Portuguese Banking System

Latest Developments

BANCO DE PORTUGAL
EUROSISTEMA

Updated: 4Q 2013

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- Portuguese Banking System
    - Balance Sheet
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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 in the weight of deposits in the funding structure

III. Asset/Credit Quality
- Credit at risk ratio increased in relation to previous year, although at a slower pace
- Credit at risk coverage ratio increased

IV. Profitability
- Profitability remains under pressure, although net interest margin recovered throughout the year
- Flow of credit impairments decreased, but continues at historical highs

V. Solvency
- Solvency levels strengthened due to asset reduction

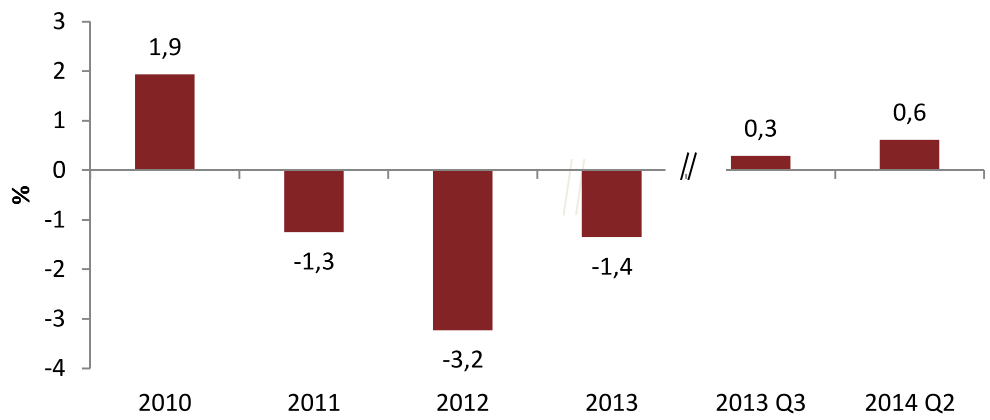
**The profitability of the Portuguese Banking System is under pressure.
At the end of 2013, liquidity and solvency were at comfortable levels.**

Latest financial stability measures

Topic	Institution	Latest measures (Q4 2013)
Solvency and liquidity	Banco de Portugal	Approval of Notice No 6/2013, which establishes transitional arrangements for own funds, under Regulation (EU) No 575/2013, and lays down measures to preserve those funds, requiring in particular a minimum level of 4.5% for the common equity Tier 1 capital ratio, applicable as of 1 January 2014, and determining that credit institutions and investment firms preserve a common equity Tier 1 capital ratio of no less than 7%.
	ECB	In November 2013, decision by the Governing Council of the ECB to continue conducting its refinancing operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the first half of 2015.
Monitoring and supervision	Banco de Portugal	Undertaking a sectoral on-site inspection (ETRICC 12), entailing the assessment of business forecasts for the largest 12 banks' counterparts, in order to ensure appropriate amounts of impairment are included in the accounts.
		Publication of Instruction No 32/2013 (revoking Instruction No 18/2012) which relates to the identification and earmarking of restructured credit due to customer's financial difficulties. This new Instruction revises the rules and assumptions defined by the revoked Instruction and makes them consistent with the EBA Implementing Technical Standards on Non-Performing Exposures.
		Undertaking an on-site inspection programme on the 8 largest banking groups to assess institutions' internal processes related to the treatment of problematic credit, from the viewpoint of maximising the capacity to recover such credit.

Macroeconomic and Financial Indicators (I/IV)

GDP growth rate - Volume



Note: Quarterly figures correspond to q-o-q growth rates.

Chart 1

Current account and capital account, %GDP

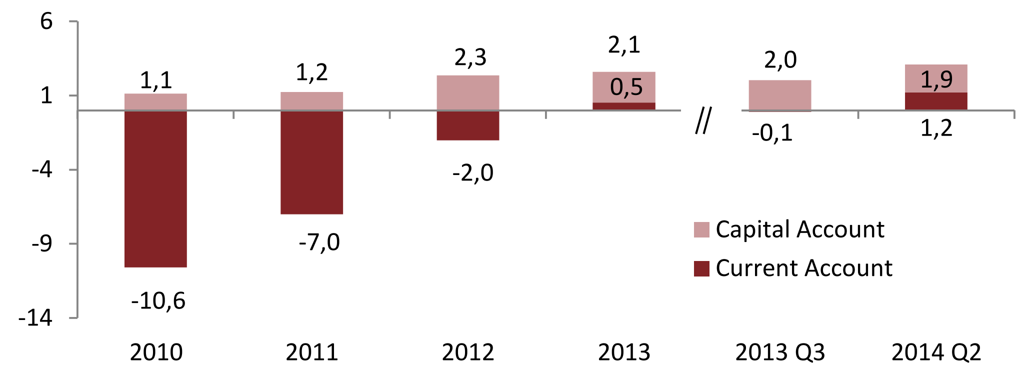


Chart 2

Source: Banco de Portugal and INE.

