Press Release

Date of Release: May 15, 2015

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

Industry: Public Finance--Sovereigns

DBRS Ratings Limited has confirmed the Republic of Portugal's long-term foreign and local currency issuer ratings at BBB (low) and short-term foreign and local currency issuer ratings at R-2 (middle). The trend on all ratings remains Stable.

The rating confirmation reflects DBRS's assessment that Portugal has made substantial progress in reducing its fiscal and external imbalances. Improvements in the public debt profile as well as the commitment at the Euro area level to ensure financial stability in the region, including potential stress in the government debt markets, provide additional support to the ratings. However, these positive credit factors are balanced by significant challenges, including elevated levels of public sector debt, low potential growth, high corporate sector indebtedness, and medium-term fiscal pressures.

The Stable trend indicates that risks to the ratings are fairly balanced, given the emerging economic recovery – as evidenced by the return to positive growth in 2014 – as well as DBRS's view that prudent fiscal policy will be sustained over the electoral cycle. The ratings could come under downward pressure if there is an unexpected weakening in the political commitment to sustainable fiscal policy or if weaker-than-expected growth over the medium term leads to a material deterioration in public debt dynamics. Conversely, the ratings could be upgraded if the improvement in the fiscal accounts is sustained and the economic recovery proves durable, thereby improving the outlook for public debt sustainability.

Portugal has made substantial progress unwinding macroeconomic imbalances. Public accounts have already undergone a sizable adjustment, with the fiscal deficit narrowing from 11.2% of GDP in 2010 to 4.5% (including one-off measures) in 2014. Moreover, the government remains committed to prudent fiscal policy, even after exiting the three-year EU/IMF financial assistance programme in June 2014. The government is targeting a deficit below 3% in 2015. Importantly, the improving deficit position is expected to put public debt dynamics on a downward trajectory this year. On the external side, improved export performance – together with import compression – has led to a large adjustment in the external accounts. The current account has shifted from a deficit of 12.1% of GDP in 2008 to a small surplus of 0.6% in 2014. In sum, the fiscal and external adjustments have placed the economy in a better position to support the recovery.

Moreover, favorable market conditions combined with active debt management operations have lowered the government's funding costs and improved its public debt maturity profile. Government bond yields have fallen below pre-crisis levels, with the 10-year bond yield averaging 2.8% over the past 12 months. Since returning to debt markets in 2013, the government has also carried out several debt management operations and more recently has started to repay part of its IMF loans ahead of schedule, thus mitigating risks arising from its high public debt and large financing needs.

As a member of the Economic and Monetary Union (EMU), Portugal benefits from the strong credibility of Euro area institutions, in particular that of European Central Bank (ECB) and its range of available monetary policy tools. In this respect, Portugal has benefited from the ECB's programs, which have helped ease market tensions and lower sovereign bond yields. The quantitative easing (QE) program launched in March 2015 should help contain the risk of deflation and help keep government borrowing costs in the markets low. DBRS believes that additional EU financial support would likely be available if necessary.

However, these positive credit factors are counterbalanced by several underlying credit weaknesses. First, gross general government debt – at 130.2% of GDP in 2014 - is very high. As a result, the government has limited fiscal flexibility and the country is vulnerable to adverse shocks.

Moreover, Portugal's potential growth remains low. Although structural reforms have been implemented over the past four years, the economy continues to show low levels of investment, insufficient competition in the non-tradable sector and rigidities in the labour market. With weak investment and high long-term unemployment, the contributions from capital accumulation and labour supply to medium-term economic growth appear limited.

Adding to the challenges facing Portugal is the high level of indebtedness of non-financial corporates. Corporate sector debt is among the highest in the Euro Area. Not only does high corporate debt weigh on investment, it could also adversely affect the performance of the banking sector.

Finally, additional structural fiscal adjustment could be needed to firmly place debt dynamics on a downward trajectory. Some of the austerity measures implemented under the EU/IMF programme are being reversed, and offsetting measures have yet to be identified. At the same time, medium-term growth assumptions appear slightly optimistic. The Government is largely relying on the cyclical recovery to progress with deficit-reduction, but over the medium term, further structural measures could be needed to support the sustainability of public finances.

Notes:

All figures are in euro (EUR) unless otherwise noted.

The principal applicable methodology is Rating Sovereign Governments, which can be found on the DBRS website under Methodologies. The principal applicable rating policies are Commercial Paper and Short-Term Debt, and Short-Term and Long-Term Rating Relationships, which can be found on our website under Rating Scales.

These can be found on www.dbrs.com at:
http://www.dbrs.com/about/methodologies

The sources of information used for this rating include Ministry of Finance of the Republic of Portugal, IGCP, Bank of Portugal, European Commission, European Central Bank, Statistical Office of the European Communities, IMF, OECD, World Economic Forum, and Haver Analytics. DBRS considers the information available to it for the purposes of providing this rating was of satisfactory quality.

DBRS does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

Information regarding DBRS ratings, including definitions, policies and methodologies are available on www.dbrs.com.

This is an unsolicited credit rating. This credit rating was not initiated at the request of the issuer.

Generally, the conditions that lead to the assignment of a Negative or Positive Trend are resolved within a twelve month period, while reviews are generally resolved within 90 days. DBRS's outlooks and ratings are under regular surveillance.

For additional information on this rating, please refer to the linking document under Related Research.

For further information on DBRS historic default rates published by the European Securities and Markets Administration ("ESMA") in a central repository, see:
http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

Ratings assigned by DBRS Ratings Limited are subject to EU regulations only.

Lead Analyst: Adriana Alvarado
Rating Committee Chair: Alan G. Reid
Initial Rating Date: 10 November 2010
Most Recent Rating Update: 21 November 2014

DBRS Ratings Limited
1 Minster Court, 10th Floor
Mincing Lane
London
EC3R 7AA
United Kingdom

Registered in England and Wales: No. 7139960

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Portugal, Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-2 (middle)	Stb	May 15, 2015
Portugal, Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-2 (middle)	Stb	May 15, 2015
Portugal, Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	BBB (low)	Stb	May 15, 2015
Portugal, Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	BBB (low)	Stb	May 15, 2015

The full report providing additional analytical detail is available by clicking on the link under Related Research at the right of the screen or by contacting us at info@dbrs.com.

Adriana Alvarado
Assistant Vice President - Global Sovereign Ratings
+44 20 7855 6647
aalvarado@dbrs.com

Michael Heydt
Vice President – Global Sovereign Ratings
+1 212 806 3210
mheydt@dbrs.com

Fergus J. McCormick
Senior Vice President - Head of Sovereign Ratings, Global Sovereign Ratings
+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