

7. FINANCIAL SITUATION

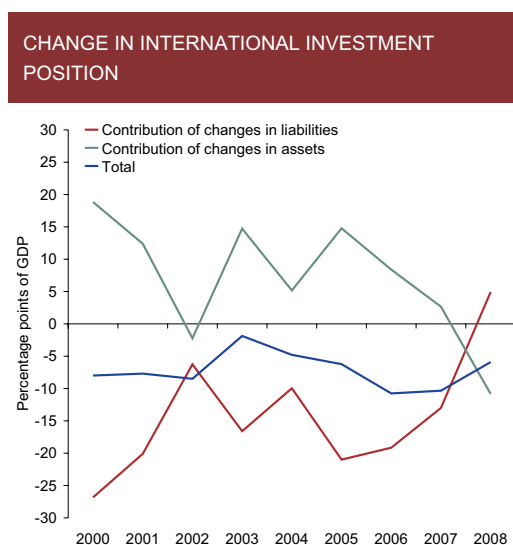
7.1. Overview

In 2008, the financial situation of the Portuguese economy was strongly conditioned by the crisis in the international financial markets, and by its growing interaction with global economic activity. In fact, after a long period characterised by growing financial integration of the Portuguese economy, translated by very substantial financial flows with the rest of the world, there was since the second half of 2007 a gradual reduction in the intensity of these flows, *i.e.*, smaller increases both in external liabilities and external assets. Given the recrudescence of the financial crisis in the second half of 2008, particularly in the fourth quarter, there was even a sudden change in the direction and dimension of the external financial flows. Accordingly, for 2008 as a whole, the current and capital account deficit (10.5 per cent of GDP) was financed by a reduction of external assets of approximately 13 per cent of GDP, with a fall in external liabilities of around 2 per cent of GDP. Note that this evolution strongly contrasts with the external deficit financing profile seen in previous years.

The maintenance of a significant current and capital account deficit caused an additional deterioration of the Portuguese international investment position in 2008. The observed deterioration was inferior to the financial account balance, mainly reflecting the substantial negative changes in value of foreign direct investment in Portugal. During the last years, the worsening of Portugal's external debtor position had been essentially associated to an accumulation of debt (net of holdings of similar instruments) by non-residents, since the Portuguese debtor position in direct investment and shares (net of Portugal's external investment position in the same instruments) remained relatively limited. In contrast, the change in 2008 in the international investment position was characterised by a significant reduction in external assets and by a fall, clearly inferior, in external liabilities (Chart 7.1.1).

The fact that resident sectors maintain a significant amount of external assets (about 170 per cent of GDP at the end of 2008) allows them to adapt to the disturbances in the international financing markets, caused by global or idiosyncratic factors, and, therefore, to sustain a discrepancy between do-

Chart 7.1.1



Sources: INE and Banco de Portugal.

mestic savings and investment. Note, however, that although this permits the existence of a prolonged adjustment, it does not eliminate inevitable inter-temporal solvency restrictions that will become active in a more or less distant moment.

The deterioration of the current and capital account reflected the increase in net borrowing from non-financial corporations, particularly associated with a fall in savings, as a result of a smaller operational profitability and an increase in capital remuneration paid by this sector, both as interest and as dividends. In turn, in an environment of relative stability in private consumption growth, the acceleration of individuals' disposable income caused a slight improvement in the sector's savings rate, after the fall registered in the previous year. Finally, General Government net borrowing showed, in 2008, an interruption in the reduction trend registered since 2005. Note that this result was achieved in a context of investment contention and of obtaining some non-current revenues, given the savings reduction in the sector.

The banking system's economic and financial environment was significantly deteriorated in 2008. There were significant falls in shares prices, most visibly in financial corporations, sharp increases in risk premiums for private debt securities, and strong tensions in the money markets. Nevertheless, the institutions revealed a strong adaptation capacity in a particularly adverse context, and we can conclude that they continued to perform their financial intermediation role. Note that despite Portuguese banks not having a significant direct exposure to the American subprime market, the disturbance effects in international financial markets had, nevertheless, a negative repercussion on the Portuguese banking system's evolution of activity, profitability and capital adequacy. Given the changes in their environment, the institutions adjusted the conditions offered to their customers. These changes translated, on one hand, into an improvement in customer's resources' compensation (whose evolution also benefited substantially from a reallocation in individuals' financial assets portfolio) and, on the other hand, from an increase in restrictiveness regarding access to financing on behalf of households and corporations.

7.2. Financial account and international investment position

In 2008, the financial account registered net inflows of 10.9 per cent of GDP, continuing to reflect the maintenance of a large deficit between domestic savings and investment. (Table 7.2.1).¹ In fact, the significant recourse to external savings to meet the borrowing requirements of resident sectors has led to a situation in which the international investment position of the Portuguese economy has become progressively more indebted.

The Portuguese banking system, while performing the crucial financial intermediation task, has been the main way of channelling external savings into the economy. However, since mid-2007, the turmoil affecting the financial markets affected bank borrowing from the international wholesale debt markets. In fact, Portuguese banks' operating context changed significantly, namely by the particularly adverse evolution of capital markets and by the continuous, significant and comprehensive deterioration of prospects regarding the evolution of economic activity. At the same time, in a context of increased risk

(1) Similarly to previous years, financial account records are affected by end-of-the-year temporary operations between banks and monetary authorities, with impact only in the distribution of the economy's external position between these two sectors, and without affecting the financial account overall balance. This type of operations has an impact on statistics regarding other investment flows of these two sectors, not allowing for a direct reading of the importance of banks in financing the economy. In the table, the figures adjusted for these operations (representing impacts of 2.1 and 3.0 per cent of GDP, respectively in 2007 and 2008) can be found in brackets. For example, values regarding 2008 are adjusted both for temporary operations happened at the end of 2007 and reversed in the first days of 2008 (3.2 per cent of GDP), and for temporary operations happened at the end of 2008 (0.3 per cent of GDP). At the end of 2007, in the context of the tension observed in the euro money market, this effect was especially relevant. In this period there was a strong increase in deposits by resident credit institutions with the Banco de Portugal, for which contributed the extraordinary liquidity absorbing operations conducted by the Eurosystem. Given the temporary nature of the mentioned operations, the following analysis is based on values also corrected for these operations.

Table 7.2.1

FINANCIAL ACCOUNT						
Percentage of GDP						
	Jan-Dec 2007			Jan-Dec 2008		
	Change			Change		
	Liabilities	Assets	Net	Liabilities	Assets	Net
Current and capital account			-8.1			-10.5
Financial account	17.0 (19.1)	-8.9 (-11.0)	8.0	-1.8 (-4.7)	12.6 (15.6)	10.9
Direct investment	1.4	-2.5	-1.1	1.5	-0.9	0.6
<i>excluding Madeira and St. Maria (Azores) offshores</i>	1.5	-2.4	-0.9	0.9	-0.4	0.5
Portfolio investment	11.0	-4.9	6.2	15.8	-7.4	8.3
Financial derivatives	-5.0	5.1	0.1	-13.8	13.9	0.2
Other investment	9.6 (11.6)	-7.1 (-9.2)	2.4	-5.2 (-8.2)	7.1 (10.0)	1.9
Reserve assets		0.4	0.4		0.0	0.0
By resident institutional sector:						
Monetary authorities ^(a)	-0.3 (1.8)	0.0	-0.3 (1.7)	7.6 (4.7)	0.1	7.7 (4.8)
Portfolio investment	0.0	0.6	0.6	0.0	-2.3	-2.3
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	-0.3 (1.8)	-1.1	-1.4 (0.7)	7.7 (4.7)	2.4	10.1 (7.1)
Reserve assets		0.4	0.4		0.0	0.0
General government	1.8	0.8	2.7	0.7	3.6	4.2
Direct investment	0.0	0.0	0.0	0.0	0.0	0.0
<i>excluding Madeira and St. Maria (Azores) offshores</i>	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio investment	1.7	-0.1	1.6	5.7	-0.3	5.4
Financial derivatives	-0.5	0.6	0.1	-3.9	4.1	0.2
Other investment	0.7	0.3	1.0	-1.2	-0.2	-1.4
Other monetary financial institutions ^(a)	13.0	-3.8 (-5.8)	9.2 (7.2)	-12.7	5.6 (8.6)	-7.1 (-4.2)
Direct investment	0.4	-0.3	0.0	0.1	0.0	0.1
<i>excluding Madeira and St. Maria (Azores) offshores</i>	0.4	-0.3	0.0	0.1	0.0	0.1
Portfolio investment	7.3	-3.0	4.3	7.3	-8.6	-1.2
Financial derivatives	-3.4	3.3	-0.1	-8.7	8.6	-0.1
Other investment	8.8	-3.8 (-5.9)	5.0 (2.9)	-11.5	5.6 (8.5)	-5.9 (-2.9)
Non-monetary financial institutions	2.6	-1.6	1.0	3.3	4.0	7.2
Direct investment	0.4	-0.1	0.2	0.3	-0.1	0.2
<i>excluding Madeira and St. Maria (Azores) offshores</i>	0.4	-0.1	0.2	0.2	-0.1	0.1
Portfolio investment	2.6	-1.8	0.8	3.3	3.7	7.1
Financial derivatives	-0.8	0.8	0.0	-0.3	0.3	0.0
Other investment	0.3	-0.4	-0.1	-0.1	0.0	0.0
Non-financial corporations	-0.1	-3.0	-3.1	0.0	-1.2	-1.2
Direct investment	0.6	-2.0	-1.4	1.1	-0.8	0.2
<i>excluding Madeira and St. Maria (Azores) offshores</i>	0.7	-2.0	-1.2	0.6	-0.3	0.3
Portfolio investment	-0.6	-0.3	-0.9	-0.6	-0.2	-0.8
Financial derivatives	-0.3	0.3	0.1	-0.3	0.3	0.0
Other investment	0.1	-1.0	-0.9	-0.1	-0.5	-0.6
Households	0.0	-1.4	-1.4	-0.7	0.6	-0.1
Direct investment	0.0	0.0	0.0	0.0	0.0	0.0
<i>excluding Madeira and St. Maria (Azores) offshores</i>	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio investment	0.0	-0.3	-0.3	0.0	0.2	0.2
Financial derivatives	0.0	0.0	0.0	-0.6	0.6	0.1
Other investment	0.0	-1.1	-1.1	-0.1	-0.3	-0.4
Errors and omissions			0.1			-0.4

Sources: INE and Banco de Portugal.

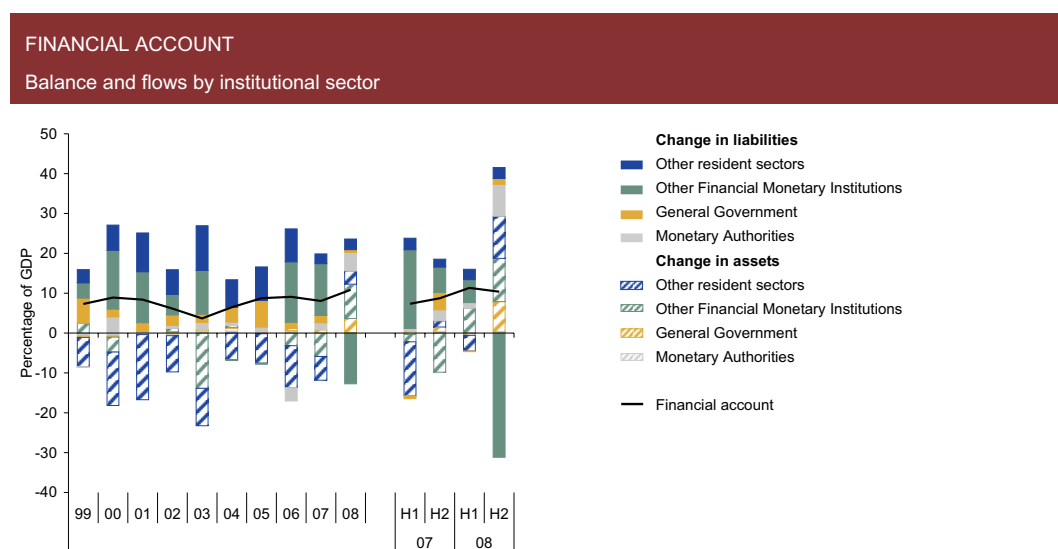
Notes: A (+) signal means an increase in external liabilities or a decrease in external assets, i.e., financial inflow. A (-) signal means a decrease in external liabilities or an increase in external assets, i.e., a financial outflow. (a) The values between brackets in other investment from monetary authorities and other monetary financial institutions are adjusted regarding temporary end-of-year operations, reversed at the first days of the following year, between these two sectors. For more details see note (1).

aversion, residents have readjusted their portfolio of financial assets in favour of bank deposits to the detriment of financial investments more sensitive to market fluctuations, such as mutual funds units.

After a period characterised by a growing financial integration, with very substantial flows with the rest of the world, there was in the second half of 2007, and more evidently in the first half of 2008, a progressive reduction in the intensity of external financial flows, *i.e.*, less increases both in liabilities and assets.² Subsequently, with the augment of the financial crisis in the second half of 2008, particularly in the fourth quarter, there was a sudden change in the direction and dimension of external financial flows (Chart 7.2.1).³ Accordingly, in 2008 as a whole, the current plus capital account deficit was financed by a reduction in external assets of approximately 13 per cent of GDP, and a fall of external liabilities of around 2 per cent of GDP.

It should be stressed, in 2008, the reversal regarding net financing flow of other monetary financial institutions, *i.e.* net outflows of funds of 4.2 per cent of GDP, contrasting with net inflows of 7.2 per cent of GDP in 2007. This reflected, to a large extent, the very significant reduction of loans or deposits in the Portuguese banking system by non-residents. This evolution may be, partly, associated with the amortisation of medium and long-term securities issued by subsidiaries and branches of Portuguese banks abroad.⁴ In this period, there was a significant increase in the Portuguese banking system's net investments in bonds and other medium and long-term debt securities issued by non-residents, which may

Chart 7.2.1



Sources: INE and Banco de Portugal.

Notes: A (+) signal means an increase in external liabilities or a decrease in external assets, *i.e.*, financial inflow. A (-) signal means a decrease in external liabilities or an increase in external assets, *i.e.*, a financial outflow. Figures for "Other investment" of Monetary Authorities and Other Financial Monetary Institutions are adjusted for temporary end-of-year operations between the two sectors which were reversed in the first few days of the following year.

- (2) It should be remembered that until the break out of the crisis, in the summer of 2007, the increase in liabilities reflected, particularly, the growing of gross indebtedness of general government and banks to non-residents, and the increase in assets reflected the significant acquisition of external securities by Portuguese investment funds.
- (3) In this period, the financial derivatives item presented very significant liability and asset flows. In what regards general government, this increase was associated to a significant issuance of registered public debt and to the respective use of interest rate and exchange rate hedging instruments, particularly in the last quarter of 2008. Regarding other monetary financial institutions and other resident sectors, in 2008 the financial derivatives item reflected, to some extent, the extension of the questionnaire - used for the calculation of this item - to include all resident monetary financial institutions, which are required to report the operations performed on their own account and on behalf of customers (up to 2007 only the main institutions were surveyed). Nevertheless, the contribution of the net change in financial derivatives to the external financial situation of the different sectors considered is virtually nil.
- (4) It should be remembered that the channelling of funds – obtained through the issuance of securities by subsidiaries and branches abroad – to their respective parent companies is registered in Portugal's financial account as an increase in liabilities regarding other investment by other financial monetary institutions, corresponding to loans or deposits made by non-resident financial institutions with resident institutions.

have been associated with credit securitisation operations.⁵ These operations made a positive contribution to the institutions' liquidity management, given that these securities are eligible as collateral in Eurosystem's monetary policy operations. Regarding portfolio investment liability flows, there was a net inflow of 7.3 per cent of GDP in 2008, value similar to the previous year. In fact, despite adverse conditions in the access to international wholesale debt market financing, other monetary financial institutions managed to preserve some access to primary markets for debt securities, particularly in the second quarter of the year, even if at shorter maturities and with higher costs. Finally, in a context of disturbances in the functioning of the interbank money market and, in general, in the wholesale debt market, banks seem to have concentrated their liquidity domestically, which led to a reduction of their other investment assets, in contrast to the previous year.

Since the beginning of the crisis in the international financial markets in the summer of 2007, there has been a substantial change in the role of non-monetary financial institutions regarding current plus capital account financing. This change reflected the above-mentioned individuals' financial assets portfolio reallocation, which involved substantial redemptions of investment funds units and, consequently, a reduction of investment in securities issued by non-residents. It should be remembered that, as part of the participation in the euro area, and in the context of a particularly favourable financial environment in force for a very long period up to the emergence of the financial crisis, institutional investors, particularly investment funds, took advantage of this environment to diversify their financial assets portfolios, gradually increasing the relative importance of foreign securities and thus contributing significantly to the accumulation of external assets. As opposed to 2007, when net outflows associated with portfolio investment of this sector amounted to 1.8 per cent of GDP (-8.0 per cent of GDP in the first half of 2007 and 4.3 per cent of GDP in the second half), 2008 witnessed a portfolio disinvestment of 3.7 per cent of GDP.

Regarding general government, net inflow of funds through debt acquisition by non-residents was significantly superior in 2008 to what happened in the previous year, reflecting to a large extent the direct acquisition of Treasury securities in the primary market, particularly in the last quarter of 2008. In contrast, the repayment of short-term loans granted by non-resident financial institutions contributed to a net outflow of funds in the first half of 2008.

In 2008, direct investment operations corresponded to net fund inflows of 0.6 per cent of GDP, in contrast to net fund outflows of 1.1 per cent of GDP in the previous year. This evolution mainly reflected a significant decrease of Portuguese direct investment abroad as a percentage of GDP.

