REPUBLICA DE PORTUGAL

PT

SOVEREIGN

A-

ISSUER RATING
Long term

OUTLOOK
Stable

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Rating Action and Rationale

EthiFinance Ratings upgrades the Republic of Portugal's unsolicited long-term rating from “BBB+” to “A-”, with an outlook change from Positive to Stable.

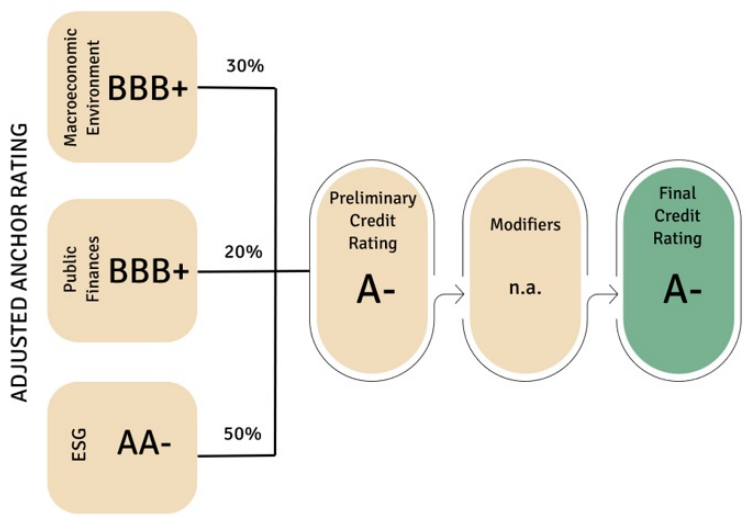
The rating upgradre reflects both methodological changes from the recent update of EthiFinance Rating’s sovereign long-term methodology and improvements in the country’s fundamentals. In particular, the swift return to fiscal surpluses following the pandemic has resulted in a highly favorable budgetary profile. Moreover, the rating is supported by a positive macroeconomic environment, further reinforced by a strong ESG assessment, underscoring Portugal’s capacity and commitment to meeting its financial obligations. Nonetheless, significant challenges remain.

The Republic of Portugal (hereinafter Portugal) enjoys a robust budgetary profile, characterized by prudent fiscal management that has strengthened fiscal sustainability, with a rapid return to surplus levels following the pandemic and an expectation that these surpluses will be maintained over the medium term. This has supported a downward trend in debt, in absolute terms, as well as a percentage of GDP, driven by both budget surpluses and nominal GDP growth. Nevertheless, debt levels remain high, representing one of the main constraints on the country’s credit rating.

The macroeconomic pillar is favorable, although some risks persist. Portugal's socioeconomic profile benefits from the solid economic performance in recent years and a resilient labor market. However, it is constrained by moderate levels of wealth, influence, and size, with additional risks stemming primarily from an aging population. On the external front, Portugal’s situation is favorable due to its inclusion in the Eurozone and consistent current account surpluses, although its status as an international debtor remains a significant risk due to the high level of debt. Finally, the financial system is sound, with strong capitalization, decreasing non-performing loans, and a low profitability that is improving with the past rise in interest rates. Nevertheless, certain risks remain, particularly due to the lags effects of elevated inflation and the European Central Bank’s (ECB) stringent monetary policy.

Furthermore, Portugal’s environmental, social, and governance (ESG) profile is strong, particularly in the social and governance aspects. On the governance front, the country benefits from a sound institutional framework, although recent years have seen a rise in political instability. Socially, Portugal has also experienced ongoing improvements in overall well-being. However, the ESG profile is constrained by the environmental aspect, impacted by currently high CO_2 emissions levels. Nonetheless, the trend is positive, with expectations that the country will align with the targets set by the European Union (EU).

FIGURE 1: DERIVING THE CREDIT RATING



Consequently, the country's credit rating is categorized as follows:

Portugal's credit rating of A- is derived from the individual assessment of three pillars as outlined in our methodology: the Macroeconomic Environment Pillar (adjusted anchor rating of BBB+), the Public Finances Pillar (adjusted anchor rating of BBB+), and the ESG Pillar (adjusted anchor rating of AA-).