- In 2013, GDP growth rate was negative in 1,4%. Nevertheless, quarter-on-quarter growth has been positive since Q2 2013.
- The adjustment process of the external balance has continued its path, leading to a net lending position of the Portuguese economy.
- In 2013 the current account exhibited a surplus, though small.

Macroeconomic and Financial Indicators (II/IV)

Unemployment rate, % of active population

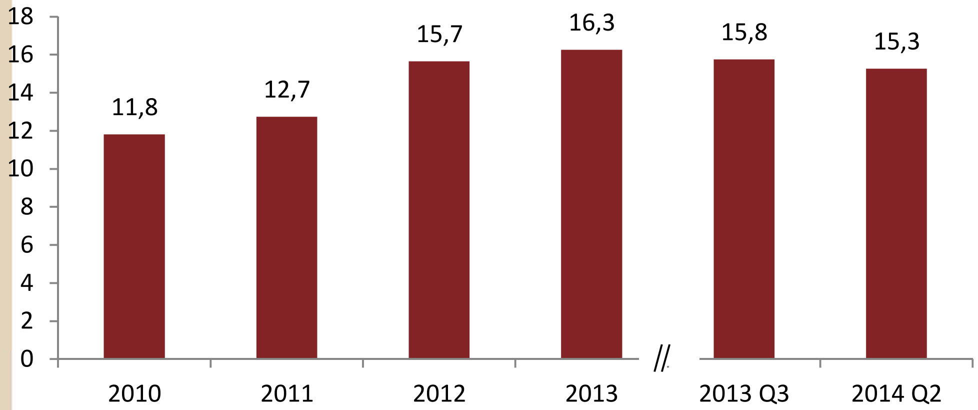


Chart 3

Fiscal deficit, % GDP

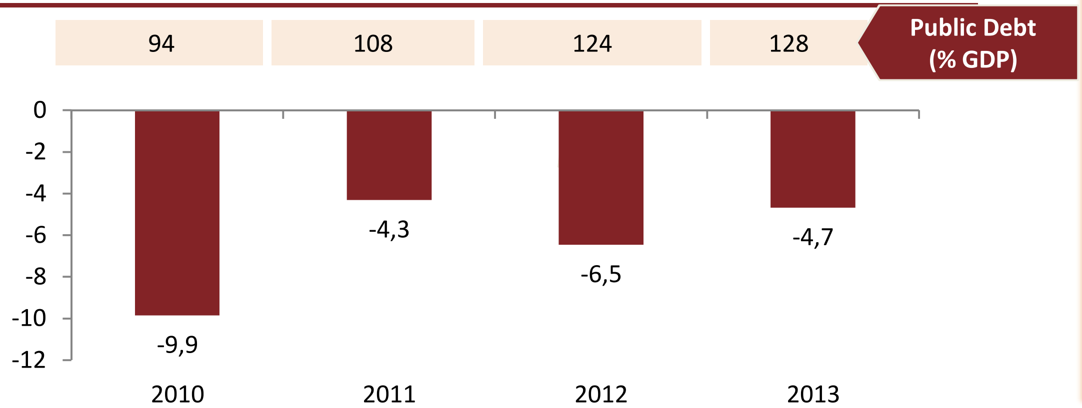


Chart 4

- In 2013, the unemployment rate remained high despite quarterly figures have been decreasing throughout the year.
- The ratio between public debt and GDP continued to increase, but at a lower pace than in 2012.
- Fiscal deficit decreased in 2013, in line with the effort of structural consolidation of public finances.

Source: Banco de Portugal and INE.

