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# The economy and the banking sector: recent developments



*Banco de Portugal*

**VÍTOR CONSTÂNCIO**

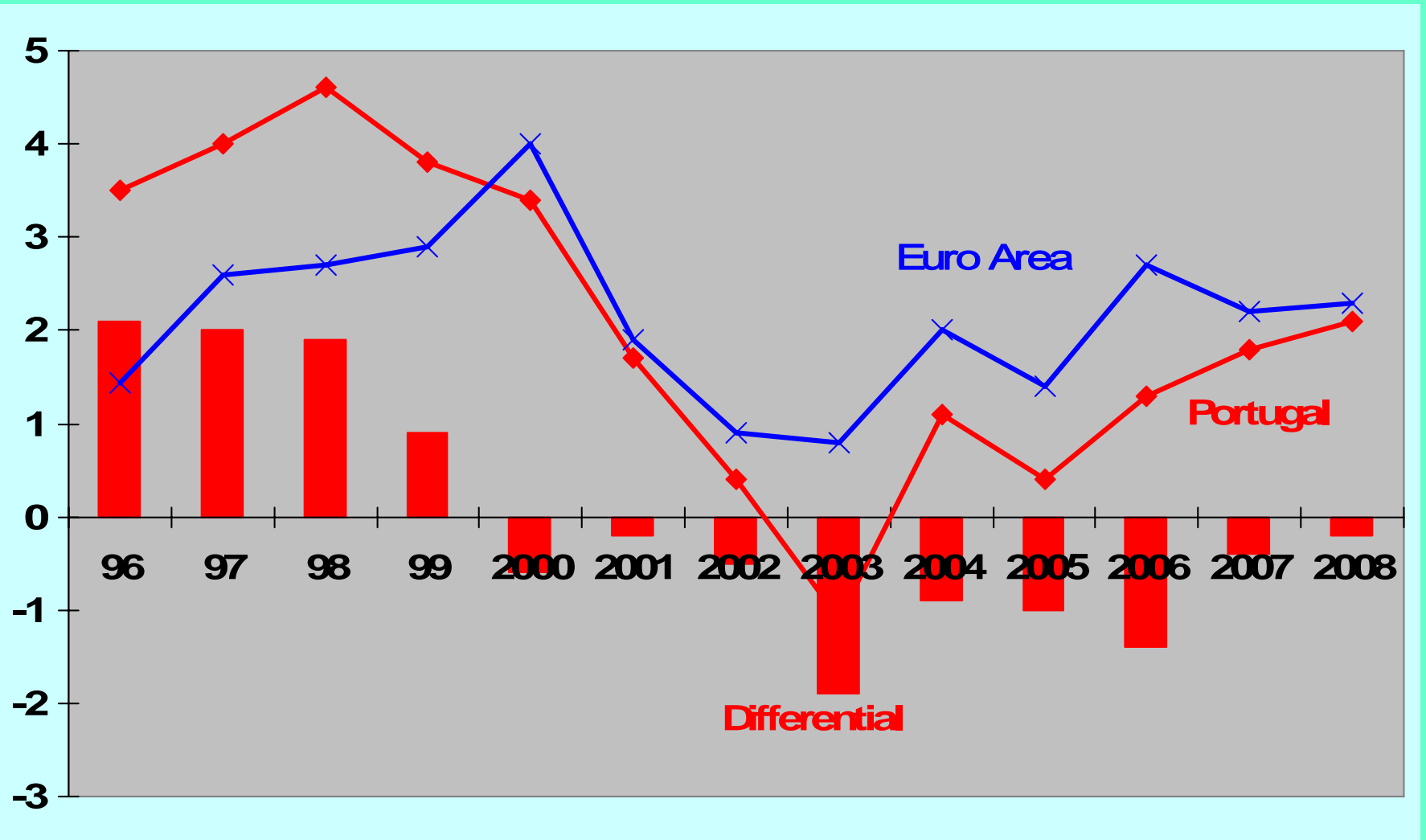
January 2007

- **Moderate but consistent economic recovery**
- **Consolidation of Public Finance**
- **Banking and Financial Stability**
- **Structural reforms and long term economic potential**

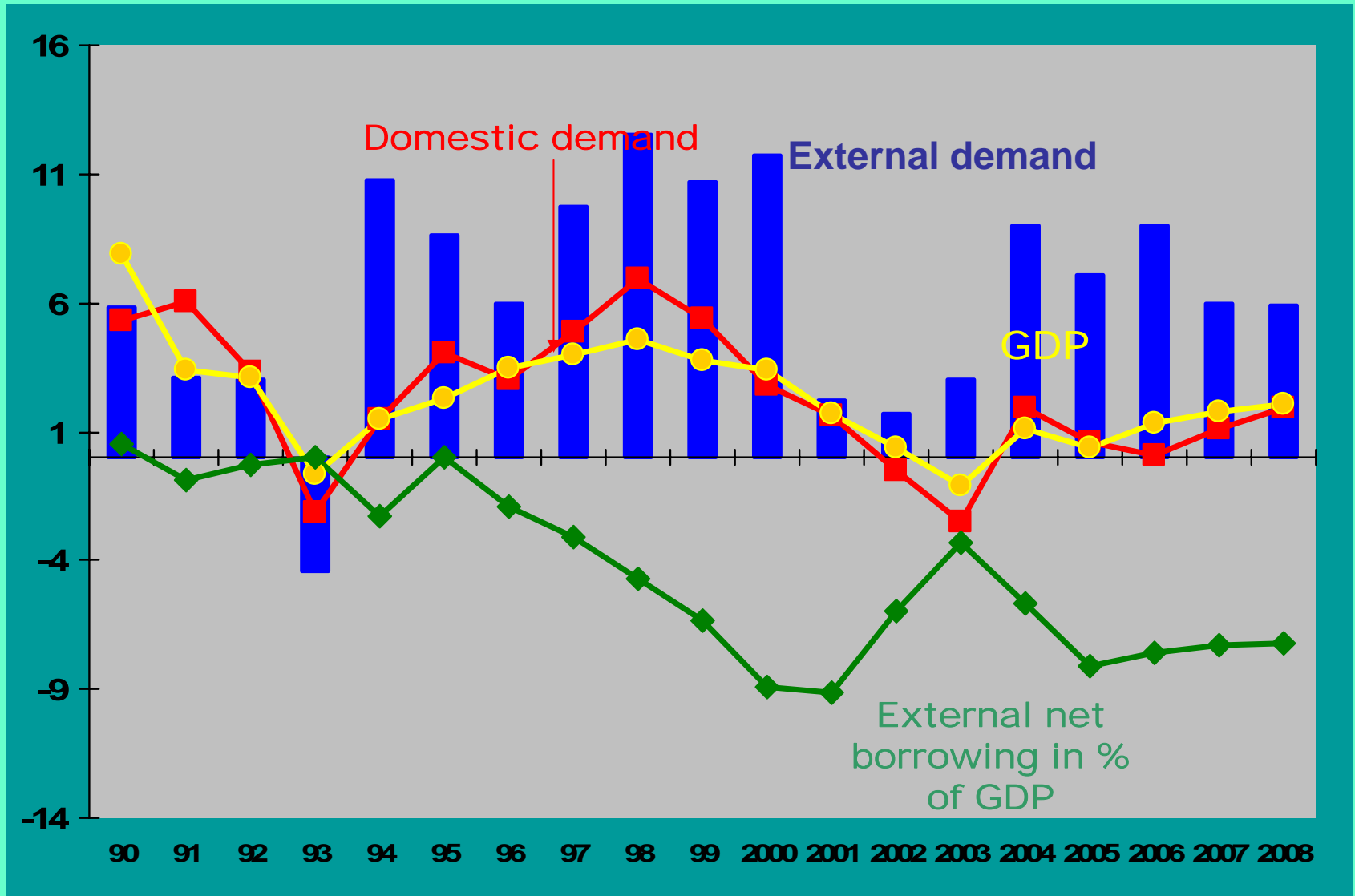
# Bank of Portugal's Economic Forecasts

Growth rates (%)	2005	2006(e)	2007	2008
<b>GDP</b>	<b>0.4</b>	<b>1.2</b>	<b>1.8</b>	<b>2.1</b>
<b>Private Consumption</b>	<b>1.7</b>	<b>1.2</b>	<b>1.5</b>	<b>1.7</b>
<b>Public Consumption</b>	<b>1.9</b>	<b>-0.2</b>	<b>0.0</b>	<b>0.3</b>
<b>Gross Fixed Investment</b>	<b>-2.6</b>	<b>-3.1</b>	<b>0.0</b>	<b>3.9</b>
<b>Domestic Demand</b>	<b>0.6</b>	<b>0.1</b>	<b>1.1</b>	<b>1.9</b>
<b>Exports of goods and services</b>	<b>1.0</b>	<b>9.3</b>	<b>6.2</b>	<b>6.1</b>
<b>Imports of goods and services</b>	<b>1.6</b>	<b>4.3</b>	<b>3.5</b>	<b>4.7</b>
<b>Inflation rate (HICP)</b>	<b>2.1</b>	<b>3.0</b>	<b>2.3</b>	<b>2.4</b>

