



Portugal upgraded to BBB+/Stable

Alvise Lennkh

Director, Public Finance
a.lennkh@scoperatings.com

Giulia Branz

Associate Analyst, Public Finance
g.branz@scoperatings.com



Update on Portugal, February 2020, Frankfurt

Table of contents

- Context: rating history and stable political environment
 - First upgrade driver:
 - Prudent fiscal policy and debt reduction
 - Second upgrade driver:
 - Gradual unwinding of economic imbalances
 - Remaining challenges
 - Annexes
-



Portugal: BBB+ with Stable Outlook

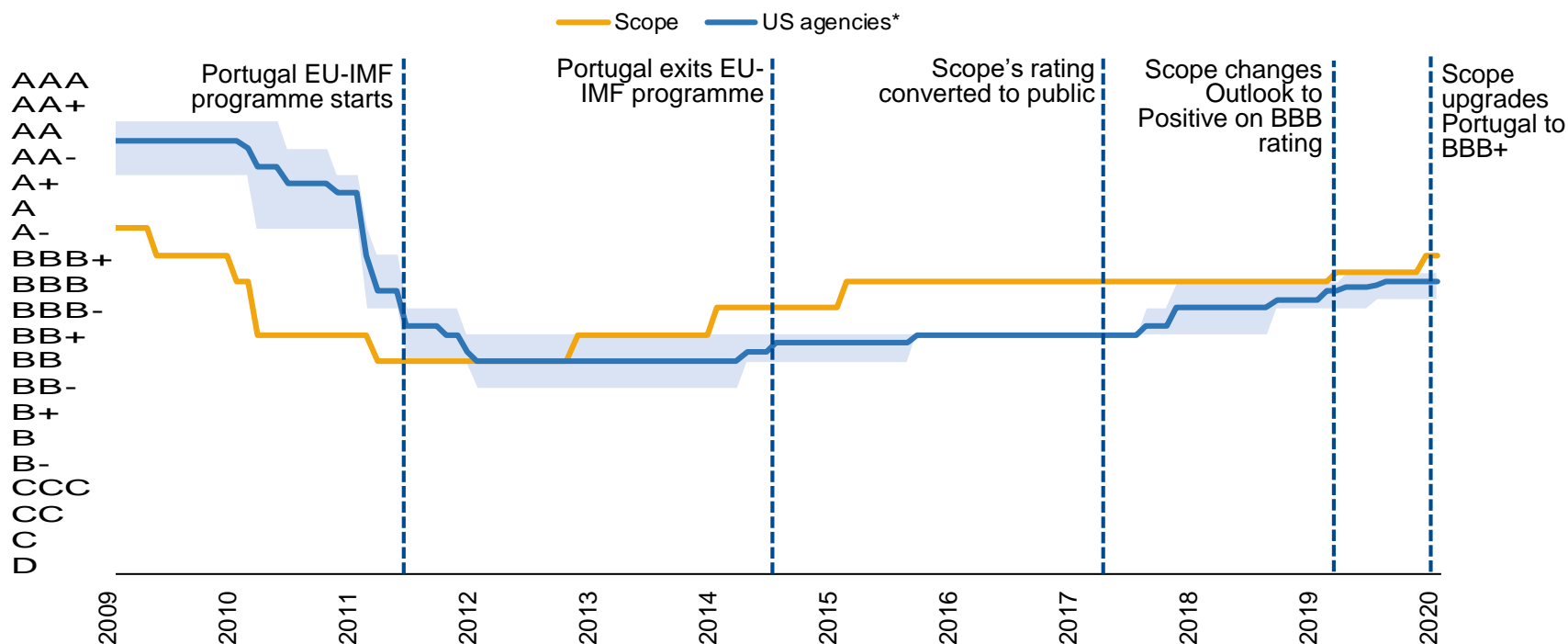
Context: rating history and stable political environment

➤ Balancing fundamental developments with rating stability

- On 31 January [Scope upgraded Portugal's rating to BBB+ with Stable Outlook](#)

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

Rating notches



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

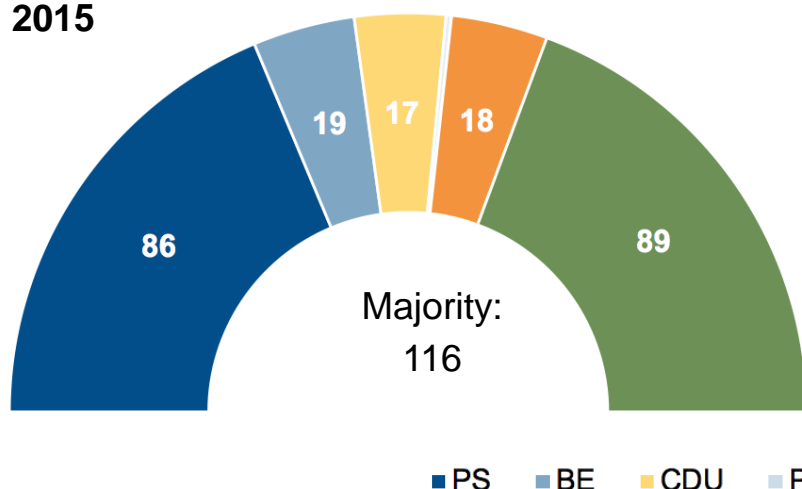
Portugal: BBB+ with Stable Outlook

Context: rating history and stable political environment

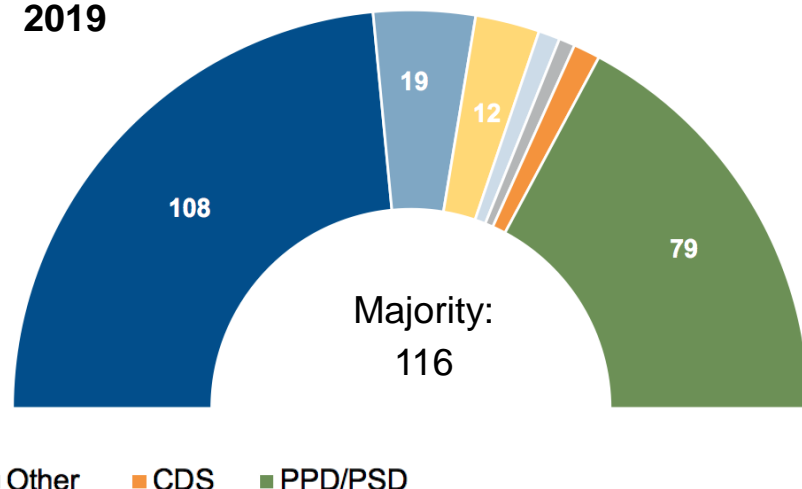
Parliamentary composition: 2015 versus 2019

