Portuguese Banking System

Recent Developments

Updated: 4th quarter 2014

BANCO DE PORTUGAL
EUROSYSTEM

Prepared with data available up to 30 March 2015

Outline

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- Macroeconomic and Financial Indicators
- Portuguese Banking System
    - Balance Sheet
    - Liquidity & Funding
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    - Profitability
    - Solvency
- Recent Measures with Impact on the Banking System

The Portuguese Banking System – main highlights

I. Balance Sheet

- Banking system total assets continued to gradually decrease.

II. Liquidity & Funding

- Deposits remained resilient over 2014;
- Eurosystem refinancing decreased in line with the trend evidenced in the former quarters;
- The downward trend of the loans to deposits ratio persisted over the quarter.

III. Asset/Credit Quality

- The credit at risk ratio remained virtually unchanged, while slightly differentiated trends were observed across loan purposes.

IV. Profitability

- In 2014, profitability of the banking system improved (excluding BES and Novo Banco) remaining, however, slightly negative in 2014;
- The flow of credit impairments decreased, though remaining at a high level.

V. Solvency

- Solvency levels decreased slightly in the fourth quarter of 2014.

Macroeconomic and Financial Indicators (I/IV)

GDP growth rate - Volume

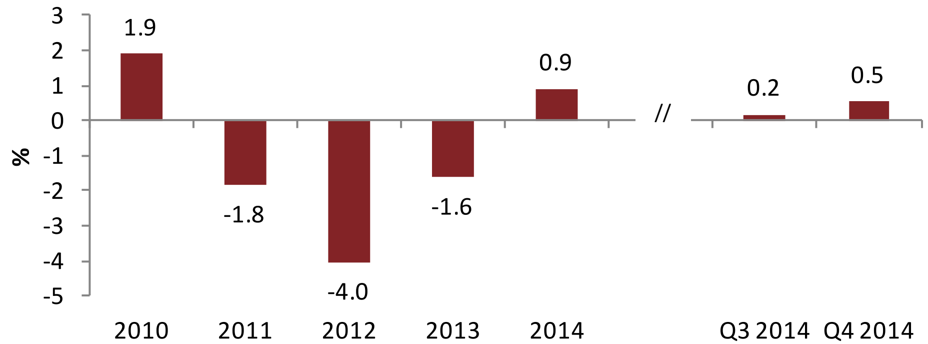

Chart 1

Note: Quarterly figures correspond to q-on-q rates of change. National Accounts and Balance of Payments figures are already presented according the rules of the European System of National and Regional Accounts (ESA 2010) and Balance of Payments and International Investment Position Manual (BPM6).

Current account and capital account, % GDP

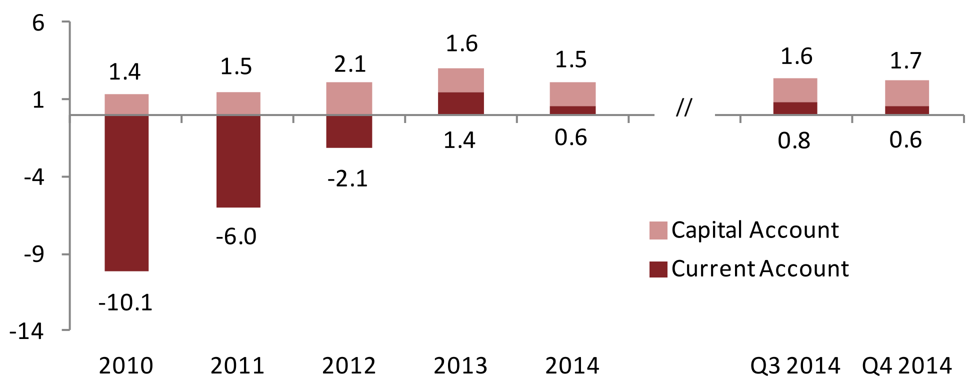

Chart 2

Note: Quarterly figures are seasonally adjusted.

- In 2014, year-on-year GDP growth rate was positive for the first time since 2010, after three successive quarters of positive variation. In the fourth quarter, quarter-on-quarter growth rate has accelerated.

- Current account recorded a surplus, reflecting the ongoing process of adjustment of the Portuguese economy's external imbalance over the recent years.

Source: Banco de Portugal and INE

Macroeconomic and Financial Indicators (II/IV)

