Portuguese Banking System: latest developments

2nd quarter 2017

BANCO DE PORTUGAL
EUROSYSTEM

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1. Portuguese Banking System – Main Highlights

Balance sheet

In the second quarter of 2017, banking system's total assets decreased slightly vis-à-vis the previous quarter.
The continued reduction of the loans to customers' portfolio was partially offset by the increase in the sovereign debt securities' portfolio. Customer deposits remained stable.

Liquidity and funding

Financing obtained from the Eurosystem declined in the second quarter of 2017, in contrast to the preceding quarter.
Banking system's liquidity indicators improved, in line with the latest quarters. The liquidity of domestic institutions, measured by the liquidity gaps, increased and remained at a comfortable level.

Asset quality

The non-performing loans ratio decreased again in the second quarter of 2017, reflecting a greater reduction in non-performing loans than the one observed in total loans. This development was common to all segments analysed.

Profitability

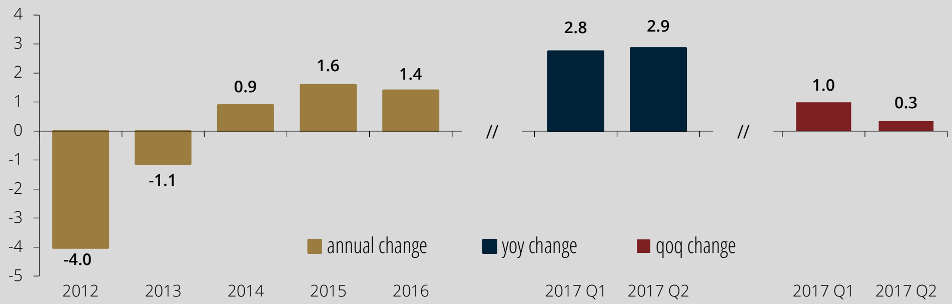
The profitability of the banking system was positive in the first half of 2017, which compares with the virtually nil figure observed in the same period of the previous year.
The improvement in profitability vis-à-vis the first half of 2016 was chiefly driven by a significant reduction in the flow of impairments.

Solvency

Solvency levels increased in the second quarter of 2017, due to the growth of the banking system's own funds and the reduction of the risk-weighted assets.

2. Macroeconomic and Financial Indicators

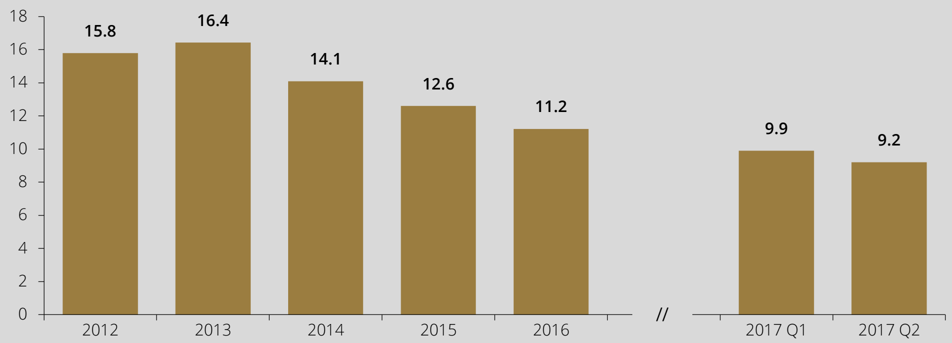
Chart 1 • GDP growth rate, in % | Volume



Source: INE.
Note: National Accounts figures are presented according to the rules of the European System of National and Regional Accounts (ESA 2010).

- In 2017 Q2, year-on-year GDP growth stood at 2.9%, a slightly higher rate than the one observed in the previous quarter (2.8%).
- GDP grew 0.3% quarter-on-quarter, which represents a slowdown from the previous quarter.

