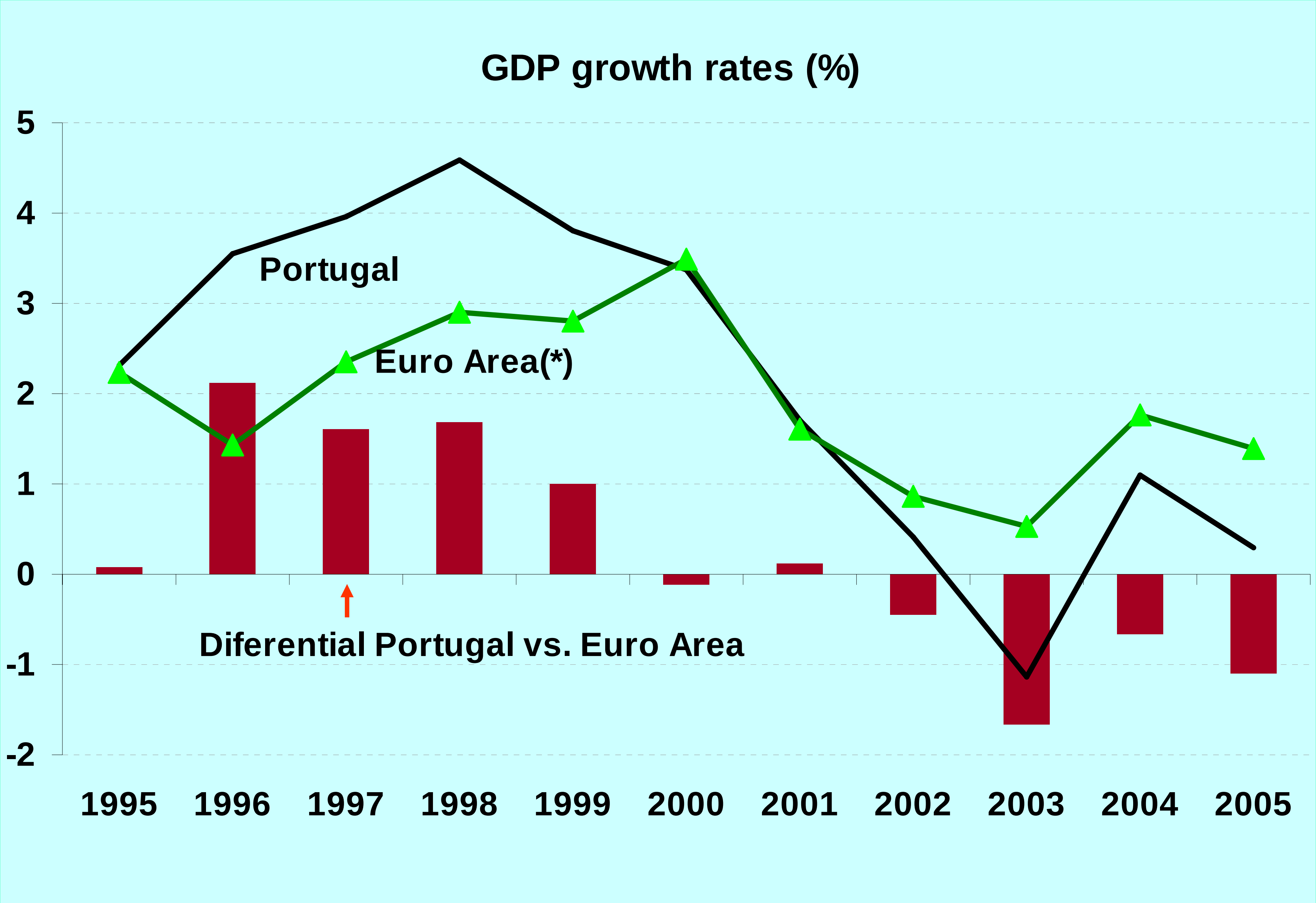
The economy and the banking sector: recent developments

VÍTOR CONSTÂNCIO

January 2006

- **Recent performance of the economy and prospects**
  - **Factors behind the period of slow growth**
- **Challenges to the Banking Sector**
  - **Regulatory changes and effects of the economic environment**
  - **Risk management (credit, liquidity, capital)**
- **Structural problems and long term economic potential**

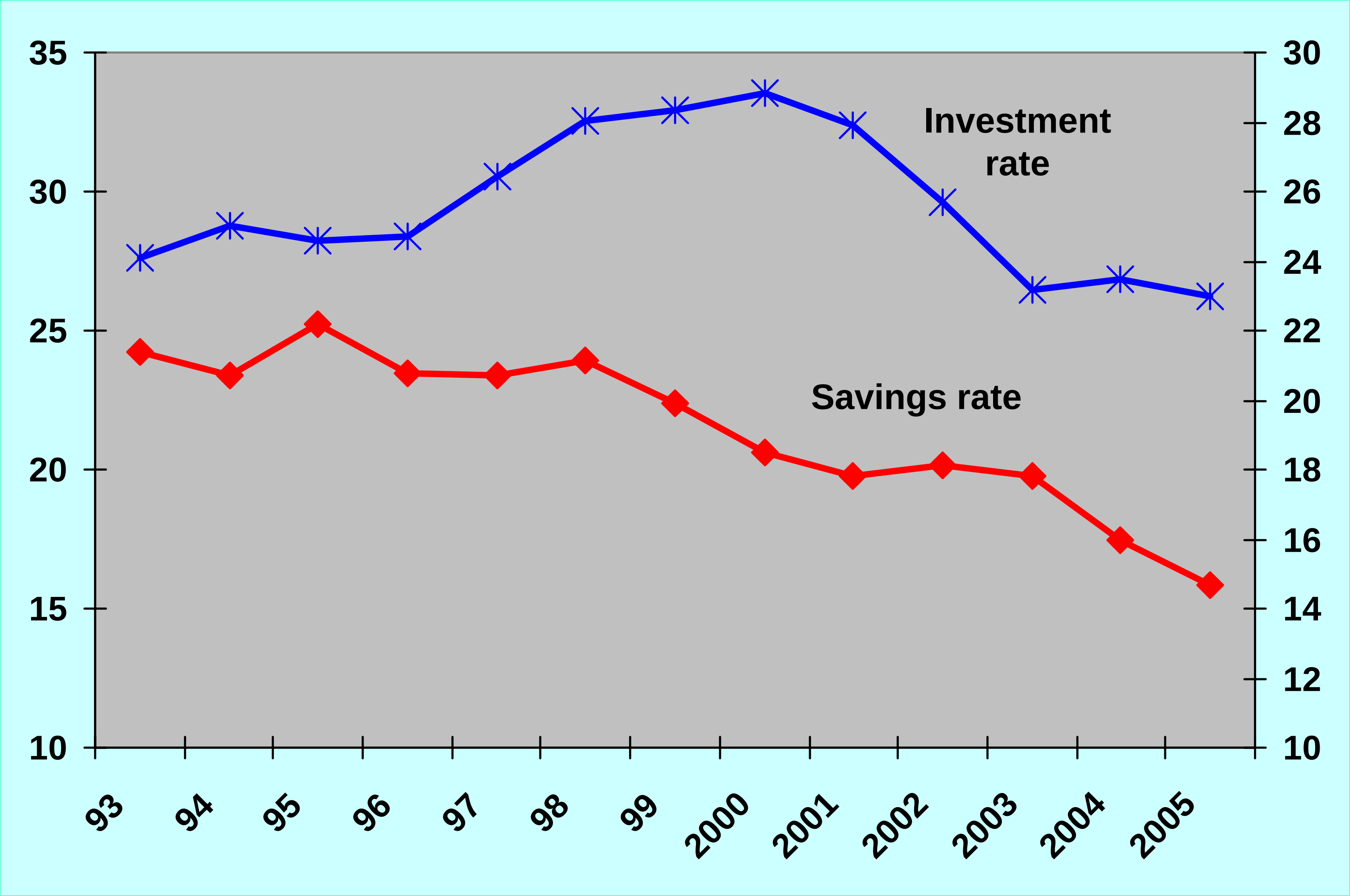


GDP growth rates (%)
5
4
3
2
1
0
-1
-2
Portugal
Euro Area(*)
Diferential Portugal vs. Euro Area
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005

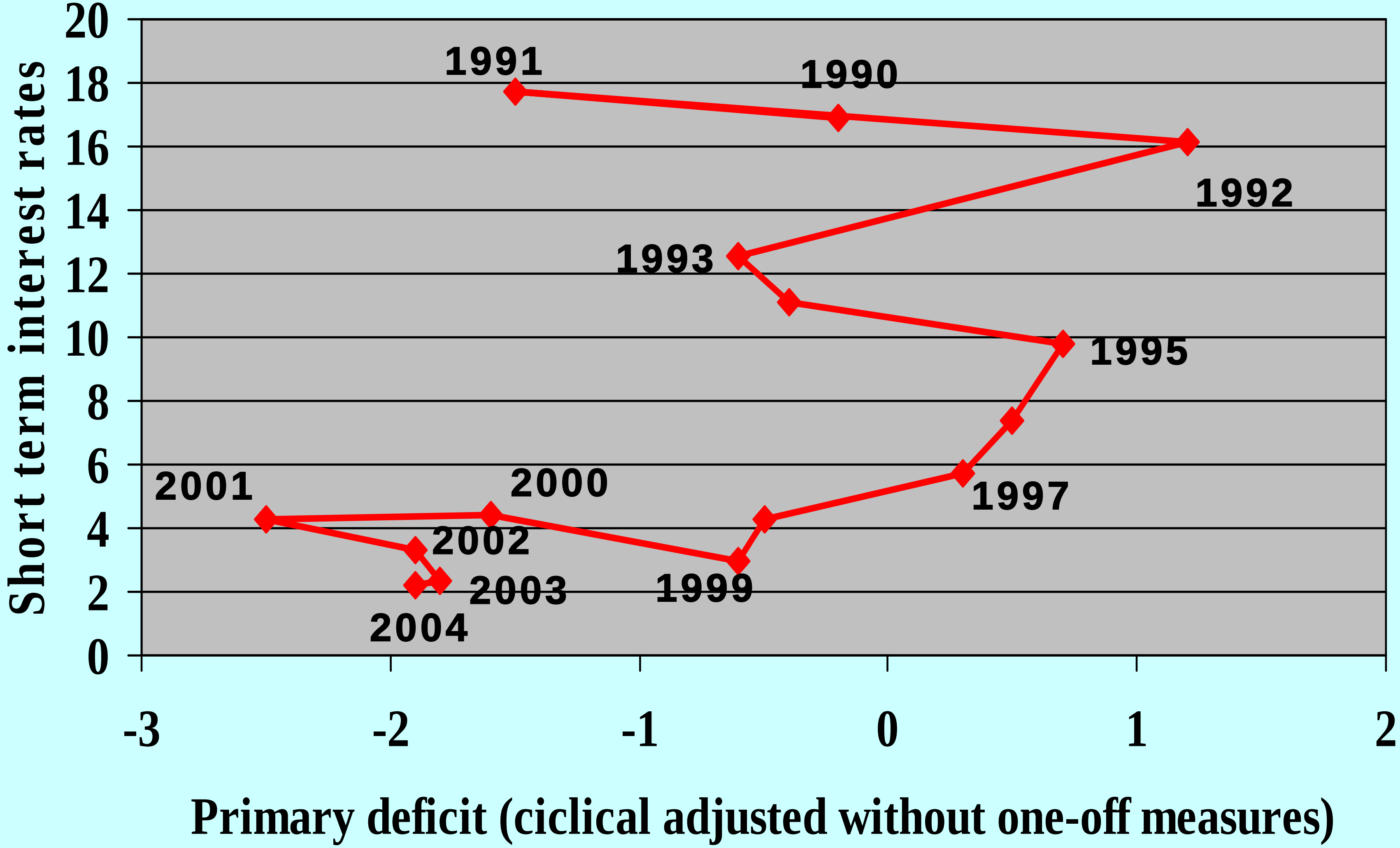
Factors behind the period of slow growth

- Cyclical pattern of slight overheating and subsequent deceleration associated with joining a monetary union coming from a regime of higher inflation
- Pro-cyclical fiscal policy
- External demand shocks
- Significance of the oil shock
- Competitiveness problems in the context of enlargement and globalisation

Investiment and domestic savings rate (% of GDP)

