

1. OVERVIEW

The summer of 2007 saw the onset of an international financial crisis that deepened in September 2008. As the crisis began to interweave with the global economic downturn, the Portuguese banking system found itself working within an extremely tight framework. The country's economy is small but economically and financially integrated, so the global turmoil impacted on the banks. The present crisis is one of the severest of recent decades. Its first phase was characterised by major difficulties in most of the wholesale debt markets, including the money markets, but it then spread, with falls in the stock markets and, more recently, with the transmission of its effects to the real economy, as credit risk took increasingly concrete form.

In the years before the crisis, financing in the wholesale markets had been of importance for the expansion of Portuguese banks, as indeed it had been internationally. Against this backdrop, it became clear that certain balance sheet items (and related pension funds), were vulnerable to fluctuations in stock markets and to the size, persistence and deepening of market woes. The result was a slowdown in banking activity and a revision of banks' asset and liabilities management strategies. The country's banks have, however, shown considerable resilience in the face of this particularly stormy climate and have managed to keep their financial intermediation activity on track. A wide range of factors has played a part in this process.

In the first place, what stands out is the situation of the economy and the banks' balance sheets when the crisis broke. The economy was not plagued by any speculative property price bubble, which was propitious for the financial situation of companies and households, and consequently for banks. In terms of the financial system, Portuguese banks may well have been exposed to turmoil in the international wholesale debt markets, but two things weighed in the balance: the fact that financing was fundamentally denominated in euros; and the medium to long-term maturities in their operations. This has eased the adjustment of the banks as they ride the financial storm and no hard landing has materialized. Furthermore, the asset portfolios of the banks have not been substantially exposed to the complex assets that were at the core of the current crisis. Asset portfolios have, of course, been considerably drained of value, above all as the contagion caught hold of stock markets. But, in the Portuguese case, the securitisation of credit – a process which has grown significantly since 2002 – has been predominantly related to mortgage loans and the majority of these have not been derecognized, since this can only happen when there is a transfer of all the rights pertaining to the assets and all the risks underlying them. This meant that the banks had made a correct assessment of risk before embarking on these operations and they have continued after securitization contracts are signed to monitor the capacity of their customers to keep up with repayments. The main reasons why the banks securitised loans were firstly to transform illiquid into liquid assets; and secondly to cut back financing costs. It is worth noting in this context that there are relatively few incentives in Portugal for banks to use securitisation with capital requirements in mind, since a clutch of the securities with greater subordination (equity tranche) is normally retained on their balance sheets: there is a high weighting for these in the determining of capital ratios.

In the second place, Portuguese banks, like other European banks, have made use of the changes in the regulatory framework of the Eurosystem monetary policy. And they have also had state guarantees available, with the government guaranteeing debt issued by the banks as part of the concerted action undertaken by the governments of Europe and other advanced economies. As a final point, the liquidity situation of the banks has benefited since the start of the crisis from portfolios shifts by their customers, above all from individuals. This has come on the back of greater risk aversion and consequently

less appetite for financial assets that are more prone to be buffeted in the markets: hence the increase in demand for bank deposits. The banks themselves have adopted more competitive strategies to build customer deposits, with a closer link between the rates they pay and the rates in the money markets.

Although slowing down in comparison to the years prior to the crisis, banks activity experienced strong growth in 2008 (8.2 per cent on a consolidated basis measured by total assets). The slowdown in banks' activity was across the globe, being particularly marked in banks mired with assets more vulnerable to price fluctuations in plummeting security markets. In Portuguese banks, the portfolio of securities and financial investments plunged 15 per cent over the year. This portfolio, however, only accounts for a relatively small proportion of total assets, where the dominant item is the customer credit portfolio. This accounts for two-thirds of the balance sheet and was up 10 per cent over the year. The fall in the portfolio of securities and financial investments reflected not only the shift in asset prices; the major groups also disposed of holdings. In part, the move in customer credit reflected the influence of international activity carried out by some of the major banking groups. In the domestic market, strong growth was still evinced in loans to non-financial corporations, though the pace slowed towards the end of the year. In addition, non-financial corporations issued substantial amounts of commercial paper, taken in large measure by the banks. In terms of households, loans for housing continued on the downward trend that had set in during 2006 which gathered momentum in the second half of the year under review. Loans for consumption and other purposes continued to grow strongly in the first half of 2008 but then slowed markedly. The lower growth in loans to the non-financial private sector came as banks tightened their criteria for new loans, in tandem with a fall in the demand for credit.

