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Portuguese Banking System

Latest Developments

Updated: 3Q 2013

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Portuguese Banking System – latest developments

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- Latest Financial Stability Measures
- Macroeconomic and financial indicators
- Portuguese Banking System
  - o Balance Sheet
  - o Liquidity & *Funding*
  - o Asset Quality
  - o Profitability
  - o Solvency

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The Portuguese Banking System – main highlights

I **Balance Sheet**

- Decrease in the credit portfolio is the main driver of the decrease in assets

II **Liquidity & Funding**

- Steady decrease in the loan-to-deposit ratio
- Increase of the weight of deposits in the funding structure

III **Asset/Credit Quality**

- Credit quality remains a challenge to banks profitability
- The provisioning effort is ongoing

IV **Profitability**

- Profitability remains under pressure
- Credit impairments at historic highs and reflecting the adverse macroeconomic conditions of the latest years, despite the recent signs of economic recovery

V **Solvency**

- Solvency levels strengthened, reflecting the 2012 and 2013 recapitalisation efforts, albeit the unfavourable evolution of profits

The profitability of the Portuguese Banking System is under pressure.
Solvency levels have been strengthened to face market adversities.

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Latest financial stability measures

Topic	Institution	Latest measures
Legal framework	Banco de Portugal	•A new Instruction, revising the Central Credit Registry Regulation (Instruction 21/2008), was published in July (Instruction 17/2013). It determines the reporting of additional loan information to the current Central Credit Registry, including (i) as of January 2014, identification of nonperforming and restructured loans; and (ii) as of July 2014, information on government guarantees, as well as the identification of overdue and written-off loans disputed in court.

Macroeconomic and Financial Indicators (I/IV)

GDP growth rate - Volume

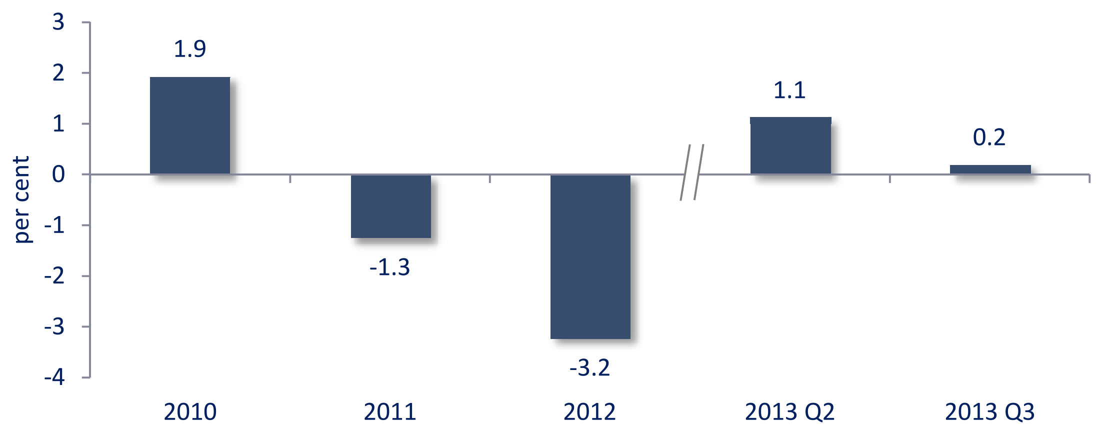

Chart 1

Current account and capital account, %GDP

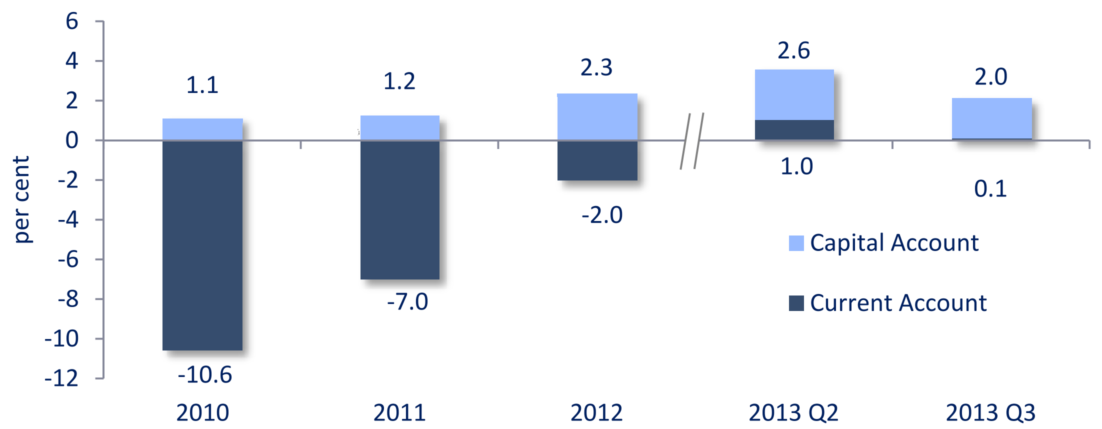

Chart 2

Source: Banco de Portugal and INE

- Following a long period of continued decrease in activity, 2Q2013 and 3Q2013 exhibited quarter on quarter positive growth. Consequently, the pace of GDP contraction in 2013 has slowed down. This trend is expected to continue in the last quarter of the year.

- The adjustment process of the external balance has continued its path, leading to a net lending position of the Portuguese economy.

- In the first three quarters of the year the current account exhibited a surplus, though small. A surplus is also expected for the 4Q2013.