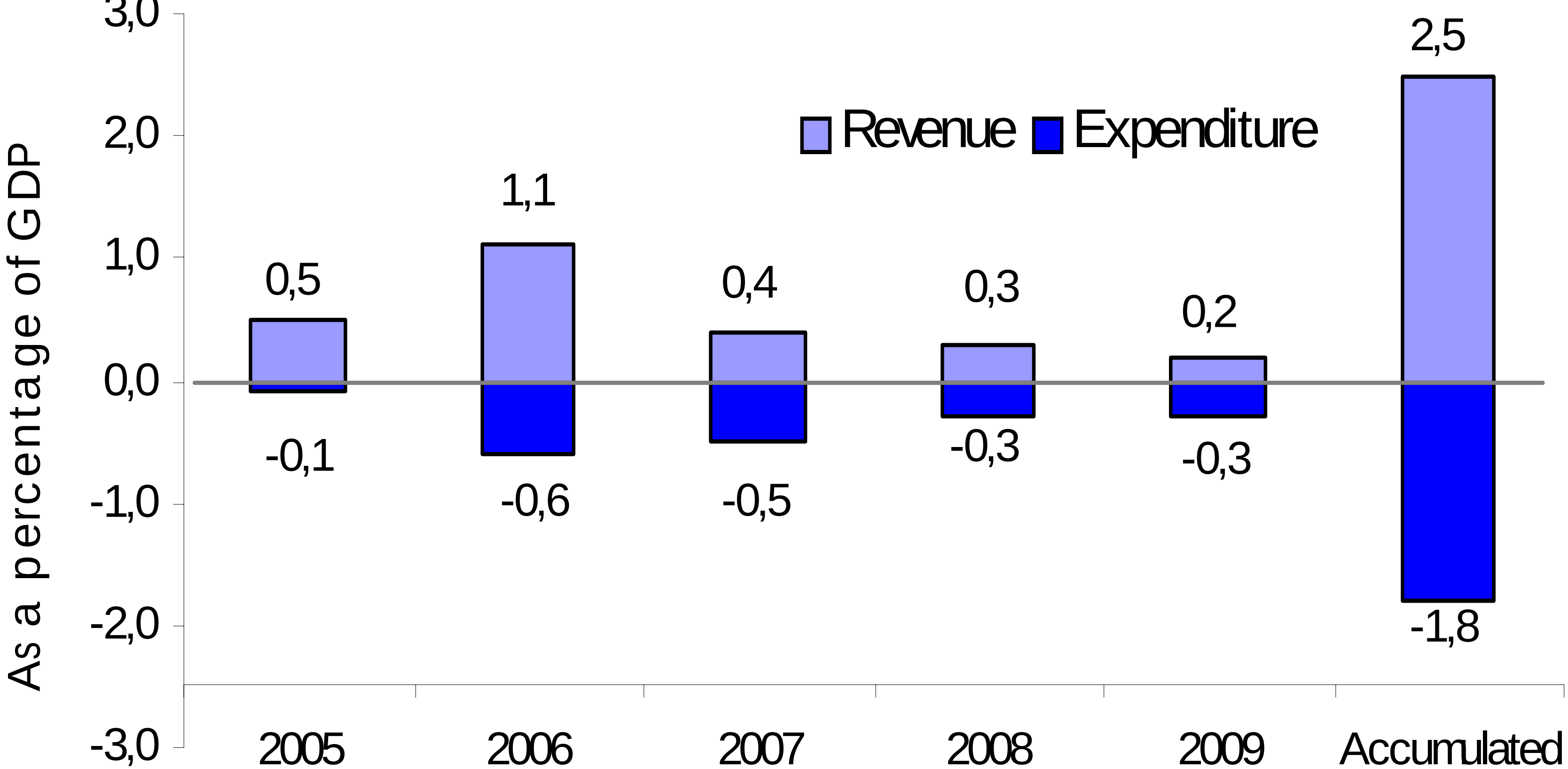


Macroeconomic policy stance



Stability and growth programme

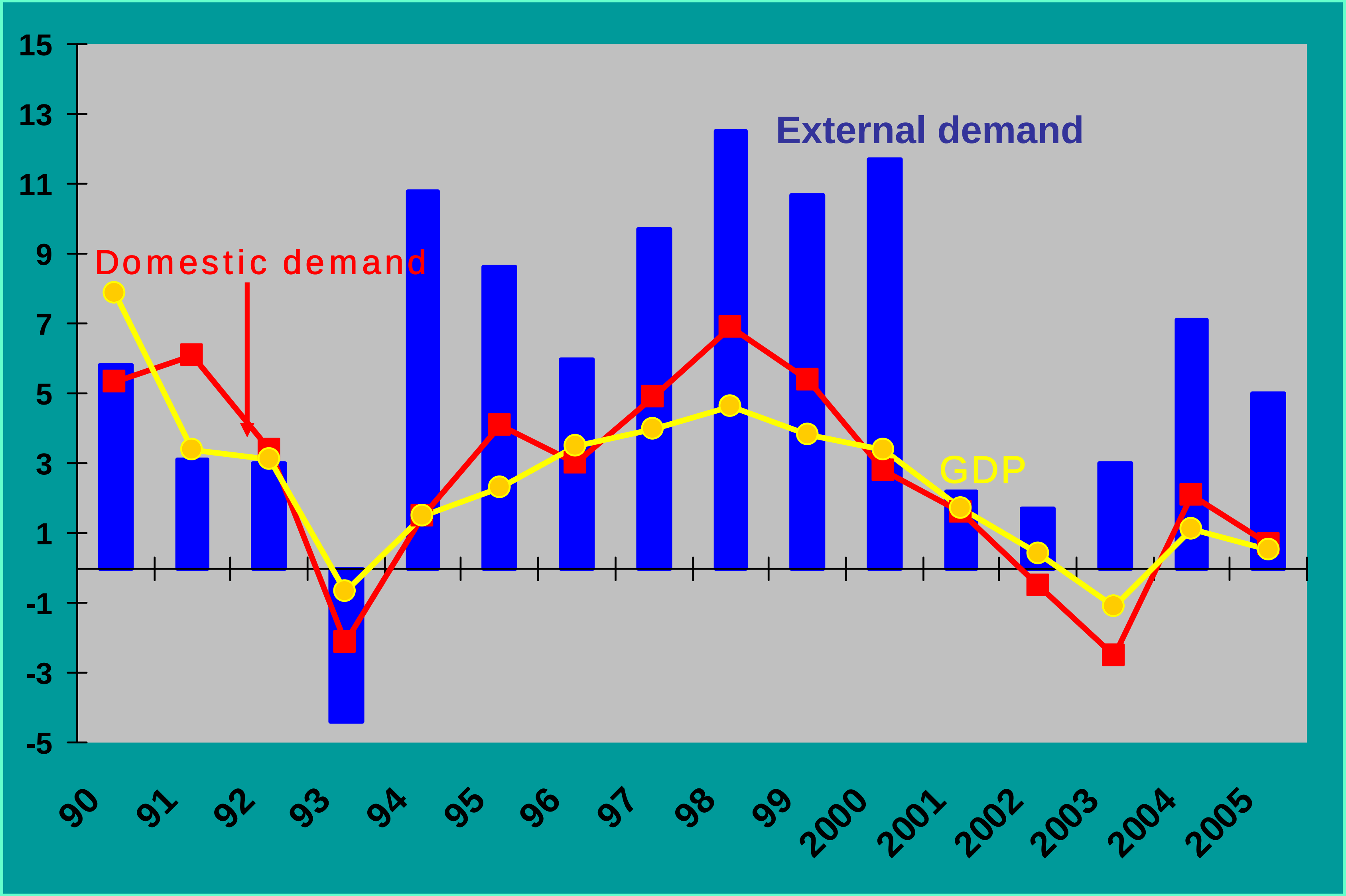
Main direct effects of consolidation measures[a]



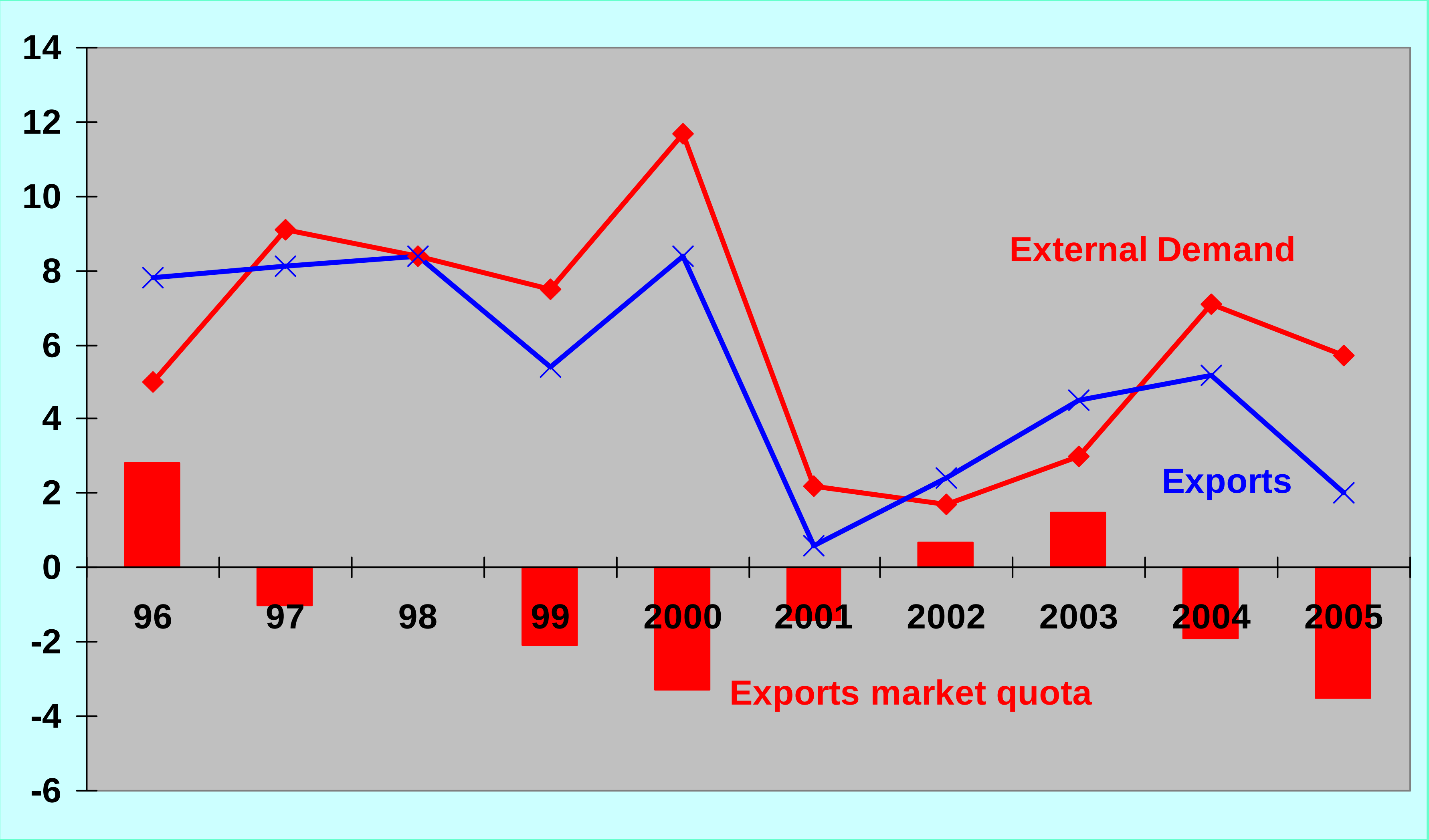
Source: Stability and growth programme, June 2005

(a) Yearly, direct effects of discretionary measures included in the SGP.

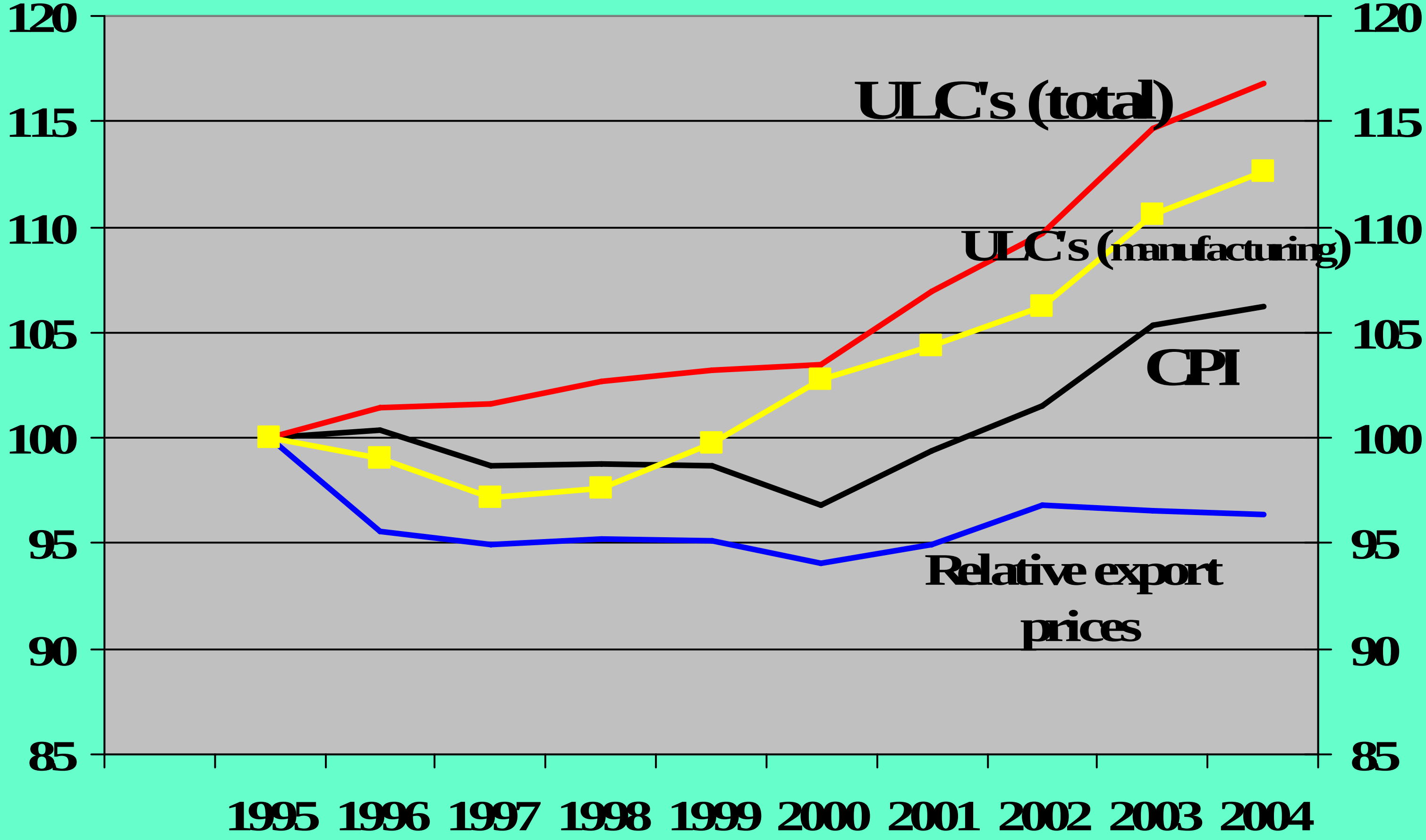
Growth rates of GDP, Domestic Demand and External Demand directed to the Portuguese economy