The Portuguese economy's debtor position *vis-à-vis* the rest of the world, as assessed by the international investment position, continued to increase, standing at 97.2 per cent of GDP in 2008, compared to 91.3 per cent in 2007 (Table 7.2.2 and Chart 7.2.2). The increase in Portugal's external debtor position has been essentially associated with the accumulation of debt with non-residents, as the debtor position in the form of direct investment and shares (excluding Portugal's external investment position in the same instruments) has not been very significant (Chart 7.2.3). This worsening in the international investment position (by 5.9 p.p. of GDP) was inferior to the financial account balance (10.9 per cent of GDP), chiefly as a result of negative changes in the value of foreign direct investment in Portugal. To a large extent, this resulted from the high level of depreciation of a major corporation, whose capital is mostly held by non-residents.

(5) These operations were materialised through the issuance of securities by non-monetary financial institutions, which are typically underwritten by non-residents. These correspond in the financial account to increases in these institutions' portfolio investment liabilities. In 2008, an amount of 4.9 per cent of GDP was issued in securities under the scope of credit securitisation operations acquired by non-residents, which compares with 1.7 per cent of GDP in the previous year. Acquisitions by lending banks (or by other resident banks usually belonging to the same banking group) regarding securities issued following credit securitisation operations are recorded, in the financial account, as an increase in investment portfolio assets of other monetary financial institutions, as they correspond to acquisitions from non-resident institutions who initially acquired them. In this case, this does not imply a change in the type of bank lending to resident sectors, which remains in the banks' portfolios, although now segregated, in the form of external securities.

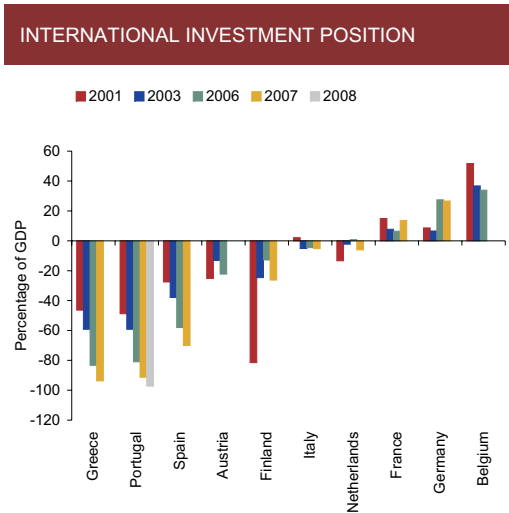
Table 7.2.2

	EUR millions							Percentage of GDP		
	2006	2007	2008				2006	2007	2008	
	End-of-period positions	End-of-period positions	Transactions	Price changes	Exchange rate changes	Other adjustments	End-of-period position	End-of-period positions		
International investment position	-125 833	-148 974	-18 050	6 295	-464	-337	-161 531	-80.9	-91.3	-97.2
Direct investment ^(a)	-26 179	-32 339	-974	7 406	-170	82	-25 996	-16.8	-19.8	-15.6
Portfolio investment	-25 786	-37 576	-13 821	-2 104	306	517	-52 678	-16.6	-23.0	-31.7
Financial derivatives	181	82	-251	332	0	0	163	0.1	0.1	0.1
Other investment ^(b)	-81 553	-86 984	-3 084	0	-601	-936	-91 605	-52.5	-53.3	-55.1
Reserve assets	7 504	7 843	79	662	1	0	8 585	4.8	4.8	5.2
By resident institutional sector:										
Monetary authorities	15 370	16 894	-12 877	805	-12	-22	4 787	9.9	10.4	2.9
Portfolio investment	10 692	9 656	3 841	147	-1	2	13 645	6.9	5.9	8.2
Financial derivatives	0	0	3	-4	0	0	0	0.0	0.0	0.0
Other investment	-2 826	-605	-16 800	0	-12	-24	-17 442	-1.8	-0.4	-10.5
Reserve assets	7 504	7 843	79	662	1	0	8 585	4.8	4.8	5.2
General government	-67 314	-72 275	-7 031	-2 882	261	2	-81 925	-43.3	-44.3	-49.3
Direct investment	118	101	0	0	-1	0	100	0.1	0.1	0.1
Portfolio investment	-70 880	-72 396	-8 976	-3 203	174	-1	-84 402	-45.6	-44.4	-50.8
Financial derivatives	-59	-57	-333	321	0	0	-69	0.0	0.0	0.0
Other investment	3 506	77	2 279	0	87	3	2 446	2.3	0.0	1.5
Other monetary financial institutions	-78 756	-93 970	11 846	3 071	-277	252	-79 079	-50.7	-57.6	-47.6
Direct investment	1 450	1 865	-206	-688	-269	-26	677	0.9	1.1	0.4
Portfolio investment	7 496	-588	2 077	3 913	74	-256	5 220	4.8	-0.4	3.1
Financial derivatives	296	186	173	-155	0	0	204	0.2	0.1	0.1
Other investment	-87 998	-95 433	9 802	0	-82	534	-85 179	-56.6	-58.5	-51.3
Non-monetary financial institutions	30 620	27 680	-12 041	-6 612	-2	-89	8 936	19.7	17.0	5.4
Direct investment	-5 335	-6 294	-335	4	1	-46	-6 670	-3.4	-3.9	-4.0
Portfolio investment	36 584	33 800	-11 727	-6 727	7	471	15 823	23.5	20.7	9.5
Financial derivatives	-55	-50	-61	111	0	0	0	0.0	0.0	0.0
Other investment	-575	224	81	0	-10	-513	-218	-0.4	0.1	-0.1
Non-financial corporations	-45 896	-49 622	1 937	14 975	-427	-694	-33 831	-29.5	-30.4	-20.4
Direct investment	-22 808	-28 532	-388	8 089	98	-60	-20 792	-14.7	-17.5	-12.5
Portfolio investment	-23 899	-22 572	1 334	6 954	1	300	-13 983	-15.4	-13.8	-8.4
Financial derivatives	-1	3	66	-68	0	0	1	0.0	0.0	0.0
Other investment	812	1 479	925	0	-526	-934	943	0.5	0.9	0.6
Households	20 142	22 318	114	-3 061	-6	215	19 580	13.0	13.7	11.8
Direct investment	395	520	-45	0	0	214	690	0.3	0.3	0.4
Portfolio investment	14 221	14 524	-371	-3 187	51	1	11 019	9.1	8.9	6.6
Financial derivatives	0	0	-99	127	0	0	27	0.0	0.0	0.0
Other investment	5 527	7 274	629	0	-58	0	7 845	3.6	4.5	4.7

Sources: INE and Banco de Portugal.

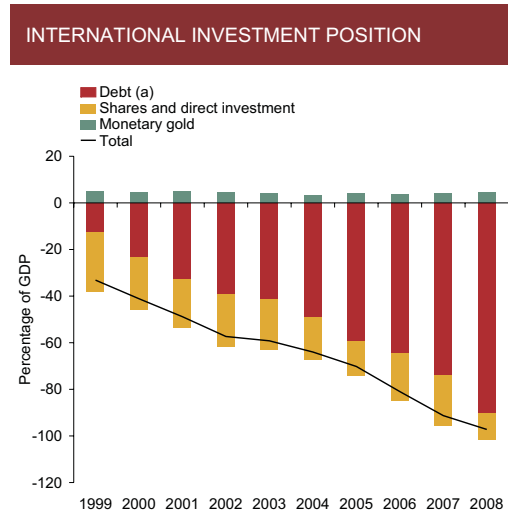
Notes: (a) Includes quarterly estimates calculated by Banco de Portugal based on the accumulation of monthly flows and the latest annual data obtained from Direct Investment Surveys. (b) Includes, in some components, quarterly estimates calculated by Banco de Portugal based on the accumulation of monthly flows.

Chart 7.2.2



Sources: IMF and Banco de Portugal.

Chart 7.2.3



Sources: INE and Banco de Portugal.

Note: (a) Includes debt securities, other investment, financial derivatives, participation units in investment funds, securitisation units and others. This debts concept is different from the one published in Table A.3.2 of the *Statistical Bulletin* of Banco de Portugal, since participation units in investment funds, securitisation units and other participation securities are recorded as debt. Additionally, the debt concept used here does not include the difference between direct investment assets and liabilities, presented as other capital, regarding available funds and liabilities over subsidiaries and direct investors. In this chart these elements are included in "Shares and direct investment". This way, this different treatment does not change the total value of the International Investment Position.

7.3. Securities market

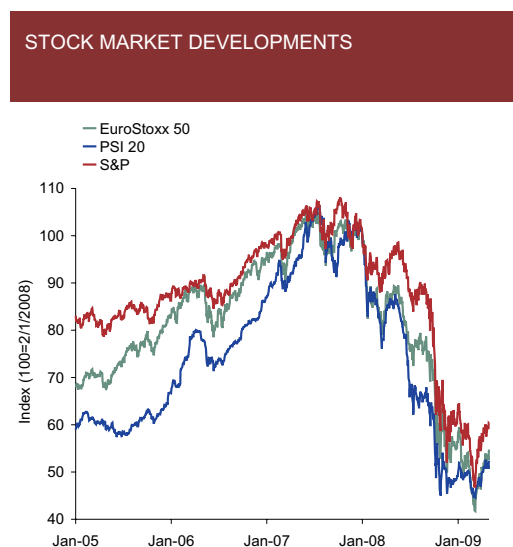
The year of 2008 was marked by a sharp reduction in the main stock market indexes in Europe and America (Chart 7.3.1). The Standard & Poor's 500 American index fell 38 per cent during 2008, reaching at the end of the year the same level as in mid-1997. The European index EuroStoxx 50 and the Portuguese PSI 20 fell 44 and 51 per cent, respectively, returning at the end of 2008 to 2003 levels. The losses in the stock market indexes happened during the whole year, but especially during the month of October. The evolution of financial institutions' securities listed in the Portuguese stock market was more unfavourable than that of the rest of the securities. For example, the weight of these institutions in total capitalisation fell to 18.4 per cent in December of 2008, comparing to 26.5 per cent in December of 2007. This pattern was seen, in general, also in other European and American stock markets. The fall in stock market indexes continued until the beginning of March of 2009, and from that moment on there was a recovery that reached – at the end of April and considering the indexes of Chart 7.3.1 – an increase between 15 and 26 per cent regarding the level of early March.

The average turnover ratio⁶ (a measure of the volume of stock negotiated), that has been increasing since 2003, increased slightly compared to 2007, suggesting a high level of activity in the Portuguese stock market (Chart 7.3.2).

Negative news continued during the whole year. We should highlight, considering its symbolic nature, the collapse of the English bank Northern Rock, in February, in the wake of a mass depositor run to its branches. In March, the American investment bank Bear Stearns was bought in distress by another American bank with Government support. Later, in September, it was announced that the American investment bank Lehman Brothers would start bankruptcy procedures. This event highlighted the extreme interdependence between institutions, with instability spreading to a growing number of financial

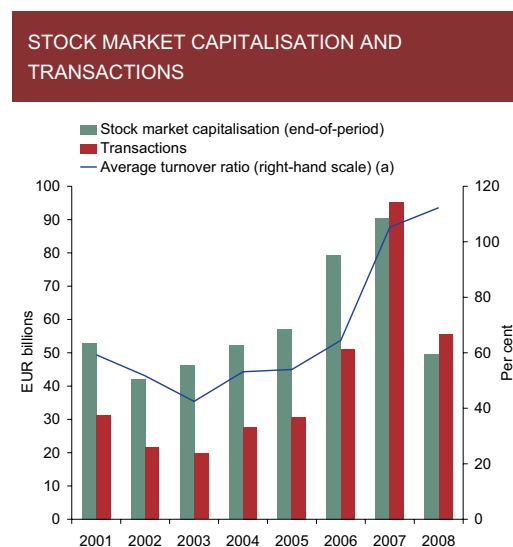
(6) This value is calculated as the quotient between the value of stock turnover in 2008 and the end-of-year stock market capitalization.

Chart 7.3.1



Source: Bloomberg.

Chart 7.3.2



Source: CMVM.

Note: (a) Defined as the ratio of the value of traded shares to the value of listed shares.

institutions, other financial market segments and other countries. The effects of the crisis were not limited to the financial sector. In a context where there was already a fall in the shares of non-financial corporations, although less sharp than the one of financial corporations, these developments lead to a global confidence crisis and to the general perception of a high counterparty risk. This led to an abrupt deterioration of prospects regarding developed economies that spread quickly to most emerging countries and securities' quotation in all sectors.

Fortis Bank collapsed at the end of September, causing this bank with Belgium, Dutch and Luxembourg capital to be partially nationalised by these States.

During the first week of October, and despite news reporting the approval of a help plan to the American financial sector, in the amount of 700 billion dollars, very negative developments continued to arise regarding the markets. The Icelandic crown collapsed, with international agents showing scepticism regarding Iceland's ability to pay its sovereign debt. Just like in other situations during this crisis, the events in Iceland had major repercussions in other economies. These developments show the global nature of this financial crisis, where news coming from certain markets strongly influenced the performance of other markets. Between 1 and 10 October, the S&P index devalued 22.7 per cent, while the EuroStoxx 50 fell by 21.1 per cent and the PSI 20 dropped 21.4 per cent. The rhythm of the fall would slow down until the end of the year, which was one of the worst ever for the stock markets, both in Portugal and worldwide.

Net security issuances in Portugal during 2008 were a clear reflex of the global financial crisis. The year was marked by the strong increase in net debt issuance by the general government. In what regards monetary financial institutions, there was a significant net bond repayment in the external market, through non-resident branches and affiliates, together with net issuances by resident entities. Non-financial corporations increased the weight of shares and other participations (especially unlisted ones) in their financing sources, in place of securitised debt. There was also an increase on behalf of investors in the rhythm of redemptions regarding security funds units.

Net issuance of securities by resident entities increased strongly during 2008, amounting to a net total of about 21.2 per cent of the Portuguese GDP, comparing to 16.1 per cent in 2007 (see Table 7.3.1).

Unlike what happened in previous years, there was a very strong increase in net issuance of debt by the general government, which was responsible by almost half the increase in net issuances by residents *vis-à-vis* 2007, moving from 1.1 to 5.7 per cent of GDP in 2008. This increase is related with public deficit financing requirements on one hand and on the other with the increase in financial assets held by general government; it is also related with the reduction of transactions on financial liabilities not included in the public debt (see Chapter 2 of this Report). The instruments used were essentially short-term ones (Table 7.3.2), whose net issuances went from -0.1 per cent of GDP in 2007 to 3.6 per cent in 2008.

At the same time, there was a slight increase in net debt issuances by resident monetary financial institutions, from 9.6 per cent of GDP in 2007 to 10.6 per cent in 2008. In opposition, estimates of net bond issuances on behalf of branches and affiliates of Portuguese banks abroad (Table 7.3.1) point to a net repayment of about 4.4 per cent of GDP. This net issuance reduction by non-resident entities to the detriment of domestic issuances is related to the fact that, among other factors, the European Central Bank stopped accepting bank securities issued through affiliates and branches abroad⁷ as collateral in monetary policy operations.

Table 7.3.1

ISSUANCE OF SECURITIES IN EXTERNAL AND DOMESTIC MARKETS BY INSTITUTIONAL SECTOR				
As a percentage of GDP				
	2005	2006	2007	2008
Net issuances by residents				
Debt securities	6.7	7.6	16.1	21.2
General government	7.9	2.7	1.1	5.7
Monetary financial institutions	-7.0	1.2	9.6	10.6
Non-monetary financial institutions	1.9	1.5	1.5	1.9
Of which:				
Securitised bonds	1.2	1.2	1.2	0.9
Non-financial corporations	3.8	2.3	3.9	3.0
Shares and other participations ^(a)	4.9	4.2	3.7	11.0
Monetary financial institutions	0.4	0.9	0.1	1.3
Non-monetary financial institutions	3.8	1.1	1.8	5.7
Of which:				
Securitisation units	2.7	1.0	1.7	4.9
Non-financial corporations	0.7	2.2	1.8	4.0
Participation Units in investment and risk capital funds	2.7	1.0	-2.0	-5.0
Of which:				
PU in Money Market Funds	0.0	-0.2	-0.2	-0.2
PU in Security Funds	2.0	0.2	-2.1	-4.9
PU in Risk Capital Funds ^(b)	0.1	0.1	0.1	0.0
PU in Real Estate Funds	0.6	0.9	0.3	0.1
Memo:				
Net issuance of debt securities by residents in the external market ^(c)	-2.7	0.4	0.8	1.6
Share issuance through incorporation of reserves ^(d)	0.2	0.7	0.2	0.3
Estimate of net issuances of bonds by Portuguese bank branches and affiliates abroad	4.3	4.0	-3.2	-4.4
Gross issuance of bonds by type of rate				
Fixed rate				
General government	11.2	8.9	5.9	8.1
Financial institutions	1.4	2.7	5.6	4.9
Non-financial corporations	0.4	1.4	0.4	0.4
Indexed rate				
General government	0.0	0.1	0.1	0.0
Financial institutions	3.7	3.5	9.2	11.2
Non-financial corporations	1.4	0.7	1.6	0.9

Sources: Bloomberg, CMVM (Stock Market Commission), Dealogic Bondware, Thomson Reuters and Banco de Portugal.

Notes: (a) Excluding participation units in investment funds. Only shares and management securitisations units are considered. (b) Information included for the first time. Information regarding PU issued by RCF includes only data regarding RCF with management rules published in the CMVM website. (c) Included in "Debt securities". (d) Included in "Shares and other participations".

(7) For more details see *Economic Bulletin-Autumn 2007*.