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Macroeconomic and Financial Indicators (II/IV)

Unemployment rate, % of active population

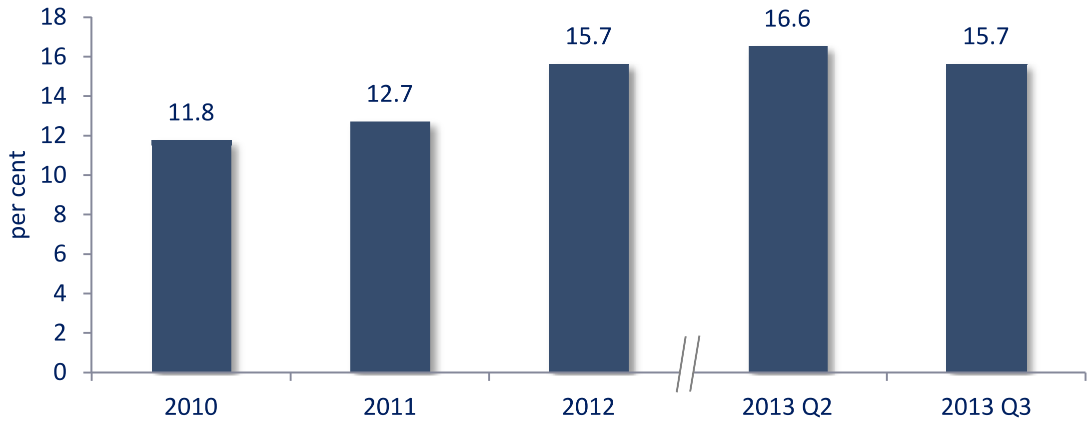

Chart 3

Fiscal deficit, % GDP

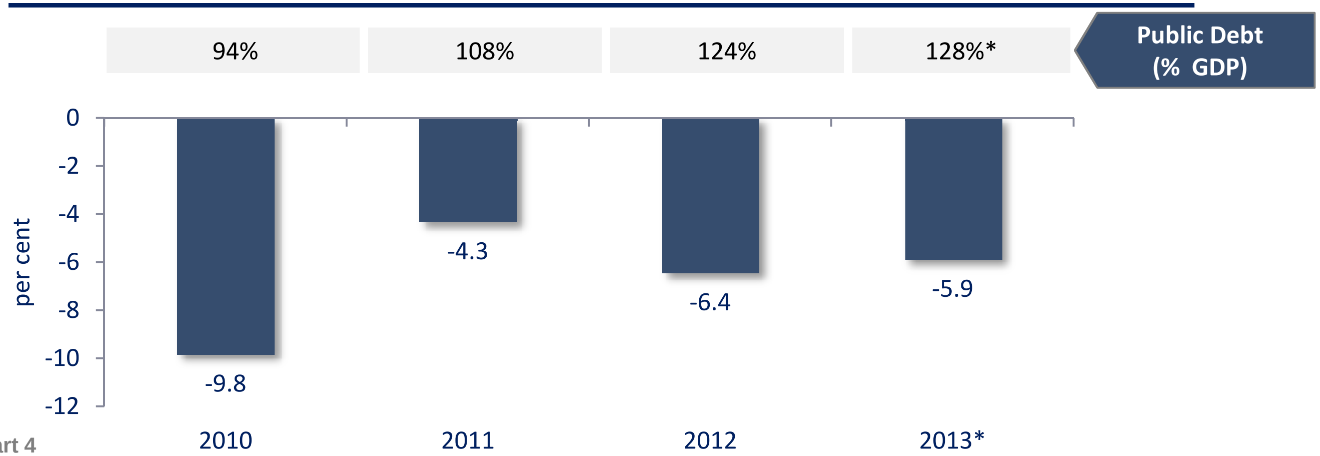

Chart 4

Source: Banco de Portugal and INE. *Estimate for 2013.

- Unemployment is still high in 2013, despite a slight decrease observed in the latest quarters.
- It is expected that in 2013, public debt has grown, even though at a lower rate than in 2012.
- Fiscal deficit should decrease n in 2013, in line with the effort of structural consolidation of public finances.

Macroeconomic and Financial Indicators (III/IV)