Growth rates of external demand and portuguese exports



Competitiveness Indicators: relative ULC's, CPI and export prices with the 13 main trading partners (1995=100)



(Source: BP AMECO e OECD)

Technological content of Exports (% of total)					
	Low technology		High technology		
	1985-89	2000-01	1985-89	2000-01	Variation
Euro Area	38	30	14	21	7
Ireland	49	14	30	46	16
Holand	42	31	19	35	16
Finland	59	38	9	32	23
Germany	26	21	15	21	6
France	38	28	14	21	7
Austria	51	37	12	18	6
Portugal	82	61	5	14	9
Italy	47	44	12	13	1
Belgium	54	41	9	12	3
Spain	57	41	6	11	5

ECB Occasional Paper “Competitiveness and export performance of the euro area” No. 30, 2005

Composition of Exports

	1985-1989	2000-2004	Variação
Agriculture & Food, Wood,Cork, Paper , Leather, Textiles, Clothing, Footwear	61,1 %	40,2%	-20,9 p,p
Electronics, Machines, Transport equipment, Chemicals, Energy	27,0 %	45,8%	+18,8 p,p
Other	11,8 %	14,0%	+2,2 p,p

Bank of Portugal's Economic Forecasts

Growth rates (%)	2004	2005	2006	2007
GDP	1.3	0.3	0,8	1,0
Private Consumption	2.3	1.8	1.2	1.1
Public Consumption	2.6	1.1	0.7	0.4
Gross Fixed Investment	0.2	-3.1	-1.1	-0.8
Domestic Demand	2.1	0.6	0.6	0.6
Exports of goods and services	5.4	1.8	4.0	5.2
Imports of goods and services	6.8	2.4	2.8	3.2
Inflation rate (HICP)	2.5	2.1	2.5	2.3

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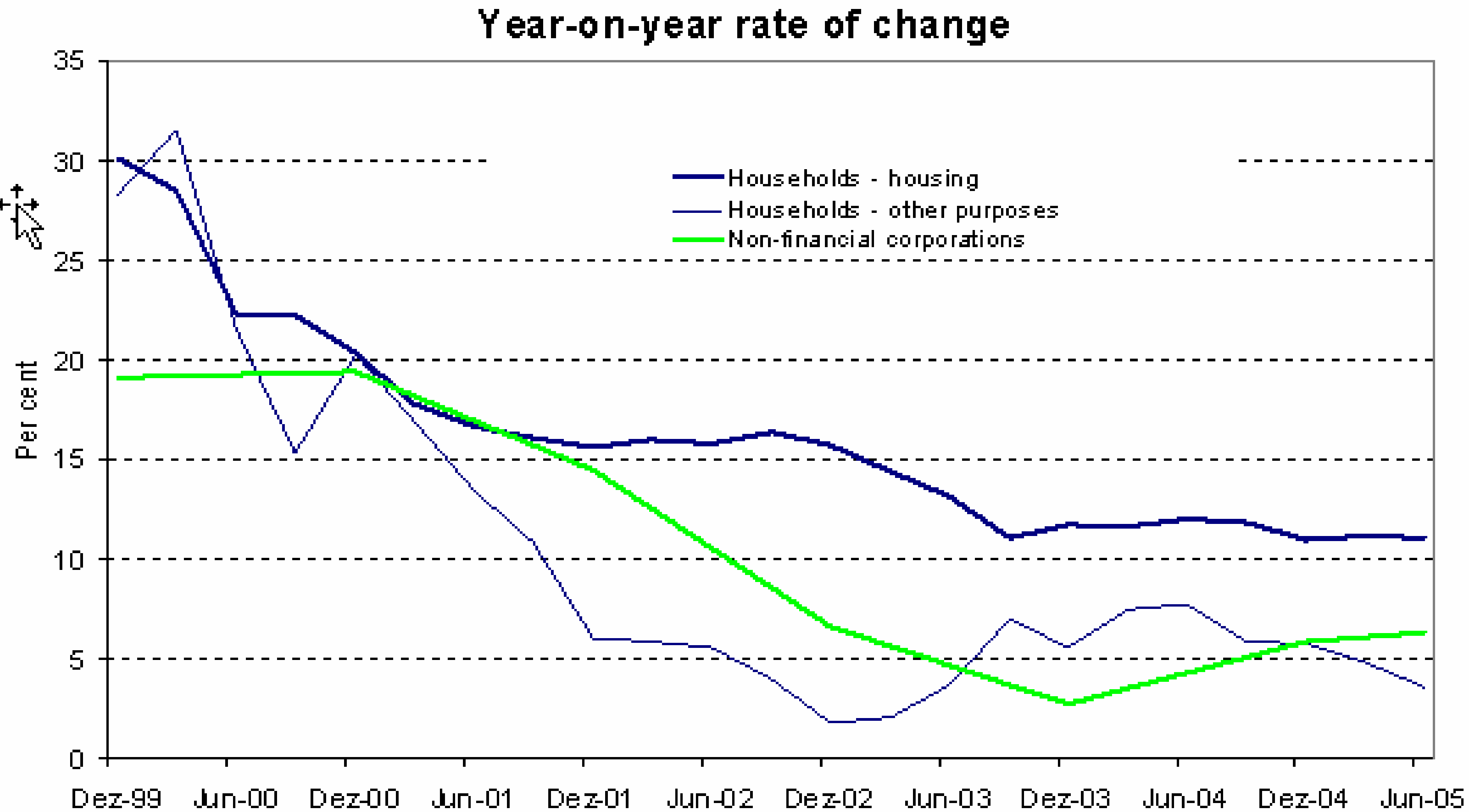
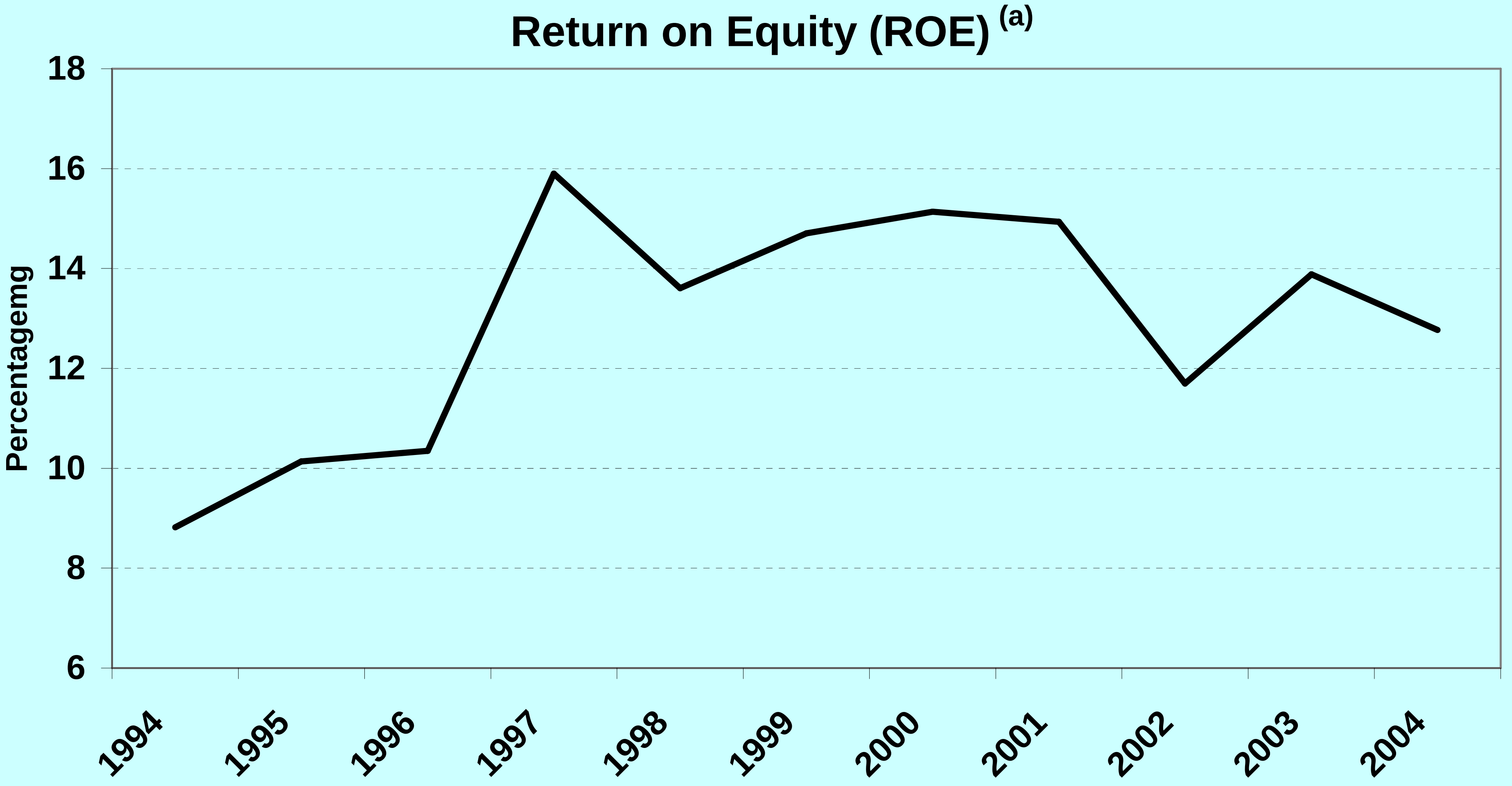
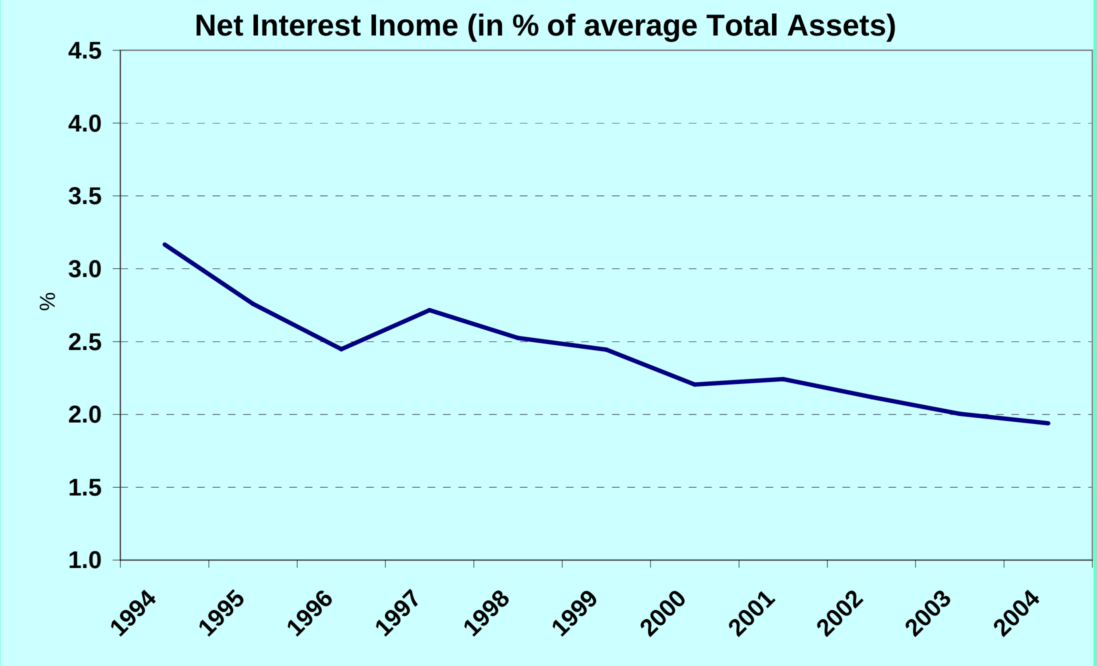
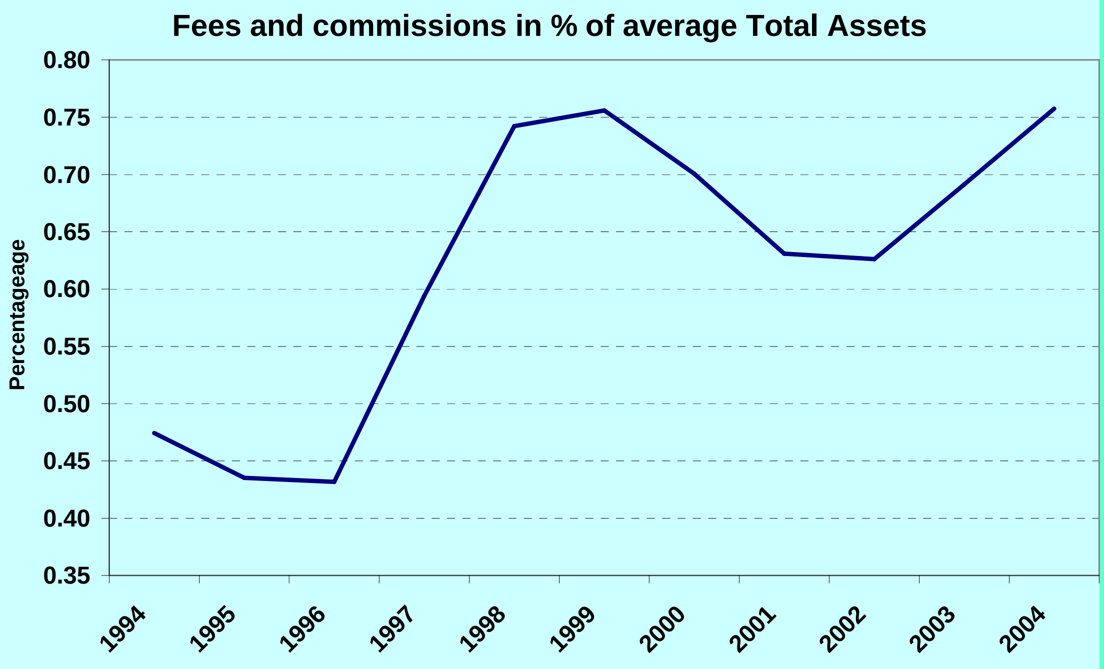
Credit to households and non-financial firms

