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Portuguese Banking System
Latest Developments

Updated: 2Q 2013

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Portuguese Banking System – latest developments

- Portuguese Banking System – Main Highlights
- Latest Banking system Measures
- Portuguese Banking System
  - Balance Sheet Structure
  - Liquidity & *Funding*
  - Asset Quality
  - Profitability
  - Solvency & Leverage

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The Portuguese Banking System – main highlights

I **Balance Sheet Structure**

- Ongoing deleveraging process

II **Liquidity & Funding**

- Positive trend in deposits, in absolute terms and as % of total funding
- Steady decrease in LTD ratio

III **Asset/Credit Quality**

- Credit quality as one of the main challenges in the Portuguese banking system
- High provisioning effort

IV **Profitability**

- Profitability under pressure
- Credit impairments at historic highs and revenues pressure reflecting the adverse macro conditions

V **Solvency & Leverage**

- Core solvency levels strengthened, reflecting the recapitalization operations carried out in 2012 and 2013

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

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Latest banking system measures

Topic	Institutions	Latest measures
Solvency & liquidity	Banco de Portugal	• Following the creation of the platform for the registration and processing of interbank money market unsecured operations, on September 3rd, 2012, Banco de Portugal launched, on May 6th, 2013, a new platform for secured operations in order to facilitate the functioning of the domestic interbank money market.
	ECB	• On May 2nd, 2013, the Governing Council of the ECB decided to continue conducting its refinancing operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the second half of 2014.
Monitoring & supervision	Banco de Portugal	• Launching of a transversal on-site inspection to the 8 major banking groups, with the aim of assessing the adequacy of impairments levels for credit portfolio; • Setting of a mandatory semiannual report for supervised credit institutions, containing a detailed assessment prepared by the external auditor on the processes and methodologies used to quantify the impairment for credit portfolio. To this effect, Instruction 5/2013 was published. The 1st report will refer to June 30, 2013.

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Portuguese banking system
I. Balance Sheet Structure