Net lending/borrowing of non-financial corporations % GDP

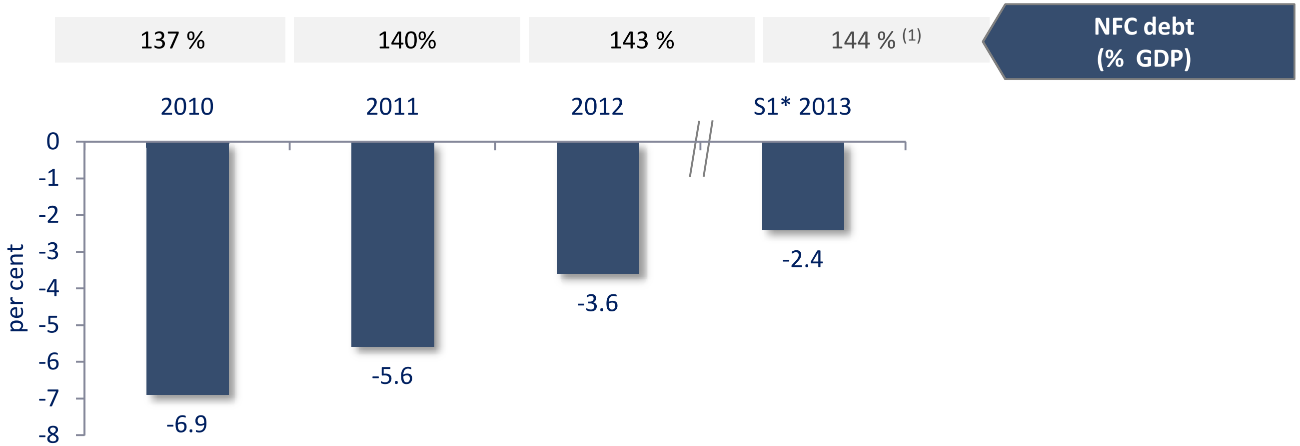

Chart 5

Net lending/borrowing of households % GDP

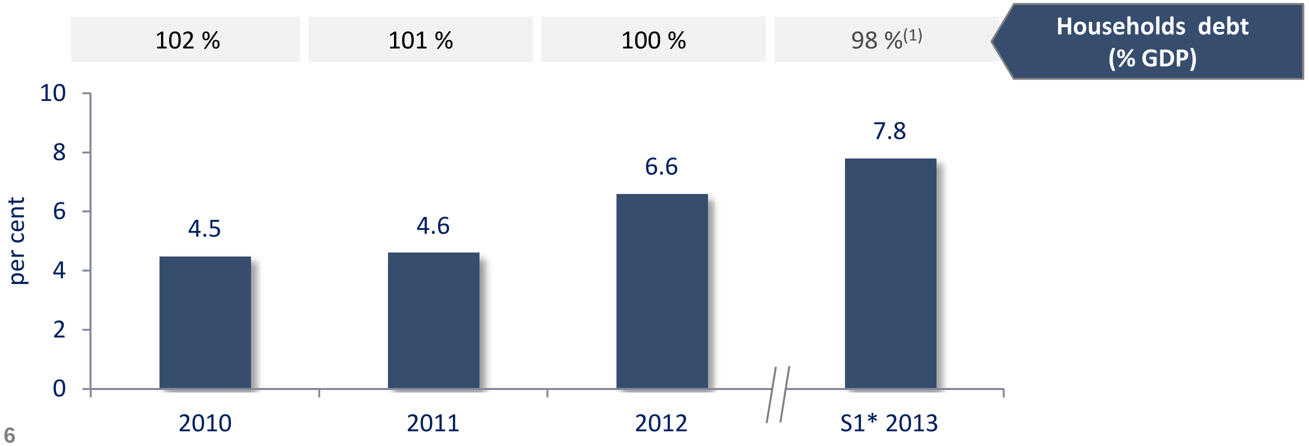

Chart 6

- The correction of the high level of indebtdeness of non financial corporations is gradually undergoing. Nevertheless, financial leverage remains high.
- In the first semester of 2013, the gradual adjustment of households financial imbalances has continued.
- The increase in the net lending position of households allowed the ongoing net reimbursement of debt.

Source: Banco de Portugal. (1) June 2013 values. * Annual value up to the semester.

Macroeconomic and Financial Indicators (IV/IV)

Sovereign debt yields 10 Y

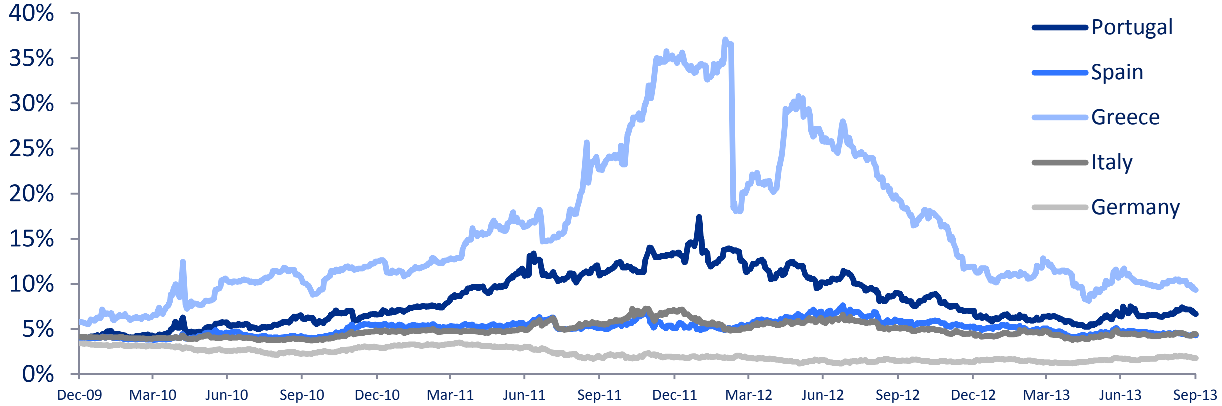

Chart 7

Euribor and ECB main refinancing rate

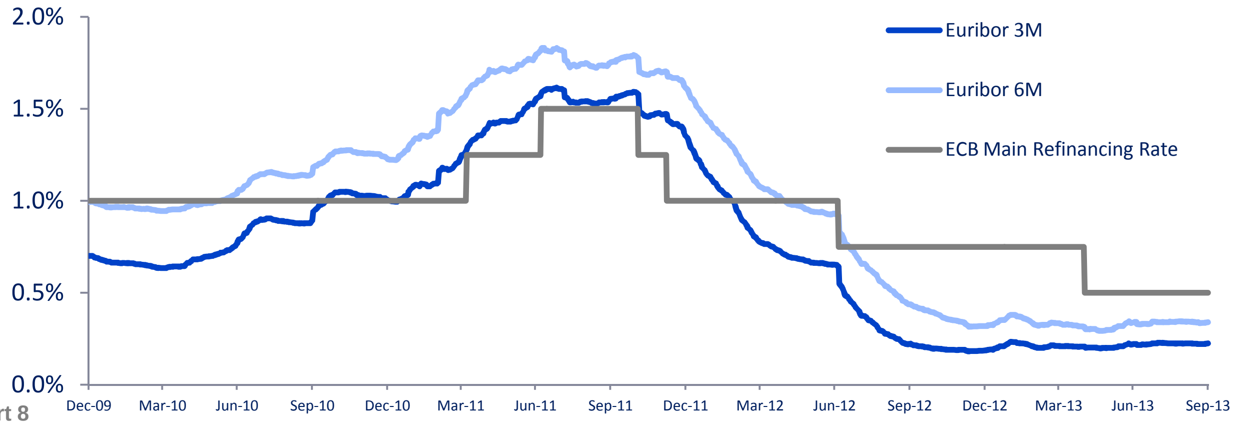

Chart 8

Source: Bloomberg and ECB

- Until mid 2013, the downward trend in Portuguese sovereign yields continued, in line with other countries under pressure. In the summer, in a framework of domestic institutional tensions, this trend was interrupted and volatility increased.