Unemployment rate, % of active population

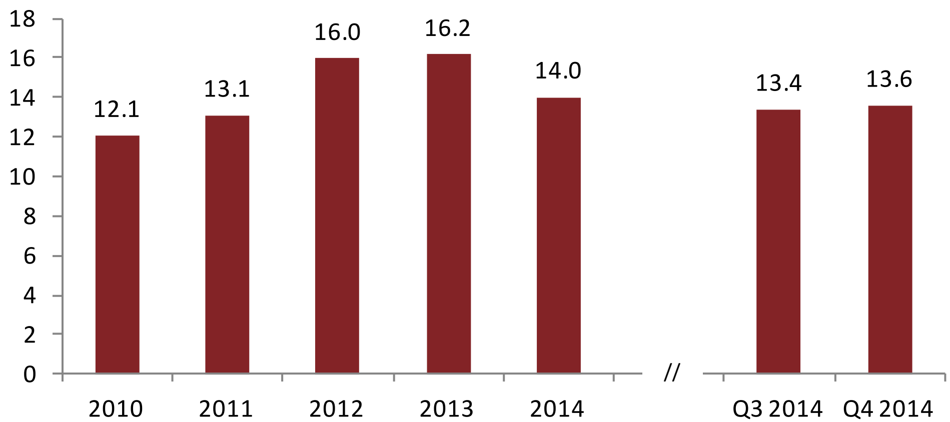

Chart 3

Fiscal deficit, % GDP

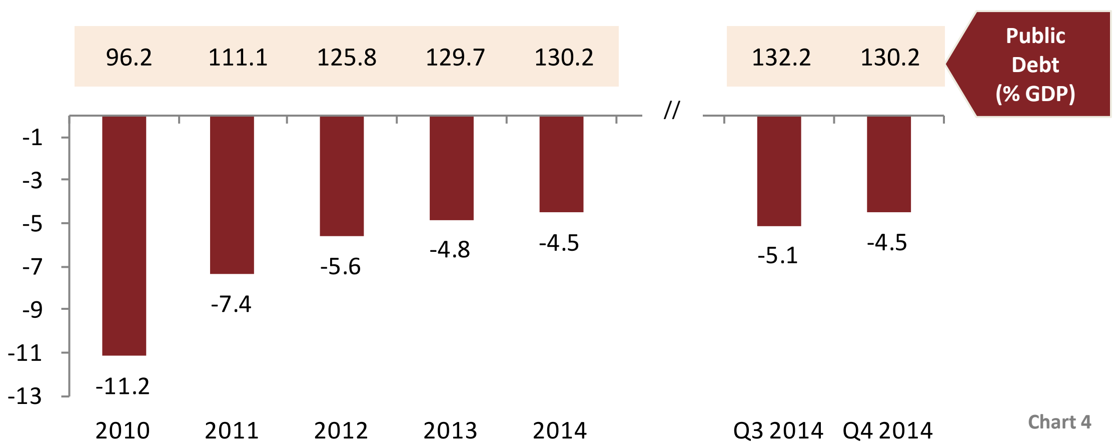

Chart 4

- The average annual rate of unemployment was 2.2 p.p. below the level recorded in 2013. In the fourth quarter of 2014, it stood at 13.6%.

- Public debt as a percentage of GDP stood at 130.2% at the end of 2014. However, there is significant amount of deposits from the General Government (above 12 p.p. of GDP by the end of 2014).

Source: Banco de Portugal and INE

Macroeconomic and Financial Indicators (III/IV)

Net lending/borrowing of non-financial corporations, % GDP

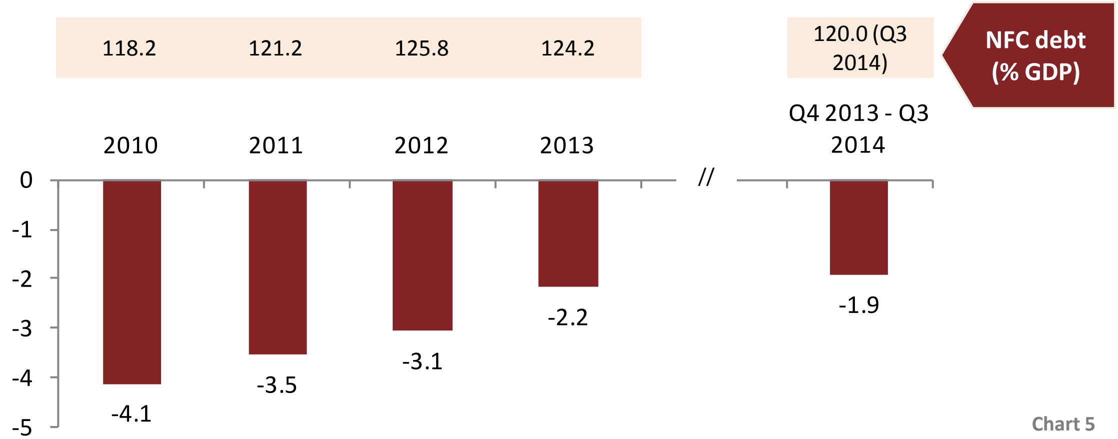

Chart 5

Net lending/borrowing of households, % GDP

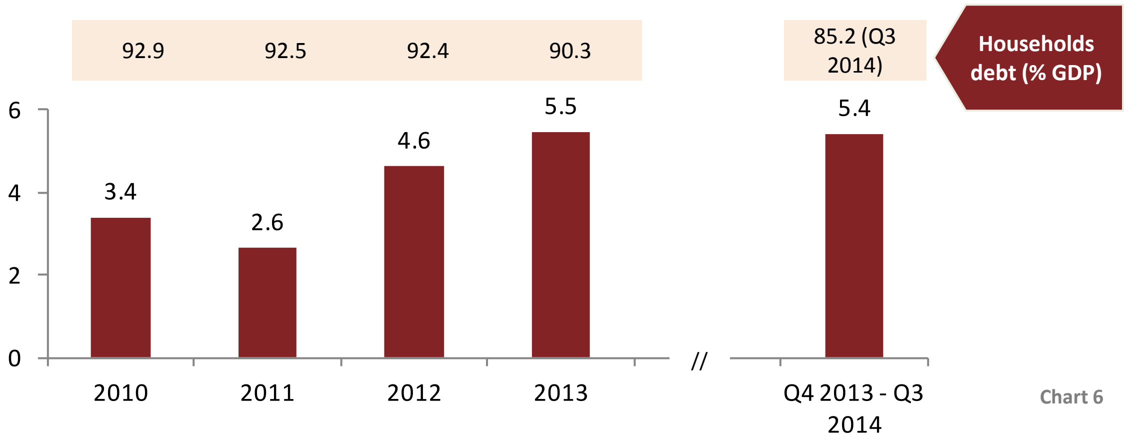

Chart 6

- Non-financial corporations' debt in the third quarter of 2014 has decreased by about 4 p.p. of GDP when compared to 2013, despite the residual increase from the previous quarter
- Non-financial corporations' cumulated financing needs recorded a small reduction compared to 2013.
- The households' indebtedness level continued to decline.
- Households' financing capacity remained above 5% of GDP in the third quarter.

