Portuguese Republic
Rating Report

STABLE OUTLOOK

BBB+

Credit strengths

- Status as a euro area member
- Good record of fiscal consolidation and structural reform
- Resilient public debt structure

Credit challenges

- Elevated stock of public debt and contingent liabilities
- Moderate growth potential
- High external debt

Rating rationale:

Core euro area member: Portugal benefits from its euro area membership, strengthening the country's resilience to face an unprecedented global shock.

Good record of fiscal consolidation and structural reform: The Portuguese government had put the country on a robust path of fiscal consolidation in the years leading up to the crisis, generating robust primary surpluses. Structural reforms have improved the business environment and lifted potential output and allowed for a moderate countercyclical fiscal response to the crisis.

Debt profile and market access: The Portuguese treasury benefits from strong market access, facilitated by the ECB's accommodative monetary policy, including its asset purchase programmes.

Rating challenges include: i) an elevated stock of public debt and contingent liabilities; ii) a moderate growth potential reflecting adverse demographic trends, impacting labour force and public spending; and iii) the Portuguese economy's vulnerability to shocks given high external debt although the composition improved considerably to more stable components.

Portugal's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	a-		-2/3	BBB+
Public Finance Risk		25%	bbb		0	
External Economic Risk		10%	ccc		0	
Financial Stability Risk		10%	aa+		0	
ESG Risk	Environmental Risk	5%	aaa		0	
	Social Risk	5%	bb+		-1/3	
	Governance Risk	10%	a+		+1/3	
Overall outcome		**bbb+**		**+1**	**-1**	

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and 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 GmbH.

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

- Growth potential increases
- Public finances improve, resulting in steady reduction in public debt

Negative rating-change drivers

- Weakened fiscal outlook, weighing on debt sustainability
- Materialisation of contingent liabilities
- Markedly lower GDP growth

Ratings and Outlook

Local and foreign currency

Long-term issuer rating	BBB+/Stable
Senior unsecured debt	BBB+/Stable
Short-term issuer rating	S-2/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

Bloomberg: RESP SCOP

Domestic Economic Risks

- **Growth outlook:** Portugal was particularly hard hit by the pandemic, recording a GDP decline of -8.4% in 2020, worse than the euro area (-6.4%) but better than peers including Italy (-8.9%) or Spain (-10.8%). We expect economic activity to have returned close to its pre-pandemic level by the end of the year, with growth at +4.6% in 2021, before accelerating at +5% in 2022. The country lifted most of its Covid-19 related restrictions in October, following a successful vaccination campaign (above 85% of the population is vaccinated), allowing for a strong rebound in consumer demand.

  The tourism sector occupies an outsized position in the Portuguese economy, accounting for 17.1% of GDP and 20.7% of employment before the health crisis. The government expects revenue from the sector in 2021 to only represent half of their 2019 level. Travel restrictions and uncertainty around the evolution of the pandemic are slowing down recovery in the sector and represent a key vulnerability in the medium-term. Sustained investment in construction mirrors favourable dynamics in the housing market. The economy's moderate growth potential, inhibited by low productivity gains, and its vulnerability to shocks remain key challenges.

  Portugal's economic recovery will also be supported by the government's Recovery and Resilience Plan, through which it is set to receive EUR 13.9 bn in grants and EUR 2.7 bn in loans from the EU by 2026. These funds will be directed towards investments supporting resilience (€11bn), the climate transition (€3bn) and the economy's digital transition (€2.5bn).

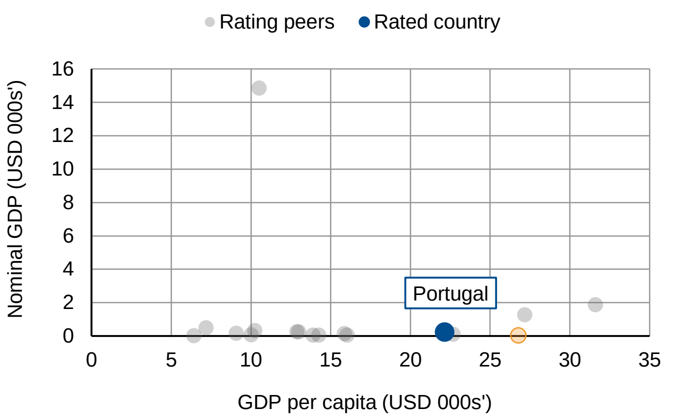
- **Inflation and monetary policy**: After a moderate decrease in 2020 (-0.1%), inflation (HICP) is expected to accelerate in 2021 (+0.9%), though more modestly than in the rest of the eurozone. This increase is mainly driven by rising commodity prices and Covid-19-related supply chain disruptions and should thus be temporary.

