

3. THE FINANCIAL SITUATION IN THE NON-FINANCIAL PRIVATE SECTOR

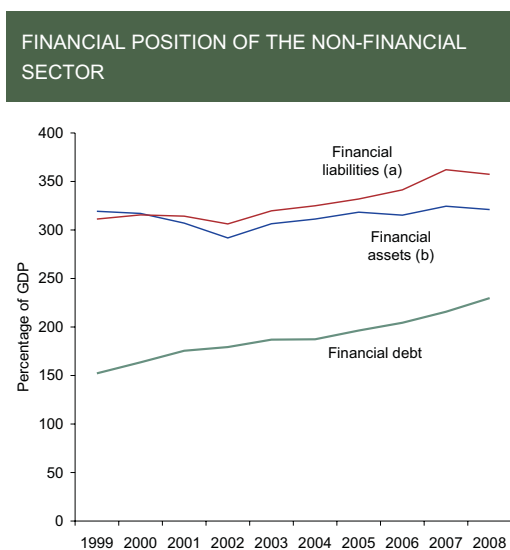
3.1. Overview

Over the past decade, increased indebtedness has become a structural feature of the Portuguese economy. The move in the International Investment Position illustrates this situation vividly. Starting from the point where the country joined the euro, the net debtor position for economic agents resident in Portugal stood at 33 per cent of GDP (1999). By the end of 2008 it had soared to around 97 per cent of GDP (Charts 3.1.1 and 3.1.2). A little less than half of this position corresponds to the resident banking sector, while the remainder is fundamentally public debt in the hands of non-residents. Given the role of the banking system in financial intermediation with the rest of the world, undertaken more markedly since the advent of the euro, the indebtedness of this sector appears as the external counterpart of the domestic indebtedness of the non-financial private sector (individuals and non-financial corporations).

Being part of the euro area has, of course, simplified access to financing in wholesale markets that are both wide and deep, and with no foreign exchange risk, though there will always be intertemporal solvency restrictions. These will become active, whether the horizon is seen as near or far, and will tend to provoke an inversion of the considerable disparity between investment and savings, either at the aggregate level or at the level of sectors and agents seen in individual terms. However, the adjustment process of economies in a monetary union tends to be drawn-out, above all if there are no speculative bubbles in the asset markets and if the financial systems are solid.

The resident sectors in Portugal hold a considerable amount of assets on the rest of the world (this stood at 170 per cent of GDP for the whole economy at year-end 2008), giving them leeway to cushion, at least temporarily, any turmoil in the international wholesale financial markets without needing abrupt

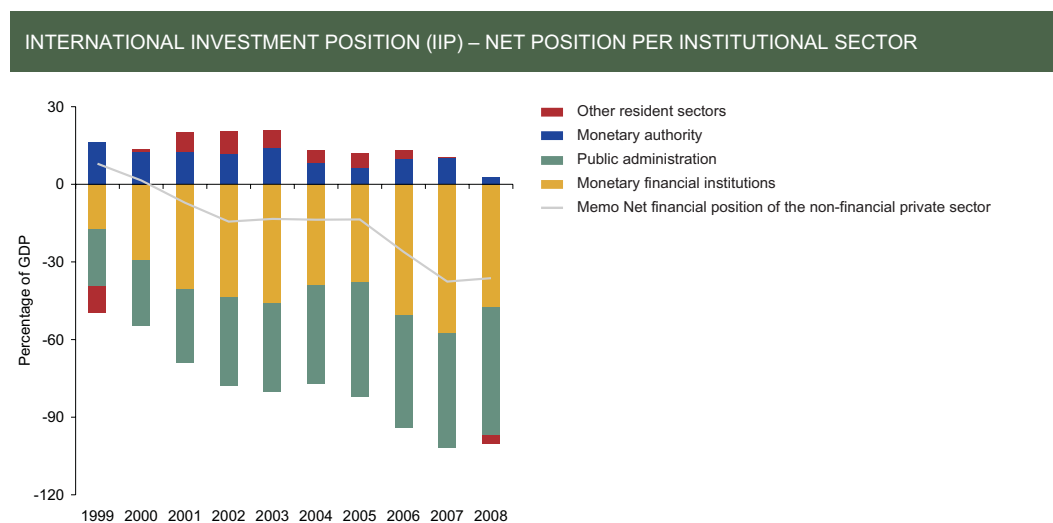
Chart 3.1.1



Sources: INE and Banco de Portugal.

Notes: (a) Includes financial debt (loans and debt securities), shares and other holdings, insurance technical resources and other liabilities. (b) Includes cash and deposits, securities, loans, insurance technical reserves and other credit.

Chart 3.1.2



Sources: INE and Banco de Portugal.

adjustments in the level or standard of domestic expenditure. The necessary adjustment of the external imbalances, which have become a feature of the Portuguese economy, can be extended over time (thus smoothing the process). In this context, it should be remembered that financing the current and capital accounts deficits through 2008 (10.5 per cent of GDP) was ensured by curtailing assets on the rest of the world by approximately 13 per cent of GDP. At the same time there was a fall in liabilities, coming in at around 2 per cent of GDP, in clear contrast to the profile of financing the external deficit that had prevailed over previous years.

The prospects for the financial position of the non-financial private sector, if the focus is on financial stability, are clearly constricted by the impact of the international economic and financial crisis. One salient point here is that the severity of the current economic and financial crisis is likely to trigger a further rise in unemployment. The intensity and breadth of this will depend on two factors: one is the number of companies in a financial drift, since they can quickly become economically unviable if there is a fall in demand; and the second, this being crucial, is the expectation on the duration of the recession. The unfolding situation will illustrate the effects of the crisis on the financial position of a large number of those who are in debt to the banks. The impact of this on financial stability for the households affected will hinge critically on the distribution of wealth, income and indebtedness. The available evidence points to the fact that the low-income strata and the younger section of the population will be the most vulnerable. However, the debt burden of these more fragile groups is of little account in the overall picture, and there is the added point that risks underlying loans in this segment are likely to be mitigated by the fact that much of the credit granted is tied to mortgage guarantees, often with additional personal collateral provided by family members (typically first degree relations). In the current economic crisis, however, an increase in the unemployment rate is likely to weigh heavily on the finances of an increasing number of households, notwithstanding the fact that interest rates are still coming down.

With the turmoil in the financial markets increasingly interwoven with a deteriorating real economy, there is likely to be considerable downward pressure on the financial situation of non-financial corporations, above all as they struggle to cushion the unexpectedly sudden and harsh impact of plummeting demand. In addition, it may not be so easy for credit institutions – given the bleak climate that they have had to face since the onset of the crisis – to provide the support needed by economically viable

non-financial corporations in straightened circumstances to ensure that they are in a financial position to keep their businesses as a going concern. It may well be, as the move in credit aggregates for the year under review suggests, that the banks provided an important financial contribution to keeping operations in the sector from stalling. However, the depth and spread of the current recession will undoubtedly cut hugely into the profitability of a swathe of companies where rigidity in a considerable portion of their operational costs is a reality, hardly offset by the anticipated fall in interest in banks' lending rates. The available evidence suggests that matters will get worse across the board, impacting not only on small enterprises, but also on larger ones, many of them owing substantial amounts to banks.

With the high level of indebtedness in the non-financial private sector, it becomes pivotal to assess the extent to which this situation affects the allocation of resources that could otherwise spur growth. For the debt burden to be manageable in the future, it is important for companies to channel their resources into financing productive capacity that will allow them to service their debt in the future; and that households set their level of debt on a par with a careful assessment of income over the life cycle. In tandem, the state support plans for different sectors should focus on generating the incentives for enterprises and households to allocate their resources properly with the medium to long term in mind.

