



# Portugal: BBB with Positive Outlook

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**Update on Portugal, April 2019, Frankfurt**

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    - Debt reduction and resilient debt profile
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## Portugal: BBB with Positive Outlook

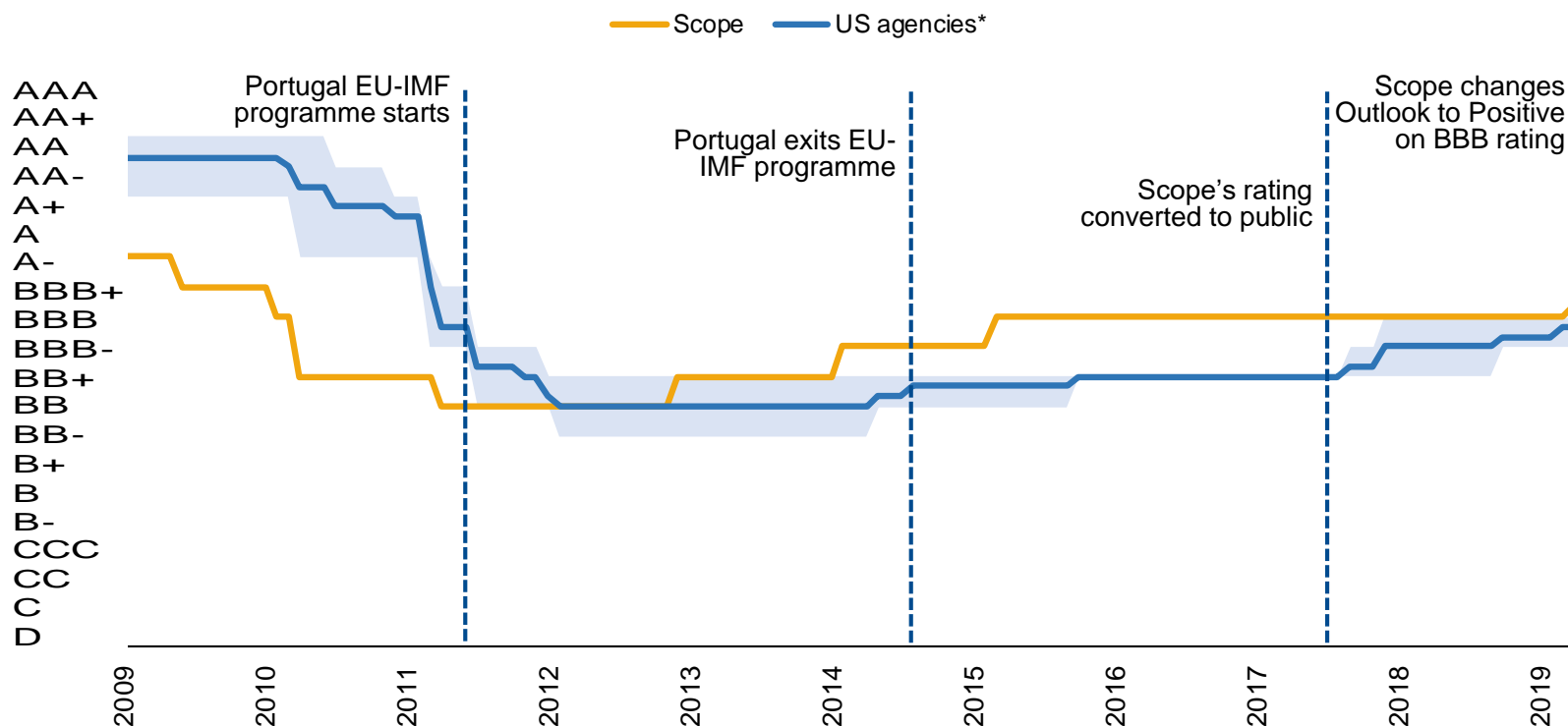
Context: Rating history and stable political environment

### ➤ Balancing fundamental developments with rating stability

- On 5 April Scope affirmed Portugal's BBB rating and changed the outlook to Positive

### Scope's rating history on Portugal vis-à-vis US competitors

Rating notches



\* Average of S&P, Moody's, Fitch.

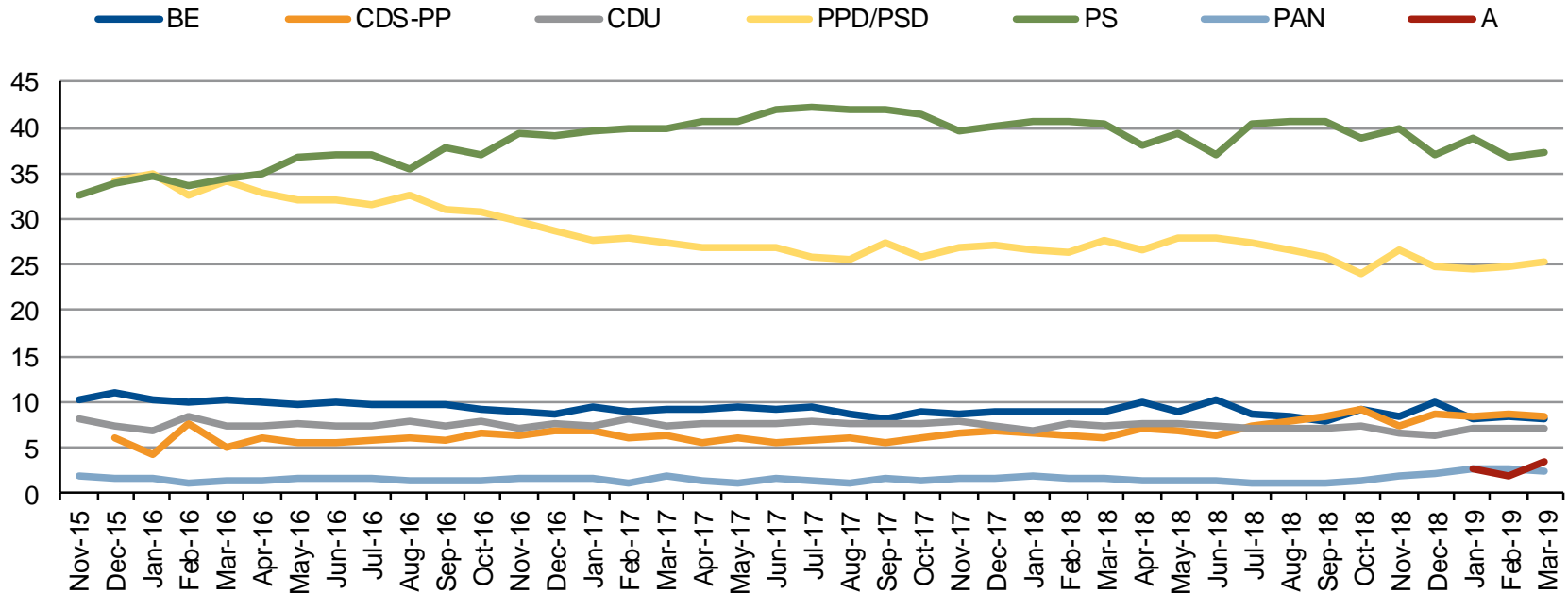
## Portugal: BBB with Positive Outlook

Context: Rating history and stable political environment

### ➤ Relatively stable political environment mindful of limited (fiscal) policy space

- Elections on 6 October expected to result in another government led by the ruling Socialist Party
- Contrasts Italy (policy reversal?) and Spain (policy paralysis amidst 3 elections in 4 years)