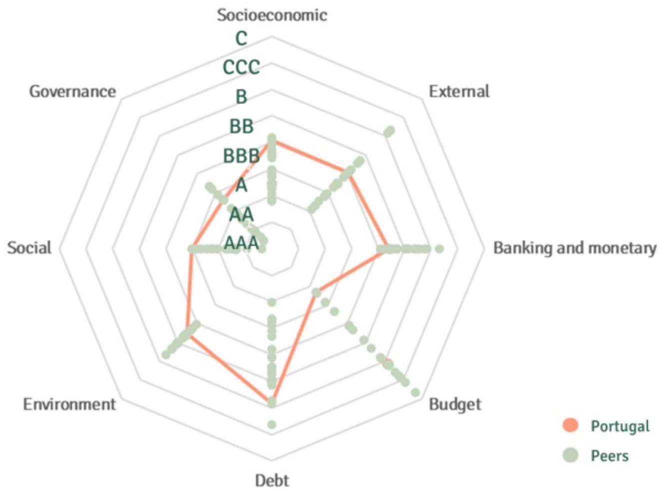
Beginning with the Macroeconomic Environment Pillar, the assigned credit rating reflects Portugal's favorable Socioeconomic and External Sector profiles. However, the Financial Sector & Monetary Policy is negatively affected by the rise in inflation and low profitability levels. On the Public Finances side, strong fiscal management supports this area, though high debt levels continue to impose constraints.

As a double materiality rating agency, we consider ESG factors to be crucial to obtain a complete understanding of a country's credit quality from a medium-to-long term perspective.

Our ESG assessment of Portugal is favorable, explained by the sovereign's high institutional and governance quality (adjusted anchor rating of AA), complemented by a high level of social welfare (adjusted anchor rating of A+). Nonetheless, our ESG assessment is constrained by the environmental pillar (adjusted anchor rating of BBB), albeit with this showing a positive trend.

The double-entry table results in a rating adjustment from "A" to "A-," as EthiFinance Ratings considers that, despite the country's strong ESG assessment, risks persist due to its macro-fiscal profile, particularly stemming from past macroeconomic imbalances and the relatively small size of its economy.

FIGURE 2: ANCHOR RATING BY SUB-PILLAR. EURO ZONE PEER COMPARISON



Modifiers

For this credit analysis, we have not applied any modifiers as no extraordinary situations with immediate impact on the sovereign credit situation have been identified.

Main Figures

	2020	2021	2022	2023	2024E	2025E
Real GDP (% change)	-8.2%	5.6%	7.0%	2.5%	1.8%	1.9%
GDP per capita (current, €)	19,473	20,987	23,530	25,733	26,830	27,887
CPI (annual change, %)	-0.1%	0.9%	8.1%	5.3%	2.3%	1.9%
Unemployment rate (% labor force)	7.1%	6.7%	6.2%	6.5%	6.5%	6.4%
Dependence ratio (<19 and >65 y/20-64 y)	56.6%	57.3%	57.9%	58.3%	-	-
NPLs	4.9%	3.7%	3.0%	2.7%	2.6%	-
ROA (financial sector)	0.1%	0.5%	0.7%	1.3%	1.5%	-
Current Account Balance (% GDP)	-1.0%	-0.8%	-1.1%	1.4%	1.0%	0.8%
NIIP (% GDP)	-102.1%	-99.2%	-87.6%	-76.0%	-	-
Fiscal Balance (% GDP)	-5.8%	-2.9%	-0.3%	1.2%	0.2%	0.2%
Public Debt (% GDP)	134.9%	124.5%	112.4%	99.1%	95.6%	91.5%
CO2 emissions per capita	5.3	5.0	5.3	-	-	-
Consumption of Renewable Energy	33.9%	33.9%	34.7%	-	-	-
Human Development Index	86	86	87	-	-	-
Gini Index	31.2	33.0	32.0	33.7	-	-
World Governance Indicators *	81.7	80.9	80.1	-	-	-

* Average of the 6 main World Bank World Governance Indicators: rule of law, regulatory quality, voice & accounting, government effectiveness, level of corruption, and political stability.

Fundamentals

Strengths

- Favorable external sector position due to eurozone membership and sustained current account surpluses, contributing to an improving trend in the net international investment position as a debtor, although this is still elevated.
- Strong fiscal management, with a swift correction of pandemic-related fiscal imbalances, resulting in current fiscal surpluses that support the reduction of public debt—one of Portugal's main credit profile constraints.
- Strong social and governance profile, reflected in an effective institutional framework and ongoing improvements in social well-being.

Weaknesses

- Presence of high dependency rate aggravated by an ageing population, which poses a future risk to public finances.
- Elevated stock of public debt, although on a pronounced downward trend stemming not only from cyclical factors but also from fiscal consolidation efforts.
- High exposure to transition risks due to significant per capita greenhouse gas emissions, albeit on a decreasing trend and in line with the trajectory set by the EU to meet environmental targets.
- Increase in parliamentary fragmentation following the 2024 elections, leading to a minority government currently in power, which hampers decision implementation and political predictability.

