Beyond Bundeslaender – Autonomous Portuguese regions

NORD/LB Floor Research

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Marketing communication (see disclaimer on the last pages)

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Beyond Bundeslaender:
Autonomous Portuguese regions

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Beyond Bundeslaender: Autonomous Portuguese regions

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Introduction and the Portuguese political system

In this publication, we – once again – shall be shining a light on Portugal's Atlantic islands of Madeira and the Azores. Portugal is a decentralised unitary state, though it is de facto highly centralised in its organisational structure. The Portuguese mainland is divided into 18 districts (distritos) at the highest level, which are each named after their capital, and in turn sub-divided into 308 counties (municípios) and 3,092 municipalities (freguesias). In contrast to this, the groups of islands that are the focus of this publication have the status "autonomous region" (região autónoma) and therefore have their own administration. In addition, Portugal is divided into five regions, but these are only of statistical significance. Portugal is a representative democracy with a semi-presidential system of government. The most important executive organs are the President and the Prime Minister with the associated Council of Ministers. The Portuguese President, who is directly elected by the Portuguese electorate every five years, nominates the Prime Minister on the basis of the results of the parliamentary elections. The parliament, known as the Assembleia da República, consists of one chamber and is elected every four years. As autonomous communities, Madeira and the Azores have had extensive legislative powers since 1976. These powers do not cover foreign policy, defence or internal security. Both regions therefore have a regional executive (governo regional) with a Regional President and a democratically elected legislative assembly (assembleia regional). As parts of Portugal, the two autonomous regions have been in the European Union since 1986.

Current political situation

The current head of state, Marcelo Rebelo de Sousa, has been President since 2016. As a member of the "Partido Social Democrata" (PSD), he won the election against his independent opponent Antonio Sampaio da Novoa in the first round with 52% of the votes cast. In 2024, the cabinet led by António Costa of the Socialist Party was replaced by a government led by the newly elected Prime Minister Luís Montenegro from the PSD. This minority government consists of twelve PSD ministers and five independent ministers. Since taking office, President Rebelo de Sousa has advocated overcoming the social divide resulting from the debt crisis and associated austerity measures. As a result of the financial crisis in 2008/09, Portugal encountered payment difficulties in the following years owing to its substantial government debt. In May 2011, the country received a bail-out in the amount of EUR 78bn from the euro rescue package. During the peak in 2014, government debt amounted to 132.9% of GDP (average in the EU: 93.5%). The measures to reduce the debt burden envisaged tough reforms, which were associated with far-reaching cuts for the population. Since 2015, the economy has largely stabilised. Between 2019 and 2023, GDP rose by an average of +1.9% each year. Portugal was hit hard by the COVID-19 pandemic and suffered a decline in real GDP of -8.3% Y/Y in 2020. Since 2013, the unemployment rate has been steadily falling and amounted to 6.6% in 2023.

2023 values in EUR (2022)

Nominal GDP
265bn (242bn)

Real GDP growth
+2.3% (+6.8%)

Nominal GDP per capita (vs. 2022)
25,740 (+2,210)

Unemployment rate
6.5% (6.2%)

Budget balance
3.2bn (-0.8bn)

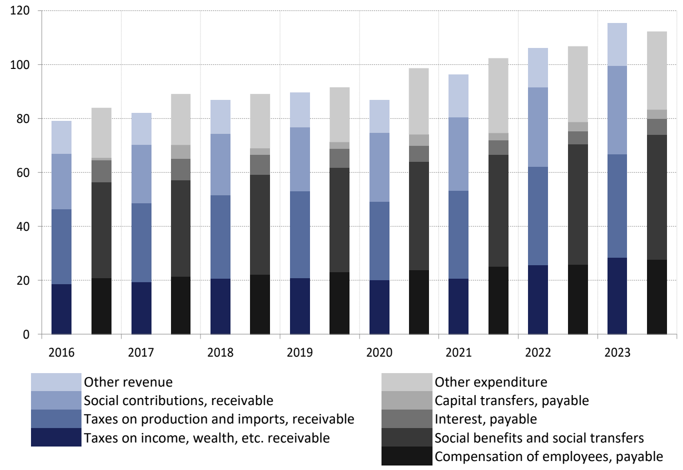
Budget balance / GDP
1.2% (-0.3%)

