Is Portugal The Next "Shoe To Drop" In Europe?

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The fate of Portugal rests in the hands of DBRS, the last remaining credit rating agency assigning an investment grade rating to its sovereign debt (Fitch, Moody's and S&P have all lowered the country's debt rating to junk). Due to a requirement that participant countries have an IG rating from at least 1 rating agency, the **DBRS rating is literally the only thing allowing Portugal's bonds to remain eligible for the European Central Bank's 1.7 trillion euro bond buying program.** DBRS is set to update its Portugal rating on October 21 and investors in Portugal sovereign risk are starting to get a little nervous.

Until last week there seemed to be little worry about a potential downgrade among investors. That changed when the release of 2Q 2016 GDP showed minimal growth. Fergus McCormick, head of sovereign ratings at DBRS, recently noted in an interview with Reuters that although Portugal's debt carries a "stable" rating that the situation appears to be deteriorating.

"Friday's Q2 GDP release (which showed growth at just 0.2 percent) raised our concerns about growth prospects, which appear to be slowing into the third quarter," he told Reuters in an interview.

"Therefore, the outlook remains stable, but pressures appear to be mounting from these various fronts," he added, also citing European Commission demands that an unwilling Lisbon implement more spending cuts.

DBRS's October review will come just a week after Portugal is scheduled to provide the Commission with a list of those new cuts to get its budget deficit back under 3 percent of GDP.

Uncertainties over the make-up of those measures and their impact on the delicate political balance were a concern McCormick said, as was the possibility that more taxpayer money may be needed to prop up banks including Caixa Geral de Depositos and BCP.

"Will the far-left parties support these two initiatives? This is unclear."

The socialist minority government that came to power in November 2015 has not helped the situation by **raising the minimum wage**, **increasing the number of public holidays and reversing other key reforms, that will make it more difficult for the country to meet its EU fiscal targets.** To be sure, the collapse in oil prices have indirectly taken a toll on Portugal as well with exports to it's 4th largest trading partner, Angola, falling by 42% in the first half of 2016.