Number of seats

2015



2019



Source: Portuguese Parliament, Scope Ratings GmbH

➤ Policy continuity: the PS (Socialist Party) won the 6 October elections

- Absence of explicit deals with other parties (“bill-to-bill” agreement) but abstention of left-wing parties enough to pass legislation (just 8 seats short of absolute majority vs 30 in 2015)
- Contrasts Italy (fragile ruling coalition) and Spain (weak minority government)

Table of contents

✓ Context: rating history and stable political environment

➤ First upgrade driver:

– Prudent fiscal policy and debt reduction

➤ Second upgrade driver:

– Gradual unwinding of economic imbalances

➤ Remaining challenges

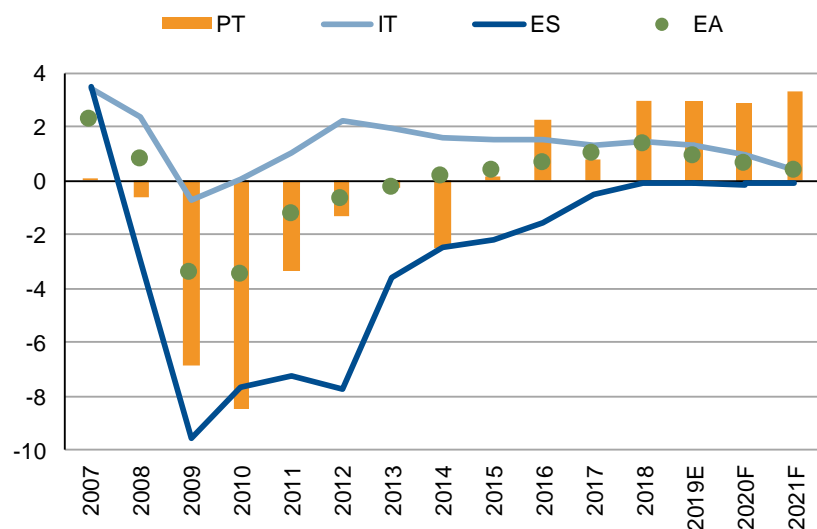
➤ Annexes

Portugal: BBB+ with Stable Outlook

First upgrade driver: prudent fiscal policy and debt reduction

Primary balance

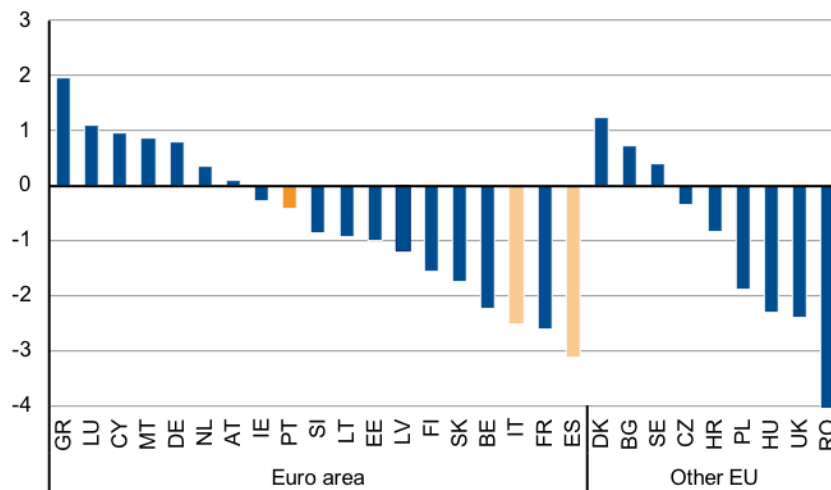
% of GDP



Source: AMECO, Scope Ratings GmbH

Structural balance

% of potential GDP, average 2019-2021F



Source: AMECO, Scope Ratings GmbH

➤ Significant fiscal adjustment, mostly expenditure-driven

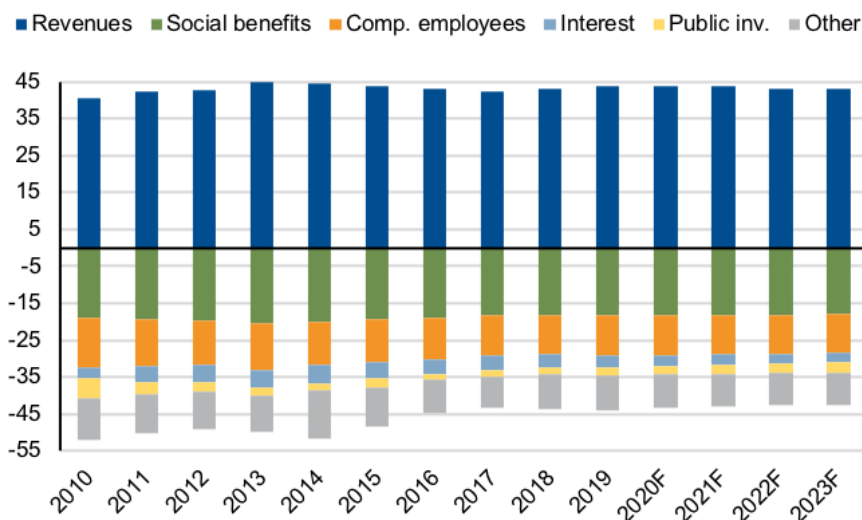
- Cyclical component (benefits) as well as structural elements (interest payments, public wages)
- Gains from economic recovery (labour market) expected to remain; public investment still to recover