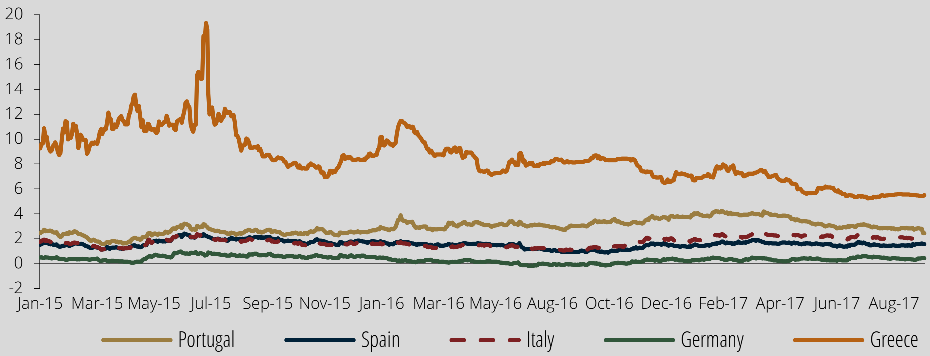
Chart 2 • Unemployment rate, % of active population



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.

- The unemployment rate stood at 9.2% in 2017 Q2, falling by 0.7 p.p. vis-à-vis the previous quarter.
- On a year-on-year basis, the unemployment rate declined by 2.1 p.p.

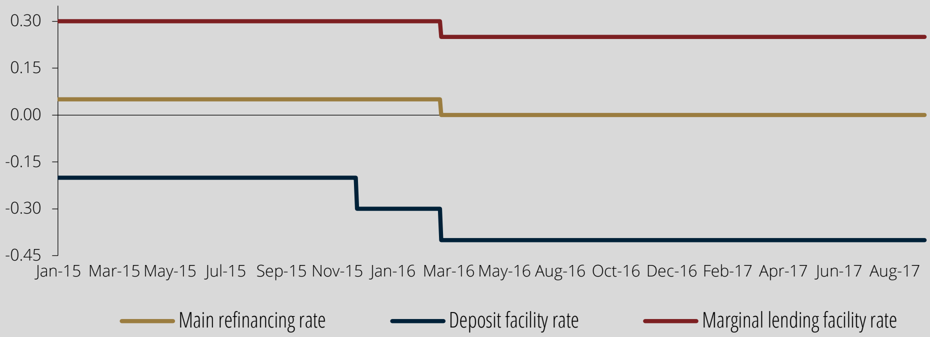
Chart 3 • Sovereign debt yields 10Y, in %



Source: Thomson Reuters.

- The Portuguese 10-year government bond yield fell by more than 90 basis points between 31 March 2017 and 30 June 2017, while the spread vis-à-vis the German 10-year government bond yield decreased by 108 basis points. This downward movement has persisted throughout the third quarter of 2017, with the yield of the Portuguese 10-year government bond declining an additional 58 basis points between 30 June 2017 and 19 September 2017. The Portuguese public debt outlook improvement, from stable to positive, by Fitch and Moody's and, more recently, the increase to an investment grade rating level by Standard & Poor's, should have contributed, inter alia, to this development.

Chart 4 • ECB rates, in %



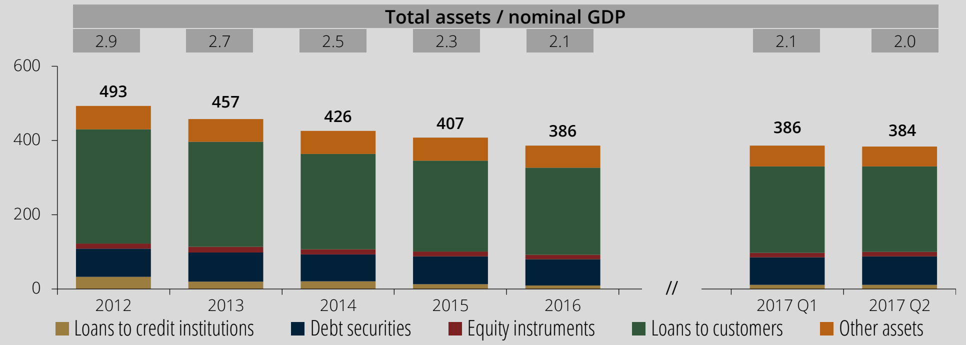
Source: ECB.