Debt / GDP
99.1% (112.4%)

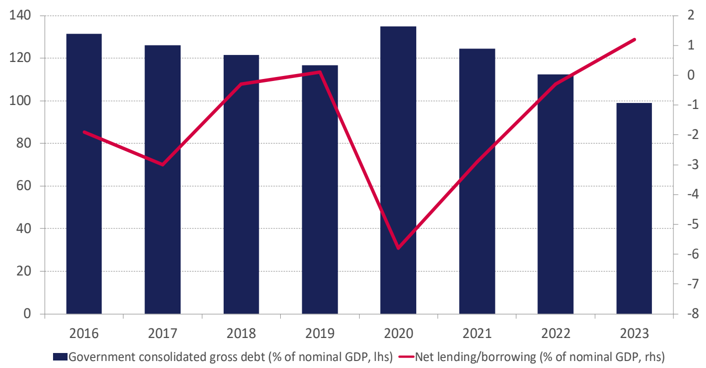
Development of the Portuguese economy

Although the agricultural sector is rather small, accounting for just under 2.2% of nominal GDP in 2022, it employed over 10% of the population. Primary areas of the Portuguese economy include grain farming, wine production and fishing. However, following a switch to synthetic wine corks and with fishing quotas upheld to secure sardine stocks, this sector is constantly confronted by new challenges. Manufacturing industries accounted for roughly 21.3% of GDP in 2022. Here, the most important sectors include the automotive industry, steel processing and the paper industry. In 2022, 322,404 vehicles were manufactured in Portugal, which are mainly exported to other EU countries. Portugal's most important trading partners include Germany, its neighbour Spain and France. At 76.5%, the service sector accounted for the largest share of GDP in 2022. The focus on renewable energies and modernisation of infrastructure should also be highlighted. For example, Montijo Airport (which serves the Lisbon region) is being expanded, while the metro lines in Lisbon and Porto are being extended. It is hoped that this will also have a positive effect on tourism. As one of the most important sectors of the service-oriented economy, tourism collapsed in March 2020 following the global travel restrictions implemented to combat COVID-19. In July, tourist numbers were 64% down on the level of the previous year. Since 2022, tourist numbers have been on the rise again, which is not least due to investments being made in upgrading the infrastructure of Portugal. Similarly to other EU Member States, Portugal was also affected by the consequences of the war in Ukraine, for example in the form of the resultant supply bottlenecks and sharp rise in inflation. In 2022, inflation stood at around 8.1%, before falling to 5.3% by year-end 2023. In the same year (2022), Portugal recorded a real GDP growth of +6.8%. With the ECB hiking key interest rates by 450 basis points between July 2022 and September 2023 as a way of counteracting rampant inflation in the Eurozone, the resulting interest burden also increased, particularly due to Portugal's above-average debt level. At the same time, however, as a result of inflation, revenues from income and wealth taxes rose disproportionately, so that in 2023 total revenue exceeded total expenditure on the national level for the first time since 2013. Likewise, since 2020, government debt has been significantly cut to below 100% of nominal GDP. In the future, the Portuguese economy will also benefit from EU support (2021-2027: EUR 60bn), which will be put to modernising infrastructure and education system.