Assets (€Bn) - Value at end of period

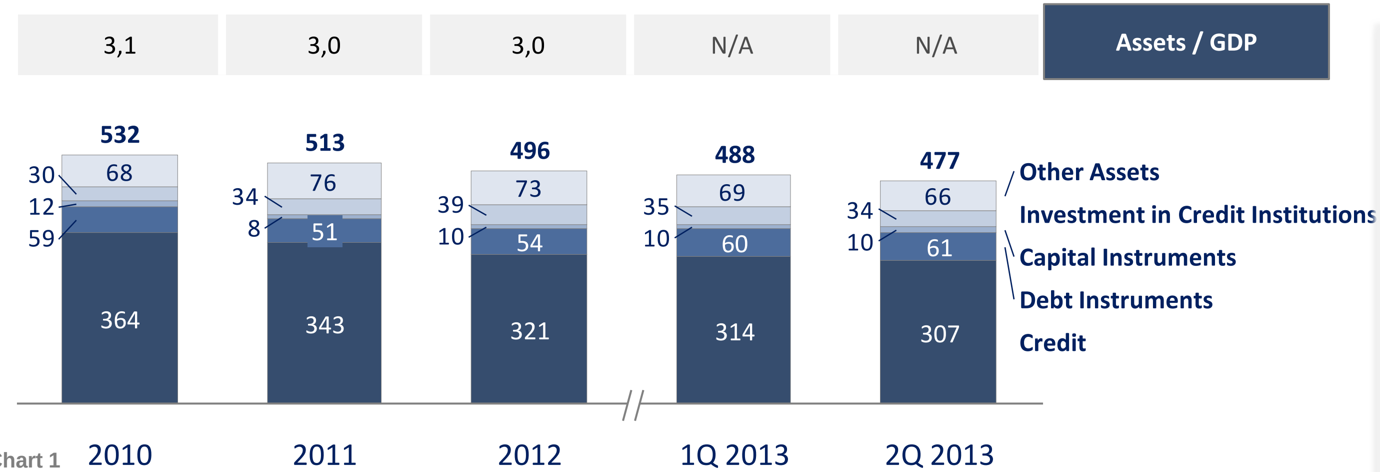

Chart 1

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

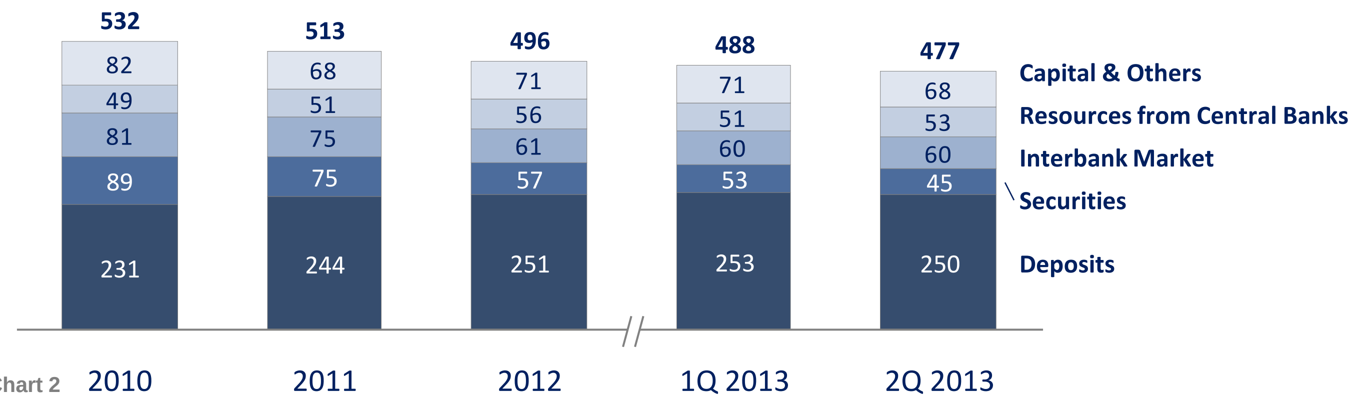

Chart 2

Source: Banco de Portugal (1 and 2)

- Throughout the last years the Portuguese banking system has been deleveraging;
- Since the end of 2010 and until June 2013 the loan book (net of impairments) has posted a contraction in excess of 10%, resulting from a decrease in new business and increase in impairment values;
- The funding structure of the banking system has been gradually adjusting to a structure with higher proportion of stable funding sources, namely deposits;
- The weight of debt issued in the financing structure has been steadily decreasing, also reflecting adverse market conditions.

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II. Liquidity & Funding (I/II)