Chart polls since last election in 2015 (% of votes)



Source: [pollofpolls.eu](http://pollofpolls.eu), Scope Ratings GmbH  
 PS = Socialist Party; PPD/PSD = Social Democratic Party; CDS/PP = CDS People's Party; BE = Left Bloc; PCP-PEV = Unitary Democratic Coalition; A = Alliance

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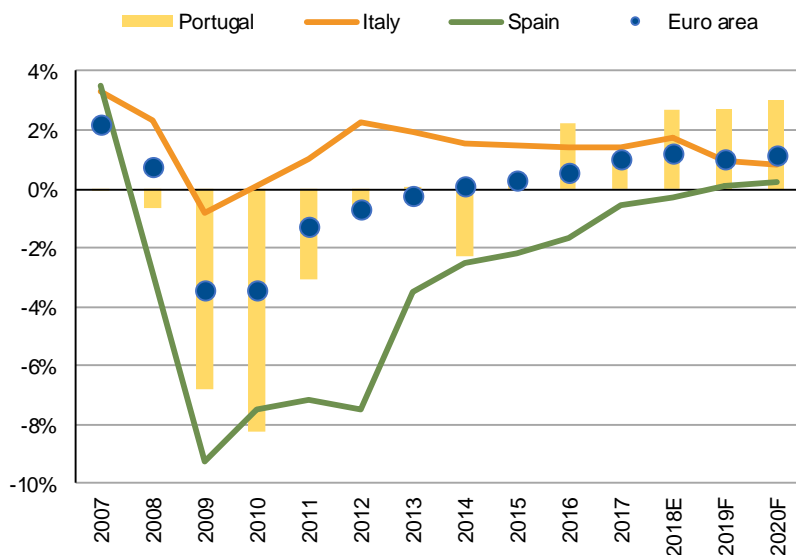
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## Portugal: BBB with Positive Outlook

First Positive Outlook driver: Debt reduction and resilient debt profile

### Primary balances

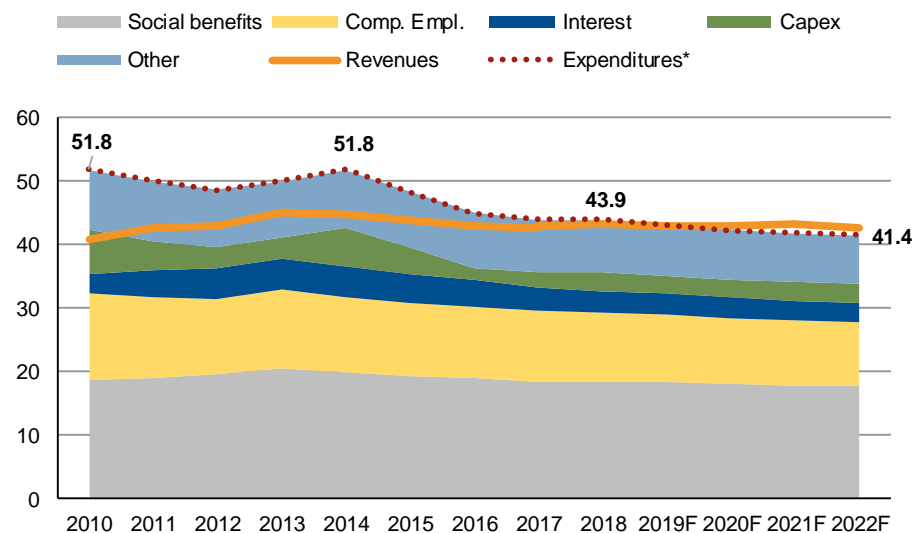
% of GDP



Source: AMECO, Scope Ratings GmbH

### Revenue Expenditure chart

% of GDP



Source: IGCP, Scope Ratings GmbH

### ➤ Significant fiscal adjustment, mostly expenditure-driven

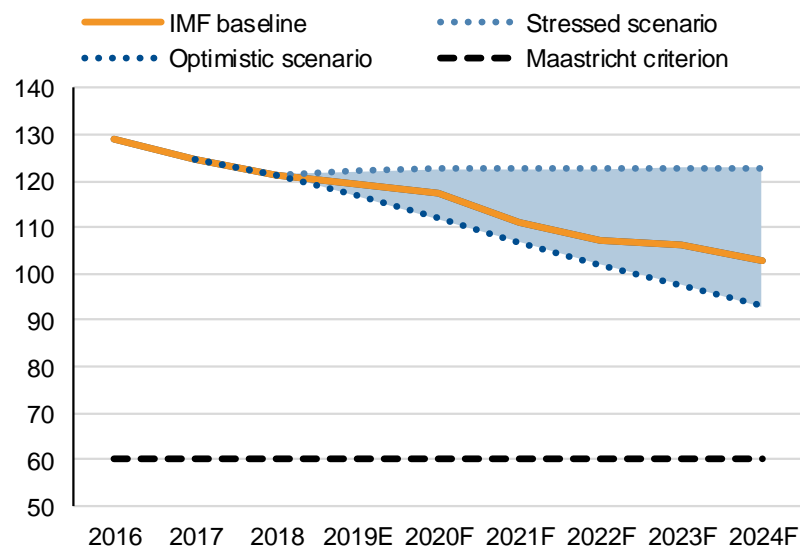
- Large cyclical component (benefits, interest payments); some structural elements (spending review)
- Gains from economic recovery (labour market) expected to persist; public investment recovery