Source: Banco de Portugal and INE

Macroeconomic and Financial Indicators (IV/IV)

Sovereign debt yields 10 Y

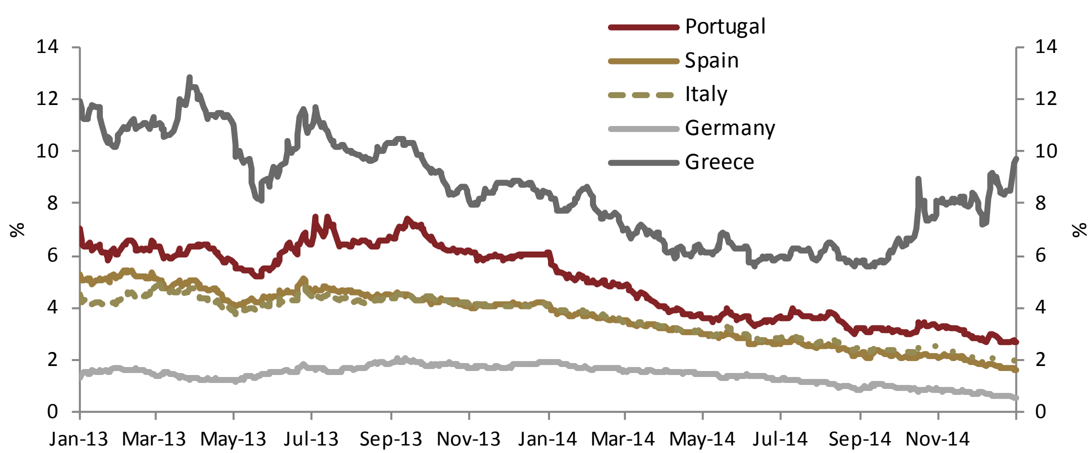

Chart 7

Euribor and ECB main refinancing rate

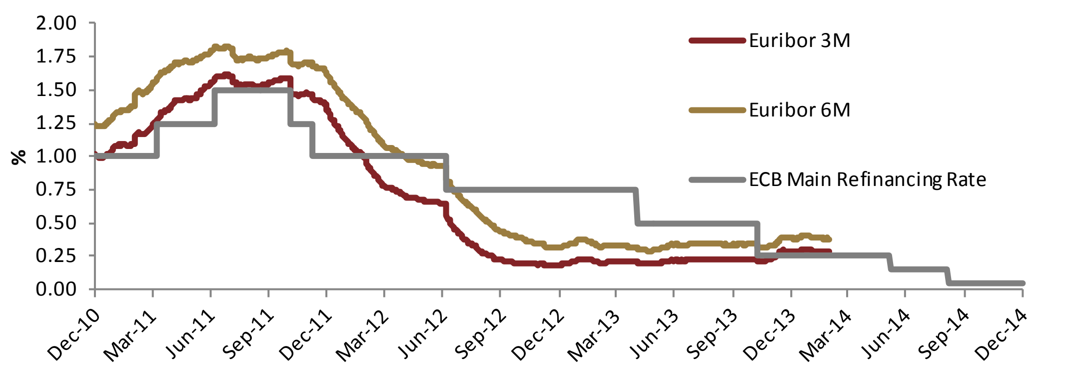

Chart 8

- The Portuguese 10-year government bond yield rates have kept on a downward trend, achieving a historical low (1.56%) in March 2015.
- The spread vis-à-vis comparable German sovereign bonds continued to decrease.
- During the fourth quarter of 2014, the ECB kept unchanged the main refinancing rate (0.05%), the deposit facility rate (-0.20%) and the marginal lending facility rate (0.30%).

Source: Bloomberg and ECB

Comment on accounting and prudential information

The banking system data present a break in time series in the third quarter of 2014 due to the resolution measure applied to Banco Espírito Santo (BES). The break in time series stems, in particular, from the fact that the assets/liabilities not transferred to the balance sheet of Novo Banco (NB) are not considered in the aggregate of the banking system from August 2014 onwards.

In the absence of accounting information for BES on a consolidated basis for the period from 30 June 2014 to the day of implementation of the resolution measure (closing balance sheet and statement of profit or loss), the reporting of BES on individual basis, with reference to 31 July 2014, was considered when determining the aggregate results of the banking system for the third quarter of 2014. However, it must be stressed the fact that the adjustments stemming from the resolution measure applied to BES were not considered.

In relation to profitability indicators, and in addition to the aggregate of the banking system, the figures for Espírito Santo Financial Group (in 2013 and 2014 Q1), Banco Espírito Santo (in 2014 Q2) and Novo Banco (in 2014 Q3 and 2014 Q4) are also presented in order to allow a more thorough analysis of the performance of the remaining institutions. Therefore, the graphs refer to this scenario as “excluding ESFG” and/or “excluding ESFG, BES and NB”, as applicable.