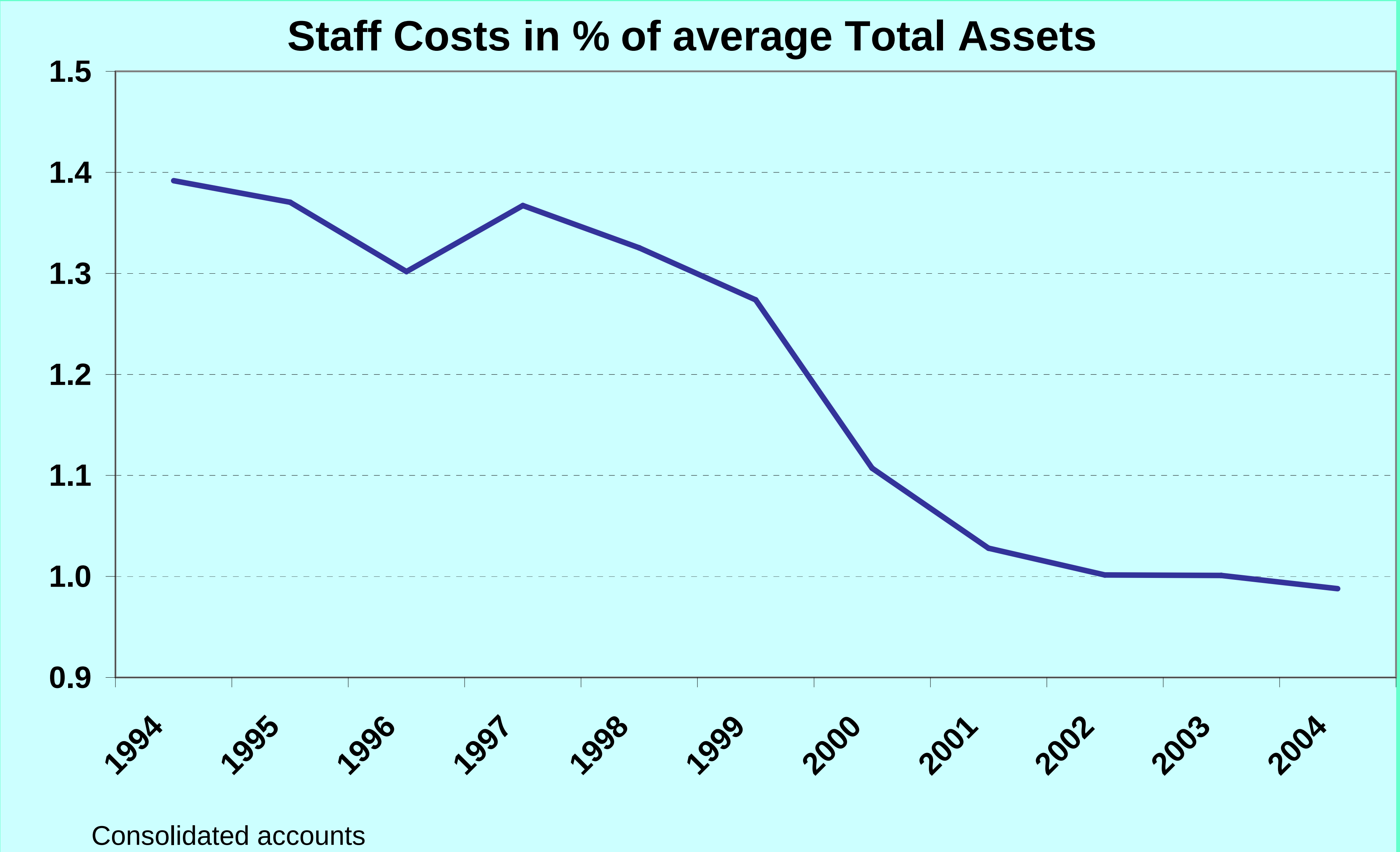




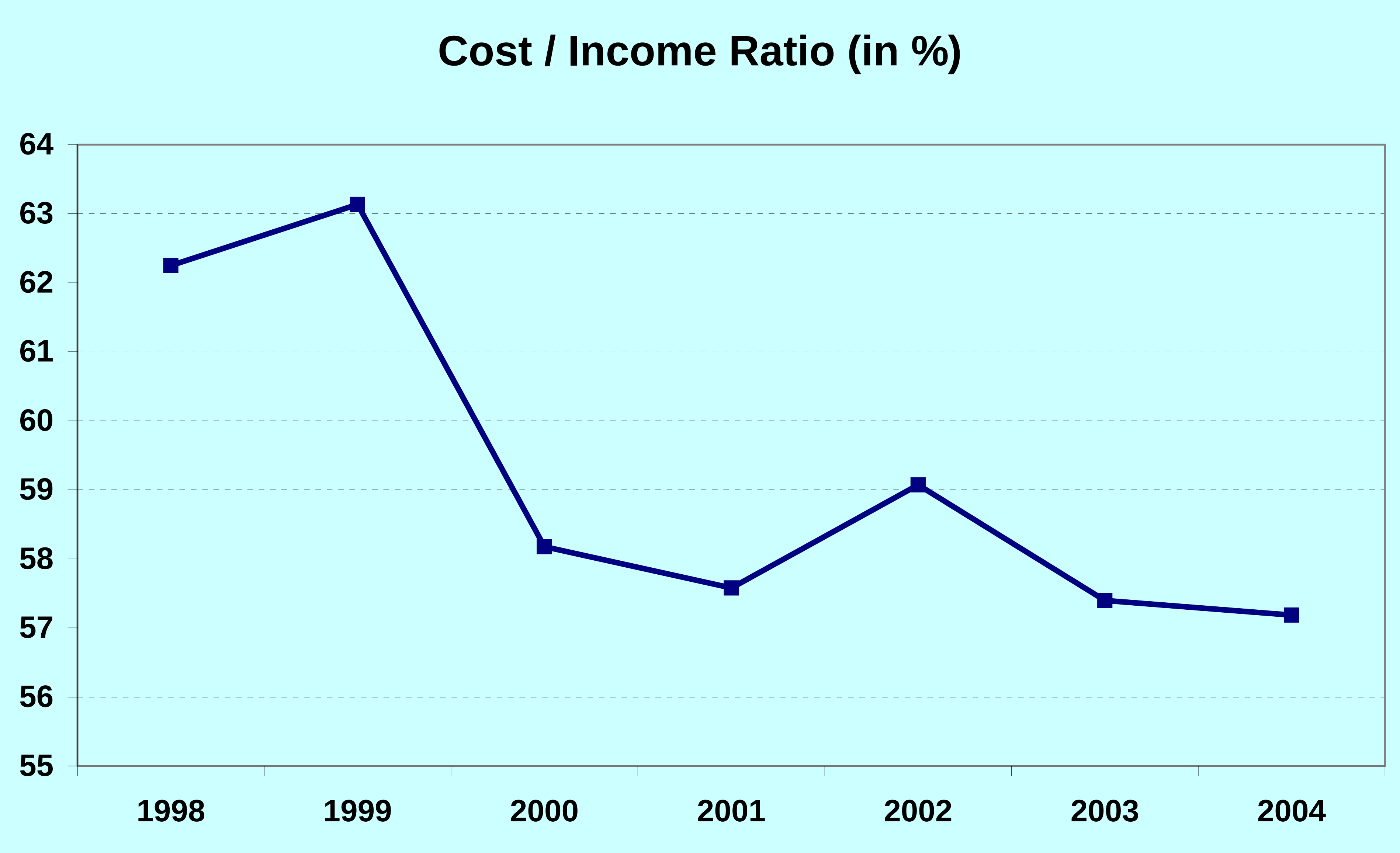
(a): ROE defined as net profit over average own funds (consolidated accounts)

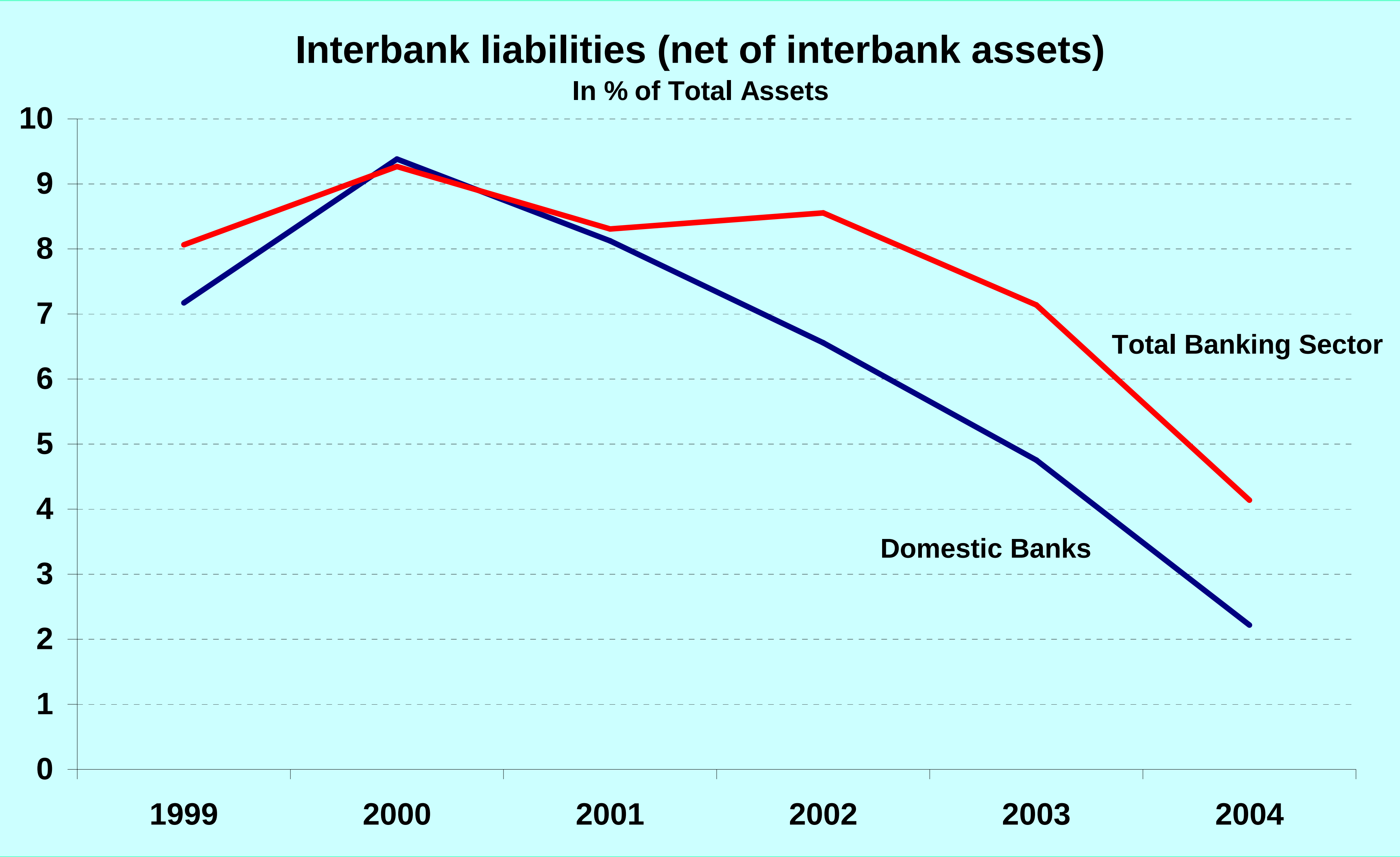

Net Interest Inome (in % of average Total Assets)
%
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004