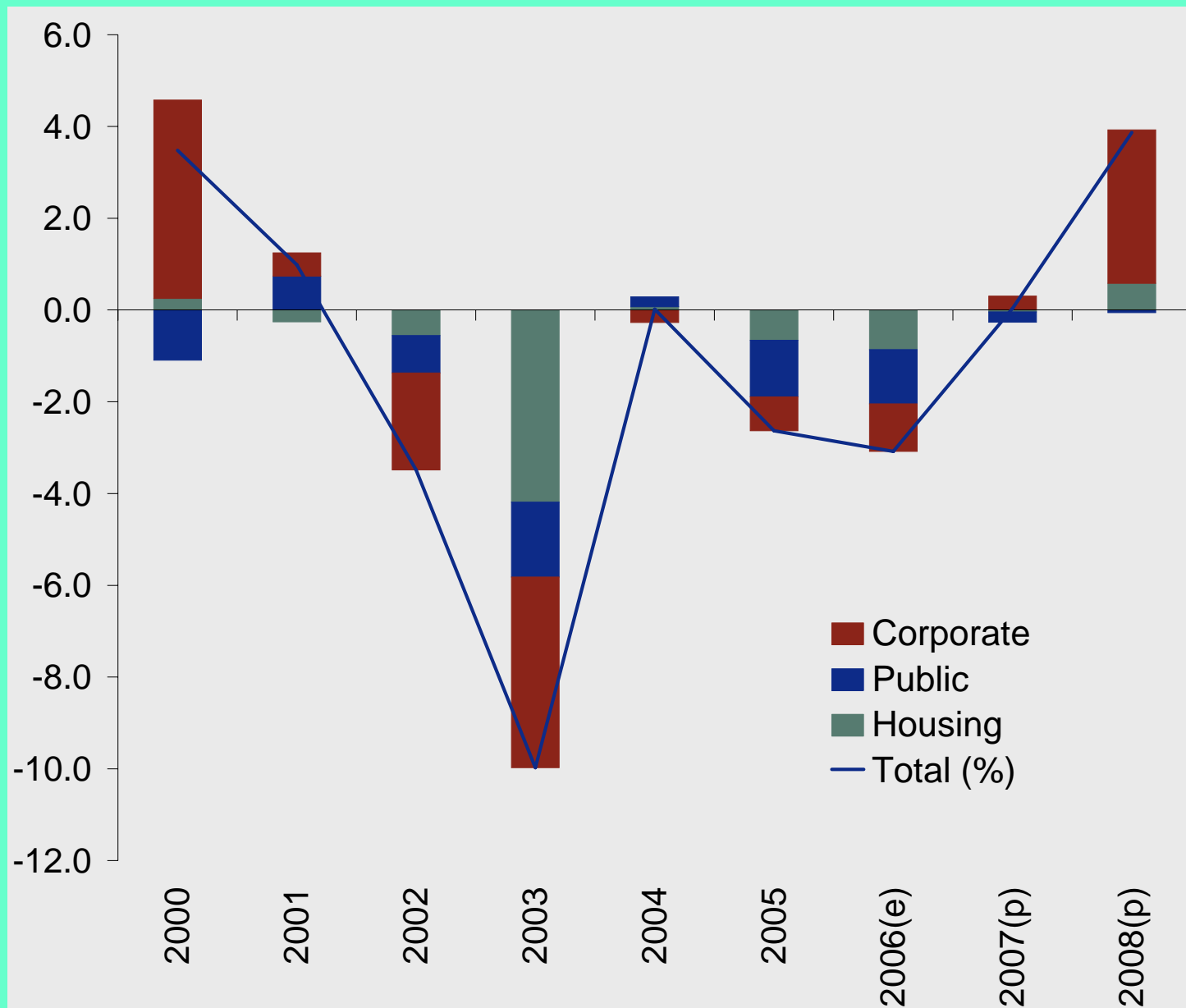
# GDP growth rates



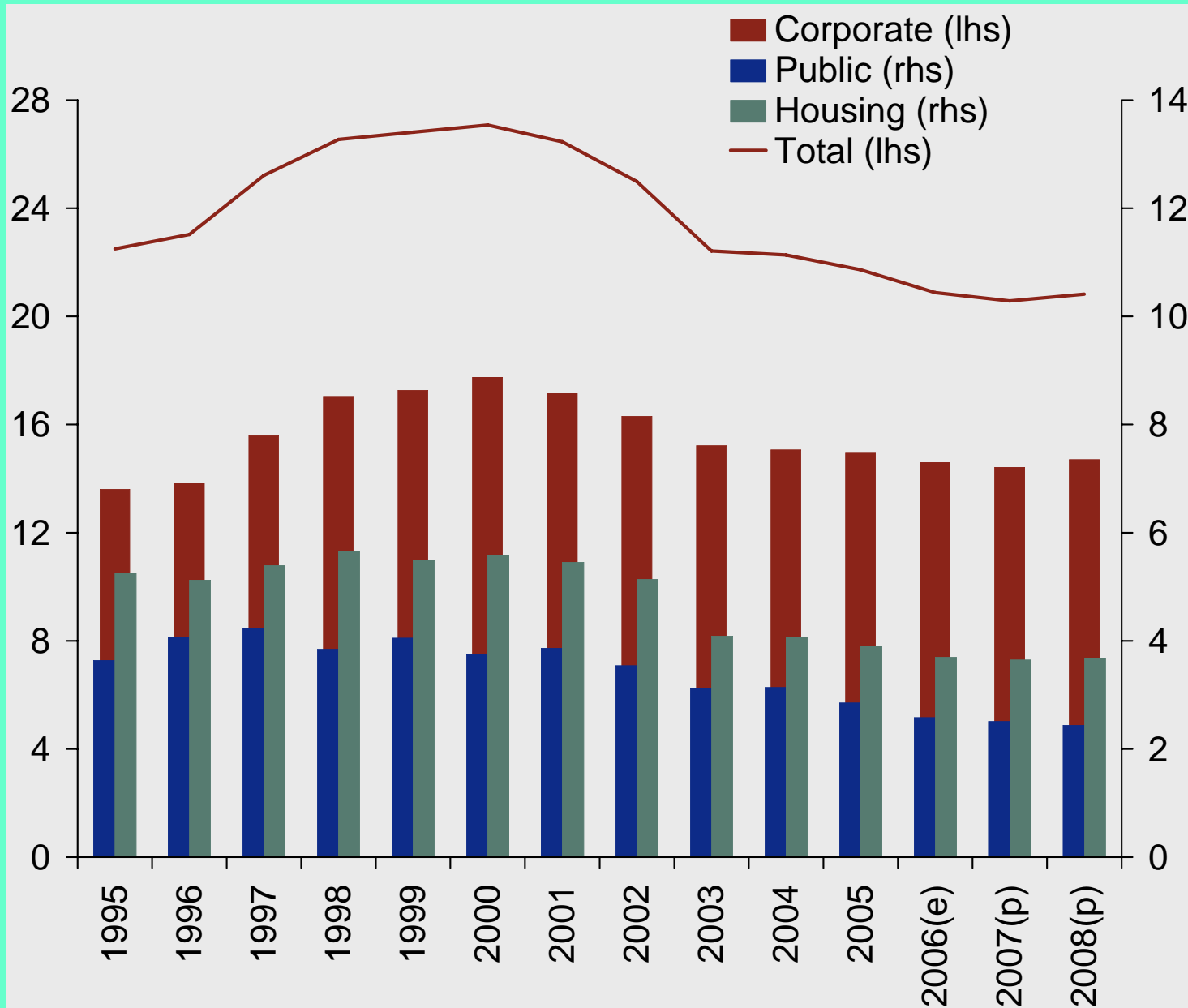
# Growth rates of GDP, Domestic Demand and External Demand



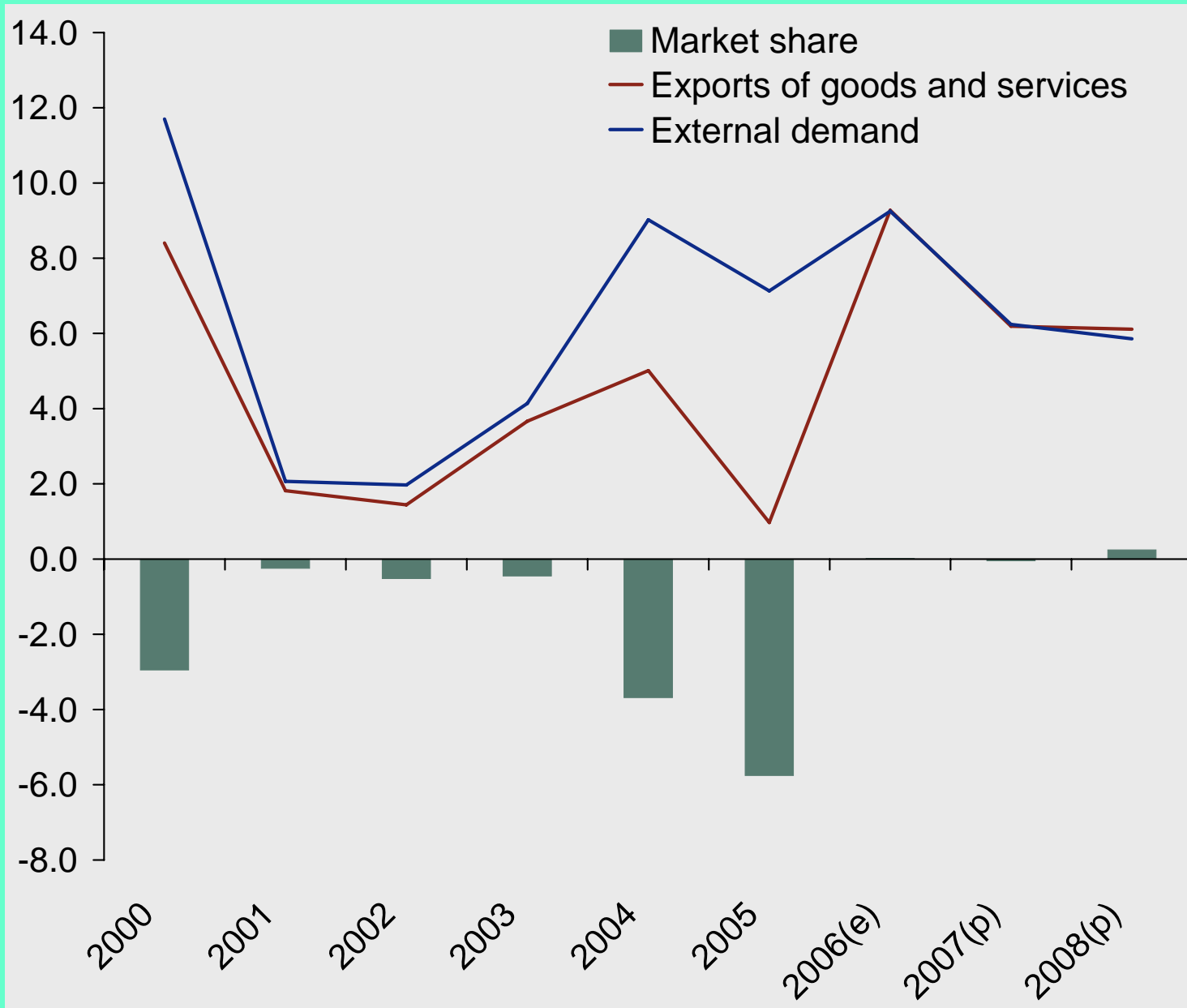
# INVESTMENT COMPONENTS: CONTRIBUTION TO GDP GROWTH (in p.p.)