Table 7.3.2

NET ISSUANCE OF SECURITIES BY RESIDENTS IN EXTERNAL AND DOMESTIC MARKETS BY TYPE OF INSTRUMENT				
As a percentage of GDP				
	2005	2006	2007	2008
Debt securities	6.7	7.6	16.1	21.2
Public debt securities ^(a)	7.9	2.7	1.1	5.7
Commercial Paper, Treasury Securities and other short term securities	1.5	-2.0	-0.1	3.6
Fixed rate (Treasury) Bonds	6.5	4.8	1.4	2.2
Variable rate (Treasury) Bonds	-0.1	-0.1	-0.1	-0.1
Commercial paper and other short term securities (excluding securities issued by GG) ^(b)	1.8	1.1	2.4	3.5
Classic bonds (excluding Bonds issued by the GG)	-1.5	0.9	6.7	1.0
Cash bonds	-2.0	0.9	-0.1	1.4
Convertible bonds	-0.5	-0.5	0.6	0.0
Mortgage bonds	0.0	1.3	3.6	4.5
Warrant bonds	0.0	0.0	0.0	0.0
Securitised bonds	1.2	1.2	1.2	0.9
Participation securities	-0.1	0.0	0.0	0.0
Other securities	-0.2	0.0	0.5	4.2
Shares and other participations	7.6	5.2	1.8	6.0
Shares and other corporate capital participations	2.2	3.2	2.0	6.1
Listed companies	0.4	1.0	0.1	1.0
Unlisted companies	1.8	2.2	1.9	5.1
Participation units in investment and risk capital funds ^(c)	2.7	1.0	-2.0	-5.0
Securitisation units	2.7	1.0	1.7	4.9

Source: Banco de Portugal.

Notes: (a) Central, regional, local government and social security. (b) Includes commercial paper with maturities over 1 year. (c) Information regarding PU issued by RCF includes only data regarding RCF with management rules published in the *CMVM* website.

Net debt issued by non-financial corporations fell about 21 per cent *vis-à-vis* 2007, and is situated at 3 per cent of GDP. This reduction was, however, more than compensated by the increase in stock and other participations issuances (especially unlisted ones), which amounted to 4 per cent of GDP.

It should also be highlighted that during 2008 there was a very significant repayment of security funds units, an observation consistent with investors' sentiment and with other existing analytical indicators regarding risk aversion and market performance. This movement strengthened disinvestment in this type of instruments, already happening in 2007, whose net repayments moved from 2.1 per cent of GDP to 4.9 per cent in 2008 (Table 7.3.1).

In what regards the type of interest rate used in issuances taking place during 2008, the previous years' structure was kept, with a predominance of fixed rate for general government issuances, and the reverse in the case of financial and non-financial corporations.

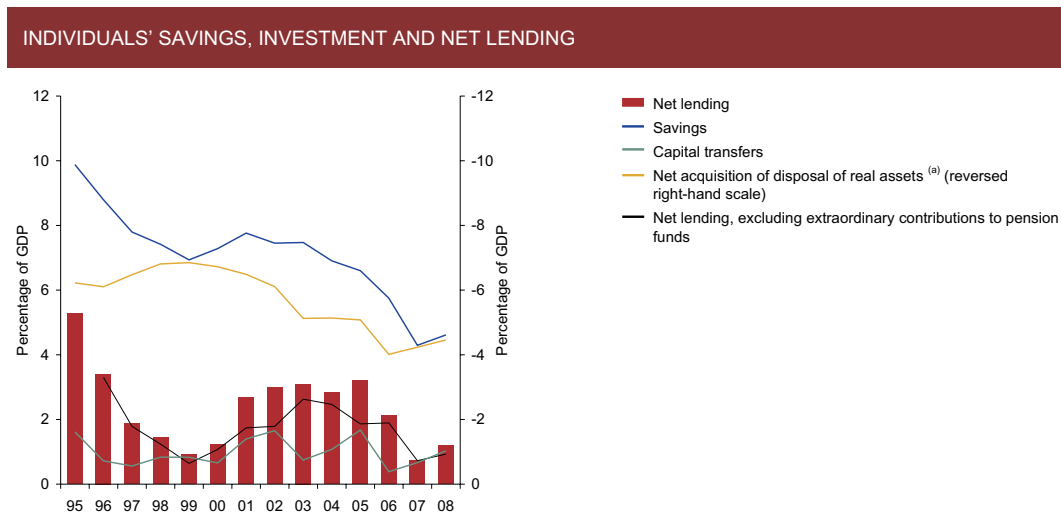
7.4. Non-financial resident institutional sectors

7.4.1. Individuals

In 2008, individuals' net lending increased to 1.2 per cent of GDP, about 0.5 p.p. of GDP above the value recorded in the previous year (Chart 7.4.1.1). This evolution essentially translated an interruption in the downward trajectory of the savings rate registered since 2001, with an increase in the (net) capital transfers that more than compensated the slight increase noticed in net acquisitions of (disposals in) real assets.⁸ According to the currently available information, individuals' savings rate might have had a slight increase in the year under analysis, after decreasing steeply in 2007, which reflected the acceleration of disposable income in a context where the annual average change rate regarding private consumption stabilised. As mentioned in chapter 4, the growth in compensations was the major contributor for the acceleration in disposable income, reflecting both an increase in total employment and a growth in unit wages above the inflation rate. Increased property income (namely distributed income of corporations and net interest), and the deceleration in household income taxes have also contributed to the observed evolution in disposable income.

An increase in uncertainty regarding the levels of household permanent income and wealth, associated with the worsening of the economic and financial crisis, and the deterioration of labour market conditions, already evident in the second half of 2008, should have induced a deceleration in private consumption over the last quarter of the year. Nevertheless, private consumption still presented, for the year as a whole, a growth above the euro area average. It should be highlighted, in this context, the growth in bank lending to households for consumption and other purposes, which maintained a relatively high growth during the first half of 2008, continuing after on a slowing down trajectory that accen-

Chart 7.4.1.1



Sources: INE and Banco de Portugal.

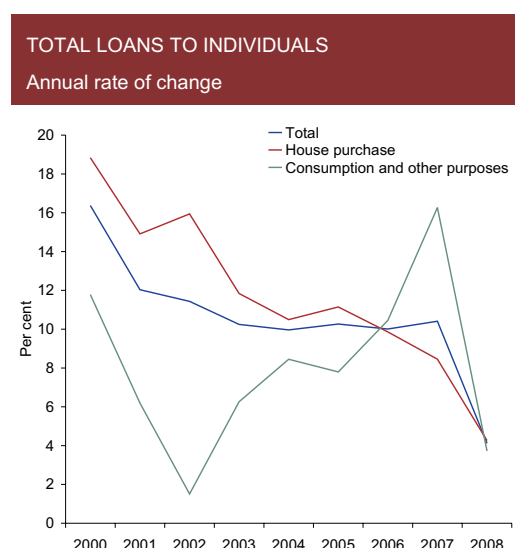
Note: (a) Corresponds to the sum of gross fixed capital formation, change in inventory, net acquisition from disposals of valuables and net acquisition of disposals of financial non-produced assets.

(8) Net acquisition of (disposals in) real assets corresponds to the sum of gross fixed capital formation, inventory change, acquisition net of disposals in valuables, and acquisition net of disposals in non financial non-produced assets. Note that only a part, even if significant, of individuals' gross capital formation corresponds to housing investment. The remainder should be related with the productive activity of this institutional sector, namely in such sectors as agriculture, commerce, repair and restoration, where the proportion of sole owner companies is important.

tuated at the end of the year. In the case of credit for house purchase, the decreasing tendency of the respective change rate seen after 2005 became stronger in 2008, especially in the second half of the year (Chart 7.4.1.2). During the first three quarters of 2008, money market interest rates, to which generally bank loans' interest rates in Portugal are indexed to, maintained the upward tendency began in the last quarter of 2005, notwithstanding the almost stability of the ECB official rates (see section 2.1 Monetary policy of the ECB, and monetary and financial conditions of the Portuguese economy). This development should have translated into an increase in the households' burden associated the service of debt, almost totally contracted at variable rates. Only at the beginning of October did the ECB's official interest rates suffered a sharp decrease, which, given the delay in the transmission of these changes to banks' interest rates, should not have been significantly transmitted to the individuals' debt cost, in the analysed year (Chart 7.4.1.3).

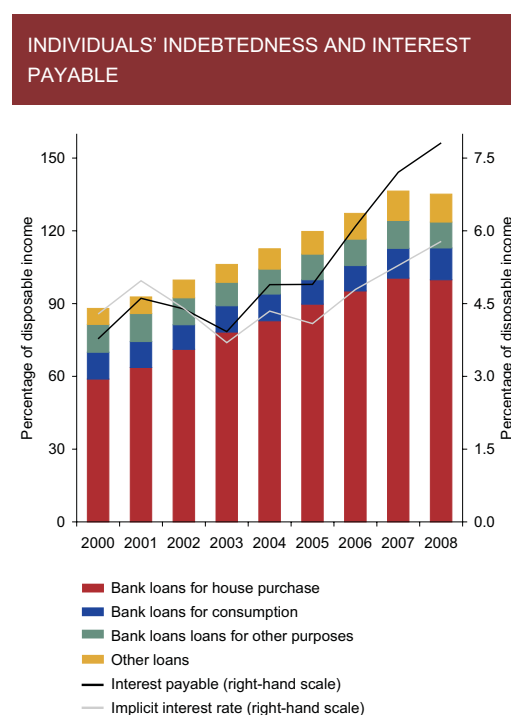
In 2008, individuals' net financial position registered a reduction, when assessed as a percentage of GDP (estimated at about 5 p.p.) (Chart 7.4.1.4). In terms of outstanding amounts at the end of the year, there was a slight decrease in total financial assets and an increase in liabilities, namely as long-term loans. So, in aggregate terms, the sectors' margin to mobilise financial assets in order to satisfy the respective financial liabilities was reduced, even if slightly (Chart 7.4.1.5). There was also a decrease in loan coverage by more liquid assets, continuing the trend shown since the beginning of the participation in the euro area (to 118 per cent at the end of 2008, after about 200 per cent in 1999). In turn, it is estimated that the financial debt coverage ratio by non-financial assets remained almost unchanged *vis-à-vis* the previous year, interrupting the downward trajectory followed since 1995. In a context of deceleration of the various financial debt segments for individuals, this development reflected the high importance of loans with a real guarantee in total credit granted to this sector. The evolution of these indicators since the beginning of the 90s has essentially reflected the progressive but significant increase of individuals' indebtedness. The ratio between total wealth (financial and non-financial) and

Chart 7.4.1.2



Source: Banco de Portugal.

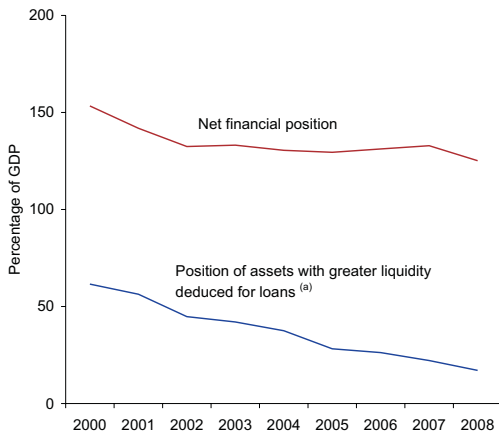
Chart 7.4.1.3



Sources: INE and Banco de Portugal.

Chart 7.4.1.4

INDIVIDUALS' FINANCIAL POSITION

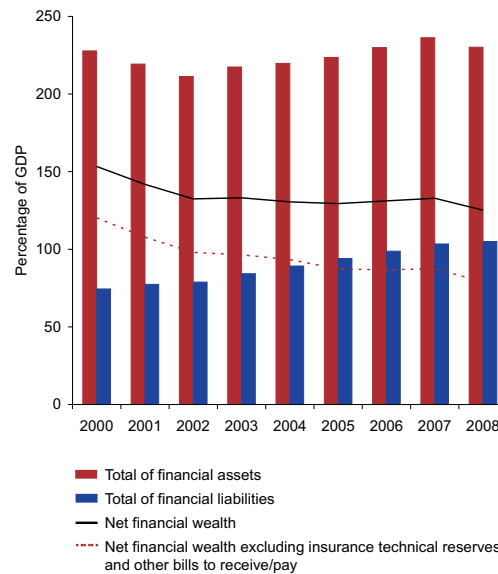


Sources: INE and Banco de Portugal.

Note: (a) Includes cash and deposits, debt securities, listed shares and participation units in investment funds, excluding personal savings pension plans.

Chart 7.4.1.5

INDIVIDUALS' FINANCIAL ASSETS AND LIABILITIES



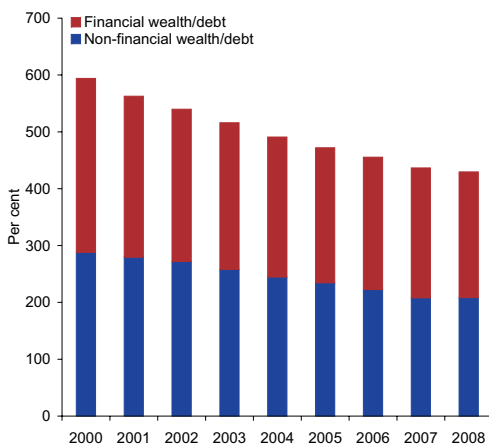
Sources: INE and Banco de Portugal.

the sectors' total debt continued, nevertheless, to point towards the maintenance of a clear solvency position, in aggregate terms (Chart 7.4.1.6).

The slight decrease registered by individuals' financial assets value reflected not only a significant reduction in transactions (to minimum values in the decade), but also significant losses in value in the financial assets portfolios more exposed to price fluctuations in capital markets, such as listed shares, long-term debt securities and investment fund units (Charts 7.4.1.7, 7.4.1.8 and 7.4.1.9). The financial markets' instability was effectively translated into very significant value fluctuations in the securities component of individuals' portfolio, being noteworthy, in the case of listed shares, an estimated net

Chart 7.4.1.6

WEALTH/DEBT RATIO



Source: Banco de Portugal.

Chart 7.4.1.7

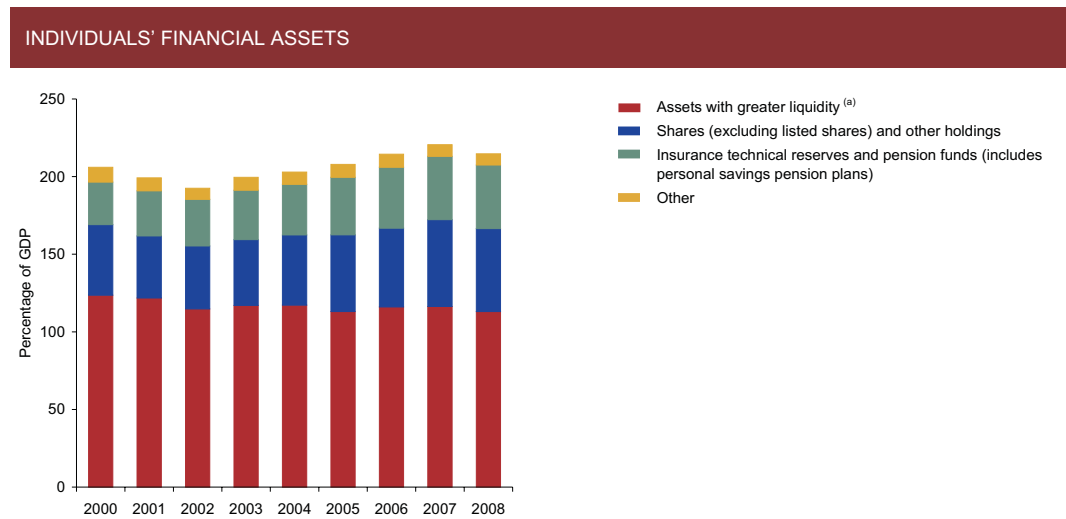


Chart 7.4.1.8

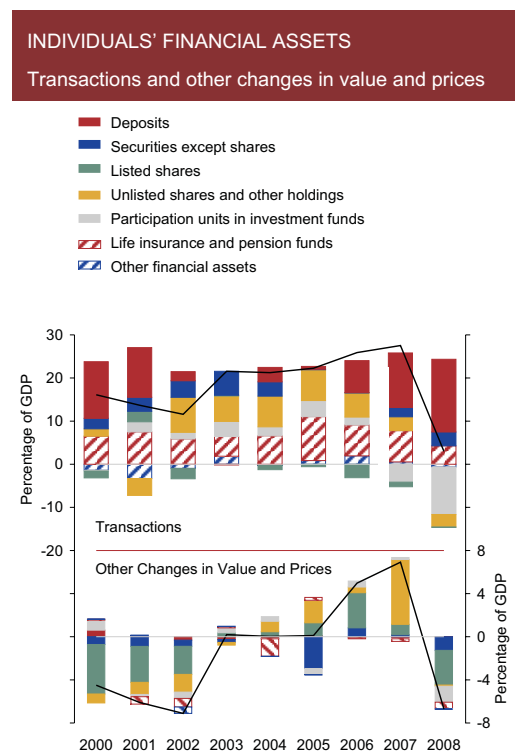
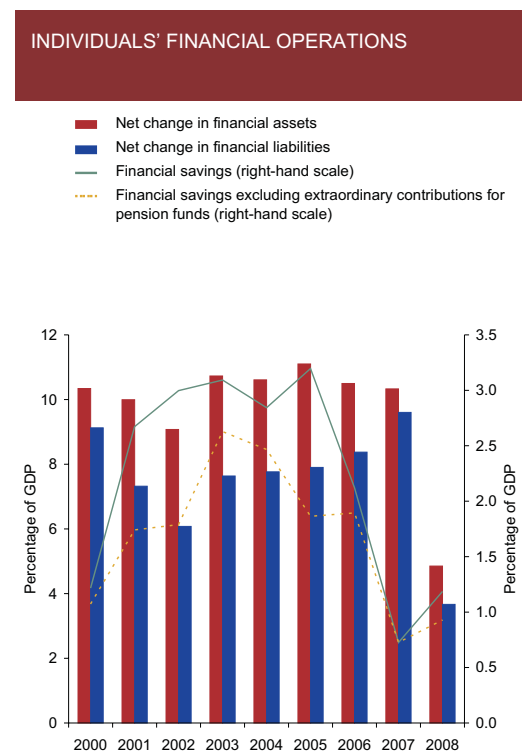


