PRESS RELEASE

OCTOBER 04, 2019

DBRS Morningstar Upgrades Republic of Portugal to BBB (high), Stable Trend

SOVEREIGNS

DBRS Ratings Limited (DBRS Morningstar) upgraded the Republic of Portugal's Long-Term Foreign and Local Currency – Issuer Ratings to BBB (high). At the same time, DBRS Morningstar upgraded Portugal's Short-Term Foreign and Local Currency – Issuer Ratings to R-1 (low). The trend on all ratings is Stable.

KEY RATING CONSIDERATIONS

The upgrade reflects the persistent improvement in several of Portugal's key rating indicators. The fiscal position is broadly in balance and the government debt-to-GDP ratio is declining at a healthy pace. Credit fundamentals among Portuguese banks have also strengthened, as evidenced by the steady improvement in asset quality. Furthermore, positive change to the structure of the Portuguese economy – including more diversified and higher quality exports and rising private sector investment – should support more balanced growth. Regardless of the electoral outcome on October 6th, 2019, DBRS Morningstar expects Portugal to remain committed to prudent fiscal management. Improvement in "Fiscal Management and Policy," and "Debt and Liquidity" building blocks were the main factors considered for the ratings upgrade.

The ratings are supported by Portugal's Eurozone membership and its adherence to the EU economic governance framework. Both help foster credible and sustainable macroeconomic policies. However, legacies of the euro area crisis continue to pose vulnerabilities, including elevated public debt, high albeit declining levels of non-performing loans (NPLs) in the financial system, and relatively low economic growth potential.

RATING DRIVERS

The ratings could be upgraded if sustained primary surpluses and steady economic growth further reduce the public debt ratio in line with DBRS Morningstar's current expectations. Continuation of the progress made strengthening the financial sector could also be credit positive. Ratings could be downgraded if there is a material deterioration in the current fiscal path or debt trajectory, either due to significant weakening of growth prospects or in the political commitment to sustainable macroeconomic policies.

RATING RATIONALE

Fiscal Repair is Key to Portugal's Ratings Upgrade

Portugal's sustained commitment to fiscal consolidation has substantially improved Portugal's fiscal position. Driven by strong tax revenues and contained spending, the headline deficit has steadily improved from 7.4% of GDP in 2014 to 0.4% in 2018. This near-balance result includes the capital transfer to Novo Banco via the Resolution Fund, as well as data revisions made by the National Statistical Institute (INE) made in September 2019. The Ministry of Finance (MoF) expects a 0.2% deficit in 2019 and a small budget surplus in 2020.

The fiscal consolidation in structural terms has also eased sustainability concerns. The MoF expects a 0.5% of potential GDP structural deficit in 2019, which would constitute a positive structural adjustment of 2.6 percentage points over four years. The MoF also expects to reach its revised structural (MTO) fiscal target of 0.0% of potential GDP by 2020. Ongoing spending reviews in various sectors, as well as incentives to find additional savings in the public administration, are important structural efforts. Long-term risks to fiscal performance primarily stem from high expenditures in concentrated sectors. Some state-owned enterprises (SOEs) are consistently loss-making and the management of persistent hospital arrears is an ongoing challenge. Over the longer term, adverse demographic trends could put upward pressure on pension spending.

High Public Debt is Portugal's Key Vulnerability, But Debt Ratios are Declining at a Rapid Pace

Portugal's high debt to GDP ratio leaves public finances vulnerable to negative growth shocks or the crystallization of contingent liabilities. The statistical revision to public finances and national accounts increased the ratios even further. Debt registered 131.5% of GDP in 2016 (previously thought to be 129.2%) and 122.2% in 2018 (previously thought to be 121.5%). However, higher primary surpluses, moderate economic growth, and low interest rates have put the debt ratio on a clear downward trajectory. The 2019 Stability Programme forecasts that the primary surplus improves from 3.0% of GDP in 2018 to 3.8% in 2021, well above the IMF's debt-stabilising primary deficit calculation of roughly balance. As a result, the debt-to-GDP ratio is expected in the coming years to decline by several percentage points per year. The resiliency of the debt trajectory to shock scenarios supports DBRS Morningstar's assessment of the Debt Management and Liquidity building block.

Portugal is taking advantage of favourable market conditions to improve its debt profile and to reduce interest costs. Debt maturities have been extended through active debt management operations and early repayments of IMF loans. The government plans to make an early repayment of EFSF loans due in 2025. Improved market confidence in Portugal's fundamentals combined with low interest rate more generally are contributing to lower interest payments. In the Stability Programme, general government interest expenditure is expected to fall from 4.9% of GDP in 2014 to 3.3% in 2019.