Fees and commissions in % of average Total Assets
Percentageage
0.80
0.75
0.70
0.65
0.60
0.55
0.50
0.45
0.40
0.35
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004



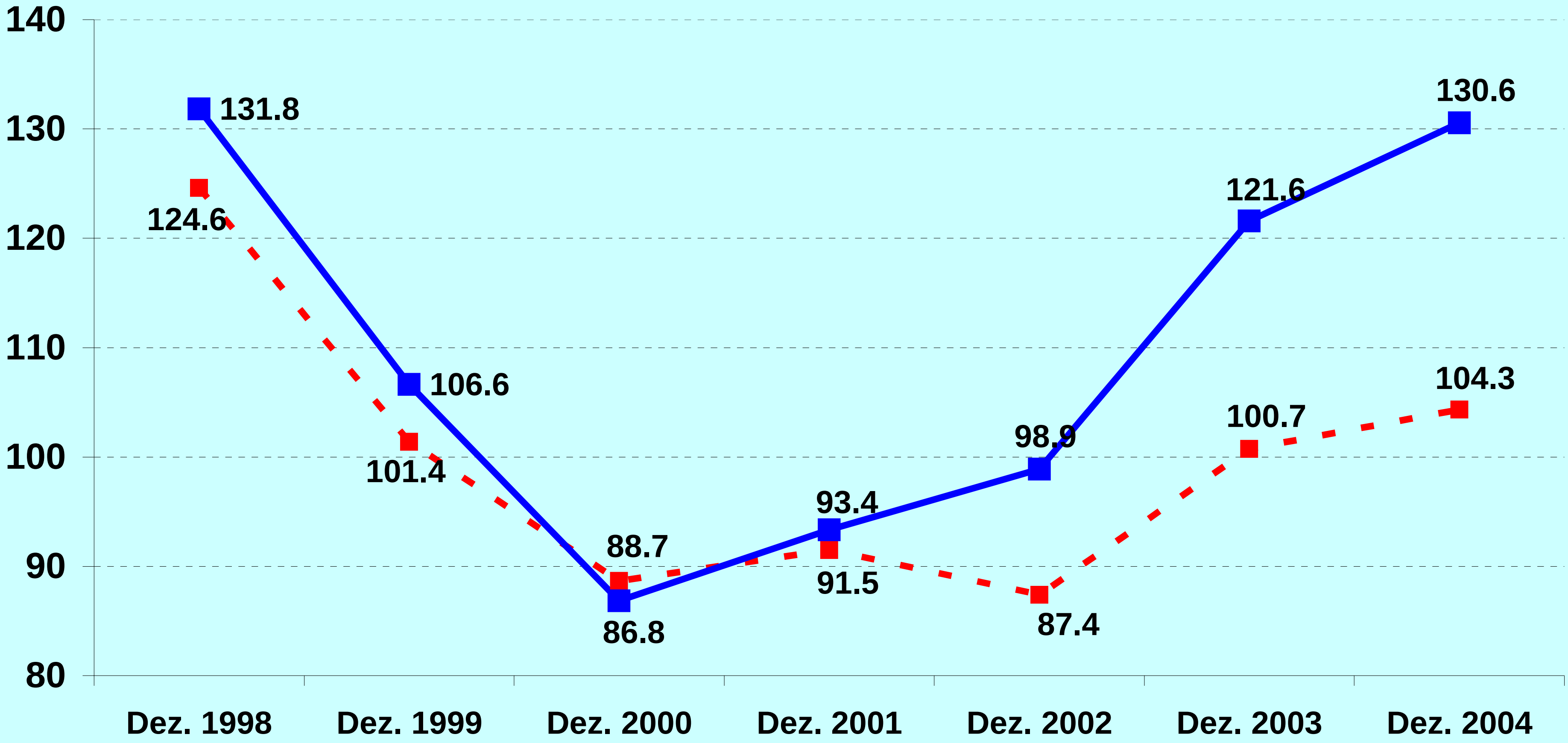
Staff Costs in % of average Total Assets
1.5
1.4
1.3
1.2
1.1
1.0
0.9
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
Consolidated accounts


Cost / Income Ratio (in %)
64
63
62
61
60
59
58
57
56
55
1998
1999
2000
2001
2002
2003
2004



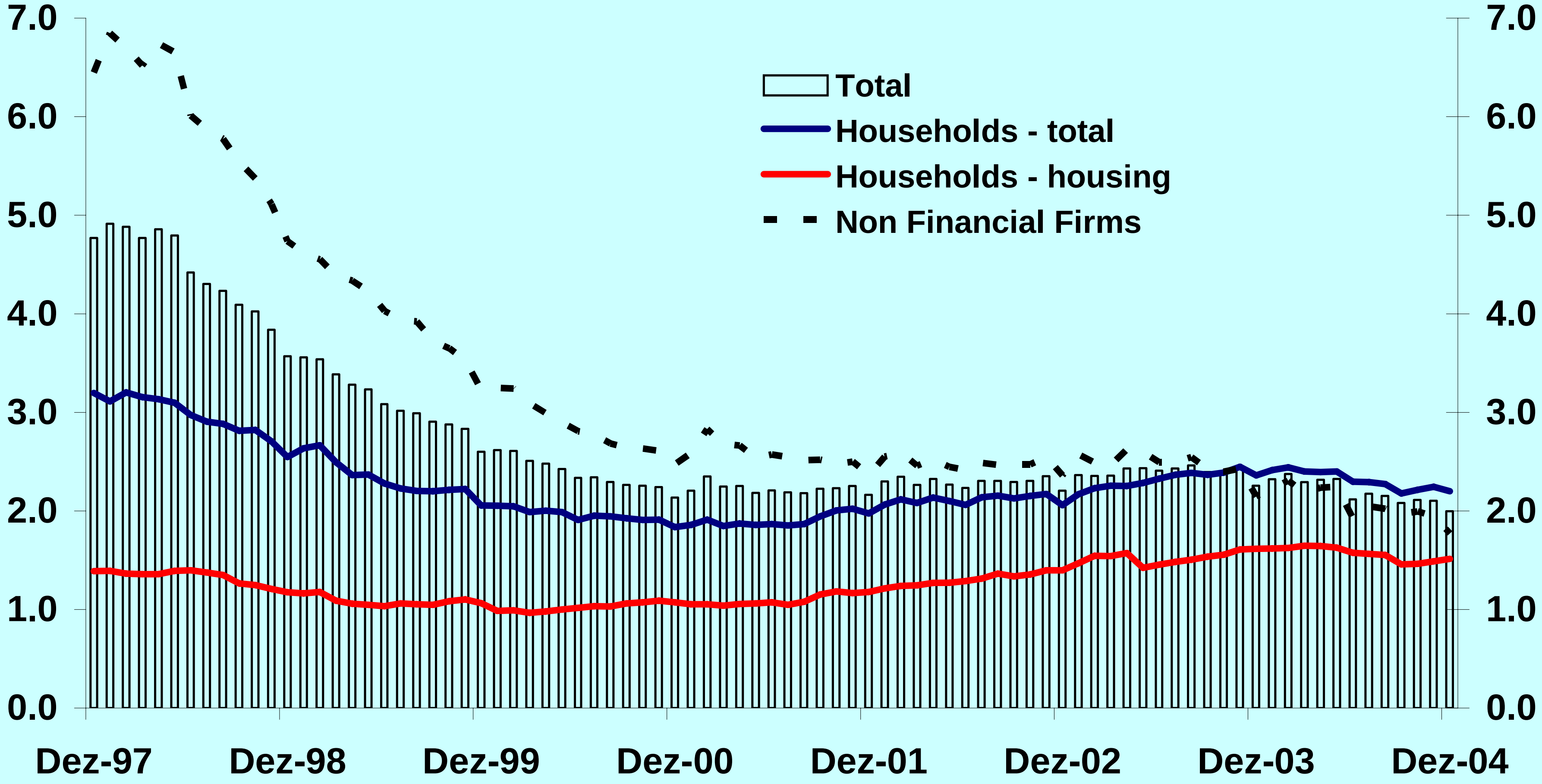
Interbank liabilities (net of interbank assets)
In % of Total Assets
10
9
8
7
6
5
4
3
2
1
0
Total Banking Sector
Domestic Banks
1999
2000
2001
2002
2003
2004

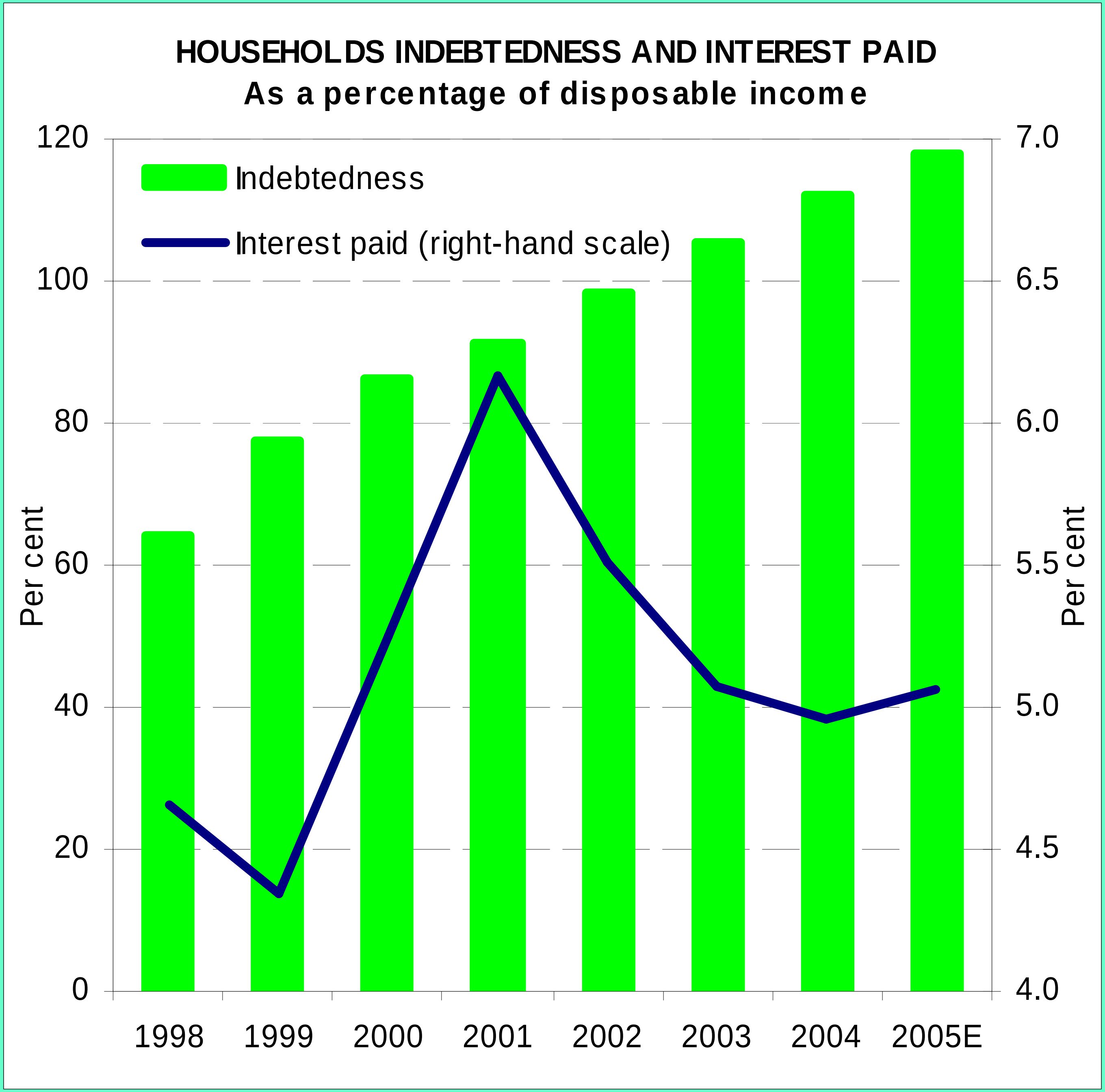
Ratio of high liquid assets over interbank liabilities