Macroeconomic and Financial Indicators (III/IV)

Net lending/borrowing of non-financial corporations % GDP

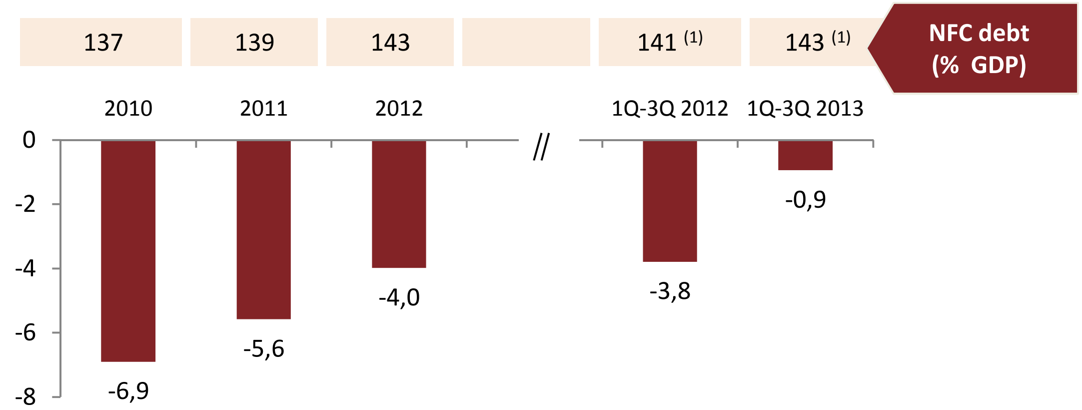


Chart 5

Net lending/borrowing of households % GDP

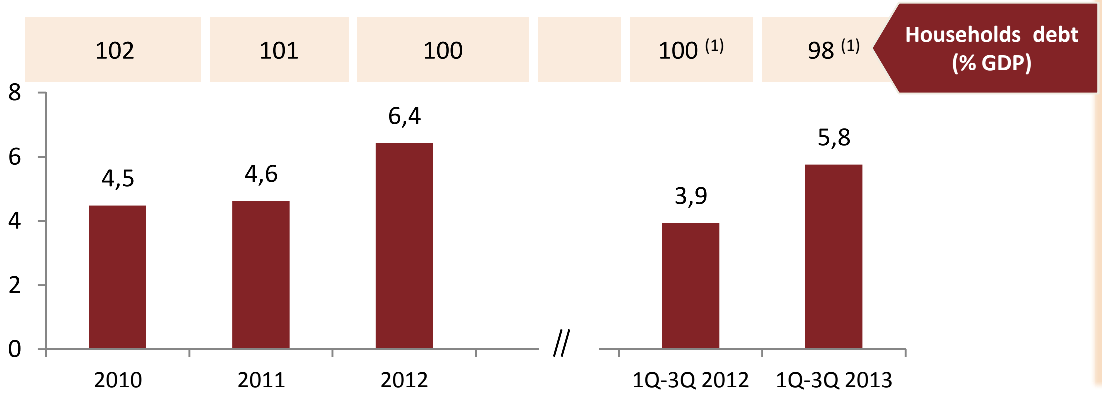


Chart 6

- Financial leverage of the non-financial corporate sector remains high. In turn, borrowing continued to decrease.
- Households debt continued to decrease in 2013, accompanied by an increase in the net lending position.

Source: Banco de Portugal and INE. (1) September values.

Macroeconomic and Financial Indicators (IV/IV)