# INVESTMENT BY SECTOR (in % of GDP)

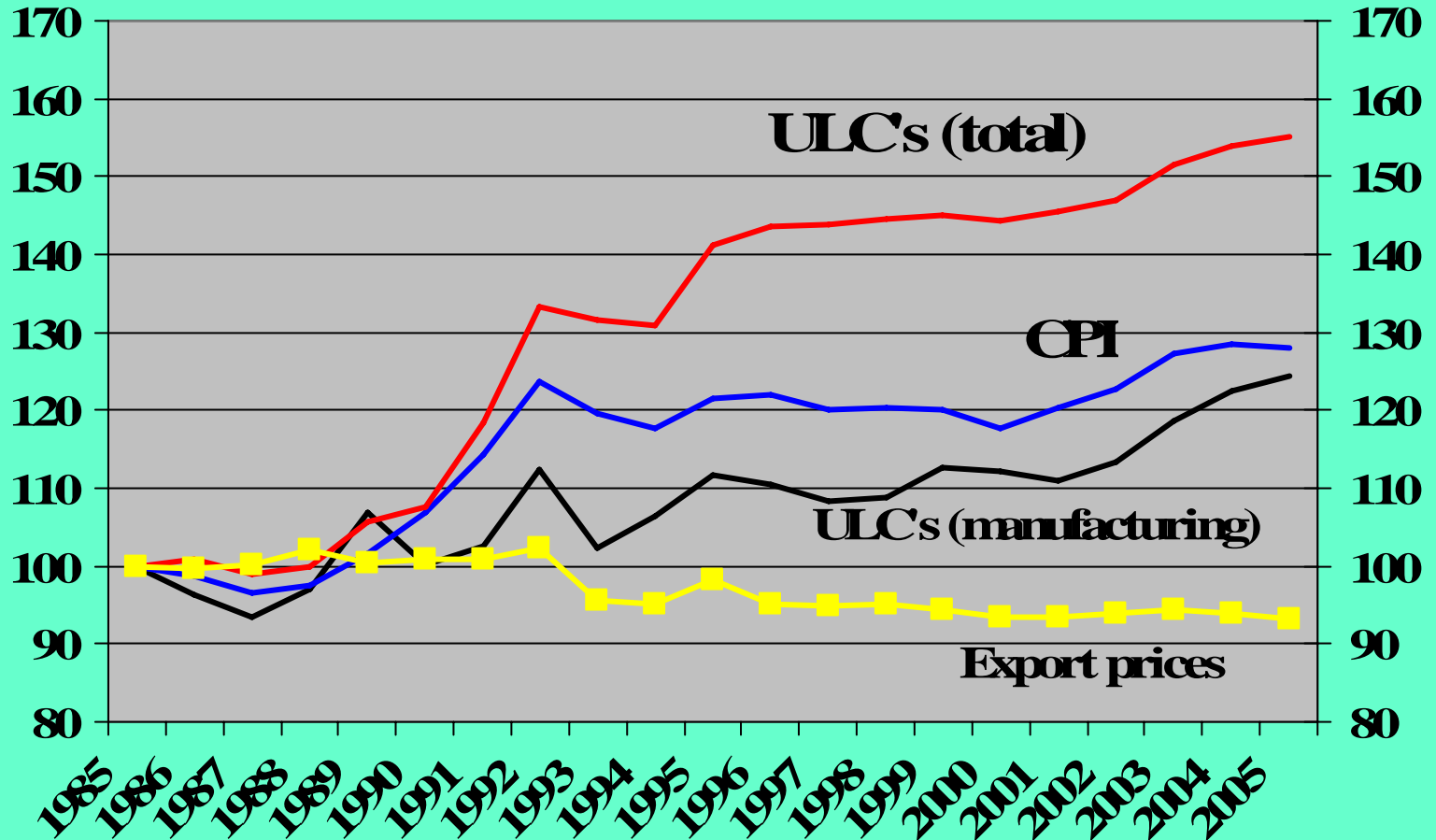


# EXPORTS AND EXTERNAL DEMAND





# Competitiveness: real exchange rates in terms of relative CPI, ULC's and relative export prices (a) (1985=100)



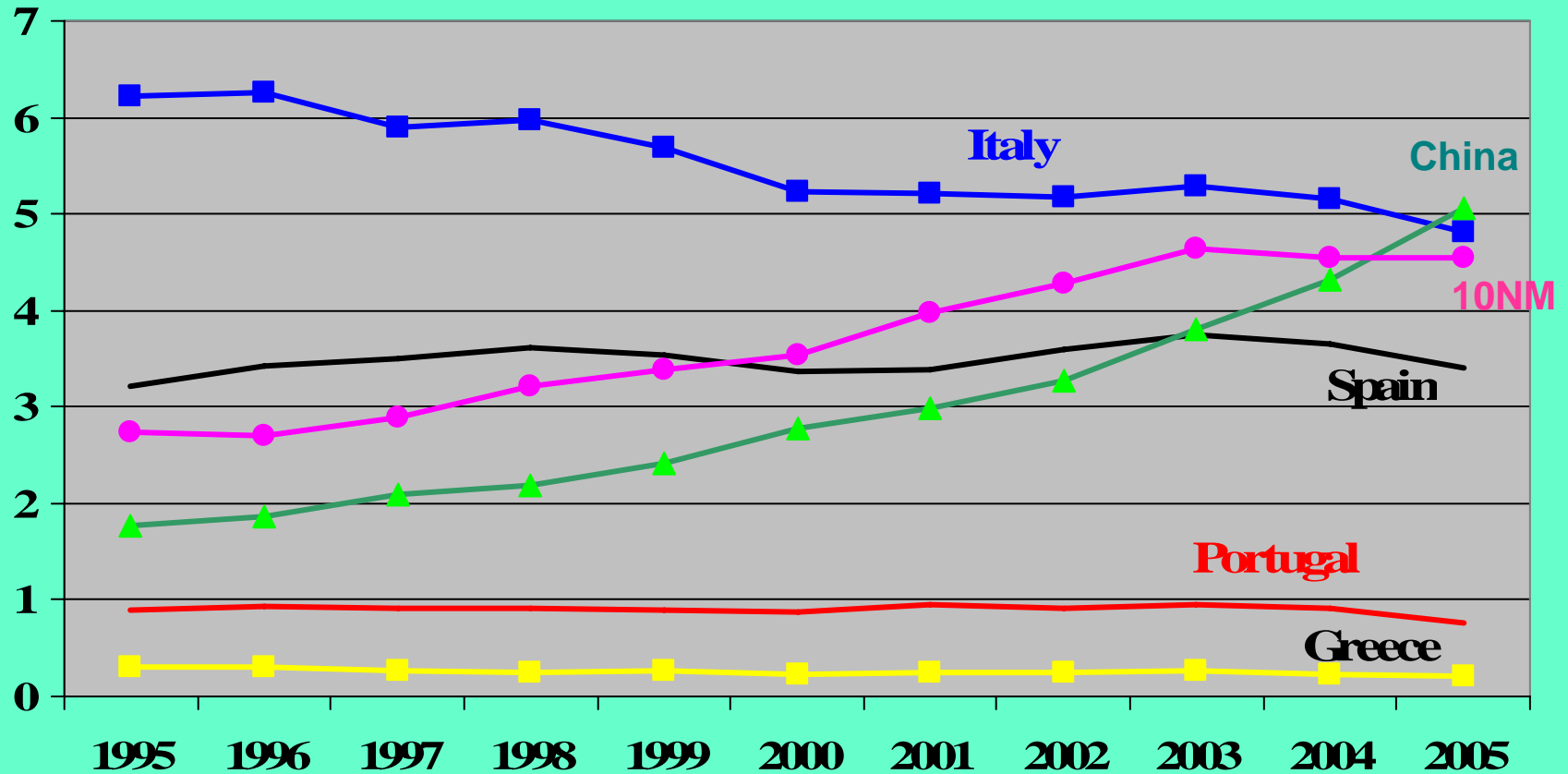
(Source: BP, AMECO and OECD)

(a): 13 countries until 1999 and 22 countries after 1999.

**Inflation and ULC's differentials in relation to the euro area  
(in %)**

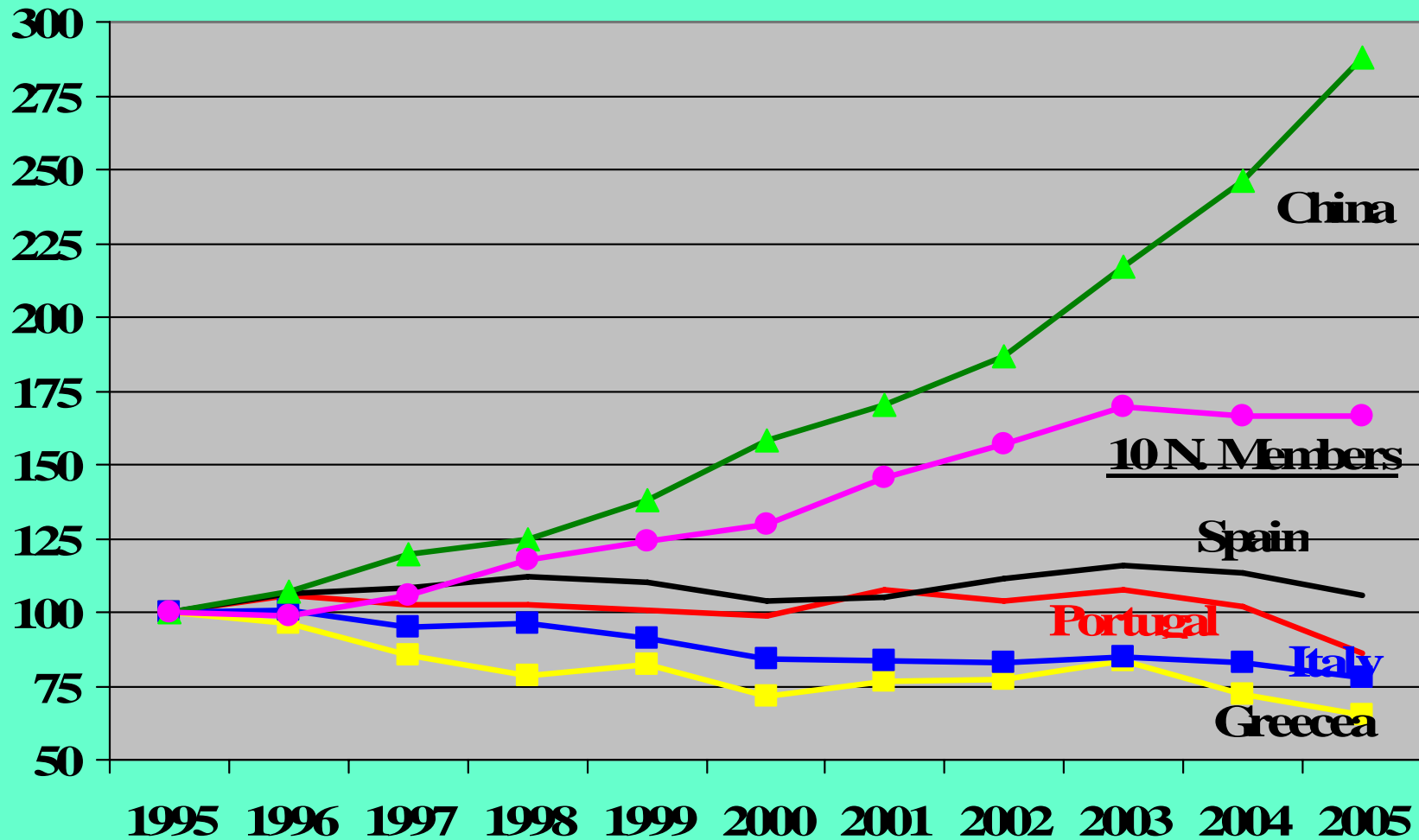
	<b>Average of 1999-2005</b>		<b>Cumulative</b>	
	<b>Inflation</b>	<b>ULC'S</b>	<b>Inflation</b>	<b>ULC'S</b>
<b>Portugal</b>	<b>1</b>	<b>2.1</b>	<b>6.2%</b>	<b>13.3%</b>
<b>Greece</b>	<b>1.2</b>	<b>1.3</b>	<b>7.4%</b>	<b>8.1%</b>
<b>Spain</b>	<b>1.1</b>	<b>1.5</b>	<b>6.8%</b>	<b>9.3%</b>
<b>Italy</b>	<b>0.3</b>	<b>1</b>	<b>1.8%</b>	<b>6.2%</b>
<b>Irleand</b>	<b>1.5</b>	<b>0.8</b>	<b>9.3%</b>	<b>4.9%</b>
<b>Belgium</b>	<b>-0.1</b>	<b>0</b>	<b>-0.6%</b>	<b>0.0%</b>
<b>Germany</b>	<b>-0.6</b>	<b>-1.1</b>	<b>-3.5%</b>	<b>-6.4%</b>
<b>France</b>	<b>-0.2</b>	<b>-0.2</b>	<b>-1.2%</b>	<b>-1.2%</b>
<b>Austria</b>	<b>-0.3</b>	<b>-0.8</b>	<b>-1.8%</b>	<b>-4.7%</b>
<b>Finland</b>	<b>-0.4</b>	<b>-0.2</b>	<b>-2.4%</b>	<b>-1.2%</b>

# Export quotas in U.E.-15 (in %)



(Source: BP based on Eurostat Comext)

# Export quotas in U.E.-15 (Index 1995=100)



(Source: BP based on Eurostat Comext)

# Structure of Exports

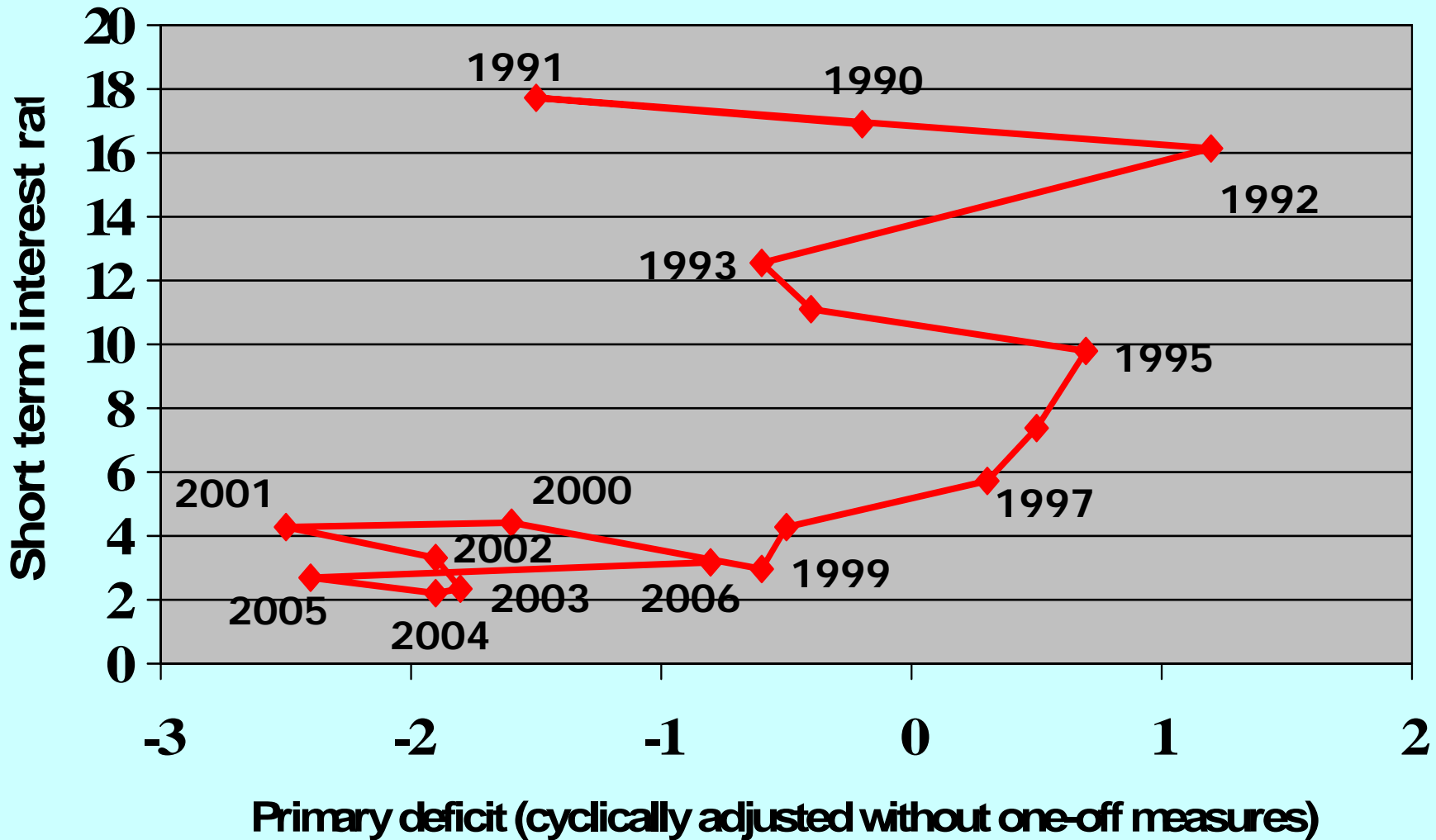
	1986-1989	2005	Variação
Food, wood products, cork, paper, leather, textiles , clothing, footwear	61,1 %	35,0%	-26,1 p,p
Machinery, optical & precision, transport equipment, rubber products, chemical, energy, plastics	28,0 %	48,4%	+20,4 p,p
Other	10,9 %	16,6%	+5,7 p,p