The scenario is one of vulnerability, given the significant dependence on external capital, with manifest sensitivity to sudden major and prolonged changes in those markets where resources are tapped. The need therefore is for support to underpin the financial situation of the non-financial private sector as part of the raft of measures being considered by authorities domestically and internationally to shore up the financial sector, households and enterprises. It should be noted, however, that significant deferral of debt – or even increased recourse to debt – could be counterproductive, with those benefiting now shouldering a bigger burden later. This is above all true if at the end of the deferral period the Portuguese economy has not picked up enough momentum to be growing in a materially relevant way; and all the more so, if the euro area has picked up in the meantime, since the effects of this will ripple out in the form of rising interest rates.

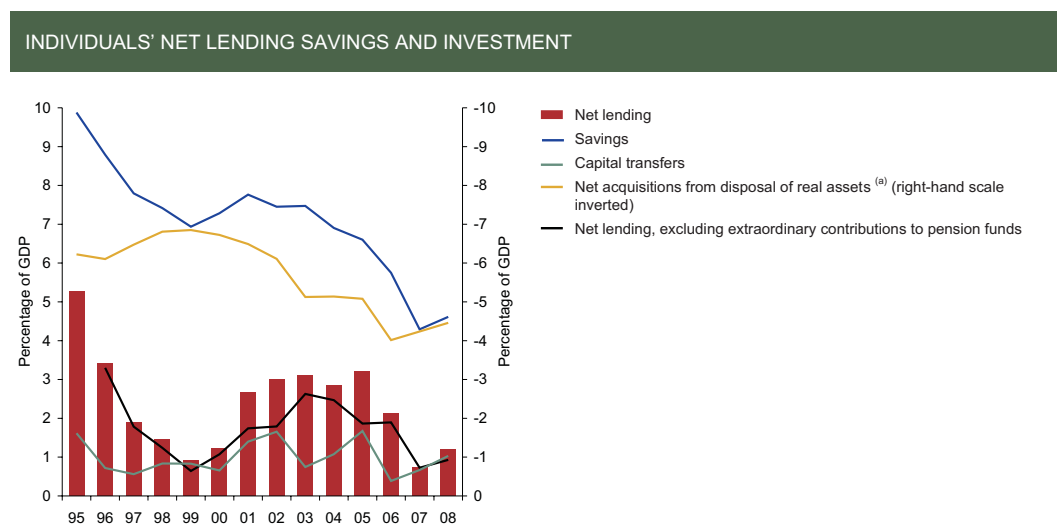
3.2. Individuals

During the year under review, individuals' net lending grew by around 0.5 p.p. of GDP in year-on-year terms to stand at 1.2 per cent of GDP (Chart 3.2.1). This move reflects above all a break in the downward trend in the savings rate for the sector since 2001 and larger in capital transfers. The move in these variables more than offset the small rise in acquisitions of real assets (net of disposals).¹

Taking the year as a whole, there was a slight recovery in the savings rate for the sector. In terms of disposable income, it rose by around 0.5 p.p., following the steep fall of around 2 p.p. in the previous year. With some pick-up in disposable income, the move was associated with a virtual stagnation (at the 2007 level) of the average annual rate of variation in private consumption. This bucked the euro area trend, where there was a major slowdown. A number of factors came into play here: income was on the rise, benefiting both from the increase in total employment and from salaries rising above the rate of inflation; there was also a rise in property income (distributed income of corporations and interest); and an upward move in social benefits.

(1) Acquisition of real assets (net of disposals) corresponds to the sum of gross fixed capital formation (GFCF), changes in inventories, acquisitions net of disposals of valuables and acquisitions net of disposals of non-produced non-financial assets. Only a part of the GFCF deriving from households relates to investment in housing, though it is a substantial part. The remainder is connected to the sector's productive operations, such as agriculture, trade, maintenance and the restaurant trade, where the proportion of sole owners is important.

Chart 3.2.1



Sources: INE and Banco de Portugal.

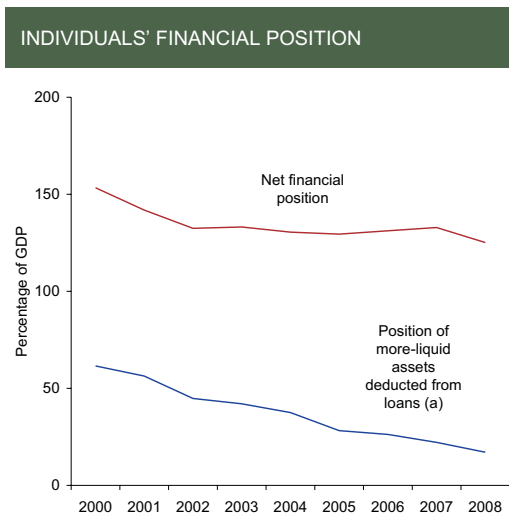
Note: (a) Corresponds to the sum of gross fixed capital formation (GFCF) changes in inventories, net acquisitions from disposal of valuables and net acquisitions from non-produced non-financial assets.

The slowdown in private consumption seen in the last quarter of the year seems to have stemmed from the deepening economic and financial crisis, and the gathering uncertainty that was clouding the prospects for household's wealth and income, with burgeoning problems in the labour market during the second half of the year. One salient point in this picture is the recent move in the growth of bank loans to individuals for consumption and other purposes. This slowed in mid-year and the trend has intensified in early 2009. In terms of mortgage loans, the pattern was the same, though the slowdown started in the early part of 2006 and intensified in 2008, especially in the second half of the year. During the first nine months of 2008, money market interest rates (used as the point of reference for most interest rates on loans) continued on the upward path that had been paved during the last quarter of 2005, even though the main operations of the ECB kept the rates practically flat. Since the start of October, in fact, official ECB rates have fallen sharply, though individuals have not derived any significant benefit from the cuts, since they are being passed on gradually by the banks, as is their wont.

During the year under review, the net financial position of individuals decreased by around 7 percentage points of GDP (Chart 3.2.2). In aggregate terms, therefore, there was less capacity in the sector to cover financial liabilities by recourse to financial assets. This shift reflected the relative stability of financial assets and the rise in liabilities, specifically in terms of long-term loans (Chart 3.2.3). There was also a fall in the cover of loans by more liquid assets, following the line that has been visible since the country joined the euro (the move is from around 200 per cent in 1999 to 118 per cent at the end of 2008). In tandem, there has been a fall in the ratio of total wealth (financial and non-financial) to total debt, though there remains a clear upside position in terms of solvency for the sector as a whole in aggregate terms (Chart 3.2.4). The way these indicators have moved since the beginning of the 1990s fundamentally mirrors the gradual but significant increase in indebtedness in the sector.