Against a backdrop of global financial and economic crisis, where turbulence in the international wholesale financing markets featured strongly, Portuguese banks have been rejigging the structure of their financing, aiming to cushion the impact of the turmoil on their operations, their profitability and their solvency. By and large, the expansion of banks' activity had come on the back of an increase in customer deposits, but they also tapped into Eurosystem monetary policy operations and to a lesser extent into the international debt markets. In the midst of all this, the year-end saw a fall in liabilities involving securities. In tandem, as in an array of European banks, there was a rise in financial leverage, defined as the ratio between total assets and own funds; and this was in spite of capital increase operations during the course of the year. The same was true for the relationship between tangible own funds and tangible assets.

Customer deposits grew strongly (they were up 12 per cent in December 2008) and this contributed to an improvement in the structural position of liquidity in the banking system, illustrated by the fall in the ratio between credit and deposits, in particular for domestic institutions. The financing problems in the wholesale debt markets were felt above all in medium to long-term operations, which led to a partial shift to shorter maturities, even though this meant higher costs. Most banks across the world were doing likewise.

Taking the year as a whole, the banks managed to issue a considerable volume of debt. The total came in at 17 thousand million euros in bonds, this being the main instrument after securitised debt. Mortgage-backed bonds accounted for 40 per cent of the total. These represent a lower risk for investors, since they are guaranteed by loans for housing which is a dedicated item in banks' portfolios. Be this as it may, the year check saw a big fall in net bond issues by banks overall.

During 2009, nearly 18 per cent of the outstanding balance of Portuguese banks' bonds will mature. More than half of this had been issued on the bond markets by the end of April as the conditions for debt issues eased in the first months of the current year. However, persistent difficulties continue to hamper access to this type of financing, so the guarantees from the Portuguese government concern-

ing debt issues by the banks are still important, making it easier for banks to refinance their liabilities in these markets. The guarantees enable Portuguese banks to tap into medium-term financing in the wholesale markets, shouldering a lower risk premium than for unsecured bonds. They do, however, have to pay a 50 b.p. commission to the State, to which must be added the premium levied on their credit default swap (or through similar banks, if there is no credit default swap for this issuer) if the security is issued with a maturity of more than one year. During the year under review, there was only one issue of state-guaranteed bonds and this was by the CGD, though other banks followed suit in early 2009. In spite of the particularly unfavourable climate, Portuguese banks have still managed to issue securitized debt without State guarantee. In fact, only around 45 per cent of the amount issued in the first four months of 2009 has been backed by the State guarantee.

In the Portuguese banking system overall, the liquidity gaps in, which highlight the relationship between highly liquid assets and volatile liabilities, have moved favourably for longer maturities (more than one year). This reflects two things: an increase in highly liquid assets, above all eligible assets for collateral Eurosystem monetary policy operations, and a cut in liabilities involving securities.

So, although the climate was particularly unfavourable, the banks managed to obtain the financing they needed for the relatively large expansion of credit seen during the year. The trend towards raising more funds from customers is a positive sign, implying less exposure to wholesale debt markets, though it must be borne in mind that the recent pace of growth in deposits is not likely to be sustainable for a long period, since there has been a major adjustment of household portfolios involved and this cannot be expected to occur again to the same extent. The measures taken to shore up the financial system, specifically in terms of the State guarantees underpinning banks' debt issues and the changes in the operational framework of the Eurosystem monetary policy operations, should continue to smooth access to financing for the country's banks, even with major turbulence still affecting the wholesale financing markets. The liquidity of Portuguese banks is not likely, therefore, to curtail financing for the economy, above all when a slowdown in demand for bank loans is expected, itself likely to go hand in hand with improvements in the credit/deposit ratio and in the liquidity gap up to one year.

As far as market risk is concerned, the banks are still very exposed, especially to the stock market through bank employees' pension funds, even though the disposal of holdings and the reclassification of some financial assets have cushioned the impact of market fluctuations on their income statements. Where pension funds are concerned, there has been a marked fall in portfolio values on the back of the market turmoil, even though the banks themselves have increased their contributions. Some actuarial gains were in fact recorded, related to the increase in the actuarial discount rate, and this helped to pin back the funds' total liabilities. At year-end, the actuarial discount rate of the main pension funds stood at between 5.5 and 6.0 per cent. This was higher than the average return on Portuguese public debt for the year and could represent a risk factor if the discrepancy in the level between the two types of rate should persist in coming years. Given the big uncertainty hanging over the performance of the financial markets in 2009, it is possible that the actuarial discrepancies in the pension funds could be negative again and generate increased pressure on the solvency ratio of a number of institutions.

