 and 2% in 2024. Inflationary pressures will dampen private consumption, while global economic uncertainty will hinder export performance. The Recovery and Resilience Plan is expected to bolster GDP through increased public investments, while private investments may face challenges due to tighter monetary policy. Portugal's medium-term growth potential, currently at 1.8%, will be strengthened by the Recovery Plan, which includes EUR 16.3bn in EU grants and EUR 5.9bn in loans by 2026. This is vital for mitigating issues related to low productivity gains, an ageing population, limited economic diversification, and susceptibility to shocks within an uncertain global context.
- **Inflation and monetary policy:** In 2022, Portugal experienced an average HICP inflation of 8.1%, mainly driven by elevated energy and food costs (Euro Area average: 8.4%). Responding to this inflation, the European Central Bank (ECB) initiated monetary policy tightening, raising the key policy rate by 4.25 percentage points since July 2022. Portugal limited energy price hikes through temporary caps, resulting in approximately 14% savings on final electricity bills. Inflation pressures extended to other sectors like transportation, restaurants, and hotels, causing core inflation to peak at 7.3% in December 2022 before declining to 4.5% in August.
- **Labour markets:** The labour market remains sturdy, showing favourable employment growth and lower unemployment at 6.1% in Q2 2023. Approximately 100,000 foreign workers entering the labour force over the last two years bolster labour market trends, partially mitigating the negative natural balance. Forecasts indicate an unemployment rate of 6.7% in 2023 and 6.6% in 2024.

**Overview of Scope's qualitative assessments for Portugal's *Domestic Economic Risks***

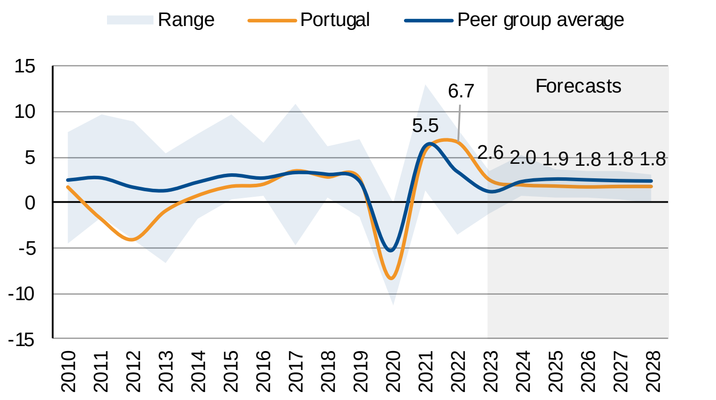
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| a+ | Growth potential of the economy | Weak | -1/3 | Moderate growth potential despite a significant wealth gap versus euro area peers |
| | Monetary policy framework | Neutral | 0 | The ECB is a credible and effective central bank |
| | Macro-economic stability and sustainability | Weak | -1/3 | Limited diversification; low share of high-value added sectors |

