Portuguese Republic
Rating Report

A- STABLE OUTLOOK

Credit strengths

- Status as a euro area member
- Good record of fiscal consolidation and structural reform
- Favourable debt profile and high cash buffer

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, 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		-2/3	
Financial Stability Risk		10%	bbb+		0	
ESG Risk	Environmental Factors	5%	aa		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

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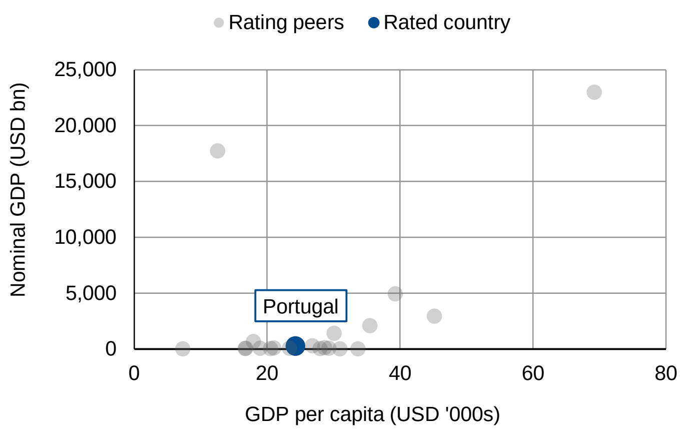
Domestic Economic Risks

- **Growth outlook:** After experiencing a sharp decline of 8.3% in GDP in 2020 due to the Covid-19 crisis, which was worse than the euro area average of 6.4%, the Portuguese economy has shown signs of recovery. In 2021, the economy rebounded to 5.5%, and this growth momentum has continued into 2022, with an expected growth rate of 6.7%. However, growth is to slow down in 2023, with an anticipated real growth rate of 1.2%, followed by a recovery of around 2% in 2024. The Russia-Ukraine conflict is expected to have an impact on Portugal's economic growth, primarily through weakened external demand and higher inflation, which could lead to a reduction in households' purchasing power, thereby reducing private consumption and investment. To enhance the economy's growth potential over the medium-term, which is currently at 1.8%, inhibited by low productivity gains, an ageing population, low economic diversification, and the country's vulnerability to shocks in an uncertain global environment, Portugal will rely on the Recovery and Resilience Plan. This plan involves the receipt of EUR 13.9bn in EU grants and EUR 2.7bn in loans by 2026 and is expected to be a significant contributor to the country's economic growth potential.
- **Inflation and monetary policy:** In 2022, HICP inflation in Portugal averaged 8.1%, primarily due to higher energy and food prices (euro area average of 9.2%). Similar to Spain, Portugal has a low dependence on Russian energy and has imposed a temporary cap on electricity prices for final consumers, resulting in savings of around 14% on their final bill.. Inflationary pressures have spread to other sectors such as transportation, restaurants, and hotels, resulting in an increase in core inflation to 7.2% in February. In response to the inflationary pressures, the European Central Bank (ECB) has started to tighten its monetary policy, raising the key policy rate by 3.5 percentage points since July.
- **Labour markets:** Government job retention schemes helped contain the pandemic's impact on the labour market. The economic recovery has led to a decline in the seasonally adjusted unemployment rate to 5.9% in 2022 and an increase in employment. We expect the unemployment rate to stabilise around 6% from 2023 to 2025 due to labour shortages, limited labour force growth, and the need to retain workers.

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

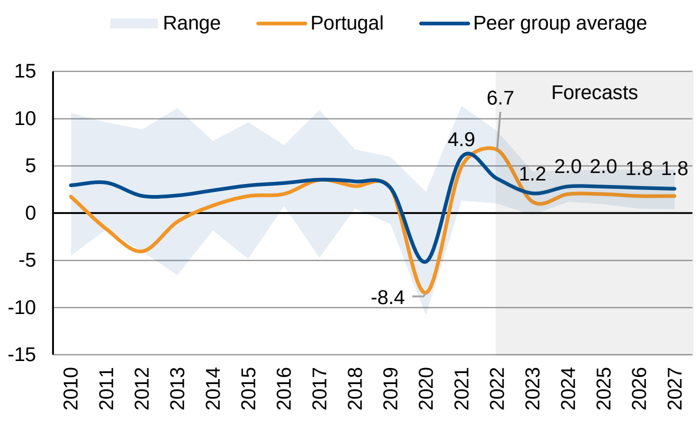
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Growth potential of the economy	Weak	-1/3	Moderate growth potential despite a significant wealth gap versus euro area peers
	Monetary policy framework	Neutral	0	The ECB is a credible and effective central bank
	Macro-economic 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