Chart 7.4.1.9

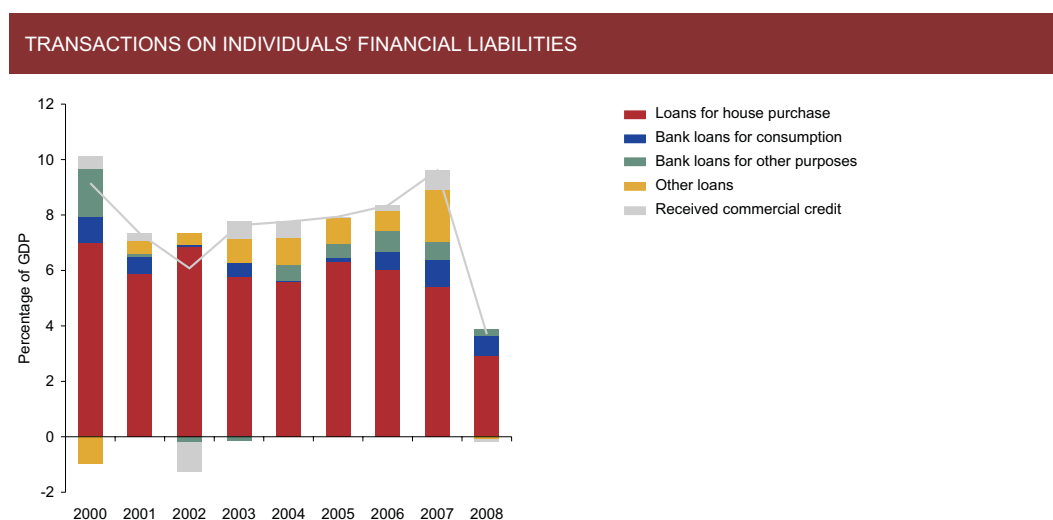


loss of more than 3 per cent of GDP. In this context, there was a significant rearrangement of these sector's financial assets, which was particularly obvious in the aggregate regarding more liquid assets. Similarly to what was seen since the second half of 2007, there was a strong disinvestment in investment funds units. This was especially significant during the second half of the year, as opposed to an increase in bank deposits (estimated at about 8 per cent of GDP for the year as a whole). In fact, the impact of the financial markets' instability on the profitability of the various savings instruments, and the increase in risk aversion of investors was translated by a bigger preference for assets less sensitive to market fluctuations, namely bank deposits.⁹ Individuals' deposits evolution may also have been influenced by the more competitive behaviour of banks, namely domestic banks, in capturing customer resources through this instrument, in an environment characterised by increased financing difficulties for financial institutions in international wholesale debt markets. This behaviour was mainly translated by the approximation of term deposits compensation to the money market interest rates.

In 2008, the flow of loans granted to individuals was much lower than the last decade's, with the indebtedness ratio of this sector almost stabilising as a percentage of disposable income, after a period of continued increase (Chart 7.4.1.10). The slowdown of credit conceded by financial institutions to individuals might have reflected changes both in demand and in supply conditions in this credit market segment. On the one hand, the effect produced by the increase in the interest rates, seen since the end of 2005, the reduction of consumers' confidence to very low levels, and the deceleration of expenditure in private consumption and housing investment may have contributed to lessen the demand for loans on behalf of individuals. On the other hand, the criteria for approval of these loans have become progressively more restrictive, in line with the Portuguese banks' access conditions to financing in wholesale markets. The greater criteria restrictiveness should have been translated in increases in interest rate spreads regarding new operations – and even more in operations assessed as having greater risk – and influenced the ratio between the value of the loan and the value of the guarantee (loan-to-value), and the agreed maturities.

The decrease in the growth rate of credit to individuals was transversal to the majority of resident monetary institutions, even if more accentuated in the case of larger institutions, similarity to 2007. In the

Chart 7.4.1.10



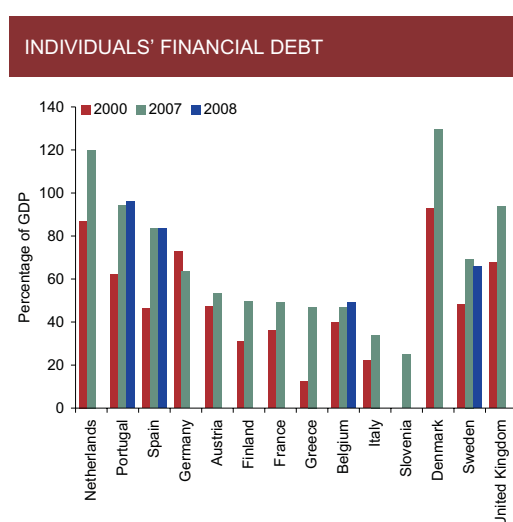
Sources: INE and Banco de Portugal.

(9) During the last decade, the proportion of assets with valuations more sensitive to market fluctuations registered a gradual increase until 2006, decreasing subsequently in 2007 and 2008, in the context of the current financial crisis.

case of the five major Portuguese banking groups, and according to the Bank Lending Survey, besides the financing costs and balance sheets restrictions, also the risks associated with the expectations regarding economic evolution might have limited the growth of lending on the supply side. In particular, the risks associated with the evolution in the housing market, in what regards credit for house purchase, have negatively conditioned this type of lending. In what regards credit for consumption, the smaller capacity from the consumers in securing debt service, as well as the risks associated with the required guarantees, might also have been factors influencing a greater restrictiveness in credit concession.¹⁰ Note that in a context of raising interest rates, the increase in delinquency by individuals in 2008 may have reflected an additional pressure on Portuguese households that, over the last years, have used bank credit as a way to smoothen their consumption profile, with decreasing savings rates.¹¹

Portuguese individuals' level of indebtedness continued to be one of the highest in the euro area, even though the increase in individuals' debt was common to most European countries during the last few years (Chart 7.4.1.11). At the end of 2007, in the context of the euro area, the Portuguese level was only surpassed by that of Netherlands, and comparable to the United Kingdom's. The evolution of indebtedness in Portugal since the beginning of the euro area reflected, to a large extent, the transition to a new interest rate regime, more reduced and with less volatility, as well as the financial innovation seen in the supply of credit products, fundamentally materialised by a set of characteristics that smoothen or postpone debt service charges. At the end of 2008, about 75 per cent of individuals' indebtedness was related to credit for house purchase, having thus a correspondence with the increase in wealth in the sector as this was translated by an acquisition of real assets. In this perspective, we should note that the available evidence does not point to the possibility of a housing price adjustment in Portugal comparable to what was seen recently in some European countries and the United States. Effectively, in aggregate terms, Portugal doesn't seem to suffer from situations of excessive valuation in the residential component of property assets. Based on data from the *Confidencial Imobiliário* index, the average annual change rate for prices in the Portuguese housing market, on the supply side, stood

Chart 7.4.1.11



Sources: Eurostat and Banco de Portugal, considering consolidated accounts, except United Kingdom.

(10) For more details, see "Section 4.6 Credit Risk", Banco de Portugal, *Financial Stability Report 2008*.

(11) According to information gathered by INE, the average value of the instalments increased almost 9 per cent in 2008, annually vis-à-vis 2007, which was associated with an increase in interest, a value that clearly exceeded the growth of the nominal disposable income.

at 3 per cent in nominal terms, and at approximately zero in real terms, since the beginning of the current decade.¹² Still, there might be some price adjustment in this market, reflecting on one hand the economical and financial crisis framework conditioning the demand for property assets, via expectations regarding income and real estate prices evolution and, on the other hand, less availability regarding bank financing for this type of investment. At the end of 2008, the *Confidencial Imobiliário* index year-on-year rate of change stood close to 4 per cent (about 2.5 per cent in the case of used houses), with a subsequent and significant decrease of that rate (to a value close to 1 per cent, in March of 2009). Reference should be made, in this context, to the fact that the Survey on Bank Valuations in the Housing Market (realised by *INE*) indicates that the average banking valuations on house prices have recorded progressively negative year-on-year rates of change since the end of 2007 (to -6 per cent at the end of the first quarter of 2009).¹³ However, it should be noted that as bank valuation indicators, these values are influenced by the increased restrictions of bank credit supply.

7.4.2. Non-financial corporations

In 2008, net borrowing of non-financial corporations represented 10.4 per cent of GDP, about 3 percentage points (p.p.) above the value of 2007 (Chart 7.4.2.1). This evolution translated essentially an additional reduction in current savings as a percentage of GDP, which has been showing a downward trajectory since 2004. According to currently available information, this reduction in current savings of non-financial corporations reflected a deterioration in corporate operating profits, there being also, on aggregate terms, a high amount paid out, in the form of interest and dividends, as remuneration of capital invested (Chart 7.4.2.2).

Financial markets instability and its growing interaction with the real economy have contributed negatively to the evolution of production and investment of non-financial corporations, mainly in the second half of 2008. Besides the direct effects on demand to Portuguese companies, resulting from a deterioration of world economic activity, the persistence of the crisis made it more difficult to access credit by way of a deterioration in economic expectations and the consequent increase in credit risk, materialised by a significant increase of delinquency in the sector.

The move in operating profits was connected with the evolution of economic activity in Portugal, in line with those observed at the international level. According to the quarterly information from Banco de Portugal Central Balance-Sheet Database, the fall in the operating profits of non-financial corporations reflected, to a large extent, the slowdown in sales in a context where operating costs (mainly employee costs) present greater downside rigidity.¹⁴ These developments may have been reflected in a decrease in the sector's aggregate operating surplus (Chart 7.4.2.3). In addition, and *vis-à-vis* the previous year, a greater portion of this surplus may have been distributed both as interest – reflecting the increase in the annual average level of interest rates and the growing level of indebtedness in the sector – and, to a lesser degree, as corporate distributed earnings (namely dividends). This fact contrib-

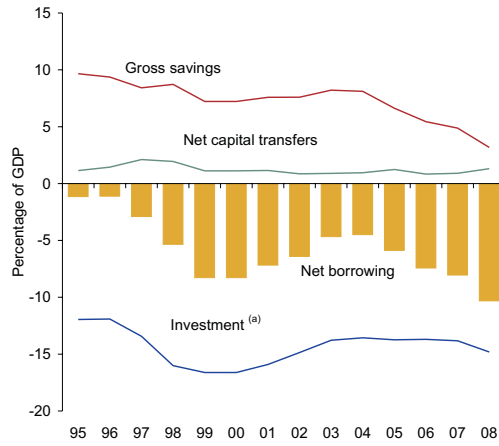
(12) This index is calculated on the basis of supply prices and is weighted according to region and condition of use. The quality adjustment in the calculation of the index, however, does not enable the changes in this parameter to be fully controlled, a fact that should underlie the relatively high growth seen at the end of 2008. For methodological information, see "*Índice Confidencial Imobiliário: procedimentos metodológicos*", by Isabel Fonseca and Ricardo Guimarães, Newsletter *Imobiliária Portuguesa – Confidencial Imobiliário*, October 2006.

(13) This evolution is in line with the results of the Bank Lending Survey, whose participating institutions have consistently indicated, and more significantly so since the end of 2006, the factors "Risks associated with housing market prospects" as inducing more restrictive supply conditions on the credit segment for house purchase by individuals, and "Prospects for the housing market" as a contributory factor for reducing demand in this market segment.

(14) For a detailed analysis of the sample of companies participating in the Central Balance-Sheet Database of Banco de Portugal, both annual (ACB) and quarterly (QCB), see Supplement 5/2005 of Banco de Portugal's Statistical Bulletin for December 2005 and Supplement 1/2008 of the Statistical Bulletin for May 2008. Note that there is a big bias towards large enterprises in the quarterly sample, and in the annual sample up to 2005, though to a lesser extent. From 2006, with the use of the Simplified Corporate Information, the annual analysis improved significantly, with a coverage of close to 100 per cent in terms of total Gross Value Added for non-financial corporations.

Chart 7.4.2.1

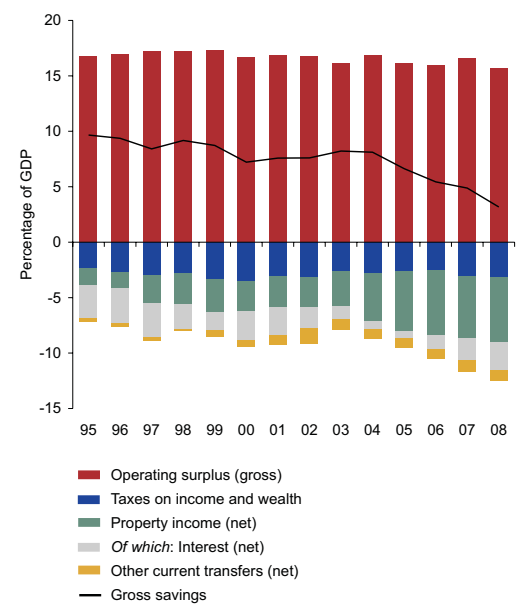
NET BORROWING, SAVINGS AND INVESTMENT OF NON-FINANCIAL CORPORATIONS



Sources: INE and Banco de Portugal.
Notes: Annual values for 2007 and 2008 calculated based on quarterly national accounts. (a) Includes GFCF, change in inventory, net acquisition from disposals of valuables and of non-financial non-produced assets.

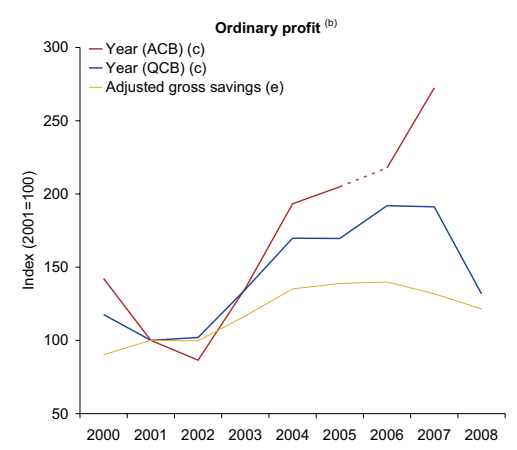
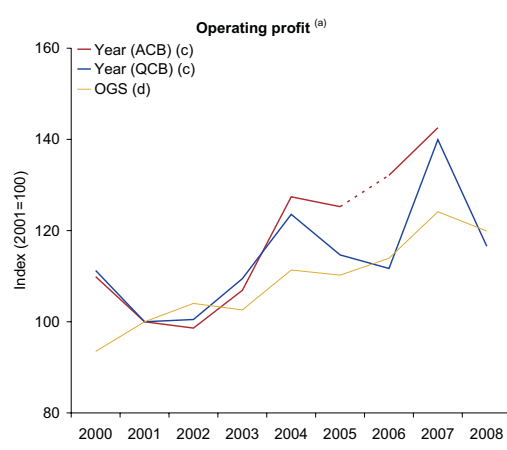
Chart 7.4.2.2

CONTRIBUTIONS TO GROSS SAVINGS OF NON-FINANCIAL CORPORATIONS



Sources: INE and Banco de Portugal.
Note: The balance corresponds to the difference between resources and applications.

EVOLUTION OF NON-FINANCIAL CORPORATIONS' RESULTS

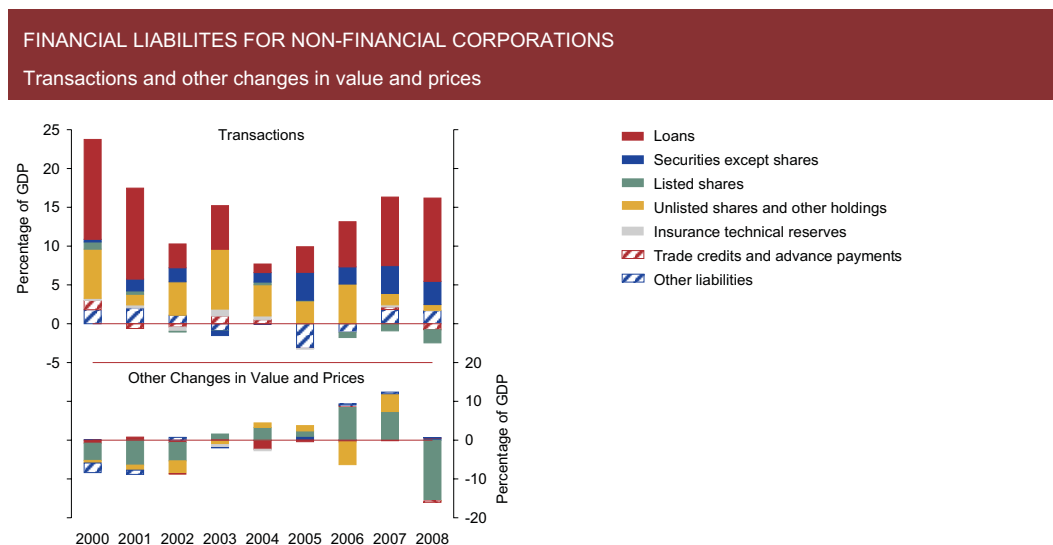


Source: Banco de Portugal.
Notes: (a) Operating profit = GVA - employee costs + other income and operational gains (net of costs and losses) - tax (except indirect) - depreciation and provisions for the year. (b) Ordinary profit = operating profit + financial profit. Year-on-year indexes of change calculated on the basis of cumulative figures for the year regarding companies on the Central Balance-Sheet database comparable in two consecutive years. (c) ACB: Annual Central Balance-Sheet Database. QCB: Quarterly Central Balance-Sheet Database. Break in series in 2006 for the ACB; from this year on Simplified Corporate Information is used. The GVA coverage rate for non-financial corporations on the ACB is of around 60 per cent up to 2005, and near 100 per cent since 2006. For the QCB, the coverage rate stands between 41 and 45 per cent. (d) OGS: operating gross surplus for the year. (e) Gross savings plus corporate distributed yields payable minus net reinvested FDI earnings.

uted to accentuate the decrease in current savings for non-financial corporations, causing greater financing requirements to the sector.^{15,16}

Similarly to recent years, net borrowing of non-financial corporations was assured through an increase of indebtedness to the financial sector, especially via bank loans (Chart 7.4.2.4). In December 2008, the annual rate of change of bank loans to non-financial corporations remained at a high level (about 10.5 per cent), only marginally below last year's. Still, this evolution interrupted the upward tendency showed by this aggregate's growth rates since 2004. The slight deceleration in loans was due mainly to the behaviour of the major banking groups, whose growth rate was inferior to that of credit conceded by the remaining financial institutions, which increased *vis-à-vis* 2007.¹⁷ This financing pattern is a characteristic of economic recession periods, in which smaller institutions tend to absorb the slowdown in credit granted by larger institutions. Looking at activity sectors, note the above average growth that loans to companies in the "other service activities rendered mainly to corporations" sector continued to record (see Table 7.4.2.1). In turn, loans of bigger amounts presented higher growth rates, which might reflect the fact that larger corporations had some difficulty in issuing debt securities in the market. Despite all of this, there was simultaneously a significant amount of net issuances regarding short-term debt securities, which were mainly taken by resident banks (Charts 7.4.2.5). This development reflected, to a large extent, the turmoil in the financial markets that made it difficult to raise capital in mar-

Chart 7.4.2.4



Sources: INE and Banco de Portugal.
Note: Consolidated values.