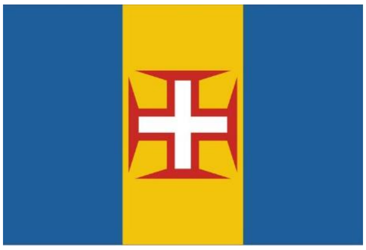
State revenue vs. government spending (EURbn)



National debt vs. budget balance (%)



Source: Eurostat, NORD/LB Floor Research



General information

Number of inhabitants (2023)
253,259

Capital city
Funchal

Nominal BIP (2022)*
EUR 6.0bn

Nominal GDP per capita (2022)*
EUR 23,675

Unemployment (2023)
6.2%

Gross debt level (2022)
EUR 5.0bn (83.3% of GDP)

Bloomberg ticker
GOVMAD

Outstanding volume
EUR 2.9bn
No FX diversification

* Provisional data

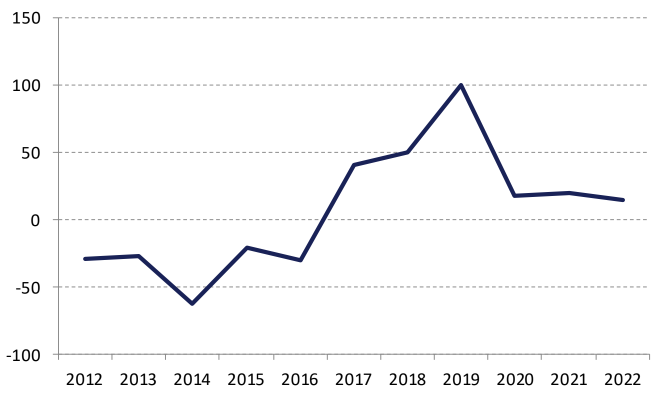
Ratings

	Long-term	Outlook
Fitch	BBB+	stab
Moody's	Ba1	stab
S&P	-	-

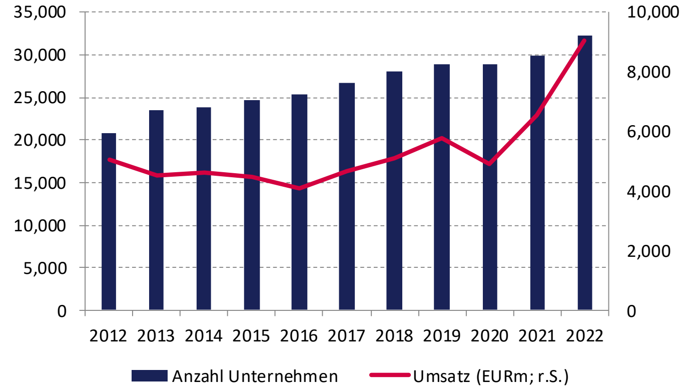
Madeira

The archipelago of Madeira consists of a group of islands covering an area of 801km^2 in the Atlantic Ocean, located around 600km off the northwest coast of Africa and 1,000km southwest of Lisbon. With 253,259 inhabitants (2023), approximately 2.4% of the Portuguese population lives on Madeira. In addition to the main island, Madeira, with its capital Funchal (approximately 110,000 inhabitants), the group of islands consists of the far smaller Porto Santo Island (approximately 5,600 inhabitants) and three uninhabited ones. Together with the Ilhas Selvagens (Savage Islands), located 280km south of the main island, the archipelago constitutes the autonomous region of Madeira. A regional government and a parliament have been instituted within the framework of a separate administration for Madeira since 1976. Taking account of its nominal GDP per capita of EUR 23,675 (2022), Madeira ranks third among all Portuguese regions. The tertiary sector accounts for the bulk of economic activities, driven primarily by long-standing growth in the tourism sector. Accordingly, the sector's contribution to the regional gross value added amounted to roughly 16%. Closer examination of the sub-segments shows that the economy is dominated by companies operating in the hotel industry and wholesale trades, in addition to banks. In the secondary sector, the food and tobacco industry as well as construction account for the largest shares. By joining the EU free trade zone, Madeira benefits from the advantages associated therewith and also operates as a global offshore financial centre through the International Business Center of Madeira (IBCM). Through a number of legislative decrees from 1986 onwards, which were supported by the EU, the region benefits from tax privileges. This aims to generate foreign investment and make the Portuguese corporate landscape more international. Specifically, the IBCM levies a tax rate on corporate profits of 5% for companies registered on Madeira until at least 2027, as against a tax rate of 21% in mainland Portugal. Accordingly, 50% of regional earnings from corporation tax is already attributable to IBCM. The volume of economic output generated by companies under the umbrella of the IBCM also amounts to 15% of national GDP. With respect to the challenging global economic situation, the economy of Madeira grew by an average of +5.3% (between 2017 and 2022) on the back of opening-up processes. As a result, its competitive standing has been enhanced.

