CareEdge Global assigns Long Term Foreign Currency Rating of A+ (Unsolicited) to Republic of Portugal

Credit Profile

Portugal's credit profile is underpinned by a relatively high GDP per capita, a buoyant tourism sector, strong institutions and an improving banking sector. Portugal has also displayed a strong record of implementing structural reforms; thereby improving economic and fiscal conditions. Notwithstanding these positives; the economy continues to be burdened by high debt and a deeply negative net international investment position. Moreover, it also remains susceptible to external shocks due to a slowdown in the European Union that constitutes 71% of its total trade.

Looking ahead, continued commitment to bringing out reforms and increasing investment associated with the European Commission's National Resilience and Recovery Plan (NRRP) could further aid economic growth. Though there are expectations of policy continuity, reforms implementation under the new minority government would be a key monitorable.

Strengths

- Reform orientation
- Relatively high GDP per capita
- Strong institutions
- Resilient banking system

Weaknesses

- High indebtedness with legacy from Euro crisis
- Large negative international position

Key Monitorables

- Ability to meet up with the requirements of National Recovery and Resilience Plan

Key Rating Drivers

Economic Structure & Resilience

Portugal is a small economy with a Nominal GDP of USD 287 billion and a relatively high GDP per capita of USD 36986 (constant PPP basis) in 2023. Post the financial crisis of 2011, Portugal's economy has gone through a remarkable transformation by focusing on exports, lowering labour costs, improving labour skills, putting impetus on tourism and restructuring the banking system. As a result, unemployment rate has been secularly declining from the highs of 2013 at 16.2% to 6.6% in December 2023. The contribution of exports to GDP increased to about 47% in 2023 from 37% in 2014. Average GDP growth was steady at 1.9% in the pre-pandemic period (2015-19), higher than the Euro Area average of 1% for the same period. Economic growth moderated to 2.3% in 2023 following a strong 6.7% in 2022 primarily due to weaker external demand and slowing private consumption demand amidst higher interest rates and high base effects. Going further, Portugal is expected to grow at 1.9% on an average till 2028 vis-à-vis Euro Average of 1.2%.

Tourism contributes a high 17% to GDP. However, Portugal's excessive reliance on EU for tourism and a high share of intra-EU trade amid a slowdown in the region are key risks to the economic growth. Portugal has one of the lowest gross fixed capital formation as percent of GDP at 19% in 2023 in comparison with its similar rated peers like Spain (20%) and Chile (24%). Unfavorable demographics continue to be a concern.

Fiscal Strength

Despite displaying commitment to fiscal consolidation in recent years, Portugal's fiscal assessment continues to be burdened by the past. The debt to GDP ratio is high at 99% of GDP in 2023. but is expected to moderate to 87% by 2028, supported by fiscal surplus. Portugal had a fiscal surplus of 1.2% in 2023 and the fiscal surplus is expected to remain in 2024 and 2025 albeit a smaller one.

Even with reforms, Portugal has high fixed expenditure in the form of elevated pension spending 12.4% of GDP vis-à-vis the OECD average of 7.7% of GDP. Portugal has access to the NextGen EU Fund via NRRP which amounts to about EUR 22.2 billion (8.3% of GDP) for the 2021-2027 period, which could bolster investment. However, only 17% of these approved funds were transferred into real economy in 2023 due to administrative and execution constraints

External Position & Linkages

Portugal's deeply negative net international investment position (NIIP) at 74.3% of GDP and high external debt at 150% of GDP in 2023, is a legacy of its past. Although these numbers seem very high, they are lower than the negative NIIP of 100% and external debt of 192% in 2019. Despite the de-leveraging cycle, the economy remains exposed to external shocks.

The current account returned to surplus levels in 2023 at 1.4% of GDP majorly due to the buoyant tourism sector and favorable terms of trade. Net Foreign Direct Investment (FDI) inflows as a percentage of GDP was strong averaging 3.2% between 2019-23 due to its relatively lower labour costs, availability of skilled workers and commitment to energy transition. Portugal also benefits from having an actively traded currency.

Monetary & Financial Stability

Portugal managed inflation in line with its EU peers with average HICP Inflation at 5.3% in 2023. HICP Inflation has slowed considerably from 8.2% in 2022 with receding energy prices, lower food and non-industrial goods prices. Inflation is estimated to considerably drop to 2.3% in 2024 and 1.9% in 2025. Since Portugal is a part of the European Monetary Union, it has access to liquidity support from the European Central Bank (ECB).