Sovereign debt yields 10 Y

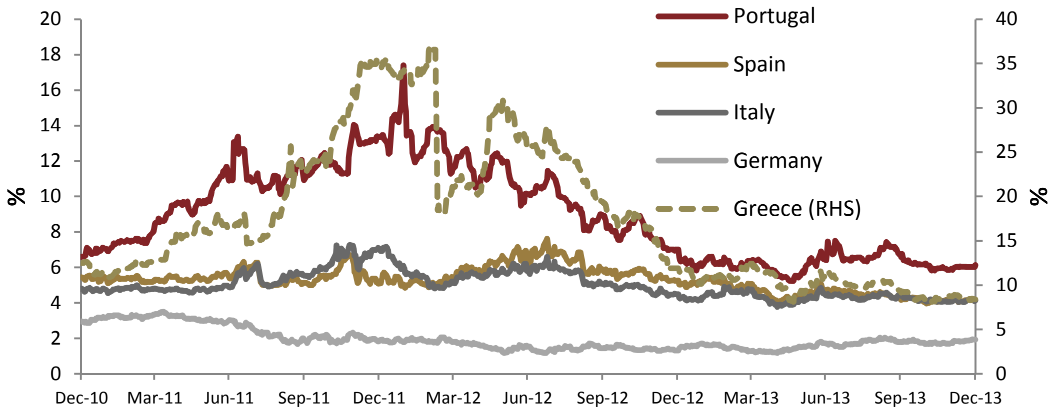


Chart 7

Euribor and ECB main refinancing rate

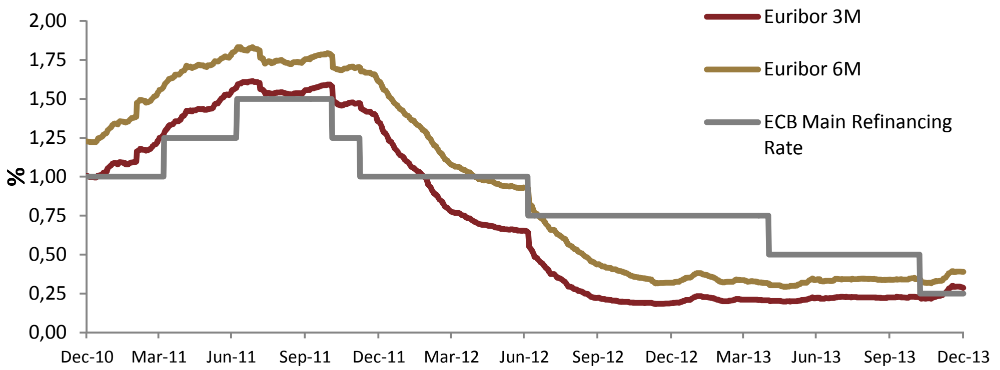


Chart 8

- After reporting some volatility in the summer, Portuguese sovereign debt yields exhibited a decreasing trend since mid September, decreasing the spread to German yields.
- Interbank rates have been stable in 2013, having increased in december following a review of market expectations towards central bank monetary stimulus.
- The eurosystem main refinancing operations rate was cut by 25b.p. in May and in November .

Source: Bloomberg and ECB.

Balance Sheet

Assets (€Bn) - Value at end of period

3.1	3.0	3.0	2.8	2.8	Assets / GDP

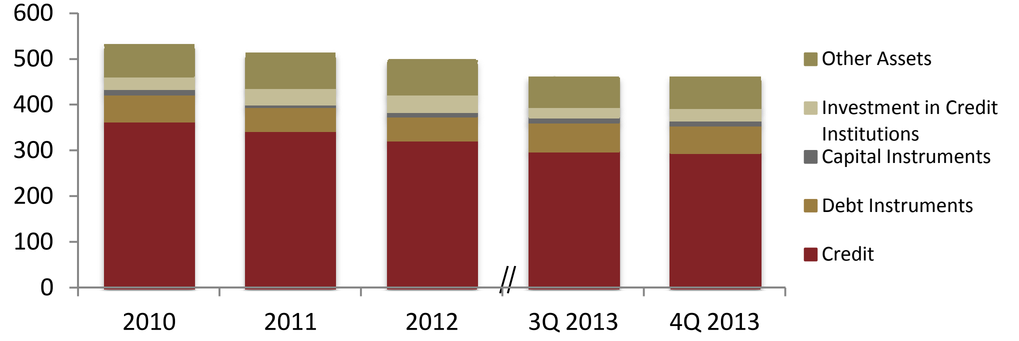


Chart 9

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

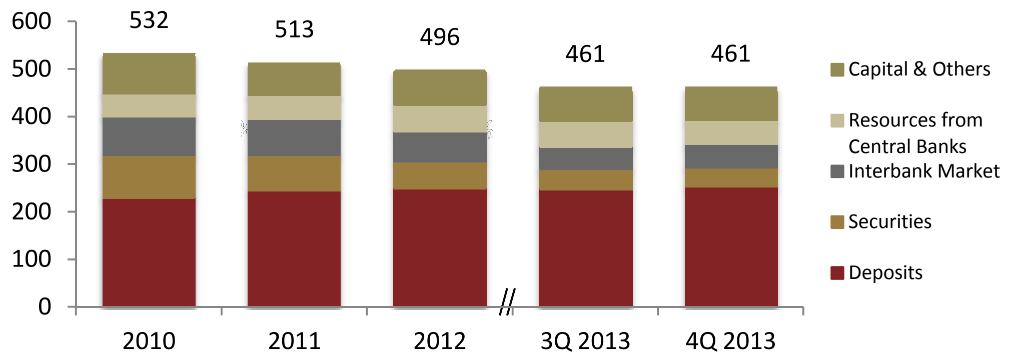


Chart 10

- Total assets remained stable in the last quarter of 2013. Nevertheless, from 2010 to 2013 assets decreased 13% mainly due to a decrease in net credit.
- The funding of the banking system has been gradually adjusting towards a higher proportion of more stable funding sources, notably deposits from households.
- The decrease of the weight of securities issued and interbank financing in the funding structure reflects, amongst other, the fragmentation of the European wholesale debt market.