External trade balance over time (EURm)



Number of Madeiran companies and trend in sales



Source: Direção Regional de Estatística da Madeira, Eurostat, NORD/LB Floor Research

General information

Number of inhabitants (2023)
239,942

Capital city
Ponta Delgada

Nominal BIP (2022)*
EUR 5.1bn

Nominal GDP per capita (2022)*
EUR 21,096

Unemployment (2023)
6.9%

Gross debt level (2022)
EUR 3.1bn (60.8% of GDP)

Bloomberg ticker
AZORES

Outstanding volume
EUR 2.3bn
No FX diversification

* Provisional data

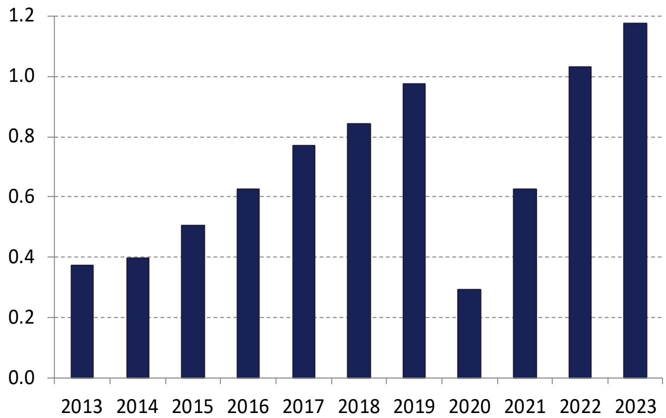
Ratings

	Long-term	Outlook
Fitch	BBB	stab
Moody's	Ba1	stab
S&P	-	-

The Azores

The Azores are a Portuguese island group situated in the middle of the Atlantic Ocean between the Eurasian and the North American plates. The most western point of Europe can therefore be found on the Azores. The group of islands includes nine larger inhabited islands with a total population of 239,942 and numerous smaller uninhabited ones. Approximately 138,000 people live on the main island, São Miguel, of whom roughly 69,000 live in the capital Ponta Delgada. With GDP per capita of EUR 21,096, the economic output of the Azores was slightly less than that of mainland Portugal (EUR 22,776). In contrast, unemployment on the Azores was very low, at 6.9% in Q4/2023, although this does reflect a rise of 1.4 percentage points compared with Q4/2022. Overall, huge progress has been achieved on the labour market in recent years, following a record high of 18% unemployment in 2014. However, youth unemployment is still a problem: 35% of the unemployed are aged under 35. In total, 76% of those in employment work in the tertiary sector, with the largest share here (33% of total employment) attributable to the public sector. The secondary sector provides 15.5% of jobs, while the primary sector accounts for an above-average share of 8.1% in a European comparison. In addition to animal husbandry, the cultivation of pineapples and tea must be highlighted here: thanks to the warm climate throughout the year, Europe's only pineapple plantation and two of the three European tea plantations are located on the Azores. Volcanic origins lend the islands a unique landscape, which has increasingly become a magnet for tourists in recent years. The number of annual visitors has more than quadrupled since the beginning of the 2000s, peaking at almost 1.2m people in 2023. However, tourism collapsed by more than 75% in 2020 due to the COVID-19 pandemic, although in the following years the number of tourists increased significantly each year. The regional economy benefits from comparatively low taxes. Corporate profits are taxed at a standard rate of 14.7% (21% in mainland Portugal) and VAT on standard products is set at 16% (23% in mainland Portugal). The latter is therefore the second lowest within the EU.

