Press Release: Neuss, 03 April 2020

Creditreform Rating revises Portugal's outlook to "stable", while affirming its ratings at "BBB"

Creditreform Rating has revised its outlook on the Republic of Portugal to "stable" from "positive" and affirmed the unsolicited long-term sovereign rating of "BBB". Creditreform Rating has also affirmed Portugal's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "BBB".

An update to Portugal's sovereign ratings and the related rating outlook was published on 03 April 2020 at 11:30pm CET. According to Creditreform Rating's Sovereign Rating Calendar 2020, the publication was originally scheduled for 20 March 2020. The publication date was postponed, as Creditreform Rating analysts wanted to have a sufficient amount of time to thoroughly review and internally discuss the implications of the escalating corona pandemic for the quantitative and qualitative analyses and the impact on the relevant key rating drivers.

This appears particularly necessary in light of the assessment and interpretation of economic developments in the near future. These are much more challenging at present, as is the case regarding other indicators, given the current considerable uncertainty in the economy and financial markets and the very dynamic development of Covid-19. Whilst reliable hard economic data is not yet available, the highly dynamic unfolding of events suggests considerable economic and fiscal effects.

Agência de Gestão da Tesouraria e da Dívida Pública (IGCP) was informed of the deviation from the publication date in a timely manner, and took notice of the postponement.

Reasons for the Outlook Revision

The outlook for the long-term credit ratings of the Republic of Portugal has been revised from positive to stable, reflecting our expectation that

(i) economic developments will weaken significantly in the near term, accompanied by a deterioration in labor market conditions, before presumably entering a recovery; and

(ii) the improvement in the sovereign's public finances will come to a halt, mainly reflected in an ad hoc increase in the public debt ratio, although the latter should resume its downward trend over the medium term; however, fiscal risks have generally risen against the backdrop of heightened volatility in government bond yields and potentially re-emerging uncertainty over banking stability.

Contact

Dr. Benjamin Mohr
Head of Sovereign Ratings

Creditreform Rating AG
Hellersbergstraße 11
D - 41460 Neuss
b.mohr@creditreform-rating.de

Reasons for the Rating Decision

Apart from the substantial uncertainties currently weighing on prospects for the Portuguese economy due to the corona crisis, an otherwise robust macroeconomic performance in our view remains balanced to a certain degree by a subdued medium-term growth outlook owing to still elevated albeit decreasing non-financial corporation (NFC) debt, which could restrain investment activity, as well as to comparatively low productivity.

Portugal's economic growth remained solid; having softened from 2.6 to 2.2% in 2018-19, it nevertheless outpaced euro area real GDP growth by a substantial margin (2019: 1.2%). We note that Portugal's solid output expansion translated into higher – albeit in a euro area comparison still subdued – levels of wealth, with GDP per capita (PPP levels, IMF data) amounting to USD 33,665 in 2019, or 76% of the weighted EU-28 average (2018: 75%).

In 2019, the unemployment rate decreased to 6.5% (EA average: 7.6%), whilst employment growth slowed markedly to 0.8% in 2019 (EA: 1.2%), from 2.3% in 2018. However, the ongoing, although decelerating, labor market recovery may end rather abruptly in the face of the substantial challenges associated with the corona crisis.

Portugal's credit ratings continue to mirror the generally high quality of its institutional framework. The sovereign's institutional strength is mainly reflected in the latest edition of the World Bank's Worldwide Governance Indicators (WGIs). Portugal thus shows a solid performance across the WGIs we consider, in particular as compared to other former program countries. Compared to the respective euro area averages, Portugal's WGI performance is broadly on par, with the notable exception of government effectiveness, where Portugal ranks 29th out of 209 (EA median: 36), indicating a relatively high quality of policy formulation and implementation.

Despite considerable consolidation effort, risks to the sovereign's fiscal sustainability continue to be its main credit weakness, which is mainly due to very high government debt and elevated, though falling, interest expenses, as well as contingent liability risks related to the banking sector.

Driven by solid economic growth, the benign interest rate environment and increasingly sound fiscal policies, the headline budget has persistently improved over the years. According to INE Portugal data, the sovereign recorded a headline surplus of 0.2% of GDP in 2019, up from -0.4% of GDP in 2018 and the first surplus since Portugal's transition to democracy. Accordingly, general government gross debt declined markedly, from 122.0% of GDP in 2018 to 117.7% of GDP in 2019, still representing one of the highest readings in the EU. Debt affordability continues to compare unfavorably among EU countries, with interest payments accounting for 7.0% of general government revenue (2018: 7.9%).

Having become more open to international trade over recent years, Portugal's economy remains vulnerable to risks emanating from the external sector. The net international investment position (NIIP) posted at -100.8% of GDP in 2019, significantly less negative than the previous year's level, but still among the most negative readings in the EU. According to Banco de Portugal data, the current account slipped into a slight deficit, declining to -0.1% of GDP in 2019 (2018: 0.4% of GDP), mainly due to a narrowing trade in services balance.

Rating Sensitivity

Downward pressure on Portugal's ratings or the related outlook could arise if medium-term growth is adversely affected, which could be the case if the detrimental effects of the corona pandemic extend well into the second half of the year and beyond, and if policy-makers fail to minimize the economic fallout. We could also consider a downgrade if the interruption of the downward trend in Portugal's debt-to-GDP ratio is not transitory and we see the public debt trajectory reverse, and/or if contingent liabilities stemming from the banking sector materialized.

We could raise the sovereign's ratings if medium-term growth surprised on the upside, if the negative labor market effects of Covid-19 turn out to be short-lived, if the government is able to implement structural reforms to enhance the economy's external competitiveness and its medium-term growth potential on a sustainable basis, and/or if we perceive that crisis legacies in the banking sector are no longer an issue, thereby reducing contingent liability risks.

Visit www.creditreform-rating.de to read the full rating update, which contains the rating outcome as well as the reasons for the rating decision and the related outlook.

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. Agência de Gestão da Tesouraria e da Dívida Pública (IGCP) participated in the credit rating process as IGCP provided additional information and data, and commented on a draft version of the report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of IGCP during their review. However, the rating outcome as well as the related outlook remained unchanged.

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology in conjunction with its basic document "Rating Criteria and Definitions". CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on the following internet page: www.creditreform-rating.de/en/regulatory-requirements/.

To prepare this credit rating, CRAG has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking

Authority, European Central Bank, Agência de Gestão da Tesouraria e da Dívida Pública – IGCP, Banco de Portugal, Direção-geral da administração e do emprego público (DGAEP), and Instituto Nacional de Estatística Portugal.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

Disclaimer