Over the last decade, growing indebtedness has become a marked structural feature of the Portuguese economy. During the year under review, there were contrasting moves in the indebtedness of households and non-financial corporations. Where households were concerned, the ratio of debt to disposable income hardly moved as the financing capacity of the sector increased and the downward trend in the savings rate was reversed. In the case of non-financial corporations, on the other hand, the borrowing requirements rose substantially, as seen by the big increases in the ratio of indebtedness to GDP and the financial leverage ratio. Given the role of financial intermediation undertaken by the banking system in cross-border operations, the net indebtedness of this sector *vis-à-vis* non-resi-

dents represents the external counterpart of the net domestic indebtedness of the private non-financial sector (households and non-financial corporations). Against a backdrop of economic and financial crisis, the high level of indebtedness in the Portuguese economy makes it even more important to analyse the financial situation of the non-financial private sector so as to assess financial stability. This is so, even though there tends to be a lengthy period of adjustment for economies belonging to monetary unions, in particular where there are no speculative asset bubbles and the financial systems are sound.

Since the end of 2007, the levels of default in the non-financial private sector have risen substantially. They have in fact gone higher than in the 2003 recession, though they are still relatively well contained. The move has reversed the trend towards a slight fall that had been seen since 2004. Within this picture, however, specific provisions for credit risk remain above the minimum required by the Banco de Portugal. Expectations are for a significant rise in default in the non-financial private sector, with the current macroeconomic prospects and the uncertainty as to the repercussions of the financial crisis on economic activity, even though interest rates have fallen. In the household segment, the anticipated rise in unemployment seems set to push up defaults; and in the non-financial corporate sector, the same is likely to happen, though here the problem stems from the current juncture, along with the high cyclical nature of some sectors of the economy. In tandem, there will likely be a rise in losses given default in situations where companies are not in a position to honour their payment commitments. In fact, according to the results of a default model that incorporates economic cycle projections, the likelihood of corporate default for 2009 comes in with a rise over 2008 that is higher than in the previous twelve months. The figure looks to be heading above the previous high, recorded in 2003. Moreover, the current crisis is bringing situations that are way beyond the experience of the previous recession, and this could well lead to a greater credit risk from major exposures to non-financial corporations, above all bearing in mind the big expansion of credit to these companies in the year under review, at a time when there was already a major slowdown in the economy.

The expected rise in the default ratio of the non-financial private sector looks unlikely to jeopardise financial stability. Among the factors that explain this is the amount of household credit that is tied up in owner-occupier housing. Apart from this, those Portuguese households with lower income account for only a very limited slice of the mortgage market, compared with households where income is higher and the average situation in the euro area. There is, in fact, some exposure among young households with a high level of debt, but for this age group the banks usually demand personal guarantees where income is more shaky. There is also no evidence of overvaluation of property prices in Portugal; even so, there will probably be some price adjustment in the market. This could come if the perception of the crisis conditions the demand for housing assets based on expectations of future income, and of housing prices themselves, along with more stringent conditions for bank finance geared to this type of investment. Another element in the frame relates to the monetary policy and governmental measures to support small and medium-sized companies, and such measures could turn out to be important in mitigating credit risk.

Following the onset of the financial crisis in the summer of 2007, the results from banking operations in the last quarter of that year were already badly affected. This came as a result of higher financing costs, the loss of value in the portfolio of financial investments and a fall in the value of some commissions. The situation deteriorated sharply in 2008, as the international financial markets bore the brunt of the storm and the prospects for global economic growth waned fast. Profits in the banks before tax and minority interests, taken on a consolidated basis, fell by around 40 per cent. The situation was the same for return on assets as it was for return on equity, with the first standing at around 0.64 at year-end and the second at 10.6 per cent. Profitability for the year was lower than the minimums seen in the 2003 recession, though they stand up well to comparisons across Europe. It should be remem-

bered, however, that there were changes in the accounting framework from the start of 2005 through the introduction of International Accounting Standards. This affected a considerable portion of banks' financial assets, especially securities, which had to be booked at market prices. They were thus more sensitive to market fluctuations than in the previous accounting system.