**Nominal GDP and GDP per capita**, USD




Source: IMF World Economic Outlook (WEO), Scope Ratings

**Real GDP growth**, %




Source: IMF WEO, Scope Ratings forecasts

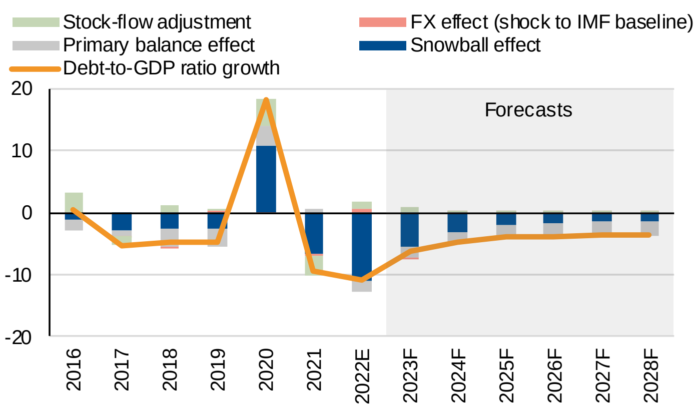
## Public Finance Risks

- **Fiscal outlook:** The fiscal deficit significantly improved to 0.4% of GDP in 2022 from 2.8% in 2021, boosted by strong revenue growth amid high inflation and strong economic performance. Covid-support measures withdrawal also played a role. Despite increased government expenditure, including measures for inflation-related support, totalling 1.2% of GDP in 2022, Portugal's primary balance has recovered rapidly compared to peers, with a surplus of 1.6% of GDP achieved last year. This trend is expected to persist, backed by economic resilience, credible fiscal policies, and a parliamentary majority. Anticipated improvements include a primary surplus of 2.0% of GDP in 2023 and eventual overall surplus. These actions enhance fiscal sustainability by increasing capacity to manage financial pressures.
- **Debt trajectory:** Public debt-to-GDP ratio resumed its decline in 2021, reaching 113.9% in 2022 from its peak of 134.9% in 2020. The return to primary surpluses will continue this downward trend, with debt-to-GDP expected to reach 107.6% in 2023 (well below pre-pandemic levels of 116.6%) and 102.8% in 2024. Supported by nominal growth and inflation, it's projected to converge toward 88% of GDP by 2028. This trajectory will benefit from controlled interest burden and reduced total guarantees (3.1% of GDP in 2022 compared to 4.7% in 2021).
- **Debt profile and market access:** Portugal has a strong debt profile with favourable market access, marked by declining debt costs in recent years. The cost stood at 1.7% of GDP in 2022, down from 4.1% in 2011 and slightly below 2021 levels (1.9%). Debt maturity averaged around 7.5 years as of July 2023, providing resilience against higher interest rates. However, debt costs are projected to rise to 2.5% of GDP this year (from 2.1% in 2022) before stabilizing around 2.8% of GDP. Portugal's ample cash buffer, totalling EUR 6.3bn in 2022 (2.6% of GDP), is expected to remain at EUR 6bn this year, covering around one third of State borrowing needs.

**Overview of Scope's qualitative assessments for Portugal's *Public Finance Risks***

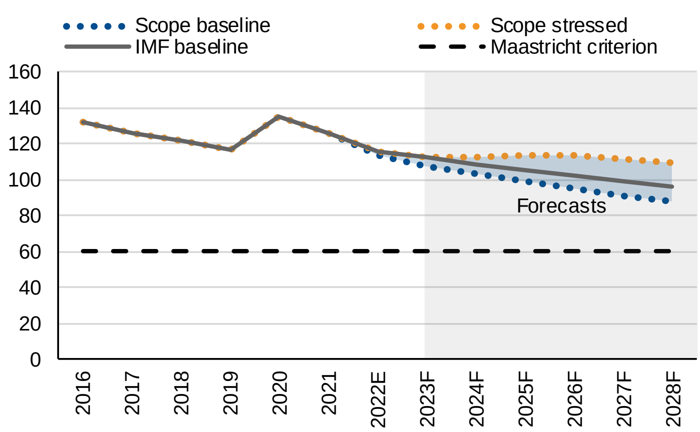
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| a- | Fiscal policy framework | Strong | +1/3 | Commitment to fiscal consolidation resulted in sustained improvements in fiscal fundamentals with declining budget deficits and rapid recovery in primary balance |
| | Debt sustainability | Neutral | 0 | Downward debt trajectory expected, although debt is likely to remain elevated over the longer term |
| | Debt profile and market access | Neutral | 0 | Strong market access in line with peers, high cash buffer and resilient public debt structure |