- **Labour market:** Government job retention schemes helped contain the impact of the pandemic on the labour market. By mid-2021, all labour market indicators had returned to their pre-crisis level, hours worked excepted. The unemployment rate stood at 6.4% in September 2021.

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

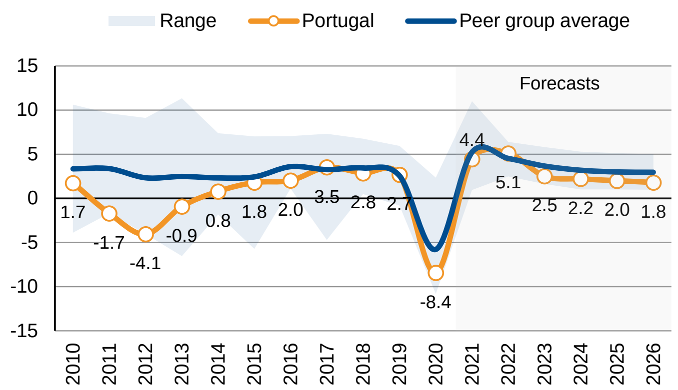
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Growth potential of the economy	Weak	-1/3	Moderate growth potential, fragmented labour market, although improving dynamics
	Monetary policy framework	Neutral	0	Highly credible and effective central bank; appropriate response to the 2020 global crisis
	Macro-economic stability and sustainability	Weak	-1/3	Small economic base with limited diversification; moderate structural unemployment

Nominal GDP and GDP per capita, USD thousands



Source: IMF, Scope Ratings GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

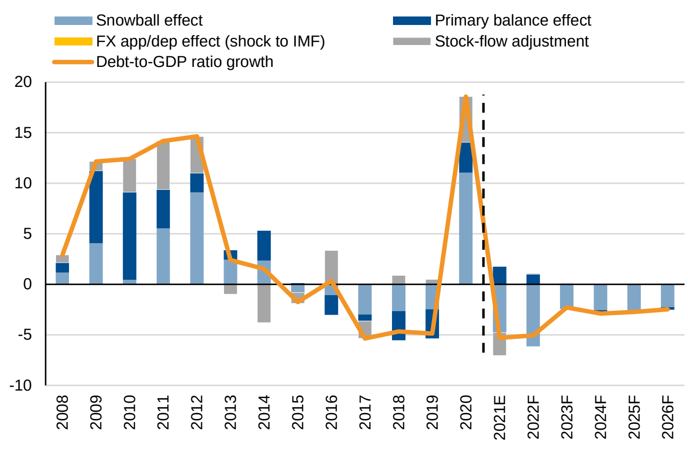
Public Finance Risks

- **Fiscal outlook:** The pandemic caused government deficit to spike to 5.7% of GDP, due to a fall in revenue and to expansionary fiscal policy. As of October 2021, additional public spending linked to the health crisis is estimated at EUR 13.8 bn (6.0% of GDP). We expect the overall government deficit to gradually decline in the coming years, reaching -4.3% in 2021 and -3.2% in 2022, before further declining to 2.2% of GDP in 2023, thus returning within the boundaries of the Stability and Growth Pact. This view is supported by the Portuguese government's good record of primary surpluses in recent years, with an average primary balance of +1.85% of GDP over 2015-2019. The recent rejection in parliament of the government's budget bill generates uncertainty regarding its ability to return to a path of fiscal consolidation, however.
- **Debt trajectory:** The government debt-to-GDP ratio jumped to 135.2% of GDP in 2020, an increase of almost 20pp from the previous year. The strong economic recovery and the gradual return to primary surpluses should support a return to a steady downward trend. We expect the debt-to-GDP ratio to decline to 130.1% in 2021 and 124% in 2022. Contingent liabilities could stem from the government's public guarantee program, rolled out in 2020 and 2021 for a maximum amount of EUR 13bn, as well as from TAP, the state-owned airline, and banking group Novo Banco.
- **Market access:** Although the pandemic caused a jump in gross financing needs (24.6bn in 2020), Portugal benefits from strong market access which allowed it to issue debt on favourable terms during the crisis. The cost of outstanding debt has been on a steady declining trend in recent years, at 2.2% of GDP in 2020, down from 4.1% in 2011. Average debt maturity stood at around 7 years in 2021 (excluding EU and IMF loans). The government's financing strategy benefitted from the EU's SURE loans (EUR 5.4bn disbursed) and the ECB's asset purchase programme. As of July 2021, 38% of debt securities were held by non-residents (excl. ECB), and 32% were owned by residents (excl. Banco de Portugal), adding to the stability of the holding structure.