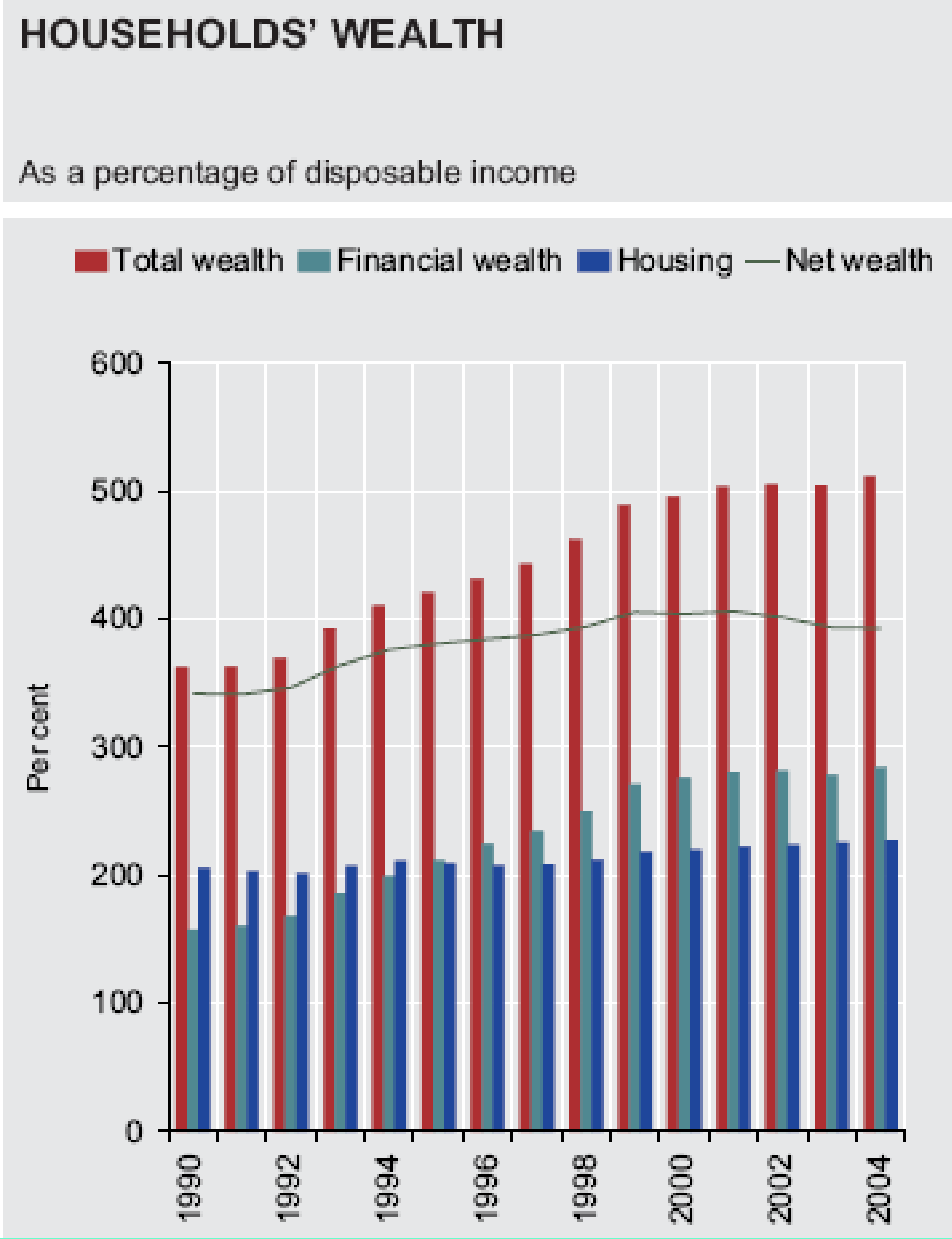
Note: High liquid assets include Interbank Assets (Banks and Central Banks) and Public Sector securities.

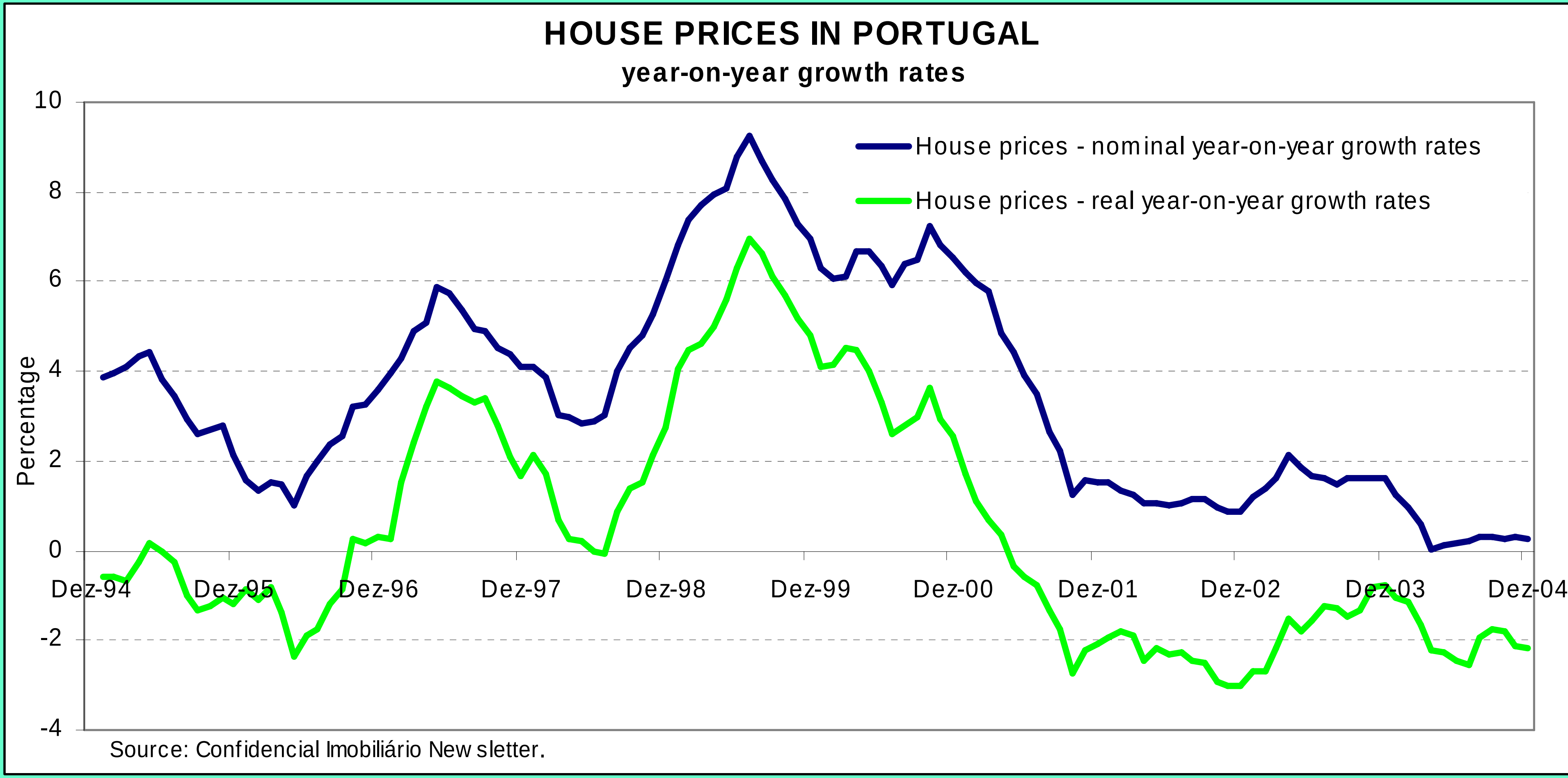
Non Performing Loans in % of Total Credit




HOUSEHOLDS INDEBTEDNESS AND INTEREST PAID
As a percentage of disposable income
Indebtedness
Interest paid (right-hand scale)
Per cent
Per cent
120
100
80
60
40
20
0
7.0
6.5
6.0
5.5
5.0
4.5
4.0
1998
1999
2000
2001
2002
2003
2004
2005E

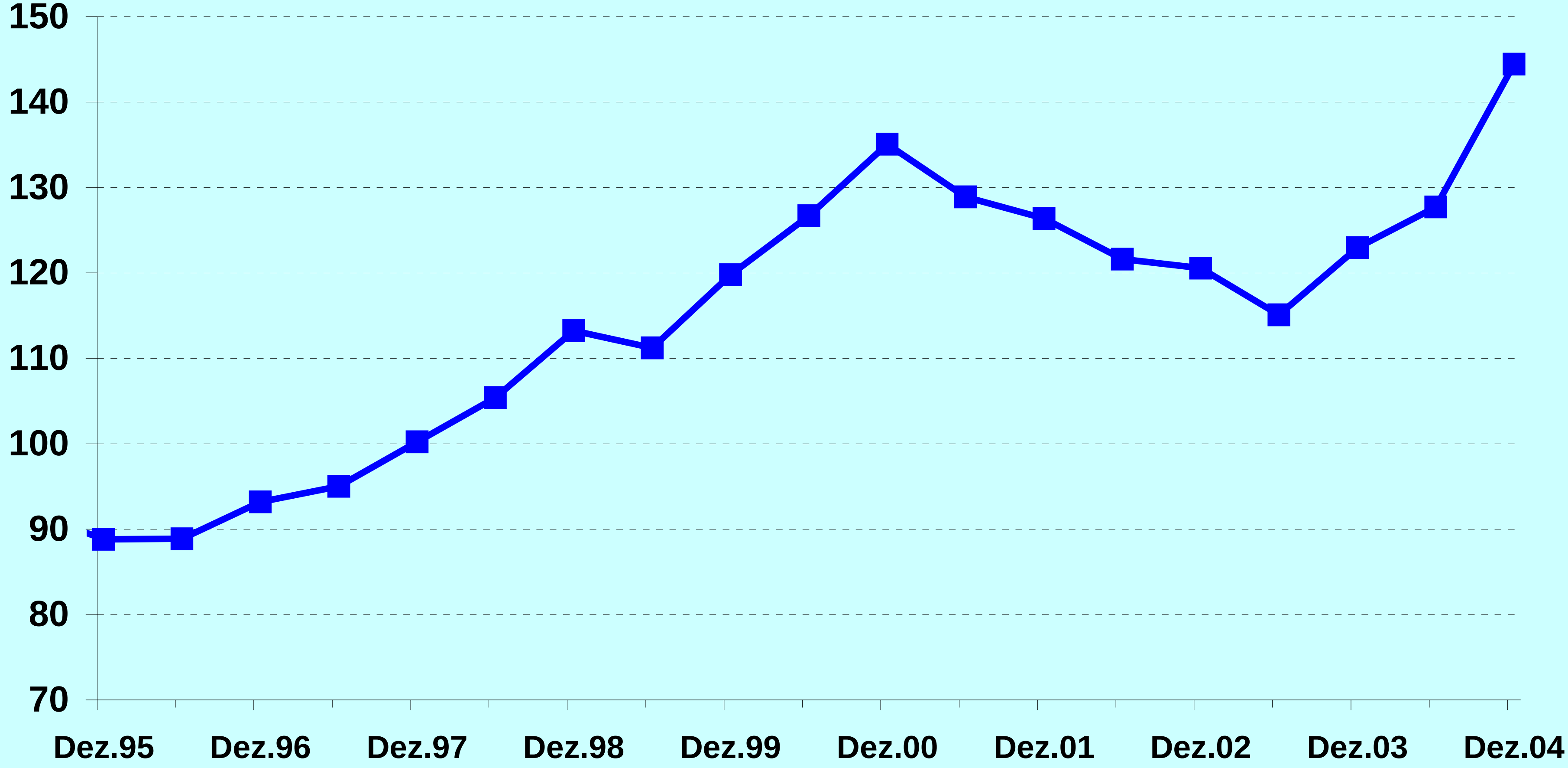
The aggregate debt-to-assets ratio increased but net wealth is estimated at a comfortable 400 percent of disposable income. Household debt is mainly comprised of housing mortgages, with direct coverage by non-financial assets (housing – in particular for owner occupation).