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# Public Administration Accounts

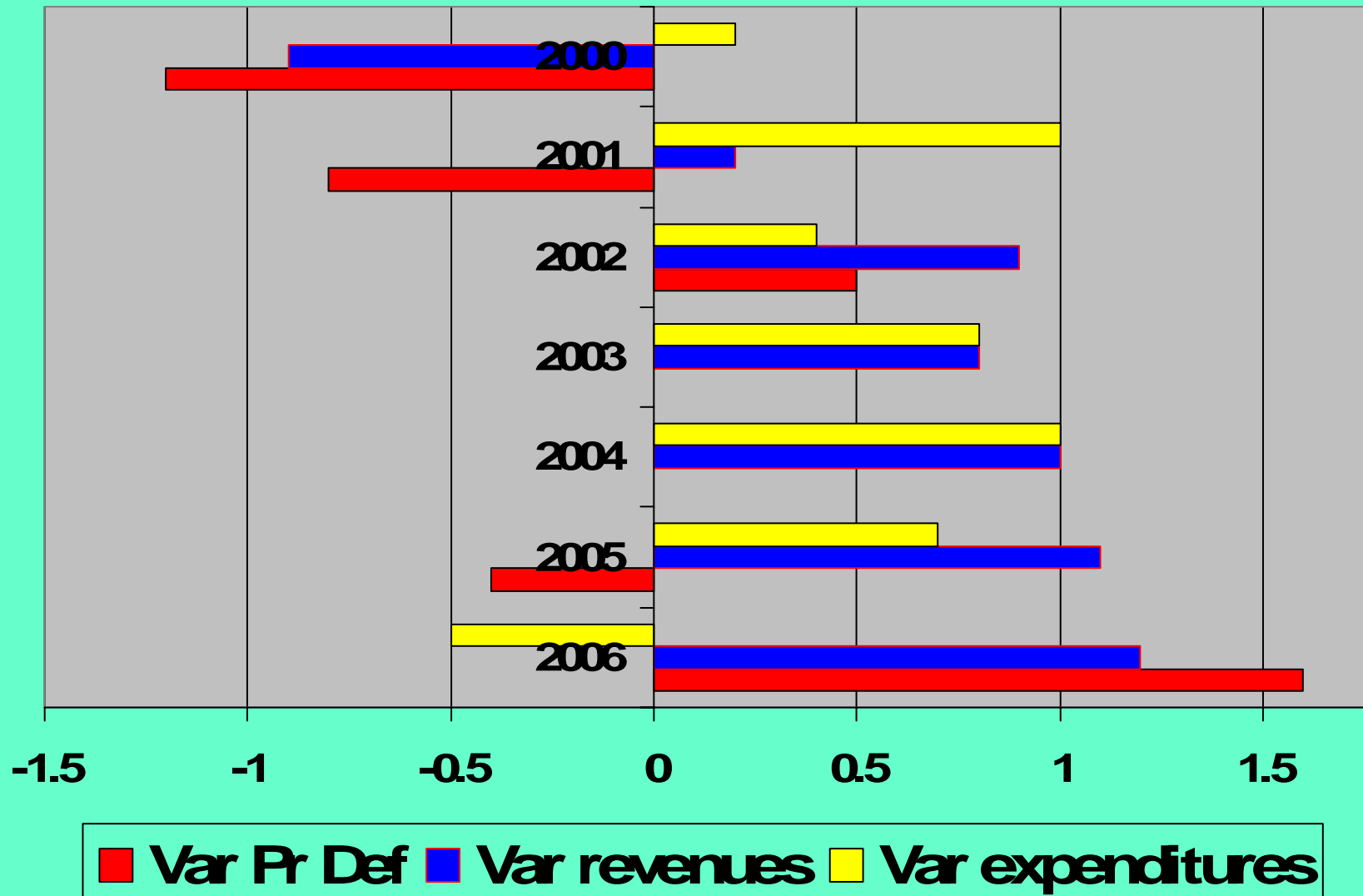
	In % of GDP		Annual growth rates
	1995	2005	1995-2005
<b>Total Revenues</b>	<b>39.6</b>	<b>41.9</b>	<b>6.6</b>
<b>Tax receipts</b>	<b>33.5</b>	<b>36.4</b>	<b>7.1</b>
<b>Total Expenditure</b>	<b>45</b>	<b>47,9</b>	<b>6.7</b>
<b>Current expenditures</b>	<b>33.5</b>	<b>43,4</b>	<b>7.1</b>
<b>Current transfers</b>	<b>16.2</b>	<b>22.1</b>	<b>9.5</b>
<b>of which: to households</b>	<b>13.2</b>	<b>18.0</b>	<b>9.4</b>
<b>to firms</b>	<b>1.3</b>	<b>1.6</b>	<b>7.1</b>
<b>Staff expenditures</b>	<b>13.6</b>	<b>14.6</b>	<b>7.0</b>
<b>Intermediate consumption</b>	<b>3.7</b>	<b>4.0</b>	<b>5.7</b>
<b>Interest payments</b>	<b>6.3</b>	<b>2.7</b>	<b>-2.1</b>
<b>Capital expenditures</b>	<b>5.3</b>	<b>4.5</b>	<b>4.3</b>
<b>BUDGET DEFICIT</b>	<b>-5.5</b>	<b>-6.0</b>	
<b>GDP</b>	<b>100</b>	<b>100</b>	<b>5.6</b>

# Macroeconomic policy





# Variation of primary deficits, revenues and expenditures, cyclically adjusted and without one-off measures



- Moderate but consistent economic recovery
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# **IMF Financial System Stability Assessment**

**«Overall, Portugal's financial system is sound, well managed and competitive, with shorter-term risks and vulnerabilities quite well contained for now, and with the system buttressed by a strong financial policy framework. Despite being relatively small and concentrated, Portugal's banking system generally compares well with other European Union (EU) countries in terms of efficiency, profitability, and asset quality, with solvency also close to European levels.»**

**.....**

**«Regulation and supervision**

**Supervision of financial institutions is active, professional, well organized, and highly compliant with international standards.»**

# Compliance with Basel Core Principles for Effective Banking Supervision

	<b>Portugal</b>	<b>UK</b>	<b>Italy</b>	<b>Holland</b>	<b>France</b>	<b>Spain</b>
	September 2006	July 2003	May 2004	September 2004	June 2005	June 2006
<b>Compliant</b>	<b>28</b>	<b>26</b>	<b>24</b>	<b>24</b>	<b>29</b>	<b>26</b>
<b>Largely Compliant</b>	<b>2</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>1</b>	<b>4</b>
<b>Materially NonCompliant</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Non Compliant</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>

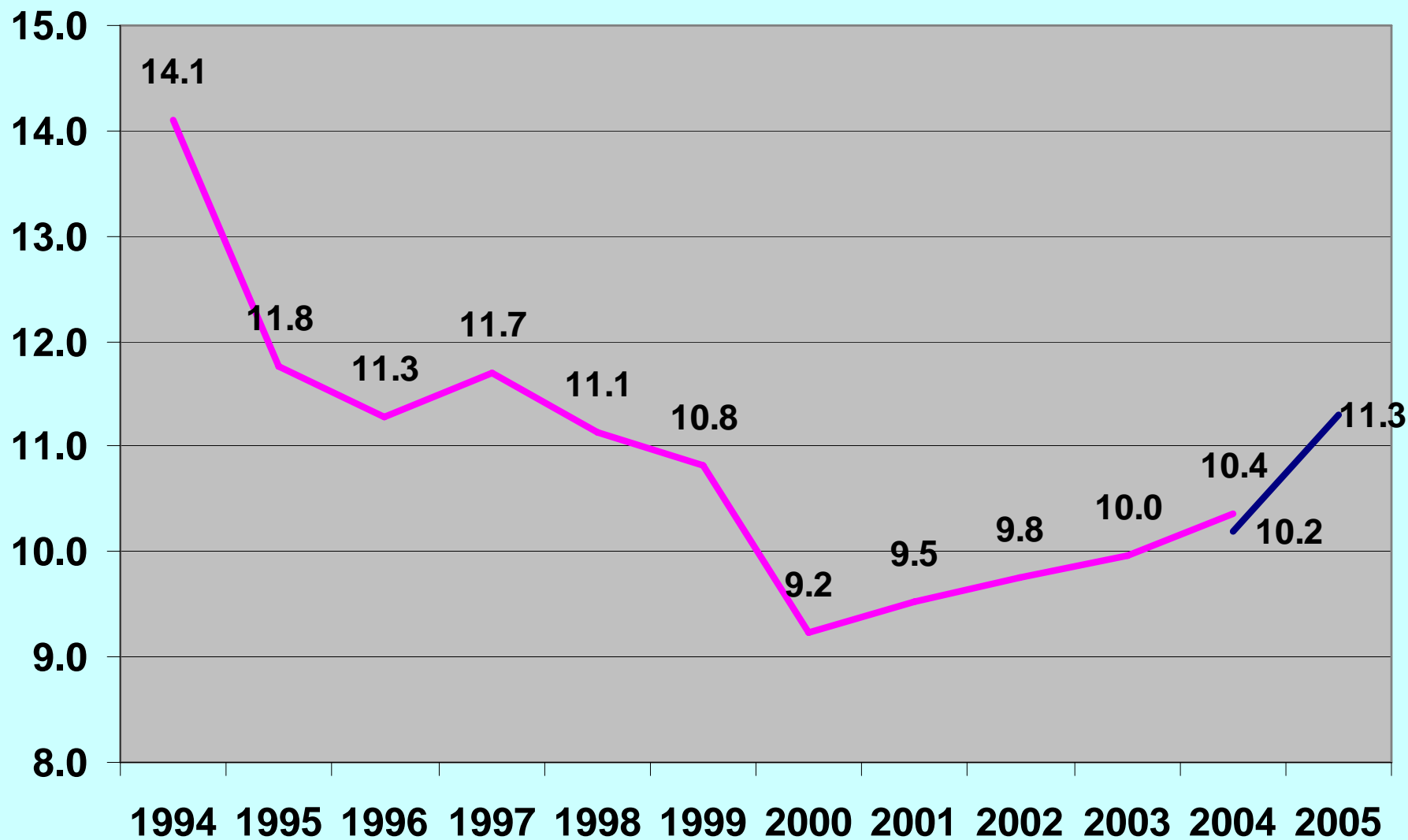
Source: IMF several Financial System Stability Assessment Reports

## Banking Sector Indicators

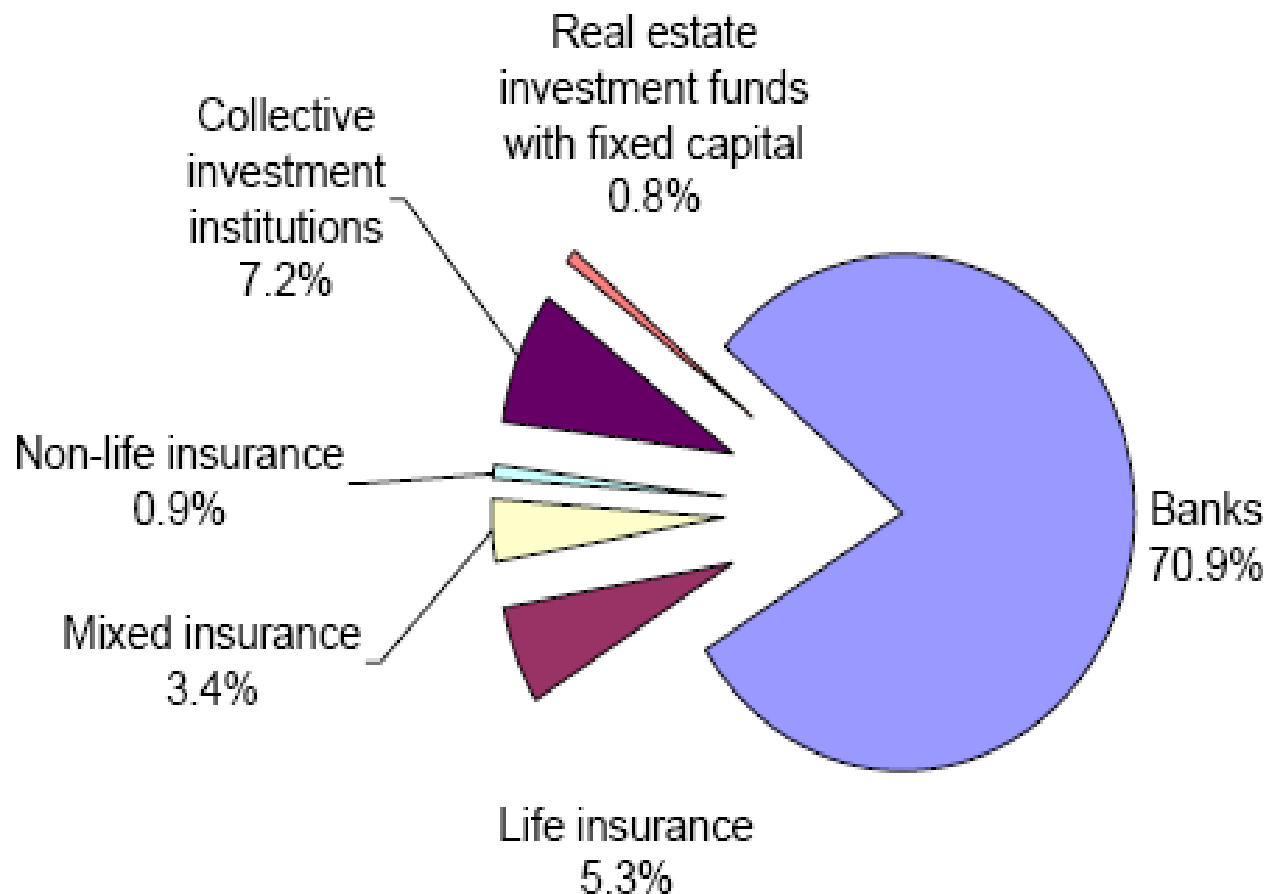
	2004	2005
<b>Capital Adequacy Ratio</b>	<b>10.2%</b>	<b>11,3%</b>
Tier 1 Capital	7.0%	7.1%
Liquid Assets to short term liabilities – total system	109.1%	99%
Liquid Assets to short term liabilities – Domestic Banks	127.3 %	126.5%
NPLs to gross loans (% do total)	1.6 %	1.5%
Net Interest Margin (% of Assets)	2.1%	2.2%
Return on Assets (ROA)	0.6%	1.0%
<b>Return on Equity (ROE)</b>	<b>12.5%</b>	<b>16.9%</b>