## Portugal: BBB with Positive Outlook

First Positive Outlook driver: Debt reduction and resilient debt profile

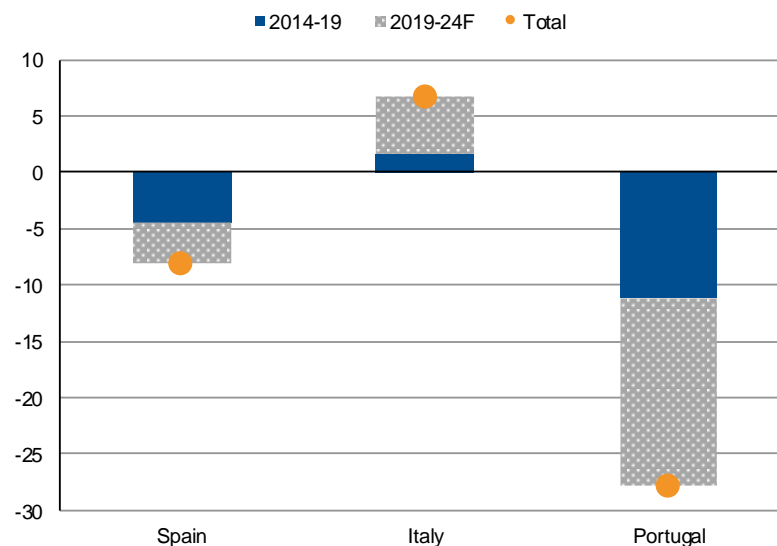
### Debt sustainability analysis

Debt, % of GDP



### Debt reduction projections

% of GDP



Source: IMF, Scope Ratings GmbH

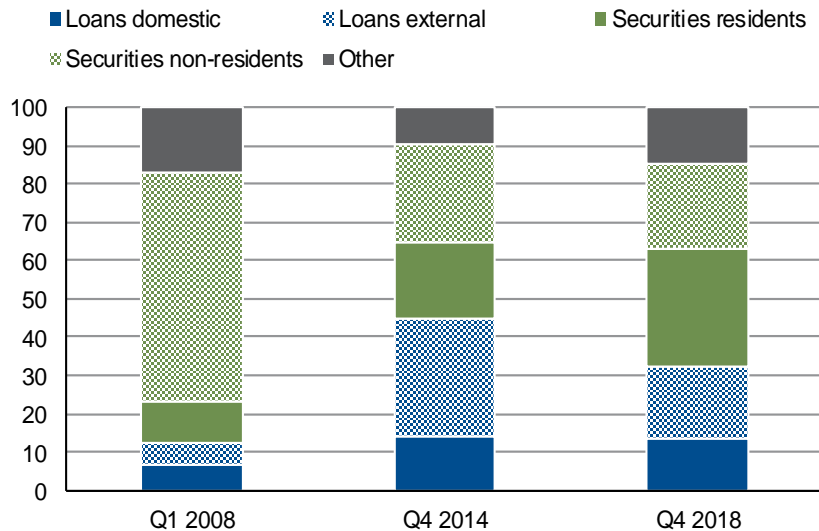
Scenario	Time period	Real GDP growth (%)	Primary bal. (% of GDP)	Real eff. int. rate (%)	Debt, end period (% of GDP)
History	2014-18	1.9	0.5	1.5	121.4
IMF baseline	2019-24	1.5	3.1	0.9	102.7
Optimistic scenario		2.0	3.3	0.8	92.9
Stressed scenario		0.5	1.1	1.5	122.8

## Portugal: BBB with Positive Outlook

First Positive Outlook driver: Debt reduction and resilient debt profile

### Government debt holders

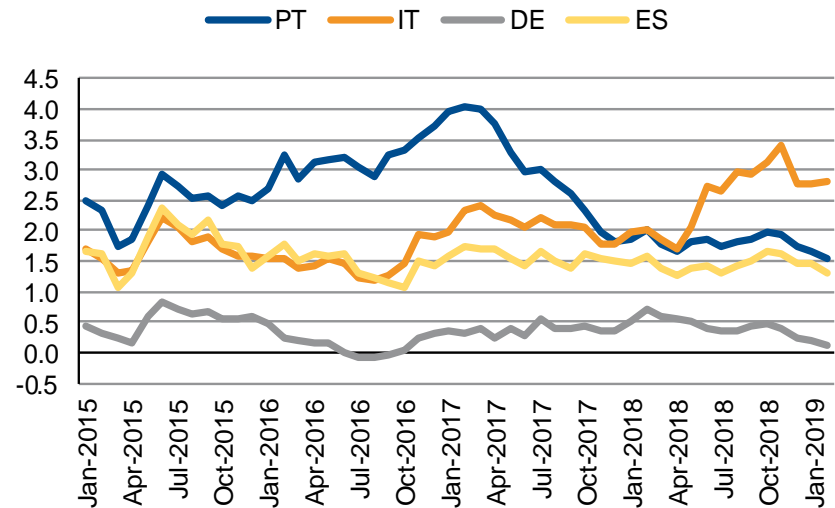
% of total debt



Source: Haver, Bank of Portugal, Scope Ratings GmbH

### 10-year Government bond yields

%



Source: FT, Bdl, TPI, BDE

### ➤ Active debt management and favourable financing environment

- Significantly smoothened debt profile (IMF fully repaid)
- Large cash buffer (>50% of next year's gross financing needs)
- Investor base shift to stable sources of funding



**Portugal's  
resilient market  
access**



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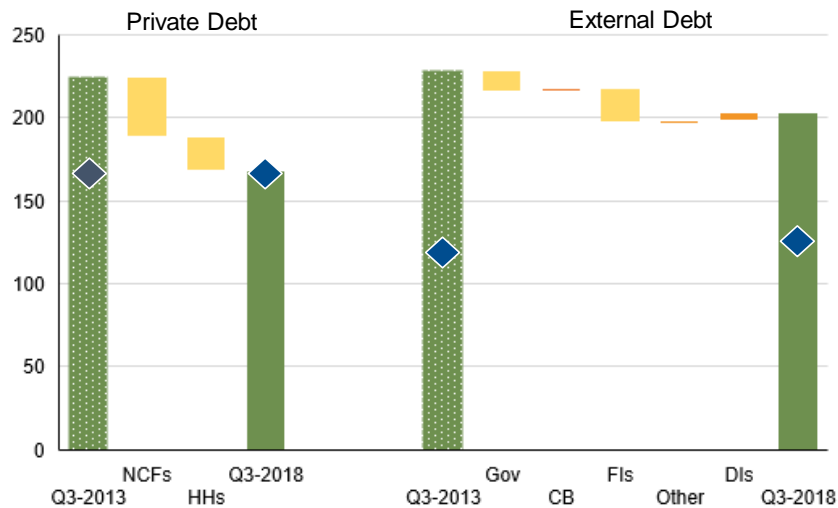
- ✓ Context: Rating history and stable political environment
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## Portugal: BBB with Positive Outlook