(15) The operating surplus of a sector corresponds to the difference between its Gross Value Added (equal to the gross value of production less intermediate consumption), salaries, and taxes on production and imports paid by the sector, being, therefore a measure of income generated (or absorbed) by the sector as a result of its productive activity (before the recording of financial costs and proceeds). Without the cost of amortization and provisions it could be interpreted, where non-financial corporations are concerned, as an approximation to the aggregate operating profits of the units that make up the sector. In the National Accounting System, the operating surplus is a resource for the sector and can be transferred to other sectors in the form of yield on assets (such as interest, dividends and rentals), tax on income and property, and current transfers. The remaining balance is the disposable income. In the case of end-user consumption sectors (households, non-profit institutions in the service of households and general government) the disposable income is shared between final consumption expenditure and savings. In the remaining sectors (including non-financial corporations) this balance is equal to the whole amount of savings for the sector.

(16) Note that, according to the European System of Accounts (ESA 1995), dividends are defined as a form of property income for shareholders, whose right comes from the fact that they supply companies with capital. This capital is a form of financing alternative to corporate indebtedness. The difference regarding debt is that capital does not give origin to a fixed amount liability nor does it guarantee the holder of shares in a company's capital a fixed or pre-established yield (§ 4.53). Dividends are recorded in the moment their payment is due to the shareholders, as determined by the company (§4.55). This type of decisions is usually made at the time of the disclosure of results by the company's administration board, i.e., in the year following that to which the results to be distributed belong to.

(17) For further details see "Section 4.6 Credit Risk", Banco de Portugal, *Financial Stability Report 2008*.

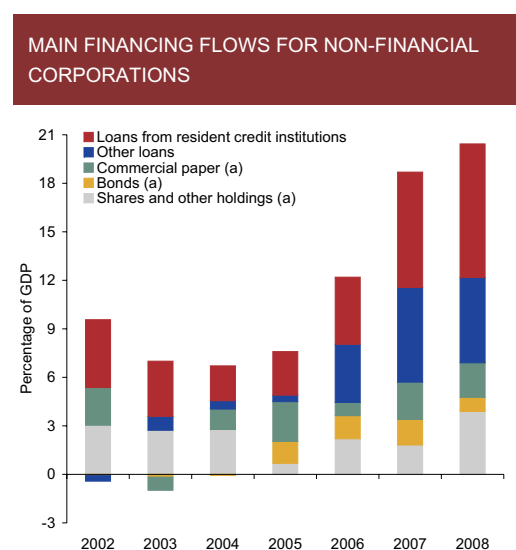
Table 7.4.2.1

LOANS GRANTED BY OTHER MONETARY FINANCIAL INSTITUTIONS TO NON-FINANCIAL CORPORATIONS ^(a)							
Breakdown by sector							
End-of-period annual rate of change							
	2004	2005	2006	2007	2008		Structure (as a percentage of total) Dec. 2008
					Jun.	Dec.	
Total loans to non-financial corporations	2.5	5.0	7.1	11.2	12.3	10.6	100.0
By branch of activity ^(b)							
Agriculture, livestock, hunting, forestry and fishing	5.0	4.5	10.0	16.1	20.7	22.0	1.7
Mining	-6.7	0.6	-5.1	4.5	12.4	13.9	0.4
Manufacturing	-3.8	-3.0	0.7	7.9	5.9	7.7	12.6
Electricity, gas and water production and supply	-2.0	37.9	-11.3	13.7	31.8	47.8	2.8
Construction	6.0	10.7	5.4	10.7	12.8	8.6	19.2
Services	3.2	4.2	9.9	11.8	12.7	10.2	63.3
of which:							
Real estate activities	13.9	11.9	12.9	14.4	14.2	8.5	19.7
Other business activities	-1.7	6.7	13.8	16.6	13.1	14.0	15.2
Trade, hotels and restaurants	2.0	3.1	7.1	6.3	10.9	7.5	17.3
Transportation, posts and telecommunications	-4.5	-10.6	0.7	11.0	14.6	18.3	5.9

Source: Banco de Portugal.

Notes: (a) Rates of change are calculated on the basis of the ratio of end-of-period outstanding amounts of bank loans and transactions, which are derived from outstanding amounts adjusted for reclassifications. They are also adjusted for securitisations, write-downs/write-offs and exchange rate and price revaluations. (b) The allocation of loans by branch of activity is estimated on the basis of the structure of *Central de Responsabilidades de Crédito* (Central Credit Register).

Chart 7.4.2.5



Source: Banco de Portugal.

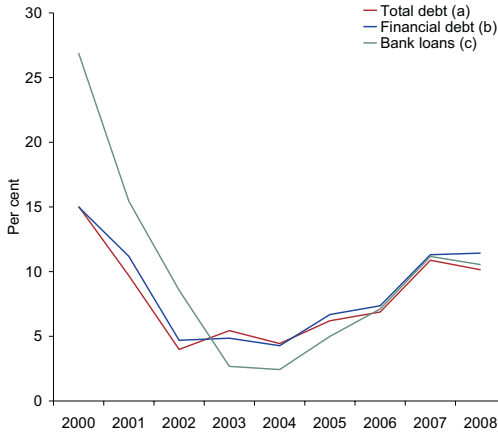
Note: (a) Non-consolidated values. Issuance values.

ket operations or to issue long-term debt, a situation that became particularly acute in the last quarter of the year. Consequently, financial debt (that corresponds to loans and debt securities) grew almost 11.5 per cent, reaching 134 per cent of GDP (122 per cent at the end of 2007), together with a considerable rise in financial leveraging for the sector, which surpassed the most recent high recorded in 2002 and placed itself among the highest of the euro area (Charts 7.4.2.6, 7.4.2.7, 7.4.2.8 and 7.4.2.9).

According to the Bank Lending Survey, the demand for loans and other credit lines by corporations decreased, more intensely in the third quarter of the year. This behaviour may have reflected a decrease

Chart 7.4.2.6

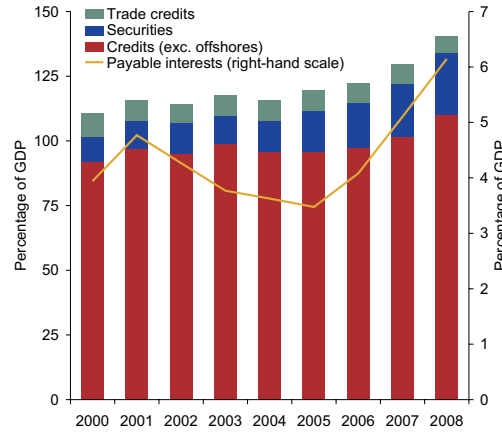
DEBT OF NON-FINANCIAL CORPORATIONS
Annual rate of change



Source: Banco de Portugal.
Notes: (a) Includes loans granted by resident and non-resident institutions; loans/supplementary payments granted by non-resident corporations from the same economic group (excluding those granted to non-financial corporations in the Madeira offshore); commercial paper and bonds issued by non-financial corporations held by other sectors, and trade credit received from other sectors. (b) As in (a) excluding trade credit received from other sectors. (c) Includes loans granted by resident monetary financial institutions, adjusted for securitisation operations and corrected for reclassifications, asset write-downs and exchange rate and price revaluations.

Chart 7.4.2.7

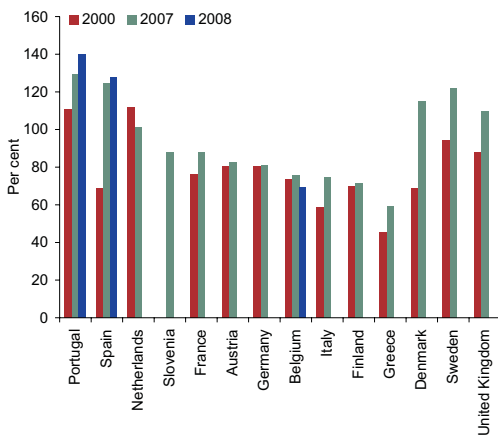
TOTAL DEBT OF NON-FINANCIAL CORPORATIONS AND INTERESTS PAYABLE



Sources: INE and Banco de Portugal.

Chart 7.4.2.8

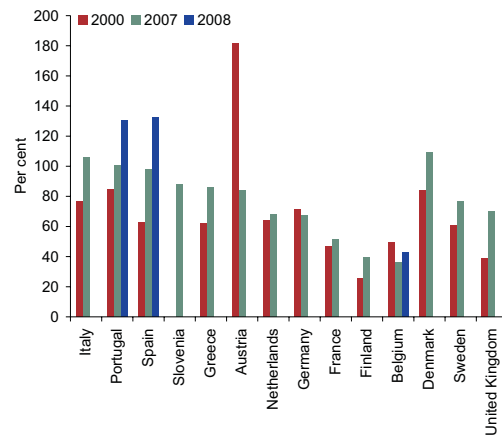
RATIO OF TOTAL DEBT TO GDP ^(a)



Sources: Eurostat and Banco de Portugal.
Note: (a) Total debt corresponds to the sum of loans, debt securities and trade credit on the liabilities side, using consolidated figures (except for the United Kingdom – non-consolidated).

Chart 7.4.2.9

FINANCIAL LEVERAGING RATIO FOR NON-FINANCIAL CORPORATIONS ^(a)



Sources: Eurostat and Banco de Portugal.
Note: (a) This corresponds to the ratio between the sum of loans and debt securities in relation to capital, using consolidated figures (except for the United Kingdom – non-consolidated).

in financing requirements for investment, mergers/acquisitions and corporate restructuring. In opposition, debt restructuring and, to a lesser extent, financing requirements regarding inventories and working capital continued to be the main factors contributing to a growth in credit demand by corporations. Simultaneously, supply conditions became more restrictive also in this segment of the credit market, which has been happening since the beginning of the turmoil in the international financial markets in the summer of 2007, reflecting difficulties in accessing wholesale financing markets. Greater credit restrictiveness reflected an increase in the costs of financing and restrictions to the bank balance sheets, as well as deterioration in the risks perceived by the surveyed institutions. Interest rate spreads increased, amidst a generalised tightening of other contractual terms, with a special reference to the reduction of the amounts granted, and in the ratio between loan and guarantee and the shortening of maturities for new contracts. Despite large Portuguese banks indicating shorter maturities as a factor conditioning approval of loans and credit lines to non-financial corporations, the maturity profile of loans to non-financial corporations continued to increase towards loans with a maturity of more than five years. This development might reflect an extension of maturities on loans that had already been contracted, as well as the replacement of debt instruments by bank loans, given the difficulties in issuing longer-term debt securities in relatively favourable terms.

In terms of non-financial corporations' financial assets portfolio, 2008 saw a substantial rise in loans given by this sector, corresponding to operations between companies and their shareholders, mainly residents, and also to direct investment abroad. In consolidated terms, net acquisitions of shares and other holdings had an increase slightly higher than 1 per cent. In non-consolidated terms, this was a 2.5 per cent rise, suggesting that a considerable part of the capital reinforcement in the sector (namely by way of supplementary capital) was associated to a process of company consolidation. The net financial position of non-financial corporations (in consolidated terms) was marginally better than a year earlier, standing at around -164 per cent of GDP (which compares with -160 per cent at the beginning of the euro area). This improvement looks to be mainly due to a reduction in the value of liabilities, namely the market value of company capital stemming from a decrease in listed share prices, both at a domestic and international level.

7.4.3. General government

In 2008 general government net borrowing stood at 2.7 per cent of GDP, almost stabilising comparing to the previous year (Chart 7.4.3.1).¹⁸ This evolution reflected a reduction in savings as a percentage of GDP stemming, essentially, from a growth in primary current expenditure, since expenditure on interest and current revenue only increased slightly as a ratio to GDP. Net borrowing was also influenced by revenue resulting from the extension in concessions already in force or new concessions in the hydro-electric and road sectors and, to a lesser extent, by a reduction in investment, strongly affected by a rise in revenue from real estate sales (see "Chapter 6 *Public Finances*", of this Report).

Debt ratio increased significantly in 2008, to 66.4 per cent at the end of the year.¹⁹ This evolution was greatly influenced by the deficit-debt adjustments and by the negative effect of the differential between the public debt implicit interest rate and the nominal growth rate for GDP, only partially compensated by the slightly positive primary balance.

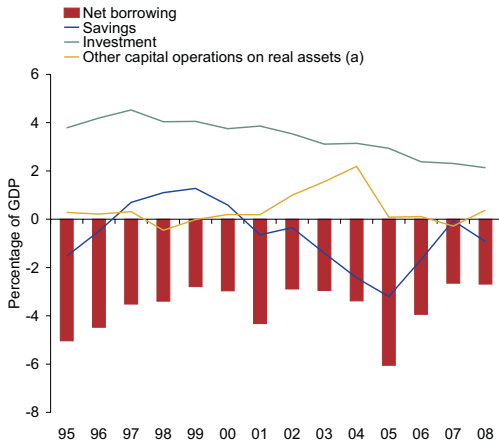
(18) This value, calculated according to the methodology defined by the European System of Accounts (ESA 1995), differs from the one presented in chapters 2 and 6 of this Report, due to a conceptual difference *vis-à-vis* the definition followed in the excessive deficit procedure. The value presented here includes net interest of financial derivatives (specifically FRA and swaps), which are also included in the debt concept calculated on the basis of financial accounts (see note in table A.7.19).

(19) According to the definition used in the excessive deficit procedure.

In 2008, the amount of public debt securities issued was higher than in the preceding year, and continued to be mainly related to fixed rate bonds. In turn, there were net redemptions of savings certificates amounting to almost 1 per cent of GDP. The non-resident sector remained as the main holder of Portuguese general government debt, increasing its share to 78 per cent (Chart 7.4.3.2).

Chart 7.4.3.1

GENERAL GOVERNMENT'S NET BORROWING, SAVINGS AND INVESTMENT

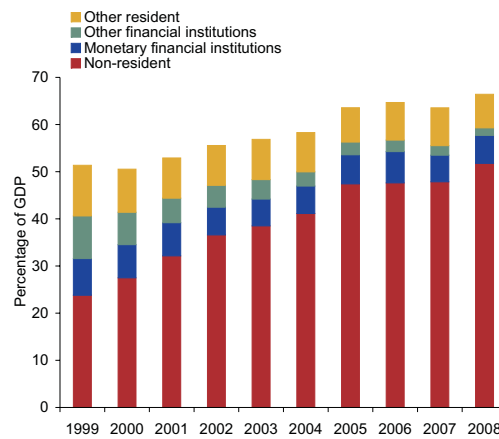


Sources: INE, Ministry of Finances and Banco de Portugal.

Note: (a) Corresponds to the difference between capital transfers balance and net acquisition of land and intangible assets.

Chart 7.4.3.2

PUBLIC DEBT BY HOLDERS



Sources: INE, Ministry of Finances and Banco de Portugal.

7.5. Financial intermediaries

Banking System^{20,21}

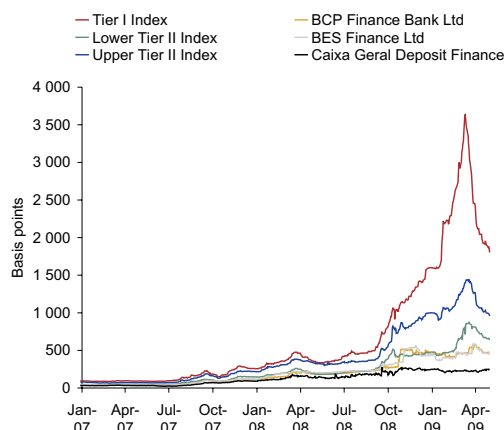
The crisis in the international financial markets, started at the summer of 2007 and deepened during the last quarter of 2008, and its growing interaction with the economic activity deceleration, substantially changed the economic and financial context where the banking system develops its activity. Initially, and reflecting a risk reassessment by investors and an increase in uncertainty, the current crisis caused strong disturbances in the functioning of international wholesale debt markets, including money markets, both in terms of the cost and quantity of available funds (Chart 7.5.1). Subsequently, the impact moved to the stock markets, with abrupt falls in share prices, especially in the financial sector, and a significant increase in volatility (Chart 7.5.2). More recently, the financial crisis extended to

(20) For a more detailed analysis of the Portuguese banking system in 2008, see Banco de Portugal, *Financial Stability Report 2008*.