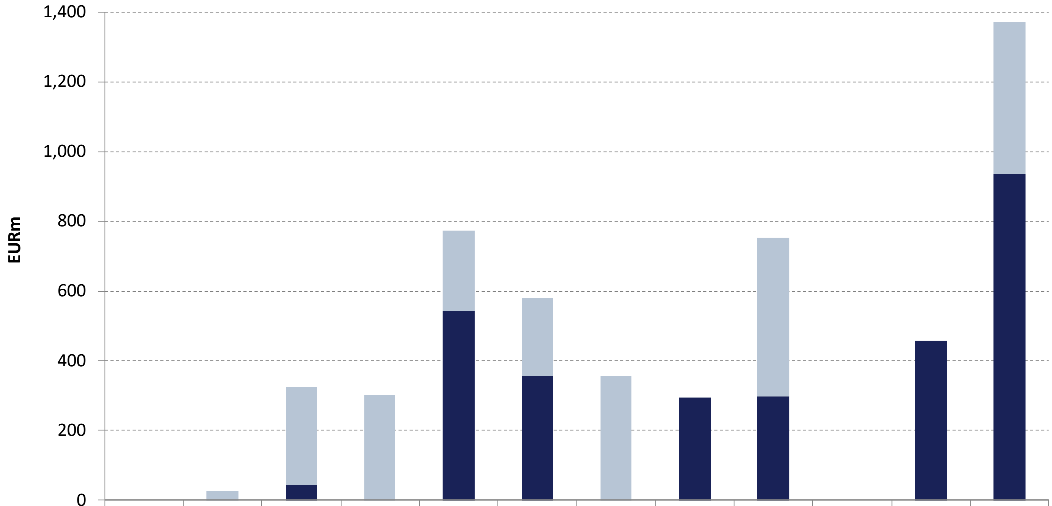
Touristes per year (in mio.)



Unemployment rate

Source: OT Acores, SREA, NORD/LB Floor Research

Autonomous Portuguese regions: outstanding bonds



	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	>2034
AZORES	0	25	285	300	230	224	355	0	455	0	0	435
GOVMAD	0	0	41	0	543	355	0	295	299	0	458	935

Source: Bloomberg, NORD/LB Floor Research

Outstanding volumes on the Portuguese sub-sovereign market

The Portuguese sub-sovereign market amounts to an outstanding volume of approximately EUR 5.2bn. The volumes are split between GOVMAD (EUR 2.9bn; 12 bonds) and AZORES (EUR 2.3bn; 11 bonds). We cannot find any evidence of foreign currency diversification. Accordingly, the FX segment plays no part in the composition of the liabilities, meaning that any diversification is provided solely in the form of different maturity segments. A total of around EUR 935m (32% of the outstanding volume) attributable to Madeira will not mature until after 2034, while the equivalent value for the Azores is EUR 435m (18.8%). The two largest bonds were both issued by GOVMAD (EUR 458m and EUR 455m), while the smallest bonds in each case are worth EUR 9.4m and EUR 16m respectively (both AZORES). Madeira was the last region to venture onto the primary market in May 2024, when it raised a total of EUR 175m with a term of 14 years. As at 28 May 2024, the spread on this bond came in at ms +75bp with a yield of around 3.6%. The rating (Baa+ / Ba1 / -) is largely responsible for this. This provides an initial indication of the spread for the segment under consideration here.

Fixed coupons dominant on Portugal's holiday islands

Fixed coupons account for the largest share of the outstanding bonds issued by the autonomous regions of Portugal. Of the bonds we have analysed (23), a total of 19 bonds featured a fixed coupon, while four are classified as "floating".

