

## Portugal's rating upgrade stirs decline in yields

The drop in the ten-year bond yield after the unexpected S&P upgrade will come handy when the ECB starts tapering



Source: istock

### A pleasant surprise

Last Friday Standard & Poor's (S&P) upgraded Portugal's rating from BB+ (stable outlook) outlook to BBB- (again, with a stable outlook). This came as a surprise as rating agencies usually first adjust their outlook and then the rating.

The Portuguese growth over-performance has finally resulted in a rating upgrade by a large rating agency. Since the second half of 2016, the Portuguese economy has been growing, reaching 2.9% YoY speed in 2Q17. Admittedly, Portugal's very high public debt/GDP ratio (at 130.4% in 2016) remains a credit handicap, but that's set to decline in 2017.

2.5%

Yield on 10-year PGB's

fallen some 30bp since S&P's announcement

## Ratings: half way there

As the new rating turns Portugal's debt into investment grade, the investor base for Portuguese government bonds (PGB) has increased significantly.

Together with DBRS, a Canadian rating agency, S&P is now the second out of four recognised rating agencies by the ECB to judge Portugal's debt as investment grade. During the 2011-14 crisis years and after, DBRS never assessed Portugal's debt as non-investment grade. This was important as it allowed the ECB to buy Portuguese bonds in its Public Sector Purchase Programme.

The other two large rating agencies still regard Portugal as non-investment grade. Two weeks ago Moody's did not change its Ba1 rating but upgraded the outlook from stable to positive. In June, Fitch Ratings agency also held its BB+ (non-investment grade) rating, but upgraded its outlook from stable to positive.

## Perfect timing

The rating upgrade and the resulting drop in government bond yields could not have come at a better time. As the ECB is thinking of tapering (and will announce more details on 26 October), government bond yields of Eurozone countries are set to increase.

Yesterday's drop in Portuguese government bond yields was almost perfectly mirrored in a contraction in the spread versus Bunds, which is in principle expected to stay. In perspective, this should help soften the impact of future tapering on Portugal's interest rate bill.