Assets (€Bn) – Value at end of period

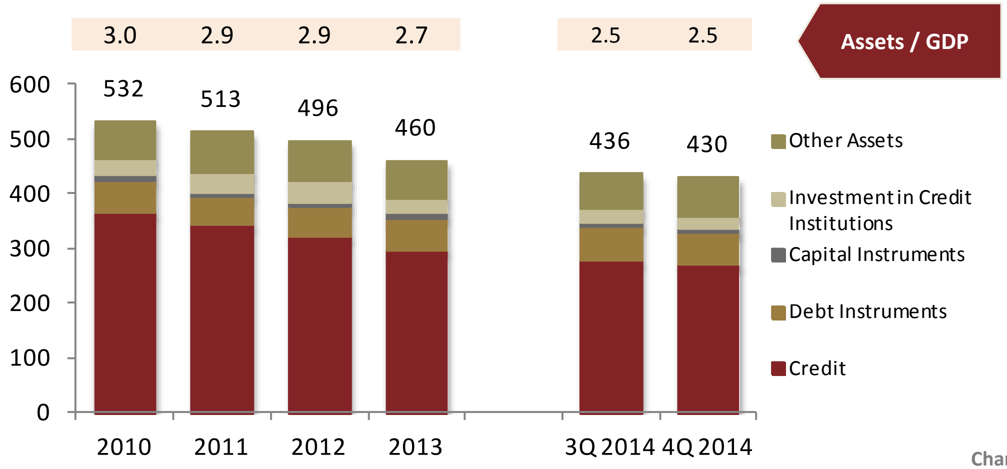

Chart 9

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

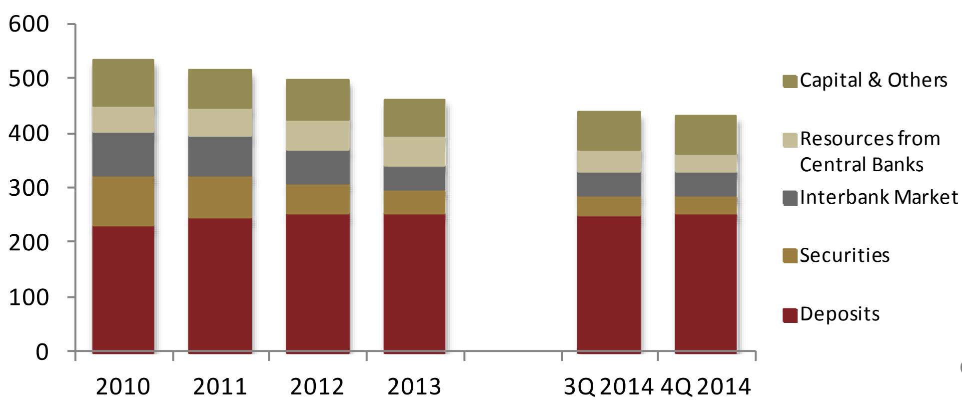

Chart 10

- In the fourth quarter of 2014, bank assets recorded a slight decrease, whereas its composition remained broadly stable.
- Deposits remained resilient.
- Eurosystem refinancing decreased to minimum levels since the beginning of the Economic and Financial Assistance Programme.

Source: Banco de Portugal

Liquidity & Funding (I/II)

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

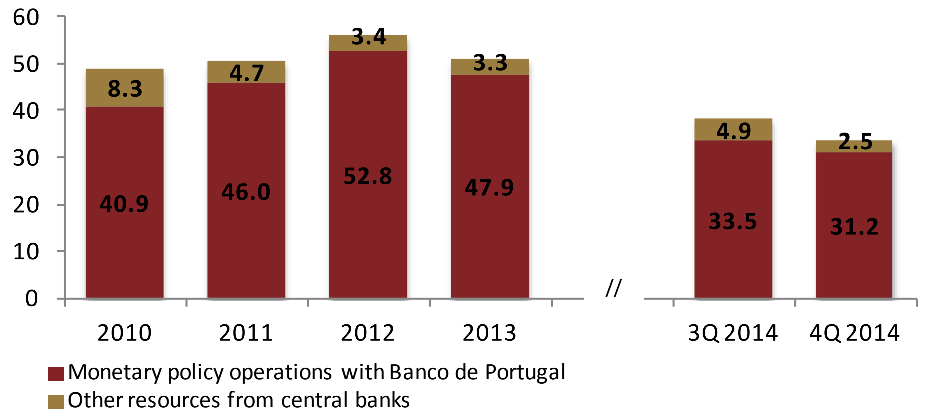

Chart 11

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

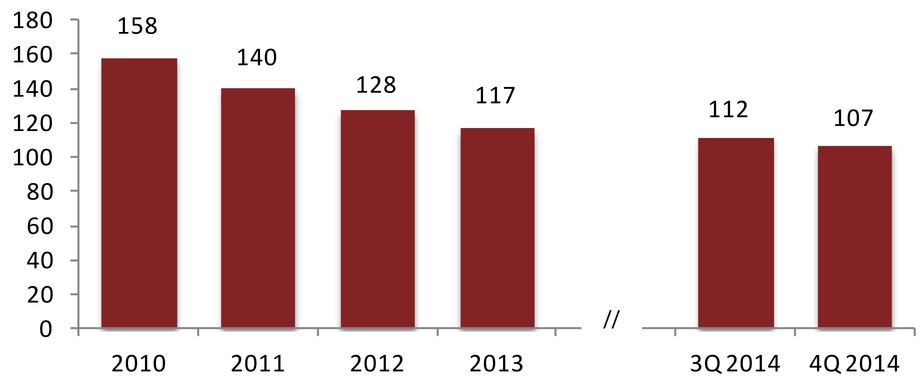

Chart 12

- In the fourth quarter of 2014, Eurosystem refinancing recorded a decrease, in line with the trend evidenced in the former quarters.

- The loans to deposits ratio continued to decrease, in line with the deleverage process observed in other sectors of the economy.