Source: IMF «Portugal: Financial System Stability Assessment », September 2006

## Capital Adequacy ratio (%)



## Portuguese Financial Sector; 2004 (Percentage share in total financial sector assets)



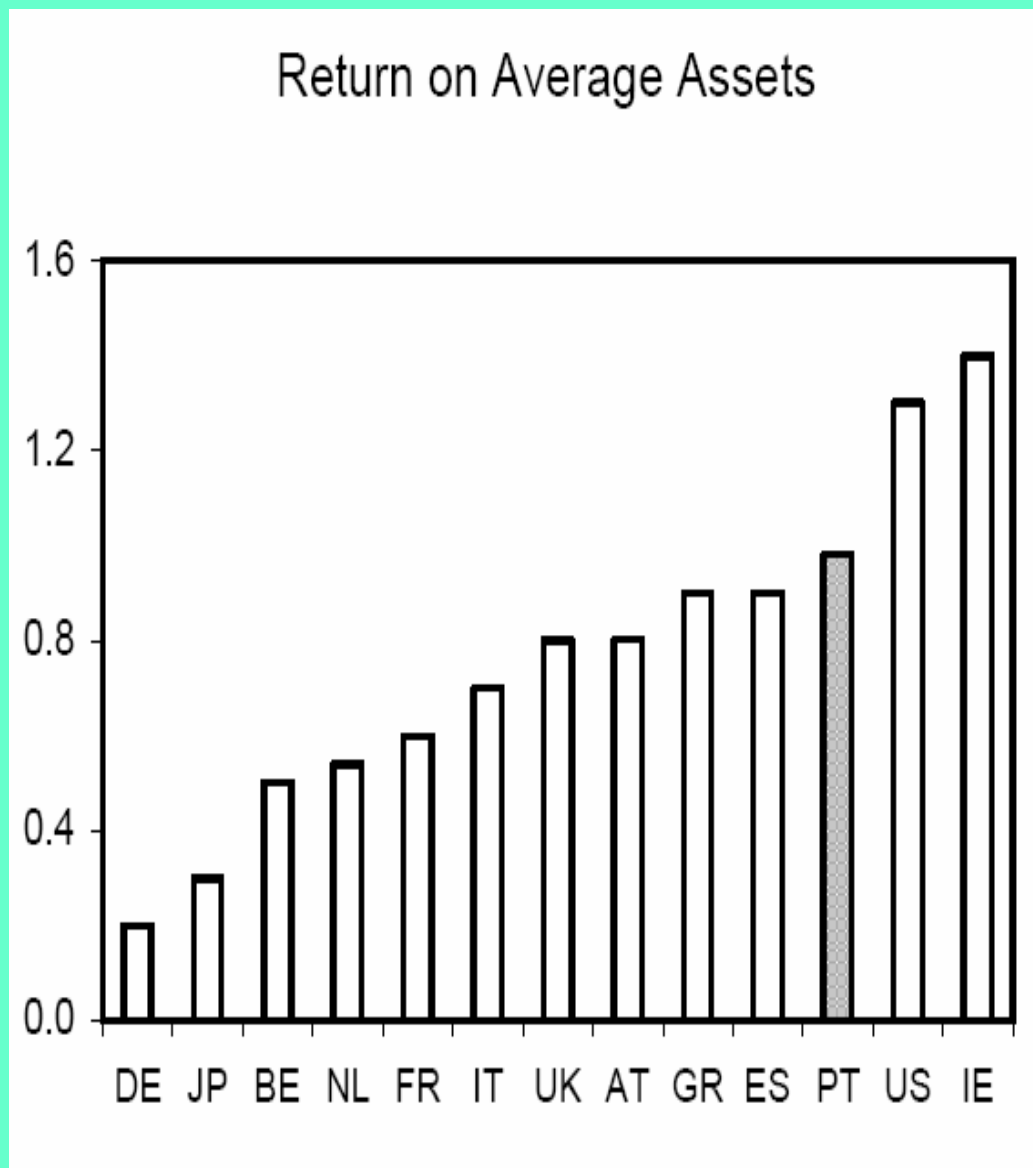
## Financial Intermediation in Portugal and Euro Area

	Euro area		Portugal	
	2001	2004	2001	2004
	<i>(in percent of GDP)</i>			
Bank credit to non-monetary private sect	113	116	132	136
Domestic debt securities 1/	38	39	25	28
Stock market capitalization	70	72	42	44
Total	221	226	199	208
<b>Memorandum items:</b>				
Total bank assets	251	263	215	221
Bank deposits	94	96	116	115

1/ Excluding government.

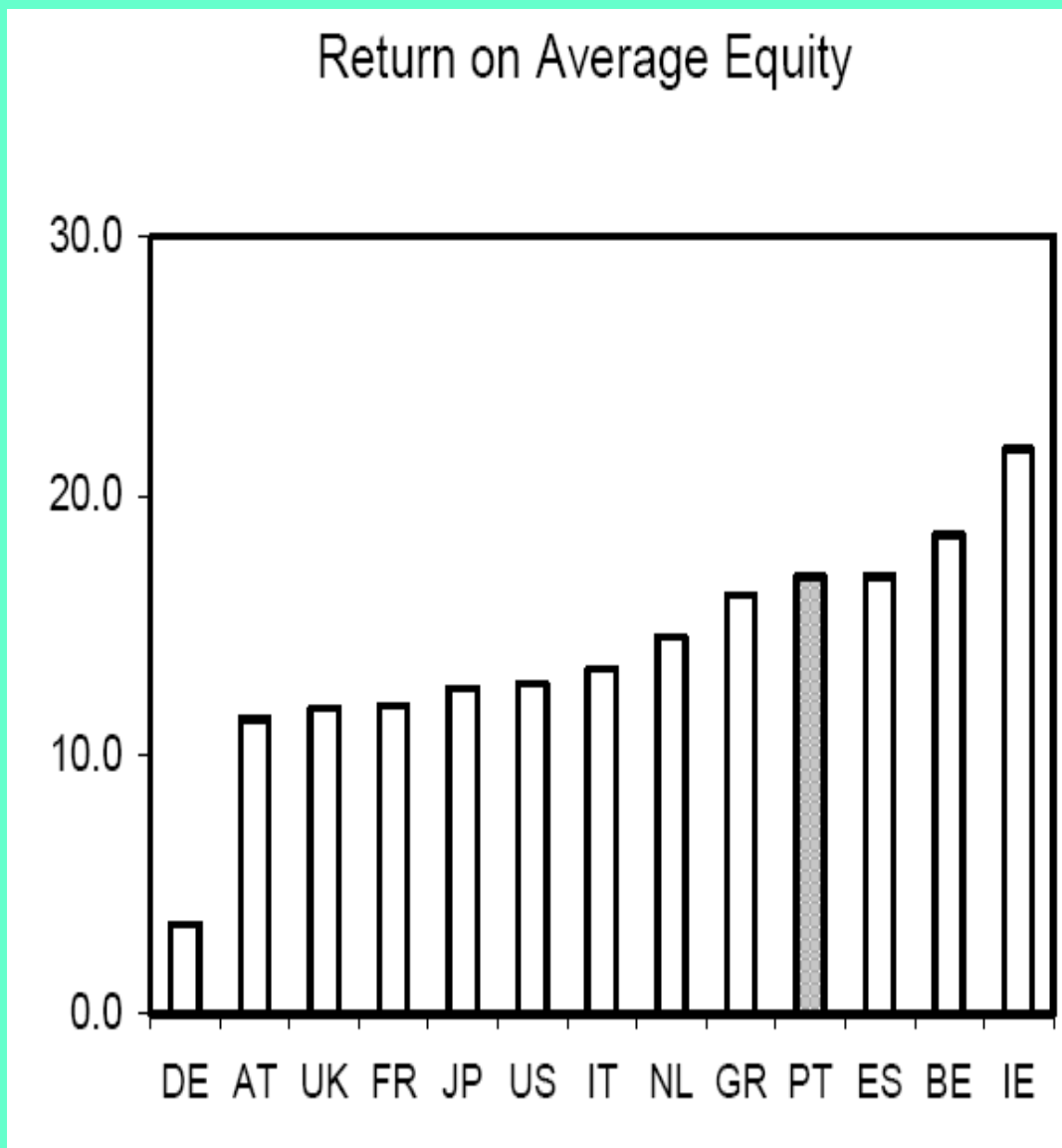


# Portugal: Banking System Indicators, 2005



Source: IMF «Portugal: Financial System Stability Assessment », September 2006

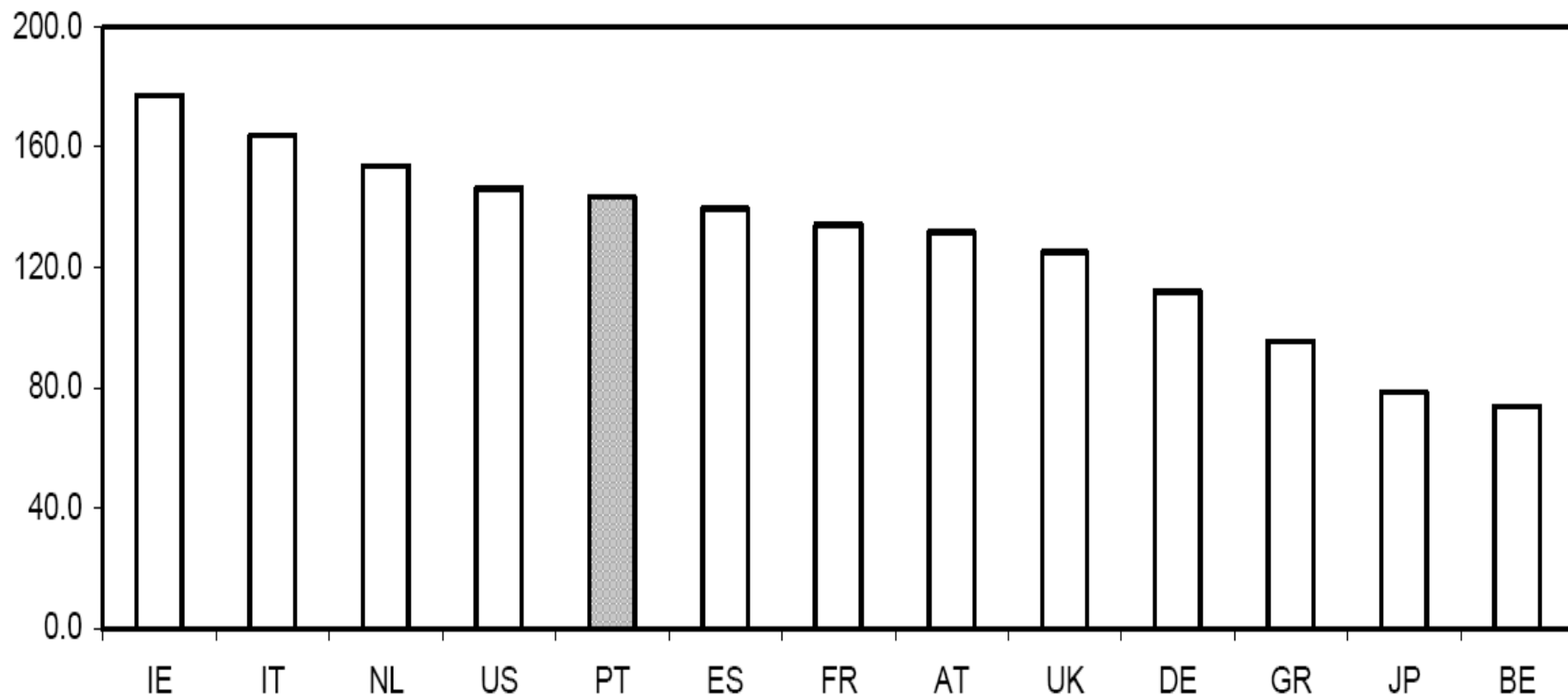
# Portugal: Banking System Indicators, 2005