**Contributions to changes in debt levels**, pps of GDP




Source: IMF WEO, Scope Ratings forecasts

**Debt-to-GDP forecasts**, % of GDP




Source: IMF WEO, Scope Ratings forecasts

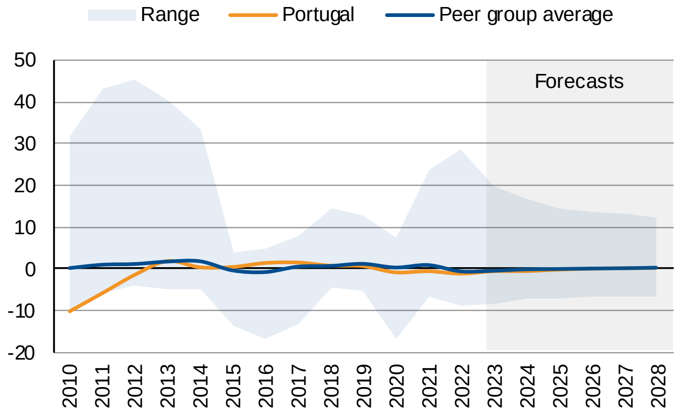
## External Economic Risks

- **Current account:** Portugal's current account exhibited a favorable trend in the years leading up to the pandemic, with surpluses averaging nearly 0.8% of GDP between 2013 and 2019. However, due to a significant drop in receipts from foreign tourism and related passenger transport services, the current account balance turned to a deficit of 1% of GDP in 2020. Portugal's 2022 current account experienced fluctuations due to price effects, while net exports improved in real terms. The deficit expanded from 0.8% to 1.2% of GDP, driven by elevated energy prices, was partially offset by robust export recovery, notably in tourism. Looking ahead, the anticipated ongoing decrease in energy costs and a continued rise in tourism exports, coupled with supportive policies for energy efficiency and renewables, are projected to balance to the current account.
- **External position:** Portugal's negative net international investment position (NIIP) has significantly improved over time and during the pandemic, albeit remaining notable. This improvement extends before and after the pandemic, with continued economic growth aiding a reduction in external indebtedness despite some projected 2023 deceleration. The NIIP recovered from -104.6% of GDP in 2020 to -84.7% in 2022, mainly due to GDP growth and valuation changes. Over time, the NIIP has strengthened by 40 percentage points, from -123.8% in 2014. Moreover, FDI composes a significant portion of Portugal's NIIP structure, bolstering the
- **Resilience to shocks:** Euro area countries gain protection from external shocks due to the euro's global reserve currency status. Still, Portugal's small, open economy faces vulnerability in its current account balance and GDP growth, particularly to external economic shocks and second-round impacts like changes in growth prospects among key European trading partners and tourism exports.

**Overview of Scope's qualitative assessments for Portugal's *External Economic Risks***

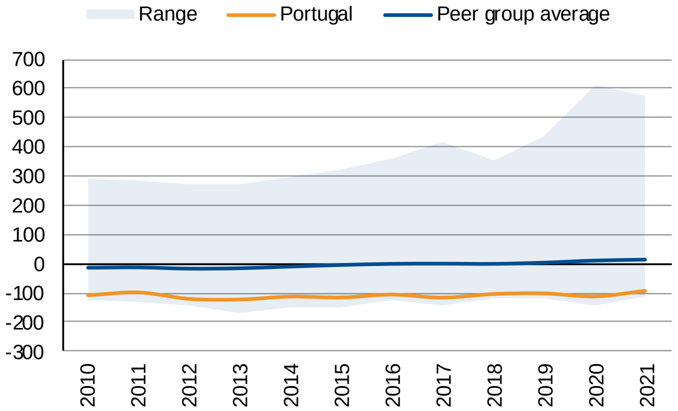
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| ccc | Current account resilience | Weak | -1/3 | Dependence on tourism sector leads to volatility in external trade |
| | External debt structure | Neutral | 0 | Elevated, albeit declining, external debt stock, with meaningful shares held by the government and central bank |
| | Resilience to short-term external shocks | Neutral | 0 | Small and open economy vulnerable to external economic shocks, although mitigated by euro area membership |