Source: Banco de Portugal

Liquidity & Funding (II/II)

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

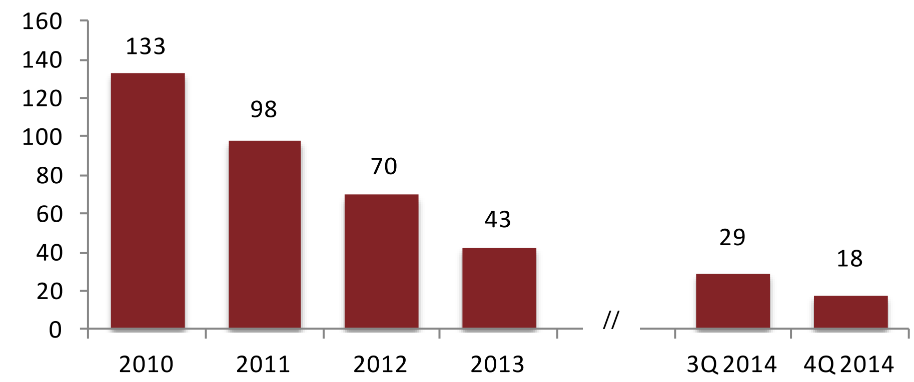

Chart 13

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

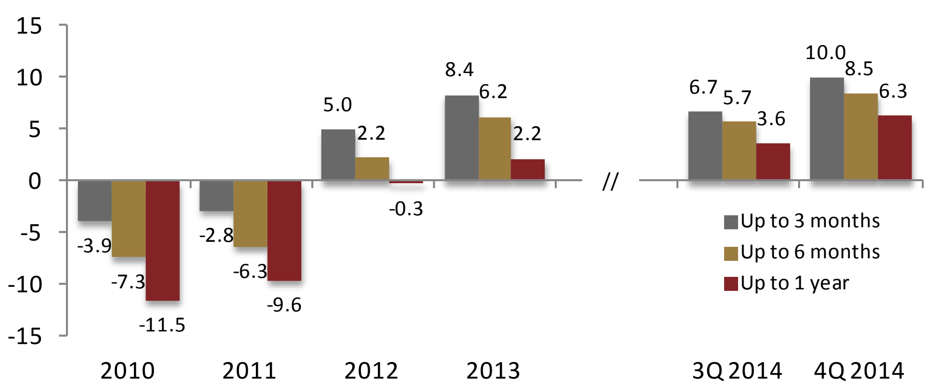

Chart 14

- In the fourth quarter of 2014, the commercial gap followed the downward trend that started in 2010, reflecting the decrease in the credit portfolio.

- Liquidity gaps increased in all maturities, especially in the 6 month maturity ladder. The widespread increase of liquidity gaps is due essentially to the increase of liquid assets.

Source: Banco de Portugal

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

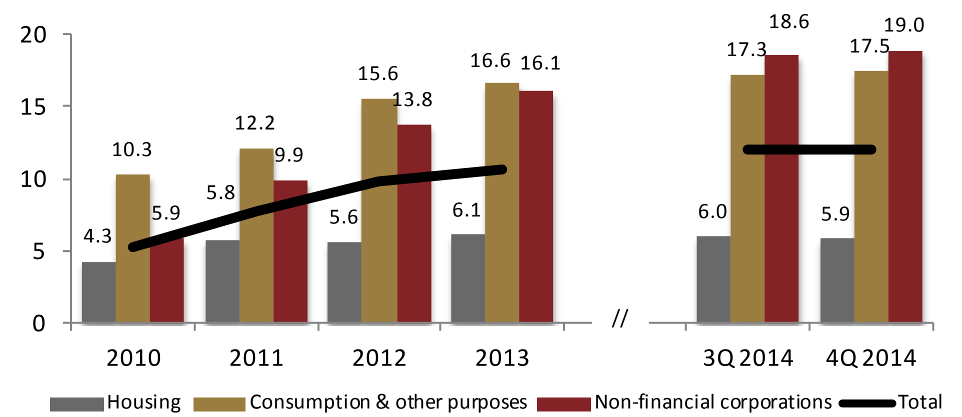

Chart 15

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

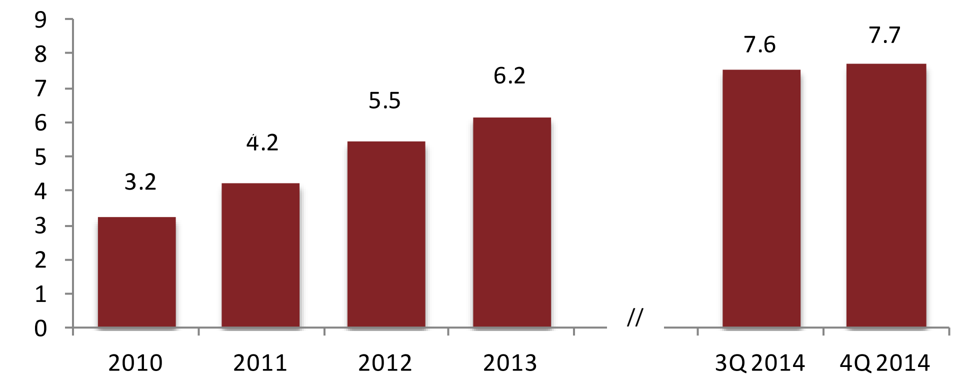

Chart 16

- The credit at risk ratio remained stable over the fourth quarter of 2014, stemming from the reduction of the value of credit at risk, which compensated the reduction in the credit portfolio.

- Notwithstanding, slightly differentiated trends were observed across loan purposes.

- The stock of impairments as a percentage of gross loans recorded a small increase when compared to the third quarter.