Second Positive Outlook driver: Gradual unwinding of imbalances

### Private and external debt: 2018 vs 2013

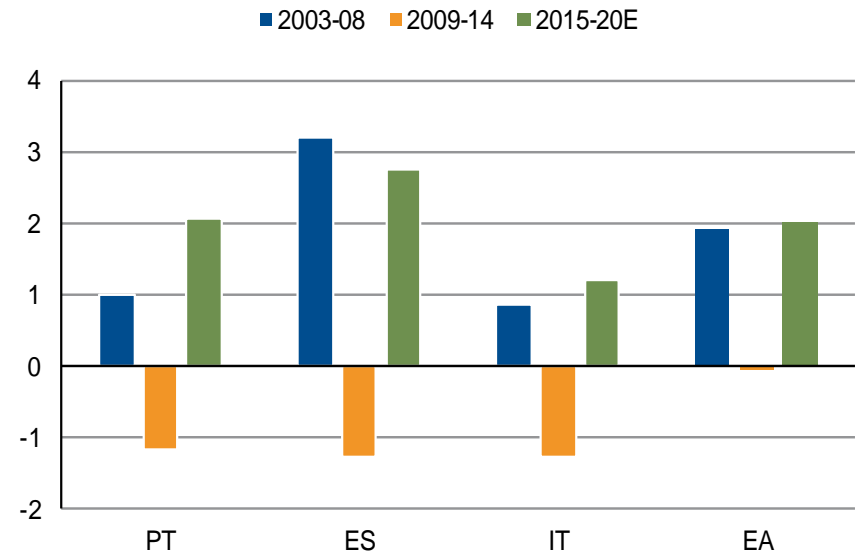
% of GDP, versus euro area average ◆



Source: Haver, BdP, PTINE, ECB, Scope Ratings GmbH

### Real GDP growth

%



Source: Haver, AMECO, Scope Ratings GmbH

➤ Declining private and external debt

➤ Supported by robust economic recovery

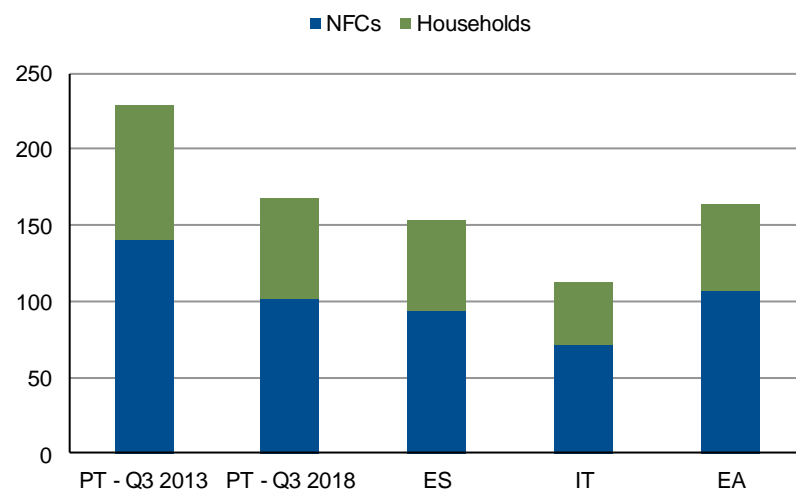
➤ Growth in line with euro area

## Portugal: BBB with Positive Outlook

Second Positive Outlook driver: Gradual unwinding of imbalances

### Private sector debt

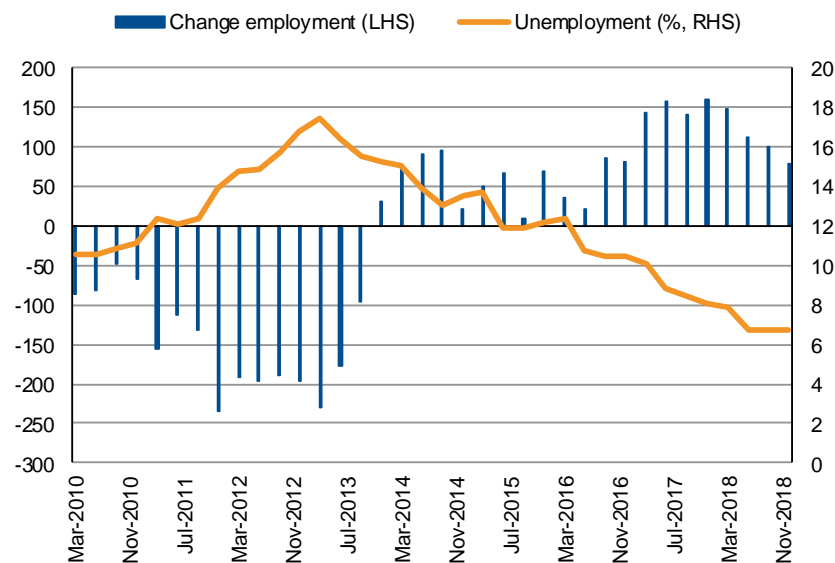
% of GDP



Source: Haver, INE, Scope Ratings GmbH

### Employment and unemployment

4-quarter moving sum ('000s), % labour force



Source: Haver, INE, Scope Ratings GmbH

### ➤ Marked decline in private debt

- In line with euro area

### ➤ Labour market turnaround

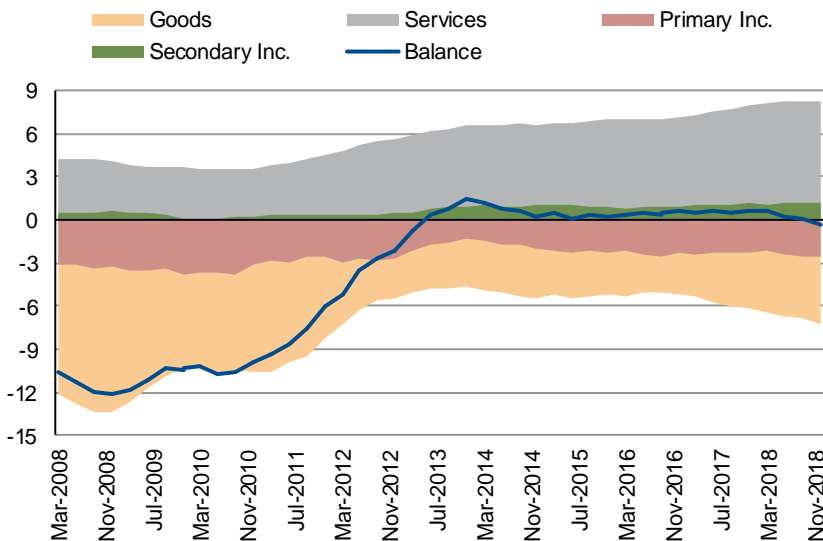
- Unemployment to record low level
- Employment growth slowing but continuing