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

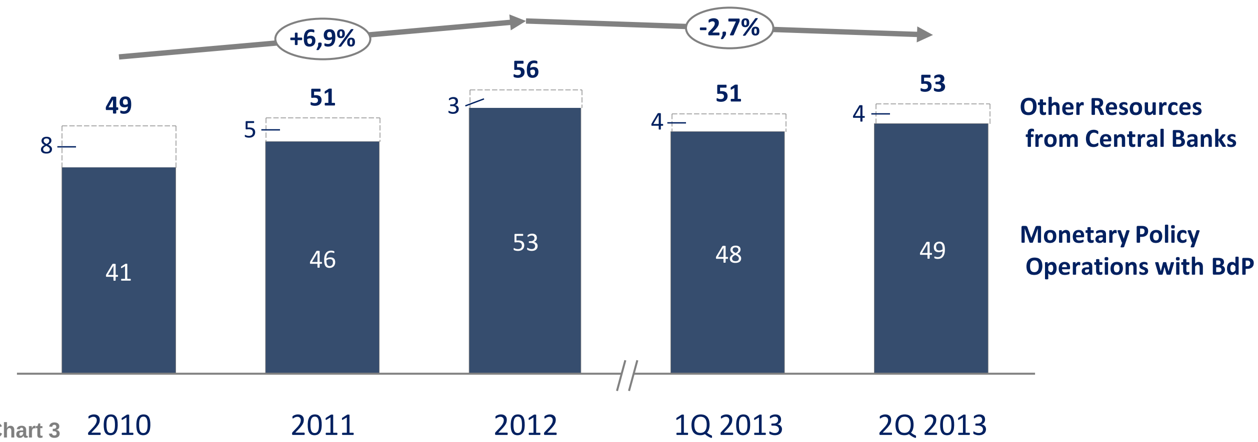

Chart 3

Loan-To-Deposits ratio - Value at end of period

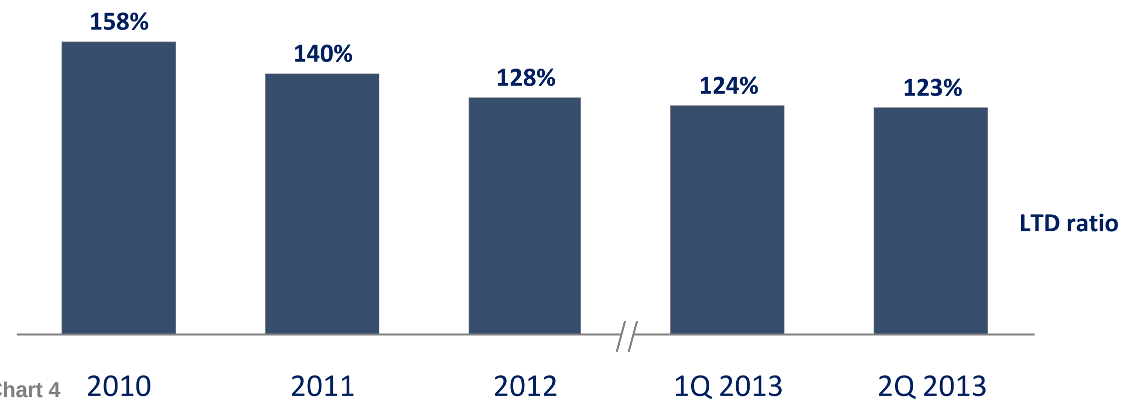

Chart 4

Source: Banco de Portugal (3 and 4)

- After a significant increase between 2010 and 2012, when it reached its peak, dependence from Eurosystem funding remained broadly stable during the first half of 2013;
- The deleveraging process that the banking system is undertaking is visible in the loan-to-deposits ratio, accomplished by an increase in deposits and a decrease in net credit.

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II. Liquidity & Funding (II/II)