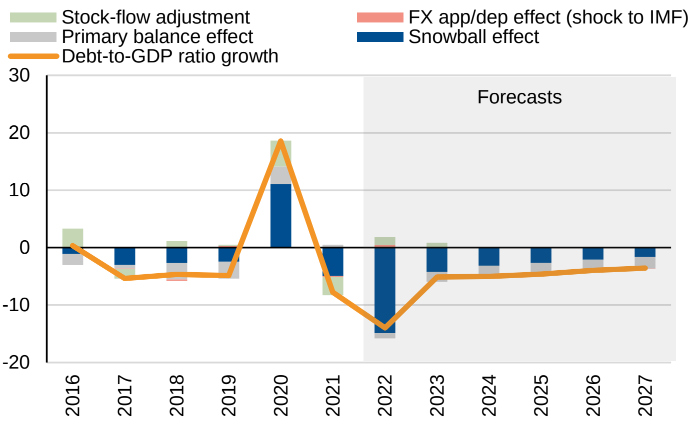
Public Finance Risks

- **Fiscal outlook:** We expect the general government deficit to gradually decrease to 1.1% of GDP in 2022, driven by revenue growth resulting from inflation and robust economic performance, alongside the continued withdrawal of Covid-support measures, and further to 0.4% of GDP in 2023. These elements have helped counter the rise in general government expenditure, including measures to support households and businesses amid rising inflation, such as subsidies and the electricity price cap mechanism, amounting to a total of 1.5% of GDP. The government's absolute majority in parliament reinforces its credibility in achieving fiscal consolidation, enabling the country to achieve the fastest recovery in primary balance compared to its rating peers. We expect the primary balance to reach a surplus already in 2022 of 0.9% of GDP, from a deficit of 0.5% of GDP. These developments enhance the country's long-term fiscal sustainability by providing greater capacity to manage fiscal pressures.
- **Debt trajectory:** Public debt-to-GDP ratio resumed its downward trajectory in 2021 and declined to 125.4% in Q4 2021, after 134.9% of GDP reached at end-2020. We expect the return to primary surpluses through conservative fiscal management will maintain the downward debt trajectory and anticipate the debt-to-GDP ratio will continue decline to 113.5% in 2022 – already below pre-pandemic levels of 116.6% - and to 108.4% in 2023, supported by high nominal growth and inflation, before converging towards 91% of GDP by 2027. The declining trajectory will be also supported by contained rise in interest burden and reduced total guarantees (3.1% of GDP in 2022 vs 4.7% of GDP in 2021).
- **Debt profile and market access:** Portugal has a strong debt profile and enjoys excellent market access, with the cost of its outstanding debt steadily declining in recent years. In 2022, this cost was 1.8% of GDP, declined from 4.1% in 2011 and slightly below 2021 levels (1.9%). Additionally, the average debt maturity as of February 2023 was around 7.7 years, providing a cushion against the impact of higher interest costs. However, these costs are expected to increase to 2.5% of GDP this year, up from 2.1% of GDP in 2022. Portugal's cash buffers remain comfortable, with EUR 6.3bn (2.6% of 2022 GDP). Furthermore, these buffers are projected to increase to EUR 8bn this year, covering around one third of State borrowing requirements.

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

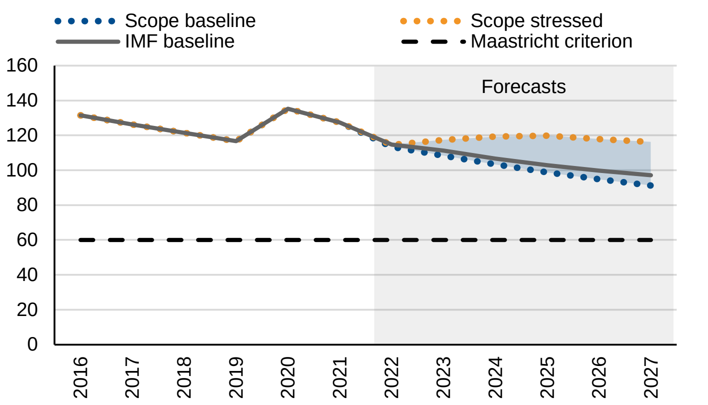
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Fiscal policy framework	Strong	+1/3	Commitment to fiscal consolidation resulted in sustained improvements in fiscal fundamentals with declining budget deficits and rapid recovery in primary balance
	Debt sustainability	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