## Portugal: BBB with Positive Outlook

Second Positive Outlook driver: Gradual unwinding of imbalances

### Current account

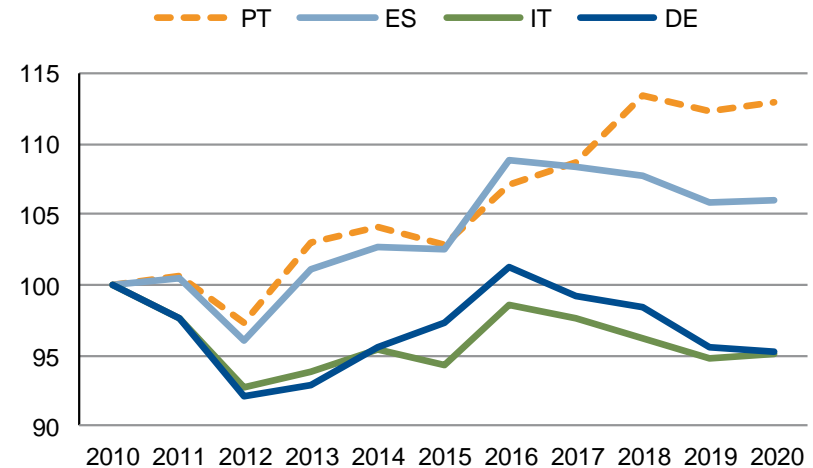
% of GDP



Source: Haver, Bank of Portugal, Scope Ratings GmbH

### Share of world exports

Incl. EU; 2010 = 100



Source: Haver, National central banks, Eurostat, Scope Ratings GmbH

### ➤ Significant turnaround in Portugal's external imbalance

- Driven by structural rebalancing of the economy; competitiveness gains; export diversification
- Balanced current account over medium-term

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### ➤ Remaining challenges

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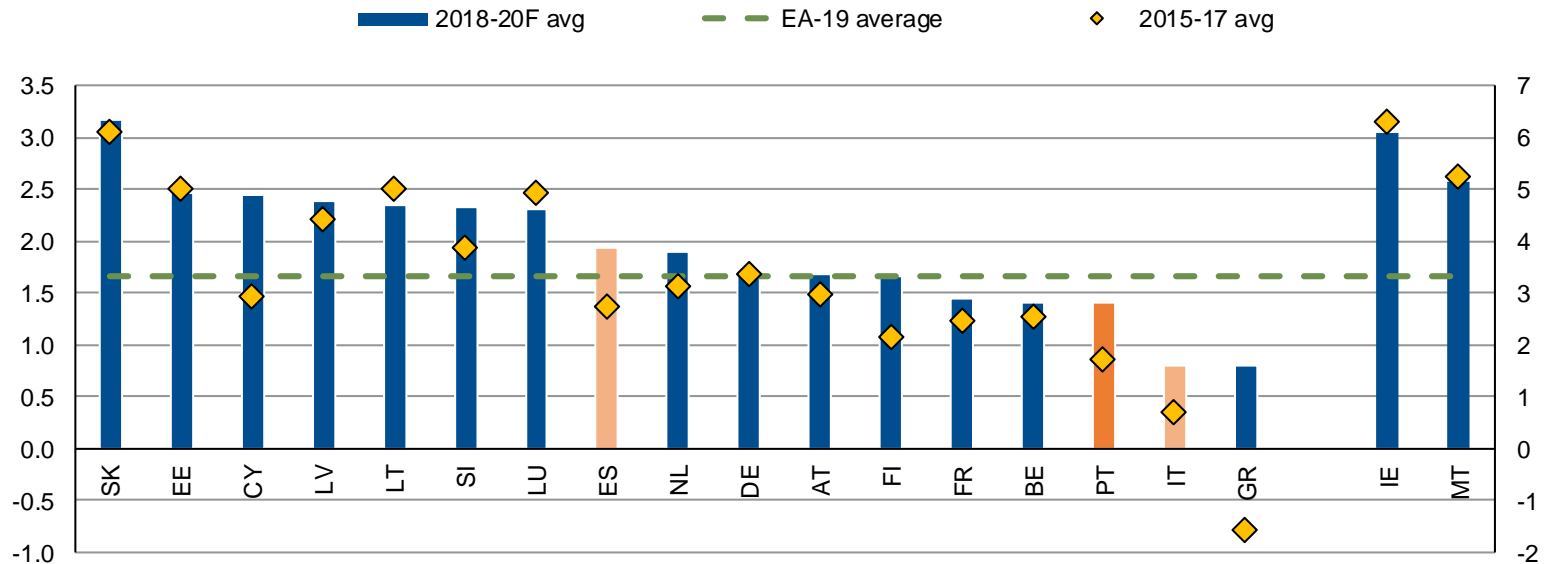
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## Portugal: BBB with Positive Outlook

Remaining challenges: 1. Potential growth

### GDP potential growth

3Y average, 2018-2020F vs 2015-2017, %



Source: Haver, AMECO, Scope Ratings GmbH.  
NB. IE and MT on RHS.

#### ➤ Structural reforms

- Significant improvement in labour market; increases in competitiveness

#### ➤ Structural challenges

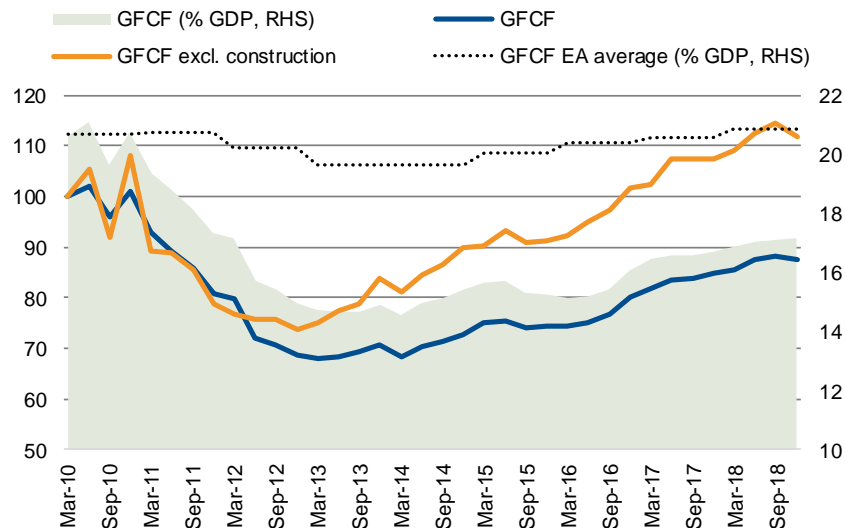
- Productivity: low skilled labour force; Investment: Recovering but below euro area