There was a slight dip during the year in the stock of financial assets held by individuals. This stemmed from a considerable fall in transactions (reaching decade minimums) but also from the substantial losses on financial assets more exposed to price fluctuations in the capital markets. The losses affected listed shares, long-term debt securities, and unit trust funds, where portfolios are fundamentally made up of the same kind of assets, as indeed are life insurance portfolios and pension funds (Charts 3.2.5, 3.2.6 and 3.2.7). Financial market turmoil was bringing substantial fluctuations in the securities

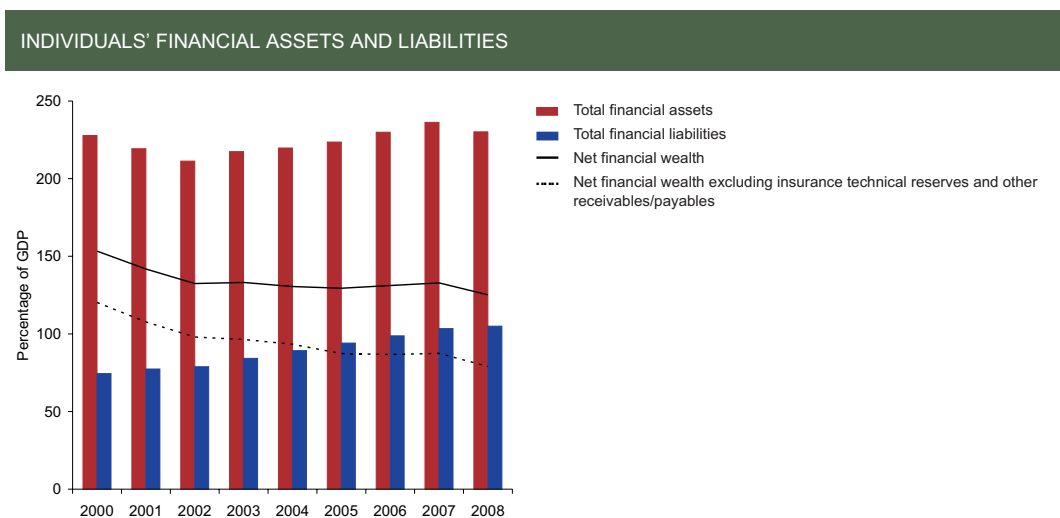
Chart 3.2.2



Sources: INE and Banco de Portugal.

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

Chart 3.2.3

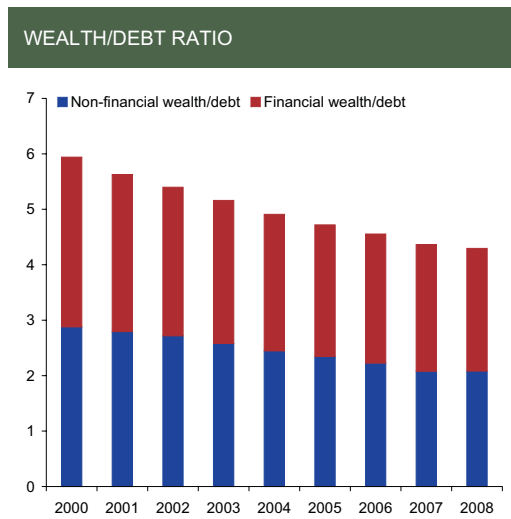


Sources: INE and Banco de Portugal.

component in individuals' portfolios, above all in listed shares, where there was an estimated loss of over 3 per cent of GDP for the year. There was, in fact, relative stability in total financial assets, but a significant rejigging was undertaken, affecting in particular the more liquid assets. This stemmed from both a greater risk aversion and the impact from financial market instability on the return from the array of instruments used for savings. Since the onset of turbulence in the financial markets, there has been a switch to assets that are less sensitive to market buffeting, specially bank deposits.² As in the second half of 2007, there was a major move out of investment funds. Net redemptions tallied up at around 6 per cent of GDP for the year, the amount being particularly marked from July onwards. The move fuelled a major increase in bank deposits (which stood at around 8 per cent of GDP for the year), and was

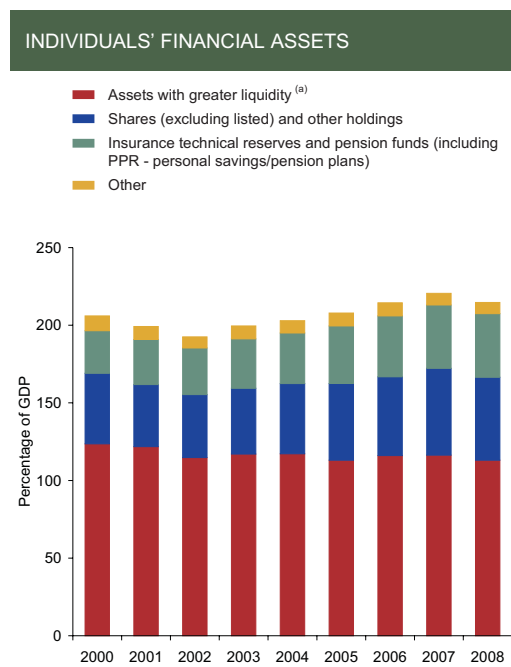
(2) Throughout the last decade, the proportion of assets where valuation is more sensitive to market fluctuations rose gradually until 2006, and then fell in 2007 and 2008, as the current financial crisis took hold.

Chart 3.2.4



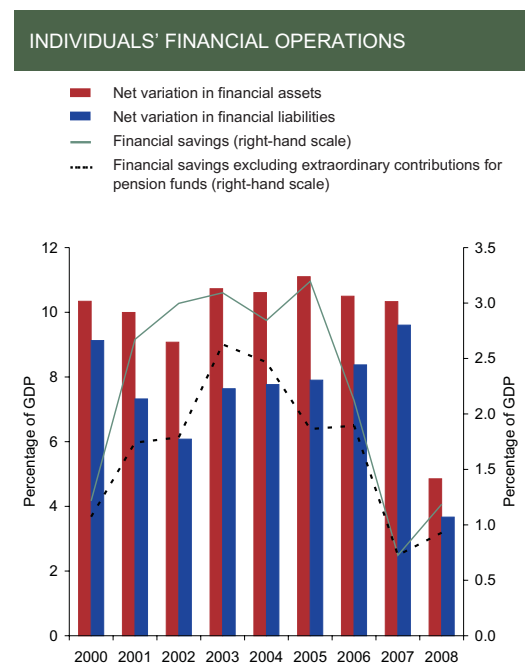
Source: Banco de Portugal.

Chart 3.2.5



Sources: INE and Banco de Portugal.
 Note: (a) Includes cash and deposits, debt securities, listed shares and units in investment funds except retirement plans (PPR).

Chart 3.2.6

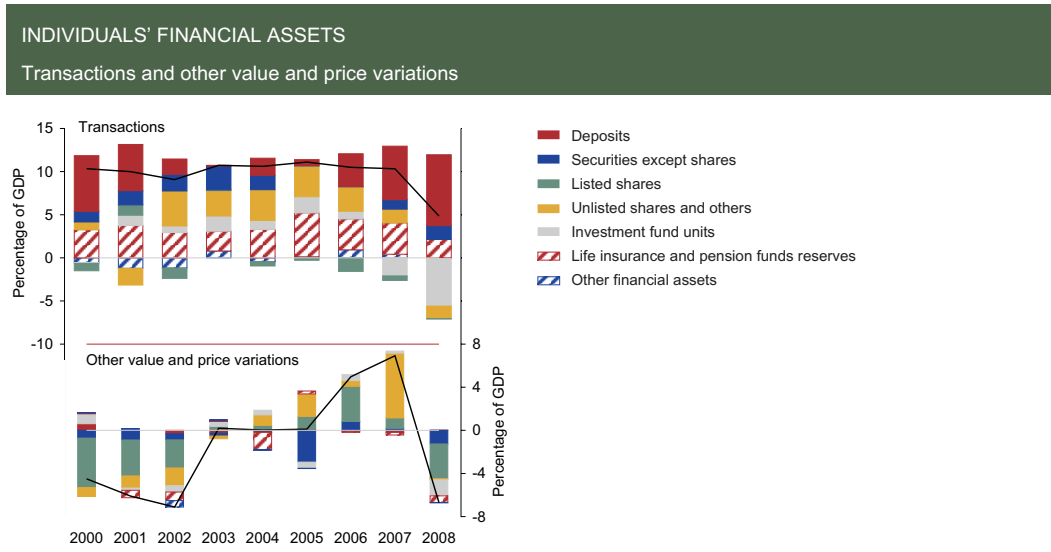


Sources: INE and Banco de Portugal.

probably also influenced by the more competitive stance of the banks (above all the domestic institutions) as they moved to draw in customer funds, with interest on term deposits coming close to money market interest rates as financing through the international wholesale markets became fraught with difficulties.

