Demonstrators opposed to bailout-mandated austerity measures carry a banner reading "Government out!" during a May Day rally in Porto. Associated Press

LISBON—Portugal said it won't need further help from its bailout lenders, a milestone in Europe's financial recovery and a gamble that one of the Continent's most indebted countries can now stand on its own.

Prime Minister Pedro Passos Coelho announced Sunday that his government had decided not to seek a precautionary credit line from the lenders—its European Union peers and the International Monetary Fund—and will rely solely on markets for financing after taking the final installment of a €78 billion ($108 billion) bailout package next month.

The clean exit from the three-year rescue program caps a surprising turnaround for Western Europe's poorest economy, which last year began a slow climb out of recession but remains burdened by high unemployment, debt and inefficiencies that could take years to overcome.
Those lingering weaknesses make Portugal's bailout less than a clear-cut vindication of the austerity formula championed by Germany to confront the debt crises that threatened to undermine Europe's common currency in recent years.

"I know the return of economic growth in the last year is yet to be translated into better day-to-day lives for a lot of people," Mr. Passos Coelho said in a televised address. But he added that Portugal is "on the right path and...recovering with a more solid and sustainable base than what we had in the past."

Euro-zone countries taking bailout money have been required to make budget cuts and structural overhauls overseen by the so-called troika—the IMF, the European Commission and the European Central Bank. Those conditions have been controversial across Europe and have met with popular protests in all four countries that have taken bailouts since 2010.

Portugal is the second of those countries, after Ireland, to regain financial independence. Greece and Cyprus are still receiving rescue loans.

Advocates of the austerity formula argue that Portugal has shown it works. German Finance Minister Wolfgang Schäuble said Sunday that the country's emergence from the bailout "shows once again that the path we have jointly taken in the euro zone was the right one."

But profit-seeking global investors also played a part in Portugal's return to financial markets, and strict bailout conditions helped prolong the recession, cutting hard into incomes and social services for many of its 10 million people.
Despite its rebound, Portugal is more heavily indebted than before the bailout—a burden that underscores the risk taken by Mr. Passos Coelho's government in choosing not to seek a precautionary credit.

Such a credit would be held in reserve, and could be tapped to shore up Portugal's finances if investors again lose faith in its ability to repay debts. But the credit would come with new austerity conditions, and Mr. Passos Coelho has said it was unclear what those conditions would be.

Portugal's cabinet approved the clean bailout exit Sunday evening. "After much thought about the pros and cons, we concluded that this is the right choice at the right moment," Mr. Passos Coelho said in his televised speech.

Portugal requested a bailout in April 2011 after concern over soaring debt sent investors fleeing. Throughout the 2000s, the economy had grown an average 1% a year as Portuguese companies lost out to low-cost producers abroad. Cheap credit had enabled the state to spend far more than it collected.

Under the troika's guidance, Portugal has slashed its budget deficit in half—to 4.9% of gross domestic product—privatized public companies and cut public holidays to 10 a year from 14. Labor restrictions were loosened, allowing companies to set more flexible contract terms, reduce overtime pay and lay off workers more cheaply.

The payoff, economists say, was an export boom. Portugal has achieved its first current-accounts surplus in 20 years, not only because it can afford fewer imports but also because the labor changes have made exports cheaper, said Christian Schulz, an economist with Berenberg Bank in London. "Exports, which are the main indicator of competitiveness, are now 15% to 16% above where they were before the crisis," he said. "Portugal's recovery is solid."

Other analysts say global financial markets and ECB President Mario Draghi's pledge to defend the euro at any cost were at least as big a factor in Portugal's comeback.

The country's borrowing costs, which had peaked at 17% a year in January 2012, began falling sharply later that year—long before the economy turned around. Investors began buying Portuguese bonds because their relatively high returns were effectively backed by Mr. Draghi's pledge—not, some analysts say, because they were bullish on Portugal's economic health.

"It's undeniable that Portugal has regained some competitiveness since the crisis began," said Nicholas Spiro, managing director at Spiro Sovereign Strategy in London. "But the dramatic improvement in market sentiment that is allowing the country to exit the bailout has everything to do with Draghi's words."

Portugal appeared to seal its financial independence by selling 10-year bonds last month at a yield of 3.59%, its lowest borrowing cost since 2006. The country now has a cash cushion to cover more than a year of financing needs.

Mr. Passos Coelho, who assumed office a month into the bailout period, took pains to shore up market confidence with repeated assurances that the troika's conditions would be met—as a chorus of skeptics here and abroad said the rescue effort was misguided.

For two years, it appeared the effort might fail. The economy spiraled downward as the government raised taxes and cut spending. Companies failed and unemployment shot up.
Protesters filled the streets, and court orders blocked some of the cuts. Portuguese bonds sank to junk status. "It was like flying a plane with four faulty engines," one official recalled. "While we focused on fixing one engine, the other three would fall apart."

Even as disagreements over the unpopular measures pushed his government to the brink of collapse last summer, Mr. Passos Coelho held on.

Critics say he stuck to overly ambitious deficit-cutting targets that proved too sudden a blow to an economy reliant on thousands of small companies.

"As a result, the recession was deeper, and that led to higher unemployment, widespread impoverishment, a destruction of the middle class and the weakening of the welfare state," said Manuela Ferreira Leite, a member of Mr. Passos Coelho's Social Democratic Party who was finance minister a decade ago.

The economy is growing again, but the government's forecast of 1.2% GDP expansion this year is less than one-third of what the economy has lost since the bailout began. Unemployment is at 15.3%, down from a peak of 17.7%. It is 35% among those under 25 years of age. Some civil servants' salaries have fallen more than 10%. Budget cuts have forced the closure of public schools and raised copayments for health-care costs.

The country's debt soared to 129% of GDP, from 93% at the start of the bailout, as the government scrambled to rescue struggling state companies and kept paying high subsidies to energy providers. The IMF has warned that the country's long-term outlook remains dependent on ambitious deficit and growth goals for many years to come.

"The troika may be leaving, but we are stuck here with decades of more austerity," said Carlos Pereira, a 57-year-old former printing-press operator, now unemployed, whose remarks at Thursday's Labor Day rally here reflected the stoic public mood.

Write to Patricia Kowsmann at patricia.kowsmann@wsj.com