The fall in return on assets came essentially as a result of impairment. Almost half was connected to credit to customers and the remainder to held-for-sale financial assets. Among the latter, a particularly salient point was the loss through impairment from cross-holdings in the banks themselves. In terms of the financial margin, however, and this is the main component in results (corresponding to approximately 60 per cent of gross income), there was a growth of around 10 per cent during the year, so its contribution to return on assets is close to the figure for a year earlier. In a period when the interest rate margin effect was relatively small, the volume effect continued to be the main determining factor for the move in financial margin; and the international activity of some of the main Portuguese banking groups played an important part in the growth of this margin. Also of note is the growing importance of international operations in the consolidated results of many institutions. The figure moved from around 20 per cent in 2007 to 40 per cent a year later, even though there was a considerable rise in the losses through impairment associated with such operations. The evolution of impairment in international banking activity reflected the downward thrust, not only in the financial markets, but also in some economies where the banks were operating, above all in Eastern Europe. Portuguese banks, in fact, do not have a very significant exposure to emerging market economies, but there are some risks, though they are limited and have low systemic impact.

Banking activity in 2009 is likely to slowdown sharply. Credit looks set to slow, after the major surge in the year under review, partly as a result of international operations. This, in tandem with greater credit risk, will put downside pressure on bank profitability. To this can be added the uncertainty as to how the financial assets and the wholesale debt markets will move, even though the first few months of 2009 have shown that the recent extreme risk aversion is ebbing.

During 2008, all the institutions under the supervisory aegis of the Banco de Portugal set out their capital adequacy ratios in accordance with the New Capital Agreement, normally designated Basle II. The criteria for Basle II fundamentally affect the calculation of capital requirements, with the definition of own funds similar to the previous agreement. As the financial crisis unfolded during the year, there were changes to the prudential and accounting supervision rules with impact on own funds. A major point here was the possibility of deferring over four years the recognition in own funds of the negative actuarial discrepancies in pension funds. At year-end, with these changes factored in, the own funds adequacy ratio for Portuguese banks, on a consolidated basis, stood at 10.3 per cent, while the Tier I ratio was 7.5 per cent.

Some banks have sold assets to focus more on their core activity and have bolstered their capital through primary market issues; and some of them have already made it clear that they will increase their own funds during 2009 to strengthen their capital ratios. This will bring them into line with the Banco de Portugal recommendation to hold Tier I capital at a minimum of 8 per cent as and from September. Financial market turmoil, however, could yet stall these plans, and the Portuguese government's recapitalisation plan can be particularly relevant here, with 4,000 million euros earmarked for the country's financial institutions.

In the current juncture, one of the main challenges for the financial system lies in the steep deterioration of the prospects for economic activity. This is likely to push up credit risk, with an increase in default rates among households and, in particular, non-financial corporations, and consequent pressure on the profitability and solvency of the country's banking system. The prospects for global economic activity are gloomy, with a severe recession expected in 2009. In addition, the size and duration of the

recession are still cloaked in uncertainty, even though some macroeconomic indicators have suggested a decline in the fall in demand. One of the preconditions for a sustained recovery of the world economy is to put the financial sector and the credit market back on an even keel. Some glimmers have been seen since the start of March, as there seems to be an easing in the extremely high level of risk aversion that was prevalent for a long period in the financial markets. The stock markets are recovering and the spreads in the debt markets are narrowing. Many uncertainties, however, still hover over the financial state of banks across the globe. Results for the first quarter of 2009 in some international banks are coming in higher than expectations. The improvement, however, may be on the back of temporary factors, as the trend for credit risk seems still to be heading upwards. Against this backdrop of extreme uncertainty, the main risk for financial stability lies in the interweaving of the financial system and the real economy, a fact that could trigger a downward spiral. Measures to support the financial system and the economy could be quintessential in the efforts to break any spiral of this nature and lay the groundwork on which the financial system can build and economic growth can flourish.

This Report was written with information available up to the end of April 2009, with the exception of monetary policy decisions, measures related to the financial system and Monetary and Financial Statistics.

MAIN INDICATORS (to be continued)