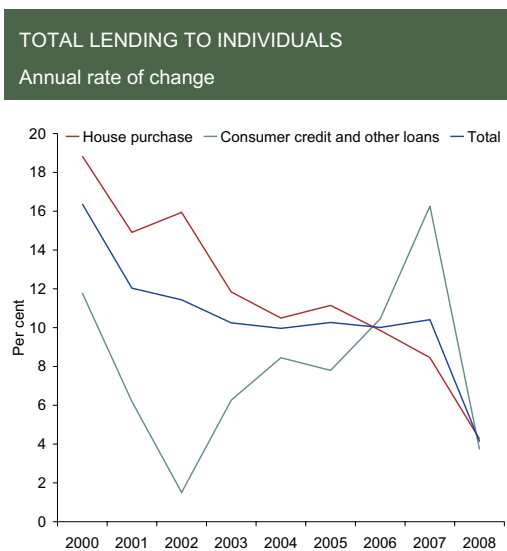
As for loans to individuals, the flow in 2008 was far less than in the last decade, to such an extent that the ratio of debt to disposable income remained virtually static after a long period on the rise (Charts 3.2.8 and 3.2.9). The slowing momentum was caused by both demand and supply side factors: there

Chart 3.2.7



Sources: INE and Banco de Portugal.

Chart 3.2.8

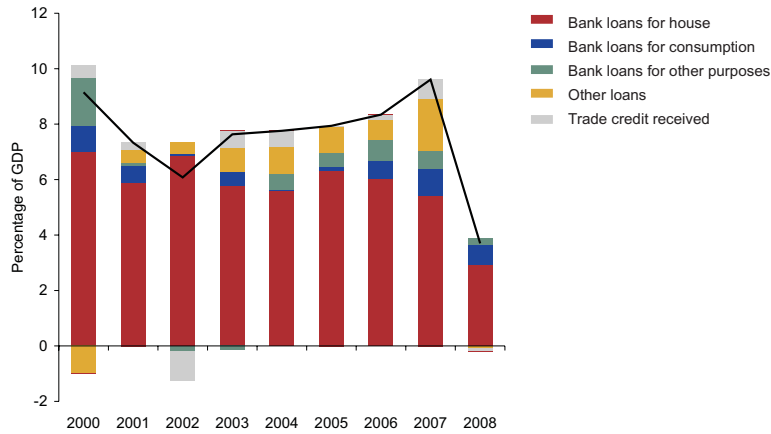


Source: Banco de Portugal.

was the effect from the rises in interest rates that had been a constant since the end of 2005 (as mentioned, the fall in interest on borrowing is only likely to have a significant effect in 2009); and credit institutions have been adjusting supply to match the major change in the macroeconomic and financial framework where they operate, coming on the back of the crisis in the international financial markets that broke out in mid-2007. In this context, Portuguese banks have been steadily tightening the terms for granting loans to individuals. In the first phase this most clearly affected loans for house purchase, but it now takes in credit for consumption and other purposes. The bigger clampdown has been more clearly visible in the increase in interest rate spreads for new operations and even more so in those considered to be of greater risk. It also, however, included reductions in loan to value figures and in the maximum maturity on offer. In the meantime, against a backdrop of falling confidence, which slipped to

Chart 3.2.9

INDIVIDUALS' TRANSACTIONS ON FINANCIAL LIABILITIES



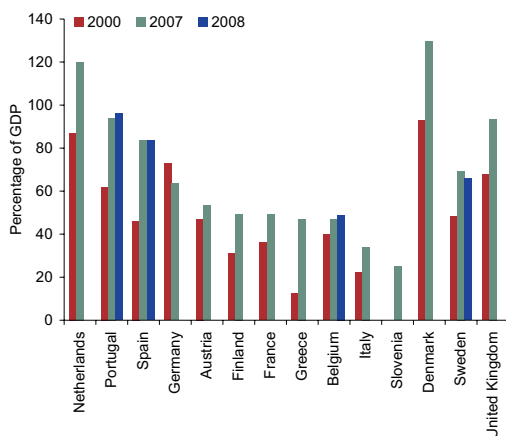
Sources: INE and Banco de Portugal.

record lows, the worsening prospects for the housing market and the cut in expenditure on consumer durables would also seem to have played a part in easing demand for loans.

The level of debt for individuals continues, however, to be among the highest in the euro area (Chart 3.2.10). It may well be that a rise in indebtedness among individuals has been common to most countries in Europe over the past few years, but the Netherlands was the only country in the euro area to surpass Portugal, though the United Kingdom is on a par and Denmark records an higher level. The move in indebtedness in Portugal came with the transition to a new regime of nominal interest rates. They were lower, less volatile, and replete with supply side credit product innovation. This took concrete form in an array of features that made it possible to smooth or defer debt service charges. Around 75 per cent of individuals' debt relates to loans for house purchases, buttressing the rise in wealth in

Chart 3.2.10

INDIVIDUALS' FINANCIAL DEBT



Sources: Eurostat and Banco de Portugal.
 Note: Consolidated accounts (except for United Kingdom, non-consolidated).

the sector. In this context, it should be mentioned that the available evidence does not point to a hard landing in residential prices in Portugal of the type witnessed in some European countries and in the United States. There was in aggregate terms no spike in the residential component of property assets. Using data from the *Confidencial Imobiliário* index, the average annual variation in prices on the supply side for the residential market in Portugal (with figures covering the period since the start of the decade) runs at 3 per cent in nominal terms, tantamount to nil in real terms. Even so, there could be some price adjustment surfacing in the market. It could stem from the economic and financial crisis, which has been hemming in demand for property through expectations on future income streams and on market prices themselves; and it could also stem from less finance from banks being available for this kind of investment. Here too mention should be made of the National Statistical Office (*INE*) survey on bank valuations in the housing market (the *Inquérito à Avaliação Bancária na Habitação*). It shows that the average figures for this indicator have been becoming ever more negative (in year-on-year terms) since the end of 2007, reaching -6 per cent at the end of the first quarter of 2009.³ We are, of course, dealing with valuations carried out for the banks, so these figures are influenced by the tightening of their credit terms. In turn, the *Confidencial Imobiliário* index for March 2009 recorded a year-on-year variation of around 1 per cent (-0.2 per cent for second-hand property), compared with around 4 per cent (approximately 2.5 per cent for second-hand property) three months earlier.⁴

Various factors combine to make debt service charges very sensitive to the move in interest rates in the money market: there is the high level of indebtedness among individuals, and the almost total prevalence of operations at variable interest rates or with an initial rate up to one year indexed to interest rates in the money market. The information compiled by the *INE* shows that the average figure for installments rose 8.9 per cent in 2008 (in annual terms compared with 2007). This was associated with the rise in interest charges, which came in at a considerably higher figure than the growth in nominal disposable income (Charts 3.2.11 and 3.2.12).⁵ The recent fall in ECB and euro money market base rates will make it possible to invert the trend towards rising installments that have characterised loans since 2006, during the cycle of ECB interest rate rises between the end of 2005 and mid-2008. We should also see a turn away from the increase in risk premiums in the international money markets since the summer of 2007, linked to the turmoil in the international financial markets. This is even more important since the banks are no longer in the position they were before the onset of the crisis, that is, in being able to adapt other contractual terms (such as, to take an obvious example, an extension to repayment periods) and thus more closely match repayments to households' capacity to carry the debt burden.