Source: Banco de Portugal.

Liquidity & Funding (I/II)

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

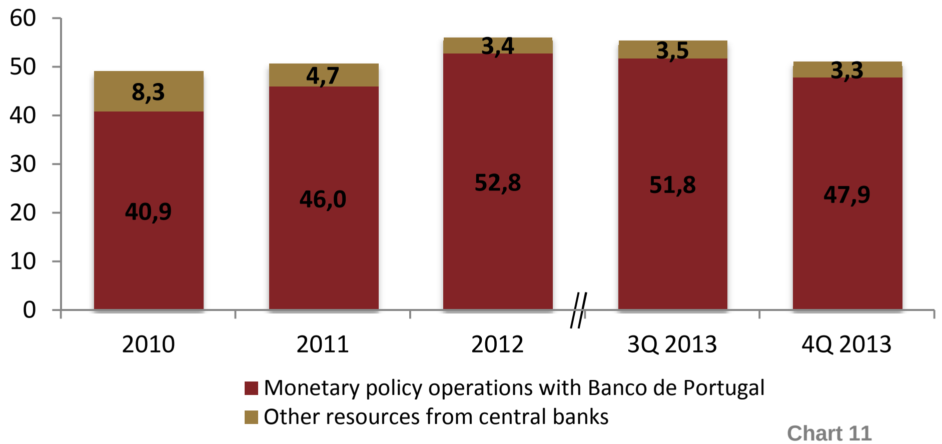


Chart 11

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

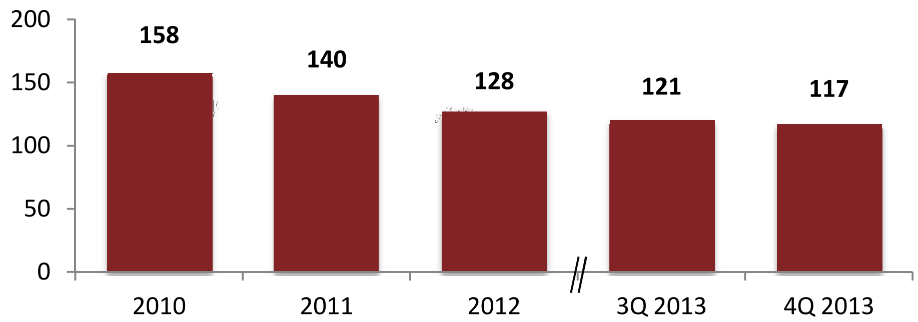


Chart 12

Source: Banco de Portugal.

- Dependence from the Eurosystem funding decreased in Q4 2014 both on a quarter-on-quarter and on a year-on-year basis.
- In 2013, the reduction of the loan-to-deposits ratio resulted from the reduction in net credit, as the level of deposits has remained stable on a year-on-year basis.

Liquidity & Funding (II/II)

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

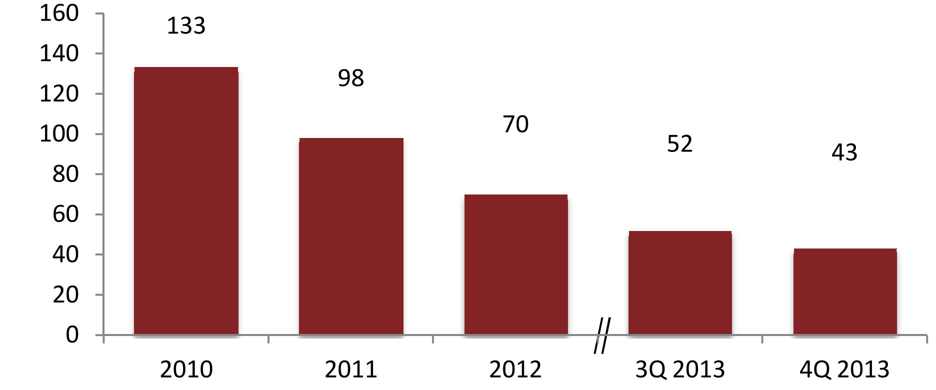


Chart 13

Liquidity gap in cumulative maturity ladders (% stable assets) - Value at end of period