(21) In the analysis made in this section, the aggregate defined as the Portuguese banking system refers to credit institutions and financial corporations operating in Portugal under the supervision of the Banco de Portugal, excepting institutions with head office in the offshore zone in Madeira. Financial groups are therefore considered if, on a consolidated basis, they include at least one credit institution or an investment company, as are credit institutions and investment companies on an individual basis if they are not subject to consolidation in Portugal (including the branches of credit institutions or investment companies). An analysis of this set of institutions is important to the extent that it is subject to the new Capital Adequacy Directive, being considered the benchmark universe in the large majority of European countries. It is not possible, however, to bring together data from before 2007, since not all banks adopted the International Accounting Standards (IAS) at the same time, and there were different accounting systems in use in 2005 and 2006. This way, similarly to the procedure adopted in the *Financial Stability Report 2008*, for the period post 2004 we consider two sets of institutions. The first, from December 2004 to December 2007, relates to the thirteen banking groups that adopted the new IAS for their financial statements in 2005 (as at December 2004, this represented around 87 per cent of the total assets of the institutions analysed up to then). The second group is analysed for the period from June 2007 to December 2008. The overlap of both periods allows for a consistent analysis of changes, with the figures for December 2007 relating to the more wide-ranging aggregate. Note that due to the exceptional circumstances surrounding the activity of BPN and BPP banking groups in 2008, involving the intervention of Banco de Portugal, and given the need to calculate accurately the financial situation of these institutions (year-end accounting and prudential data of these groups were not yet formally reported to Banco de Portugal), these two banking groups were not considered in the analysis in this section.

Chart 7.5.1

SPREADS OF SUBORDINATED DEBT ISSUED BY EUROPEAN BANKS



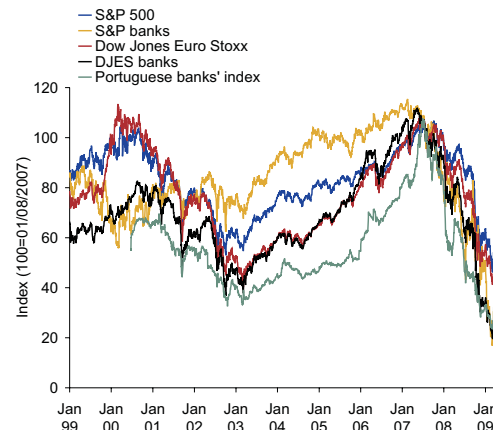
Sources: Bloomberg and JP Morgan.

Notes: Spreads refer to three distinct levels of debt subordination. Tier I represents the highest degree of subordination (i.e. the riskier exposure), while lower Tier II represents the lowest degree of debt subordination. Spreads of Portuguese banks securities are computed to German public debt. Most recent figure: 30 April 2009.

Chart 7.5.2

DEVELOPMENTS IN STOCK MARKETS

Financial sector



Source: Bloomberg.

Notes: Latest value: 30 April 2009. The Portuguese banks' index includes BCP, BPI and BES banks, weighted according to stock market capitalisation.

the economic activity, with severe recessions in several of the major advanced economies. Since Portugal is a small economy but economically and financially integrated, Portuguese banks were also affected by the international developments, with impact on their activity, profitability and solvency, and implying an adjustment of their strategies (Table 7.5.1).

In fact, in the more recent years, and in line with the international tendency, financing in the wholesale markets recorded a growing importance in the expansion of Portuguese banks' activity. This reflected the very favourable conditions prevailing in international financial markets and the access to a broad market with no exchange rate risk. With the onset of the financial crisis, access to this type of financing was strongly conditioned, causing institutions to look for other financing sources. Additionally, the economic and financial crisis put a severe pressure on institutions' income and capital, reflecting to a large extent a deterioration in credit quality and losses in value in the financial asset portfolio, even though Portuguese banks were not directly exposed to the assets related with the US subprime market. Despite these developments, it should be highlighted that the Portuguese banking system showed a considerable resilience to the particularly adverse environment, continuing to perform its financial intermediation activity. The changes to the regulatory framework regarding the Eurosystem's monetary policy operations, and the support measures to the financial system presented by the Governments of several countries contributed for this evolution, as they helped decreasing the extreme levels of risk aversion and uncertainty observed after the bankruptcy of Lehman Brothers, and given that they contributed to mitigate banks' liquidity constraints.²²

In 2008, although showing a significant slowdown in comparison to previous years, the banking system's activity, assessed in terms of total assets on a consolidated basis, continued to show a high growth of about 8 per cent (Table 7.5.2). This evolution was supported by the growth in customer credit – around 10 per cent – since the portfolio of securities and financial instruments recorded a decrease of about 15 per cent. The expansion in banking activity was possible, fundamentally, by the substantial

(22) With the aim of stabilizing the functioning of financial and money markets and mitigating the impact of market turmoil on institutions' capital and results, a set of support measures to the financial system was implemented by the authorities of several countries. For more details on these measures, especially those relating to Portugal, see "Box 2.1 Measures taken by the Portuguese authorities relating to the financial system during the international financial crisis", Banco de Portugal, *Financial Stability Report 2008*.

Table 7.5.1

MAIN BANKING SYSTEM INDICATORS ^(a)

On a consolidated basis; per cent

	2000	2001	2002	2003	2004	2004	2005	2006	2007	2007	2008
Profitability, credit quality and solvency											
ROE - Return on equity ^(b)	18.3	17.8	14.1	16.2	14.5	13.1	19.4	20.6 (18.8)	18.0	18.2	10.6
ROA - Return on assets ^(b)	1.11	1.01	0.78	0.91	0.87	0.65	1.03	1.30 (1.18)	1.18	1.15	0.64
Financial margin (as a percentage of average assets)	2.21	2.24	2.12	2.00	1.94	1.91	1.86	1.89	1.88	1.96	1.95
Cost-to-income ratio	58.2	57.6	59.1	57.4	57.2	71.7	58.3	53.4	53.7	54.1	53.7
Default ratio of the non-financial private sector ^{(c),(d)}	2.10	2.12	2.13	2.09	1.78	1.78	1.71	1.54	1.51	1.51	2.04
Specific credit provisioning (without country risk) ^(e)	1.41	1.33	1.30	1.60	1.59	1.13	1.18	1.04	0.96	1.09	1.24
Specific credit in default provisioning (without country risk) ^(f)	-	-	-	-	-	72	83	84	76	77	73
Ratio of credit and interest overdue net of specific provisions to credit net of specific provisions ^(d)	0.72	0.71	0.85	0.66	0.34	-	-	-	-	-	-
Ratio of non-performing loans (net) to total credit (net) ^(g)	-	-	-	-	-	0.44	0.25	0.20	0.31	0.33	0.45
Overall capital adequacy ratio ^(h)	9.2	9.5	9.8	10.0	10.4	10.2	11.3	10.9	10.0	10.3	10.3
Original own funds adequacy ratio - Tier I ^(h)	7.6	7.3	7.1	7.1	7.3	7.0	7.1	7.7	6.5	6.8	7.5
Liquidity (for the whole of domestic institutions) ^(j)											
Credit-to-deposits ratio	115	121	126	125	127	129	134	141	151	146	143
Credit-to-deposits ratio (including securities issued and placed with clients)	107	113	117	116	118	119	126	132	140	136	132
Coverage ratio of interbank liabilities by highly liquid assets	-	88	92	120	121	127	127	118	107	115	107
Liquidity gap ⁽ⁱ⁾											
Up to 3 months	-	-3.5	-3.4	0.5	0.7	0.6	-0.7	-0.9	-2.1	-1.4	-2.2
Up to 1 year	-	-7.8	-7.6	-6.5	-4.8	-5.4	-7.4	-8.9	-10.1	-9.0	-6.7

Source: Banco de Portugal.

Notes: End-of-period values, except those regarding period returns. (a) The 2004 break in series is due to the introduction of the International Accounting Standards, which also implied a redefinition of the set of banking institutions that were analysed. The 2007 break corresponds to an extension in the number of institutions analysed. (b) The figures in brackets are adjusted for the deduction of results regarding the impact of the restructuring operation from corporate participations (namely insurance companies) performed by one of the main banking groups considered. (c) The default ratio is defined as credit and interests overdue plus other non-performing loans as a percentage of total loans, adjusted for securitisation. (d) Includes credit and interests overdue above 30 days. (e) Ratio of provisions for non-performing loans and for credit and interests overdue in total loans. (f) Ratio of provisions for non-performing loans and for credit and interests overdue in default credit, as defined by Banco de Portugal Instruction no. 16/2004. (g) Quality credit indicator defined according to Banco de Portugal Instruction no. 16/2004. It corresponds to the ratio of credit overdue, net of provisions for credit overdue and for non-performing loans, and total net credit. (h) In 2008, all institutions analysed calculated the capital adequacy ratio according to Basel II criteria, which mainly affected the determination of capital requirements. (i) Institutions whose management control is performed by resident entities. (j) The liquidity gap can be defined as the ratio of the difference between liquid assets (LA) and volatile liabilities (VL) to the difference between total assets (A) and liquid assets, for each residual maturity ladder, i.e. $gap = (LA - VL) / (A - LA)$. For further details on this indicator, see "Box 4.1 Monitoring the banking system's liquidity risk", Banco de Portugal, *Financial and Stability Report 2004*.

Table 7.5.2

BALANCE SHEET OF THE BANKING SYSTEM

On a consolidated basis

	EUR millions				Structure (as a percentage of total assets)				Year-on-year rates of change ^(a) (per cent)							
	2007		2008		2007		2008		2007			2008				
	Jun.	Dec.	Jun.	Dec.	Jun.	Dec.	Jun.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Cash and claims on central banks	5 279	8 809	7 602	9 261	1.3	2.1	1.7	2.0	18.2	-11.9	3.5	12.4	34.6	44.0	27.5	5.1
Claims on other credit institutions	3 468	4 094	3 857	4 184	0.9	1.0	0.9	0.9	-0.4	-19.4	23.6	2.5	11.5	11.2	-12.2	2.2
Investment in credit institutions	37 614	35 995	35 898	28 001	9.2	8.4	8.0	6.0	-15.1	11.2	0.9	-6.7	-0.9	-4.6	-1.2	-22.2
Financial assets at fair value through profit or loss	25 691	22 582	23 944	21 037	6.3	5.3	5.4	4.5	5.2	13.4	4.7	0.1	-5.5	-6.8	-8.9	-6.8
Equity	1 482	1 644	1 340	1 082	0.4	0.4	0.3	0.2	-9.6	32.8	-10.3	21.9	-25.0	-9.6	-15.0	-34.1
Debt instruments	16 414	13 127	12 964	8 788	4.0	3.1	2.9	1.9	0.4	3.4	-4.0	-12.8	-20.4	-21.0	-29.0	-33.1
Other	7 795	7 812	9 640	11 166	1.9	1.8	2.2	2.4	23.3	34.9	28.5	22.3	35.8	23.7	31.0	42.9
Available-for-sale financial assets	23 894	26 467	26 861	25 961	5.9	6.2	6.0	5.6	23.3	29.9	25.4	34.2	14.7	12.4	21.4	-1.9
Equity	7 870	7 681	5 774	4 954	1.9	1.8	1.3	1.1	42.4	66.8	29.9	25.9	-9.6	-26.6	-22.9	-35.5
Debt instruments	15 548	18 019	19 290	19 177	3.8	4.2	4.3	4.1	20.3	22.4	22.6	37.0	23.9	24.1	35.4	6.4
Other	476	767	1 797	1 830	0.1	0.2	0.4	0.4	-39.2	-56.4	40.3	78.2	69.3	277.3	161.4	138.7
Investment held to maturity	1 620	1 438	2 283	4 898	0.4	0.3	0.5	1.1	-19.2	-21.8	-27.2	-28.4	65.6	40.9	81.1	240.6
Hedging derivatives	2 060	1 385	1 596	2 298	0.5	0.3	0.4	0.5	31.6	56.3	-5.6	-12.9	15.0	-22.5	17.8	65.9
Investment in subsidiaries	3 097	3 229	2 765	2 480	0.8	0.8	0.6	0.5	6.1	-11.6	-7.4	-15.3	-25.2	-10.7	-29.7	-23.2
Net credit to costumers	265 636	285 561	299 858	313 786	65.3	66.7	67.0	67.7	12.5	13.9	16.8	14.5	17.9	12.9	11.9	9.9
Gross credit	272 150	292 171	306 943	321 745	66.9	68.2	68.6	69.4	12.2	13.6	16.4	14.3	17.8	12.8	12.0	10.1
of which: overdue credit to costumers	4 882	4 905	5 957	6 702	1.2	1.1	1.3	1.4	4.5	8.4	5.1	14.1	21.5	22.0	31.9	36.6
Impairment and value adjustments in credit to costumers	-6 514	-6 610	-7 085	-7 958	-1.6	-1.5	-1.6	-1.7	-0.4	3.9	-0.7	8.4	13.6	8.8	13.6	20.4
Securitised non-derecognised assets	18 454	19 212	22 255	27 276	4.5	4.5	5.0	5.9	23.3	20.8	3.7	18.5	10.4	20.6	19.6	42.0
of which: credit to costumers	18 454	19 279	22 255	26 784	4.5	4.5	5.0	5.8	23.0	20.8	3.7	19.1	10.6	20.6	19.6	38.9
Tangible and intangible assets	4 962	5 184	5 220	5 583	1.2	1.2	1.2	1.2	13.0	12.6	10.0	10.0	10.7	5.2	6.7	7.7
Other assets	15 218	14 248	15 385	18 559	3.7	3.3	3.4	4.0	-0.3	5.4	0.6	-0.9	8.2	1.1	23.5	30.3
Total assets	406 993	428 205	447 524	463 323	100.0	100.0	100.0	100.0	10.2	13.4	13.1	11.7	13.8	10.0	10.7	8.2
Resources from central banks	2 151	5 465	6 612	13 968	0.5	1.3	1.5	3.0	-77.3	-76.6	150.0	198.8	110.2	207.4	132.9	155.6
Resources from other credit institutions	70 445	69 620	71 615	70 582	17.3	16.3	16.0	15.2	8.8	6.7	-3.0	4.1	9.8	1.7	7.6	1.4
Resources from costumers and other loans	172 779	188 487	195 135	210 572	42.5	44.0	43.6	45.4	4.2	5.6	10.3	8.2	16.9	12.9	13.4	11.7
Liabilities represented by securities	95 019	96 629	104 503	92 765	23.3	22.6	23.4	20.0	32.0	44.2	23.5	17.5	12.0	10.0	4.2	-4.0
Subordinated liabilities	10 202	11 201	10 886	11 319	2.5	2.6	2.4	2.4	0.8	0.9	4.7	9.3	12.8	6.7	15.7	1.0
Financial liabilities held for trading	9 565	9 662	11 633	17 338	2.4	2.3	2.6	3.7	16.9	29.7	55.2	61.1	42.7	21.6	46.8	79.4
Hedging derivatives	2 777	2 013	2 428	2 493	0.7	0.5	0.5	0.5	76.9	92.8	7.6	7.8	5.2	-12.6	10.7	23.8
Liabilities for non-derecognised assets in securitisation operations	4 852	4 512	3 916	3 299	1.2	1.1	0.9	0.7	77.1	81.0	47.4	9.3	-10.8	-19.3	-40.0	-26.9
Other liabilities	13 470	14 105	13 979	13 171	3.3	3.3	3.1	2.8	-4.6	-0.1	3.3	0.9	2.1	3.8	3.6	-6.6
Total liabilities	381 260	401 694	420 707	435 506	93.7	93.8	94.0	94.0	9.5	13.1	13.2	11.7	14.3	10.3	11.0	8.4
Capital	25 733	26 511	26 818	27 817	6.3	6.2	6.0	6.0	21.6	17.5	12.0	11.8	6.1	4.2	5.8	4.9
Total liabilities and net wealth	406 993	428 205	447 524	463 323	100.0	100.0	100.0	100.0	10.2	13.4	13.1	11.7	13.8	10.0	10.7	8.2

Source: Banco de Portugal.

Note: (a) In 2007 year-on-year rates of change were based on thirteen banking groups which adopted the International Accounting Standards in 2005, due to lack of comparable financial statements for the banking sector as a whole in 2006 and 2007.

growth in customer deposits, and, to a lesser extent, by the increased resource to Eurosystem's monetary policy operations and by the maintenance of some access to financing in the international wholesale debt markets.