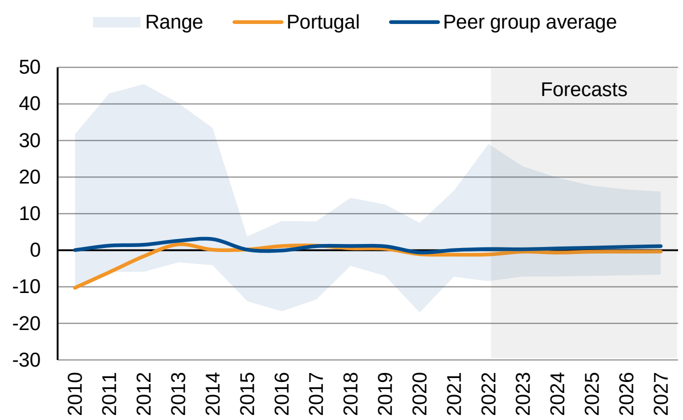
External Economic Risks

- **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. Despite the challenges posed by higher import prices, the negative effect on the trade deficit has been mitigated due to the recovery in goods exports and increased service exports driven by tourism activities. Nevertheless, the modest current account deficit (-1.3% of GDP in 2022) is anticipated to persist this year due to continuing inflationary pressures and lower external demand. Portugal has limited direct trade exposure with Ukraine or Russia, with these countries accounting for just 1.7% of total imports and 0.4% of total exports.
- **External position:** The significant negative Net International Investment Position (NIIP) showed an improvement, declining from -102.1% of GDP in 2020 to -87.8% in 2022 and is expected to continue to improve in the medium-term, reaching around -78.0% in 2023. Although the high level of external debt poses risks, these risks are partially mitigated by its favorable composition, with a growing proportion of equity-based foreign direct investment. Portugal's gross external debt remains high but is on a downward trend, falling from 204.8% of GDP at the end of 2020 to 167.9% in 2022. General government accounts for the highest share of foreign debt (32% as of Q3 2022), followed by the Central bank (26%) and other financial institutions (14%).
- **Resilience to shocks:** All euro area members including Portugal benefit from the euro's status as a global reserve currency, significantly mitigating risks to external shocks. However, the small and highly open economy's current account balance and GDP growth are highly susceptible to external economic shocks and second-round effects, including shifts in growth prospects in key European trading partners and tourism exports.

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

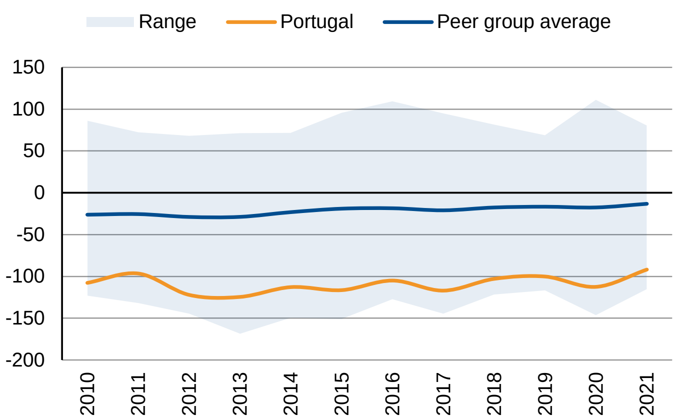
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Current account resilience	Weak	-1/3	Dependence on tourism sector may temporarily weaken external trade
	External debt structure	Neutral	0	Elevated debt stock, with meaningful shares held by the government and central bank
	Resilience to short-term external shocks	Weak	-1/3	Small and highly open economy; uncertain external environment