Source: Banco de Portugal

Profitability (I/II)

ROA & ROE – Value in the period

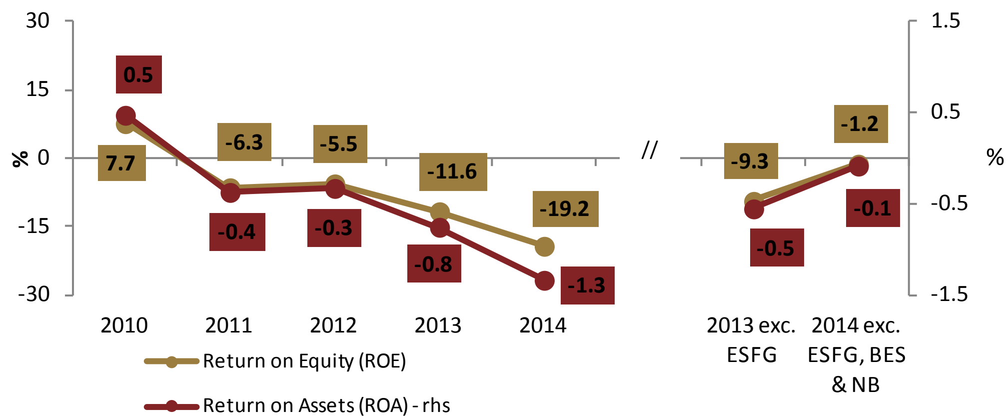

Chart 17

Note: Return is measured by earnings before taxes and minority interests.

Income and costs as a % of gross income - Value in the period

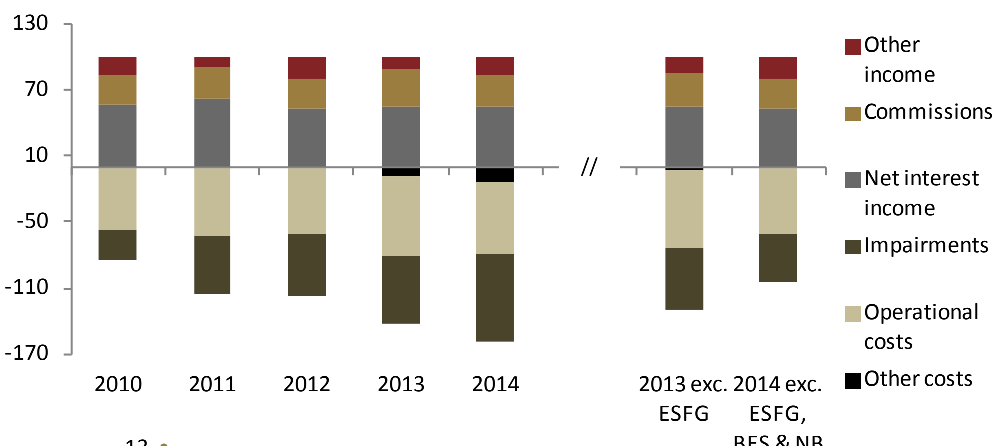

Chart 18

Source: Banco de Portugal

- Excluding ESFG/BES/NB, there was an improvement of both return on assets and return on equity, remaining, however, negative in 2014.

- The increase of net interest income and returns of financial operations (included in other income), as well as the reduction of the flow of impairments, contributed to the aforementioned improvement of banking system returns.

Profitability (II/II)

Cost-to-Income (%), Operational Costs (€Bn) - Value in the period

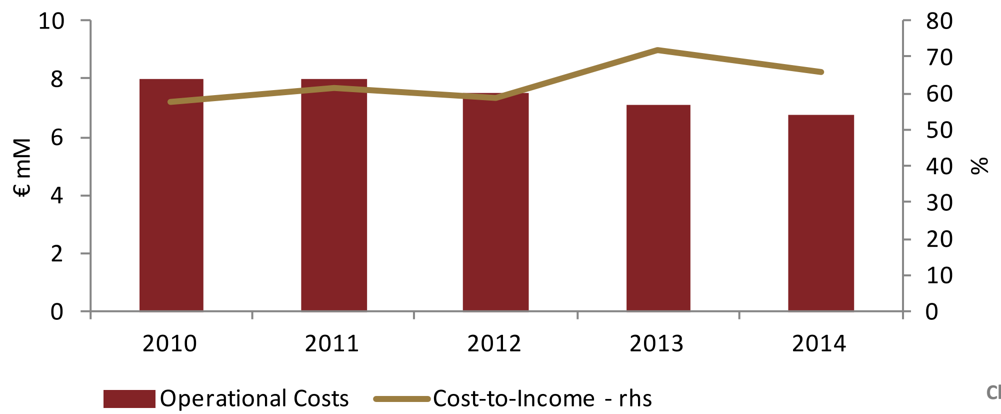

Chart 19

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

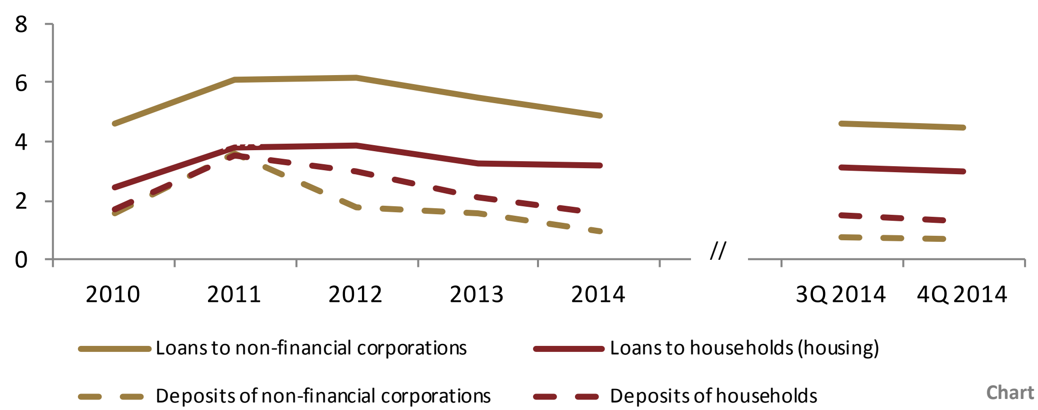

Chart 20

Source: Banco de Portugal

- In 2014, the reduction of the cost-to-income ratio was mainly driven by the increase of gross income when compared to 2013. The operational costs decreased marginally.
- In the last quarter of 2014, interest rates on new loans remained stable for the non-financial corporations' segment.
- Interest rates on new loans granted to households (for housing purposes) remained stable since the beginning of 2013.
- The cost of new deposits kept a downward trend, recording in the fourth quarter a reduction of 12 b.p. for the non-financial corporations' segment and 19 b.p. for households' segment.