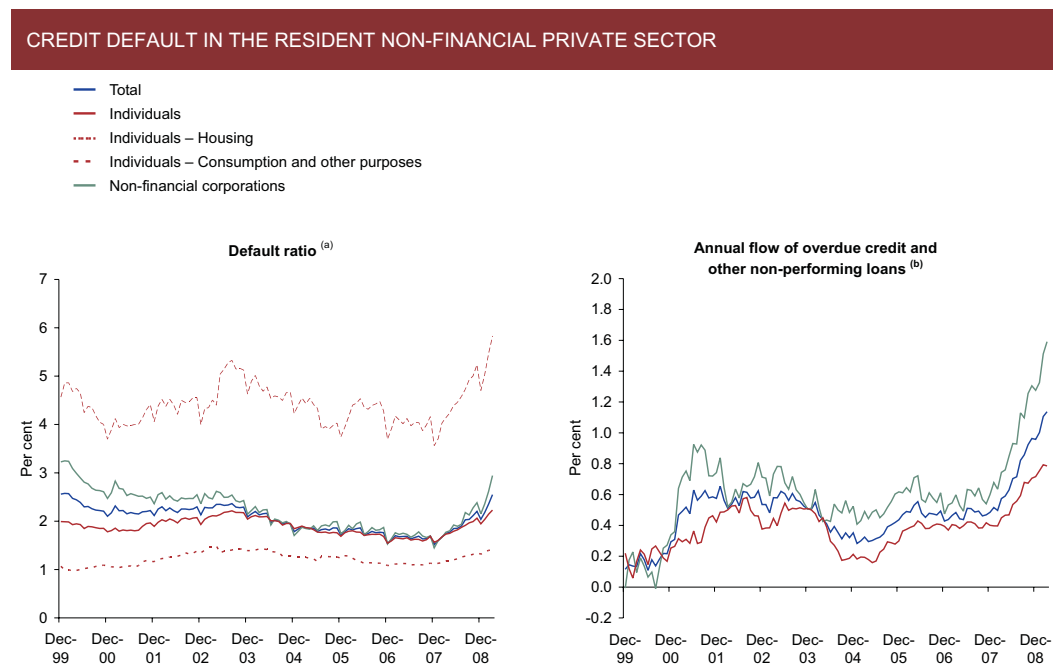
In fact, in 2008, credit to customers continued to present a strong growth, although there was a decrease in the rate of change *vis-à-vis* December 2007. The growth of credit reflected the high contribution of the international activity developed by some of the major banking groups, in line with the growing relevance of these markets in total activity. In the domestic market, lending to the non-financial private sector presented a slowdown, with its growth rate having decreased from about 10 per cent at the end of 2007 to approximately 7 per cent at the end of 2008.²³ In what concerns non-financial corporations, loans continued to present a relevant growth, although with some slight slowdown at the end of the year - with a rate of change of 11 per cent. Additionally, bank credit to this segment also involved the acquisition of substantial amounts of debt securities, mostly commercial paper. Regarding individuals, the growth rate of loans to this segment registered a significant decrease, standing around 5 per cent at the end of 2008 (9 per cent in December 2007). Loans for house purchase kept the slowdown trend seen since 2006, which accentuated in the second half of 2008. In turn, loans for consumption and other purposes showed a high growth in the first half of the year, decelerating considerably since then. The behaviour of credit to the non-financial private sector reflected changes both in supply and demand. According to the results from the Bank Lending Survey, since the onset of the crisis banks have been reviewing their lending policies, tightening the credit criteria. On the other hand, this survey's results suggest that there might also have been a decrease in bank lending demand during 2008, mostly by households in the segment of loans for house purchase.

The increase in interest rates, seen until October 2008, and the progressive deterioration in economic activity contributed for a significant raise in credit risk in 2008, which continued during the first months of 2009. Therefore, default levels in the non-financial private sector have been rising considerably since the end of 2007, and have in fact gone beyond what was seen in the 2003 recession, (Chart 7.5.3). While in December 2007 overdue credit and other non-performing loans accounted for 1.5 per cent of total loans (adjusted for securitisation), in December 2008 that value stood at 2.0 per cent²⁴, and in March 2009 this indicator increased to 2.5 per cent. From early 2004 there had been a slight dip in the trend, but this was now reversed. The increase in the default ratio reflected the growth in the annual flow of new overdue credit, as a percentage of the overall amount for loans (adjusted for securitisation). This figure stood at 1.0 per cent in December 2008. In March 2009, the flow of new overdue credit stood at 1.1 per cent of total loans, the highest value for the decade. In terms of segments, there were significant increases in default both regarding non-financial corporations and individuals. In what concerns non-financial corporations, the default ratio increased to 2.2 per cent in December 2008. During the early months of 2009, this indicator continued to increase, presenting values above those of the 2003 recession. Among the factors behind the worsening of this ratio were the substantial increase in new overdue credit and other non-performing loans and the fact that credit written down against assets flows suffered a reduction. At the end of 2008 new overdue credit and other non-performing loans from non-financial corporations represented around 1.3 per cent of the loans' outstanding amounts, adjusted for securitisation (0.6 per cent in December 2007). In March 2009, the proportion of this flow moved up to 1.6 per cent. Regarding individuals, their default ratio increased to 1.9 per cent at the end of 2008, standing at 2.2 per cent in March 2009. In turn, the flow of new overdue credit and other

(23) Developments in loans granted to the non-financial private sector are based on information relating to the group of resident financial monetary institutions, in accordance with the Monetary and Financial Statistics. The annual rate of change was calculated on the basis of the ratio of outstanding amounts of bank loans at the end of the month, adjusted for securitisation operations, and monthly transactions (which were calculated on the basis of outstanding amounts, adjusted for reclassifications, write-offs and price and exchange rate revaluations).

(24) This aggregate corresponds to the definition in Monetary and Financial Statistics. Credit overdue includes loans (principal or interest) overdue for more than 30 days. Other non-performing loans concern the future instalments of doubtful credit, such as defined in Notice no 3/95 of Banco de Portugal and other legal acts in force.

Chart 7.5.3



Source: Banco de Portugal.

Notes: (a) The default ratio is defined as overdue credit and interests and other non-performing loans as a percentage of total loans, adjusted for securitisation. (b) Estimates of the annual flow of new overdue credit and other non-performing loans as a percentage of the loans, adjusted for securitisation. The estimate of the annual flow of new overdue credit and other non-performing loans was calculated by adjusting the variation in the balance of overdue loans and other non-performing loans to write-offs/write-downs, reclassifications and, as and from December 2005, sales of overdue credit and other non-performing loans outside the banking system and not written-off from assets, reported on a quarterly basis as per Banco de Portugal Instruction no. 2/2007 and with information available only up to December 2008.

non-performing loans also recorded an increase, standing at 0.7 per cent of total credit in December 2008 (0.8 in March 2009). Default worsening was particularly harsher in the segment of credit for consumption and other purposes. The more moderate behaviour shown by default in the segment of loans for house purchase reflected, to a large extent, the fact that the purpose of these loans was related to owner occupation.

As mentioned previously, the Portuguese banks' portfolio of securities and financial investments presented a negative contribution for the change in assets in 2008.²⁵ The portfolio reduction, of around 15 per cent, was in line with the negative evolution in the international financial markets, but reflected also the net disposal of securities. Among these securities it should be highlighted the holdings in other Portuguese banking groups, which had already recorded impairment in 2007. This increased considerably during 2008, given the abrupt fall in stock markets' prices (Chart 7.5.2). The disposal of holdings and the reclassification of some financial instruments, performed by some banking groups according to the International Accounting Standards changes regarding the accounting of financial instruments at market value, contributed to soften the impact of market fluctuations on the financial statements.²⁶ Regarding the breakdown of the financial assets' portfolio in terms of risk, interest rate continued to represent the main source of risk, given the high proportion of debt securities in the banks' portfolio. Financial assets particularly exposed to changes in share prices decreased, in line with developments in stock markets and the already mentioned disposal of holdings carried out by some major banking groups.

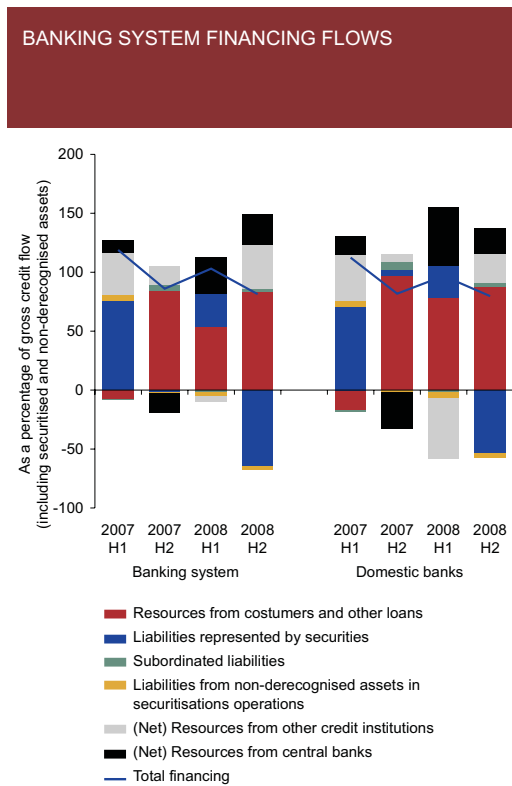
(25) The portfolio of securities and financial investments includes financial assets at fair value through profit or loss, including trading derivatives (net of held-for-trading financial liabilities), available-for-sale financial assets, held-to-maturity investments, investment in branches, and the net value of derivatives for hedging.

(26) In the second half of 2008, the International Accounting Standards Board introduced some changes in the accounting rules of financial instruments at market value, making more flexible the application of the marked-to-market principle in these assets' assessment. This change was performed to bring the requirements of the International Accounting Standards, namely IAS 39, closer to the US standards (US GAAP - Generally Accepted Accounting Principles in the United States). These changes were implemented through European Commission Regulation no 1004/2008.

In 2008, resources from customers and other loans, which represent the main source of financing for Portuguese banking activity, recorded a strong growth rate - of about 12 per cent - in line with the developments seen during the second half of 2007 when the crisis in the financial markets started (Chart 7.5.4). The growth of these resources reflected on one hand a rise in the demand for this type of products, in a context of financial assets' restructuring in the economic agents' portfolios, given the increase in investors' risk aversion and the devaluation tendency regarding financial assets more sensitive to market fluctuations. On the other hand, with wholesale financing markets still in turmoil, the evolution of these resources also reflected the adoption of more competitive strategies by banks to raise funds from customers, namely the offering of higher returns on deposits. Since these resources grew faster than the credit, the credit/deposit ratio decreased, especially for the domestic institutions.

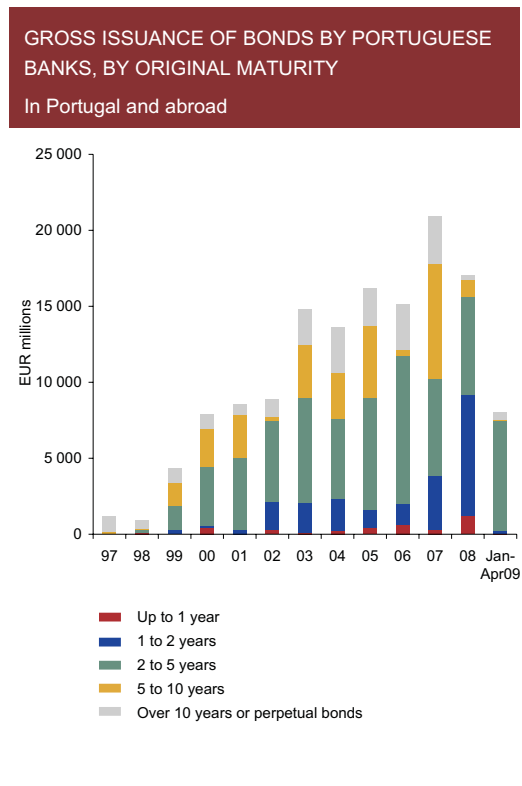
Notwithstanding the deep deterioration in the conditions in the securitised debt markets in 2008, Portuguese banks managed to issue during the year a very significant volume of securitised debt, with a special reference to bonds (about 17 billion euros). Given the greater difficulties in issuing debt at longer maturities, these issues were made with shorter maturities (average maturity was down from 5 to 3 years) and at higher costs, in comparison to 2007 (Chart 7.5.5). In addition, more than 40 per cent of the bonds issued in 2008 were covered bonds. There is a lower underlying risk for investors on these bonds, since they are secured by housing loans which constitute autonomous property in the banks' portfolios. However, a considerable part of these issues was earmarked for the refinancing of debt securities issued in previous years, and there was a drop in the net flows of this source of financing. In fact, liabilities in the form of securities were down by 4.0 per cent in 2008.

Chart 7.5.4



Source: Banco de Portugal.
 Notes: Estimates of securities issued by banks but placed with their customer base are included in the item 'Resources from customers'. There is a series break in June 2007 which corresponds to an extension in the number of institutions analysed.

Chart 7.5.5



Sources: Bloomberg, Dealogic Bondware and Thomson Reuters.
 Notes: Includes observations until the end of April. Includes issues from branches and subsidiaries of Portuguese banks abroad.

Net financing through central banks rose significantly in 2008. The use of this source of financing allowed to smooth part of the turmoil seen in other international wholesale debt markets, including the interbank money market, and benefited from the various measures adopted by the Eurosystem since the summer of 2007, as a way to ensure access to liquidity by the banks of the euro area. As for net financing through other credit institutions, there was a different evolution between domestic and non-domestic banks. While non-domestic banks boosted, in particular, their financing through other credit institutions, which reflected in part their intra-group financing, domestic banks moved away from the interbank money market and other wholesale financial markets and moved to the central banks as their source.

The growing importance of central banks as financing source caused banks to reinforce their portfolio of eligible assets as collateral for Eurosystem's monetary policy operations. This way, in 2008, similarly of what was done by other European banks and given the decrease in the demand for securities resulting from securitisation operations, some Portuguese banks acquired securities from these operations to special purpose vehicles held by third parties, with a view to use them as collateral in Eurosystem's monetary policy operations.

The changes in money market financing influenced the coverage ratio of interbank liabilities by highly liquid assets, defined as interbank assets and assets eligible as collateral in Eurosystem's monetary policy operations. This ratio fell slightly during 2008, following the worsening in the international financial markets' situation, mainly reflecting an increase in the resource of central bank funding during this period. The decrease in this ratio was more significant for domestic banks.

Finally, note that in 2008 only one issuance of bonds was made using guarantees provided by the Portuguese government, in the amount of 1250 million euros, within the scope of the measures designed to support the financial system announced in October of 2008 by the governments of several countries.²⁷

Despite the particularly adverse environment in overall terms, liquidity gaps of the Portuguese banking system, that relates highly liquid assets and volatile liabilities, presented a favourable evolution in 2008, excepting the shorter maturities. This evolution reflected, on one hand, the increase in highly liquid assets, particularly eligible assets as collateral in Eurosystem's monetary policy operations, and, on the other hand, the decrease in liabilities represented by securities.²⁸

Therefore, in 2008, in a context of strong disturbances in the functioning of financial wholesale debt markets, Portuguese banks made several adjustments in their financing structure which reflected an improvement in the banking system's global liquidity position. The adjustment process has been based on the expansion of resources from costumers and, to a lesser extent, on the access to central banks, allowing banks to decrease their exposure to the wholesale financing markets. Notwithstanding, Portuguese banks have managed to maintain some access to these markets.

In what regards the Portuguese banking system's profitability in 2008, in a context of marked worsening in the economic and financial crisis during the year, the negative effects on the income of institutions already seen at the end of 2007 deepened considerably, namely through increases in financing costs, losses in value of the financial assets portfolio, and a negative evolution of some commissions. Income before tax and minority interests in the banking system were, therefore, down by around 40 per cent, which induced a reduction of both return on assets and return on equity, with these indicators standing respectively at 0.64 and 10.6 per cent (Table 7.5.3). Comparing with the 2003 recession, re-

(27) In 2009, other banks also used these guarantees, in an amount around 3500 million euros.

(28) Liquidity gap defined as the ratio of the difference between liquid assets (LA) and volatile liabilities (VL) and the difference between total assets (A) and liquid assets, for each residual maturity ladder, i.e. $gap = (LA - VL)/(A - LA)$. For further details on this indicator, see "Box 4.1 Monitoring the banking system's liquidity risk", Banco de Portugal, *Financial Stability Report 2004*.