The prospects for the financial situation of individuals, with implications in terms of financial stability, depend critically on the impact of the international economic and financial crisis. Portugal is a small economy, closely integrated in economic and financial terms, so greatly exposed to global developments. One aspect of this is that 2009 is likely to see a rise in unemployment. The intensity and scope of this in the near future depends on two factors: the number of companies that are in such a fragile financial situation that they will rapidly become economically unviable as demand weakens; and, crucially, the anticipated duration of the recession. With expectations pointing to a prolonged crisis, companies will tend to lay off more workers and/or take on fewer new staff. This situation will have its repercussions on the financial situation of a considerable number of individuals needing to pay back

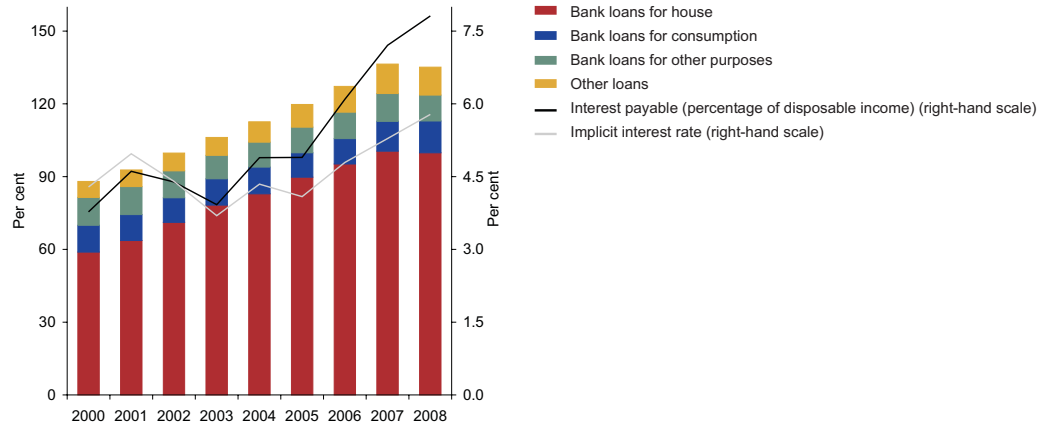
(3) This move is in line with the findings of the Bank Lending Survey, where the institutions taking part have been pointing out the risks associated with the prospects for the housing market as a factor that could hamstring the supply of credit and the prospects for the housing market being a factor in the fall in demand in the segment. These risks have been highlighted consistently, but in a more focused way since the end of 2006.

(4) This indicator is calculated on the basis of supply-side prices, weighted by region and state of use. The quality adjustment used for the calculation means, however, that it is not possible to exercise complete control over the parameters and this fact could well underlie the relatively high growth recorded towards the end of 2008. For information on methodology, see "*Índice Confidencial Imobiliário (base 2005)*", *Imométrica*, October 2006.

(5) The average value of the installment is equal to the sum of the average amount of capital paid off and the average amount of interest. More information on the survey can be obtained on www.ine.pt.

Chart 3.2.11

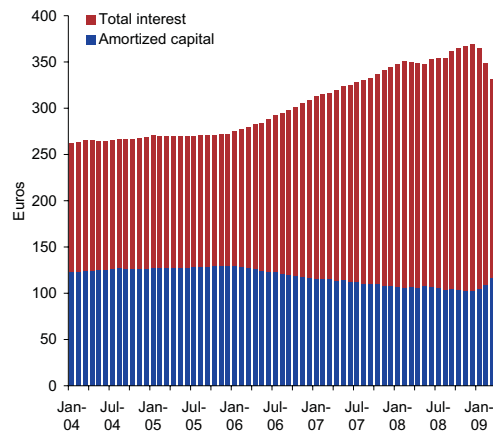
INDIVIDUALS' INDEBTEDNESS AND INTEREST PAYABLE
Percentage of disposable income



Sources: INE and Banco de Portugal.

Chart 3.2.12

AVERAGE INSTALMENT OF HOUSING LOAN



Source: INE.

loans to banks. In addition, it is not possible at present to assess the effectiveness and the temporal reach of the social measures to support households that have been announced by the government. The reasons for this lie in the uncertainty over how viable it is to keep these measures in place over a long period, allied to the possibility of the current economic crisis lasting for a long time, over and above its possible effects on employment, and, in the final instance, on household income. As a final point, it should be noted that to the extent that these measures carry with them a deferral of the financial charges on current debt, this will be picked up at some point in the future, with the households that are benefiting today having to shoulder a bigger financial burden at that point.⁶ Current projections point to a recovery setting in across the euro area, with monetary and financial conditions slotting back

(6) The moratorium on repayment of instalments on owner-occupier mortgages to the equivalent of 50 per cent of the monthly amount (with a 500 euro ceiling on the reduction) fits in this framework.

into place, but if the Portuguese economy moves asynchronously, the point made above could be particularly relevant. On the other hand, against a backdrop of very low, nil or even negative inflation, those agents that are in debt cannot benefit from the nominal erosion of the debt itself, with the uncertain prospects in the labour market also in the frame.

Lastly, in terms of an assessment of the potential impact on financial stability, a deeper analysis of individuals' financial situation must bring the spotlight to bear on the distribution of wealth, income and debt. Such an assessment, however, is hampered by the fact that the information needed for it is not constantly updated. The most recent data are those from the survey on household assets and debt (the *Inquérito ao Património e Endividamento das Famílias - IPEF*), carried out during the last quarter of 2006 and the first quarter of 2007. It brings together microeconomic data on wealth and debt, income and other socio-economic features, collated from a direct interview with a sample of households. The findings suggest that households have been participating more in the debt market, with the average level of indebtedness and the debt service burden on the rise. As for participation in the debt market for purposes other than housing, the findings show that this market has also opened up, above all for households in intermediate income brackets and those where the wage-earner is under 50 years of age. The findings also point to the fact that this participation and the level of debt are particularly sensitive to the family income and to the age of the wage-earner. The figure rises with income up to a maximum at an intermediate stage, and it goes down with age and the level of schooling of the wage-earner, being higher for households with income from employment. A salient fact here is the difficulty for households on lower income to access the credit market, especially for housing. As for the ratio of debt service to monthly income, this is particularly high among younger households, although in aggregate terms for households with a mortgage, the figure for this ratio in Portugal compares favourably with the euro area.⁷ The most vulnerable income brackets are certainly those at the lower end and the young, but this is not likely to jeopardise the stability of the financial system, since the debts of the households involved are a relatively small portion of the total. In addition to the mortgage, a considerable number of these debts are backed by personal guarantees, and many of these are from the family (most typically the parents). This means there is a much reduced financial stability risk from this segment (see "Box 4.2 *The main characteristics of loans to households for house purchase in Portugal*", of this Report). It should be noted that in the current context, the rise in the unemployment rate is likely to put great downside pressure on the financial situation of a growing number of households, even though interest rates continue to go down.