Outlook

The outlook change from Positive to Stable is based on the recent rating upgrade and our expectation that the rating fundamentals will remain broadly unchanged over the next 12 months. There are several areas with positive trends, particularly fiscal metrics, with the country achieving budget surpluses and a declining debt ratio. In addition, steady economic growth and resilient employment levels reinforce Portugal's socioeconomic profile. However, there are potential global developments which could lead to renewed upward pressure on inflation. Although the ECB has begun easing monetary policy, the potential delayed impact of previously high interest rates may still pose challenges to Portugal's macroeconomic stability.

Sensitivity Analysis

Detailed below are the factors that individually or collectively would impact Portugal's rating:

Positive factors (↑).

The credit rating and/or outlook could be upgraded if economic growth exceeds expectations, surpassing its potential rate over 2.2% in the medium term and facilitating convergence of GDP per capita toward the EU average. Additionally, sustained inflation around the ECB's 2% target would further support an upgrade. On the fiscal front, maintaining fiscal surpluses that reduce debt levels closer to the 60% threshold would be a positive factor. Finally, continued political cohesion, with agreements among different political parties to help ensure the implementation of key measures and maintain government stability, would also bolster the rating.

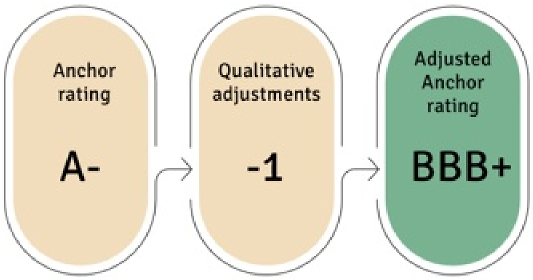
Negative factors (↓).

The credit rating and/or outlook could be downgraded if the risk factors - such as a renewed rise in inflation- leading to sustained below-potential growth and negatively affecting other key rating fundamentals like the labor market, external sector, and public finances - intensify. Moreover, any move away from fiscal responsibility, with the return of deficits in the fiscal balance that lead to the debt level rising above 100% of GDP, could also negatively impact the rating.

Rating Committee

The rating committee agreed to upgrade the rating and change the outlook to Stable. Key topics discussed included the impact of the new methodology, along with improvements in fundamental indicators over recent years, particularly in fiscal metrics. Moreover, the rating committee discussed the influence of ESG factors on the rating.

Macroeconomic environment pillar



The *Macroeconomic Environment Pillar*, anchor rating (BBB+) assigned is based on the assessment of three sub-pillars as defined in our methodology: *Socioeconomic* (anchor rating of A+), *External Sector* (anchor rating of BBB), and *Financial Sector & Monetary Policy* (anchor rating of BBB).

The qualitative adjustments have a negative effect, resulting in a Macroeconomic Environment adjusted anchor rating of BBB+, as explained below.

Regarding the first sub-pillar, Portugal has delivered a solid economic performance with respect to both growth and the labor market in recent years. However, its international influence, size, and overall wealth remain moderate. In addition, the country faces significant risks related to its aging population, which could pose future challenges.

Following the Covid-19 pandemic, Portugal experienced strong economic growth, with a notable rebound in early 2022, reaching a 7.0% growth rate, largely fueled by the robust recovery of the tourism sector. Nevertheless, by 2023, growth had slowed to 2.5%, reflecting weaker external demand from other Eurozone economies and the fading impact of the rebound of tourism. This deceleration was further compounded by the sharp rise in inflation and tighter financing conditions, which affected both the international environment and the domestic economy. Nonetheless, due to its less industrialized structure and lower reliance on Russian gas, the country outperformed the Euro area average growth (3.5% in 2022 and 0.4% in 2023).

For this year and the next, we expect the economy to maintain a solid, although more moderate, growth pace, with a shift towards a model increasingly supported by domestic demand, particularly private consumption and investment, underpinned by more favorable macroeconomic conditions. EthiFinance Ratings projects growth rates of 1.8% for 2024 and 1.9% for 2025, albeit these figures remain below the potential growth rate of 2.2% estimated by the European Commission.

The labor market has shown remarkable progress, with a steady reduction in unemployment levels in recent years (see Annex Figure 1). Currently, the country maintains a moderate unemployment rate, standing at 6.5% in 2023. Looking ahead, unemployment is expected to remain stable, with European Commission projections of 6.5% for 2024 and 6.4% for 2025. This stability reflects an increase in the labor force effectively balanced by the trend in the employment rate, which reached a historic high of 75.3% in 2023.

Nevertheless, the country's socioeconomic profile is constrained by the relatively small size of its economy, which holds limited influence on the international stage. Likewise, wealth levels remain modest, with GDP per capita standing at around 60% of the Eurozone average.

Moreover, the country faces significant demographic challenges, with an aging population and a dependency ratio of 58.3% in 2023. According to the European Commission, the old-age dependency ratio could reach 70% of the working-age population by 2025. This is likely to create heightened fiscal pressures, driven by increasing expenditures on pensions and healthcare, as well as declining economic productivity, potentially impacting the country's long-term growth potential.