Source: IMF «Portugal: Financial System Stability Assessment », September 2006

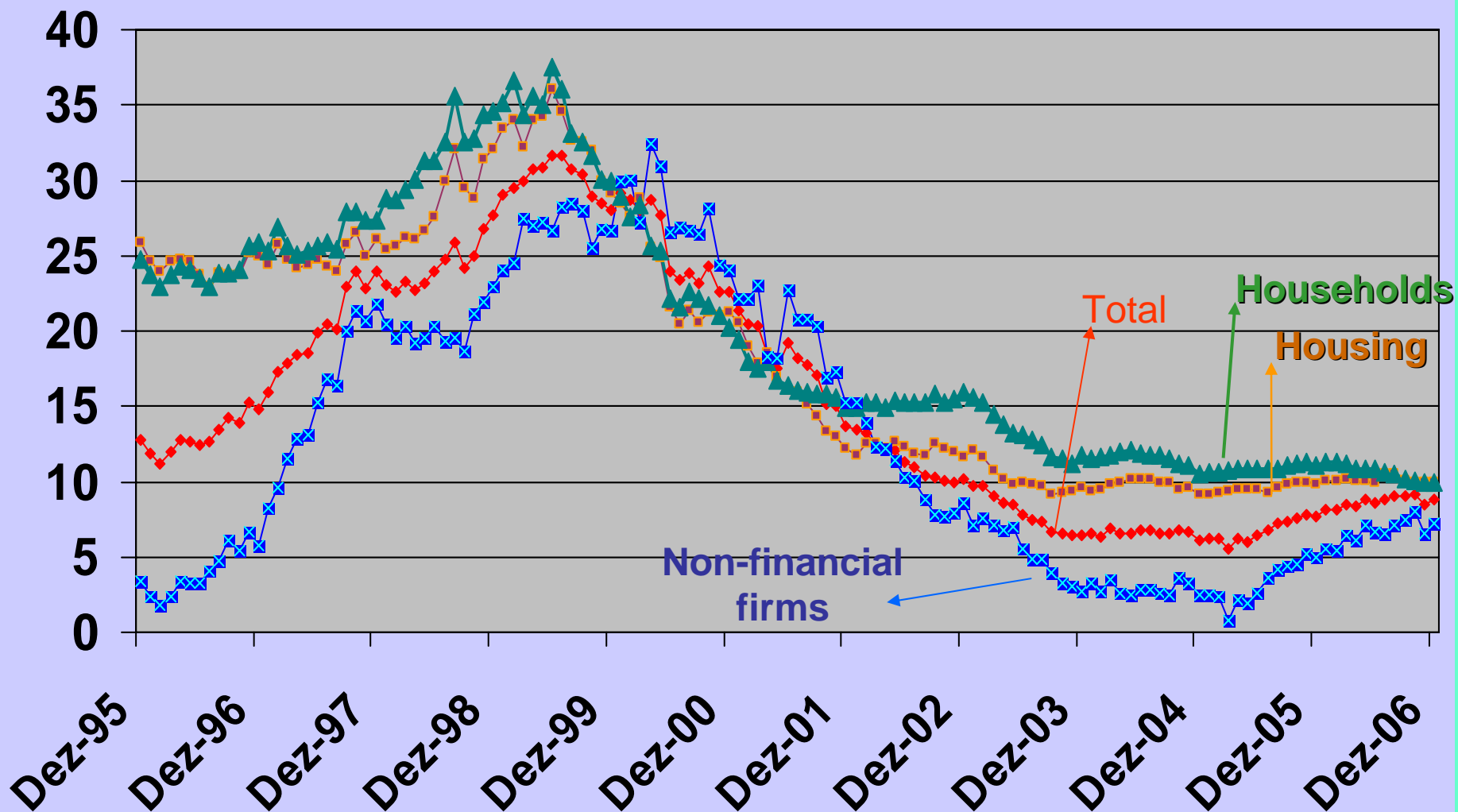
# Portugal: Banking System Indicators, 2005

Private Credit to Deposit Ratio

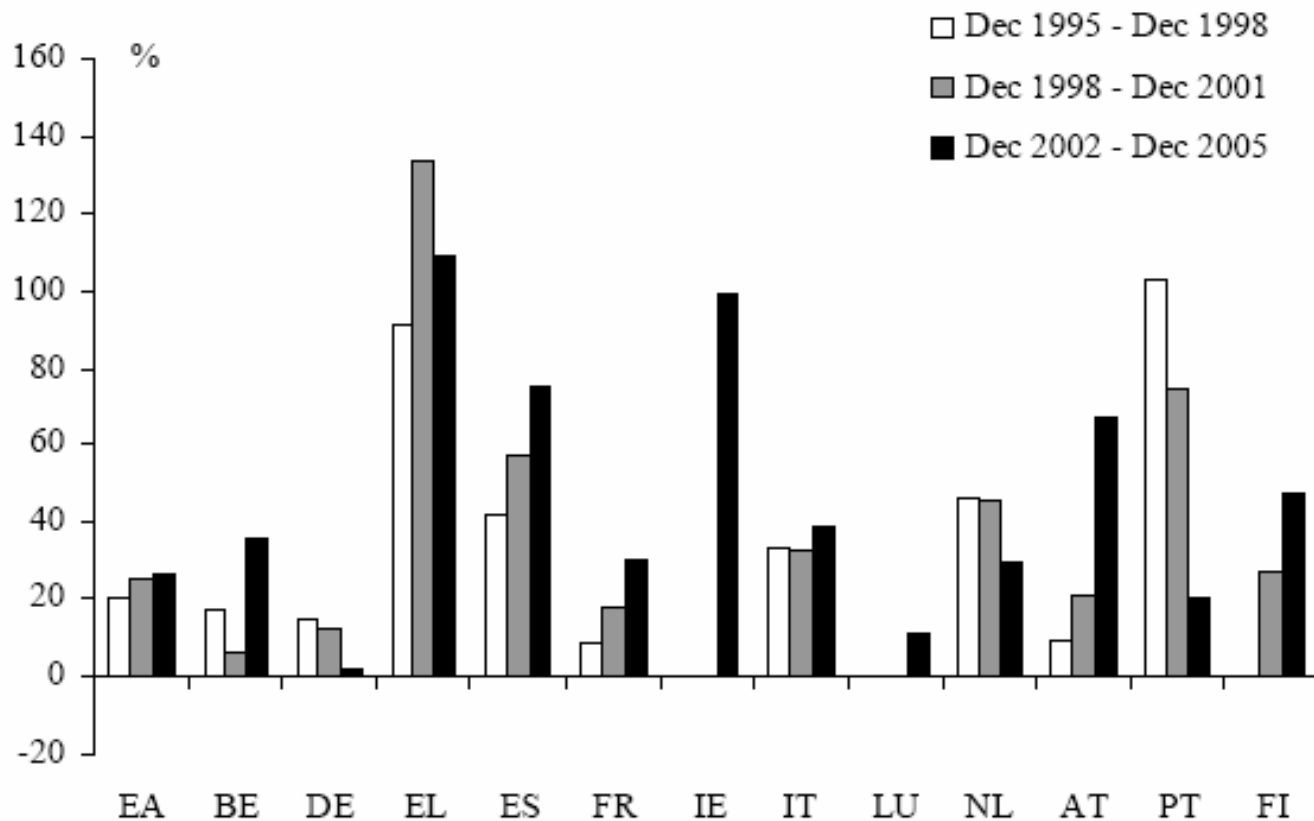


Source: IMF «Portugal: Financial System Stability Assessment », September 2006

# CREDIT GROWTH (annual rates in %)

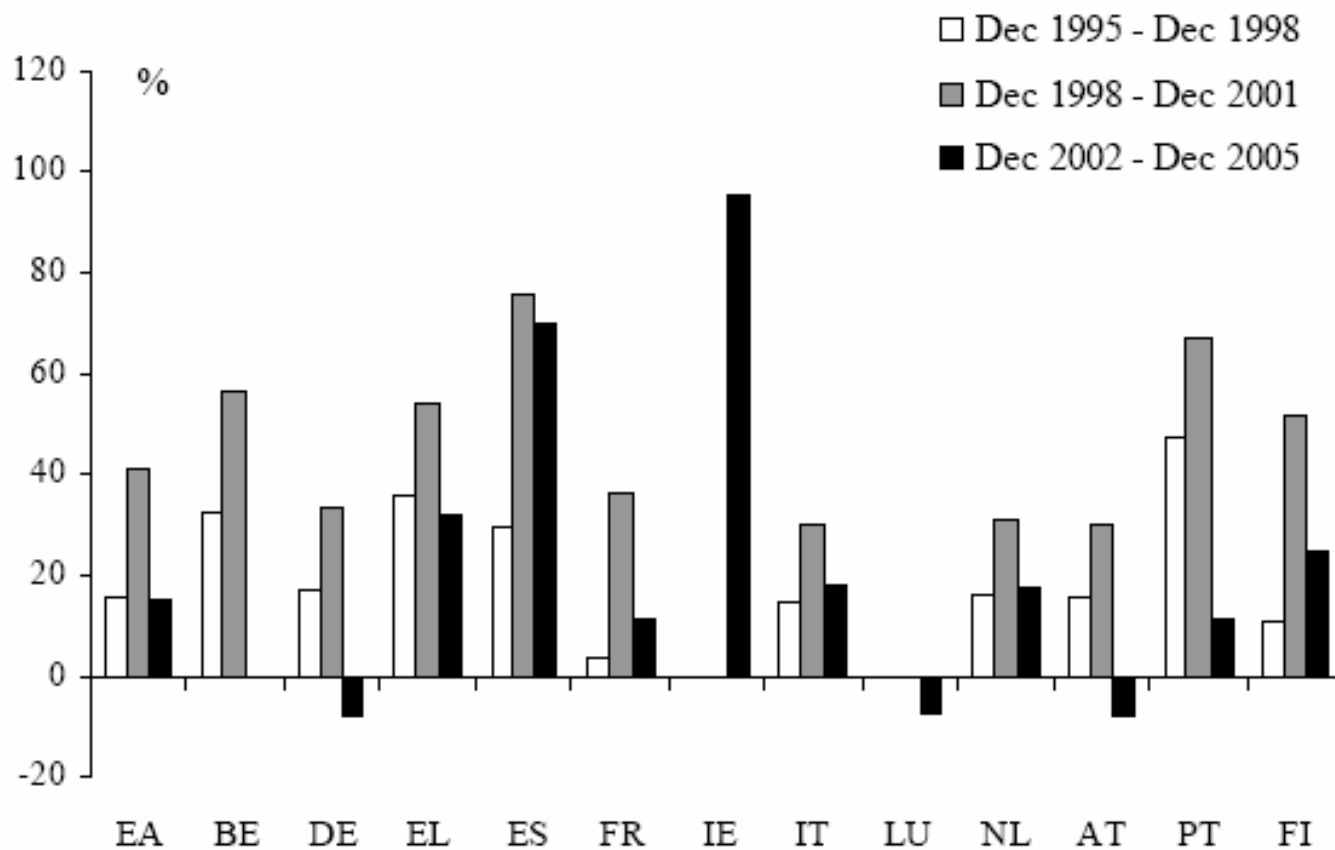


**Graph 2.4.4: Growth rates of nominal credit to the household sector in the euro area, 1995-1998, 1998-2001 and 2001-2005**



Source: European Commission (2006) "The EU economy 2006 review: Adjustment dynamics in the euro area"