- Interbank rates have been stable in 2013 and at lower levels than the Eurosystem main refinancing operations rate*.

* Eurosystem main refinancing operations rate was cut again in november 2013

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PORTUGUESE BANKING SYSTEM
I. Balance Sheet

Assets (€Bn) - Value at end of period

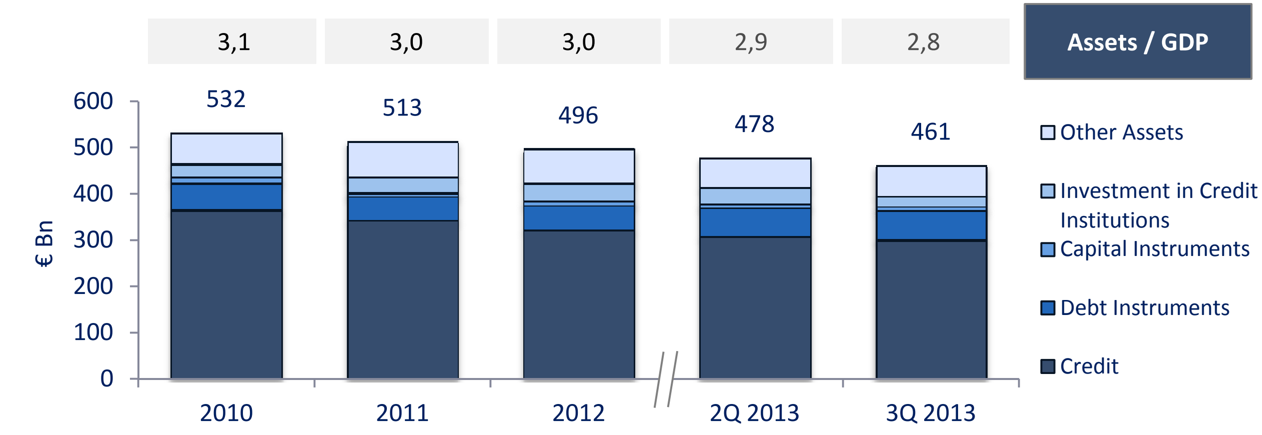

Chart 9

Bank financing structure (€Bn) - Value at end of period

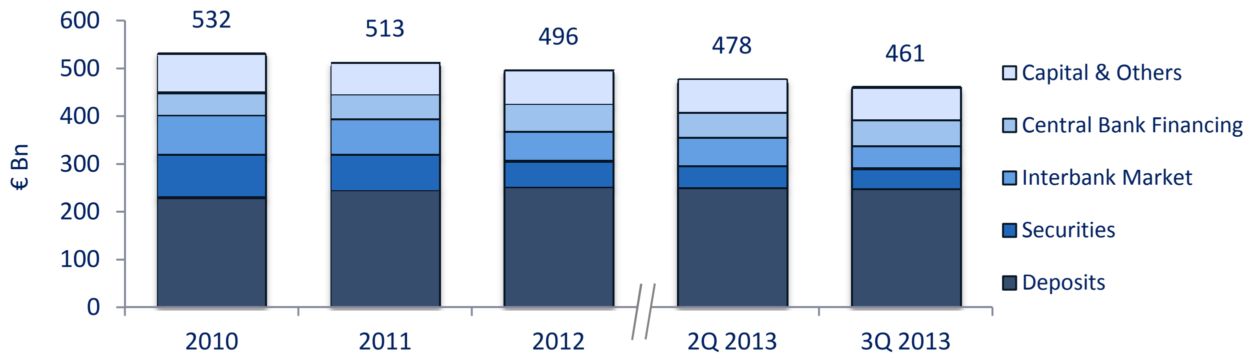

Chart 10

Source: Banco de Portugal

- The evolution of the balance sheet of the Portuguese banking system reflects the undergoing deleverage process.
- Since the end of 2010 and until Sep2013 the loan book (net of impairments) has decreased more than 13%, due to net reimbursements and deterioration of the quality of the credit portfolio.
- The funding of the banking system has been gradually adjusting towards a higher proportion of more stable funding sources, notably deposits.
- The weight of debt issuance in the financing structure has been decreasing, reflecting, amongst other, the fragmentation of the European wholesale debt market.