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

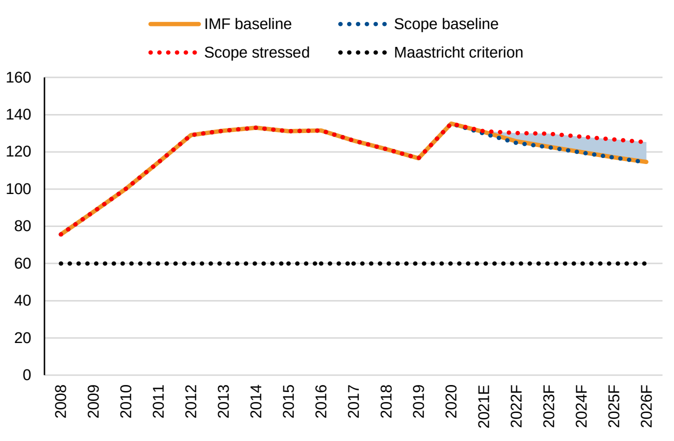
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb	Fiscal policy framework	Neutral	0	Good record of prudent fiscal policy, including elevated primary surpluses prior to Covid-19 shock
	Debt sustainability	Neutral	0	Debt expected on a downward trajectory after the shock, although to remain elevated 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: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

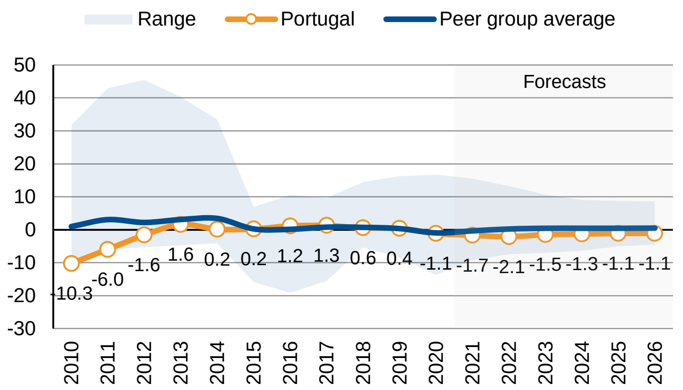
External Economic Risks

- **Current account:** Portugal's external position was on a positive trend in the years leading up to the pandemic, generating current account surpluses averaging close to 0.8% of GDP between 2013 and 2019. The current account balance moved to a deficit of 1.1% of GDP in 2020, due to the fall in receipts from foreign tourism and related passenger transport services. We expect this to gradually improve in coming years, in parallel with the progressive recovery in foreign tourism, though the deficit in the trade of goods should further widen, due to the strong rebound in consumer demand and to the rise in energy prices.
- **External position:** The crisis caused Portugal's net international investment position (NIIP) to dip to -106.4% of GDP in 2020, down from -100.0% in 2019, due to the decrease in output. Sustainability concerns stemming from the large negative NIIP are partially offset by its favourable composition, with an increasing share of equity-based foreign direct investments. The country's gross external debt is elevated, standing at 201% of GDP as of end-2020, above the euro area average (122.9%).
- **Resilience to shocks:** Portugal, along with all euro area members, benefits from the euro's status as a global reserve currency, significantly mitigating risks to external shocks.

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

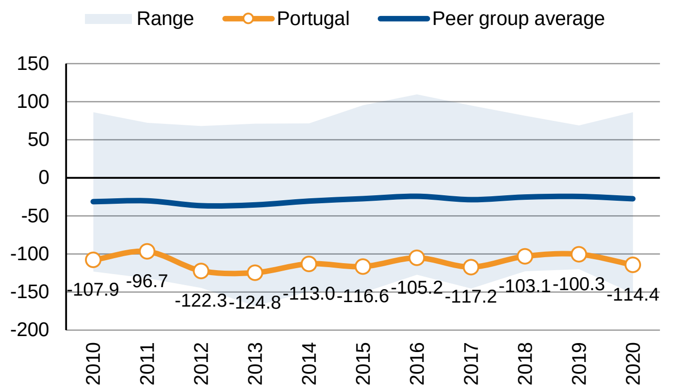
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Current account resilience	Neutral	0	Dependence on tourism sector may temporarily weaken external trade
	External debt structure	Neutral	0	Elevated debt stock, with meaningful shares by the government and central bank
	Resilience to short-term shocks	Neutral	0	Euro area membership shields against short-term external shocks