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

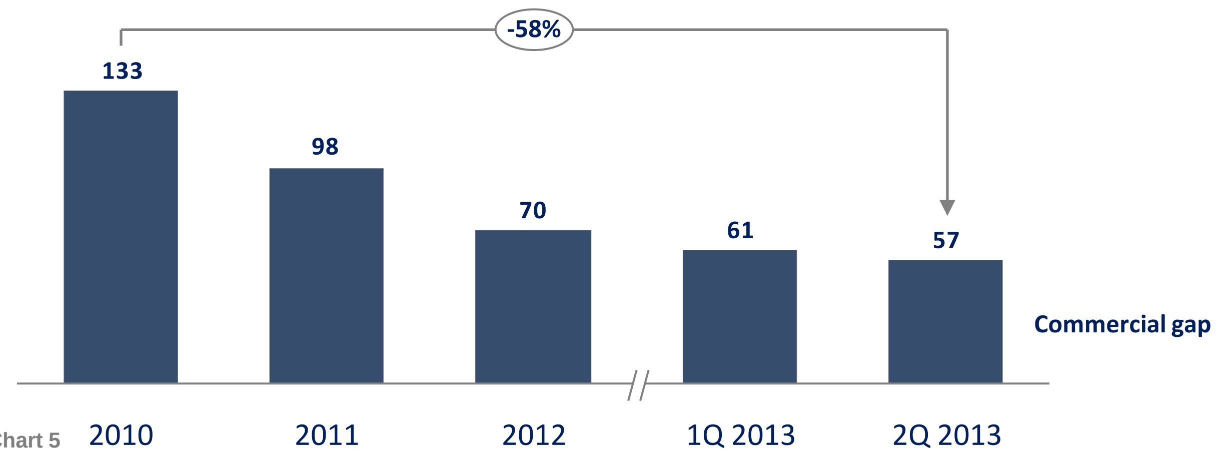

Chart 5

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

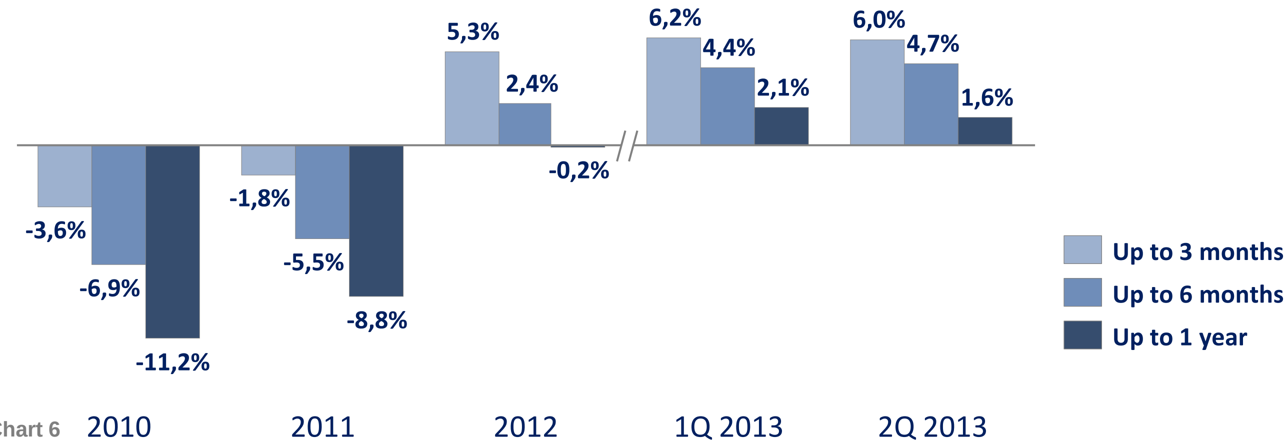

Chart 6

Source: Banco de Portugal (5 and 6)

- The structural adjustment on the banking sector also reflected the decrease of the commercial gap to 57 €Bn;
- Since 2012, the liquidity gap has been signaling a comfortable situation for all maturities up to 1 year.