Portugal: BBB+ with Stable Outlook

First upgrade driver: prudent fiscal policy and debt reduction

Revenues and expenditures

% of GDP



Source: IGCP, Scope Ratings GmbH

Draft budgetary plan 2020

Discretionary measures		2019	2020
Revenues	Taxes on production and imports	0.00	0.02
	Current taxes on income, wealth	-0.01	-0.05
	Capital taxes	0.00	0.00
	Social contributions	0.00	0.00
	Property income	0.00	0.00
	Other	-0.01	0.06
	Total revenues	0.00	0.03
Expenditures	Comp. of employees	0.32	0.33
	Intermediate consumption	0.00	-0.09
	Social payments	0.26	0.17
	Interest expenditure	0.00	0.00
	Subsidies	0.00	0.00
	Gross fixed capital formation	0.00	0.00
	Capital transfers	0.00	0.48
	Other	0.00	0.00
	Total expenditures	0.58	0.89

Source: EC, Scope Ratings GmbH

➤ Fiscal strategy: broadly balanced budgets, slightly higher expenditure in 2020

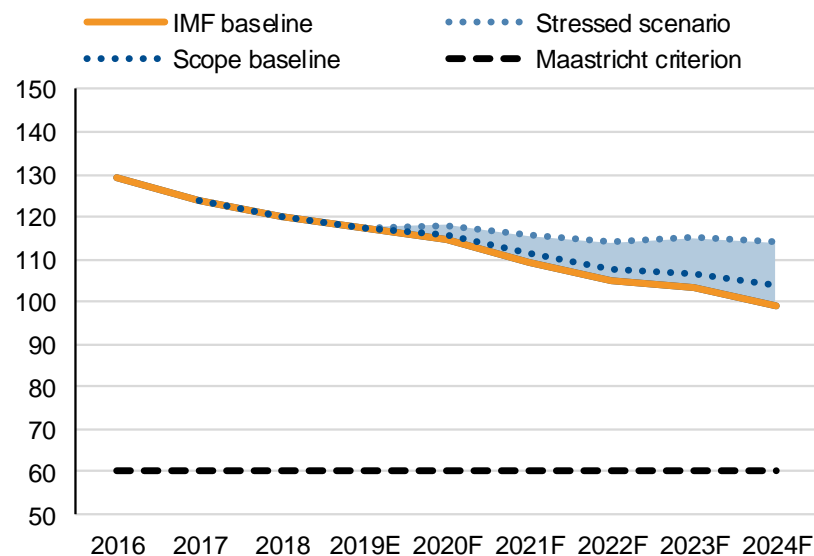
- Strong cyclical revenue, lower interest expenditure, and subdued public investment
- Slightly higher public wages and social payments do not weaken commitment to high primary surpluses
- Additional capital injections to Novo Banco limited to EUR 2.0bn until 2025

Portugal: BBB+ with Stable Outlook

First upgrade driver: prudent fiscal policy and debt reduction

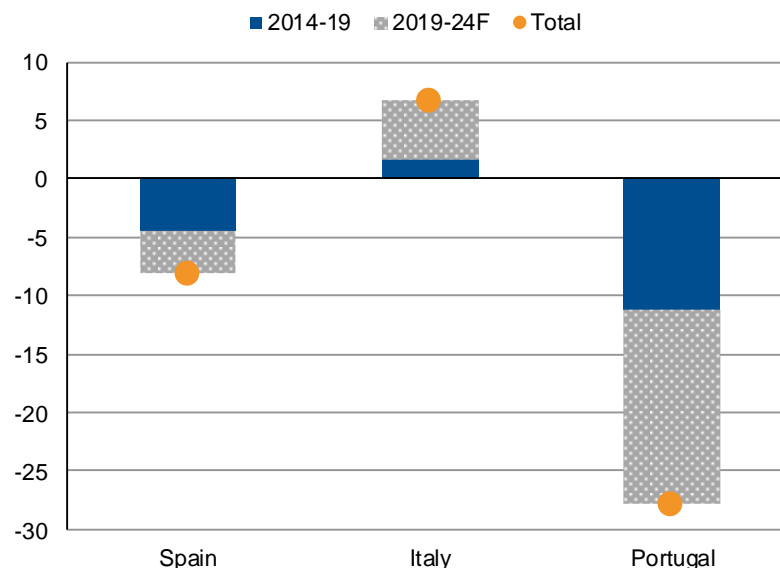
Debt sustainability analysis

Debt, % of GDP



Debt reduction projections

% of GDP



Source: IMF, Scope Ratings GmbH

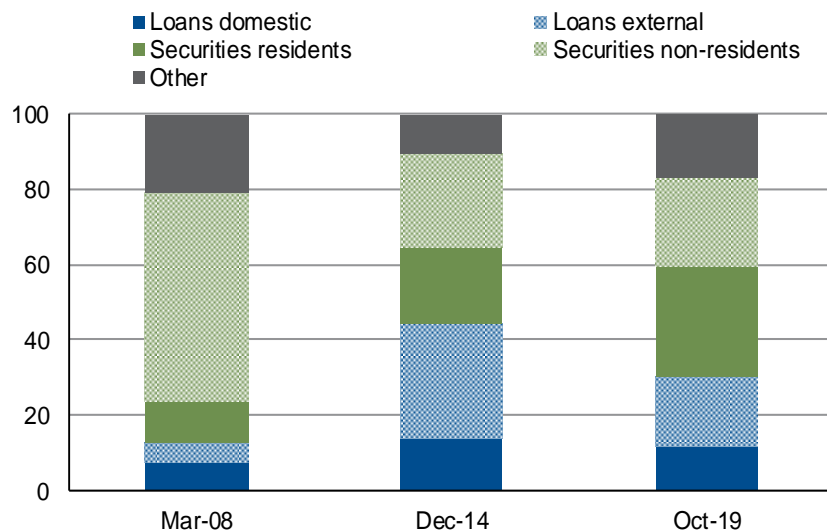
Scenario	Time period	Real GDP growth (%)	Primary bal. (% of GDP)	Real eff. int. rate (%)	Debt, end period (% of GDP)
History	2014-18	2.1	0.5	1.5	120.1
IMF Baseline	2019-24	1.6	3.1	0.8	99.3
Scope Baseline		1.4	2.7	0.9	103.7
Stressed Scenario		0.8	2.3	1.4	113.9