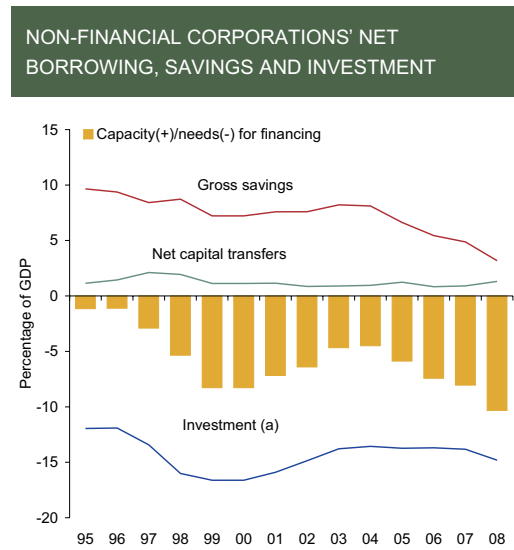
3.3. Non-financial corporations

During the year under review, net borrowing of non-financial corporations were around 2 p.p. of GDP higher than a year earlier, standing at a record high of 10.3 per cent of GDP (Chart 3.3.1). This move fundamentally reflects another fall in current savings (by 1.7 p.p. of GDP). The sequence goes back to 2004, with estimates for the growth of GFCF for this sector coming in at around 1 p.p. of GDP. The fall in current savings for non-financial corporations derives basically from a fall in their operating results and a high amount paid out, in the form of interest and dividends, as remuneration of capital invested (Charts 3.3.2, 3.3.3 and 3.3.4).

The move in operational results would seem to be closely related to how economic activity was faring in Portugal and the world at large. It was particularly bleak in the last quarter of the year. The quarterly information from the Banco de Portugal Central Balance-Sheet Database (*Central de Balanços*) shows that the fall in these results reflects to a large extent a slowdown in production (and therefore

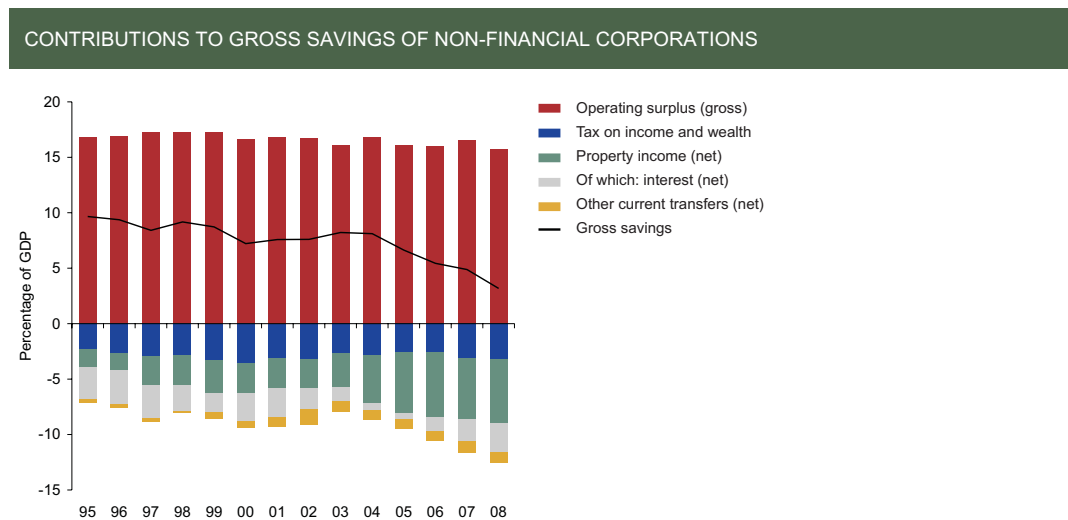
(7) See "Box 4.3 *Aspects of higher risk mortgage loans in the United States and Europe*", of this Report.

Chart 3.3.1



Sources: INE and Banco de Portugal.
 Notes: Annual figures for 2007 and 2008 calculated on the basis of national quarterly accounts. (a) Includes GFCF, changes in inventories, net acquisitions from disposal of valuables and net acquisitions from non-produced non financial assets.

Chart 3.3.2

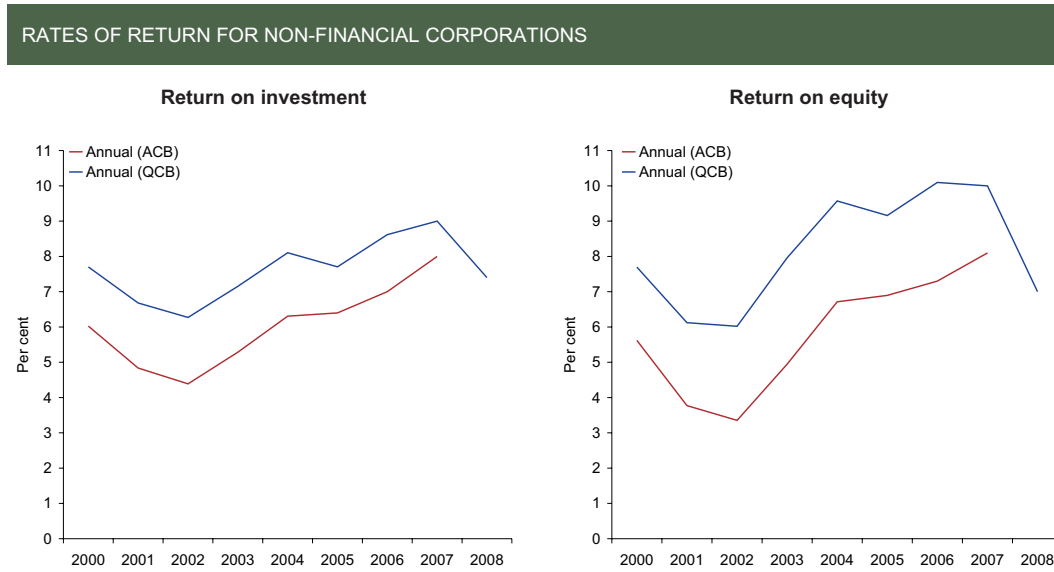


Sources: INE and Banco de Portugal.
 Note: Net figures correspond to the difference between resources and uses.

sales) in the sector, against a backdrop where operating costs (mainly payroll costs but also intermediate consumption) present greater downside rigidity.⁸ Added to the decrease in the operating surplus of the sector, there is the fact that a great deal of the return generated has been distributed in the form of interest, stemming from the rise in the average annual level of interest rates and indebtedness, and to

(8) A detailed analysis of the sample of companies in the *Central de Balanços do Banco de Portugal*, both annual (ACB) and quarterly (QCB), will be found in Supplement 5/2005 of the Banco de Portugal *Statistical Bulletin* for December 2005 and Supplement 1/2008 of the *Statistical Bulletin* for May 2008. There is a big skew towards large enterprises in the quarterly sample up to 2005 and in the annual sample, though to a lesser extent. From 2006, a simplified version was used (the *Informação Empresarial Simplificada*) and the annual analysis improved significantly, with cover now close to 100 per cent in terms of total Gross Value Added of non-financial corporations.