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III. Asset Quality

Credit at Risk (NPL) ratio - Value at end of period

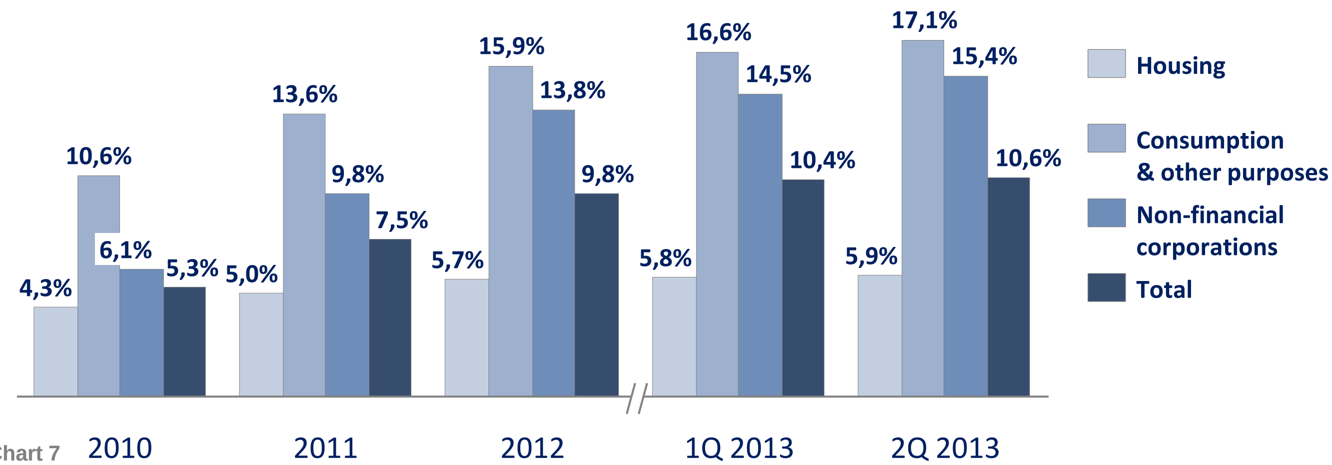

Chart 7

Credit Impairment as % of total credit (gross) - Value at end of period

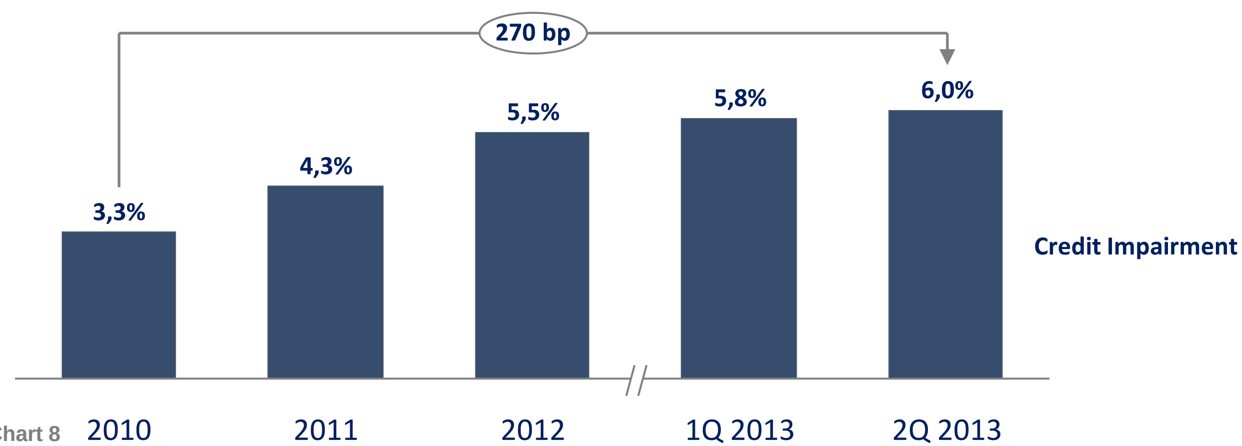

Chart 8

Source: Banco de Portugal (7 and 8)

- The deterioration in the asset quality indicators reflects the challenging macroeconomic environment in which banks have been operating;
- The NPL ratio has been steadily rising for the last years, with the non-financial corporation segment as the main driver for the increase. Despite its high ratios, the consumption & other purposes segment does not influence significantly the total, due to its small weight in the credit portfolio;
- In line with the deterioration in the credit quality situation, impairments for credit have also been increasing, representing currently almost 6% of total loans.

IV. Profitability (I/II)

ROA & ROE - Value at end of period

Chart 9

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

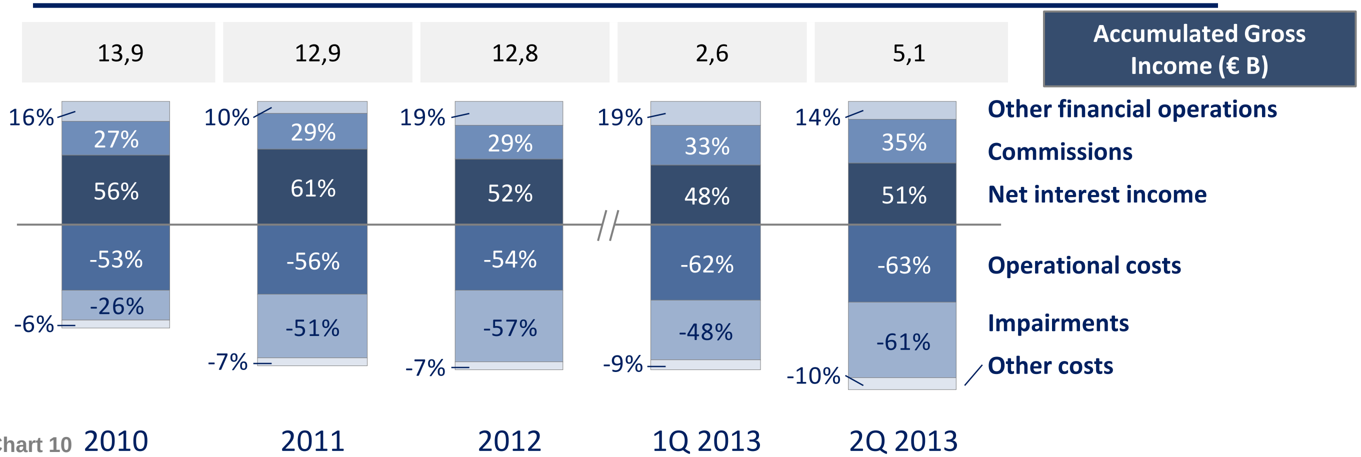

Chart 10

Source: Banco de Portugal (9 and 10)

- Results generated in the last years (since 2011) have been negative;
- Main sources of pressure in the profitability levels in the banking system stem from strong increases in impairment levels (credit and other assets) and from the net interest income.
- Profitability in 2011 suffered relevant impacts from one-off items (impairments for Greek government bonds, the impact from the partial transfer of pension funds to the Social Security);
- Revenues, mainly net interest income, are under pressure in a context of very low interest rates, lower credit volumes, higher cost of funding and deterioration in asset quality.