Portugal: BBB+ with Stable Outlook

First upgrade driver: prudent fiscal policy and debt reduction

Government debt holders

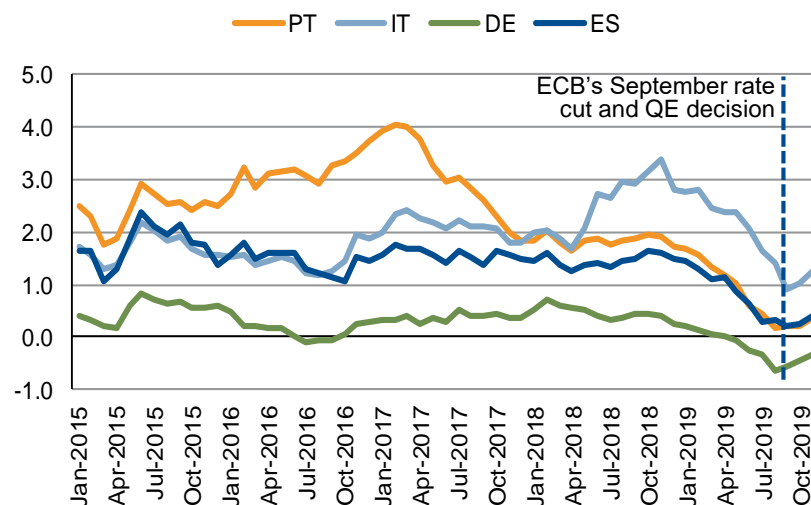
% of total debt



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 by 2018)
- Early voluntary repayment to the EFSF of EUR 2bn (October 2019)
- Annual gross financing needs below 10% of GDP
- Large cash buffer (>30-40% of 2020-22 gross financing needs)



**Portugal's
resilient market
access**

Table of contents

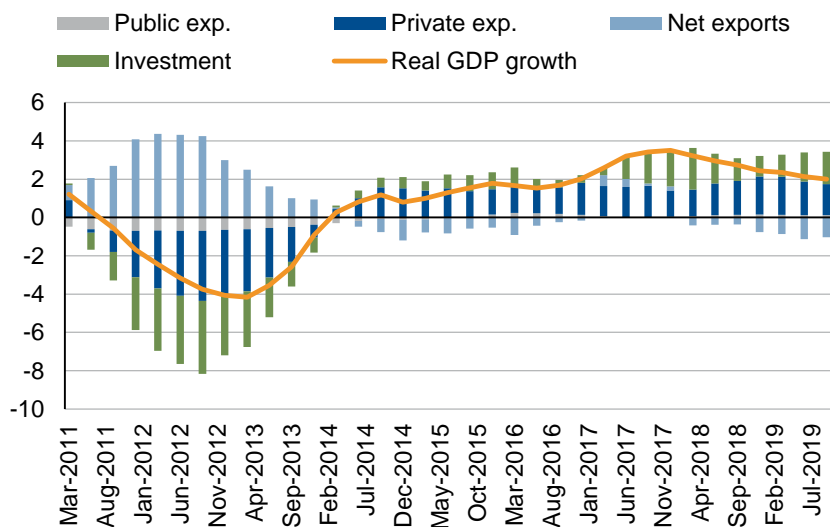
- ✓ Context: rating history and stable political environment
 - ✓ First upgrade driver:
 - Prudent fiscal policy and debt reduction
 - Second upgrade driver:
 - Gradual unwinding of economic imbalances
 - Remaining challenges
 - Annexes
-

Portugal: BBB+ with Stable Outlook

Second upgrade driver: gradual unwinding of economic imbalances

GDP growth

%



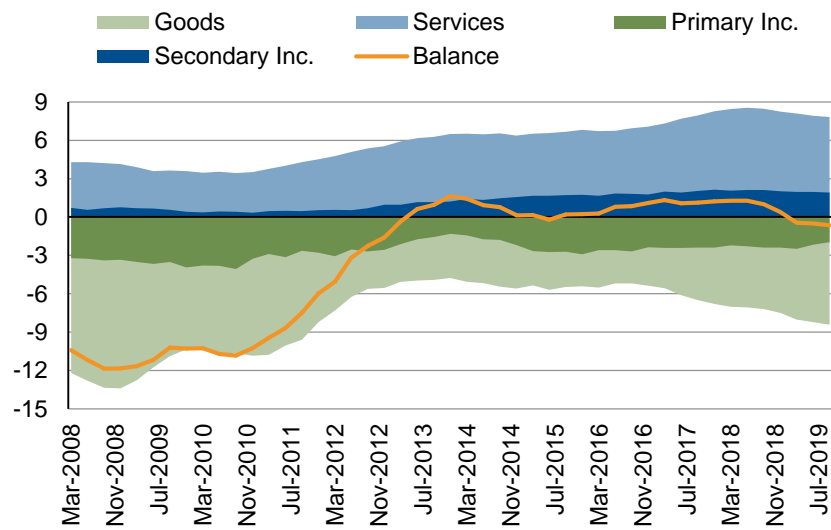
Source: Haver, AMECO, Scope Ratings GmbH

➤ Robust economic growth

- Above the euro area average since 2016
- Resilient domestic demand compensates for weakened contribution from net exports