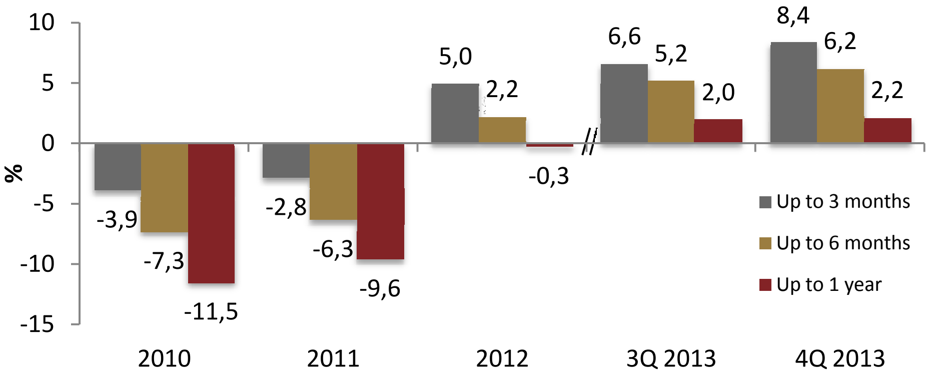


Chart 14

- The continued reduction of the commercial gap reinforces the conclusion about the structural adjustment of the banking sector.
- Liquidity gaps improved comparing to 2012, being this improvement more pronounced in the last quarter of 2013.

Source: Banco de Portugal.

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

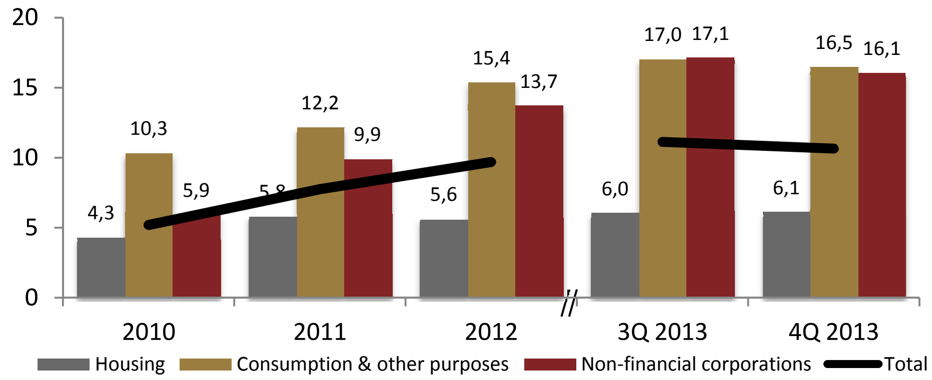


Chart 15

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

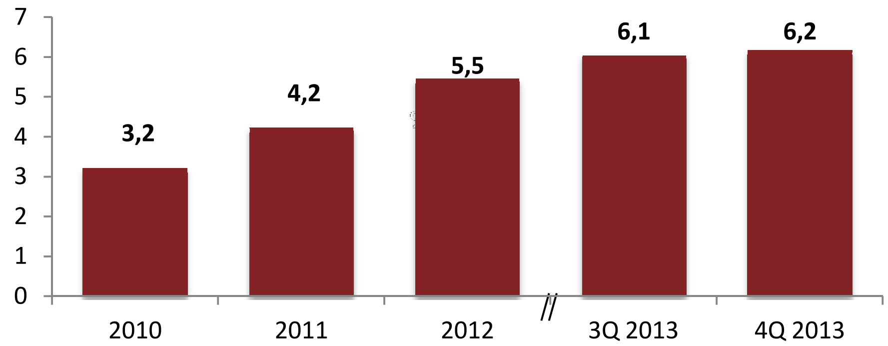


Chart 16

Source: Banco de Portugal.

- The credit at risk ratio continued to increase in 2013, although at a slower pace.
- The deterioration of the credit at risk ratio since 2010 results mainly from the evolution of the non-financial corporate sector.
- The coverage of gross credit by impairments has been increasing since 2010. In the last quarter of 2013 this ratio remained stable.