Risks stemming from the **External Sector**—the second sub-pillar—are moderate. While the country benefits from its inclusion in the Eurozone, with a globally recognized and stable currency, it remains exposed to external imbalances, though these are showing signs of correction.

Portugal consistently registers a current account surplus. Although it experienced declines during the pandemic, mainly due to reduced tourism and global trade, and again in 2022 due to a rising energy deficit, the surplus rebounded in 2023, reaching 1.4% of GDP. The continued strong performance of the tourism sector, along with the recovery of key trading partners, is expected to sustain the current account surplus at favorable levels. The European Commission forecasts the surplus to be around 1.0% in 2024 and 0.8% in 2025.

However, Portugal's status as an international debtor acts as a constraint on its credit rating. A net international investment position (NIIP) of -76% in 2023, which, although on an improving trend (-102.9% in 2019), still reflects the macroeconomic imbalances stemming from the 2008 crisis. This improvement is driven by sustained deleveraging in both the private and public sectors, as well as robust growth in exports, particularly from tourism, and rising nominal GDP. Despite this progress, Portugal's high level of external indebtedness remains a concern, leaving the country vulnerable to external shocks.

Furthermore, Portugal's moderate dependency on tourism within its export sector stands out. Although no single good or service accounts for more than 20% of total exports, the significant contribution of exports to GDP (49% in 2023) and the share of tourism in the economy (15.8% of GDP) represent areas of vulnerability. They leave the economy highly exposed to external shocks, as demonstrated during the pandemic, which is particularly concerning given Portugal's still-present external imbalances.

Regarding the third sub-pillar, **Financial and Monetary Policy**, our assessment factors in both financial system and monetary policy situation.

Portugal's banking sector is in a strong position, with solid capitalization and a CET1 ratio of 17.1% in 2023. Additionally, the non-performing loan (NPL) ratio has significantly declined over recent years—from 9.4% in 2018 to 2.7% in 2023—a trend that continued into the first half of 2024, reaching 2.6%, despite the rise in interest rates during 2022 and 2023. Although Portuguese banks have faced low profitability from a prolonged period of low interest rates, they have recently benefited from those rate increases, with return on assets (ROA) rising from 0.7% in 2022 to 1.5% in the first half of 2024.

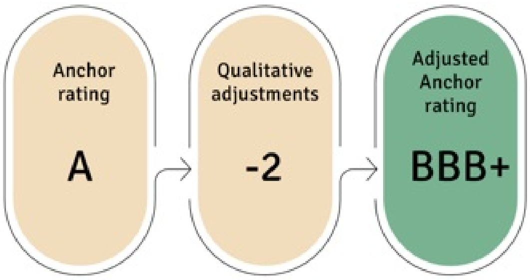
Regarding monetary policy, headline inflation in Portugal surged to 8.1% (Harmonized Index) in 2022 due to rising energy prices and supply chain disruptions. The trend has been down since then, although the rate remained high in 2023 at 5.3%, driven by strong wage growth and demand pressures from tourism-related activities. Moreover, inflationary pressures were exacerbated by droughts, which pushed up food prices.

Despite the overall stability of the financial system, our assessment of the financial system and monetary policy sub-pillar factors in challenges due to persistent inflationary pressures. For this year, inflation is expected to remain elevated, with the Bank of Portugal estimating it at 2.6%, still influenced by second-round effects and the cessation of certain one-off measures, such as VAT reductions. Inflation is projected to moderate further, reaching the ECB's target of 2% in 2025. However, risks remain, particularly external pressures, such as a potential escalation of conflict in the Middle East, which could once again drive-up transportation costs and energy prices.

While we continue to include higher interest rates in our risk profile due to potential lag effects, the beginning of the rate-cutting cycle reduces the likely impact. In June, the ECB implemented its first rate cut since September 2019, of 25 basis points, lowering the deposit facility rate to 3.75%, due to the slowdown in major Eurozone economies and the moderation of inflation. Since then, the ECB has delivered two more cuts, taking the rate down 3.25%. Further cuts are anticipated, bringing rates closer to the neutral rate (which the IMF puts at 2.5%), which should alleviate emerging risks on this front.

Finally, the Macroeconomic Environment's anchor rating of A- is negative adjusted by one notch to a BBB+ adjusted anchor rating due to the qualitative adjustments. While Portugal's inclusion in the Eurozone provides access to a globally recognized and stable currency with a flexible exchange rate regime, supporting a consistent current account surplus and moderate export concentration, and while the financial sector benefits from a stable and credible financial system, these strengths are tempered by significant negative factors. Risks of credit overheating, particularly from rapidly increasing housing prices in recent years, as well as Portugal's limited international influence and a GDP growth outlook that remains below its potential rate, weigh negatively on the rating.