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IV. Profitability (II/II)

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

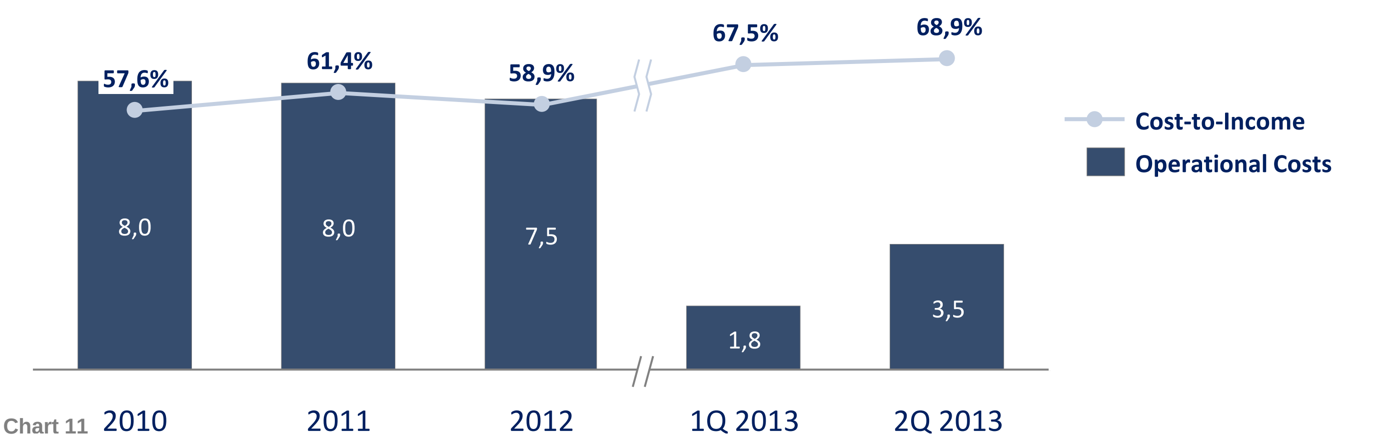

Chart 11

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

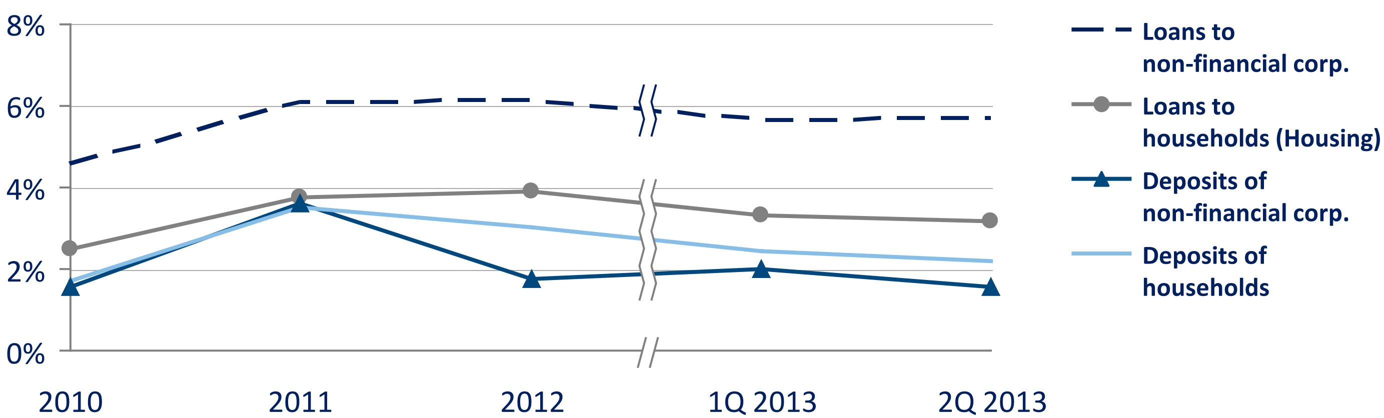

Chart 12

Source: Banco de Portugal (11 and 12)