Profitability (I/II)

ROA & ROE - Value at end of period

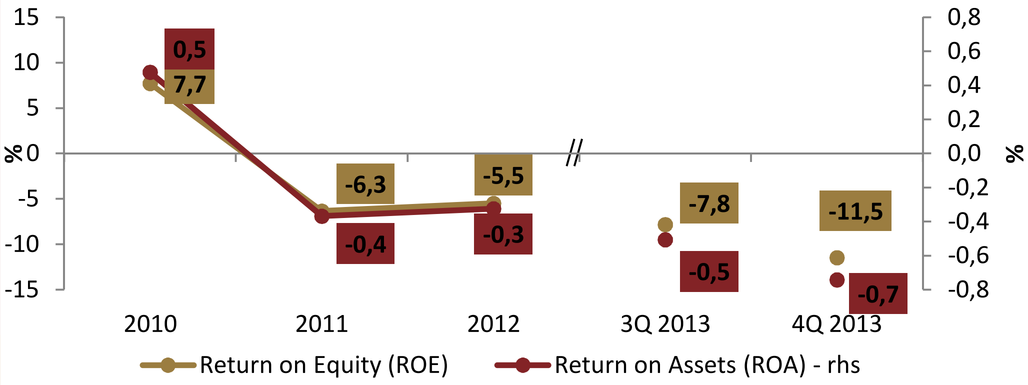


Chart 17

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

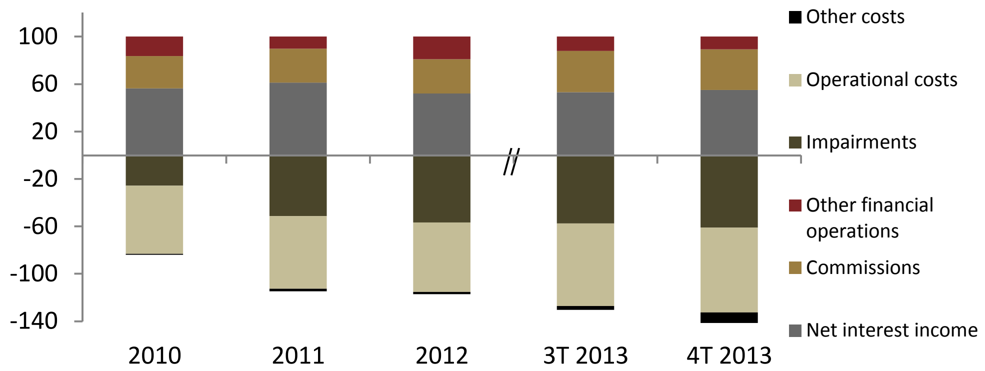


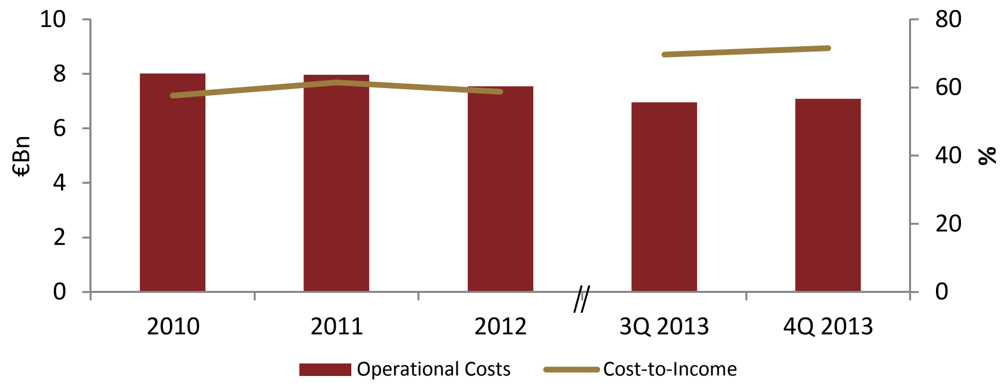
Chart 18

- In 2013, the deterioration in profitability resulted mainly from the reduction of income from the sale of financial assets and the decrease in the net interest margin, which were partially outweighed by the reduction of the impairments flow.
- Although there was a reduction of the net interest margin in 2013 vis-a-vis 2012, there was a gradual recovery of this aggregate throughout 2013.

Source: Banco de Portugal.

Profitability (II/II)

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



* Annualized values.