Public Finance Pillar



Portugal's *Public Finances Pillar* is adequate, with an anchor rating of A, primarily driven by its favorable budgetary position (anchor rating of AA+), characterized by consistent fiscal surpluses. However, this strength is offset by its debt profile (anchor rating of BBB-), reflecting the country's high levels of debt.

Negative qualitative adjustments bring down the Public Finance’s adjusted anchor rating to BBB+, as explained below.

The **Budget sub-pillar** benefits from the strong fiscal management that Portugal has demonstrated in recent years. Although the deficit surged to 5.8% of GDP in 2020 due to the pandemic response, the country swiftly corrected its fiscal imbalance, achieving a 1.2% surplus by 2023. This rapid correction was driven by a robust economic recovery, higher tax revenues, and the gradual phasing out of pandemic-related expenditure.

Although a reduction in the level is expected, the country is projected to maintain a surplus, estimated at 0.2% of GDP for 2024 and 2025 by the IMF. This decrease is driven by several factors, including the economic slowdown, moderating inflation, and new budgetary measures. Notably, the reform of personal income tax, along with discretionary increases in public sector wages and pensions, will put additional pressure on the budget. At the same time, public investment is expected to rise, supported by the continued implementation of the Recovery and Resilience Plan.

Nevertheless, the country faces some budgetary rigidity, with only moderate revenue-raising capacity due to its wealth levels. On the expenditure side, structural spending is expected to rise, particularly on pensions, healthcare, and public sector wages, which will limit the government's ability to reduce overall spending.

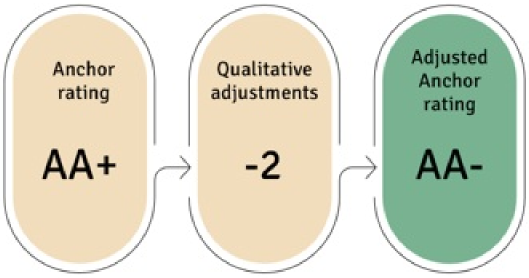
Assessment of the second sub-pillar, **Public Sector Debt**, reflects the persistently high levels, albeit there is an improving trend in relative terms.

Portugal has maintained high debt levels, which were exacerbated in 2020 with the onset of the pandemic (see Annex Figure 2). However, the subsequent downward trend in debt is significant, driven by fiscal consolidation and nominal GDP growth, reducing the debt from 134.9% of GDP in 2020 to 99.1% in 2023. This trend is expected to continue, supported by the anticipated primary surpluses (projected at 2.5% for both 2024 and 2025, according to Portugal’s 2025 Stability Program) bringing public debt down to 95.6% of GDP in 2024 and 91.5% in 2025 according to the European Commission.

Although the country demonstrates elevated short-term debt issuance (6.6% in 2023), within the ranges defined in our methodology, this risk is offset by sufficient market access and a lengthy average maturity of approximately 7 years. Furthermore, despite increased expenditure due to the rise in interest rates, the sustainability ratio remains manageable and is expected to hover around 5% of current revenues for the 2024-25 period, buoyed by robust revenues.

Lastly, our qualitative assessment results in a two-notch negative adjustment, bringing the adjusted anchor rating down to BBB+. This is primarily due to the fact that, while the country has demonstrated strong fiscal discipline, achieving surpluses in both the overall fiscal balance and the primary balance, this is offset by notable budgetary rigidity and, more significantly, risks stemming from its debt profile. In particular, debt levels remain high, and compliance with fiscal rule limits is not expected in the medium term. Additionally, Portugal's credit history, while not involving an outright default, does include a debt restructuring, and contingent liabilities remain elevated, with public corporation liabilities amounting to almost 40% of GDP in 2022.

ESG Pillar



Our favorable assessment of the *ESG Pillar*, with an anchor rating of AA+, is supported by Portugal's strong institutional framework and high governance standards (anchor rating of AAA) and a high level of social well-being (anchor rating of AA+). Nevertheless, the ESG assessment is constrained by the environmental pillar (anchor rating of BBB), which faces certain risks, particularly regarding the green transition.

The *ESG pillar* overall anchor rating is negatively adjusted to an adjusted anchor rating of AA- as explained below.

The **Environmental sub-pillar's** anchor rating (BBB) reflects a moderate level of risk. Portugal's environmental risk remains relatively contained, with manageable transition risks; however, the country faces notable challenges, particularly in climate change mitigation.