Current account balance, % of GDP



Source: IMF, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

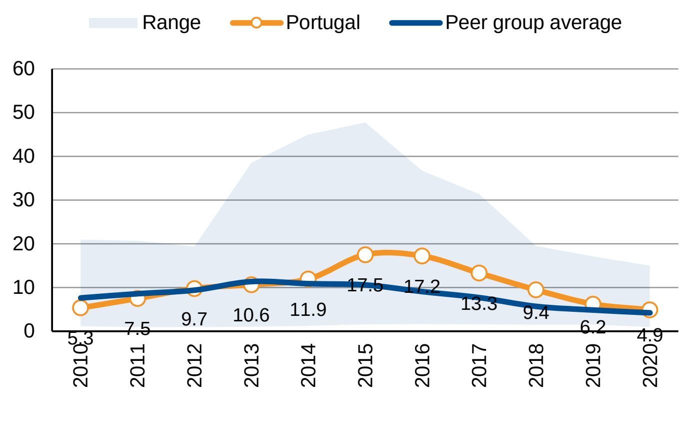
Financial Stability Risks

- **Banking sector:** The Portuguese banking sector has remained stable throughout the crisis, maintaining comfortable liquidity (LCR of 245.9% at end 2020) and adequate capital buffers (CET-1 ratio at 15.3% at end 2020). Non-performing loans (NPL) ratios are elevated compared to peers but have declined to 4.9% in December 2020, down from a high of almost 18% in 2016. The economic recovery allowed profitability to improve in the first half of 2021 to 5.2%, thanks to an increase in income from financial operations and to a decrease in provisions and impairments. The gradual lifting of the loan moratorium carries uncertainty for banks' asset quality and could lead to a rise in NPLs.
- **Private debt:** Non-financial corporate (NFC) debt stood at 99% of GDP as of end-2020, a 7pp increase from 2019, mostly driven by the decrease in GDP level, and to a lower extent by the moratorium on loan repayments. After a prolonged decline since 2009, household indebtedness, as measured by the debt-to-disposable-income ratio, increased moderately to 95.2% in 2020 (+.3pp), close to the euro area average. This occurred in parallel with a substantial increase in the savings rate, which stood at 11.5% in 2021 Q2, fueling a corresponding increase in deposits (+7% in the first half of 2021). Banco de Portugal expects the savings rate to decline and reach 10.4% on average for 2021 (vs. 7.2% in 2019).
- **Financial imbalances:** House prices have continued to grow over the pandemic period, albeit at a somewhat slower pace, with an increase of 8.4% in 2020, compared to 9.6% in 2019. Low interest rates and increased household savings should support demand for housing in the medium term, though certain segments of the market, linked to demand by non-residents or associated with tourism, remain exposed to Covid-19 related volatility.

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

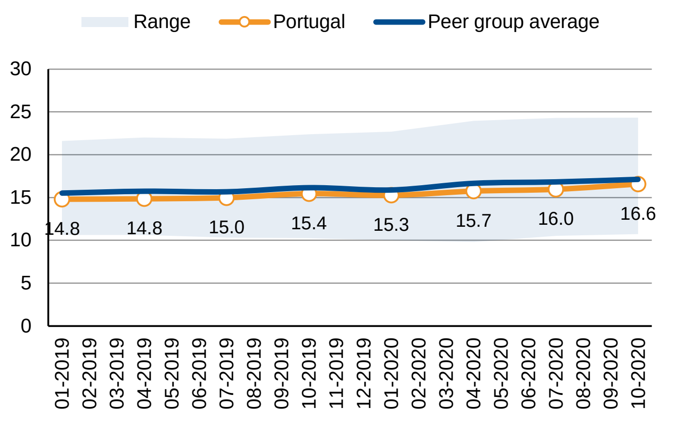
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Banking sector performance	Neutral	0	Banking-system capitalisation remains sound, but declining profitability
	Banking sector oversight	Neutral	0	Effective oversight under European Banking Union authorities and the Bank of Portugal
	Financial imbalances	Neutral	0	Low savings and high but declining private indebtedness; challenges to private sector debt service