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 maintained adequate capital buffers (CET1 ratio at 17.2% as of Q3 2022) and stable funding structure. Non-performing loan (NPL) ratios steadily declined from the peak of 20% reached in 2016, to 3.2% in Q3 2022. In recent years, liquidity indicators, with the liquidity coverage ratio (LCR) at 262% as of June 2022, almost unchanged compared to December 2021. The increase in customer deposits from December 2021 to June 2022 was 4.5%, accounting for 69.4% of assets. During the first half of 2022, the Portuguese banking system's return on assets (ROA, 0.71%) exceeded the average ROA of the Euro area (0.43%). Unlike the declining trend observed in previous years, the net interest income has contributed more to the ROA. This was due to an increase in interest income from loans and debt securities. In June 2022, sovereign debt securities accounted for 14.2% of assets – shielding banks' exposure to the current financial market volatility – with Portuguese debt accounting for slightly less than half of the portfolio.

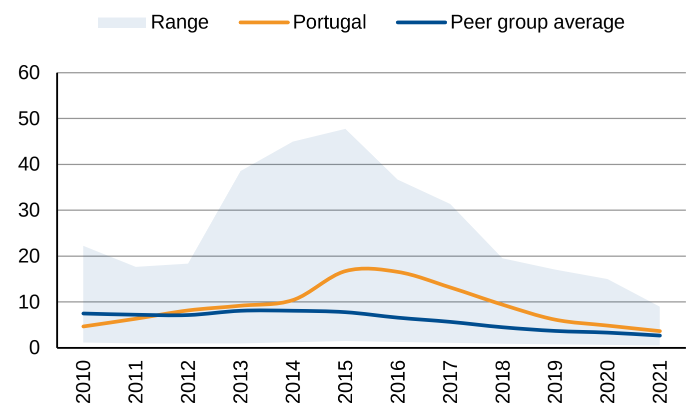
- **Private debt:** Households' and non-financial corporations' debt has decreased overtime, being at 62.7% of GDP and 95.4% of GDP as of Q3 2022, respectively, below pre-Covid levels. The pre-pandemic period was characterized by a reduction in the weight of indebtedness in income, as well as increased labour market participation and household disposable income. During the pandemic, the sector's greater resilience to the interest rate rise was supported by credit moratoria, income support, and increased saving rates, which led to an accumulation of bank deposits. However, household saving capacity varies, and households with less liquid assets may struggle to accommodate higher debt service burdens if high inflation persists. Moreover, the debt service burden on bank loans for house purchase, primarily with a variable interest rate, has been on the rise.

- **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. Housing prices remained on an increasing trajectory through 2022, on the back of high housing demand by non-resident, limited house supply and, more recently, labour and material shortages.

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

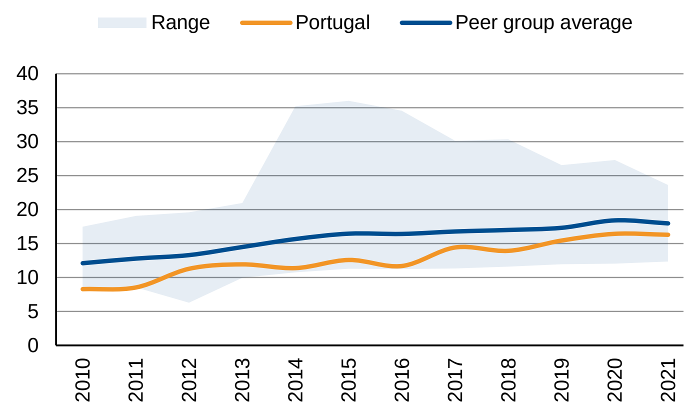
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Banking sector performance	Neutral	0	Banking-system capitalisation remains sound but NPL ratio remains high compared to peers
	Banking sector oversight	Neutral	0	Effective oversight under European Banking Union authorities 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