Portugal recorded CO2 emissions of 5.3 metric tonnes per capita in 2022. While currently considered a risk to the sovereign rating under our methodology due to elevated levels, the trend is down (emissions were 6.2 metric tonnes per capita in 2019). This risk arises from potential economic impacts and public finance challenges associated with green transition investments or the failure to meet environmental objectives outlined in international agreements, such as the Paris Accord and EU directives.

Nonetheless, Portugal is on a trajectory of emissions reduction aligned with EU environmental goals. Additionally, with current policy measures and further actions outlined in its National Energy and Climate Plan, the country is expected to exceed its greenhouse gas reduction target in the Effort Sharing Sectors, achieving a projected 38.5% reduction by 2030, well above the initial target of 28.7%. Overall, the latest projections indicate that transition risks are expected to remain manageable, alleviating concerns about potential deviations from established emissions targets.

Portugal's current energy mix is robust, with renewable energy accounting for 32.5% of total energy consumption in 2022. This share reflects Portugal's substantial investment in renewables, particularly in wind and solar power, positioning it among Europe's leaders in renewable energy use. However, Portugal is projected to fall slightly short of its 2030 target for renewable energy consumption, with an estimated 49% share expected by 2030, compared to the 51% target. This shortfall is primarily due to limitations in grid infrastructure and energy storage capacity, which have constrained further integration of renewable sources.

TABLE 1: MAIN ENVIRONMENTAL ACTIONS

Rating Category	Main Actions	EthiFinance's Assessment
Transition risks	Measures such as EU-backed grants and loans aimed at improving building efficiency are currently being implemented.	In progress but challenges remain
	Clean transportation is being promoted, especially in the public sector. For private transportation, programs like **PAME** offer grants and tax benefits for purchasing electric vehicles, alongside incentives to expand charging infrastructure. However, the country currently has very few low-emission zones, with Lisbon being the only city to implement them.	In progress but challenges remain
Energy	Portugal has made significant progress in developing renewable energy sources; however, it is expected to fall slightly short of the EU target due to limitations in grid capacity.	In progress, but challenges remain
Protected areas	The level of biodiversity protection is adequate, although the country has presented environmental investment below its needs (estimated at EUR 6 billion per year compared to the reported EUR 4.3 billion) in the past.	Some challenges remain
Physical risks	Portugal has developed an adaptation strategy to address various climate risks. In drought-prone areas, the country is implementing more efficient irrigation technologies. Additionally, it is increasing resources for fire protection and developing prevention systems that include natural firebreaks, alongside reforestation initiatives and riverbank restoration projects to enhance resilience against extreme weather events.	In progress but challenges remain

Environmental risks are partially mitigated by Portugal's solid level of environmental protection. As of 2022, 22.9% of terrestrial areas and 7% of marine areas are designated as protected. While proactive conservation measures contribute to sustainable environmental management, the country's high exposure to climate change—particularly to forest fires—is leading to biodiversity loss. This is evidenced by the decline in the common farmland bird index, which dropped from 104 in 2011 to 94 in 2020.

Likewise, Potugal's exposure to physical risks from climate change is mitigated by the relatively low significance of its primary sector, accounting for an average of 2% of GDP between 2019 and 2022, coupled with its high capacity to manage such risks.

While an increase in the frequency of extreme weather events is anticipated, and Portugal's geographic location makes it particularly vulnerable to rising temperatures, wildfires, droughts, and flooding, these factors are not seen as significant short-term determinants of credit quality. This assessment is supported by Portugal's limited reliance on the primary sector and its strong risk management capabilities, as reflected in the INFORM Risk Management Index, one of the indicators included in our evaluation.

However, there is a significant gap in insurance coverage, with penetration below 50% for these risks, highlighting a potential economic vulnerability to such events. On the public side, the state is not legally obligated to provide compensation for these events, although ad-hoc payments have been issued following disasters. While this approach helps safeguard public finances, it introduces uncertainty and increases exposure risks.

Regarding the **Social sub-pillar**, the anchor rating (AA+) reflects Portugal's economic progress in recent years, which has led to an improvement in overall well-being. However, some risks remain, and a comparison with other Eurozone countries shows that Portugal still lags behind in several key areas, even though it is steadily improving.

In terms of the Human Development Index (HDI), Portugal ranks 42nd among the 193 countries assessed by the United Nations, with an index score of 87 in 2022. Nonetheless, Portugal lags behind other Eurozone economies (see Annex Figure 3). While the country has a high life expectancy of around 82 years, it has a relatively low GNI per capita (€35,314) and an average schooling duration that is one to two years below that of its peers (16 years expected and 9 years of actual schooling).

Regarding employment quality, the level of vulnerable employment is low, at around 11.8% of total employment in 2022, although it has remained steady at this level since 2018. Additionally, the country has progressively raised the minimum wage in recent years. It has reached €760 per month and expected to rise to €900 per month by 2026, although it remains relatively low.