Economic Growth Performance to Moderate Along with External Demand

INE statistical revision to the national accounts increased the performance of GDP growth to 3.5% in 2017 (2.8% previously) and 2.4% in 2018 (2.1% previously). Economic growth is expected to continue to moderate due to weaker external demand. In contrast, domestic demand conditions are likely to remain favourable. Private consumption has been supported by healthy job creation and wage growth, while non-construction related investment has picked up. Investment is set to rebound further as capacity utilization increases and the economy fully absorbs EU structural funds. Consensus forecasts expect growth to moderate to around 1.5%-1.7% in the next few years, broadly in line with output potential. Downside risks to the near-term growth outlook stem primarily from further deterioration in the external environment.

Portugal's current account surplus shifted to a small deficit last year, according to the Bank of Portugal. The government forecasts small external deficits over the coming years, as rising capital investment increases demand for imports. Services exports driven by tourism remain strong. Portugal, nonetheless, has a high level of external debt and will likely need sustained current account surpluses to reduce its high stock of net external liabilities. The negative net international investment position stood at 99% of GDP as of the second quarter 2019.

Financial Stability Risks are Gradually Receding

The high levels of NPLs and corporate sector debt continue to pose risks to financial stability, even as those risks are receding. Non-financial corporate debt has fallen from a peak of 142% of GDP in 2013 to 100% in the first quarter of 2019, according to the IMF's International Financial Statistics. After reaching a peak of 17.9% in mid-2016, the banking system's NPL ratio declined to

8.3% in the second quarter of 2019, according to Bank of Portugal. Improved economic conditions and the broad strategy for improving asset quality are contributing to the reduction of NPLs. However, almost two thirds of the banking system's total NPLs relate to non-performance in the corporate sector. NPLs among corporates was 16.6% of total loans in the second quarter of 2019, down from above 30% in 2016. The still elevated NPL ratio among corporates points to still unresolved financial system stress and is in part a feature that weighs on DBRS Morningstar's assessment in the Monetary Policy and Financial Stability building block.

Excluding Novo Banco, banks have been profitable since 2017 and capital increases and higher cash leverage levels have placed the banking sector in a better position. Bank profitability is supported by lower cost of risk and improved efficiency. Nonetheless, banks' revenues and profitability remain challenged by a tough environment with lower interest rates and high competition. Additional earnings pressure might result from the recent fines imposed to 14 banks totalling EUR 225 million by the Portuguese Competition Authority. The fines relate to concerns about unlawful information sharing from 2002 to 2013. While this announcement increases risk to the reputation of the Portuguese financial sector, banks are likely to appeal the decision and DBRS Morningstar expects the ultimate effect on the banking sector to be manageable.

Regardless of the Election Outcome, DBRS Morningstar Still Expects Strong Commitment to the EU Framework

Portugal is a stable liberal democracy with strong public institutions. The government led by the Socialist Party (PS) has a minority position in the parliament and support from the Left Bloc, the Communists, and the Greens. Although the governing party's minority position raised concerns in the past about its ability to maintain a durable long-term fiscal strategy, the government remained in power for the full term and complied with the fiscal rules under the EU Stability and Growth Pact. Irrespective of the October 6, 2019 election result, DBRS Morningstar expects political dynamics to broadly result in policy continuity, as popular support remains centred on mainstream pro-European political parties.

For more information on the Rating Committee decision, please see The Scorecard Indicators and Building Block Assessments.

EURO AREA RISK CATEGORY: Low

Notes:
All figures are in EUR unless otherwise noted. Public finance statistics reported on a general government basis unless specified.

The principal applicable methodology is Rating Sovereign Governments, which can be found on the DBRS Morningstar website www.dbrs.com at http://www.dbrs.com/about/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 at http://www.dbrs.com/ratingPolicies/list/name/rating+scales.
The sources of information used for this rating include Ministry of Finance of the Republic of Portugal, Agência de Gestão da Tesouraria e da Dívida Pública (IGCP), Banco de Portugal (BdP), Instituto Nacional de Estatistica Portugal (INE), Portuguese Public Finance Council (CFP), European Commission, European Central Bank (ECB), Statistical Office of the European Communities (Eurostat), OECD, IMF, World Bank, UNDP, Haver Analytics. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

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

This rating included participation by the rated entity or any related third party. DBRS Morningstar had no access to relevant internal documents for the rated entity or a related third party.