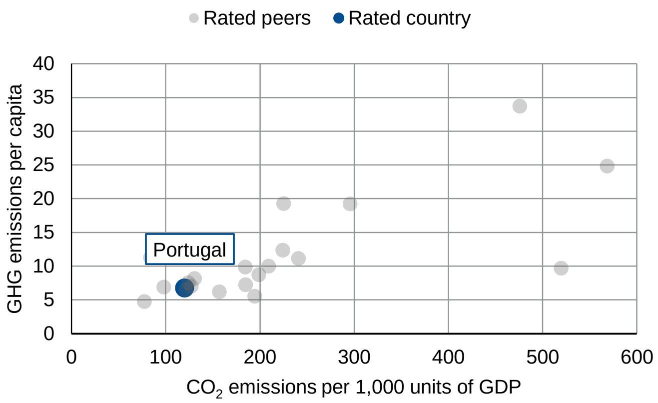
ESG Risks

- **Environment:** In recent years, Portugal has faced several environmental challenges, including forest fires, droughts, and floods in certain regions. These natural disasters have highlighted the need for sustainable policies. Despite these challenges, Portugal has demonstrated its commitment to environmental protection by being among the first EU nations to commit to achieving net-zero emissions by 2050. Achieving this ambitious target will require significant investments in renewable energy and carbon reduction measures. The government has already implemented several initiatives to support the transition towards a low-carbon economy, such as subsidies for electric vehicles and renewable energy projects. Air quality in Portugal remains a concern, particularly in major metropolitan areas. The use of personal transport systems exacerbates seasonal air quality issues and traffic congestion.
- **Social:** Portugal faces challenges related to its ageing population, which is reflected in the country's increasing old-age dependency ratio over the long term. This demographic trend is expected to worsen, with the old-age dependency ratio projected to exceed 60 by 2050, one of the highest levels in the EU. Additionally, youth unemployment remains a significant concern, although Portugal has taken measures to address this issue. Despite above-average scores on income inequality and labour force participation rates, the country has implemented legislation to address the gender pay gap. The European Commission projects that Portugal will face an increase in health spending of 1.6 percentage points of GDP between 2019 and 2070, the fourth highest in the European Union. These factors suggest that Portugal will need to take additional measures to manage the impacts of an ageing population and address youth unemployment to maintain its social stability and ensure long-term economic sustainability.
- **Governance:** Portugal scores strongly on a composite index of six World Bank Worldwide Governance Indicators, indicating the presence of robust democratic institutions. The country also enjoys stable political conditions and consensus on key policy issues. This recognition acknowledges the authorities' effective implementation of prudent fiscal policies and structural reforms, such as rebalancing the current account and reducing structural unemployment.

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

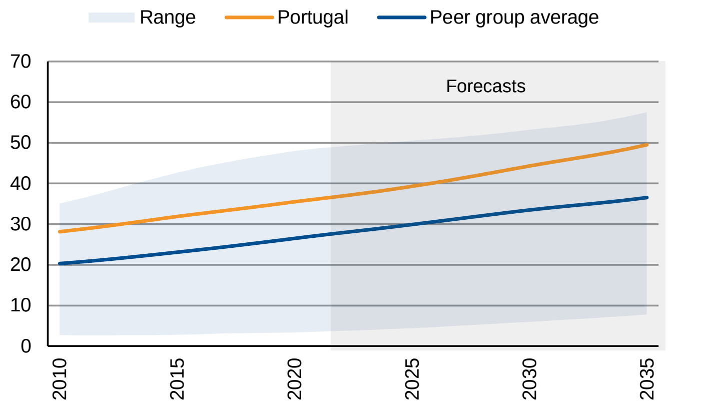
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Environmental risks	Neutral	0	Exposure to natural disasters, ambitious commitment to achieve carbon neutrality by 2050
	Social risks	Weak	-1/3	Adverse demographics; income inequality and risk of social exclusion
	Institutional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