NPLs, % of total loans



Source: IMF, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

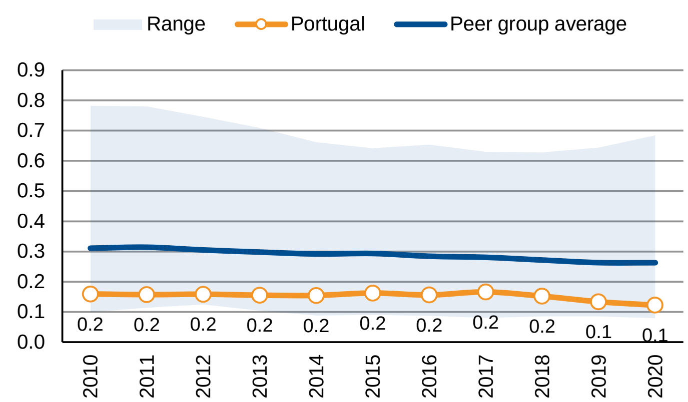
ESG Risks

- **Environment:** The Portuguese government was one of the first in the EU to commit to net zero emissions by 2050. It has rolled out ambitious policies to achieve that goal, including the 2014 Green Taxation Law which introduced a carbon tax. Renewable energy represented 30.6% of final energy consumption in 2019, close to its 2030 target of 31%, and the country's last power plant is set to close in 2022. Challenges remain however, notably due to its high energy import dependency, which stood at 74% in 2019, one of the highest levels among IEA members. The country is exposed to significant physical risks resulting from natural disasters, having experienced dramatic droughts and forest fires in recent years.
- **Social:** Portugal has achieved improvements in the European Commission Social scoreboard, with regards to its labour market performance and the reduction in gender and income inequality. Significant social risks remain however, as reflected in the high rate of population at risk of social exclusion (21.1% in 2019) or its low degree of social mobility (the country ranked 24th in the World Economic Forum's Global Social Mobility index). Portugal is also facing severely adverse age dynamics impacting public spending, with an old-age dependency ratio forecast to stand above 60 by 2050, one of the highest levels in the EU.
- **Governance:** Portugal benefits from a resilient institutional framework and the authorities' good record of prudent fiscal policy and structural reform including current account rebalancing and structural unemployment reduction. Snap elections which will take place in January 2022.

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

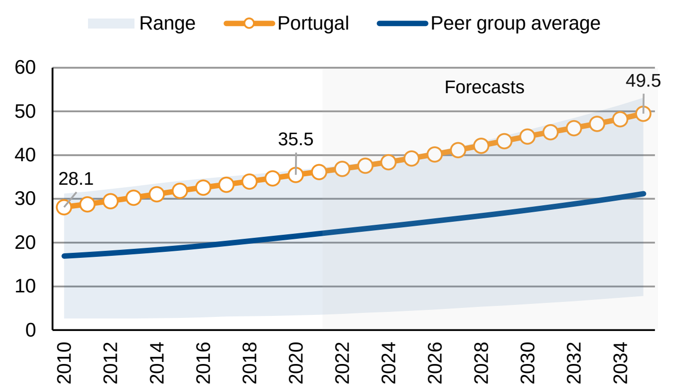
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Environmental risks	Neutral	0	Exposure to natural disasters, ambitious commitment to achieve carbon neutrality by 2050
	Social risks	Weak	-1/3	Adverse demographics, income inequality and risk of social exclusion
	Institutional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