Per cent; end-of-period figures

	2002	2003	2004	2005	2006	2007	2008
Macroeconomic and financial indicators							
Real GDP (rate of change)							
US	1.6	2.5	3.6	2.9	2.8	2.0	1.1
Euro area	0.9	0.8	2.2	1.7	2.9	2.7	0.9
Portugal	0.8	-0.8	1.5	0.9	1.4	1.8	0.0
Fiscal Balance (as a percentage of GDP)							
US	-3.8	-4.8	-4.4	-3.3	-2.2	-2.9	-6.1
Euro area	-2.6	-3.0	-2.9	-2.5	-1.3	-0.7	-1.8
Portugal	-2.8	-2.9	-3.4	-6.1	-3.9	-2.6	-2.6
Current account balance (as a percentage of GDP)							
US	-4.4	-4.8	-5.3	-5.9	-6.0	-5.3	-4.7
Euro area	0.7	0.5	1.2	0.4	0.3	0.2	-0.7
Portugal	-8.1	-6.1	-7.6	-9.5	-10.0	-9.4	-12.1
Oil price (USD Brent; y-o-y rate of change)	47.9	-1.4	34.0	43.1	8.2	55.4	-58.4
Key interest rates - Monetary policy							
US	1.25	1.00	2.25	4.25	5.25	4.25	0.25
Euro area	3.75	3.00	3.00	3.25	4.50	4.00	2.50
3-month Euribor	2.9	2.1	2.2	2.5	3.7	4.7	2.9
Yields on (10-year) Government bonds							
US	3.8	4.3	4.2	4.4	4.7	4.0	2.2
Euro area	4.3	4.3	3.7	3.4	4.1	4.4	3.8
Stock markets (annual rate of change)							
S&P 500	-23.4	26.4	9.0	3.0	13.6	3.5	-38.5
Dow Jones Euro Stoxx	-34.5	18.1	10.0	23.0	20.3	4.9	-46.3
PSI Geral	-20.7	17.4	18.0	17.2	33.3	18.3	-49.7
PSI Financial Services	-24.8	4.0	12.0	24.4	34.8	4.9	-62.9
Financial situation of the non-financial private sector							
Households							
Indebtedness							
As a percentage of GDP	70	75	80	85	90	94	96
As a percentage of disposable income	100	106	113	120	127	136	135
Loans granted by resident financial institutions ^(a)							
Annual rate of change	11.3	11.0	9.7	10.1	9.7	10.1	4.3
of which:							
Housing purposes	16.0	11.8	10.5	11.1	9.9	8.5	4.3
Consumption and other purposes	-0.1	8.9	7.4	6.9	9.3	15.9	4.6
Net lending (+) / borrowing (-) ^(b)							
As a percentage of GDP	3.0	3.1	2.8	3.2	2.1	0.7	1.2
As a percentage of disposable income	4.3	4.4	4.0	4.5	3.0	1.1	1.7
Currents savings ^(b)							
As a percentage of GDP	7.5	7.5	6.9	6.6	5.8	4.3	4.6
As a percentage of disposable income	10.6	10.6	9.8	9.3	8.1	6.2	6.5
Investment in real assets ^(b)							
As a percentage of GDP	6.1	5.1	5.1	5.1	4.0	4.2	4.5
Non-financial corporations							
Total debt ^(c)							
As a percentage of GDP	114	118	116	120	123	130	140
Annual rate of change	4.0	5.4	4.4	6.2	6.9	10.9	10.1
Financial debt ^(d)							
As a percentage of GDP	109	112	108	112	115	122	134
Loans granted by resident financial institutions ^(a)							
Annual rate of change	7.3	5.4	3.2	4.1	6.6	11.4	12.1
Net lending (+) / borrowing (-) ^(b)							
As a percentage of GDP	-6.4	-4.7	-4.5	-5.9	-7.4	-8.0	-10.3
Currents savings ^(b)							
As a percentage of GDP	7.6	8.2	8.1	6.6	5.4	4.9	3.2
Investment in real assets ^(b)							
As a percentage of GDP	14.9	13.8	13.6	13.7	13.7	13.8	14.8

Notes: y-o-y year-on-year. n.a. not available. (a) Loans granted by monetary financial institutions and other financial intermediaries adjusted for securitisations conducted through non-resident special purpose vehicles. (b) Net lending/borrowing, savings and investment ratios to GDP up to 2006 use National Accounts base 2000; 2007 and 2008 ratios are based on INE's quarterly accounts. It corresponds to the sum of GFCF, changes in inventories, acquisitions less disposals of valuables and acquisitions less disposals of non-produced non-financial assets. (c) It includes loans granted by resident and non-resident credit institutions, loans/additional capital by non-resident intra-group corporations (excluding those granted to non-financial corporations having their head-office in Madeira's off-shore), commercial paper and bonds issued by non-financial corporations held by other sectors and trade credits received from other sectors. (d) Total debt excluding trade credits and including loans granted to non-financial corporations having their head-office in Madeira's off-shore. It corresponds to the financial accounts instruments "Securities other than shares" and "Loans".