- Banks have been implementing cost cutting programmes in the domestic activity, with the closing of branches and headcount reductions;
- Despite the efforts, the adopted measures have not been able to overcome the reduction in net operating revenues;
- Interest rates for new loans remain high whereas deposits remuneration rate for new business dropped from its peak in 2011, with a tendency to lower the pressure on net interest margin;

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V. Solvency & Leverage

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

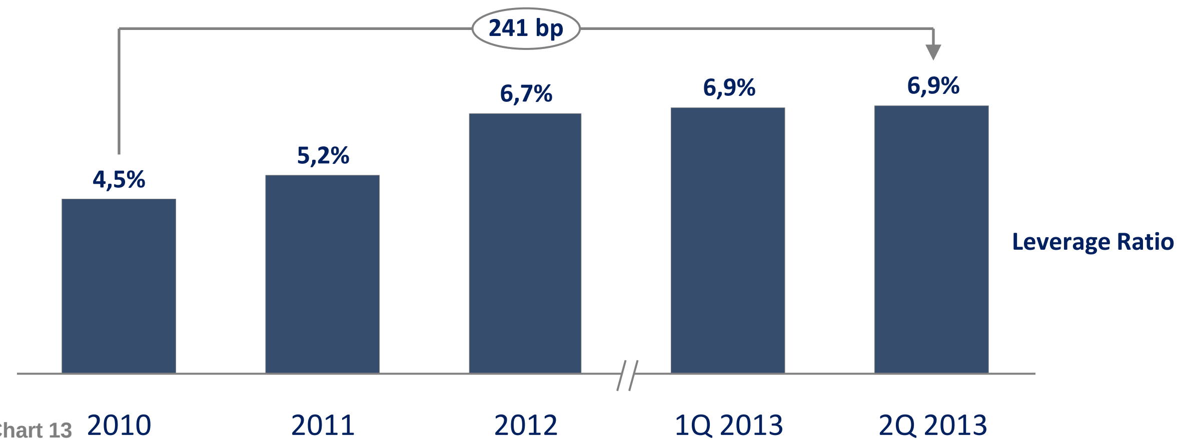

Chart 13

Core Tier I ratio - Value at end of period

2010	2011	2012	1Q 2013	2Q 2013	
11,1%	10,7%	12,6 %	13,0 %	13,1 %	Total Solvency Ratio

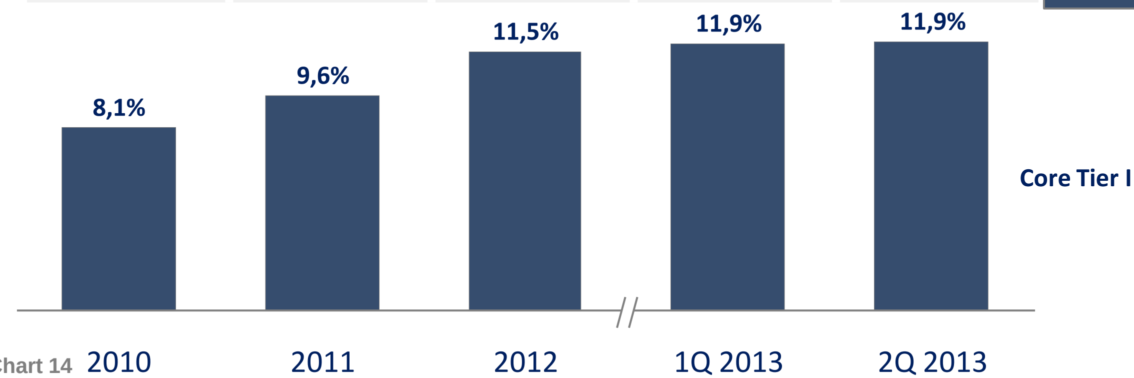

Chart 14

Source: Banco de Portugal (13 and 14)

- Despite the strong pressure in profitability, the solvency levels in the Portuguese banking system have been strengthened;
- The improvement in 2012 and 2013 reflects the recapitalization operations carried out through public and private investments;
- Core Tier1 capital represents almost 7% of total assets, which compares very favourably with the average in the European banking sector.
- Core Tier I ratio stands comfortably above the minimum of 10% required by Banco de Portugal since 2012 (9% in 2011)

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