Current account

% of GDP



Source: Haver, AMECO, Scope Ratings GmbH

➤ Rebalancing of the external sector

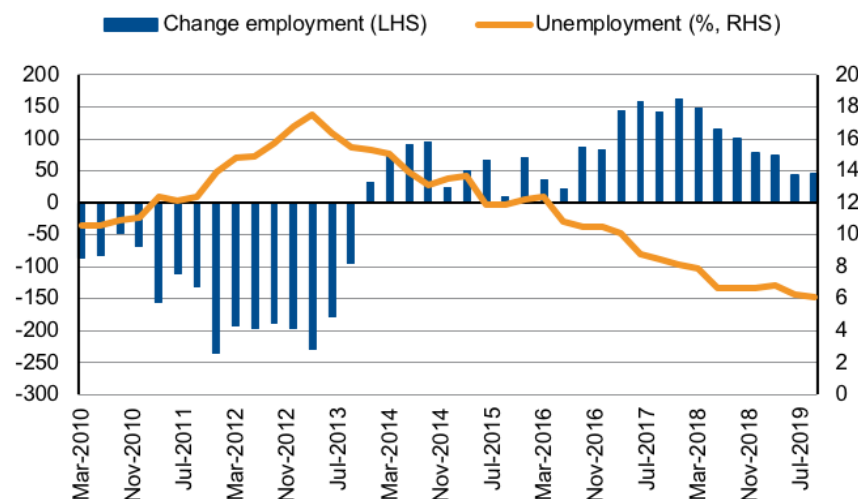
- Competitiveness gains; export diversification, growth of services (tourism)
- Balanced CA, despite investment growth

Portugal: BBB+ with Stable Outlook

Second upgrade driver: gradual unwinding of economic imbalances

Employment and unemployment

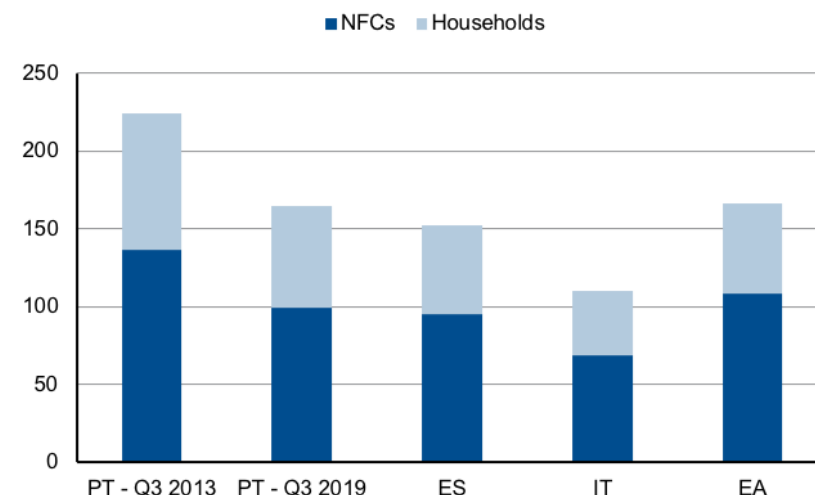
4-quarter moving sum ('000s), % labour force



Source: Haver, Eurostat, Scope Ratings GmbH

Private sector debt

% of GDP



Source: Haver, INE, Scope Ratings GmbH

➤ Labour market turnaround

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

➤ Continued deleveraging process

- Private debt now in line with euro area

Table of contents

- ✓ Context: rating history and stable political environment
- ✓ First upgrade driver:
 - Prudent fiscal policy and debt reduction
- ✓ Second upgrade driver:
 - Gradual unwinding of economic imbalances