MAIN INDICATORS (continued)

Per cent; end-of-period figures

	2002	2003	2004	2004*	2005*	2006*	2007*	2007**	2008**
Profitability									
ROE - Return on equity ^(e)	14.1	16.2	14.5	13.1	19.4	20.6	18.0	18.2	10.6
ROE - Return on equity - adjusted ^{(e), (f)}						18.9			
ROA - Return on assets ^(e)	0.78	0.91	0.87	0.65	1.03	1.30	1.18	1.15	0.64
ROA - Return on assets - adjusted ^{(e), (f)}						1.18			
Financial margin (as a percentage of average assets)	2.12	2.00	1.94	1.91	1.86	1.89	1.88	1.96	1.95
Income from services and commissions (net, as a percentage of average assets)	0.63	0.69	0.76	0.72	0.77	0.78	0.76	0.76	0.71
Cost to income ratio	59.1	57.4	57.2	71.7	58.3	53.4	53.7	54.1	53.7
Capital adequacy ^(g)									
Overall capital adequacy ratio	9.8	10.0	10.4	10.2	11.3	10.9	10.0	10.3	10.3
Market risk									
Net open position in equities to regulatory capital	n.d.	n.d.	n.d.	1.8	1.3	2.6	2.3	2.0	0.2
Coverage ratio of the pension funds of bank employees (as a percentage of regulatory capital)	-0.8	0.1	-0.4	-0.4	1.2	5.3	5.1	4.7	1.1
Liquidity risk									
Credit-to-deposit ratio	129.5	129.1	128.3	130.9	137.5	145.6	153.9	155.0	152.8
Coverage ratio of interbank liabilities by highly liquid assets	80.0	100.7	99.5	110.0	98.5	99.2	88.1	75.4	68.3
Liquidity gap ^(h)									
Up to 3 months	-2.4	1.6	2.4	1.4	-0.9	-1.5	-2.5	-1.5	-1.5
Up to 1 year	-7.2	-6.3	-3.6	-5.4	-8.2	-8.9	-11.4	-9.9	-6.4
<i>For domestic banks</i>									
Credit-to-deposit ratio	125.6	124.8	127.2	129.2	134.2	140.6	150.8	145.9	142.8
Coverage ratio of interbank liabilities by highly liquid assets	91.6	120.1	120.8	127.3	126.5	118.0	107.1	115.4	106.9
Liquidity gap ^(h)									
Up to 3 months	-3.4	0.5	0.7	0.6	-0.7	-0.9	-2.1	-1.4	-2.2
Up to 1 year	-7.6	-6.5	-4.8	-5.4	-7.4	-8.9	-10.1	-9.0	-6.7
Credit risk									
Loans granted by resident financial institutions to the non-financial private sector ^(e)									
Annual rate of change	9.3	8.3	6.6	6.6	7.4	8.4	10.7	10.7	7.7
Credit and interest overdue (on a consolidated basis)									
As a percentage of credit to customers	2.3	2.4	2.0	1.8	1.7	1.5	1.5	1.7	2.1
As a percentage of assets	1.6	1.6	1.3	1.3	1.1	1.0	1.0	1.1	1.4
Non-performing loans of households									
As a percentage of loans to households	1.9	2.0	1.8	1.8	1.7	1.5	1.6	1.6	1.9
Non-performing loans of non-financial corporations									
As a percentage of loans to non-financial corporations	2.4	2.1	1.7	1.7	1.7	1.5	1.4	1.4	2.2
Annual flow of new credit overdue and other credit considered to be doubtful ⁽ⁱ⁾									
As a percentage of bank loans adjusted for securitisation transactions									
Households	0.4	0.5	0.2	0.2	0.2	0.3	0.4	0.4	0.7
Adjusted for sales outside the banking system					0.3	0.4	0.4	0.4	0.7
Non-financial corporations	0.7	0.5	0.5	0.5	0.6	0.4	0.6	0.6	1.2
Adjusted for sales outside the banking system					0.6	0.5	0.6	0.6	1.3
International exposure (for domestic banks):									
Share of external assets in total assets ^(j)	18.1	21.6	20.5	30.5	27.6	30.0	26.8	27.6	28.9
of which:									
Local assets denominated in local currency	1.2	1.7	1.6	7.2	6.4	6.7	8.0	8.2	8.4
International assets by counterparty sector:									
Banking sector	8.3	14.1	14.8	13.7	12.7	14.0	8.2	8.4	6.5
Non-banking sector	8.5	5.8	4.0	9.7	8.5	9.3	10.7	11.0	14.0

Sources: Bloomberg, IMF, INE, Thomson Reuters and Banco de Portugal.