- ECB rates remain stable 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 accommodative monetary policy, including ECB's asset purchase programme, continues to be reflected in the levels of benchmark interbank interest rates.

3. Portuguese Banking System

3.1. Balance sheet

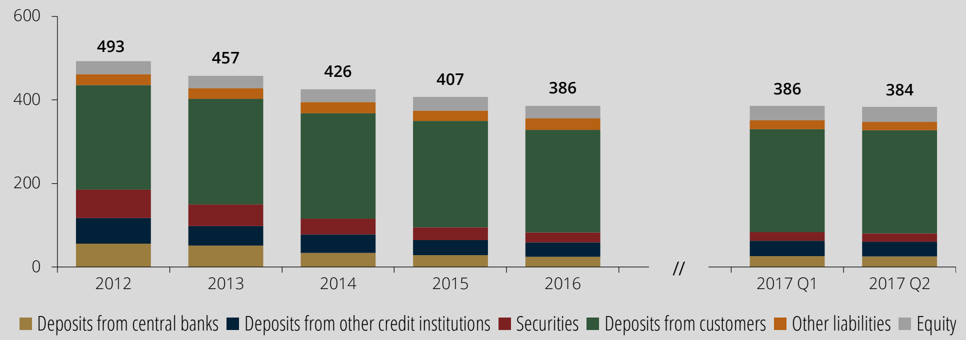
Chart 5 • Asset structure, in €Bn | Value at end of period



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 2017 Q2, Portuguese banking system's total assets diminished by 0.6% vis-à-vis the previous quarter. This development mainly reflects a reduction in loans to customers and other assets, which was partially offset by an increase in sovereign debt securities, including Portugal.
- The decline of the loans to customers' portfolio reflects mainly a decrease in loans to Non-financial corporations.

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

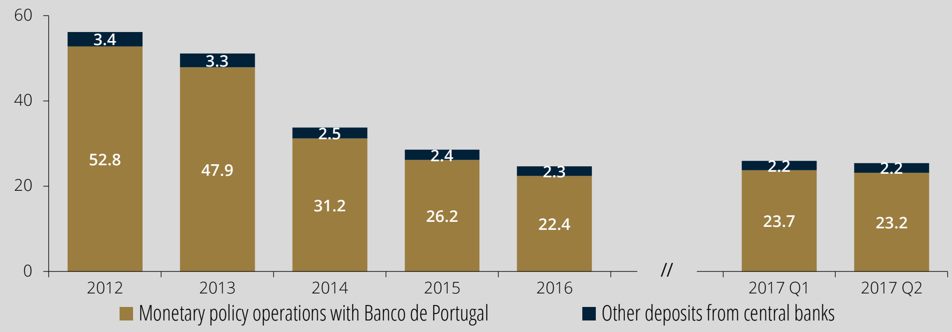


Source: Banco de Portugal.

- On the financing side, the stability of customer deposits in the quarter should be stressed. On the contrary, deposits from other credit institutions decreased by 4.5% and its weight in total assets decreased by 0.4 p.p. to 9.2%.

3.2. Liquidity and funding

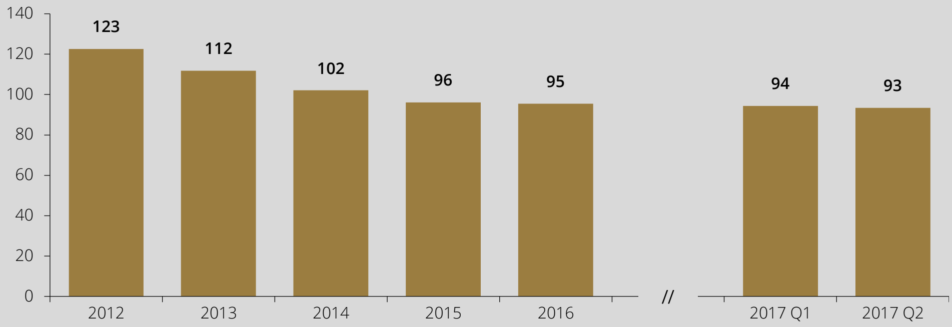
Chart 7 • Central banks' funding, in €Bn | Value at end of period



Source: Banco de Portugal.