➤ Remaining challenges

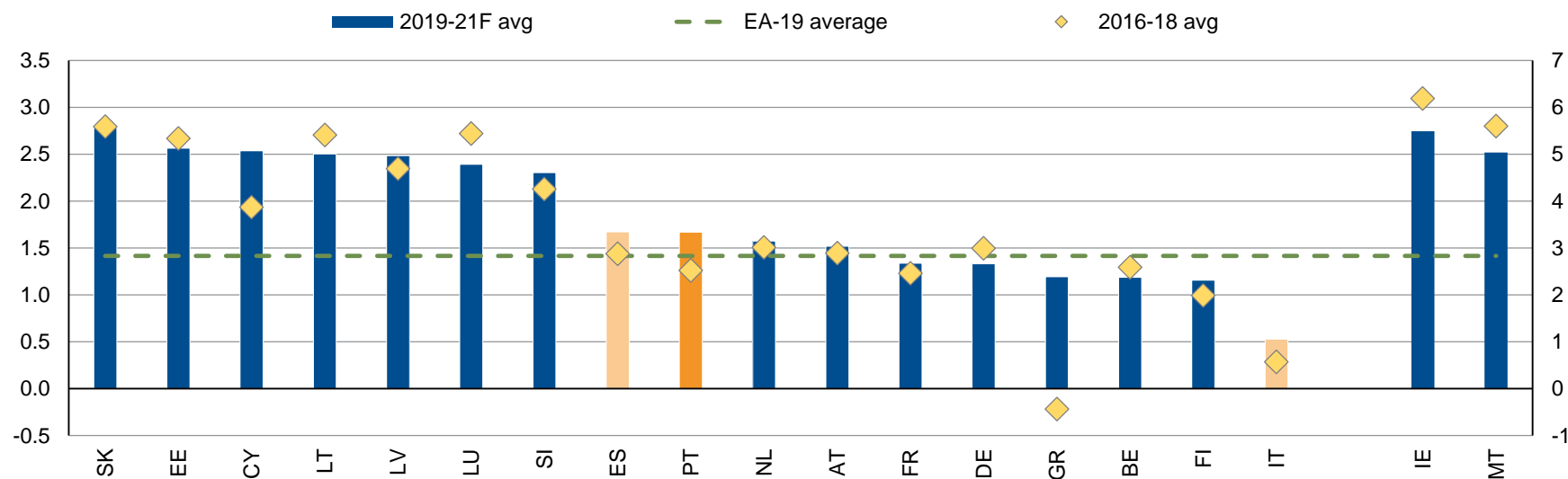
➤ Annexes

Portugal: BBB+ with Stable Outlook

Remaining challenges: 1. Modest growth potential

GDP potential growth

3Y average, 2019-2021F vs 2016-2018, %



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

➤ Modest growth potential given country's comparatively moderate wealth level

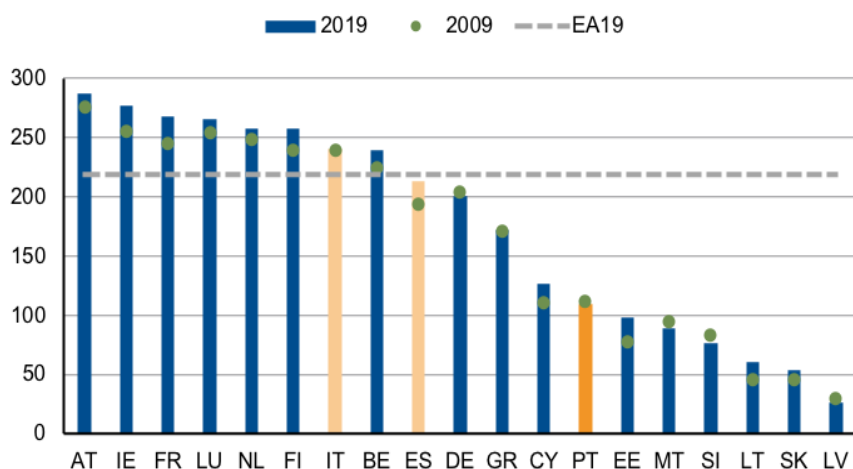
- Structural constraints: low physical and human capital and unfavourable demographics

Portugal: BBB+ with Stable Outlook

Remaining challenges: 1. Modest growth potential

Net capital stock per person employed

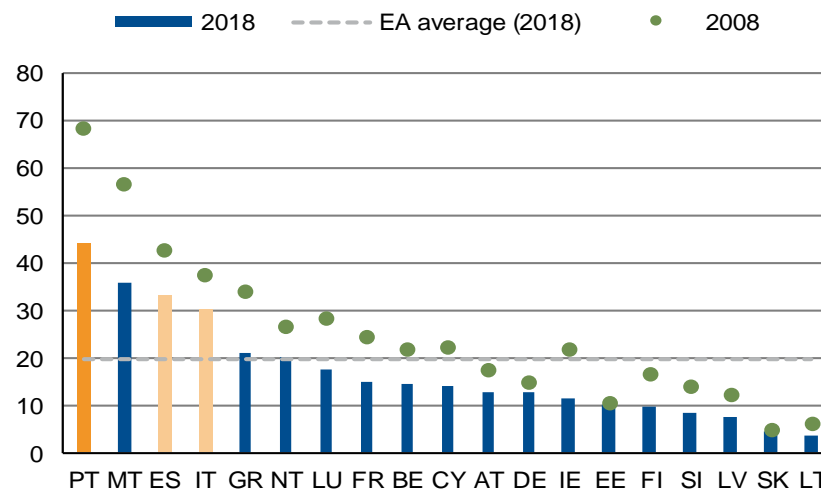
EUR, '000s



Source: Haver, AMECO, Scope Ratings GmbH

Share of low-skilled employed

15-64 years, % total employment



Source: Eurostat, Scope Ratings GmbH

➤ Low physical capital

- *Government's policy response:* Fostering private and public investment (third largest beneficiary of EFSI as a % of GDP) and R&D expenditure

➤ Low human capital

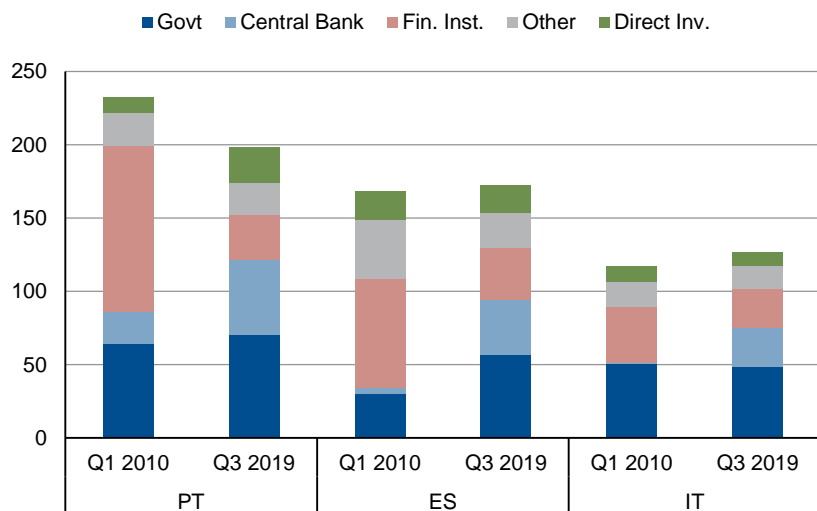
- *Government's policy response:* enhancing the population's skill level, supporting long-term productivity gains (e.g. *Qualifica Programme*)