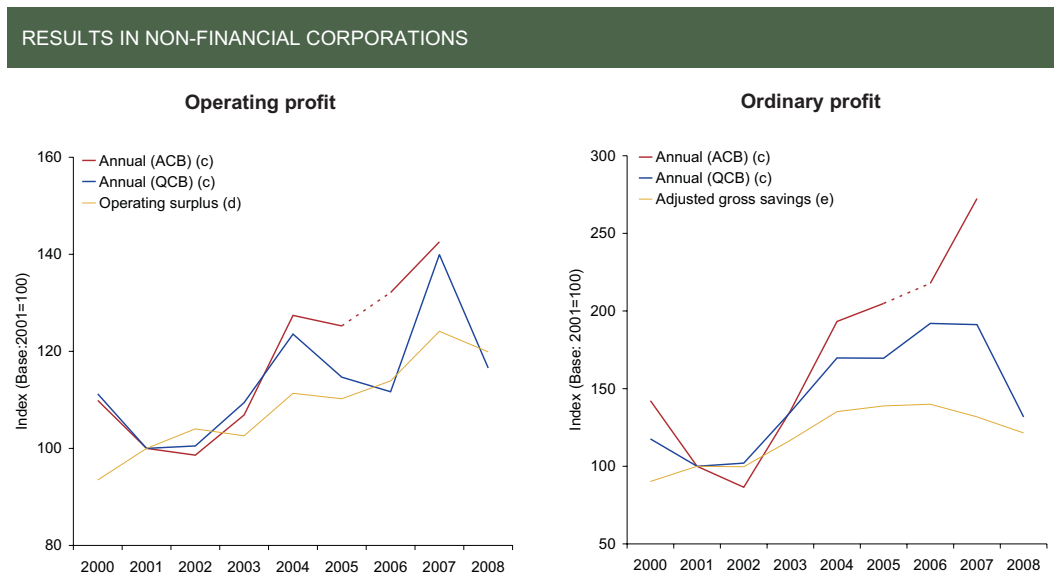
Chart 3.3.3



Source: Banco de Portugal.

Notes: Return on capital invested = (ordinary profit + interest costs)/(shares and other equity + financial debt). Return on equity = ordinary profits/shares and other equity. ACB: Annual Central Balance-Sheet Database. QCB: Quarterly Central Balance-Sheet Database (quarterly). Ratios are calculated by applying to the most recent figure available rates of change calculated on the basis of companies with comparable figures in two consecutive years. As and from 2007, the CBA ratio has been calculated using data from the Simplified Corporate Information.

Chart 3.3.4



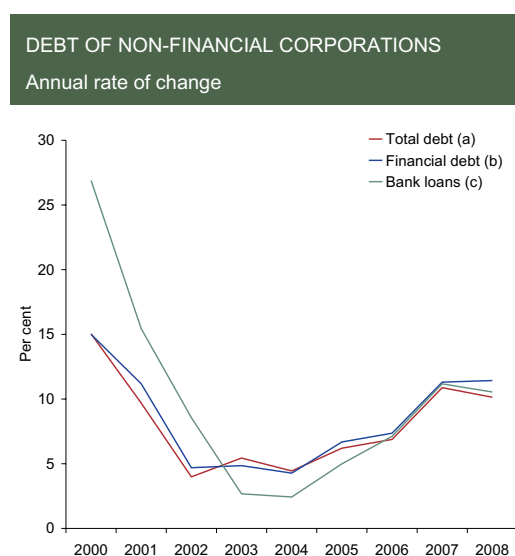
Source: Banco de Portugal.

Notes: (a) Operating profit = gross value added - personal costs + other income and operating 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 indices calculated on the basis of cumulative figures for the year in companies on the Central Balance-Sheet database with comparable figures in two consecutive years. (c) Ordinary profit = operating profit + financial profit. The series was broken in 2006. From that year data from the Simplified Corporate Information was used. The GVA cover rate for non-financial corporations on the CBA is around 60 per cent up to 2005 and near 100 per cent since 2006. For the CBT, the cover rate is between 41 and 45 per cent. (d) Operating surplus for the year. (e) Gross savings plus distributed income of corporations payable minus net reinvested FDI earnings.

a lesser extent in the form of distribution as dividends. These factors have led to a fall in the savings rate for the sector, which knocks on to greater borrowing requirements.⁹

As all of this has unfolded, the self-financing capacity of the sector has been badly mauled. With the rise in investment as a percentage of GDP, this has translated into considerable financing requirements. These have been covered, as in recent years, through an increase in indebtedness to the financial sector through bank loans. At year-end, lending to non-financial corporations were rising considerably (it was up by 10.5 per cent), with net debt securities issues also substantially higher. These were mainly short-term, and were mainly taken by resident banks, pushing financial debt (loans and securities issues) up by 11.4 per cent (Charts 3.3.5 and 3.3.6). This pattern for financing is consistent with financial market turmoil: funds are hard to raise through increases in capital using market mechanisms or the issue of long-term debt, and the situation was particularly acute in the last quarter of the year. Financing needs hoisted the financial debt of these corporations to around 134 per cent of GDP (compared with 122 per cent at the end of 2007). This brought in its train a considerable rise in financial leverage for the sector, surpassing the most recent high, recorded in 2002 (Charts 3.3.7 and 3.3.8). Both the debt ratio and the financial leverage ratio in this sector are among the highest in Europe (Charts 3.3.9 and 3.3.10).

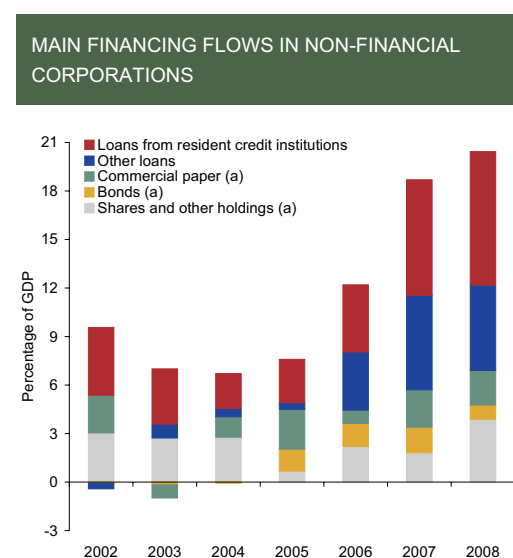
Chart 3.3.5



Source: Banco de Portugal.

Notes: (a) Includes loans granted by resident and non-resident institutions; loans/supplementary payments granted by non-resident companies from the same economic group (excluding those granted to non-financial corporations in Madeira off-shore); 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 commercial 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 3.3.6



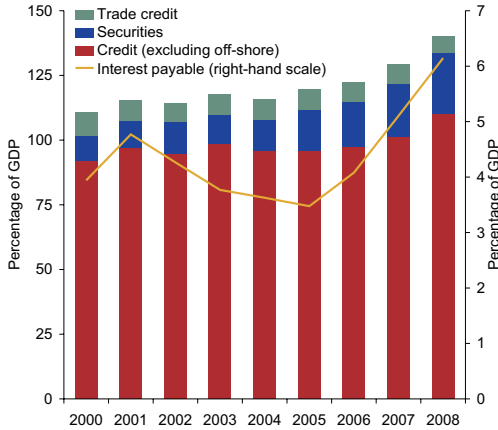
Source: Banco de Portugal.

Note: (a) Non-consolidated figures. Issue values.

(9) The operating surplus of a sector corresponds to the difference between its GVA (equal to the gross value of production less intermediate consumption) and the salaries, tax on production and imports paid by the sector. It is therefore the average of income generated (or absorbed) as a result of its productive operations (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 operational results of the units that make up the sector. In the national accounting system (the *Sistema Integrado de Contas Nacionais*), 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 assets, and current transfers. The remaining balance is the disposable income. In the case of end-user consumption sectors (families, non-profit institutions in the service of families and public administration) 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.