Notes: y-o-y year-on-year; n.a. not available. *The break in the series results from the implementation of the International Accounting Standards (IAS), which also implied a redefinition of the group of banking institutions under analysis. ** Break in the series related to the widening of the group of banking institutions under analysis. Breaks in the series do not apply to indicators based on Monetary and Financial Statistics, which consider resident banking institutions. (e) ROE and ROA indicators are based on Income before taxes and minority interests, considering average values for the period for the stocks variables. (f) The adjusted profitability indicators are obtained after deducting from profit and loss account the impact of the restructuring of participating interests in companies (namely in the insurance sector) in one of the major banking groups considered in the analysis. (g) In 2008, all analysed institutions have computed the capital adequacy ratio in accordance with Basel II criteria, which mainly affected the determination of capital requirements. (h) This indicator is computed using information from Notice No. 1/2000, which is applicable only to financial institutions which collect deposits. (i) Change in amounts outstanding of credit overdue and other non-performing loans recorded in the balance sheet of resident MFIs plus write-offs/write-downs as a percentage of bank loans adjusted for securitisations. Sales outside the banking system included in the adjusted flow correspond to credit overdue and other non-performing loans not written-off, in accordance with the quarterly report defined in Instruction of Banco de Portugal No 2/2007. (j) From 2004 onwards, figures on external assets are based on a new information report. Comparable figures for 2004, 2005, 2006 and 2007 are based on estimates on total assets for the whole set of domestic banks. Comparable figures for 2007 and 2008 are based on assets for domestic institutions.

BALANCE SHEET OF THE BANKING SYSTEM

On a consolidated basis

	EUR millions				Structure (as a percentage of total assets)				Year-on-year rate of change (per cent) ^(a)							
	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 customers	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
<i>of which: overdue credit to customers</i>	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 customers	-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
<i>of which: credit to customers</i>	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 customers 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 the thirteen banking groups that 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.

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 rate of change (per cent) ^(b)					
	2007			2008			2007			2008			2007			2008		
	H1	H2	Year	H1	H2	Year	H1	H2	Year	H1	S2	Year	H1	H2	Year	H1	H2	Year
1. Interest income	11 727	13 540	25 267	14 790	16 359	31 149	6.00	6.50	6.25	6.75	7.15	6.95	27.5	29.8	28.7	26.1	20.8	23.3
2. Interest expenses	7 821	9 505	17 325	10 560	11 861	22 420	4.00	4.56	4.29	4.82	5.18	5.00	34.9	40.3	37.8	35.0	24.8	29.4
3. Financial margin (1-2)	3 906	4 035	7 941	4 231	4 498	8 729	2.00	1.94	1.96	1.93	1.97	1.95	14.2	9.1	11.5	8.3	11.5	9.9
4. Income from capital instruments	158	37	195	219	59	278	0.08	0.02	0.05	0.10	0.03	0.06	12.8	42.7	17.5	39.0	59.6	42.9
5. Income from services and commissions (net)	1 409	1 647	3 056	1 546	1 641	3 187	0.72	0.79	0.76	0.71	0.72	0.71	4.3	14.2	9.4	9.8	-0.4	4.3
6. Income from financial assets and liabilities measured at fair value	281	-452	-172	-206	265	59	0.14	-0.22	-0.04	-0.09	0.12	0.01	-	-	172.7	-173.4	-158.6	-134.4
7. Income from available-for-sale financial assets	400	681	1 080	406	128	534	0.20	0.33	0.27	0.19	0.06	0.12	72.7	190.1	130.8	1.5	-81.2	-50.6
8. Income from foreign exchange revaluation	116	292	409	57	134	190	0.06	0.14	0.10	0.03	0.06	0.04	-60.8	31.0	-20.8	-51.4	-54.3	-53.5
9. Income from the sale of other financial assets	191	-31	160	51	271	322	0.10	-0.01	0.04	0.02	0.12	0.07	-67.1	-102.7	-79.0	-73.3	-980.1	101.0
10. Other operating profit and loss	315	371	686	345	312	656	0.16	0.18	0.17	0.16	0.14	0.15	-16.5	-22.5	-19.7	9.5	-16.0	-4.3
11. Gross income (3+4+5+6+7+8+9+10)	6 775	6 580	13 356	6 648	7 307	13 956	3.46	3.16	3.30	3.03	3.19	3.12	9.1	3.0	6.0	-1.9	11.0	4.5
12. Staff costs	1 821	2 091	3 912	1 965	2 049	4 013	0.93	1.00	0.97	0.90	0.90	0.90	-0.1	8.0	4.1	7.9	-2.0	2.6
13. General administrative costs	1 283	1 465	2 748	1 369	1 510	2 878	0.66	0.70	0.68	0.62	0.66	0.64	8.5	11.8	10.2	6.7	3.1	4.7
14. Depreciation and amortisation	264	295	559	283	315	598	0.14	0.14	0.14	0.13	0.14	0.13	6.5	14.1	10.4	6.9	6.9	6.9
15. Provisions net of restitutions and annulments	131	81	212	36	-98	-62	0.07	0.04	0.05	0.02	-0.04	-0.01	112.0	-11.1	41.2	-72.6	-221.4	-129.3
16. Impairment losses and other net value adjustments	803	887	1 690	1 307	2 329	3 636	0.41	0.43	0.42	0.60	1.02	0.81	45.9	27.2	35.6	62.7	162.5	115.1
17. Negative consolidation differences	-4	-9	-12	0	0	0	0.00	0.00	0.00	0.00	0.00	0.00	-	-	-	-	-	-
18. Appropriation of income from associates and joint ventures (equity method)	161	232	393	59	-88	-29	0.08	0.11	0.10	0.03	-0.04	-0.01	25.0	237.2	97.4	-63.0	-138.0	-107.3
19. Income before taxes and minority interests (11-12-13-14-15-16-17+18)	2 637	2 002	4 639	1 749	1 114	2 863	1.35	0.96	1.15	0.80	0.49	0.64	7.1	-4.7	1.7	-33.7	-44.4	-38.3
20. Taxes on profit	460	311	772	356	252	607	0.24	0.15	0.19	0.16	0.11	0.14	25.5	-41.4	-11.9	-22.7	-19.2	-21.3
21. Income before minority interests (19-20)	2 177	1 691	3 868	1 394	862	2 256	1.11	0.81	0.96	0.64	0.38	0.50	4.1	5.3	4.6	-36.0	-49.0	-41.7
22. Minority interests	372	281	653	293	168	462	0.19	0.13	0.16	0.13	0.07	0.10	8.2	19.4	12.8	-21.2	-40.0	-29.3
23. Net profit and loss (21-22)	1 805	1 410	3 215	1 101	694	1 795	0.92	0.68	0.80	0.50	0.30	0.40	3.2	2.6	2.9	-39.0	-50.8	-44.2

