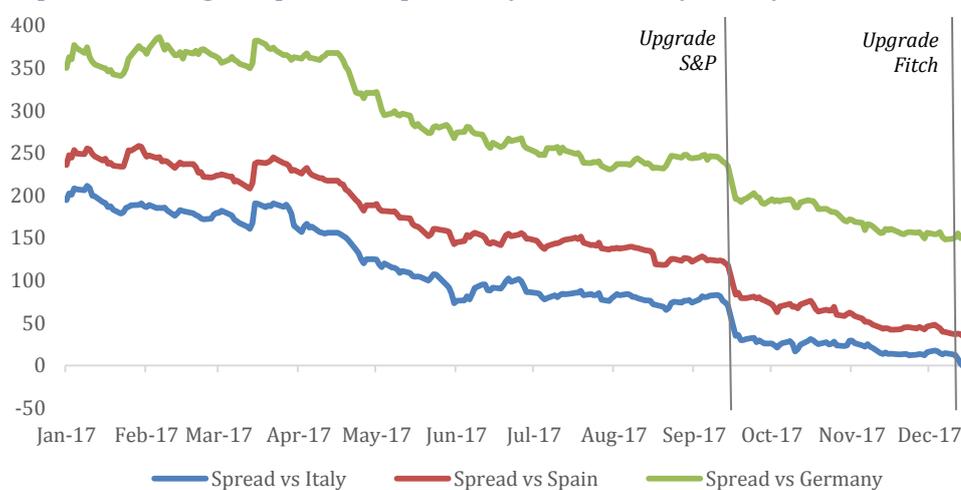


Box 2.3: RECENT RATING CHANGES AND IMPACT ON THE SECONDARY MARKET

The year 2017 was marked by Portugal's return to investment grade by two of the three major rating agencies, which was a clear sign that the improvements in macroeconomic performance, fiscal consolidation and public debt dynamics were recognised internationally.

On 15 September 2017, S&P upgraded the Portuguese Republic to BBB-, the first level of the investment grade category, which caused a reduction in the spread of *OT* rates versus the German, Spanish and Italian rates of about 40b.p., as shown in the graph below. Later, on 15 December 2017, confirming Portugal's good moment, Fitch upgraded the Republic's rating by two notches, to BBB. On that occasion, the impact on the markets was less pronounced, since this was a more expected event.

Graph 11 - Portugal's spread vs Spain, Italy and Germany in 10-year bonds



Source: Bloomberg

However, this second upgrade was very important, as Portuguese government debt securities became part of sovereign debt indices followed by a large investor community worldwide, thus significantly increasing the *OT* investor base as a direct consequence of the return to investment grade.

Table 3 - Rules for inclusion in the main bond indices

Index	Minimum rating	Rule	What's left?
Bloomberg Barclays Global Agg Index	BBB-/Baa3	Midpoint Fitch/Moody's/S&P	Included in Jan-18
BarCap Euro Govt Index	BBB-/Baa3	Midpoint Fitch/Moody's/S&P	Included in Jan-18
BoAML Global Broad Index	BBB-/Baa3	Average Fitch/Moody's/S&P	Included in Jan-18
iBoxx	BBB-/Baa3	Average Fitch/Moody's/S&P	Included in Jan-18
JPMorgan EMU IG & GBI Broad IG	BBB-/Baa3	Minimum Fitch/Moody's/S&P	Upgrade Moody's 3 notches S&P
Citi World Govt Index	A-/A3	Better Moody's/S&P	(or 4 notches Moody's)

Source: Nomura

The improvement in the rating made it possible not only to increase the number of investors in Portuguese debt, but also the quality of these investors. In fact, the vast majority of investors who were prevented from buying Portugal before the rating increase were insurers, pension funds and asset managers, institutions that are now returning to the Portuguese market. More speculative investors, such as hedge funds, are now giving way to more conservative investors, this being the normal path, which was expected due to the fact that the country returned to investment grade.