## Portugal: BBB with Positive Outlook

Remaining challenges: 1. Potential growth

### Investment

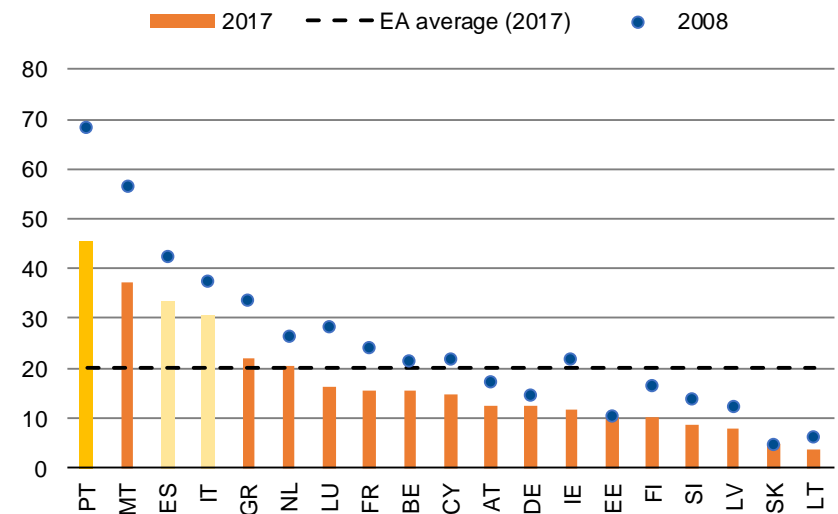
Gross fixed capital formation, 2010=100, % of GDP



Source: Haver, INE, AMECO, Scope Ratings GmbH

### Share of low-skilled employed

15-64 years, % total employment



Source: Eurostat, Scope Ratings GmbH

### ➤ Investment

- Full recovery excluding construction
- But overall level well below euro area average

### ➤ High low-skill, low-wage population

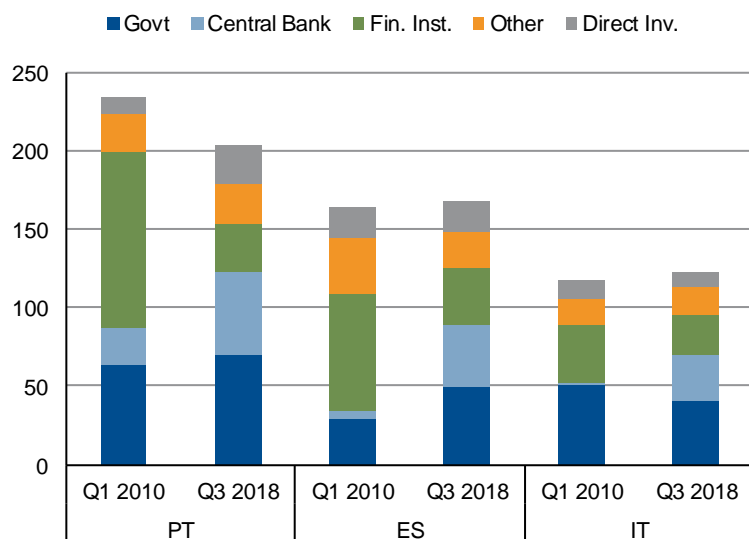
- Weighs on productivity growth, tax revenue base and creates inequality and poverty risks

## Portugal: BBB with Positive Outlook

Remaining challenges: 2. External imbalance

### External debt

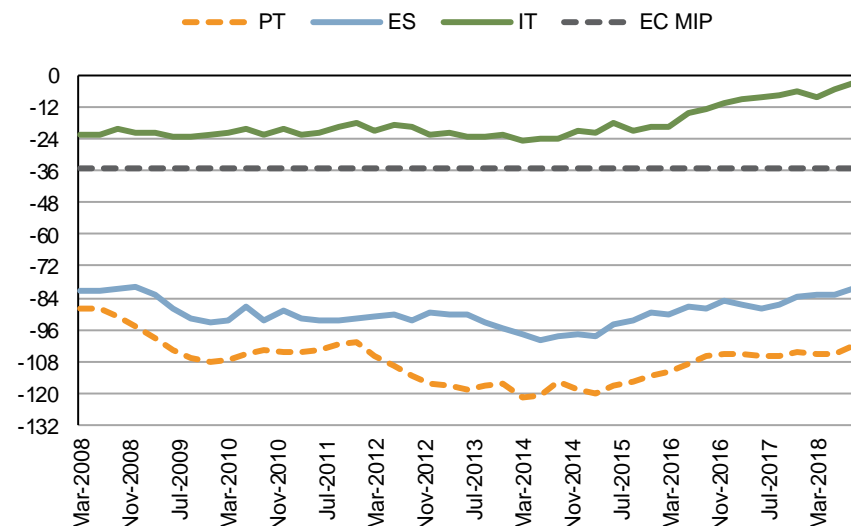
% of GDP



Source: Haver, Bank of Portugal, Scope Ratings GmbH

### Net International Investment Position

% of GDP



Source: Haver, National central banks, Eurostat, Scope Ratings GmbH

### ➤ Despite decline in external debt, external imbalances remain high

- High negative Net IIP remains a source of concern
- Requires sustained current account surpluses (2018 minor deficit)
- Still, external debt risks mitigated by composition (official loans; FDI inflows)