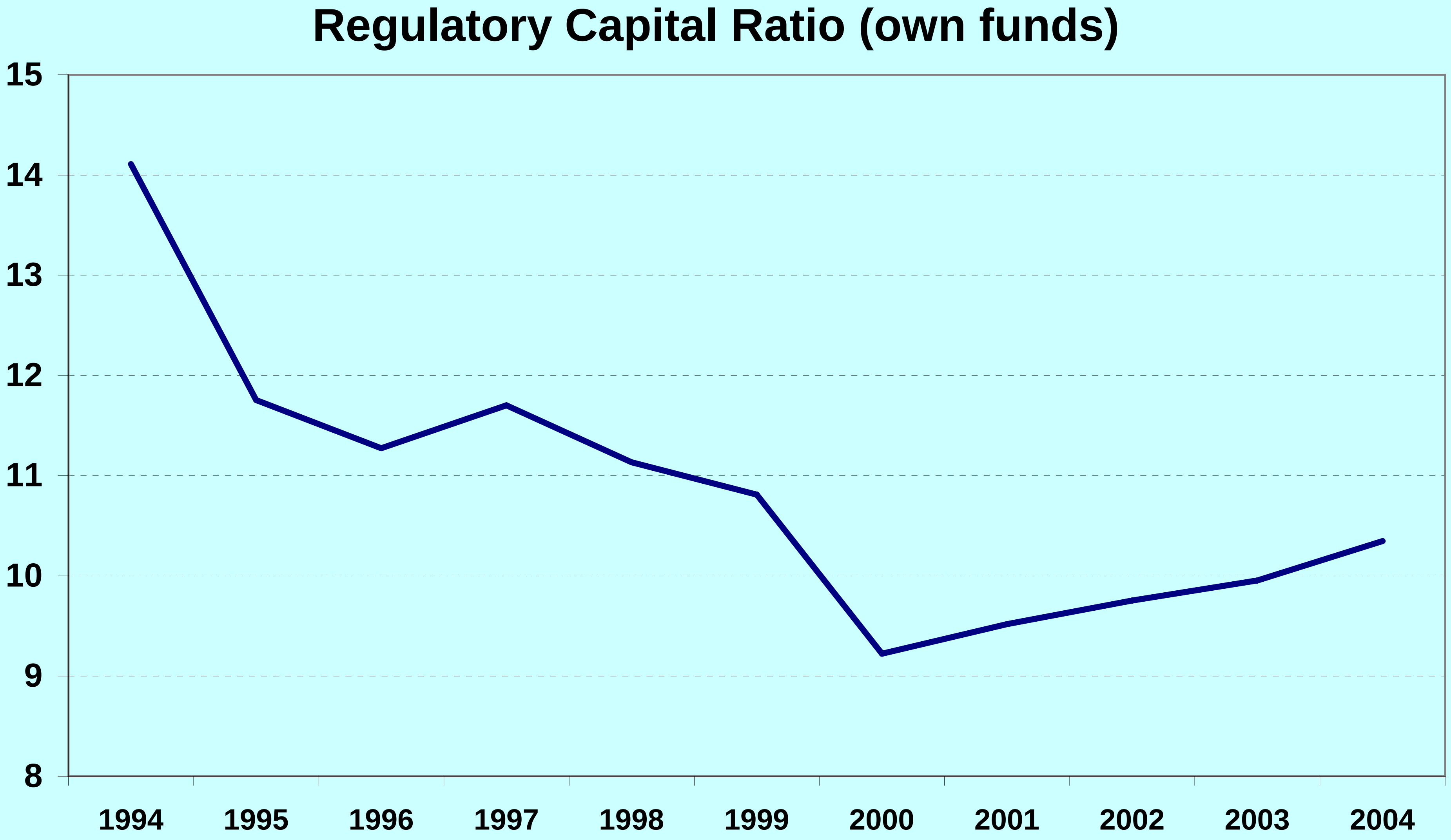




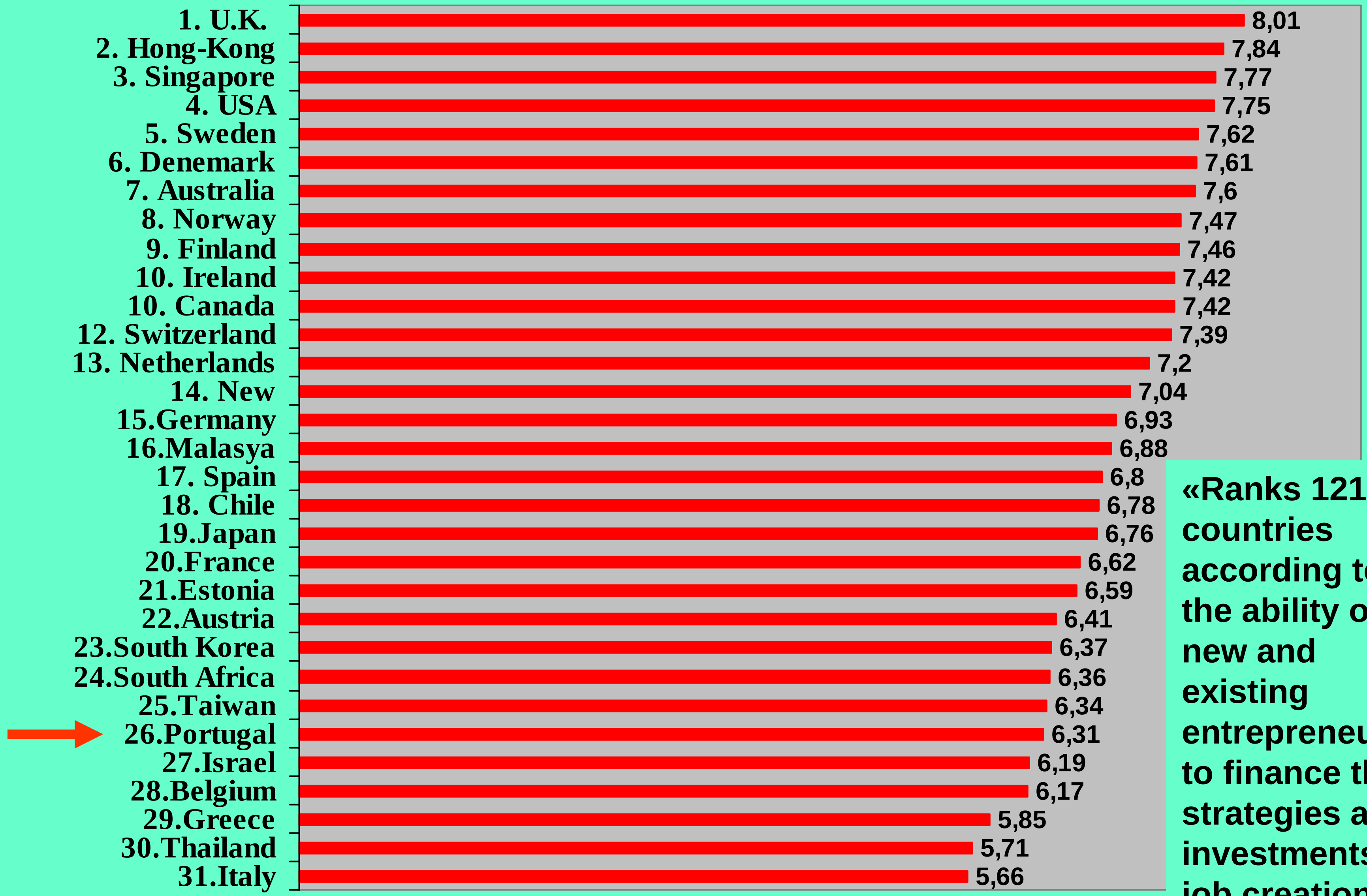
HOUSE PRICES IN PORTUGAL
year-on-year growth rates
House prices - nominal year-on-year growth rates
House prices - real year-on-year growth rates
Percentage
10
8
6
4
2
0
-2
-4
Dez-94
Dez-95
Dez-96
Dez-97
Dez-98
Dez-99
Dez-00
Dez-01
Dez-02
Dez-03
Dez-04
Source: Confidencial Imobiliário Newsletter.

Total Provisions in % of Non Performing loans




Regulatory Capital Ratio (own funds)
15
14
13
12
11
10
9
8
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004

Capital Access Index (2005)



«Ranks 121 countries according to the ability of new and existing entrepreneurs to finance their strategies and investments for job creation and capital formation»

Source: Milken Institute, USA

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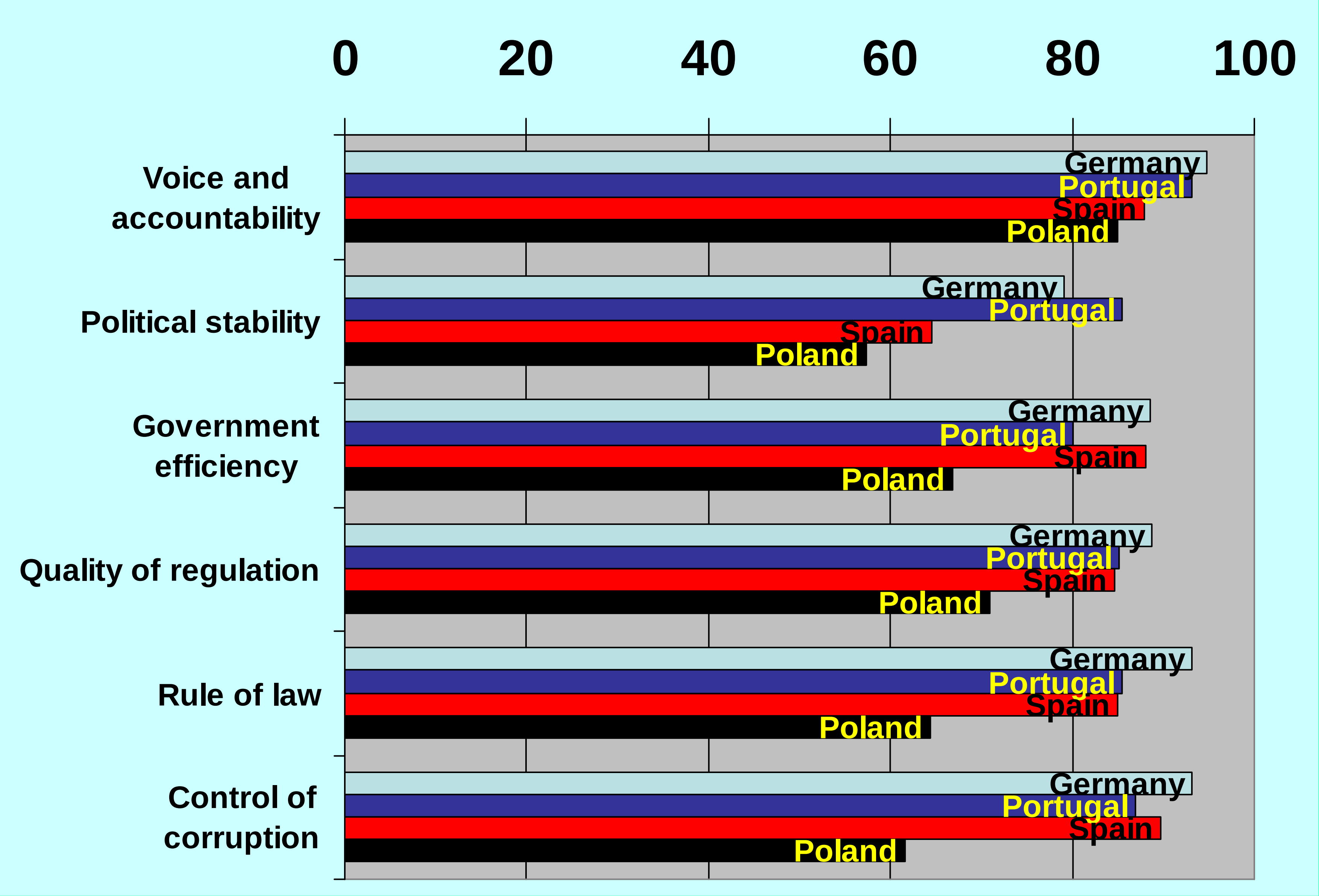
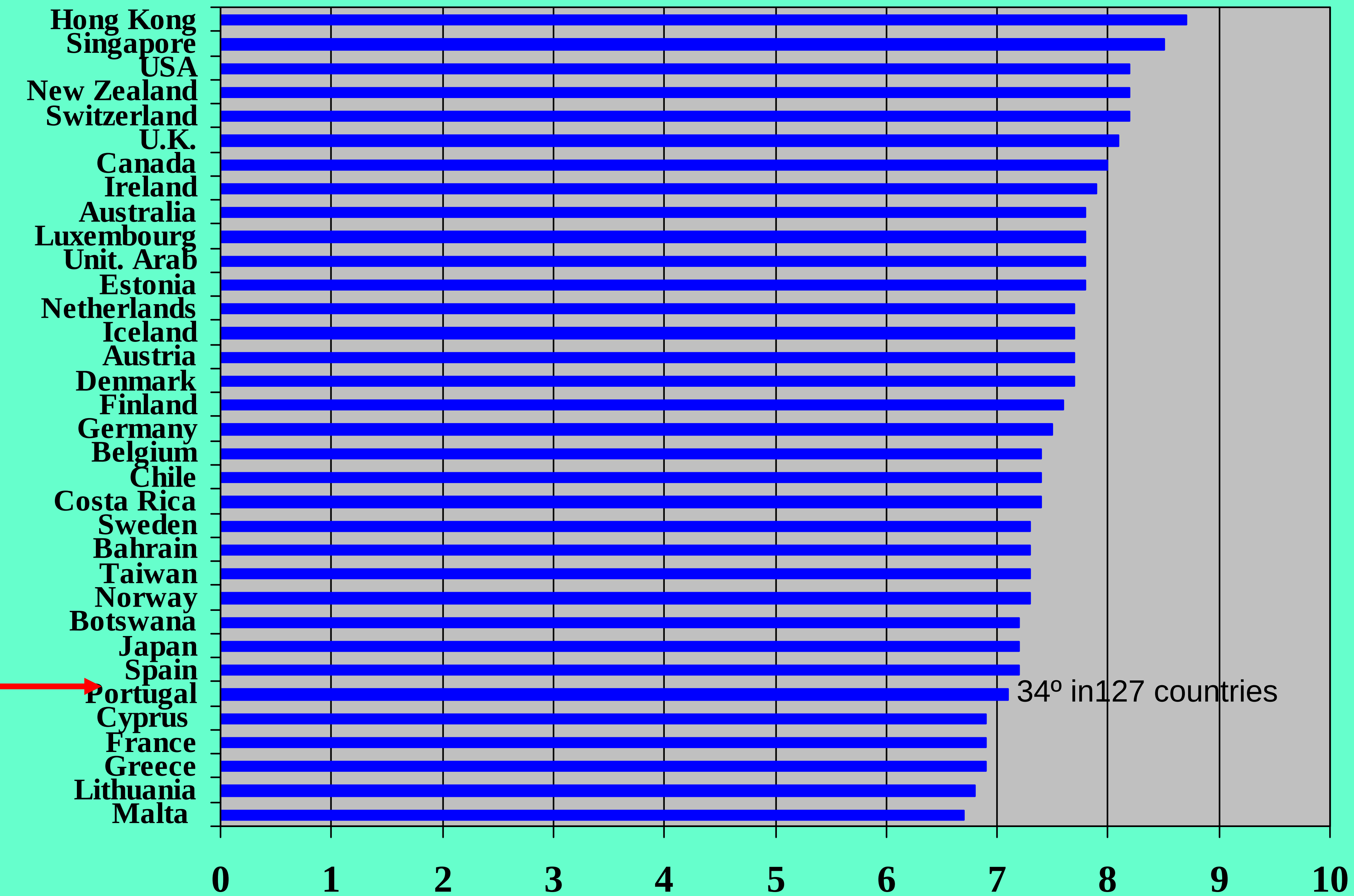
Growth competitiveness index (WORLD FORUM 2005)				
	Total	Quality of Institutions	Technological absorption	Macroeconomic environment
Finland	1	5	2	4
USA	2	18	1	23
Sweden	3	17	4	12
Denmark	4	2	5	3
Taiwan	5	26	3	17
Singapore	6	4	10	1
Iceland	7	3	9	11
Switzerland	8	9	6	13
Norway	9	6	13	2
Australia	10	10	14	14
....				
Portugal	22	15	20	37
Spain	29	38	27	24
Ireland	26	13	31	7
Greece	46	43	37	51