**Current account balance**, % of GDP




Source: IMF WEO, Scope Ratings

**Net international investment position (NIIP)**, % of GDP




Source: IMF, Scope Ratings

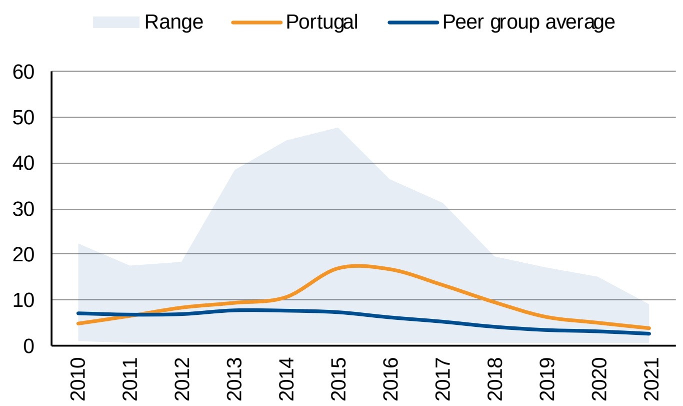
## Financial Stability Risks

- **Banking sector:** The Portuguese banking sector demonstrated resilience throughout 2022. Profitability saw an upswing, primarily due to increased ECB interest rates and minimal deposit costs, consequently boosting net interest income and leading to the highest return on equity since the financial crisis, registering at 8.8% in Q1 2023. Non-performing loans sustained their downward trajectory. NPL reduction strategies, including sales and write-offs, drove the NPL ratio down to 3% by the end of 2022. Despite challenges posed by the energy crisis and inflation, asset quality remained robust, contributing to a decrease in risky loans, particularly in Stage 2 and Stage 3 categories. However, the sector's prospects remain marked by uncertainties, with rising interest rates exerting pressure on borrowers' debt-servicing capacity.
- **Private debt:** Private indebtedness continues to decline, fuelled by pandemic-driven adjustments and strong nominal GDP growth. From 157% in 2021, the debt-to-GDP ratio dropped to 143% in 2022. Both corporate and household sectors contributed to this downward trend, yet the ratios remain high. However, deposit growth outpaced loans for both households and corporations in 2022, offering a liquidity cushion. With projected GDP growth and moderated net lending, private debt is set to further decrease.
- **Financial imbalances:** The economic slowdown, coupled with the rise in inflation and the subsequent increase in market interest rates, could exacerbate the financial situation of households, particularly those already vulnerable and in an environment of low saving rates. However, Portugal's robust macroprudential policies ensure minimal financial stability concerns. Moreover, housing prices remain on an increasing trajectory, on the back of high housing demand by non-resident, limited house supply and, more recently, labour and material shortages. However, households' borrowing capacity may decline due to elevated house prices, mortgage rates, and weakened real incomes amidst inflation pressures.

**Overview of Scope's qualitative assessments for Portugal's *Financial Stability Risks***

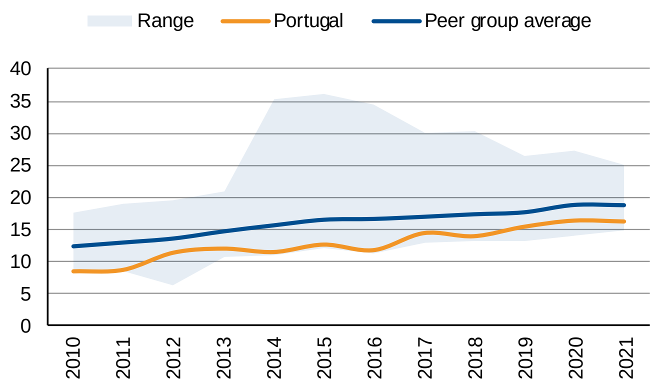
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| bbb+ | Banking sector performance | Neutral | 0 | Banking-system capitalisation remains sound, but NPL ratio remains high compared to peers |
| | Banking sector oversight | Neutral | 0 | Effective oversight under European Banking Union authorities and Banco de Portugal |
| | Financial imbalances | Neutral | 0 | Low savings and moderate private indebtedness; challenges to private sector debt service |

**Non-performing loans**, % of total loans




Source: IMF, Scope Ratings

**Tier 1 ratio**, % of risk-weighted assets




Source: IMF, Scope Ratings

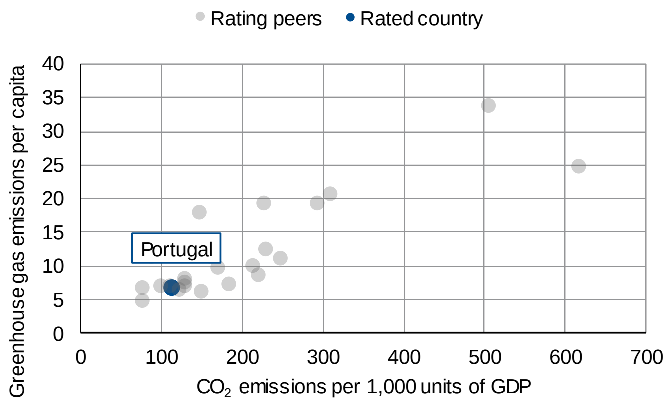
## ESG Risks

- **Environment:** Portugal has confronted environmental challenges like fires, droughts, and floods, underscoring the need for sustainable policies. Despite this, the nation's commitment to environmental protection is evident as one of the earliest EU members pledging to achieve net-zero emissions by 2050. This goal mandates substantial investments in renewable energy and carbon reduction, with initiatives like electric vehicle subsidies already in place. Addressing air quality concerns, especially in urban areas, is pivotal, with personal transport systems worsening congestion and seasonal air quality problems.
- **Social:** Portugal faces challenges with ageing demographics, leading to a rising old-age dependency ratio expected to surpass 60 by 2050, one of the EU's highest levels. Youth unemployment and gender pay disparity are also concerns being addressed, while health spending is projected to rise substantially. These factors underscore the need for Portugal to implement measures for addressing its ageing population and youth unemployment to ensure social stability and long-term economic sustainability.
- **Governance:** Portugal excels in a composite index of World Bank Worldwide Governance Indicators, highlighting strong democratic institutions. Stable politics and consensus on crucial policies further reflect effective fiscal management and successful structural reforms, including current account adjustment and reduced structural unemployment.