Chart 3.3.7

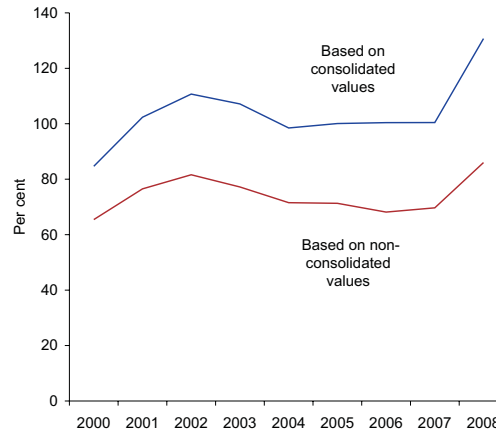
TOTAL DEBT OF NON-FINANCIAL CORPORATIONS AND INTEREST PAYABLE



Sources: INE and Banco de Portugal.

Chart 3.3.8

FINANCIAL LEVERAGE RATIO ^(a)

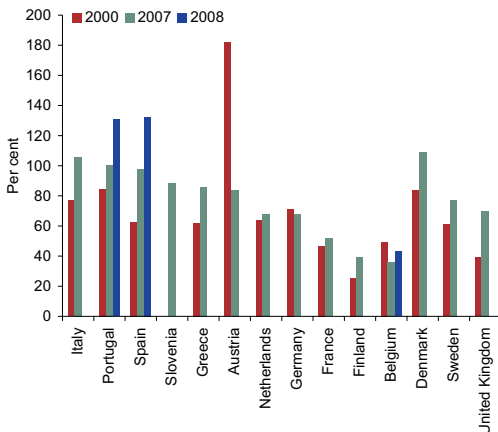


Source: Banco de Portugal.

Note: (a) Defined as the ratio between financial debt and capital.

Chart 3.3.9

FINANCIAL LEVERAGE RATIO IN NON-FINANCIAL CORPORATIONS

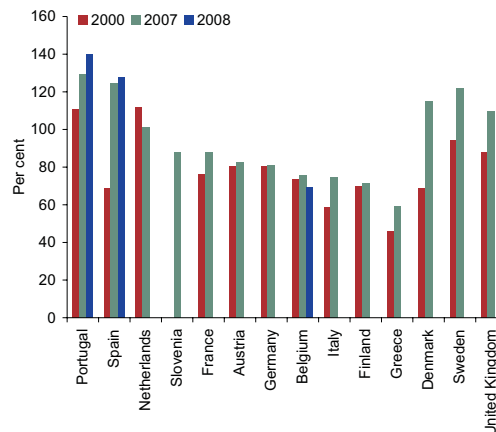


Sources: Eurostat and Banco de Portugal.

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

Chart 3.3.10

RATIO OF TOTAL DEBT TO GDP

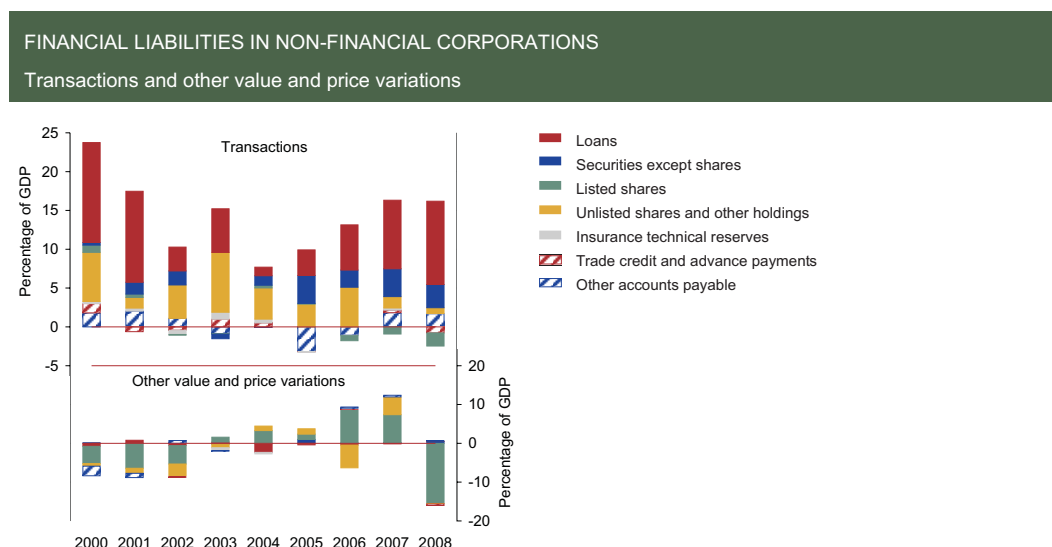


Sources: Eurostat and Banco de Portugal.

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

In terms of the financial asset portfolios of non-financial corporations, the year saw a substantial rise in loans. These related to operations between companies and their shareholders, mainly residents, and also to direct investments abroad. In consolidated terms, net acquisitions of shares and other holdings came in a tad 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 of the sector (for instance through supplementary capital) was coming through a process of company consolidation. The net financial position of the sector (in consolidated terms) was marginally better than a year earlier, standing at around -164 per cent of GDP. This compares with -160 per cent when the country joined the euro. The move in 2008

Chart 3.3.11



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

looks to have stemmed from a considerable fall in the figures for company capitalisation, as listed share prices, domestic and international, ebbed in value (Chart 3.3.11).

Unstable financial markets are interweaving ever more closely with a deteriorating real economy, bringing considerable influence to bear on non-financial corporations' production and investment decisions. The crisis has taken its toll on the world economy, with repercussions in the demand for Portuguese goods and services; and it has also made it more difficult to tap into credit, above all because of the falling expectations for the economy and consequent rise in credit risk. This could ripple on in its turn, bringing a worsening financial situation on the back of the difficulty in cushioning a sudden major slowdown in demand. In addition, given the particularly adverse operating conditions that have pervaded the world since the onset of the financial crisis, credit institutions may now have less leeway for providing the conditions that will allow weakened non-financial corporations that are nonetheless economically viable to keep themselves on an even enough keel to continue as a going concern. There has of course been a big loss of momentum recorded in aggregate credit to non-financial corporations at the end of the year and at the start of 2009, but leaving aside considerations underlying the assessment of risk by banks at an individual company/operation level, the supply of credit does not seem in overall terms to be impacting greatly on the sector's capacity to stay afloat. In addition, the information coming through the survey of banks relating to the credit market (the *Inquérito aos Bancos sobre o Mercado do Crédito*) points to loan or credit line requests from companies being more associated with financing inventories and working capital and with debt restructuring. The growing importance of these needs would seem to stack up with a view of straightened financial circumstances in a swathe of companies: less of the demand focuses on the need to finance investment or mergers and acquisitions as business operations are overhauled. The banks would seem to be playing an important role in providing companies with a financial bridge over troubled waters.

The heterogeneous nature of the situation for non-financial corporations is similar to that of individuals, in terms of sectors, geographical location or dimension. Even so, and in spite of the anticipated fall in banks' lending rates, the current recession is so deep and its reach so wide that it will perforce imply a worsening return for an array of companies, especially when faced with rigidity in substantial parts of their operating costs. The deterioration is likely to be across the board in the various segments men-

tioned, leading in many cases to a cutback in operations and, in the last resort, a rise in insolvencies.¹⁰ The recent financial and fiscal measures announced by the government to underpin companies could provide a short-term buffer, but their effectiveness and sustainability could be at stake if the crisis morphs into a deep and long-lasting recession.

(10) On this issue, see “Box 4.5 *Likely developments in the default situation among non-financial corporations*”, of this Report.