II. Liquidity & Funding (I/II)

Central Banks Financing (€Bn) - Value at end of period

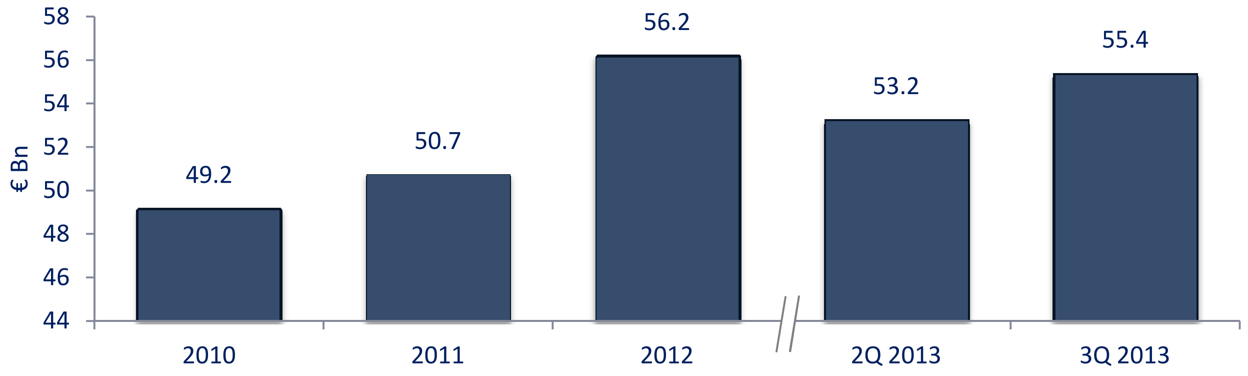

Chart 11

Loan-To-Deposits ratio (%) - Value at end of period

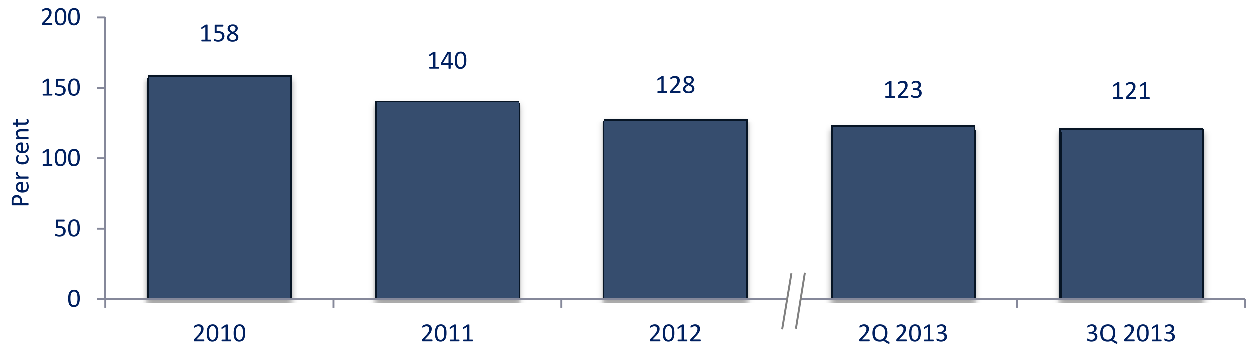

Chart 12

Source: Banco de Portugal

- After a significant increase until 2012, when it reached its peak, the dependence from the Eurosystem funding remained broadly stable. However, in Sep2013 this source of funding increased to higher levels, when compared to the first two quarters of 2013.

- The reduction observed in the loan-to-deposits ratio results mainly from the reduction in net credit, as the level of deposits has remained stable on a year on year basis.