Portugal: BBB+ with Stable Outlook

Remaining challenges: 2. External imbalances

External debt

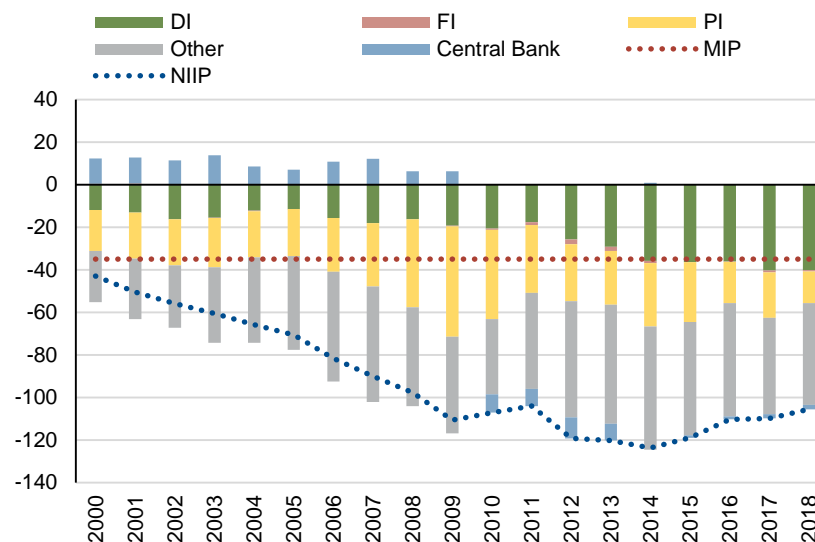
% of GDP



Source: Haver, BdP, BDE, BdI, Scope Ratings GmbH

Net international investment position

% of GDP



Source: Haver, Eurostat, Scope Ratings GmbH

➤ Despite decline in external debt, external imbalances remain high

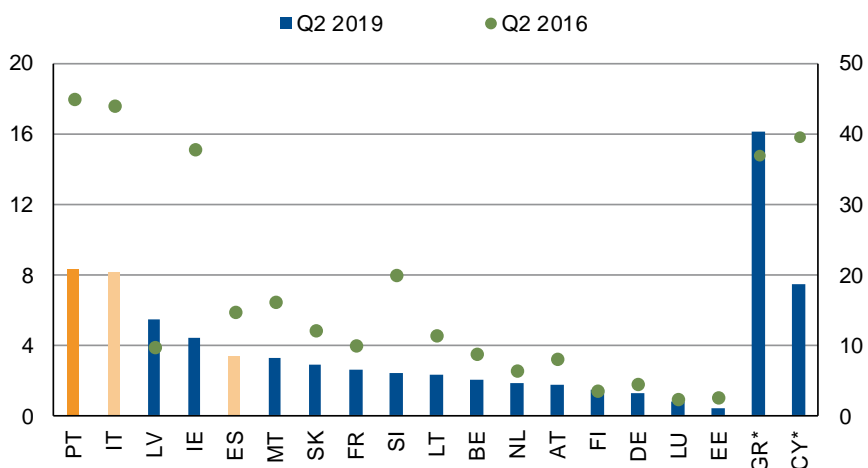
- High negative Net IIP remains a source of concern
- Sustained current account surpluses are required to reduce the imbalances
- Still, external debt risks mitigated by improved composition (official loans; FDI inflows)

Portugal: BBB+ with Stable Outlook

Remaining challenges: 3. Banking sector and housing

Asset quality: NPLs

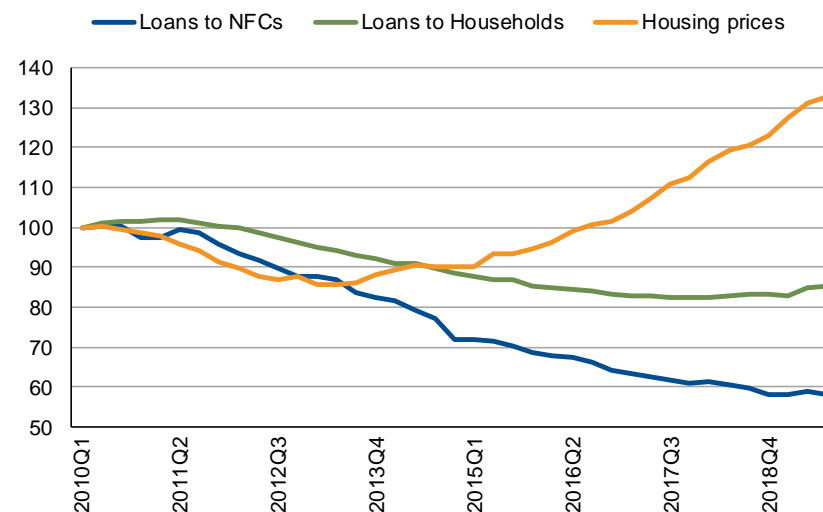
% of total gross loans



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

Housing and credit

Index (2010-Q1 = 100)



Source: Haver, ECB, Scope Ratings GmbH

➤ Stabilisation of the banking sector, but vulnerabilities remain

- Novo Banco contingent capital mechanism expected to require budgetary resources until 2025 of up to EUR 2.0bn (0.3% GDP in 2020)

➤ Real estate prices continue to rise

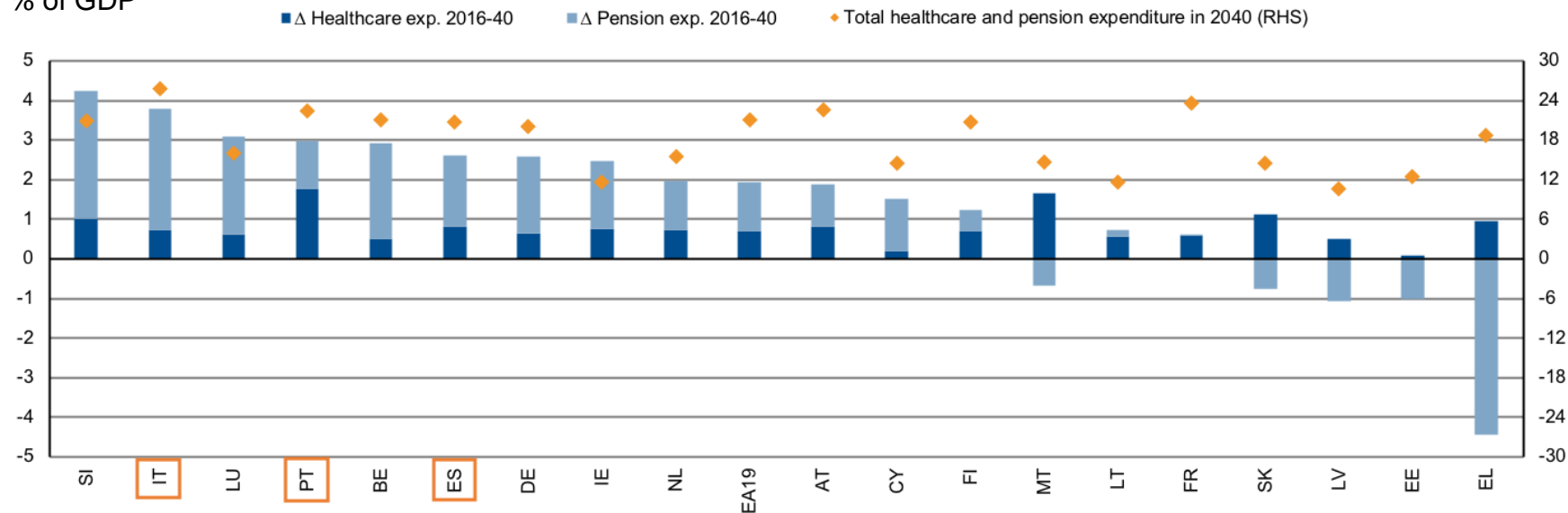
- Signs of overvaluation (Lisbon)
- Real estate about 38% of bank's assets