Tier 1 capital to Total Assets ratio - Value at end of period (%)

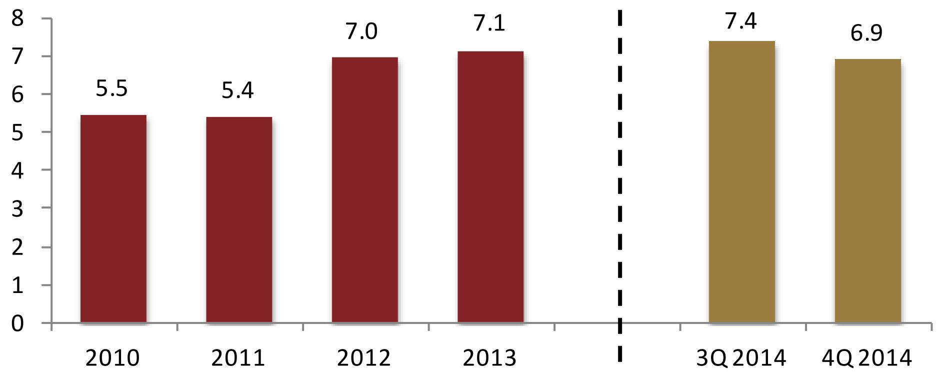

Chart 21

Core Tier 1 ratio (until 2013) and CET 1 ratio (2014) - Value at end of period (%)

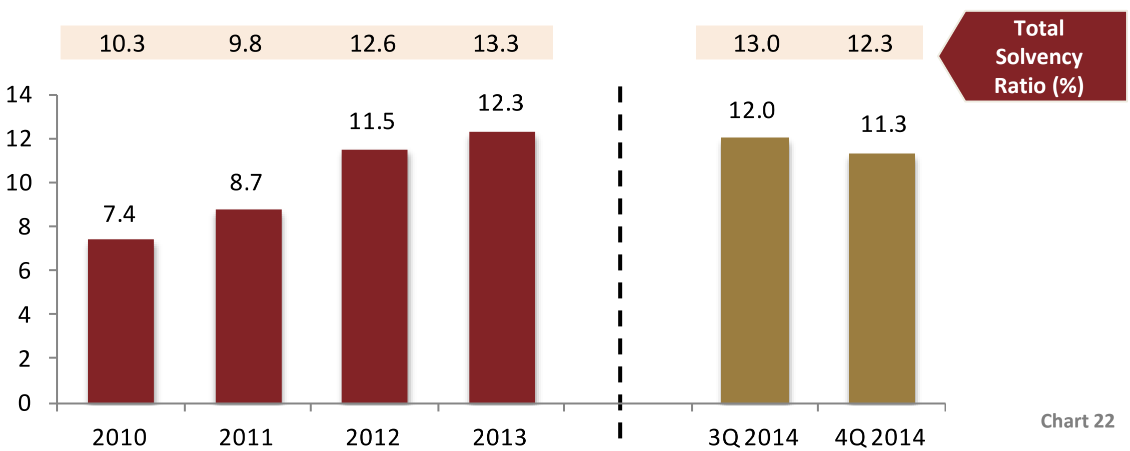

Chart 22

- The ratio between Tier 1 capital and total assets stood at 6.9% at the end of the fourth quarter of 2014 decreasing 0.5 p.p. vis-à-vis the previous quarter.

- The CET 1 ratio reached 11.3% for the aggregate of the Portuguese banking system.

- The decrease in capital ratios in the fourth quarter resulted in part from the revision of the actuarial assumptions followed by some banks' pension funds.

Source: Banco de Portugal

Recent Measures with Impact on the Banking System (I/IV)

Topic	Institution	Latest measures (Q4 2014)
Monitoring and Supervision	**Banco de Portugal**	Entry into force of Notice No 24/2014 of Banco de Portugal that regulates FINREP on solo basis. With the publication of an updated version of European Banking Authority's (EBA) Implementing Technical Standards ("ITS") on Supervisory Reporting on a consolidated basis, the EBA is currently working on similar reporting concerning solo basis. Meanwhile, Banco de Portugal concluded it was crucial to anticipate the FINREP reporting on solo basis (on a simplified format) that allows the aggregation of data concerning every institution of the Portuguese banking system for statistical purposes, until the ECB puts forward its own FINREP reporting framework on solo basis, which may be more extensive.
	ECB	Under Regulation 1024/2013, the European Central Bank (ECB) assumed, on 4 November, responsibility for the supervision of Euro Area banks, following a year-long preparatory phase which included an in-depth examination of the resilience and balance sheets of the biggest banks in the euro area (Comprehensive Assessment), as well as the adoption of legal acts defining how the Single Supervisory Mechanism (SSM) operates and the establishment of new governance structures at the ECB. The ECB will directly supervise about 120 significant institutions/banking groups. For all other 3500 banks the ECB will also set and monitor the supervisory standards and work closely with the national competent authorities in the supervision of these banks.
	ECB and Banco de Portugal	Comprehensive Assessment results were published on 26 October 2014. The Comprehensive Assessment was a financial health check of the significant institutions/banking groups (including Lithuania), covering approximately 82% of total bank assets. It was carried out by the ECB together with the national supervisors between November 2013 and October 2014 in preparation for the Single Supervisory Mechanism to become fully operational. The Comprehensive Assessment concluded with an aggregate disclosure of the overall outcomes as well as bank-level data, together with recommendations for supervisory measures.