NPL ratio declined to 2.9% in September 2023 from 3% in December 2022, as banks continued to dispose of NPLs through sales and write-offs. Credit quality remained resilient to withdrawal of pandemic related measures. Also, banks have a better loan-to-deposit ratio at 79% in 2023 from the peak of 146% in 2015, implying most of the credit is now funded internally. Private sector continued to deleverage as corporate debt ratio fell to 129% in 2023 from 211% in 2012. Household debt also declined to 55% in 2023.

Institutions & Quality of Governance

Post 2011, Portugal has brought its fiscal and external situation under control by bringing in reforms. Portugal has repaid its debt obligations to the IMF and EU five years before schedule. This highlight government's effectiveness and healthy institutional framework. Luis Montenegro, head of the centre-right Democratic Alliance (AD), has been appointed as the country's new prime minister forming a minority government after eight years of Socialist rule. Despite a minority government at helm, there is expectation of policy continuity especially on fiscal reforms and implementation of NRRP.

Portugal – Select Indicators									
	Unit	2018	2019	2020	2021	2022	2023	2024 F	2025 F
Economic Indicators									
Nominal GDP	USD Billion	242	240	229	256	255	287	299	310
GDP Per Capita (Constant-PPP)	USD	34083	34989	32051	33898	36198	36986	37589	38328
Real GDP Growth	%	2.8	2.7	-8.3	5.7	6.8	2.3	1.7	2.1
GFCF/GDP	%	17.5	18.1	19.2	20.2	20.1	19.4	-	-
Gross Domestic Savings/GDP	%	18.8	18.9	17.0	17.8	18.2	20.4	-	-
Exports (G&S)/GDP	%	43.4	43.5	37.0	41.4	49.6	47.4	-	-
Working-Age (15-64) Population (% Share in Total)	%	64.5	64.4	64.2	64.1	63.9	63.7	63.4	63.2
Old-Age (65+) Population (% Share in Total)	%	21.7	22.0	22.3	22.6	22.9	23.3	23.7	24.1
Fiscal Indicators – General Government									
Fiscal Balance/GDP	%	-0.3	0.1	-5.8	-2.9	-0.3	1.2	0.2	0.2
Revenue/GDP	%	42.9	42.5	43.4	44.6	43.8	43.4	43.4	43.3
Expenditure/GDP	%	43.2	42.4	49.2	47.5	44.1	42.4	43.2	43.1
GG Gross Debt/GDP	%	121.5	116.6	134.9	124.5	112.4	99.0	94.7	90.8
GG External Debt (by Creditor)/GG Gross Debt	%	52.2	55.0	52.4	47.7	42.5	40.7	-	-
Interest/Revenue	%	7.8	6.9	6.6	5.4	4.4	5.0	-	-
External Indicators									
Current Account Balance/GDP	%	0.6	0.4	-1.0	-0.8	-1.1	1.4	1.6	1.5
FDI, Net Inflows/GDP	%	3.24	4.30	1.74	3.07	3.73	3.38	-	-
Outstanding FII Liabilities/GDP	%	60.5	66.4	77.9	60.3	53.0	49.0	-	-
NIIP/GDP	%	-103.1	-100.3	-112.4	-90.0	-84.6	-74.0	-	-
Foreign Exchange Reserves	USD Billion	24.9	25.0	29.5	32.6	32.3	35.3	-	-
Import Cover	Months	2.9	2.9	4.0	3.5	2.9	3.2	-	-
External Debt/GDP	%	196	191.6	204.8	189.9	166.0	150.4	-	-
Monetary and Financial Indicators									
HICP Inflation	%	1.20	0.30	-0.10	0.90	8.10	5.30	3.20	2.40
Exchange Rate (Average)	LC per USD	0.85	0.89	0.88	0.85	0.95	0.93	-	-
Non-Performing Loans/Total Gross Loans	%	9.43	6.18	4.89	3.68	3.00	2.90	-	-
Private debt, loans and debt securities/GDP	%	167.1	160.9	176.6	169.7	153.7	-	-	-

Sources: International Monetary Fund, World Bank, Bank for International Settlements, National Sources, CareEdge Global

Note: F - Forecast; PPP – Purchasing Power Parity; GFCF – Gross Fixed Capital Formation; Exports (G&S) – Exports of Goods and Services; GG – General Government; FDI – Foreign Direct Investment; FII – Foreign Institutional Investment; NIIP – Net International Investment Position; Data refers to fiscal/calendar year and actual/estimate as reported by the source; Where general government data is unavailable, central government data is used; Latest available data for 2023

Rating History

Instrument	Type	Rating	Date
Issuer Rating	Long Term Foreign Currency (Unsolicited)	A+	October 3, 2024

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Criteria Applied

CareEdge Sovereign Rating Methodology

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