Portugal: BBB+ with Stable Outlook

Remaining challenges: 4. Ageing-related expenditure

Implicit liabilities

% of GDP



Source: EC 2018 Ageing Report, Scope Ratings GmbH

➤ Ageing related expenditure developments pose medium-term fiscal challenges

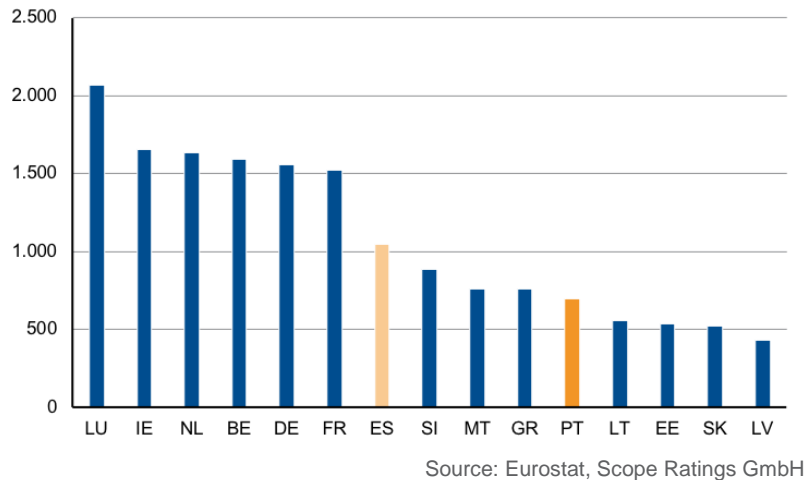
- Healthcare expenditure increase projected to be one of the highest in the euro area
- Hospitals continue to require capital injections (arrears at EUR 259m in December 2019)
- Portugal to have one of the highest healthcare and pension expenditures (in % of GDP) by 2040

Portugal: BBB+ with Stable Outlook

Remaining challenges: 5. Inequality and poverty

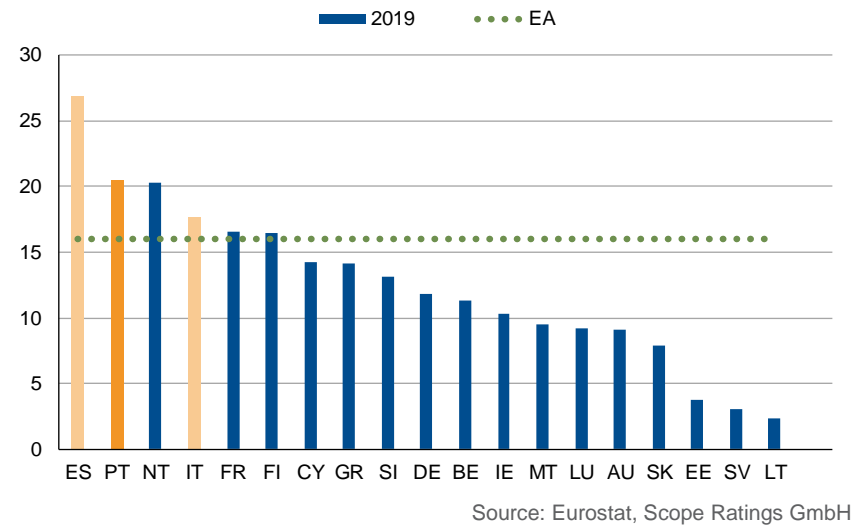
Minimum wage

EUR, H2 2019



Temporary contracts

% employed population, Q3 2019



- Low wage levels (~70% earn less than EUR 1.200) and widespread use of temporary contracts
- *Policy response*: plan to gradually further increase the minimum wage by 25% by 2023 (EUR 700 monthly) may risk creating rigidities in the labour market and lower the education premium

Table of contents

- ✓ Context: rating history and stable political environment
- ✓ First upgrade driver:
 - Prudent fiscal policy and debt reduction
- ✓ Second upgrade driver:
 - Gradual unwinding of economic imbalances
- ✓ Remaining challenges

➤ Annexes

Credit strengths

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

Positive rating-change drivers

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

Credit weaknesses

- ✓ Modest potential growth
- ✓ High public and external debt
- ✓ Financial sector vulnerabilities
- ✓ Elevated ageing-related liabilities

Negative rating-change drivers

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

Additional research

- ✓ [Sovereign Outlook 2020: slow growth, political uncertainty, rising debt add pressure on policymakers – December 2019](#)
- ✓ [Portugal: PS election victory promises continued fiscal consolidation though pace may slow – October 2019](#)
- ✓ [Portuguese politics: balancing growth-friendly fiscal consolidation with social pressures – August 2019](#)
- ✓ [Portugal's debt reduction and unwinding of economic imbalances underpin positive credit outlook – April 2019](#)
- ✓ [Rating report – April 2019](#)
- ✓ [Portugal, Spain and Italy: Fiscal Convergence or Divergence? – February 2019](#)



BERLIN

Lennéstraße 5
10785 Berlin
Germany

+49 30 27891-0
info@scoperatings.com
www.scoperatings.com



FRANKFURT – GERMANY

Eurotheum
Neue Mainzer Straße 66-68
60311 Frankfurt am Main



LONDON – UK

2 Angel Square
EC1V 1NY London



MADRID – SPAIN

Paseo de la Castellana 95
Edificio Torre Europa
28046 Madrid



MILAN – ITALY

Via Paleocapa 7
20121 Milan



OSLO – NORWAY

Haakon VII's gate 6
0161 Oslo



PARIS – FRANCE

1 Cour du Havre
75008 Paris



Disclaimer

© 2020 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Analysis GmbH, Scope Investor Services GmbH and Scope Risk Solutions GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided 'as is' without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5, D-10785 Berlin. Scope Ratings GmbH, Lennéstraße 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Director: Guillaume Jolivet.