DBRS Morningstar 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.

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

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority ("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 and US regulations only.

Lead Analyst: Jason Graffam, Vice President, Global Sovereign Ratings
Rating Committee Chair: Roger Lister, Managing Director, Chief Credit Officer – Global FIG and Sovereign Ratings
Initial Rating Date: 10 November 2010
Last Rating Date: 5 April 2019

DBRS Ratings Limited
20 Fenchurch Street, 31st Floor
London EC3M 3BY United Kingdom
Registered and incorporated under the laws of England and Wales: Company No. 7139960

For more information on this credit or on this industry, visit www.dbrs.com.

Ratings

Portugal, Republic of

Date Issued	Debt Rated	Action	Rating	Trend	Issued
04-Oct-19	Long-Term Foreign Currency - Issuer Rating	Upgraded	BBB (high)	Stb	EU
04-Oct-19	Long-Term Local Currency - Issuer Rating	Upgraded	BBB (high)	Stb	EU
04-Oct-19	Short-Term Foreign Currency - Issuer Rating	Upgraded	R-1 (low)	Stb	EU
04-Oct-19	Short-Term Local Currency - Issuer Rating	Upgraded	R-1 (low)	Stb	EU

ALL DBRS RATINGS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE DISCLAIMERS AND LIMITATIONS. ADDITIONAL INFORMATION REGARDING DBRS RATINGS, INCLUDING DEFINITIONS, POLICIES AND METHODOLOGIES, ARE AVAILABLE ON WWW.DBRS.COM.

Contacts

Jason Graffam
Vice President – Global Sovereign Ratings
+44 20 3356 1543
jgraffam@dbrs.com

Roger Lister

Managing Director, Chief Credit Officer - Global FIG and Sovereign Ratings

+1 212 806 3231

rlister@dbrs.com

The DBRS group of companies consists of DBRS, Inc. (Delaware, U.S.)(NRSRO, DRO affiliate); DBRS Limited (Ontario, Canada)(DRO, NRSRO affiliate); DBRS Ratings GmbH (Frankfurt, Germany)(CRA, NRSRO affiliate, DRO affiliate); and DBRS Ratings Limited (England and Wales)(CRA, NRSRO affiliate, DRO affiliate). For more information on regulatory registrations, recognitions and approvals, please see: http://www.dbrs.com/research/highlights.pdf. The DBRS group and Morningstar Credit Ratings, LLC are wholly-owned subsidiaries of Morningstar, Inc. Morningstar Credit Ratings, LLC is a separately registered NRSRO. © 2019 Morningstar. All Rights Reserved. © 2019, DBRS. All rights reserved. The information upon which DBRS ratings and other types of credit opinions and reports are based is obtained by DBRS from sources DBRS believes to be reliable. DBRS does not audit the information it receives in connection with the analytical process, and it does not and cannot independently verify that information in every instance. The extent of any factual investigation or independent verification depends on facts and circumstances. DBRS ratings, other types of credit opinions, reports and any other information provided by DBRS are provided "as is" and without representation or warranty of any kind. DBRS hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall DBRS or its directors, officers, employees, independent contractors, agents and representatives (collectively, DBRS Representatives) be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting therefrom, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of ratings and rating reports or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of DBRS or any DBRS Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. No DBRS entity is an investment advisor. DBRS does not provide investment, financial or other advice. Ratings, other types of credit opinions, other analysis and research issued or published by DBRS are, and must be construed solely as, statements of opinion and not statements of fact as to credit worthiness, investment, financial or other advice or recommendations to purchase, sell or hold any securities. A report with respect to a DBRS rating or other credit opinion is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. DBRS may receive compensation for its ratings and other credit opinions from, among others, issuers, insurers, guarantors and/or underwriters of debt securities. DBRS is not responsible for the content or operation of third party websites accessed through hypertext or other computer links and DBRS shall have no liability to any person or entity for the use of such third party websites. This publication may not be reproduced, retransmitted or distributed in any form without the prior written consent of DBRS. ALL DBRS RATINGS AND OTHER TYPES OF CREDIT OPINIONS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE DISCLAIMERS AND LIMITATIONS AT http://www.dbrs.com/about/disclaimer. ADDITIONAL INFORMATION REGARDING DBRS RATINGS AND OTHER TYPES OF CREDIT OPINIONS, INCLUDING DEFINITIONS, POLICIES AND METHODOLOGIES, ARE AVAILABLE ON http://www.dbrs.com.