- Central bank's funding decreased by 1.9% in 2017 Q2, reflecting a reduction of monetary policy operations with Banco de Portugal. Central banks' funding accounted for 6.6% of total assets, virtually the same figure as in the previous quarter.

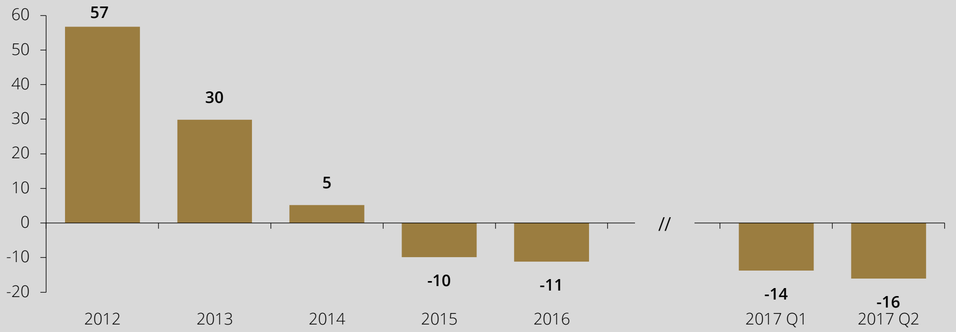
Chart 8 • Loan-to-deposit ratio, in % | Value at end of period



Source: Banco de Portugal.

- The loan-to-deposit ratio stood at 93% in 2017 Q2, decreasing about 1 p.p. from the previous quarter. This development reflects a decrease in loans and a stabilisation of deposits.

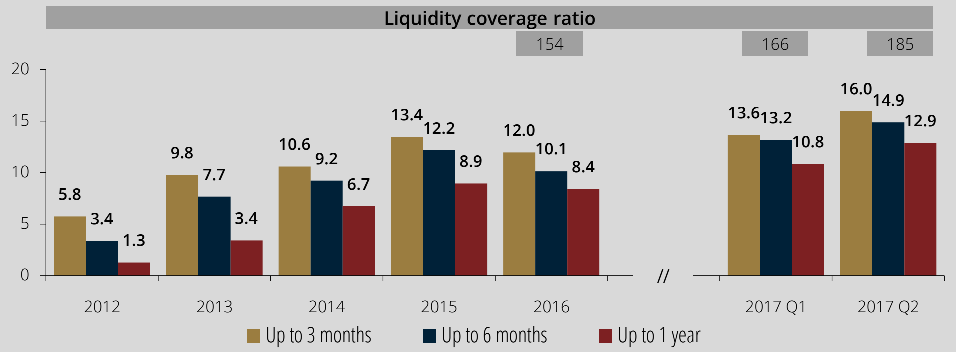
Chart 9 • Commercial gap, in €Bn | Value at end of period



Source: Banco de Portugal.

- The commercial gap (loans minus deposits) diminished approximately 17.2% in 2017 Q2, standing at -16 €Bn.