II. Liquidity & Funding (II/II)

Commercial gap (€Bn) - Value at end of period

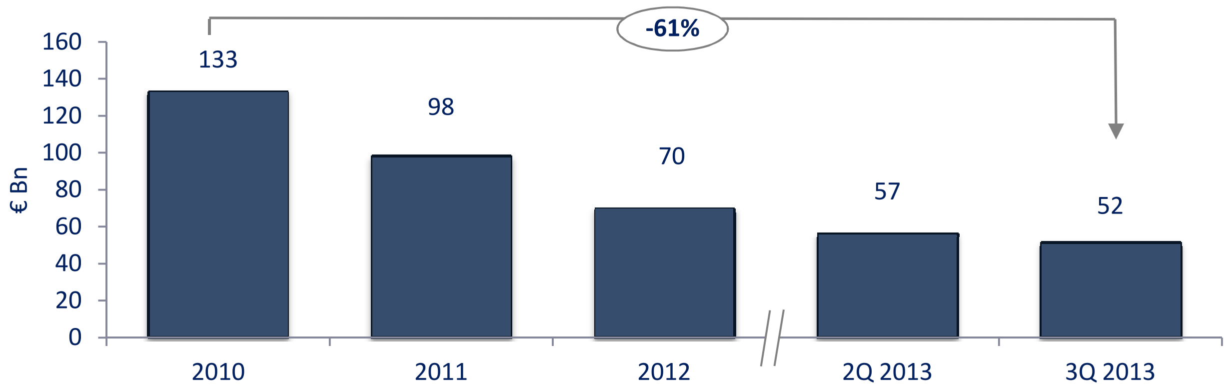

Chart 13

Liquidity gap in cumulative maturity ladders - Value at end of period

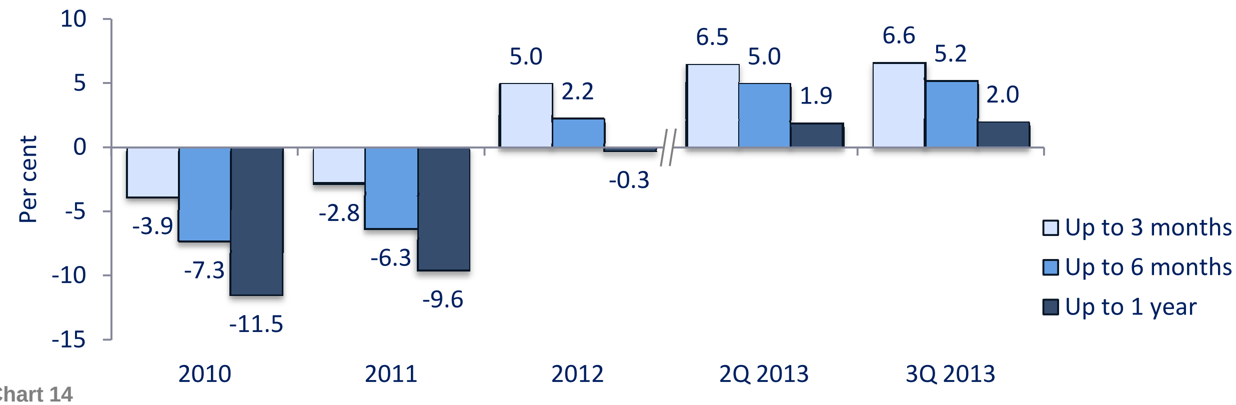

Chart 14

Source: Banco de Portugal

- The reduction in the commercial gap to 52 Bn€ also points to the structural adjustment of the banking sector.
- Since 2012 (inc.), the liquidity gap has been improving, showing a stable evolution in the second and third quarters of 2013.

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III. Asset Quality

Credit at Risk ratio (% of gross credit) - Value at end of period

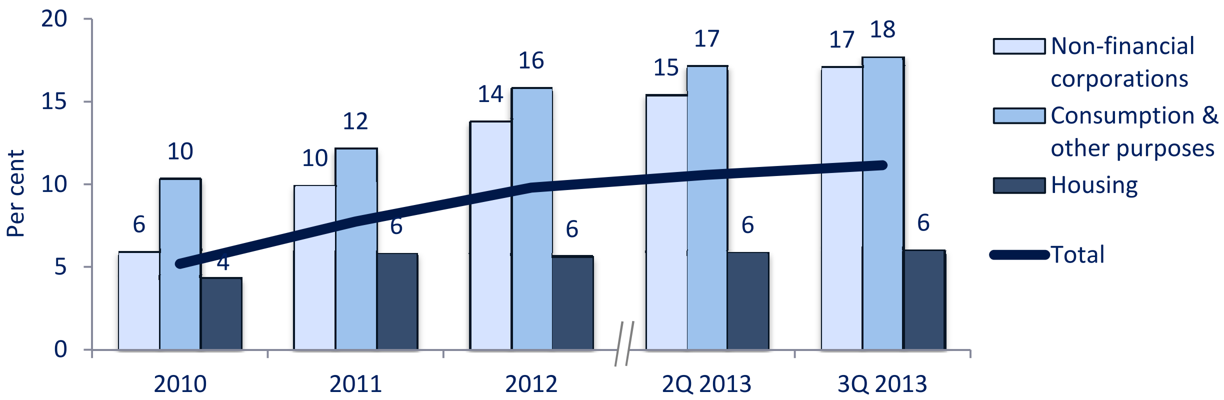

Chart 15

Credit Impairments as % of gross credit - Value at end of period

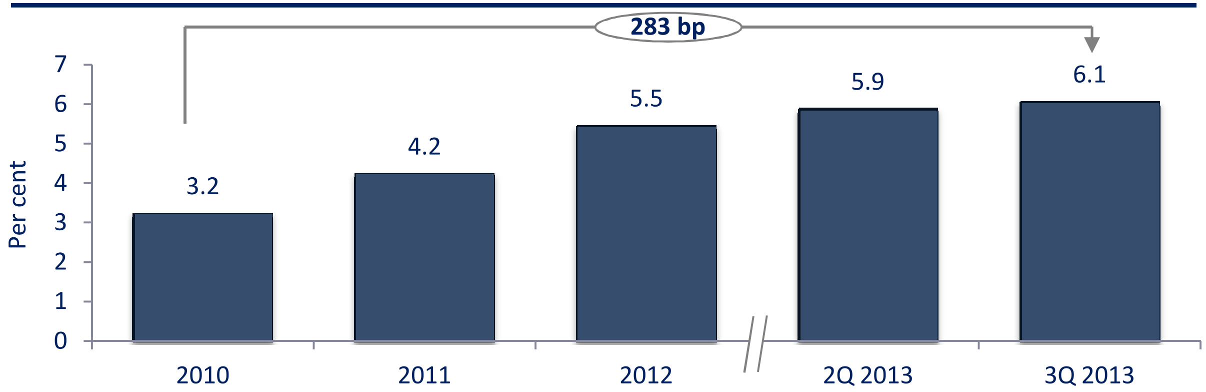

Chart 16

Source: Banco de Portugal

- The deterioration in the asset quality indicators reflects the challenging macroeconomic environment in which banks have been operating over the last few years, due to the reduction in economic activity and disposable income. In turn, the recovery signs in 2Q and 3Q2013, which can be extrapolated to the 4Q2013, are still insufficient to allow for a reversal of the credit at risk ratio trend.

- The credit at risk ratio significantly increased from 5% in Dec2010 to 11% in Sep2013, mainly due to the developments in the non financial corporate segment.

- Impairments for credit have been increasing, in line with the effort to maintain the coverage ratio.

