Press Release

Insight beyond the rating.

Date of Release: December 13, 2013

DBRS Confirms the Republic of Portugal at BBB (low), Negative Trend

Industry: Public Finance--Sovereigns

DBRS Ratings Limited (DBRS) has confirmed the Republic of Portugal's long-term foreign and local currency issuer rating at BBB (low) with a Negative trend on both ratings. DBRS has also confirmed the short-term foreign and local currency issuer ratings at R-2 (middle) with Negative trend.

The ratings are underpinned by the progress which Portugal has made with respect to fiscal consolidation and in reducing its large external imbalances. In addition, the ratings are supported by the continued political commitment to the Economic and Financial Adjustment Programme (EFAP) and a sound record of reform implementation. The likely continuation of support for the country's adjustment drive by the Euro area creditor countries, beyond the end of the current EFAP next year, also underpins the rating.

The Negative trend reflects the significant uncertainty over Portugal's fiscal outlook, especially regarding the country's ability to reduce its elevated stock of public sector debt over the medium-term. Moreover, the repeated unfavourable rulings by the country's Constitutional Court with respect to some of the adjustment measures raise implementation risks. This is the case for the fiscal consolidation measures announced in the 2014 budget, and which are essential to the country meeting its fiscal deficit target of 4.0% of GDP next year. The trend further reflects the uncertainty associated with Portugal's growth prospects over the coming months.

The ratings could therefore come under pressure if, in the absence of a new financial support program, it becomes likely that the sovereign will not be able to attain a sustainable mix of public and private sector financing to meet its borrowing needs once Portugal exits the current EFAP. In addition, deficits above the targets over the coming years as a result of fiscal slippage could also put downward pressure on the ratings. Fiscal slippage could result from implementation failure, lower than anticipated growth, or the materialisation of contingent liabilities from the state-owned enterprises (SOEs), the public-private partnerships (PPPs), or the banking sector. However, DBRS acknowledges that the risks emanating from contingent liabilities in Portugal appear to have subsided a little as a result of the introduction of new expenditure controls and the savings achieved on some of the PPP contracts.

Conversely, the trend could be changed to Stable from Negative if Portugal makes significant

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headway in reducing its public debt and if the country's medium-term growth prospects were to improve. Such an improvement could come from a mix of a better than expected external environment, providing a sustained impetus to the country's export sector, and from structural reforms that lead to long-lasting increases in employment and productivity. An improvement in the financing environment faced by households and firms would also support the recovery.

Since it entered the adjustment programme in May 2011, Portugal has made considerable progress in reducing its fiscal deficit, lowering it from 9.9% of GDP in 2010 to a target of 5.5% of GDP by end 2013. In structural terms, the deficit has improved from 9.0% of GDP in 2010 to an estimated 3.6% of GDP by the end of 2013. The primary structural balance is expected to reach a 0.5% of GDP surplus by the end of 2013. Moreover, the nascent signs of an economic recovery and the apparent peaking of the unemployment rate at a lower and earlier-than-previously-anticipated level could prove supportive of the fiscal adjustment going forwards.

In addition, Portugal has experienced some success in rebalancing the economy towards the tradable sector, which helped by a marked contraction in imports, has underpinned the reduction in the country's current account deficit to an estimated surplus of 0.5% of GDP in 2013, from a deficit of 1.9% of GDP in 2012. The current account balance is expected to improve further and reach a surplus of 1.1% of GDP by 2015 and 2.8% of GDP by 2018 driven by sustained growth in exports of goods and services.

The ratings are also supported by the implementation of structural reforms aimed at improving competitiveness, and the enactment of laws to better monitor and control government spending. The ratings are further supported by the continued political support for the adjustment programme and by a relatively benign outlook for the long-term sustainability of age-related spending.

These factors, which underpin Portugal's sound track record of compliance with most aspects of the adjustment programme, are likely to help the country secure further support from the various euro-area financial assistance mechanisms, were it to find market access difficult once the assistance programme expires in June 2014. However, marked challenges remain. In particular, the combination of an elevated public debt ratio and uncertain growth prospects continues to severely constrain Portugal's credit worthiness.

Notes:
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Lead Analyst: Carla Clifton
Rating Committee Chair: Alan G. Reid
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DBRS Ratings Limited
1 Minster Court, 10th Floor
Mincing Lane

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London
EC3R 7AA
United Kingdom

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Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Portugal, Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	BBB (low)	Neg	Dec 13, 2013
Portugal, Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	BBB (low)	Neg	Dec 13, 2013
Portugal, Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-2 (middle)	Neg	Dec 13, 2013
Portugal, Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-2 (middle)	Neg	Dec 13, 2013

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Carla Clifton
Assistant Vice President - Financial Institutions, Sovereign Group
+44 20 7855 6647
cclifton@dbrs.com

Michael Heydt
Vice President – Financial Institutions, Sovereign Group
+1 212 806 3210
mheydt@dbrs.com

Fergus J. McCormick
Head of Sovereign Ratings – Financial Institutions, Sovereign Group
+1 212 806 3211
FMcCormick@dbrs.com

Alan G. Reid
Group Managing Director – Financial Institutions and Sovereign Group
+1 212 806 3232
areid@dbrs.com

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