Chart 19

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

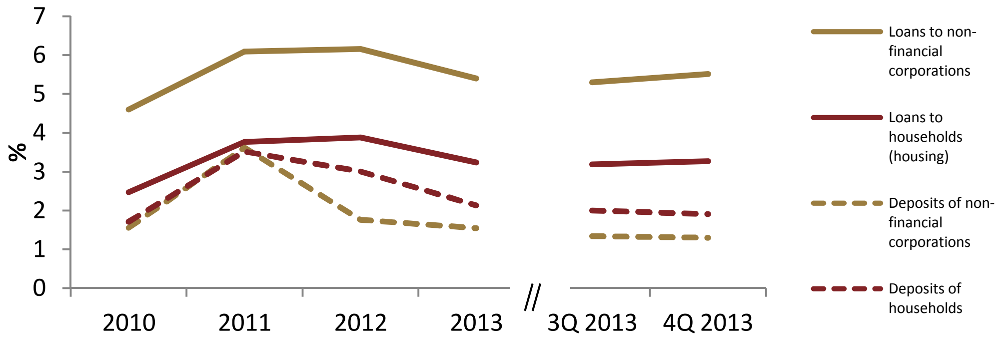


Chart 20

Source: Banco de Portugal.

- The deterioration of the cost-to-income ratio is mainly due to the reduction of gross income.
- Reduction in operational costs was smaller than the decrease in revenues. The restructuring plans being implemented in some of the largest banks should only produce effects in the medium term
- In 2013, the evolution of interest rates had a negative contribution to the evolution of the net interest income.

Solvency

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

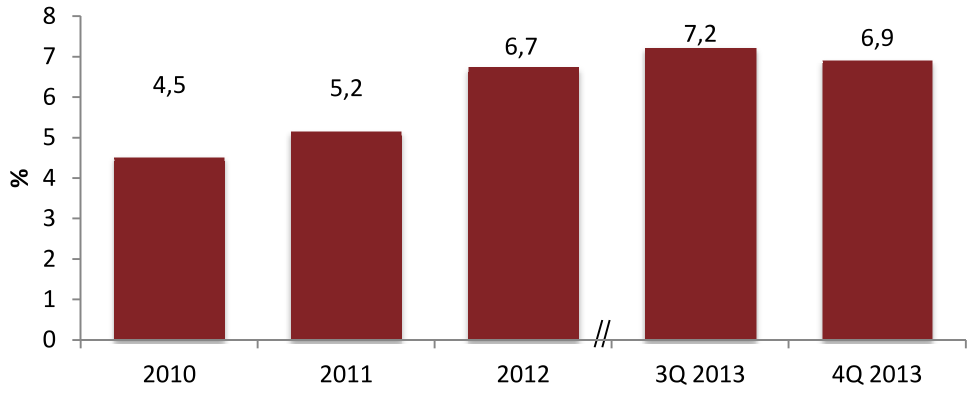


Chart 21

Core Tier 1 ratio - Value at end of period

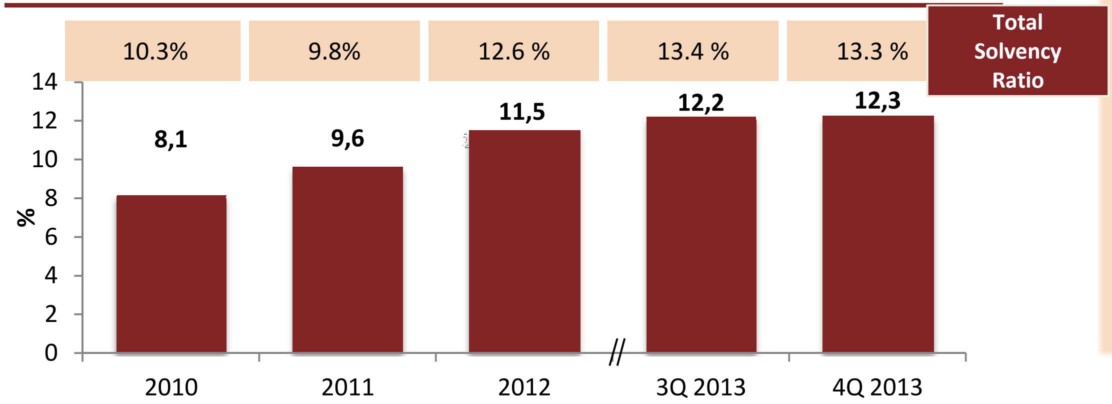


Chart 22

Source: Banco de Portugal.

- The leverage of the banking system, measured by the ratio of capital core tier I and total assets, remained stable in 2013, close to 7%.
- Core Tier 1 ratio increased in 2013, standing above the 10% minimum required by Banco de Portugal.
- Unlike 2012, the strengthening of solvency levels in 2013 resulted from the reduction of assets and not from the increase in own funds.

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