Income and gender inequality slightly weaken Portugal's social profile. In 2023, Portugal recorded a Gini Index of 33.7 (with 100 representing the highest level of inequality), up from 32 in 2022, influenced by the rising cost of living. Furthermore, gender disparities persist, with a 15.3 percentage point gap in employment between men and women during the same period.

In addition, we identify certain areas where improvements could be made:

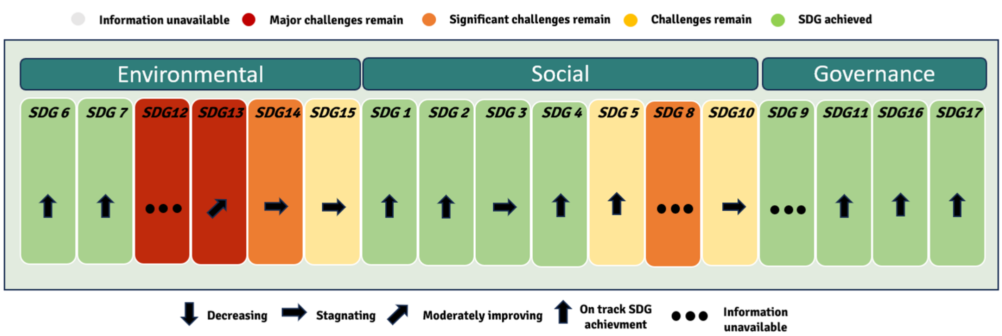
First, housing affordability is a significant challenge for Portugal, especially in Lisbon and Porto. Between 2015 and 2023, property prices have risen by approximately 80% across the country. This increase, combined with the rising cost of living and relatively low wages, poses a risk to purchasing power, heightens poverty risks, and limits social mobility.

Second, education presents a risk to Portugal's economic potential. The country has a high share of underachievers in mathematics—an increasing trend—with an underachievement rate of 29.7% in 2022, well above the EU average of 20.5% and 6.4 percentage points higher than in 2018. Additionally, there are significant regional disparities, with an average early school leaving rate of 8% in 2023, rising to 21.7% in regions such as the Azores. This underperformance in education contributes to skill gaps, with only 21% of university graduates in STEM fields, below the EU average of 26%.

Third, Portugal falls below the EU average in most social-related sustainable development goals (SDGs) (see Annex Figure 4). While the country has made notable progress in areas such as healthcare access, education, and poverty reduction, it still lags in several key indicators. Specifically, achievements in income equality, education quality, and labor market participation, while positive, remain below EU benchmarks. These gaps reflect structural challenges in social inclusion and economic opportunity, which could hinder Portugal's ability to sustain long-term improvements in social well-being and economic resilience.

Finally, the **Governance sub-pillar** assessment is generally favorable, with an assigned anchor rating of AAA. This is primarily attributed to Portugal's high score on the World Bank's Governance Indicators -an average of 80.1 points-, reflecting the country's strong institutional quality and governmental standards, particularly when compared to other Southern European Nations (see Annex International Comparison).

TABLE 2: SGD ACHIEVEMENTS



Source: SDG report ranking.

Portugal's institutional quality and government effectiveness are high, as demonstrated by the successful implementation of structural measures that have helped the country recover from the 2010 debt crisis. Nonetheless, some risks remain, such as the significant bureaucracy businesses face (Regulatory Quality indicator below average at 75 in 2022) and a lingering presence of corruption (Control of Corruption at 75.9), which can discourage investment and erode trust in institutions. The recent corruption scandal that impacted the former government is a notable example, although the swift resolution and accountability of those involved have set a positive precedent, potentially deterring similar cases in the future.

In addition, political stability in Portugal has been somewhat disrupted in recent years, as evidenced by a decline in the World Governance Indicator for political stability, from 81 to 75.9 points. The corruption scandal led to the resignation of former Prime Minister António Costa, prompting President Marcelo Rebelo de Sousa to dissolve the Assembly and call an early election for May 2024. This election resulted in the Socialist Party (PSD) losing its absolute majority, giving rise to a center-right minority government under Luís Montenegro.

Thus, the current government governs as a minority, relying on ad-hoc alliances to implement measures, which limits its capacity and reduces political predictability. However, it is notable that the 2025 budget was approved with the PSD's abstention, a strategic move aimed at avoiding another early election, which would have been the third in three years.

In light of these developments, the ESG Pillar anchor rating (AA+) is adjusted downward by two notches to an adjusted anchor rating of AA- following EthiFinance Ratings' qualitative analysis, reflecting adjustments to both the social and governance profiles. For the social profile, our assessment of SDG progress shows that while Portugal has made advancements, it still lags behind the average of the EU. On the governance side, the negative assessment reflects reduced policy predictability and effectiveness in the current political landscape following the 2024 general election.