Autonomous regions yet to issue benchmarks

Given the lack of benchmark bonds, we have opted not to carry out any detailed analysis of spreads or a comparison with peers such as the German Laender, Belgian and Spanish regions or Canadian provinces. Moreover, the bonds are not listed in the iBoxx universe either, as this contains deals with outstanding bond volumes of EUR 1bn per ISIN. Nevertheless, GOVMAD and AZORES do offer a pick-up for investors, especially due to their ratings and their limited liquidity. Moreover, both issuers are likely to be open to private placements and certain expectations in terms of yield on the part of institutional investors.

Regulatory overview for RGLAs* / ** (Examples)

Issuer	Risk weighting	LCR classification	NSFR classification	Solvency II classification
Belgian regions	0%	Level 1	0%	preferred (0%)
German Laender	0%	Level 1	0%	preferred (0%)
French regions	0%	Level 1	0%	preferred (0%)
Italian regions	20%	Level 2A	15%	non-preferred (individual review)
Spanish regions	0%	Level 1	0%	preferred (0%)
Portuguese regions	***20%***	***Level 2A***	***15%***	**preferred (0%)**
(Guaranteed bonds: Madeira)	***(0%)***	***(Level 1)***	***(0%)***	

* Regional governments and local authorities
** NB: in the absence of an explicit guarantee from the respective nation state, the current LCR level is dependent on the relevant rating (see CQS classification and LCR classification of assets).
Source: NORD/LB Floor Research

Exceptions to scope of application of the Leverage Ratio (CRD IV Art. 2 no. 5) (examples)

EU	Central banks of Member States
Germany	Kreditanstalt für Wiederaufbau (KfW), entities recognised under the "Wohnungsgemeinnützigkeitsgesetz" as bodies of State housing policy and are not mainly engaged in banking transactions, and undertakings recognised under that law as non-profit housing undertakings
France	Caisse des Dépôts et Consignations (CDC)
Italy	Cassa Depositi e Prestiti (CDP)
Spain	Instituto de Crédito Oficial (ICO)
Portugal	***Caixas Económicas existing on 01 January 1986, with the exception of those incorporated as limited companies and Caixa Económica Montepio Geral***

Source: CRD IV, NORD/LB Floor Research

Regional governments and local authorities (solvency stress factor allocation of 0% possible; examples)

Country	Regional and local governments
Belgium	Communities (Communautés/Gemeenschappen), regions (Régions/Gewesten), municipalities (Communes, Gemeenten) & provinces (Provinces, Provincies)
Germany	Laender, municipalities & municipal associations
France	Regions (région), municipalities (commune), "départements"
Spain	Autonomous regions (comunidades autónomas) and local government (corporación local)
Portugal	***Autonomous regions the Azores and Madeira***

Source: (EU) 2015/2011, NORD/LB Floor Research

Summary of Portuguese regions

Risk weighting	20% (state-guaranteed bonds of Madeira: 0%)
LCR classification	Level 2A (state-guaranteed bonds of Madeira: Level 1)
NSFR classification	15% (state-guaranteed bonds of Madeira: 0%)
Solvency II classification	Preferred (0%)

Source: NORD/LB Floor Research

Issuer (Ticker)	Number of inhabitants (2023)	Unemployment (2023)	Nom. GDP per capita (2022)	Outstanding volume	No. of bonds	Rating
GOVMAD	253,259	6.2%	EUR 23,675*	EUR 2.9bn	12	(BBB+ / Ba1 / -)
AZORES	239,942	6.9%	EUR 21,096*	EUR 2.3bn	11	(BBB / Ba1 / -)
Portugal	10,467,366	6.6%	EUR 22,776	EUR 181.6bn	37	(A- / A3 / A-)

* Provisional data from 2022 (most recent available data)
Source: Bloomberg, SREA, Regional Directorate of Statistics of Madeira (DREM), Eurostat, NORD/LB Floor Research (Rating: Fitch / Moody's / S&P)