**Overview of Scope's qualitative assessments for Portugal's *ESG Risks***

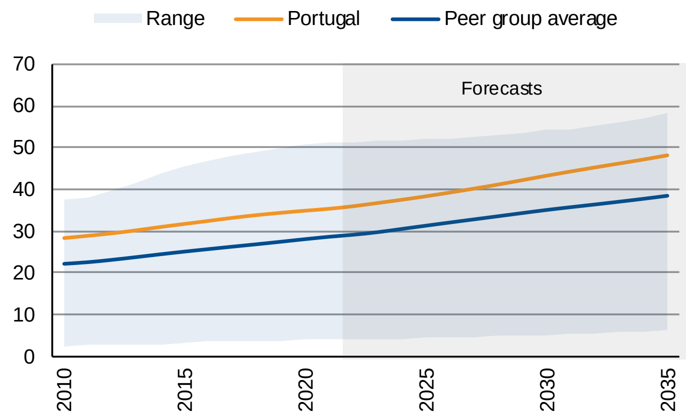
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| bbb+ | Environmental risks | Neutral | 0 | Exposure to natural disasters, ambitious commitment to achieve carbon neutrality by 2050 |
| | Social risks | Weak | -1/3 | Adverse demographics; income inequality and risk of social exclusion |
| | Institutional and political risks | Neutral | 0 | Resilient institutional framework; comparatively reform-oriented political environment |