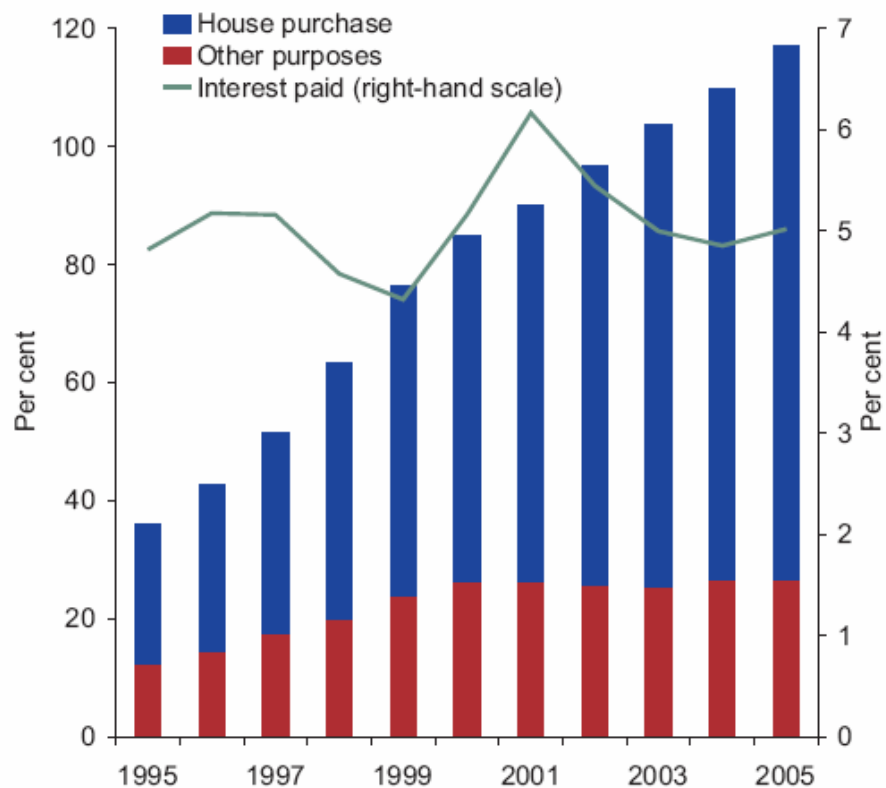
# Graph 2.4.7: Growth rates of nominal credit to the corporate sector in the euro area



Source: European Commission (2006) "The EU economy 2006 review: Adjustment dynamics in the euro area"

## HOUSEHOLD INDEBTEDNESS AND INTEREST PAID

As a percentage of disposable income



Sources: INE and Banco de Portugal.

## HOUSEHOLD INDEBTEDNESS IN EURO AREA COUNTRIES<sup>(a)</sup>

As a percentage of GDP

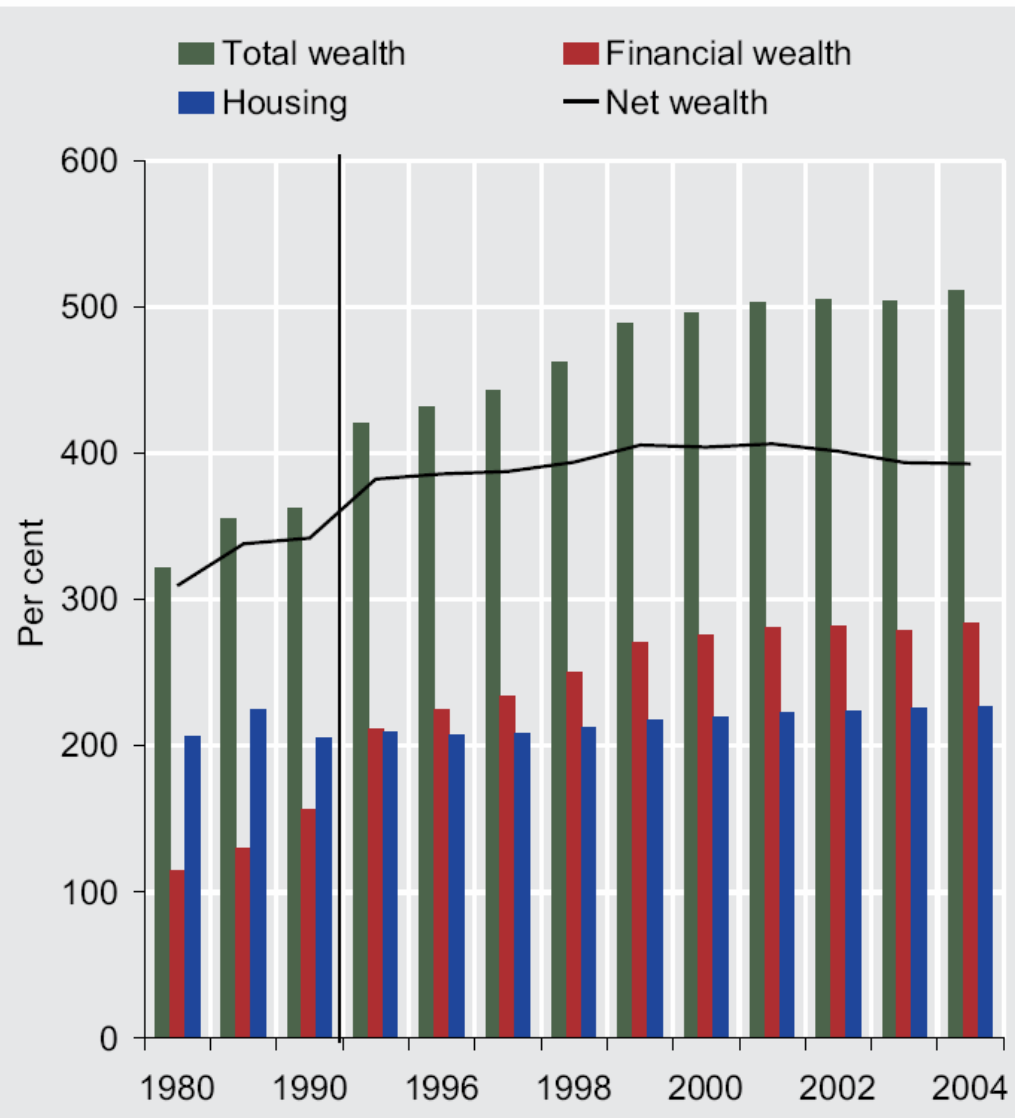
		Year <sup>(b)</sup>
Portugal	84.2	2005
Belgium	43.1	2005
Germany	70.3	2004
Greece	38.4	2005
Spain	72.3	2005
France	44.4	2005
Italy	30.8	2005
Netherlands	109.7	2004
Austria	53.8	2005
Finland	40.7	2004
Euro area <sup>(c)</sup>	55.0	2004

Sources: Eurostat (up to and including 2004, except Portugal), national central banks, national statistical institutes and Banco de Portugal.

Notes: Banco de Portugal calculations for 2005 (a) Includes liabilities on account of loans and securities other than shares. (b) Last known value (c) Excluding Ireland and Luxembourg.

# HOUSEHOLD WEALTH

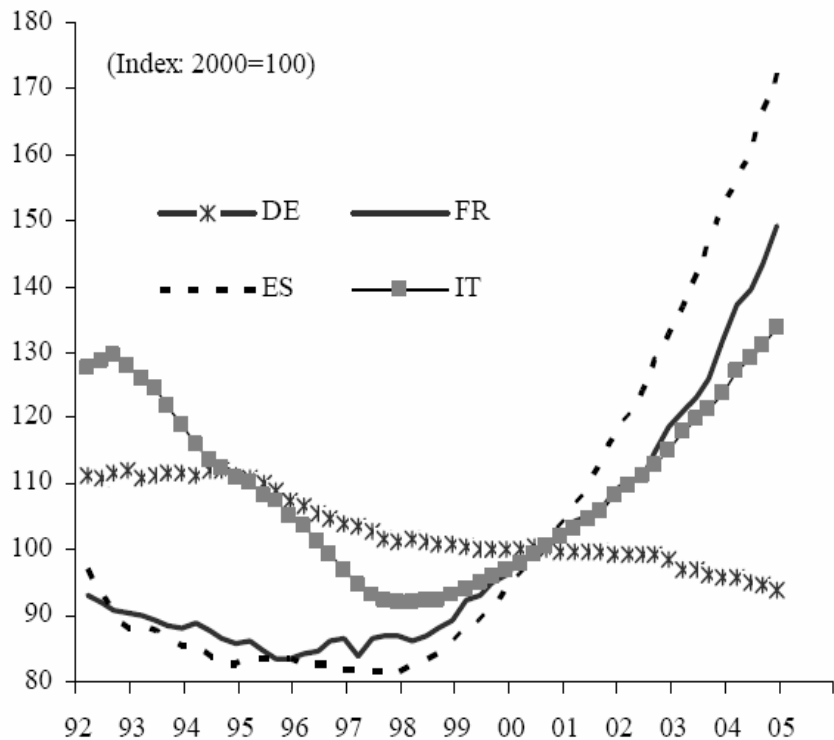
As a percentage of disposable income



SOURCES: *INE* and Banco de Portugal.

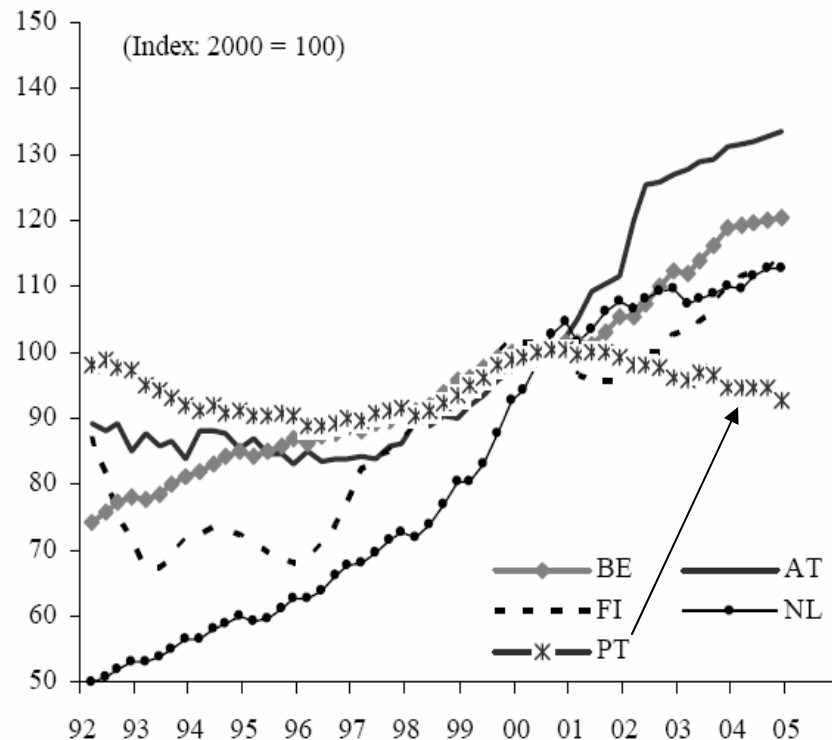


**Graph 2.1.7: Real<sup>1</sup> house prices 1992-2005 – Germany, Spain, France and Italy**



Note: 1 - Deflated by the private consumption deflator

**Graph 2.1.8: Real<sup>1</sup> house prices 1992-2005 – Belgium, Austria, Finland, the Netherlands and Portugal**



Note: 1 - Deflated by the private consumption deflator

Source: European Commission (2006) "The EU economy 2006 review: Adjustment dynamics in the euro area"

## Stress Tests Scenarios

	Scenario 1 of Disruptive adjustment			Scenario 2 of Cyclical asynchrony		
	2006	2007	2008	2006	2007	2008
	Deviations in p.p from the baseline scenario					
Real GDP growth	-1.7	-1.7	-1.4	-1.0	-1.6	-1.5
3-month interest rates	-1.2	-1.5	-1.5	1.4	1.9	2.5
Dollar/euro exchange rate	+24	0	0	0	0	0
Stock prices	-30	0	0	0	0	0
Total credit	1.4	1.1	0.2	-2.6	-5.1	-5.9