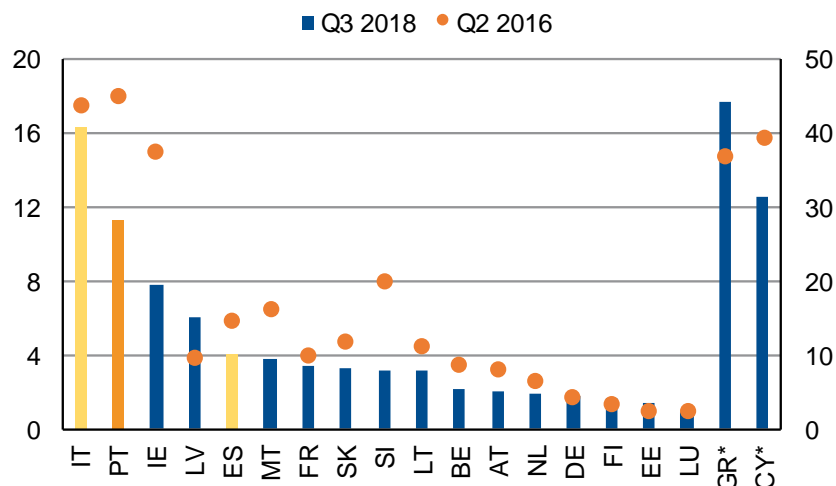


## Portugal: BBB with Positive Outlook

Remaining challenges: 3. Banking sector

### Asset quality: NPLs

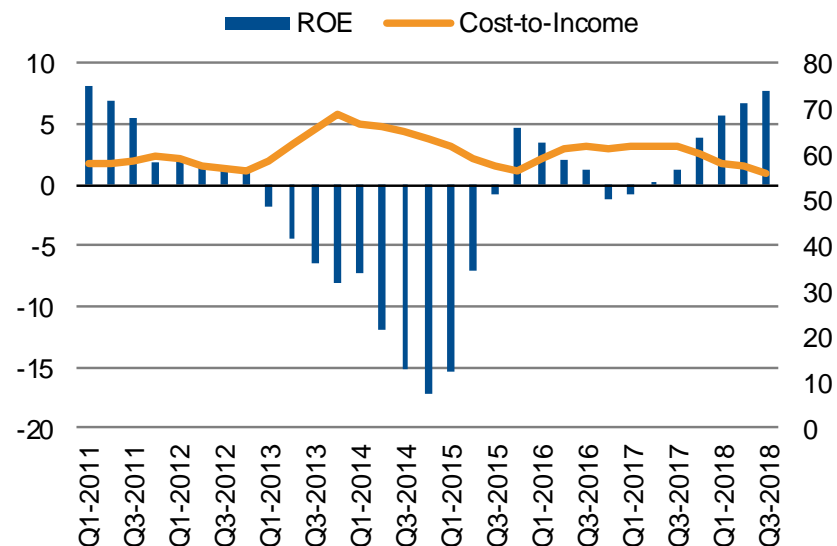
% of total gross loans



Source: Haver, IMF, Scope Ratings GmbH; NB:\*RHS

### Profitability: ROE and Cost-to-income ratio

4-quarter moving average, %



Source: Haver, Bank of Portugal, Scope Ratings GmbH

### ➤ Stabilisation of the banking sector

- Sizeable reduction in NPLs; capital and liquidity ratios in line with recommendations

### ➤ Improving profitability; cost reduction

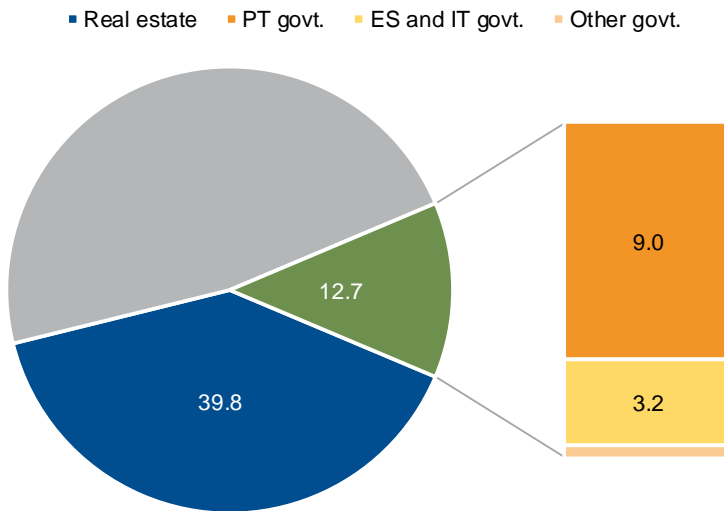
- Cyclically driven as income gains due to impairments reduction

## Portugal: BBB with Positive Outlook

Remaining challenges: 3. Banking sector and housing

### Bank exposure to sovereign and real estate

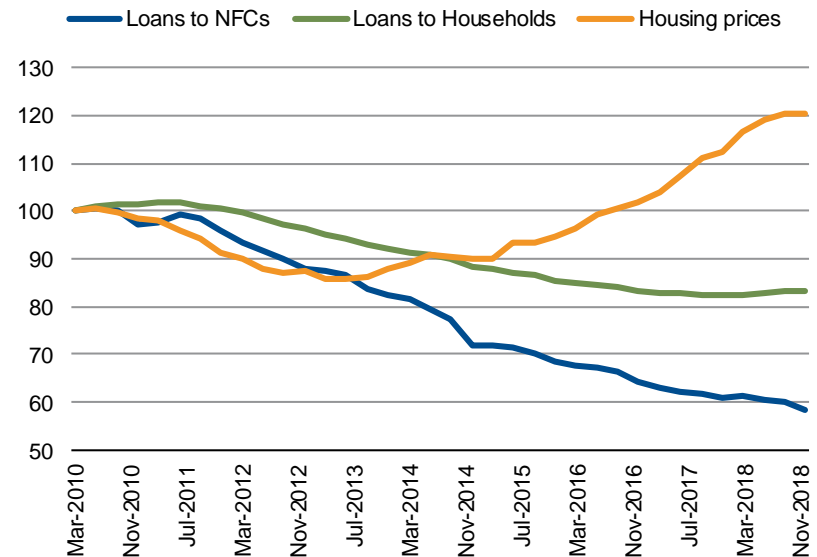
% of total assets



Source: Banco de Portugal, Scope Ratings GmbH

### Housing and credit

Index (2010-Q1 =100)