Alliances necessary for policy implementation will be closely monitored to assess future impacts on the rating in this area.

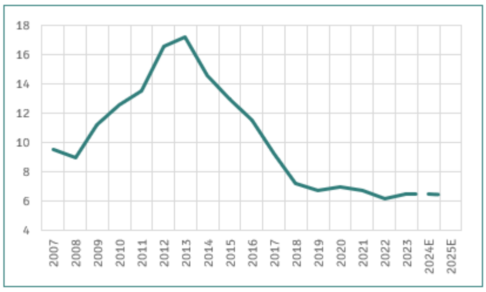
Annexes

Main Figures: International Comparison

	Year	Portugal	Spain	France	Italy	Ireland
Real GDP (% change)	2024E	1.8%	2.5%	1.0%	0.8%	1.2%
GDP per capita (current, €)	2023	25,733	33,308	40,799	35,349	95,285
HCPI (interannual change, %)	2024E	2.6%	3.1%	2.5%	1.6%	1.9%
Unemployment rate (% labour force)	2024E	6.5%	11.6%	7.7%	7.5%	4.4%
Dependency rate (% 20-64 yo population)	2023	58.3%	50.9%	62.5%	57.4%	52.7%
NPL	2022	3.0%	3.5%	2.3%	2.8%	2.3%
ROA	2022	0.7%	0.9%	0.4%	0.7%	1.2%
Current Account Balance (% GDP)	2024E	1.0%	2.8%	-1.4%	-1.3%	9.1%
NIIP (% GDP)	2023	-76.0%	-55.6%	-29.1%	5.7%	-109.1%
Fiscal Balance (% GDP)	2024E	-0.2%	-3.1%	-5.3%	-4.4%	1.3%
Gross Public Debt (% GDP)	2024E	95.6%	105.5%	112.4%	138.6%	41.3%
CO2 emissions (metric tons per capita)	2022	5.3	5.5	5.7	6.7	13.1
Consumption of Renewable Energy (% total final energy consumption)	2022	34.7%	22.1%	20.2%	19.1%	13.1%
Human Development Index	2022	87	91	91	90	95
Gini Index	2023	33.7	31.5	29.7	31.5	27.4
World Governance Indicators	2022	80.1	73.2	80.2	67.4	91.5

Figures

Figure 1. Unemployment Rate Evolution (2008-2025E, % of labor force)

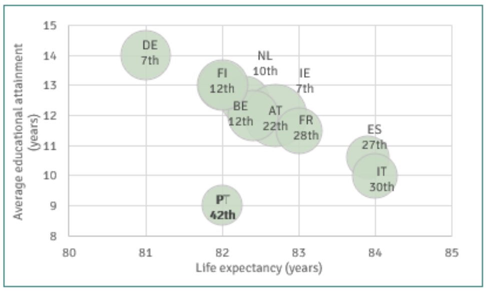


Source: AMECO

Figure 2. Evolution of Public Debt (2008, 2025E, % of GDP at market prices)

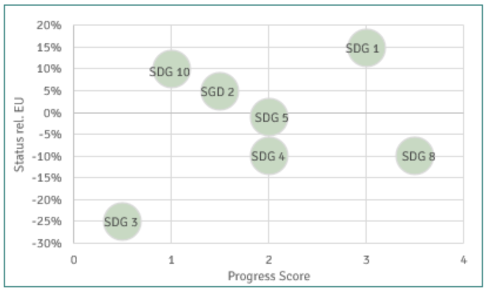
Source: AMECO

Figure 3. Human Development Comparison: Life Expectancy, Education, HDI Ranking, and Wealth (Bubble size)



Source: United Nations

Figure 4. Social Related SDGs Assessment



Source: European Commission

Sources of information

The credit rating issued in this report is unsolicited. The main sources of information used are the following:

1. Public information from public access sources, mainly official statistics institutes, central banks, and other government sources, in addition to the OECD, Eurostat, World Bank, European Central Bank and International Monetary Fund, among others.
2. Own information of EthiFinance Ratings.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, EthiFinance Ratings assumes no responsibility for the accuracy of the information and the conclusions drawn from it.

Level of the rated entity participation in the rating process

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	NO
With Access to Internal Documents	NO
With Access to Management	NO

Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies. Principal methodology used in this research are :
    - Sovereign Rating Methodology : https://files.qivalio.net/documents/methodologies/CRA 157 V2 Sovereign-Rating-Methodology.pdf
- The rating scale used in this report is available at https://www.ethifinance.com/en/ratings/ratingScale.
- EthiFinance Ratings publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has not provided ancillary services to the rated entity or its related third parties.
- The issued credit rating has been notified to the rated entity, and has not been modified since.