IV. Profitability (I/II)

ROA & ROE - Value at end of period

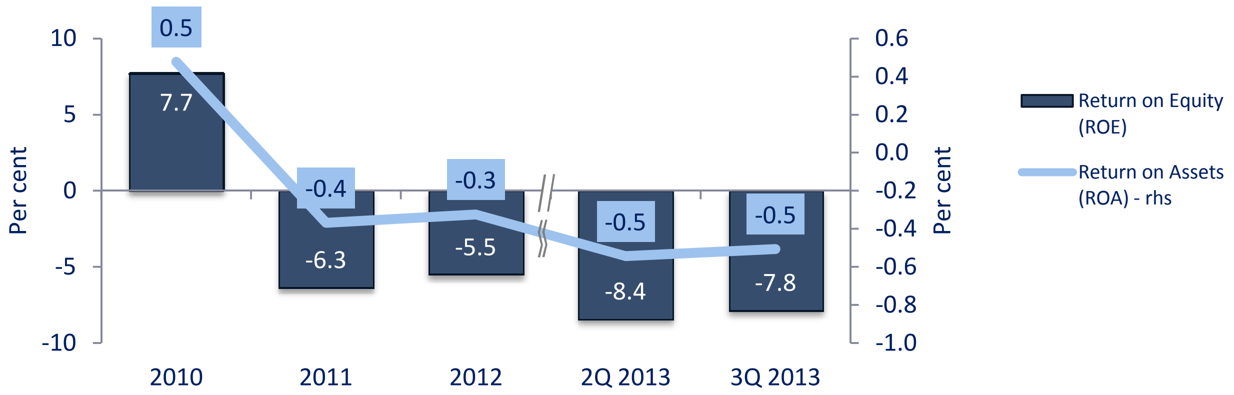

Chart 17

Income and costs as a % of gross income - Value at end of period

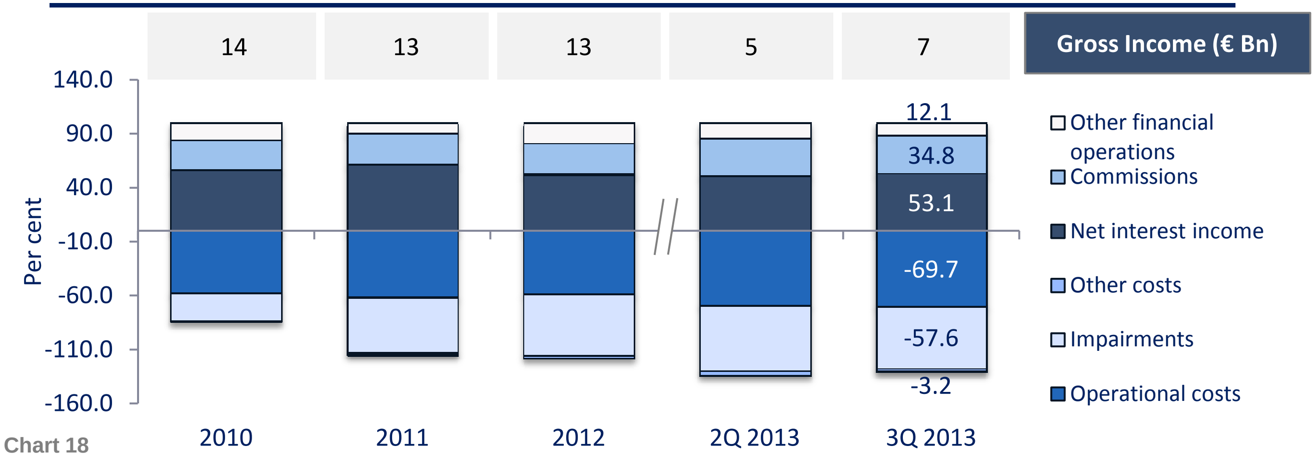

Chart 18

Source: Banco de Portugal

- Since 2011, net income has remained negative due to the behaviour of the net interest income and, in particular, the significant increase in total impairments.

- Net interest income should remain under pressure in a context of very low interest rates, low new credit volumes, and deterioration in asset quality.