Emissions per GDP and per capita, $mtCO_2e$



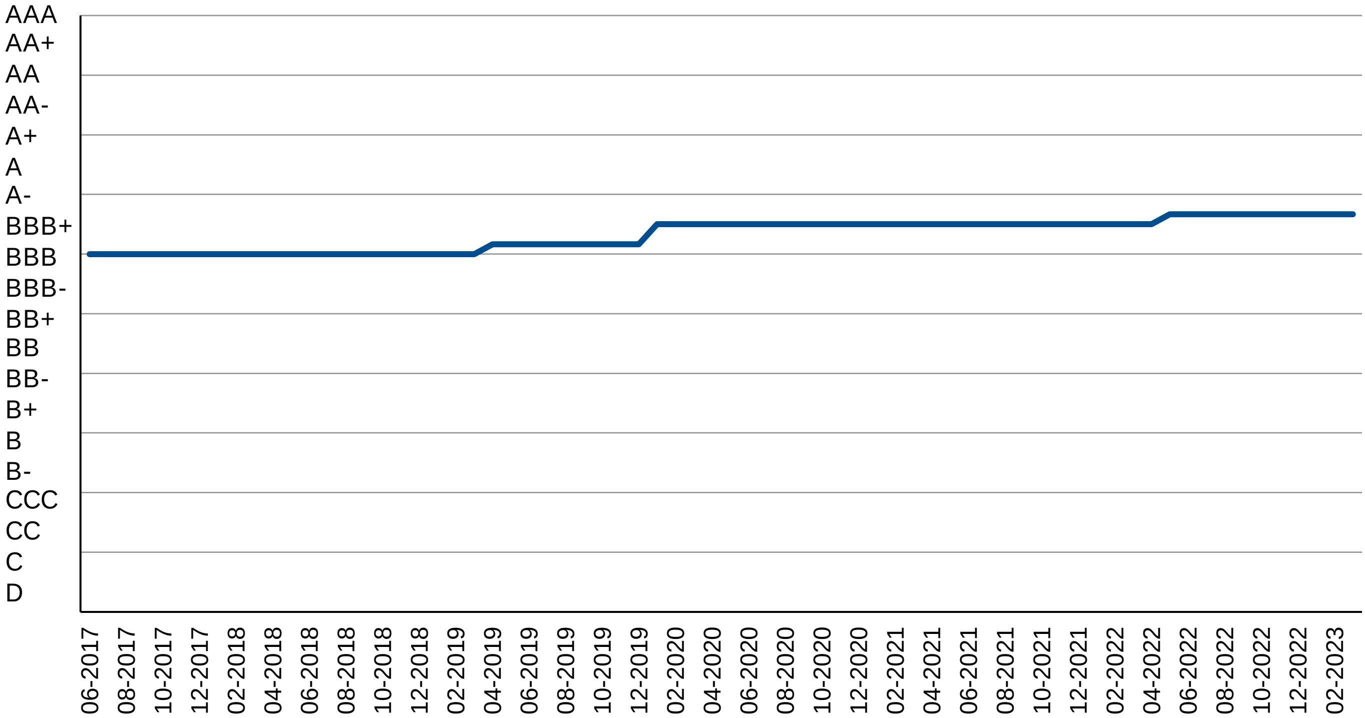
Source: European Commission, Scope Ratings

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

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

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.

*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	2017	2018	2019	2020	2021	2022
Domestic Economic	**GDP per capita, USD '000s**	IMF	21,483	23,573	23,333	22,177	24,296	24,910
	Nominal GDP, USD bn	IMF	221.3	242.4	240.0	228.4	250.1	255.9
	Real growth, %	IMF	3.5	2.8	2.7	-8.4	4.9	6.2
	CPI inflation, %	IMF	1.6	1.2	0.3	-0.1	0.9	7.9
	Unemployment rate, %	WB	8.9	7.0	6.5	6.8	6.6	-
Public Finance	**Public debt, % of GDP**	IMF	126.1	121.5	116.6	135.2	127.4	114.7
	Interest payment, % of revenue	IMF	8.5	7.5	6.6	6.4	5.1	4.6
	Primary balance, % of GDP	IMF	0.7	2.9	2.9	-3.1	-0.5	0.1
External Economic	**Current account balance, % of GDP**	IMF	1.3	0.6	0.4	-1.0	-1.2	-1.1
	Total reserves, months of imports	IMF	2.9	2.5	2.5	3.5	3.1	-
	NIIP, % of GDP	IMF	-117.2	-103.1	-100.3	-112.7	-92.0	-
Financial Stability	**NPL ratio, % of total loans**	IMF	13.2	9.4	6.2	4.9	35.4	-
	Tier 1 ratio, % of risk-weighted assets	IMF	13.2	14.2	14.8	15.3	16.2	15.8
	Credit to private sector, % of GDP	WB	102.6	97.0	90.3	101.0	-	-
ESG	**CO_2 per EUR 1,000 of GDP, mtCO_2e**	EC	164.2	148.1	130.9	120.3	112.0	-
	Income share of bottom 50%, %	WID	18.9	19.5	19.6	20.0	20.0	-
	Labour-force participation rate, %	WB	74.9	75.4	75.8	-	-	-
	Old-age dependency ratio, %	UN	33.0	33.7	34.2	34.7	35.2	35.8
	Composite governance indicators*	WB	1.1	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 24 March 2023	52.1

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