Liability mechanism

The Portuguese government does not provide an explicit guarantee for the autonomous regions. However, in the event that Madeira or the Azores were to encounter payment difficulties, Moody's, for example, believes that it is highly likely that government support would be forthcoming (implicit guarantee). Although official support for Madeira from the national government ended in December 2015 upon completion of a cost-cutting plan for the region, financing is still exposed to the Portuguese treasury. The national government approves Madeira's new borrowing and has guaranteed the region's bond issues since 2017. The Portuguese government's guarantee associated with a 0% risk weight and a Level 1 classification under the LCR only applies to these bonds. Four of the currently outstanding bonds were issued prior to this date (exclusively floaters). However, a certain degree of caution would be advisable here when selecting investment opportunities.

ECB purchase programmes

With regard to the Eurosystem's purchasing activities under the Asset Purchase Programme (APP) and the Pandemic Emergency Purchase Programme (PEPP), it is striking that, regardless of the fact that there are currently no outstanding benchmark bonds, securities issued by both AZORES and GOVMAD have been purchased. As part of its purchase programmes, the Eurosystem has acquired nine ISINs from AZORES and four from GOVMAD through purchases by the Banco de Portugal (the Portuguese central bank) over time.

Conclusion

Even after the period of favourable financing conditions on the part of the ECB has come to an end, we are seeing increasing interest in investment opportunities in the niche markets which we refer to as "Beyond Bundeslaender". This report on mainland Portugal (politics and economy) and its autonomous regions (issuers) must also be interpreted in this light. The traditional SSA portfolio is being supplemented in terms of maturity and/or yield and is becoming increasingly diversified. The resilience of the Portuguese economy, which was built up in the wake of the sovereign debt crisis in 2014, reached a high point in 2023, when total revenues exceeded expenditure for the first time since 2013. The reduction in national debt is also testament to the country's economic and fiscal policy efforts. The autonomous regions of Madeira and the Azores, whose budgets have developed solidly, are also benefiting from this. The debt levels of both regions are well below 100% of nominal GDP, with the Azores' debt level of just under 60% of GDP standing out particularly positively. In our view, tourism, which is being promoted in equal measure with the modernisation of infrastructure, harbours additional growth potential in particular. The rating experts at Fitch and Moody's also rate both regions quite positively. For example, in comparison with their Spanish peers, the ratings are converging, which serves to underline once again the positive development of the regions even during the phase of high inflation. Nevertheless, the difference between explicit and implicit guarantees for the regions and/or individual bonds is key for investors. As a point of criticism, we believe that the autonomous regions could improve the quality of their investor relations presentations, particularly with regard to keeping information up to date.

Appendix
Publication overview

Covered Bonds:

Issuer Guide – Covered Bonds 2023

Covered Bond Laws

Covered Bond Directive: Impact on risk weights and LCR levels

Risk weights and LCR levels of covered bonds (updated semi-annually)

Transparency requirements §28 PfandBG Q2/2024 (quarterly update)

Transparency requirements §28 PfandBG Q2/2024 Sparkassen (quarterly update)

SSA/Public Issuers:

Issuer Guide – German Laender 2024

Issuer Guide – German Agencies 2024

Issuer Guide – Canadian Provinces & Territories 2024

Issuer Guide – European Supranationals 2023

Issuer Guide – French Agencies 2023

Issuer Guide – Nordic Agencies 2024

Issuer Guide – Dutch Agencies 2024

Issuer Guide – Non-European Supranationals (MDBs) 2024

Beyond Bundeslaender: Belgium

Beyond Bundeslaender: Greater Paris (IDF/VDP)

Beyond Bundeslaender: Spanish regions

Fixed Income Specials:

ESG-Update 2024

ECB decision: Cut, sleep, repeat

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Fixed Income Relationship Management Europe	+352 452211-515

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Governments	+49 511 9818-9660
Länder/Regionen	+49 511 9818-9660
Frequent Issuers	+49 511 9818-9640

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