Table 7.5.3

PROFIT AND LOSS ACCOUNT OF THE BANKING SYSTEM

On a consolidated basis

	EUR millions						Structure (as a percentage of average assets) ^(a)						Year-on-year rates of change (per cent) ^(b)					
	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
	Year	Year	H1	H1	H2	H2	Year	Year	H1	H1	H2	H2	Year	Year	H1	H1	H2	H2
1. Interest income	25 267	31 149	11 727	14 790	13 540	16 359	6.25	6.95	6.00	6.75	6.50	7.15	28.7	23.3	27.5	26.1	29.8	20.8
2. Interest expenses	17 325	22 420	7 821	10 560	9 505	11 861	4.29	5.00	4.00	4.82	4.56	5.18	37.8	29.4	34.9	35.0	40.3	24.8
3. Financial margin (1-2)	7 941	8 729	3 906	4 231	4 035	4 498	1.96	1.95	2.00	1.93	1.94	1.97	11.5	9.9	14.2	8.3	9.1	11.5
4. Income from capital instruments	195	278	158	219	37	59	0.05	0.06	0.08	0.10	0.02	0.03	17.5	42.9	12.8	39.0	42.7	59.6
5. Income from services and commissions (net)	3 056	3 187	1 409	1 546	1 647	1 641	0.76	0.71	0.72	0.71	0.79	0.72	9.4	4.3	4.3	9.8	14.2	-0.4
6. Income from financial assets and liabilities measured at fair value through profit or loss	-172	59	281	-206	-452	265	-0.04	0.01	0.14	-0.09	-0.22	0.12	172.7	-134.4	-	-173.4	-	-158.6
7. Income from available-for-sale financial assets	1 080	534	400	406	681	128	0.27	0.12	0.20	0.19	0.33	0.06	130.8	-50.6	72.7	1.5	190.1	-81.2
8. Income from foreign exchange revaluation	409	190	116	57	292	134	0.10	0.04	0.06	0.03	0.14	0.06	-20.8	-53.5	-60.8	-51.4	31.0	-54.3
9. Income from the sale of other financial assets	160	322	191	51	-31	271	0.04	0.07	0.10	0.02	-0.01	0.12	-79.0	101.0	-67.1	-73.3	-102.7	-980.1
10. Other operating profit and loss	686	656	315	345	371	312	0.17	0.15	0.16	0.16	0.18	0.14	-19.7	-4.3	-16.5	9.5	-22.5	-16.0
11. Gross income (3+4+5+6+7+8+9+10)	13 356	13 956	6 775	6 648	6 580	7 307	3.30	3.12	3.46	3.03	3.16	3.19	6.0	4.5	9.1	-1.9	3.0	11.0
12. Staff costs	3 912	4 013	1 821	1 965	2 091	2 049	0.97	0.90	0.93	0.90	1.00	0.90	4.1	2.6	-0.1	7.9	8.0	-2.0
13. General administrative costs	2 748	2 878	1 283	1 369	1 465	1 510	0.68	0.64	0.66	0.62	0.70	0.66	10.2	4.7	8.5	6.7	11.8	3.1
14. Depreciation and amortisation	559	598	264	283	295	315	0.14	0.13	0.14	0.13	0.14	0.14	10.4	6.9	6.5	6.9	14.1	6.9
15. Provisions net of restitutions and annulments	212	-62	131	36	81	-98	0.05	-0.01	0.07	0.02	0.04	-0.04	41.2	-129.3	112.0	-72.6	-11.1	-221.4
16. Impairment losses and other net value adjustments	1 690	3 636	803	1 307	887	2 329	0.42	0.81	0.41	0.60	0.43	1.02	35.6	115.1	45.9	62.7	27.2	162.5
17. Negative consolidation differences	-12	0	-4	0	-9	0	0.00	0.00	0.00	0.00	0.00	0.00	-	-100.0	-	-100.0	-	-100.0
18. Appropriation of income from associates and joint ventures (equity method)	393	-29	161	59	232	-88	0.10	-0.01	0.08	0.03	0.11	-0.04	97.4	-107.3	25.0	-63.0	237.2	-138.0
19. Income before taxes and minority interests (11-12-13-14-15-16-17+18)	4 639	2 863	2 637	1 749	2 002	1 114	1.15	0.64	1.35	0.80	0.96	0.49	1.7	-38.3	7.1	-33.7	-4.7	-44.4
20. Taxes on profit	772	607	460	356	311	252	0.19	0.14	0.24	0.16	0.15	0.11	-11.9	-21.3	25.5	-22.7	-41.4	-19.2
21. Income before minority interests (19-20)	3 868	2 256	2 177	1 394	1 691	862	0.96	0.50	1.11	0.64	0.81	0.38	4.6	-41.7	4.1	-36.0	5.3	-49.0
22. Minority interests	653	462	372	293	281	168	0.16	0.10	0.19	0.13	0.13	0.07	12.8	-29.3	8.2	-21.2	19.4	-40.0
23. Net profit and loss (21-22)	3 215	1 795	1 805	1 101	1 410	694	0.80	0.40	0.92	0.50	0.68	0.30	2.9	-44.2	3.2	-39.0	2.6	-50.8

Source: Banco de Portugal.

Notes: (a) Half-a-year data are annualised. (b) In 2007, year-on-year rates of change were based on thirteen banking groups that adopted International Accounting Standards in 2005, due to lack of comparable financial statements for the banking sector as a whole in 2006 and 2007.

turn on assets was lower in 2008. It should be remembered, however, that there were profound changes to the accounting framework in 2005, specifically the adoption of the International Accounting Standards (IAS). One of the new points was that a substantial part of the banks' financial assets became recorded at market prices, which meant greater sensitivity to market fluctuations by the institutions' financial statements.

The decrease in return on assets was mainly due to the increase in provisions and losses through impairment, of nearly 90 per cent, visible both in the component relating to financial assets and the one relating to credit to customers, in line with unfavourable developments in financial markets and the deterioration in economic activity. Regarding impairment of financial assets, note the impairment related to holdings in other Portuguese banking groups, given the significant fall in shares of these securities. The fall in income from financial operations, of around 25 per cent, and the moderate growth of (net) income from services and commissions, of about 4 per cent, both resulting from the adverse financial environment, also contributed for a reduction in profitability.²⁹

In the opposite direction, *i.e.*, contributing for an increase in the return on assets, the evolution of operating costs stood out, in line with what happened in previous years. Since both the growth in operating costs – of 4 per cent – and in gross income was similar, cost-to-income indicator for the banking system presented a virtual stabilization in 2008.³⁰

In what regards financial margin, which is the main component of income, its contribution for return on assets remained similar to 2007, as it presenting a growth close to 10 per cent. The volume effect continued to be a determinant element for this evolution, in a period when the interest rate change effect had far less impact. Implicit average interest rates regarding outstanding amounts of the main deposit and lending operations continued on an upward path, reflecting the rise in interest rates in the money market, seen up to October 2008, as well as rising financing costs in other debt markets. For the year as a whole, there was virtually no change in the spread between implicit deposit and lending rates. In fact, the slight increase in the spread associated with securities was almost offset by the slight dip in the spread between implicit rates in credit and customer deposits, resulting from the time lag between the transmission to the average interest rates on outstanding amounts and the adoption of more competitive strategies in the capture of deposits.

As a final point, international operations of some of the main banking groups have shown a growing relevance in the Portuguese banking system's income over the last years. In 2008, this tendency continued, with income from international operations on total income increasing to a weight of 40 per cent (19 per cent in the previous year). The main contribution continued to be related with the financial margin, given the more traditional financial intermediation task performed by banks in these economies. However, in 2008, reference should also be made to the significant increase in impairment losses, although the respective weight in the total of impairment is reduced. This has reflected unfavourable developments in international financial markets, but also deterioration in some economies where international operations are carried out, among them some Eastern European economies.

In 2008, all the institutions under the supervision of Banco de Portugal brought their capital adequacy ratios into line with the New Capital Accord, commonly known as Basel II.³¹ The criteria of Basel II fundamentally affected the determination of capital requirements, while the definition of own funds re-

(29) Profits from financial operations correspond to the sum of income from financial assets and liabilities valued at fair value through profit or loss, income from available-for-sale financial assets, income from the sale of other financial assets and income from foreign exchange rate revaluation.

(30) Cost-to-income indicator corresponds to the ratio between operating costs (defined as the sum of staff costs, administrative costs and depreciation and amortisations) and gross income.

(31) In 2007 the New Capital Accord, also known as Basel II, came into force. One of the objectives of the prudential Basel II regime is to ensure a better match between capital requirements and the real risk profile held by institutions, including a broader coverage of risks, such as the operational risk. However, Community Directive no 2006/48/EC allowed the institutions to use the previous regime (Basel I) in 2007, an option that was taken up by most institutions in the Portuguese banking system.

mained similar to the previous Accord's. Given the deepening of the international financial crisis during 2008, some prudential and accounting rules, impacting on the evolution of own funds, were changed. So, in December 2008, and according to the already mentioned changes, the Portuguese banking system's own funds adequacy ratio, on a consolidated basis, stood at 10.3 per cent, while the original own funds adequacy ratio (Tier I) came in at 7.5 per cent.

The evolution of capital requirements was greatly conditioned by the Basel II methodology. In particular, and since requirements regarding credit risk presented a very moderate growth, compared to end of 2007 levels, the increase in capital requirements came essentially from the setting up of operational risk requirements. The behaviour of credit risk requirements should have translated the smaller weight given to a significant portion of the institution's credit portfolio, according to the standardised approach of Basel II, given that credit to costumers continued to grow at a significant rate.

The adverse economic and financial framework of the year also originated a strong pressure on the institution's capital, mainly through the decrease in income and the reduction in the value of available-for-sale financial assets' portfolio. In this context, several institutions performed equity increases, in an amount of over 2000 million euros, which constituted the main contribution for the increase in own funds. However, this evolution also reflected, as mentioned, the regulatory changes made during the year, highlighting among these the possibility for a gradual deferring, during four years, of actuarial losses, calculated in 2008 and deduced of the assets' expected returns for the year, in bank employees' pension funds.³²

Institutional Investors³³

In the context of the international economic and financial crisis, there was in 2008 a significant increase in the level of risk aversion of investors, which reinforced the adjustment in the financial investment portfolios started in the second half of 2007, with the intent to decrease their exposure to financial markets fluctuations. This way, savings invested in financial instruments managed by institutional investors were substantially reduced in 2008, with a negative flow of about 3 per cent of GDP (Table 7.5.4). The significant amount of redemptions (net of new subscriptions) regarding participation units in investment funds - mainly mutual funds - was crucial for this evolution. In the opposition direction were net contributions for pension funds, increasing *vis-à-vis* 2007, and investment in life insurances, although in an amount below the previous year's.

Contributions to pension funds, representing 1.5 per cent of GDP, reflected essentially those made to banking employees' pension funds in 2008, which stood above 1 per cent of GDP.^{34,35} Despite an increase in contributions, the fall in the return on assets portfolio induced a decrease in the value of the portfolio of pension funds of about 9 per cent, in line with the strong turmoil in debt markets and steep falls in the stock markets (Chart 7.5.6). Amidst these disturbances, the tendency to an adjustment of portfolios was also noticeable in these funds, causing a change in the portfolio structure of Portuguese pension funds. Particularly, there was an increase in the weight of the cash, deposits and debt securities components at the expense of shares and other equity.

(32) Regulation set out in Banco de Portugal Notice no. 11/2008.

(33) Institutional investors are entities that have special competence and experience in assets management, whose major task is to invest large amounts of funds, and who are usually subject to specific regulation and supervision. This section specifically regards collective investment institutions (mutual and real estate investment funds), insurance corporations and pension funds.

(34) Banking employees' pension funds, whose liabilities are fully covered by banking groups, are mandatory (for both employers and employees). Therefore, these funds are different from other pension funds whose objective is to capture savings in order to complement legally established pensions, having consequently a voluntary nature. Additionally, given that pension funds of bank' employees fall within "defined benefits" schemes category, extraordinary contributions over the previous years have been mainly channelled to these funds.

(35) For more details on the evolution of banking employees' pension funds see "Section 4.4 *Market risk*", Banco de Portugal, *Financial Stability Report 2008*.

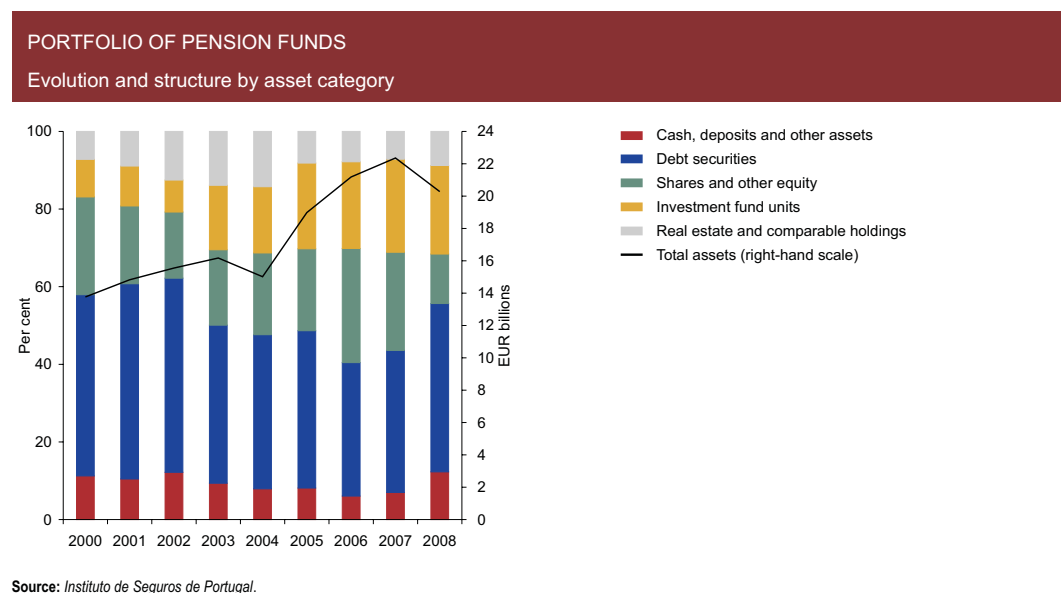
Table 7.5.4

RESOURCES RAISED BY RESIDENT INSTITUTIONAL INVESTORS										
As a percentage of GDP										
	2000	2001	2002	2003	2004	2005	2006	2007	2008	End-of-period position Dec-2008
Total	n.a.	4.2	4.5	3.1	2.7	8.1	4.6	1.4	-2.9	54.1
Pension funds ^(a)										
Net contributions ^(b)	0.7	1.4	1.5	-0.2	-0.6	1.5	0.5	1.3	1.5	13.8
Excluding extraordinary contributions	0.5	0.4	0.3	-0.7	-1.0	0.1	0.3	1.3	1.3	
Life insurances and similar ^(a)										
Net contributions	1.7	2.0	2.0	1.6	1.8	3.9	3.1	2.1	0.6	24.7
Investment and risk capital funds ^(c)										
Net subscriptions:										
Money Market Funds	n.a.	0.0	0.4	0.3	0.0	0.0	-0.2	-0.2	-0.2	0.0
Mutual Funds	n.a.	0.2	0.0	0.9	0.7	2.0	0.2	-2.1	-4.9	8.6
Real Estate Funds	n.a.	0.5	0.6	0.5	0.7	0.6	0.9	0.3	0.1	6.4
Risk Capital Funds ^(d)	n.a.	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.5
Memo:										
Deposits from the resident non-monetary sector ^(e)	8.8	5.4	0.6	1.1	2.7	8.5	9.3	8.3	14.5	128.0
Savings certificates	1.0	0.8	0.6	0.2	0.0	0.2	0.6	0.5	-0.5	10.3

Source: Banco de Portugal.

Notes: (a) Amounts outstanding in December 2008 correspond to the technical reserves of insurance corporations and pension funds, as a measure of the liabilities associated with life insurance instruments in the insurance sector and the payment of pensions. (b) Figures for 2003 and 2004 are adjusted for the transfer of pension funds from publicly-owned companies to *Caixa Geral de Aposentações*. In 2003, it included the transfer of the Post Office fund (€1,300 million) and in 2004 the transfers involved *Caixa Geral de Depósitos* (€2,504.4 million), *Navegação Aérea de Portugal* (€235.7 million), *Aerportos de Portugal* (€173.6 million) and *Imprensa Nacional Casa da Moeda* (€137.8 million). (c) Data are not adjusted for mutual fund units held by resident funds. (d) Information on units issued by risk capital funds (RCF) only includes data on RCF whose management regulations are published on the CMVM site. (e) In Portugal and abroad.

Chart 7.5.6

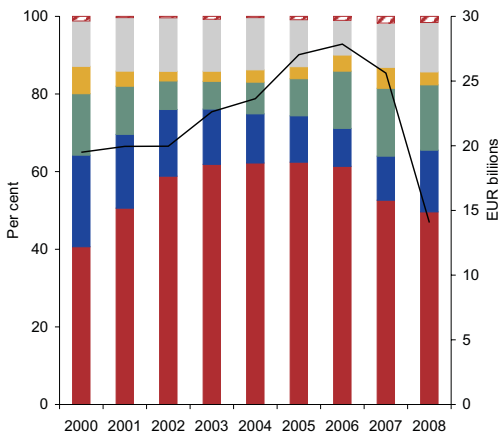


In 2008, there was a high amount of net redemptions from mutual and money market investment funds, ascending to about 5 per cent of GDP, in line to what was observed in 2007, especially in the second half of the year. The value of the portfolio of mutual funds recorded a reduction of above 40 per cent in 2008 (Charts 7.5.7 and 7.5.8). This reflected the significant volume of net redemptions and the sharp fall in returns from most funds, in particular, in those related to the stock markets. In this context,

Chart 7.5.7

PORTFOLIO OF MUTUAL FUNDS AND MONEY MARKET FUNDS
Evolution and structure by asset category

- Securities other than shares – non-resident issuers
- Securities other than shares – resident issuers
- Shares and other equity – non-resident issuers
- Shares and other equity – resident issuers
- Cash and deposits
- Other assets
- Total assets (right-hand scale)

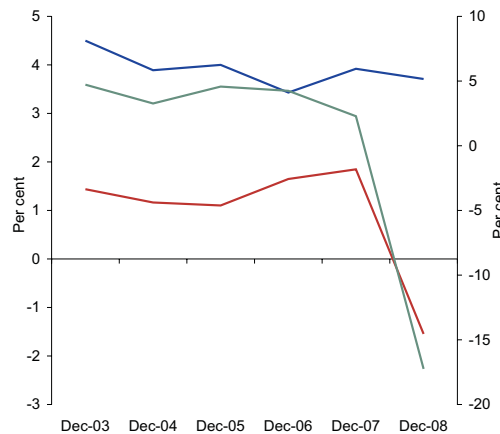


Source: Banco de Portugal.
Note: Data were adjusted for mutual fund units held by other funds.

Chart 7.5.8

INVESTMENT FUND YIELDS

- Money market and cash funds
- Real estate funds ^(a)
- Mutual funds (excluding cash funds) (right-hand scale)



Sources: APFIPP and Banco de Portugal.
Notes: Yields were calculated on the basis of 12-month yields of investment funds administered by management companies that are members of the APFIPP. However, these represented almost all the funds. (a) Change in the real estate index APFIPP.

the portfolio structure of these funds also recorded some changes, translated in a decrease in the weight of shares and other equity. In turn, investment in real estate funds recorded a positive net flow that accounted for 0.1 per cent of GDP, a level below the value of 2007.

In what regards holders of investment fund units, similarly to 2007, the net redemptions were focussed essentially in the individuals' sector, representing 5.5 of GDP.³⁶ The remaining institutional sectors also performed net redemptions of these investments, excepting general government and, more particularly, other monetary financial institutions. In fact, in 2008, the amount of net subscriptions performed by these institutions corresponded to 1.1 per cent of GDP, a level substantially higher than in 2007 (0.2 per cent). This fact suggests that these institutions may have taken part of the net redemptions performed by other sectors in investment funds managed by corporations belonging to the same financial group.

(36) The flows mentioned in this paragraph concern not only net subscriptions/redemptions regarding resident investment funds, but also foreign investment funds.