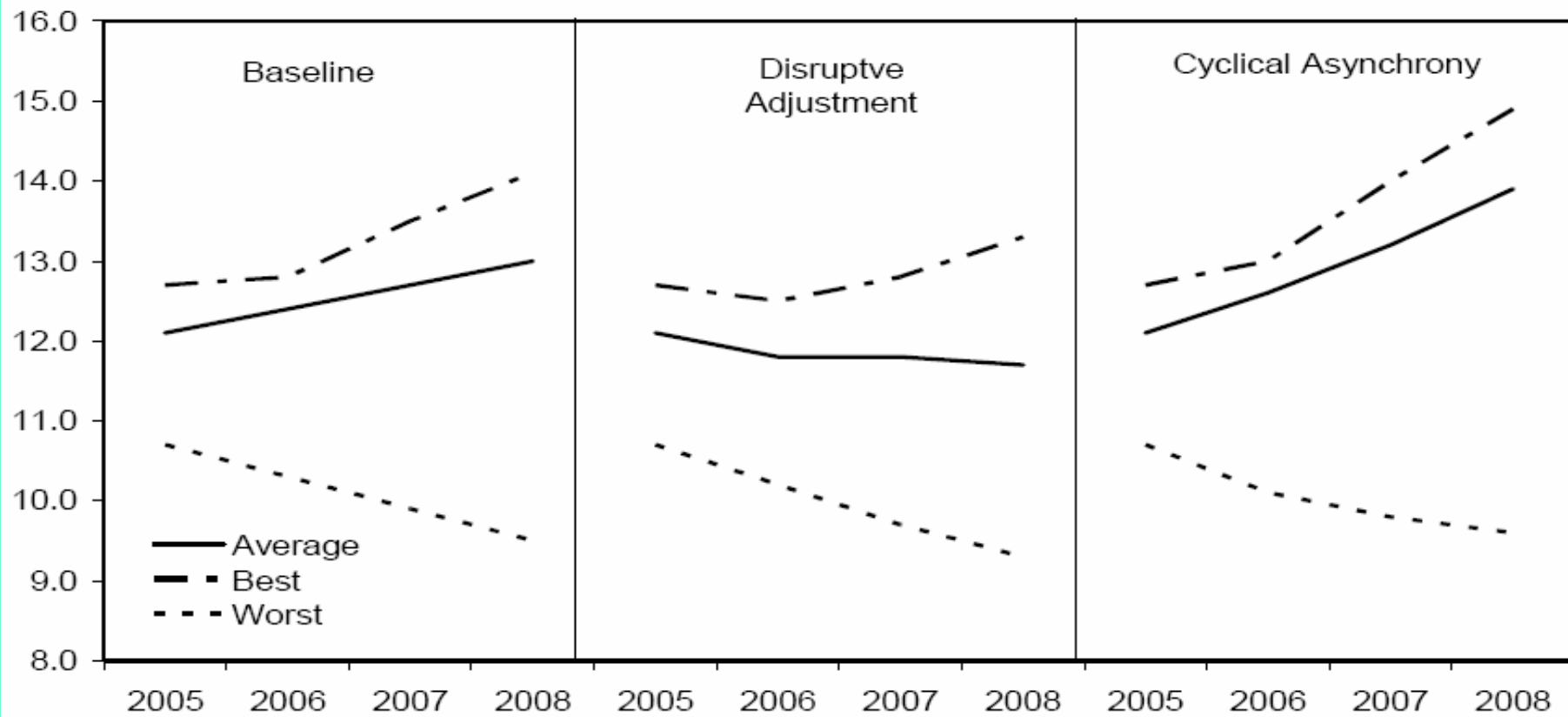
Source: IMF «Portugal: Financial System Stability Assessment », September 2006

**Table 1. Portugal: Banking Scenario Stress Tests;  
Cumulative Impact on CAR**  
(In percentage points)

	Disruptive Adjustment	Cyclical Asynchrony
Credit risk (expected losses)	-0.25	-0.43
Credit growth	-0.05	0.00
Equity price risk	-0.22	0.00
Interest rate risk	0.03	-0.10
Exchange rate risk	-0.04	0.02
Pension funds	-0.77	-0.06
Total	-1.30	-0.58

**Source: IMF «Portugal: Financial System Stability Assessment », September 2006**

Figure 1. Portugal: Banking Stress Tests;  
CAR after Scenario Shocks



Source: Banco de Portugal.

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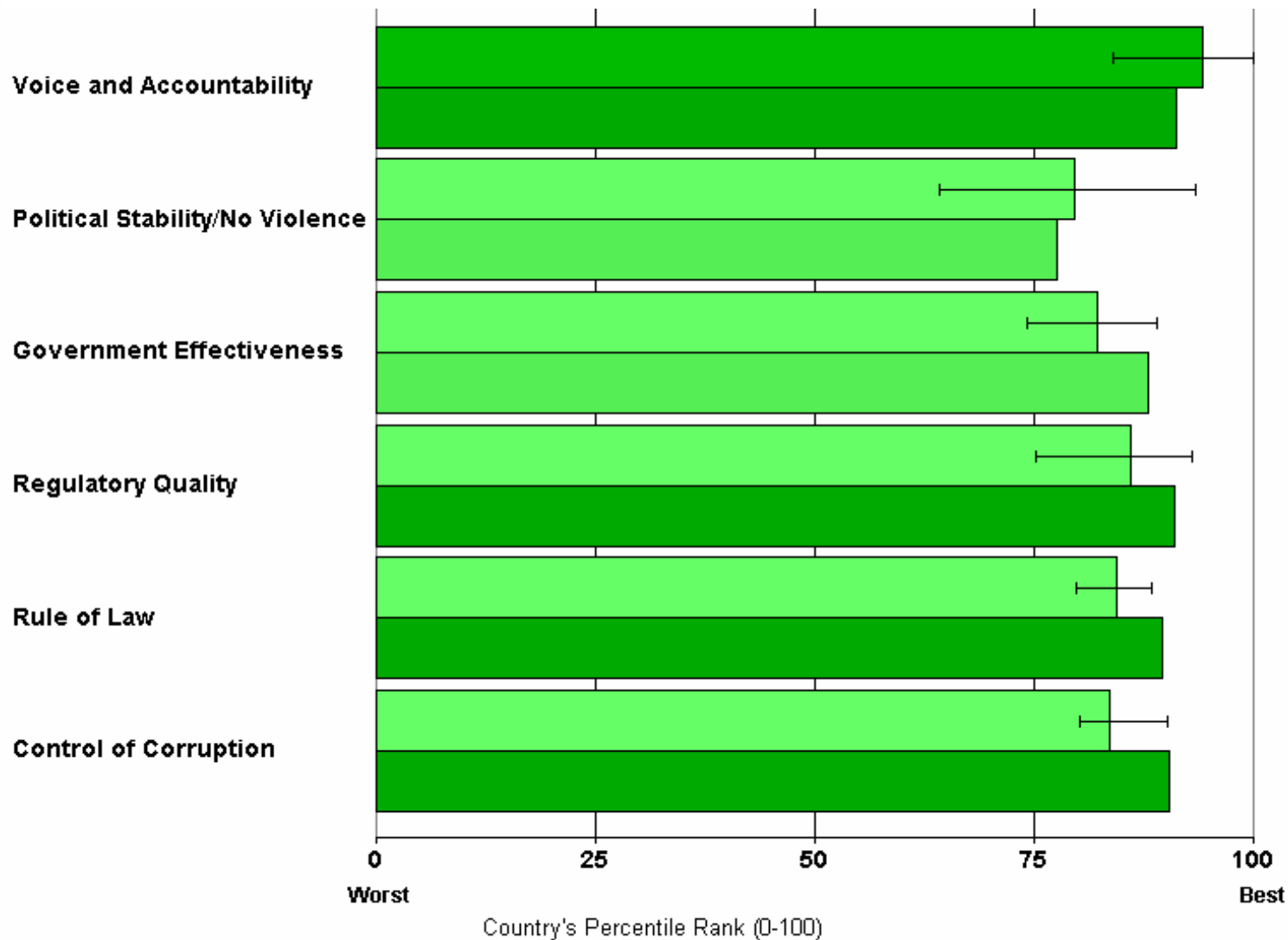
# Regulation Indexes of OECD

	1998	2003
<b>General Index of product markets</b>		
Portugal	2.2	1.6
OECD average	2.1	1.5
<b>Index of barriers to trade and investment</b>		
Portugal	1.2	0.8
OECD average	1.5	1.0
<b>Index of barriers to entrepreneurship</b>		
Portugal	1.8	1.3
OECD average	1.9	1.5

Source: Conway, P. Veronique Janod and G. Nicoletti (2003) «Product and market regulation in OECD countries: 1998 to 2003» OECD WP n° 419

# World Bank Governance index (2005)

Portugal: Comparison with OECD average (lower Bar)

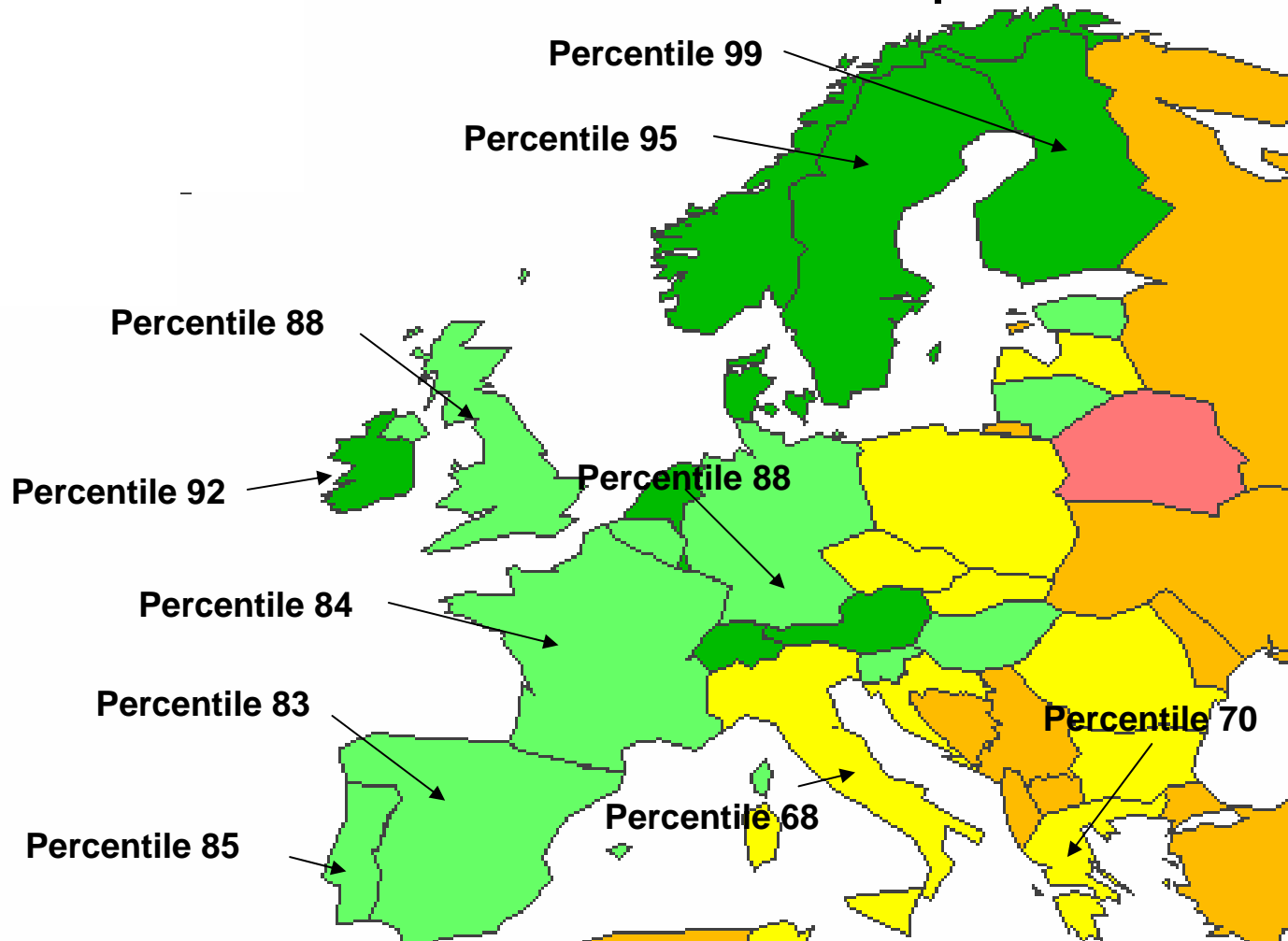


**COLOR CODING**

90<sup>th</sup>-100<sup>th</sup> percentile ■ 75<sup>th</sup>-90<sup>th</sup> percentile ■ 50<sup>th</sup>-75<sup>th</sup> percentile ■ 25<sup>th</sup>-50<sup>th</sup> percentile ■ 10<sup>th</sup>-25<sup>th</sup> percentile ■ 0<sup>th</sup>-10<sup>th</sup> percentile ■

# World Bank Governance index (2005)

## Illustrative Composite Governance Indicator Worldwide Map



### COLOR CODING

90<sup>th</sup>-100<sup>th</sup>percentile ■ 75<sup>th</sup>-90<sup>th</sup>percentile ■ 50<sup>th</sup>-75<sup>th</sup>percentile ■ 25<sup>th</sup>-50<sup>th</sup>percentile ■ 10<sup>th</sup>-25<sup>th</sup>percentile ■ 0<sup>th</sup>-10<sup>th</sup>percentile ■