# Axesor maintains Portugal's unsolicited rating at BBB+ with a change of outlook from Stable to Negative for the foreseeable impact that COVID-19 will have on economic performance and public debt.

A 9.4% contraction in GDP and an increase in the unemployment rate to 11.6% are expected in an economy that has a high level of public debt which will approach 136% at the end of 2020. However, we underline the best situation from which it starts compared to previous crises to address the circumstantial shock due, thanks to the process of fiscal consolidation and the correction of the labor market of recent years.

# Sovereign rating of the Republic of Portugal

The unsolicited credit rating of BBB+ with a change of outlook to Negative relies on the still uncertain evolution of the economic impact that the COVID-19 health crisis will have on the Portuguese economy. Although it starts from a better situation compared to previous crises, a contraction of 9.4% in GDP is expected in late 2020 due to its high dependence on the service sector and touristic activities. In addition, it is expected that the unemployment rate will reach 11.6% and public debt will rise to 117.6%.

**Madrid, July 6, 2020**

Axesor Rating has revised its unsolicited rating on Portugal and confirms the credit rating of BBB+, although with a change of outlook from Stable to Negative, due to uncertainties about the ultimate economic impact of the health crisis on the Portuguese economy that might affect the credit rating of the country.

Despite the positive development in recent years ──with a year-on-year growth rate of 2.2% in 2019 (almost double the one of the Eurozone, 1.2%) ──, the rating reflects how the severity of the measures taken to address the circumstantial impact derived from the pandemic has affected the Portuguese economy. Consequently, **a decrease in GDP that could even exceed -9.4% year-on-year in 2020 is expected and it will be accompanied by the deterioration of the labor market that will reach an unemployment level of 11.6% at the end of the year (compared to 6.5% in 2019)**. Figures that are based on Portugal's notable dependence on service sector, mainly tourism, and international trade.

Even though last year Portugal managed to reduce by almost three points its level of public debt (one of the highest in the countries of the European Union), the health crisis caused by COVID-19 will reverse this trend, and debt is expected to increase again and reach 135.9% of GDP.

However, at Axesor Rating we believe that the rating outlook of the Republic of Portugal could improve if the deterioration of the GDP in the next six months were significantly lower than expected, the recovery of the economy for 2021 were to occur at a much higher rate than estimated (6.3%) and public finances continued on the path of fiscal consolidation and debt reduction, as it has been the case until now.

The rating has considered the improvement of Portuguese public finances in recent years, which has resulted in achieving, during 2019, the first fiscal surplus of 0.2% since the economic recovery started. A figure that is one tenth above the forecasts of the Government for last year. In terms of tax collection, income grew by 3.9% in 2019, a fact that was accompanied by a progressive reduction in expenses in relation to interest payment on the debt. Despite these efforts, which favored GDP per capita convergence with the rest of the European countries, it continued below 65% of the Community's average, which has constrained Portugal's rating.

Regarding 2020, the initial budget of the Republic of Portugal incorporated the implementation of structural fiscal policies, with a review of taxation applicable to both individuals and companies. Regarding expenses, a negative impact of 0.3% of GDP was estimated due to the measures approved concerning the revision of employment in the public sector and an increase in social transfers worth 0.2% of GDP.

These forecasts have become outdated after the impact of the health crisis. In fact, at Axesor Rating we rule out that 2020 will continue with the positive trend of recent years due to the increase in spending of up to 9% and the reduction in revenue. For the latter, a drop of around 6.2% is expected, mainly because of reductions in taxes on production and imports due to the pandemic. This situation could be alleviated once the aid from the European Restructuring Fund is received. Therefore, by 2021, revenues are foreseen to recover and increase by 6.4%.

**High level of debt**

Debt to GDP ratio of the Portuguese economy has developed positively and in line with the forecasts of the Stability Program, which, in the long term, estimated to reach a value of 100% and less than 90% in 2026 and 2030 respectively. In particular, during 2019, this ratio dropped to 117.6% (more than six and almost three points less than the previous two years respectively).

The rating has taken into account this positive path, and particularly remarkable are the completion of the payment of its obligations with the IMF in 2018 and the advance payment of 2,000 million euros to the European Financial Stability Fund, all in line with the requirements and forecasts of the Stability and Growth Pact.

At the same time, the Republic of Portugal must meet the maturities scheduled for 2020 and 2021, 14,000 million and 24,000 million euros, respectively. These figures will require issuing additional debt to finance the deficit generated during these two years. Yet we do not expect tensions in the capital markets considering the bond purchase program. —recently expanded— by the ECB and the European Reconstruction Fund pending approval.

We expect that addressing all these challenges, will result in an increase of debt levels to 135.9% of GDP in 2020, a situation that would tend to improve moderately in 2021, when it would decrease to 131.4% constituting one of the limitations of our rating.

**Increased spending to halt the impact of COVID-19**

Portugal was one of the first countries to implement measures of social distancing due to the COVID-19 pandemic and, although these were only adopted in the second half of March, these actions have led to a drop in household income and delayed consumer spending decisions as well as negatively affecting consumer confidence levels. In response, private consumption is expected to drop this year by 10% yoy.

Moreover, it is noteworthy that the hardest hit economic players are self-employed and SMEs —almost 16% of businesses closed temporarily during March—. Additionally, in the same month vehicle registrations and production fell 57% and 46% respectively.

In order to address this situation and avoid a deeper impact, the Portuguese Government took fiscal measures simultaneously and complementary to the monetary policy measures adopted by the European Central Bank, focused on three pillars: health, social and business in order to minimize the effects of the crisis and ensure economic activity. These include: 600 million euros to fight against loss of jobs (0.3% GDP), moratoriums on payments to social security worth 7,900 million euros (3.7% GDP), 13,000 million euros to guarantee credit lines for SMEs in order to ensure business liquidity (6.8% GDP) in addition to monthly contributions of 400 million euros (0.2% GDP) to the health system.

All this will mean an increase in spending of 9% in 2020 with a subsequent reduction of 3.1% in 2021.

**Understanding and coordination**

Portugal remains in the highest ranges of World Bank's governance indicators and shows an appropriate institutional framework. This fact is considered in the credit rating granted to the country. Moreover, and despite the current minority government, we positively assess the climate of understanding and coordination among the different parties with regards to the new economic recovery and that is reflected in the recent approval of the additional Budgets for 2020.

In addition, we positively assess the membership in the European Union, where the economy is favored by the use of a single currency, economic cooperation among the different member countries, and access to aid in the face of severe imbalances, such as the current economic crisis caused by COVID-19 or the last sovereign debt crisis of 2011, for which the 27 members approved a pseudo-aid of 6,000 million euros that is allowing the country to shore up public finances in the short term.