**Emissions per GDP and per capita**, $mtCO_2e$



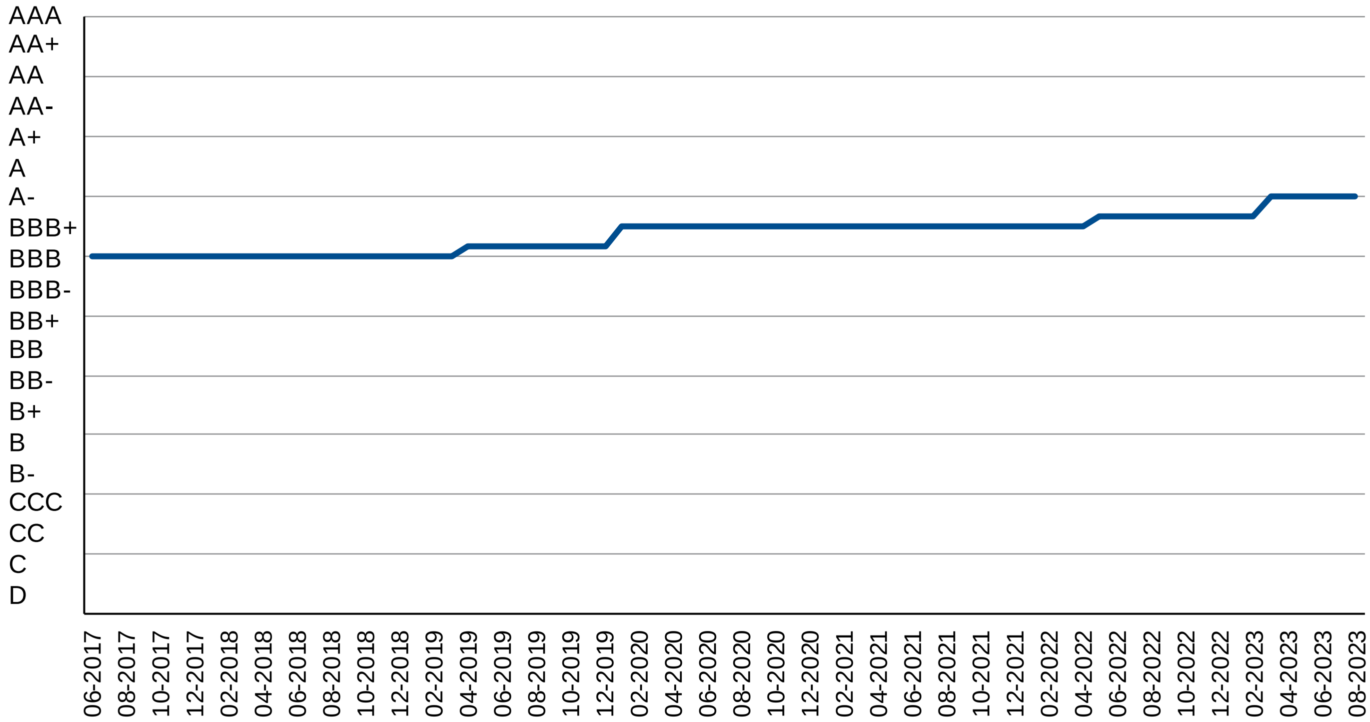

Source: European Commission, Scope Ratings

**Old age dependency ratio**, %




Source: United Nations, Scope Ratings

## Appendix I. Rating history (foreign-currency long-term debt)




NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

## Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

| Peer group* |
|---|
| Belgium |
| Croatia |
| Cyprus |
| Czech Republic |
| Estonia |
| France |
| Italy |
| Japan |
| Latvia |
| Lithuania |
| Malta |
| Poland |
| Slovakia |
| Slovenia |
| Spain |
| United Kingdom |
| United States |

*Publicly rated sovereigns only; the full sample may be larger.

## Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

| Pillar | Core variable | Source | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|
| Domestic Economic | GDP per capita, USD '000s | IMF | 23.6 | 23.3 | 22.2 | 24.7 | 24.5 |
| | Nominal GDP, USD bn | IMF | 242.4 | 240.0 | 228.8 | 254.2 | 252.4 |
| | Real growth, % | IMF | 2.8 | 2.7 | -8.3 | 5.5 | 6.7 |
| | CPI inflation, % | IMF | 1.2 | 0.3 | -0.1 | 0.9 | 8.1 |
| | Unemployment rate, % | WB | 7.0 | 6.5 | 6.8 | 6.6 | 5.8 |
| Public Finance | Public debt, % of GDP | IMF | 121.5 | 116.6 | 134.9 | 125.4 | 116.0 |
| | Net interest payment, % of revenue | IMF | 7.5 | 6.6 | 6.4 | 5.1 | 4.5 |
| | Primary balance, % of GDP | IMF | 2.9 | 2.9 | -3.1 | -0.5 | 0.0 |
| External Economic | Current-account balance, % of GDP | IMF | 0.6 | 0.4 | -1.0 | -0.8 | -1.3 |
| | Total reserves, months of imports | WB | 2.5 | 2.5 | 3.5 | 3.1 | - |
| | NIIP, % of GDP | IMF | -103.1 | -100.3 | -112.4 | -90.5 | - |
| Financial Stability | NPL ratio, % of total loans | IMF | 9.4 | 6.2 | 4.9 | 3.7 | - |
| | Tier 1 ratio, % of risk-weighted assets | IMF | 14.2 | 14.8 | 15.3 | 16.2 | 15.7 |
| | Credit to the private sector, % of GDP | WB | 97.0 | 93.4 | 104.3 | 99.7 | - |
| ESG | $CO_2$ per EUR 1,000 of GDP, $mtCO_2e$ | EC | 148.1 | 130.9 | 120.3 | 112.0 | - |
| | Income share of bottom 50%, % | WID | 19.5 | 19.7 | 20.1 | 20.0 | - |
| | Labour-force participation rate, % | WB | 75.1 | 75.5 | 74.2 | 75.2 | - |
| | Old-age dependency ratio, % | UN | 33.7 | 34.2 | 34.7 | 35.2 | 35.8 |
| | Composite governance indicators* | WB | 1.1 | 1.0 | 1.0 | 1.0 | - |

* Average of the six World Bank Worldwide Governance Indicators.

## Appendix IV. Economic development and default indicators

| | |
|---|---|
| IMF Development Classification | Advanced economy |
| 5y USD CDS spread (bps) as of 8 September 2023 | 47 |

## Scope Ratings GmbH

### Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

### Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

### Paris

10 avenue de Messine
F-75008 Paris

Phone +33 6 62 89 35 12

### Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

### Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

### Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30 31 58 14

## Scope Ratings UK Limited

### London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
**www.scoperatings.com**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