Source: Banco de Portugal.

Note: (a) Half-year data are annualised. (b) In 2007 year-on-year rates of change were based on the thirteen banking groups that 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.

CAPITAL ADEQUACY OF THE BANKING SYSTEM

On a consolidated basis

EUR millions	2007		2008	
	Jun.	Dec.	Jun.	Dec.
1. Own funds				
1.1. Total original own funds for solvency purposes	19 086	19 443	21 458	23 015
1.1.1. Original own funds (gross)	19 900	20 216	22 179	23 799
1.1.2. Deductions from original own funds	814	773	721	783
1.2. Total additional own funds for solvency purposes	10 068	10 766	9 433	10 006
1.2.1. Additional own funds (gross)	10 875	11 523	10 130	10 765
1.2.2. Deductions from additional own funds	807	757	697	759
1.3. Deductions from total own funds	1 116	841	1 013	1 276
1.4. Total supplementary own funds eligible to cover market risk	17	14	0	0
Total own funds	28 055	29 381	29 878	31 745
2. Capital requirements				
2.1. Capital requirements for credit risk, counterparty credit risk and free deliveries	20 568	22 096	21 570	22 197
2.2. Settlement risk	2	1	0	0
2.3. Capital requirements for position risk, foreign exchange risk and commodities risk	881	737	803	629
2.4. Capital requirements for operational risk	9	11	1 726	1 758
2.5. Capital requirements - Fixed overheads	6	6	5	5
2.6. Large exposures - Trading book	0	0	2	0
2.7. Other and transitional capital requirements	1	0	0	0
Total capital requirements	21 465	22 850	24 107	24 589
3. Ratios (per cent)				
3.1. Own funds/Total requirements	130.7	128.6	123.9	129.1
3.2. Own funds/(Total requirements x 12.5)	10.5	10.3	9.9	10.3
3.3. Original own funds/(Total requirements x 12.5)	7.1	6.8	7.1	7.5

Source: Banco de Portugal.

Note: The break in the series shown in the table corresponds to the adoption of Basel II criteria, which is mainly reflected in developments in the capital requirement components.