World Bank Indicators of «Governance» (2004)

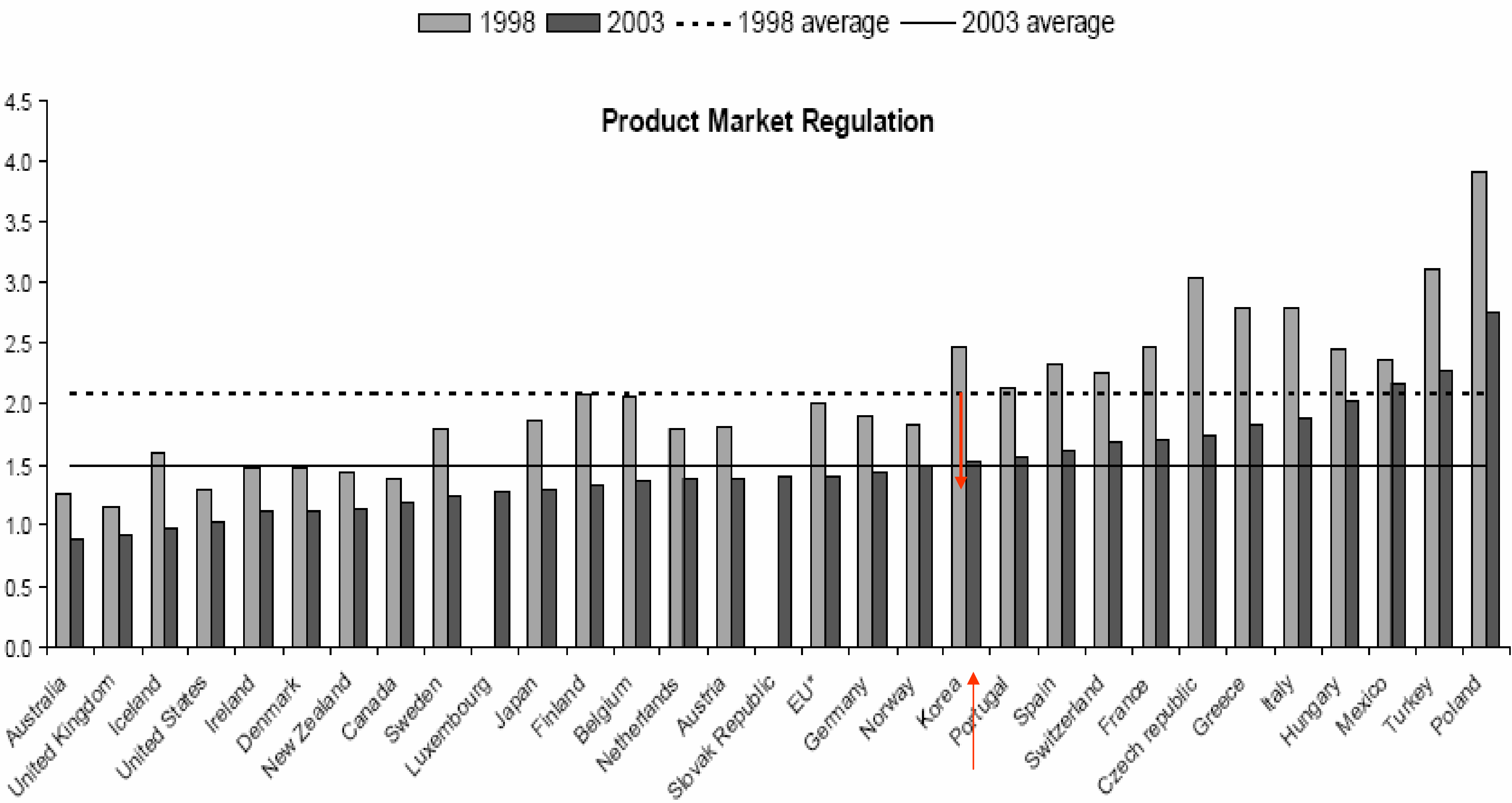


Source: World Bank " Governance Indicators for 1996-2004" , 2005

Index of economic freedom (Fraser Institute 2003)

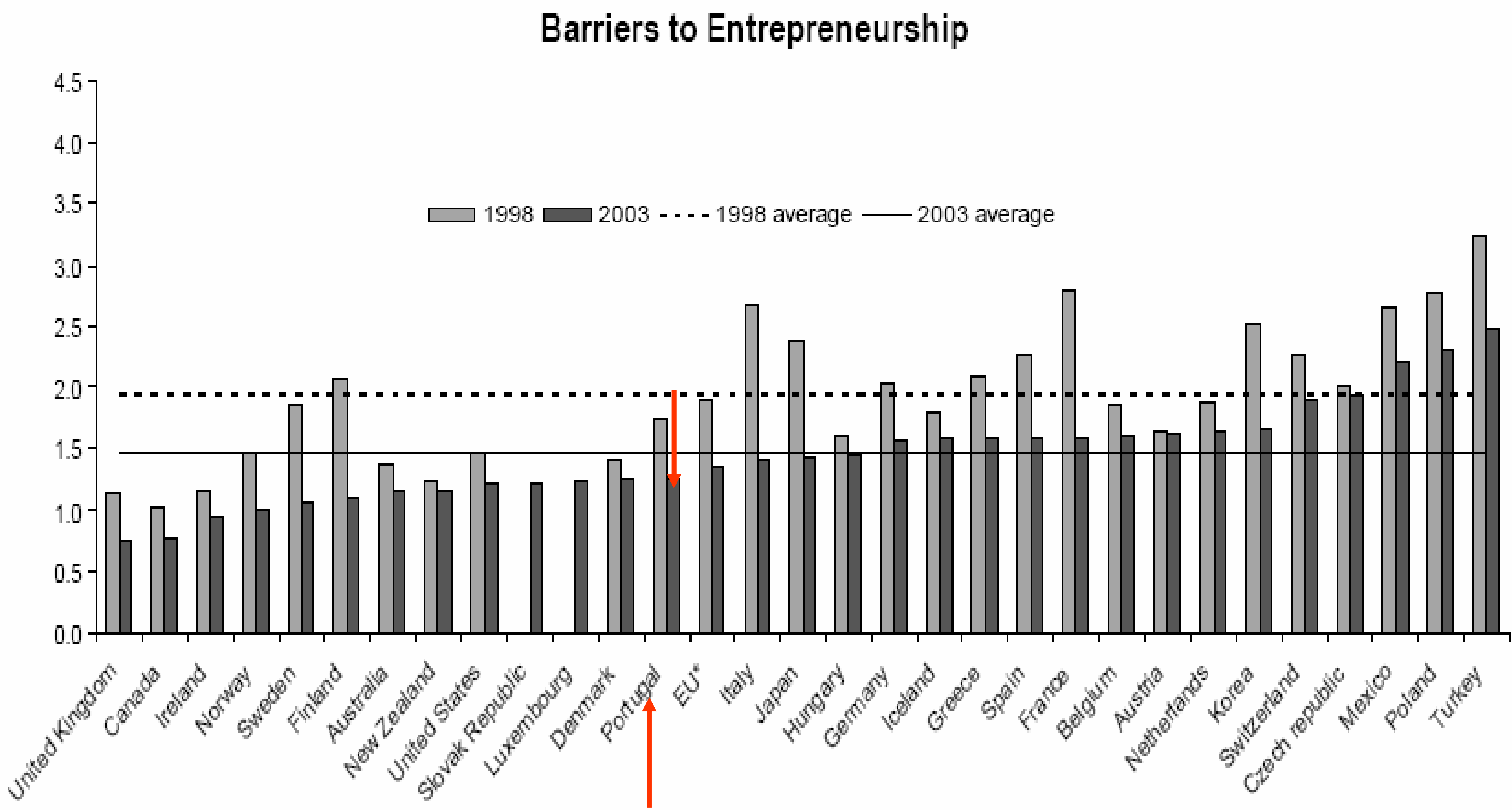


OECD Regulation Index (1998-2003)



Source:OECD «PRODUCT MARKET REGULATION IN OECD COUNTRIES: 1998 TO 2003»

OECD Regulation Index (1998-2003)



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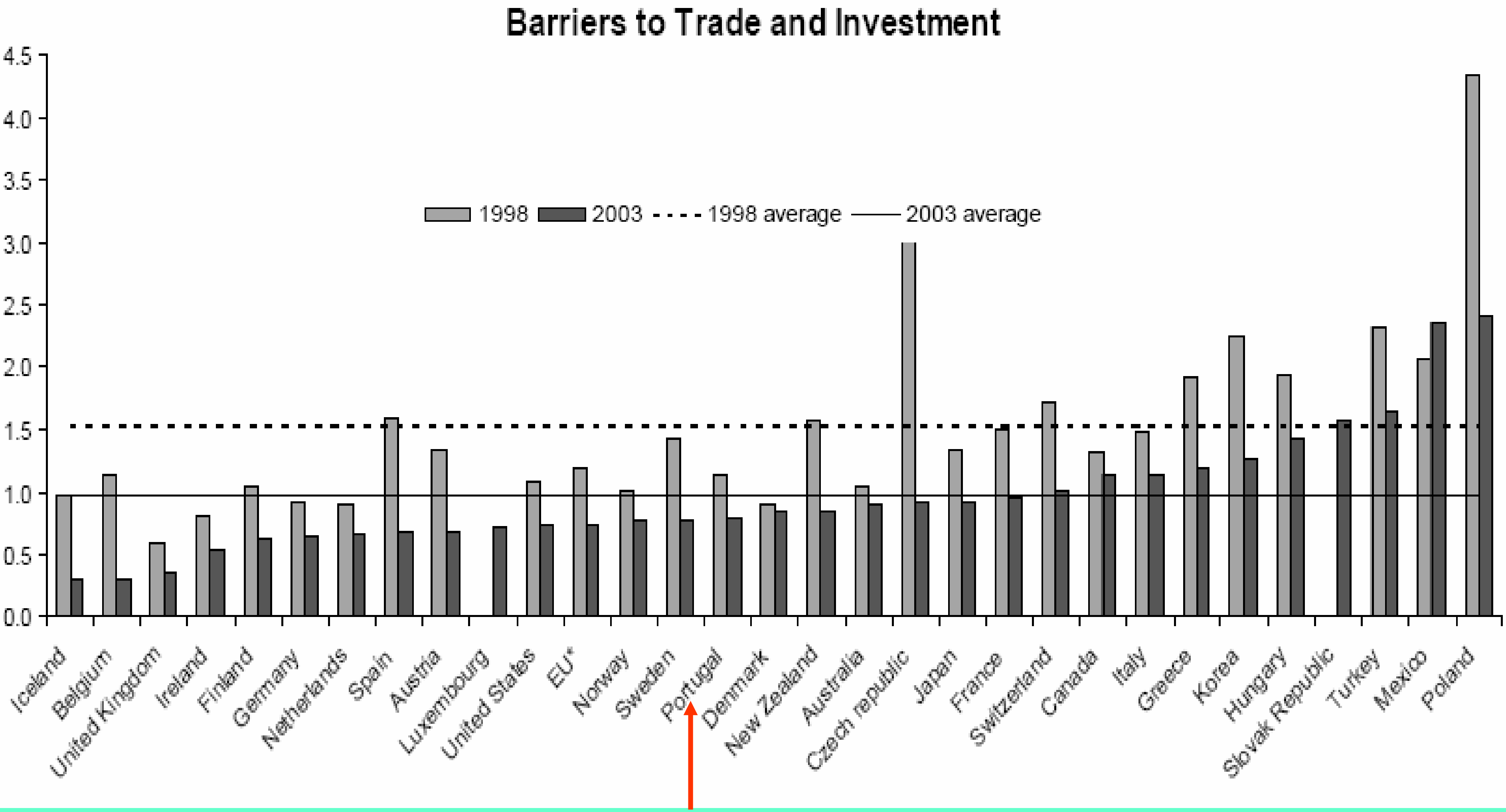
OECD Regulation Index (1998-2003)



Source:OECD «PRODUCT MARKET REGULATION IN OECD COUNTRIES: 1998 TO 2003»

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