Recent Measures with Impact on the Banking System (II/IV)

Topic	Institution	Latest measures (Q4 2014)
Solvency and liquidity	**Banco de Portugal**	Decision of the Banco de Portugal's Board of Directors of 1 December to deactivate the MMI/SG platform from 1 July 2015.
	ECB	Announcement by the Governing Council of the ECB, on 2 October 2014, of the operational details of the two new asset purchase programmes, the Covered Bond Purchase Programme 3 (CBPP3) initiated on 20 October 2014 and the Asset-backed Securities Purchase Programme (ABSPP) initiated on 21 November 2014.
Legal framework	**Banco de Portugal**	Publication of Notice No 11/2014, of 22 December, which regulates the application of prudential requirements to certain types of Portuguese companies – "*sociedades financeiras de crédito*", "*sociedades de investimentos*", "*sociedades de locação financeira*", "*sociedades de factoring*", "*sociedades de garantia mútua*" and "*IFD – Instituição Financeira de Desenvolvimento, S.A.*"
		Publication of Instruction No 25/2014 on 15 December (revoking Instruction No 12/2010), concerning Monetary Financial Institutions Balance Sheet and Interest Rates Statistics. The new Instruction transposes into the national legal framework the statistical reporting requirements to the ECB defined by the Regulations (EU) No 1071/2013 (ECB/2013/33) and No 1072/2013 (ECB/2013/34) of the European Central Bank, both of 24 September 2013.
		Publication of Notice of Banco de Portugal No 10/2014 on 3 December, on "Duties of information during the lifetime of consumer credit agreements", that enters into force on 1 July 2015. This Notice requires institutions to send their customers a regular statement on the evolution of the consumer credit agreements, covering credit cards, personal credit and car credit. The Notice also establishes that customers have the right to information on the situation of their credit in case of arrears, settlement of arrears or early repayment, in part or in full, of the credit agreement. The Notice also sets out in detail the information to be included in the statements.
		Publication of Notice No 9/2014, of 3 November, which regulates certain options provided for in Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms, whose exercise is assigned to the competent authorities.

Recent Measures with Impact on the Banking System (III/IV)

Topic	Instituition	Latest measures (Q4 2014)
Legal framework	**ECB**	Publication of Regulation (EU) No 1333/2014 of the European Central Bank of 26 November 2014, concerning statistics on the money markets (ECB/2014/48), which defines the reporting requirements to the ECB of comprehensive, detailed and harmonised statistical information on the money markets in the euro area. This report has a daily periodicity and it will be implemented in two phases: the first, from April 2016, for the information related to the major banking institutions, in which Portugal won't be, in principle, represented; and the second, subject to a decision of the ECB Council, from 2018 onwards, in which all Member-States will be represented by a minimum of three institutions.
	Portuguese Government	Publication of Decree-Law No 157/2014 of 24 October 2014 that: (i) implements in Portuguese law a number of options conferred on Member States by Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013; (ii) transposes the Directive No 2013/36/EU 26 June which constitutes, together with the Regulation (EU) No 575/2013, the basis of the European Union legal framework which regulates the access to the activity of the credit institutions and the supervisory framework and prudential rules applicable to the credit institutions and investment companies. This Decree-law amends: the Legal Framework of Credit Institutions and Finance Companies, approved by the Decree-law No 298/92 of December 31 (the "Banking Law"); the Securities Code; Laws Nos 25/2008 (establishing the preventive and repressive measures for the combat against the laundering of benefits of illicit origin and terrorism financing) and 28/2009 (reviews the legal framework for imposing penalties in the financial sector concerning criminal and administrative penalties); and the Decree-laws Nos 260/94 (legal framework of investment companies), 72/95 (legal framework of financial leasing companies), 171/95 (legal framework of factoring companies and factoring agreements), 211/98 (legal framework of mutual guarantee companies), 357-B/2007 (legal framework applicable to companies whose exclusive object is to provide investment advice in financial instruments and the reception and transmission of orders on behalf of a third party with respect to same), 357-C/2007 (legal framework applicable to management companies of regulated markets, management companies of multilateral trading facilities, management companies of the clearing-house acting as a central counterparty, management companies of the settlement system and management companies of the Central Securities Depositary), 317/2009 (legal framework governing the taking up of the business of payment institutions and the provision of payment services) and 40/2014 (implements Regulation (EU) no. 648/ 2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories as well as Delegated and Implementing Acts related to such Regulation).

Recent Measures with Impact on the Banking System (IV/IV)

Topic	Instituition	Latest measures (Q4 2014)
Legal framework	**Portuguese Government**	Publication of Decree-Law No 155/2014, on 21 october, under which is created *the IFD – Instituição Financeira de Desenvolvimento, S.A.* and approved its by-laws. The IFD was set with the purpose of overcoming the market's shortfalls to funding viable SMEs by means of (i) managing investment funds and other similar vehicles financed by public funds aimed at supporting the economy; (ii) granting credit, collaterals and other tools, as necessary.
Other	**Banco de Portugal**	Amendment to Instruction of Banco de Portugal No 3/2009, in order to reschedule the clearing and settlement times of the SEPA CORE and SEPA B2B Direct Debit subsystems. In addition, the text of the Instruction was updated following the completion of the migration to SEPA occurred on 1 August 2014, in accordance with Regulation (EU) No 260/2012 of the European Parliament and of the Council, of 14 March, establishing technical and business requirements for credit transfers and direct debits in euro. Specifically, the references to the direct debits legacy subsystem were eliminated and the references to the credit transfers legacy subsystem was replaced by the expression non-SEPA credit transfers subsystem.

Portuguese Banking System

Recent Developments – 4th quarter 2014

BANCO DE PORTUGAL
EUROSYSTEM