IV. Profitability (II/II)

Cost-to-Income (%), Operational Costs (€Bn) - Value at end of period

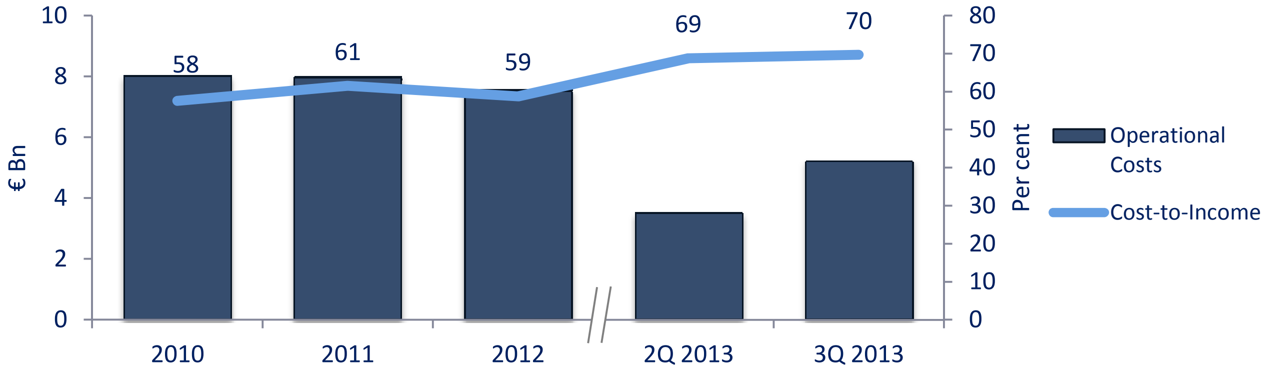

Chart 19

Banking interest rates (new business) - Average value at end of period

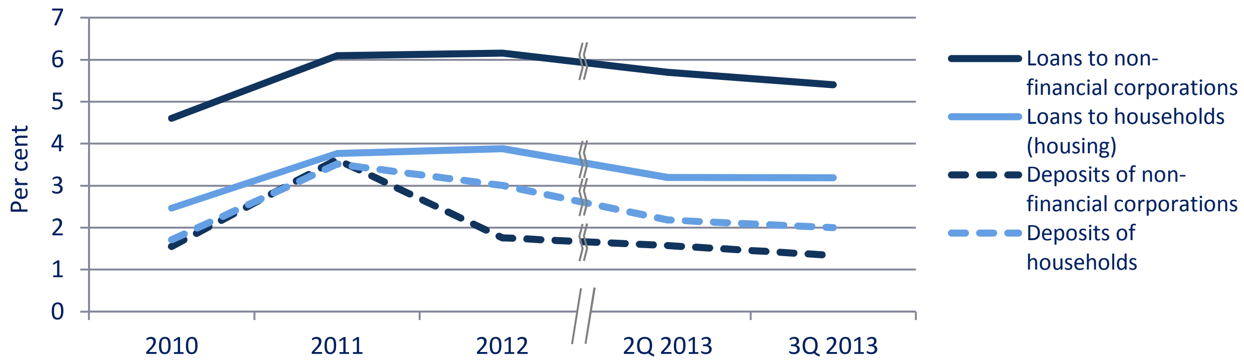

Chart 20
Source: Banco de Portugal

- The deterioration in the cost-to-income ratio is mainly due to reduction of gross income.
- Reduction in operational costs was smaller than the decrease in revenues, despite business restructuring plans being implemented in some of the largest banks.
- Interest rates on new deposits have been decreasing since 2011, whereas interest rates for new loans remain high, positively contributing to the net interest income.

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V. Solvency

Core Tier 1 capital to Total Assets ratio - Value at end of period

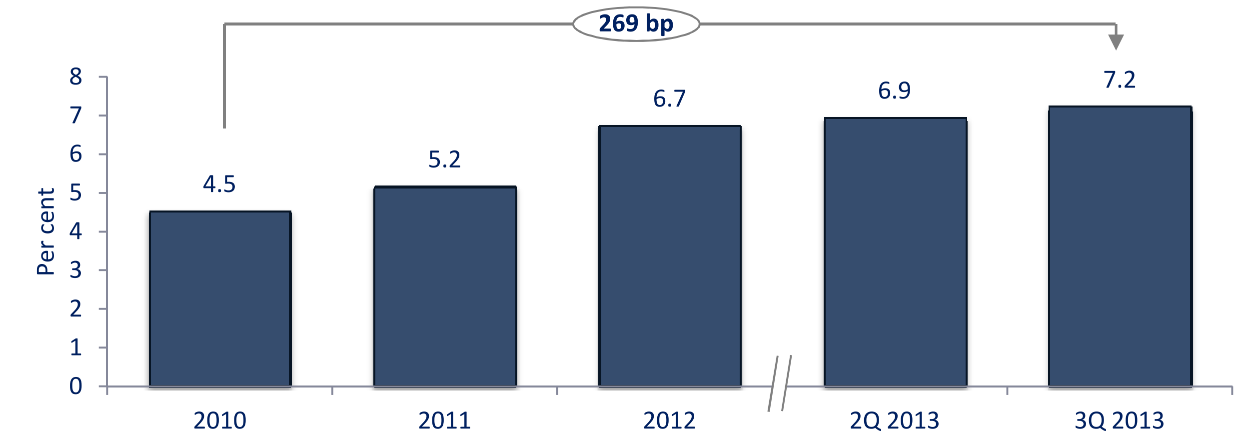

Chart 21

Core Tier 1 ratio - Value at end of period

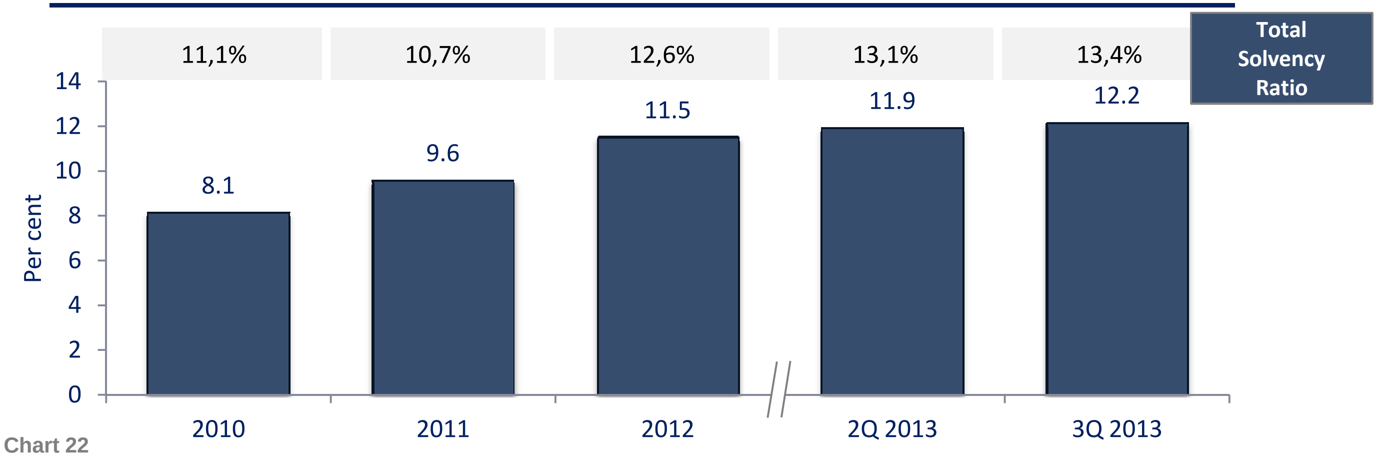

Chart 22

- The strengthened solvency in 2012 and 2013 reflects the recapitalisation efforts from both public and private investors.
- Core Tier 1 capital represents almost 7% of total assets, remaining stable in 2013.
- Core Tier 1 ratio stands comfortably above the 10% minimum required by Banco de Portugal since 2012 (9% in 2011) .

Source: Banco de Portugal

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