CO2 emissions per GDP, mtCO2e



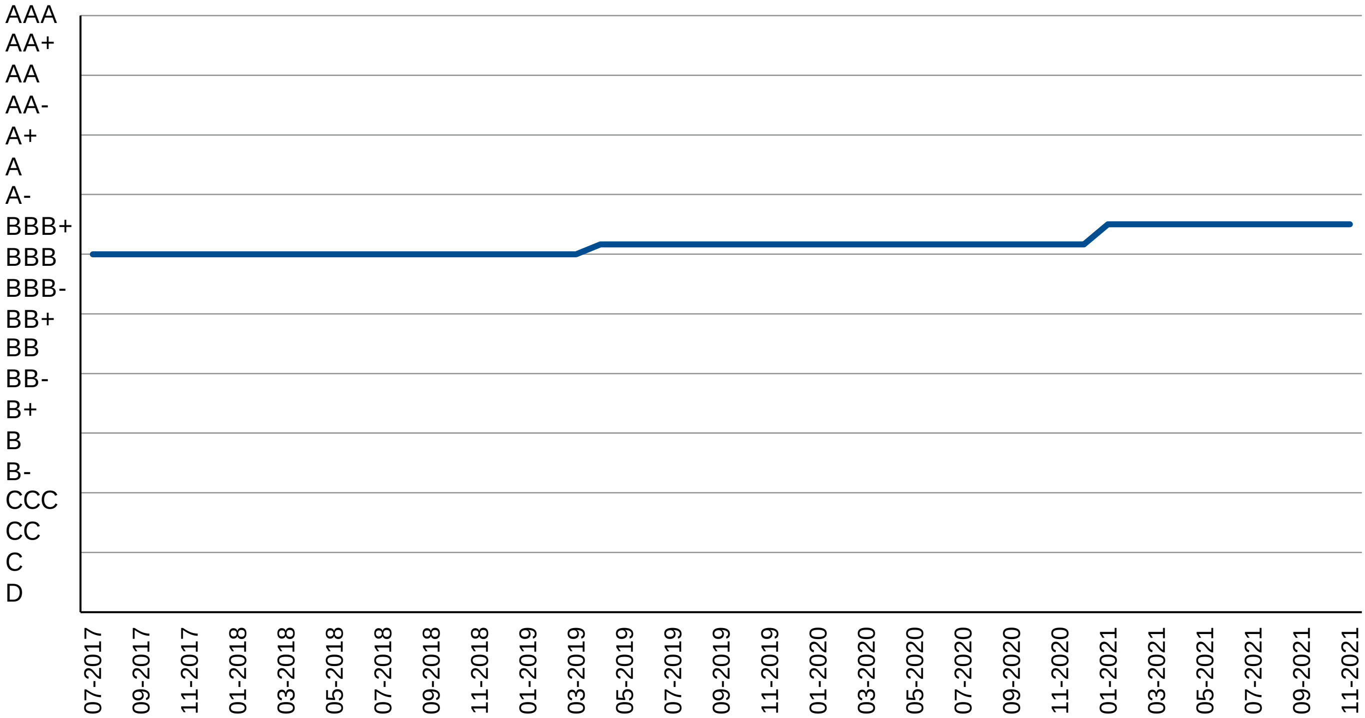
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



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.

Peer group
Bulgaria
China
Croatia
Cyprus
Hungary
Italy
Portugal
Romania
Spain

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 29) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021F	2022F
Domestic Economic Risk							
GDP per capita, USD 000s'	20.0	21.5	23.6	23.3	22.1	24.5	26.4
Nominal GDP, USD bn	206.4	221.3	242.4	240.0	228.4	251.7	271.2
Real growth, %[1]	2.0	3.5	2.8	2.7	-8.4	4.6	5.0
CPI inflation, %	0.6	1.6	1.2	0.3	-0.1	1.2	1.3
Unemployment rate, %[1]	11.5	9.2	7.2	6.6	7.0	6.9	6.7
Public Finance Risk							
Public debt, % of GDP[1]	131.5	126.1	121.5	116.6	135.2	129.9	124.8
Interest payment, % of government revenue	9.1	8.5	7.5	6.6	6.3	5.8	5.1
Primary balance, % of GDP[1]	1.9	0.7	2.9	2.9	-3.0	-1.8	-1.0
External Economic Risk							
Current account balance, % of GDP	1.2	1.3	0.6	0.4	-1.1	-1.7	-2.1
Total reserves, months of imports	3.2	2.9	2.5	2.5	3.5	-	-
NIIP, % of GDP	-105.2	-117.2	-103.1	-100.3	-114.4	-	-
Financial Stability Risk							
NPL ratio, % of total loans	17.2	13.3	9.4	6.2	4.9	-	-
Tier 1 ratio, % of risk weighted assets	11.7	14.4	13.9	15.4	16.6	0.0	-
Credit to private sector, % of GDP	111.2	102.6	97.0	90.4	100.0	-	-
ESG Risk							
CO^2 per EUR 1,000 of GDP, $mtCO^2e$	155.6	165.6	151.7	133.3	121.9	-	-
Income quintile share ratio (S80/S20), x	6.2	5.6	5.6	-	-	-	-
Labour force participation rate, %	74.0	74.9	75.4	75.8	-	-	-
Old age dependency ratio, %	32.6	33.3	34.0	34.7	35.5	36.2	36.9
Composite governance indicator[2]	1.0	1.1	1.1	1.1	1.1	-	-

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: European Commission, IMF, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 18 November 2021	29.2

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

23 Boulevard des Capucines
F-75002 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
28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer