Portuguese Banking System: latest developments

1st quarter 2017

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EUROSYSTEM

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1. Portuguese Banking System – Main Highlights

Balance sheet

Banking system's total assets remained stable vis-à-vis the last quarter of 2016.
The recapitalization processes of CGD and BCP contributed to changes in the balance sheet structure and resulted in a strengthening of the banking system's capital position.
The deconsolidation of some assets/liabilities in the context of the partial sale of BPI's participation in the Angolan operation also led to a change in the structure of system's balance sheet.

Liquidity and funding

Contrary to recent periods, the financing obtained from the Eurosystem increased.
The loan-to-deposit ratio and the commercial gap decreased slightly compared to the previous quarter, exhibiting a trend of relative stabilization in the latest quarters.

Asset quality

The non-performing loans ratio declined in the first quarter of 2017, reflecting a reduction in the total value of non-performing loans. This development was common to all segments analysed.

Profitability

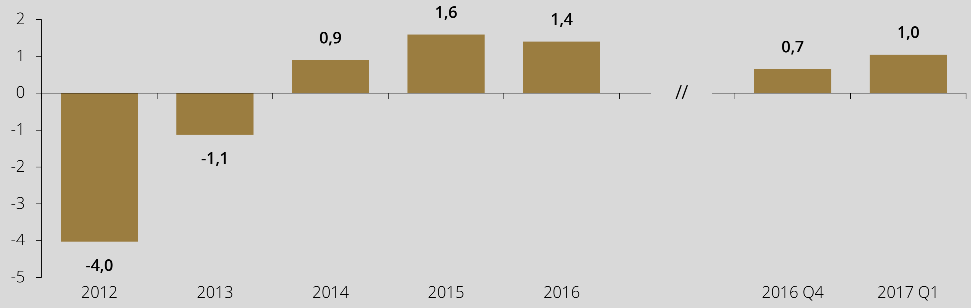
The profitability of the banking system was positive in the first quarter of 2017, after being negative in 2016.
Compared to the first quarter of the previous year, there was an improvement in profitability driven by a growth in net interest income and in income from financial operations and a decrease in the flow of impairments.

Solvency

Following a temporary fall in the last quarter of 2016, chiefly due to the extraordinary increase in the level of impairments, solvency levels returned to figures close to those observed in the third quarter of 2016.

2. Macroeconomic and Financial Indicators

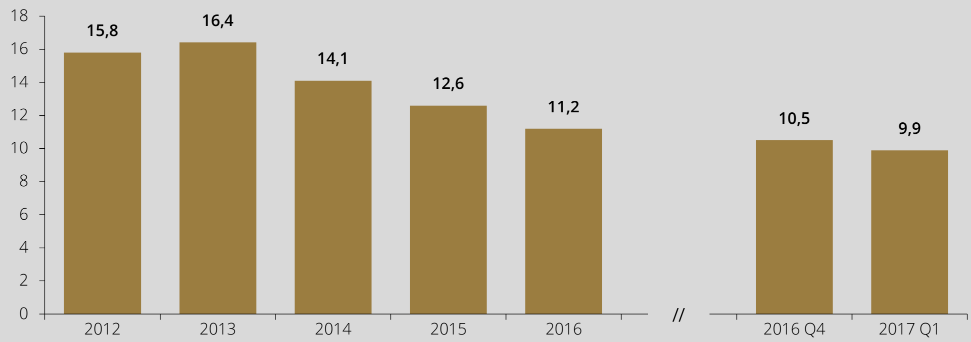
Chart 1 • GDP growth rate, in % | Volume



Source: INE.
Note: Quarterly figures correspond to quarter-on-quarter rates of change. National Accounts figures are already presented according the rules of the European System of National and Regional Accounts (ESA 2010).

- Following a 1.4% growth in 2016, GDP grew 2.8% in 2017 Q1 (year-on-year).
- In 2017 Q1, the GDP quarter-on-quarter growth rate stood at 1.0%.

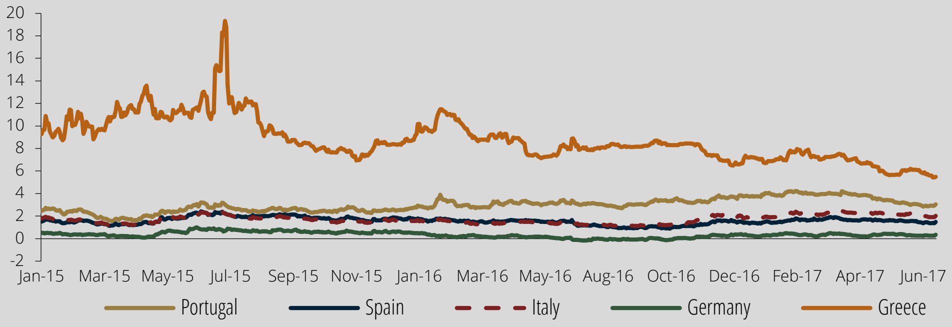
Chart 2 • Unemployment rate, % of active population



Sources: Banco de Portugal and INE.
Note: The unemployment rate corresponds to the figure of the central month of each quarter published by the National Statistical Institute, seasonally adjusted.

- In 2017 Q1, the unemployment rate fell by 0.6 p.p. vis-à-vis the previous quarter standing at 9.9%.
- The unemployment rate declined 2.3 p.p., year-on-year.

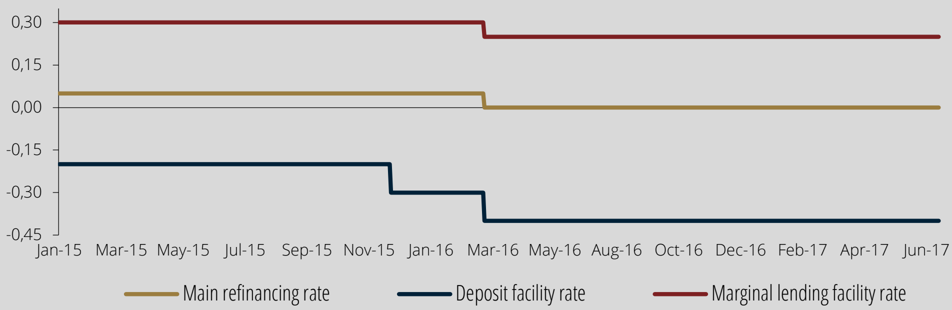
Chart 3 • Sovereign debt yields 10Y, in %



Source: Thomson Reuters.

- The Portuguese 10-year government bond yield rose by approximately 20 basis points between 30 December 2016 and 31 March 2017, while the spread vis-à-vis the German 10-year government bond yield increased by 9 basis points. However, these movements were reverted throughout the second quarter of 2017, with the yield of the Portuguese 10-year government bond declining significantly (94 basis points), as well as the spread vis-à-vis the German 10-year government bond yield (96 basis points).

Chart 4 • ECB rates, in %



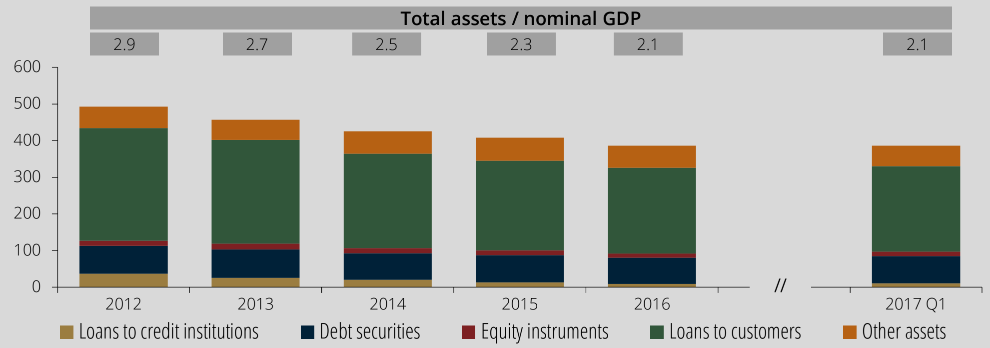
Source: ECB.

- ECB rates have been kept unchanged since March 2016: the deposit facility interest rate at 0.40%, the main refinancing operations interest rate at 0% and the marginal lending facility interest rate at 0.25%.
- The ECB's accommodative monetary policy, including the asset purchase programme, continues to be reflected in the levels of benchmark interbank interest rates.

3. Portuguese Banking System

3.1. Balance sheet

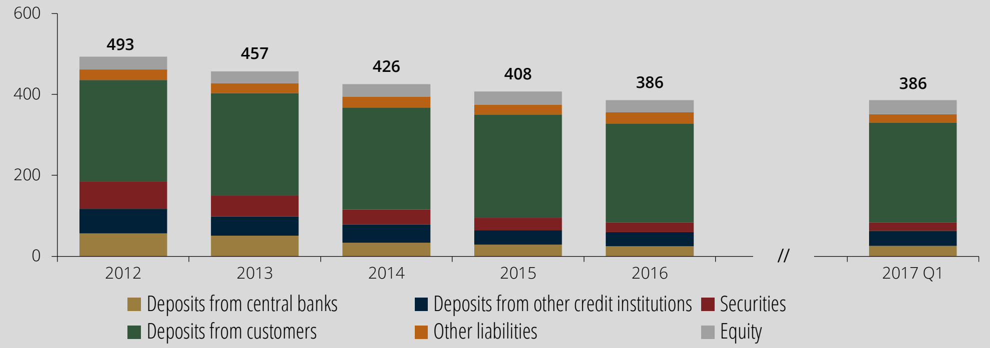
Chart 5 • Assets, in €Bn | Value at end of period



Source: Banco de Portugal.
Note: The other assets item includes cash and cash balances at central banks, cash balances at other credit institutions, derivatives, tangible and intangible assets and other assets.

- In the first quarter of 2017, banking system's total assets remained virtually unchanged compared to the end of 2016, amounting to 386 €Bn.
- CGD's and BCP's recapitalization processes led to changes in the balance sheet structure, strengthening the capital of the banking system. Furthermore, the deconsolidation of assets/liabilities within the ambit of the partial sale of BPI's Angolan operation, impacted also on the structure of the banking system's balance sheet.
- The derecognition of assets that arose from the aforementioned deconsolidation process, and the decline in loans to customers were accompanied by increases in other items, in particular, debt securities and balances with central banks.

Chart 6 • Bank financing structure, in €Bn | Value at end of period

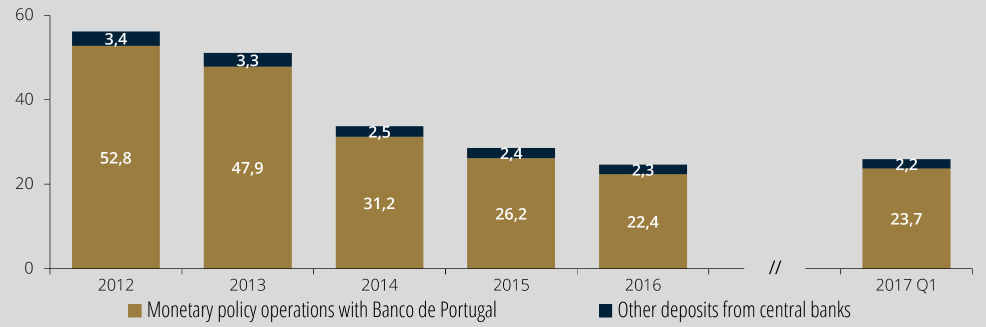


Source: Banco de Portugal.

- In 2017 Q1, the weight of equity in the total assets' financing structure increased, mainly reflecting the abovementioned recapitalization processes.
- Deposits from customers grew in the quarter under review, while liabilities represented by securities continued its declining trajectory.

3.2. Liquidity and funding

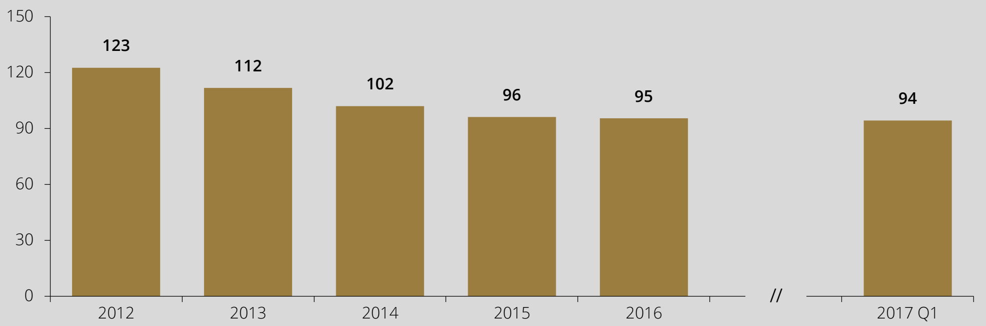
Chart 7 • Central banks' funding, in €Bn | Value at end of period



Source: Banco de Portugal.

- Central bank's funding increased in 2017 Q1, accounting for 6.7% of banking system's total assets, which represents an increase of 0.3 p.p. vis-à-vis the previous quarter.

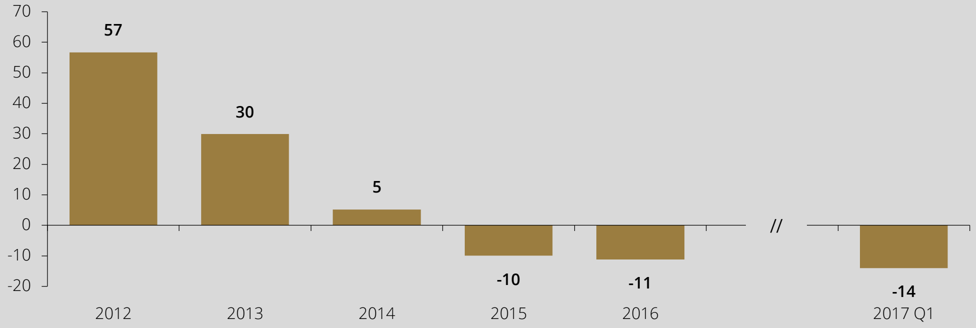
Chart 8 • Loan-to-deposit ratio, in % | Value at end of period



Source: Banco de Portugal.
Note: This ratio takes into account the data requirements stated in the Implementing Technical Standards on Supervisory Reporting.

- The loan-to-deposit ratio stood at 94% in 2017 Q1, decreasing marginally from the previous quarter. This development is in line with the stabilization trend observed in the latest quarters, after the significant fall seen in recent years.

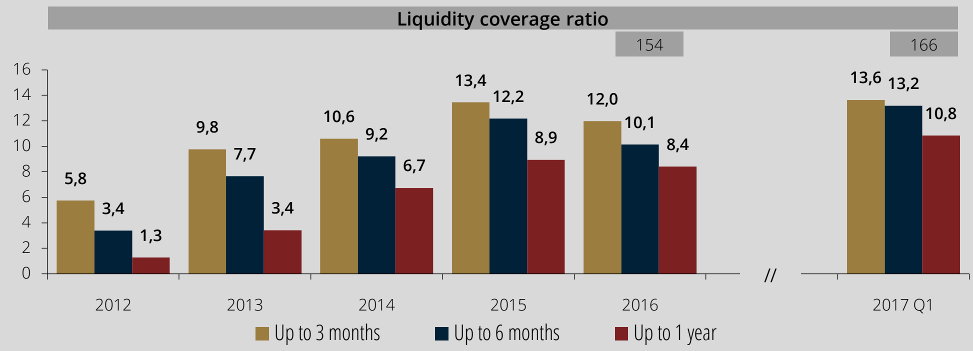
Chart 9 • Commercial gap, in €Bn | Value at end of period



Source: Banco de Portugal.
Note: This indicator takes into account the data requirements stated in the Implementing Technical Standards on Supervisory Reporting.

- The commercial gap (loans minus deposits) diminished in 2017 Q1, continuing to exhibit a downward trend.

Chart 10 • Liquidity gaps for domestic institutions[(a)] and Liquidity Coverage Ratio (LCR)[(b)], in % | Value at end of period

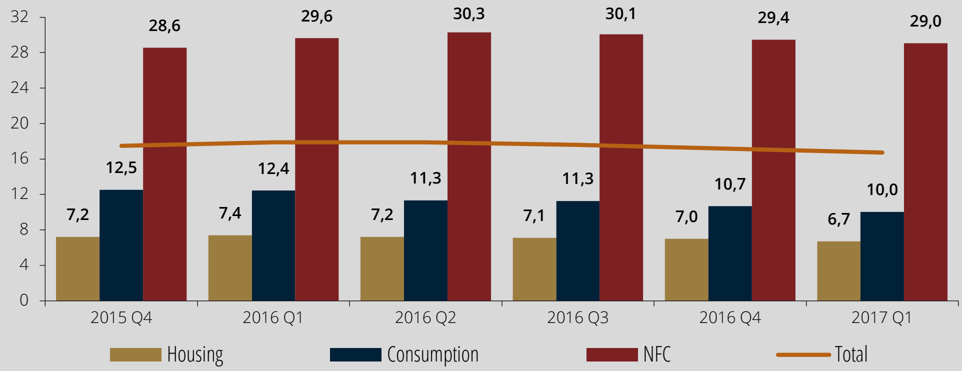


Source: Banco de Portugal.
Notes: a) The liquidity gap is defined as the difference between liquid assets and volatile liabilities in proportion of the difference between total assets and liquid assets, for each cumulative maturity scale. An increase of this indicator reflects an improvement of banks' liquidity position; b) The liquidity coverage ratio is expressed as the ratio between the value of the stock of high quality liquid assets and the total net cash outflows for a 30 calendar day liquidity stress scenario.

- Portuguese banking system's liquidity coverage ratio increased again in the first quarter of 2017, in line with the previous quarter, reaching a figure well above the 100% requirement as of January 2018.
- Liquidity gaps for domestic institutions increased in the quarter under review, standing at higher levels than those observed in recent periods for all maturities.

3.3. Asset quality

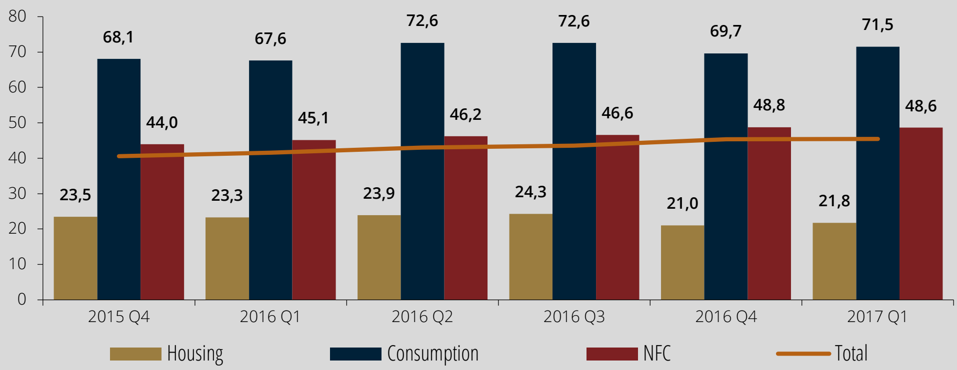
Chart 11 • Non-performing loans ratio, in % | Value at end of period



Source: Banco de Portugal.
Note: The non-performing loans ratio is the amount of loans non-performing in relation to total loans, according to EBA's ITS on Supervisory Reporting.

- In a context of a reduction in the value of non-performing loans (around 10% since the end of June 2016), the total non-performing loans ratio stood at 16.7% in 2017 Q1, which compares to 17.2% in the previous quarter. The decline of non-performing loans (numerator effect) more than offset the reduction in total loans (denominator effect).
- The decrease of the total non-performing loans ratio in 2017 Q1 reflects positive developments in all segments analysed. The 0.4 p.p. decline observed in the NFC segment ratio reflects a reduction of 2.9% in the value of non-performing loans, which was the largest contribution to the decline in the total non-performing loans ratio. Since June 2016, the value of NFC non-performing loans fell by 11.5%.

Chart 12 • Non-performing loans coverage ratios, in % | Value at end of period



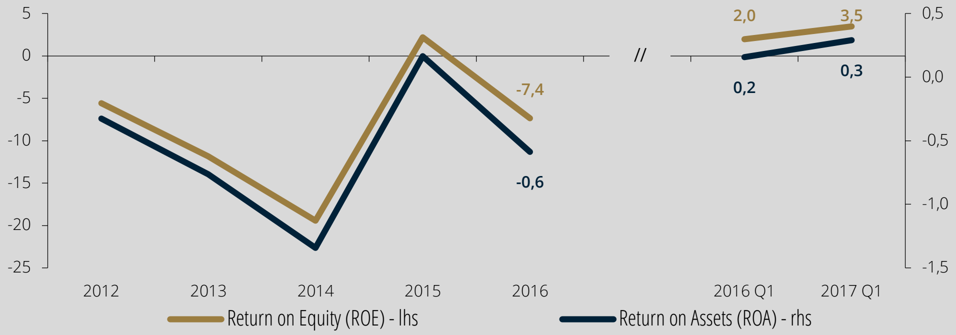
Source: Banco de Portugal.
Note: The coverage ratio is the percentage of non-performing loans that is covered by impairments.

- In 2017 Q1, the non-performing loans coverage by impairments remained stable around 45%.

- Notwithstanding, slight changes amongst segments were observed. Coverage ratios in the Housing and Consumption segments increased by 0.8 p.p. and 1.8 p.p., respectively, while the coverage ratio in Non-financial corporations segment decreased by 0.2 p.p. to 48.6%.

3.4. Profitability

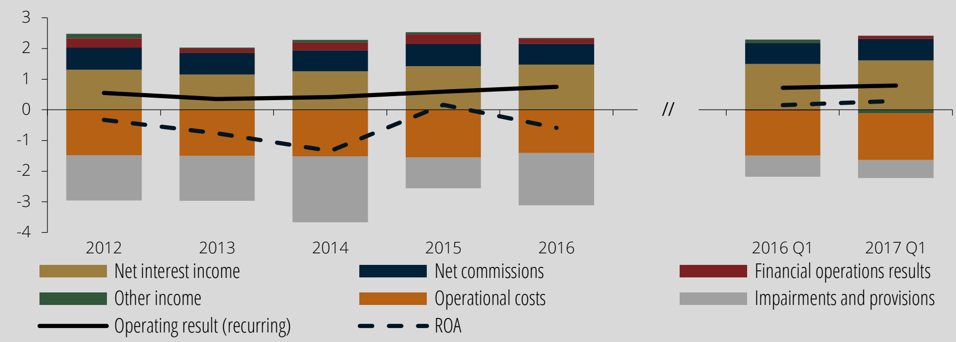
Chart 13 • ROE and ROA, in % | Value in the period



Source: Banco de Portugal.
Note: Return is measured by profit or loss before tax.

- Following a significant fall in profitability in 2016, chiefly due to the extraordinary increase in the flow of impairments, the return on equity and the return on assets reverted to positive levels in 2017 Q1.
- In comparison with the same quarter of the previous year, the return on equity increased by 1.5 p.p. and the return on assets grew 0.1 p.p..

Chart 14 • Income and costs, in % of average total assets | Value in the period

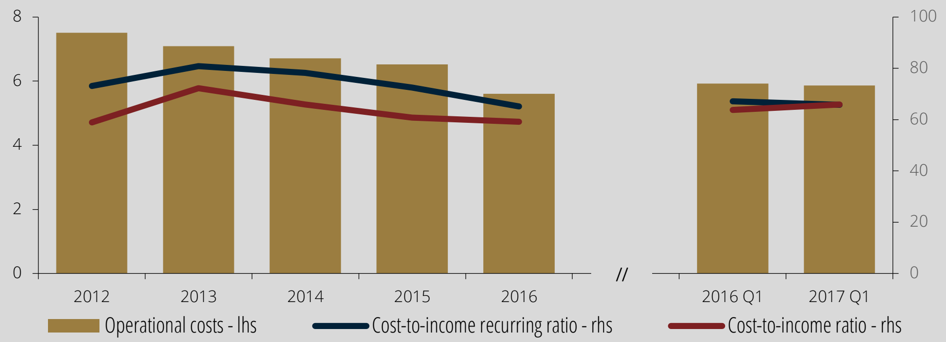


Source: Banco de Portugal.
Note: Recurring operating result corresponds to the sum of net interest margin and net commissions minus operational costs, as a percentage of average total assets.

- The increases in net interest income and in results from financial operations, as well as the reduction in the flow of impairments and provisions, led to an improvement in profitability in 2017 Q1, on a year-on-year basis.

- Net interest income increased by 2.8% compared with 2016 Q1, reflecting a greater decrease in interest expense than the one observed in interest income (contributions of +0.18 p.p. and -0.16 p.p, respectively).

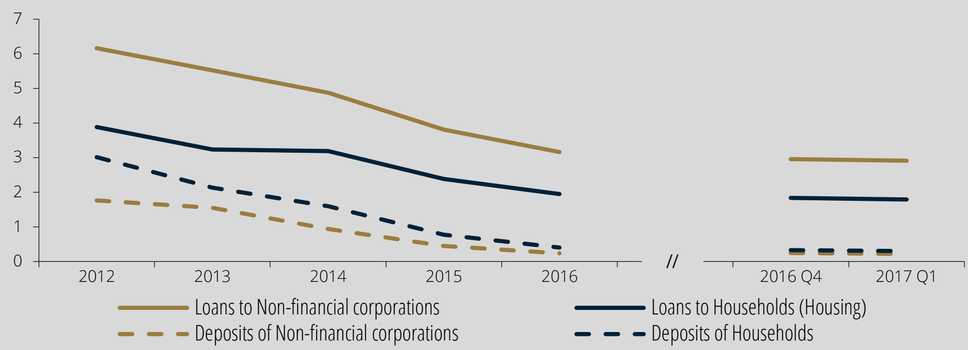
Chart 15 • Operational costs and Cost-to-income, in €Bn and in % | Value in the period



Source: Banco de Portugal.
Note: The cost-to-income recurring ratio corresponds to operational costs as a percentage of the sum of net interest income and net commissions.

- The cost-to-income ratio stood at approximately 66% in 2017 Q1, having increased on a year-on-year basis. This development reflects a sharper reduction in net operating income than in operating costs.
- The cost-to-income recurring ratio also stood at 66% in 2017 Q1, however, it diminished on a year-on-year basis. This decline was due to a reduction in operating costs as well as to an increase in the sum of net interest income and net commissions.

Chart 16 • Banking interest rates (new business), in % | Average value of the period

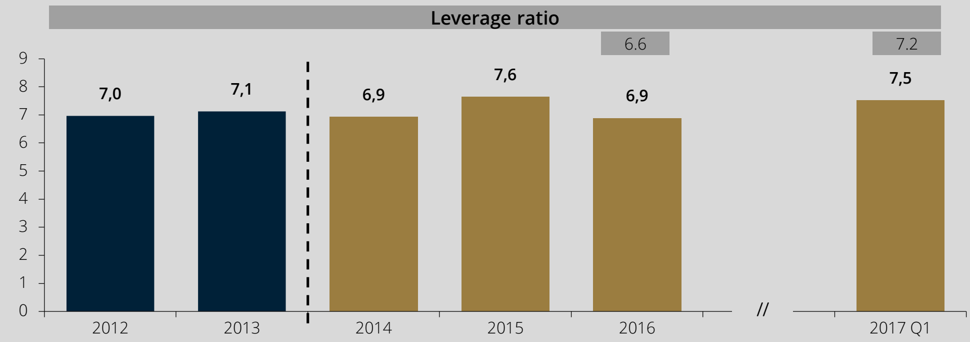


Source: Banco de Portugal.

- In 2017 Q1, interest rates on new loans to Households (Housing) and to Non-financial corporations decreased by 5 basis points.
- The cost of new deposits decreased by 3 basis points in the Households and in the Non-financial corporations segments.

3.5. Solvency [a]

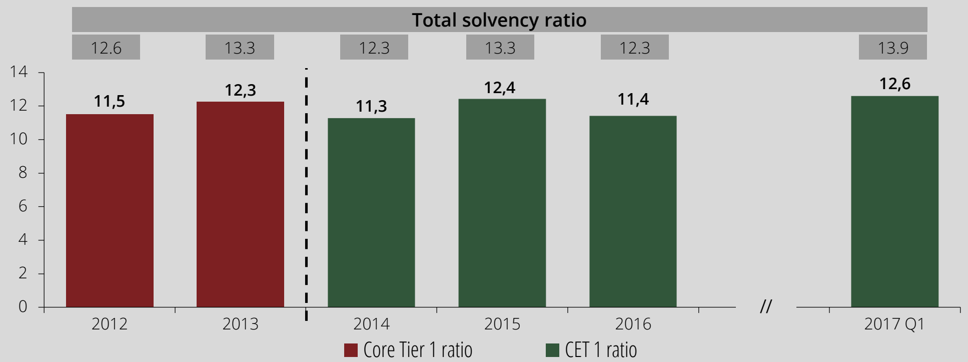
Chart 17 • Tier 1 capital to total assets ratio and Leverage ratio, in % | Value at end of period



Source: Banco de Portugal.
Note: The Tier 1 capital to total assets ratio serve as a proxy for the leverage ratio, allowing for a more comprehensive period of analysis. The leverage ratio is calculated as the capital measure (Tier 1 capital) divided by the total exposure. The leverage ratio is calculated in accordance with the methodology set out in article 429 of the Regulation (EU) No 575/2013.

- The reduction observed in the capital adequacy ratios in 2016 Q4 was temporary and reflected, above all, the developments associated with CGD.
- In 2017 Q1, both the Tier 1 capital to total assets ratio and the leverage ratio returned to levels close to those observed in 2016 Q3.

Chart 18 • Own funds ratios, in % | Value at end of period



Source: Banco de Portugal.

- The total solvency ratio stood at 13.9% (the highest figure in recent years), increasing by 0.7 p.p. vis-à-vis 2016 Q3.
- The Common Equity Tier 1 ratio (CET 1) increased by 0.3 p.p. compared to 2016 Q3, reflecting a smaller reduction in CET 1 capital than the one observed in risk-weighted assets.

(a) In 2014, the transition to a new prudential regime determined the existence of breaks in the series of solvency indicators justified by methodological differences in the calculation of own funds components, affecting the comparability of ratios with previous years.