Source: Haver, ECB, Scope Ratings GmbH

### ➤ Banks' high exposure to sovereign and real estate assets

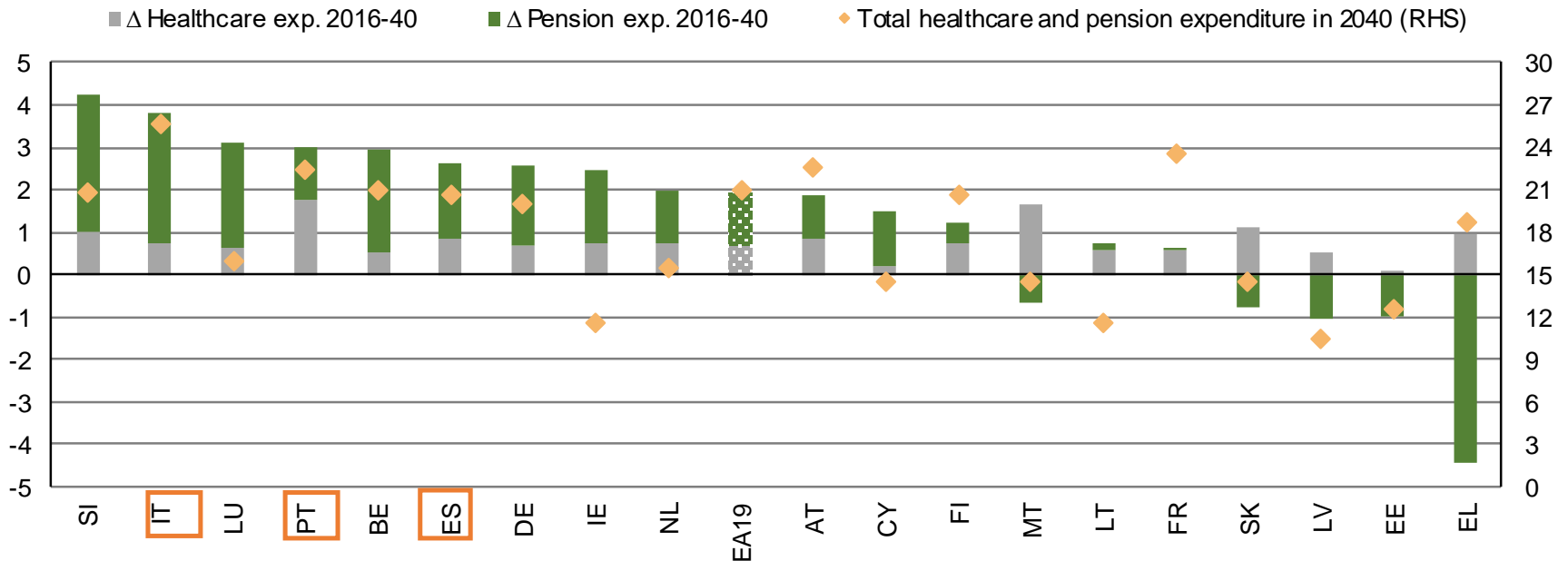
- High share of government bonds and real estate assets in banks balance sheets warrant monitoring
- Real estate prices give first sign of overvaluation, but price rebound not generated by debt accumulation
- Households remain fragile with low savings rate

## Portugal: BBB with Positive Outlook

Remaining challenges: 4. Ageing-related expenditure

### Implicit liabilities

% GDP



Source: EC 2018 Ageing Report, Scope Ratings GmbH

### ➤ Ageing related expenditure developments pose challenges

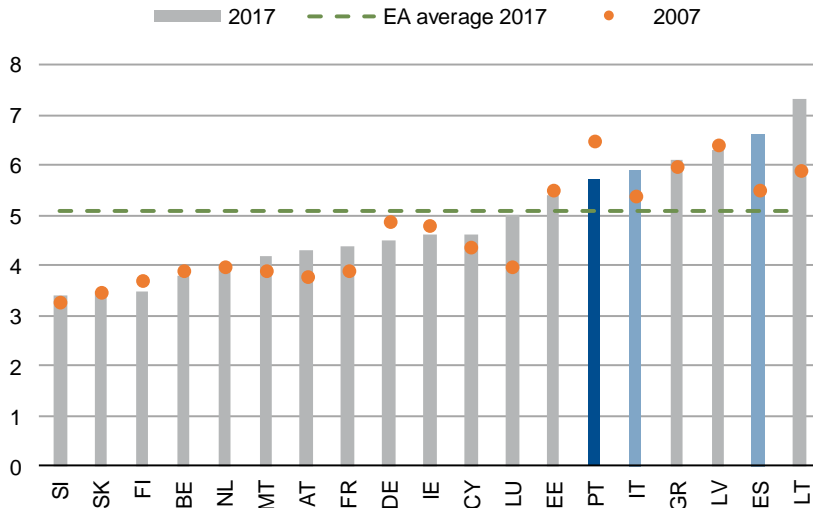
- The increase in healthcare expenditure projected to be one of the highest among euro area peers
- Portugal to have one of the highest healthcare and pension expenditures (in % of GDP) by 2040

## Portugal: BBB with Positive Outlook

Remaining challenges: 5. Inequality and poverty

### Income quintile share ratio

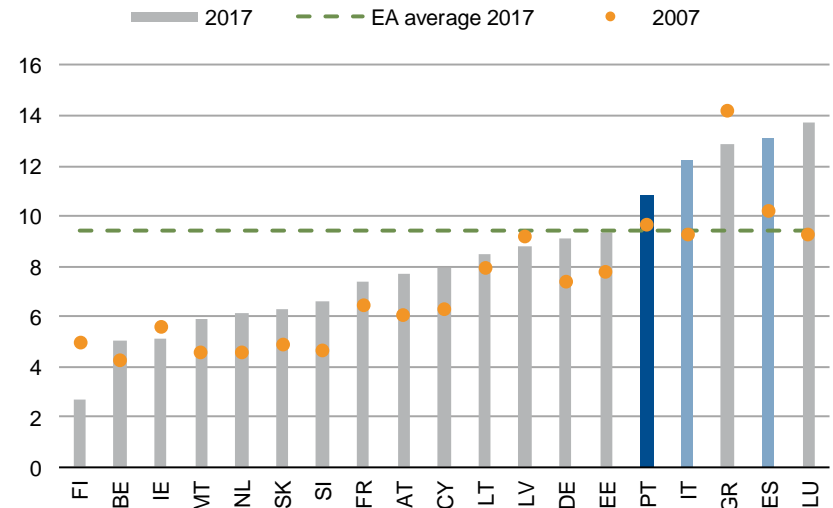
Income received by the top quintile (the richest) to income received by the lowest quintile (the poorest), %



Source: Eurostat, Scope Ratings GmbH

### In-work poverty rate

% of employed with disposable income below the risk-of-poverty threshold\*



Source: Eurostat, Scope Ratings GmbH

\* 60% of the national median equivalized disposable income, after social transfers

- Decrease in income inequality: improved labour market conditions and increase in minimum wage
- But increase in in-work poverty rate:
  - ~ 20% of employees live on minimum wage; ~70% earn less than EUR 1.200
- Will the rise in the minimum wage reduce poverty and/or the education premium?

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### Credit strengths

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- ✓ Euro area membership
- ✓ Ongoing unwinding of imbalances
- ✓ Sustained primary surpluses
- ✓ Favourable public debt profile

### Positive rating-change drivers

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- ↑ Steady reduction in public debt
- ↑ Higher potential growth
- ↑ Reduction of imbalances

### Credit weaknesses

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- ✓ High public and external debt
- ✓ High private sector debt
- ✓ Elevated ageing-related liabilities
- ✓ Low potential growth

### Negative rating-change drivers

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- ↓ Reversal of fiscal consolidation
- ↓ Markedly lower GDP-growth
- ↓ Increases in imbalances

### Additional research

- ✓ [Rating report – April 2019](#)
- ✓ [Q2 Sovereign Update: Slower growth, political uncertainty mitigated by easier monetary policy – April 2019](#)
- ✓ [Portugal, Spain and Italy: Fiscal Convergence or Divergence? – February 2019](#)



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