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

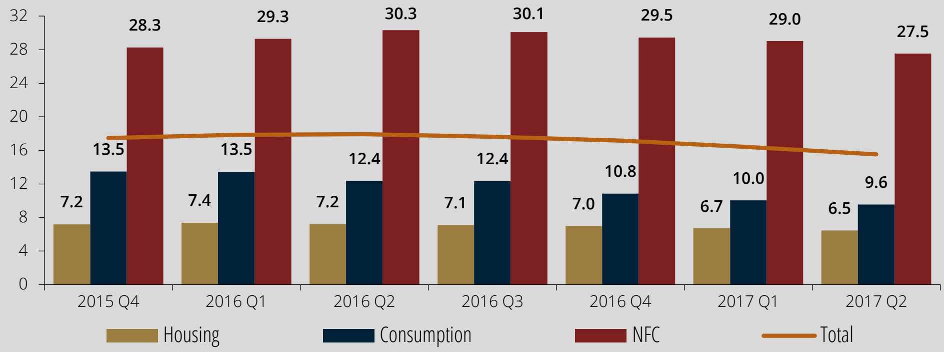


Source: Banco de Portugal.
Notes: a) The liquidity gap is defined as the difference between liquid assets and volatile liabilities in proportion of the difference between total assets and liquid assets, for each cumulative maturity scale. An increase of this indicator reflects an improvement of banks' 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 by 18 p.p. to 185%, due to an increase in liquid assets held by institutions.
- Liquidity gaps for domestic institutions increased for all maturities, as in the previous quarter.

3.3. Asset quality

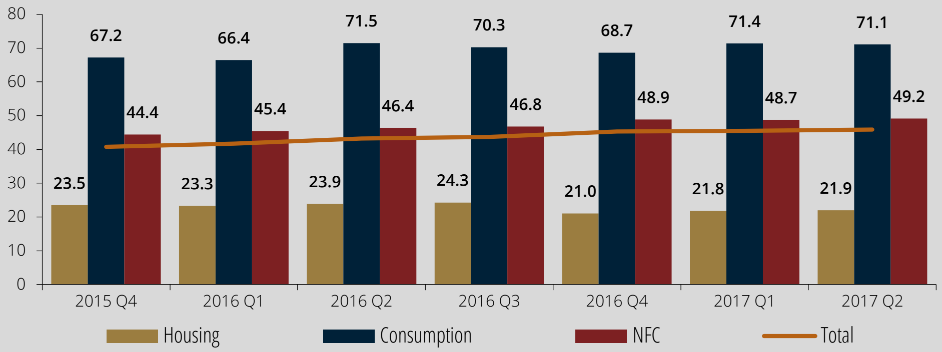
Chart 11 • Non-performing loans ratio, in % | Value at end of period



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.

- The non-performing loans ratio stood at 15.5% in 2017 Q2, which represents a 0.9 p.p. reduction vis-à-vis the previous quarter. The 6.1% decrease of non-performing loans (numerator effect) more than offset the reduction in total loans (denominator effect). This decline of non-performing loans is the largest since December 2015 and since June its value fell by 16.2%.
- The decrease of the total non-performing loans ratio in 2017 Q2 reflects positive developments in all segments, but more significantly in the Non-financial corporations (NFC) segment. The 1.5 p.p. decline observed in the NFC segment ratio reflects a non-performing loans reduction of 2.1 €Bn (7%) in 2017 Q2 (5.9 €Bn since June 2016, which amounts to an 18% fall).

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

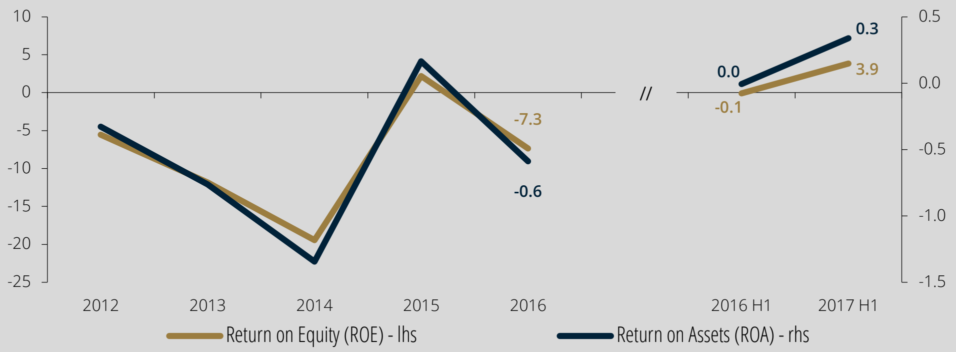


Source: Banco de Portugal.
Note: The coverage ratio is the percentage of non-performing loans that is covered by impairments.

- In 2017 Q2, the non-performing loans coverage by impairments stood at approximately 46%. The Non-financial corporations' coverage ratio increased slightly to 49.2%, due to the decline of non-performing loans (denominator effect).

3.4. Profitability

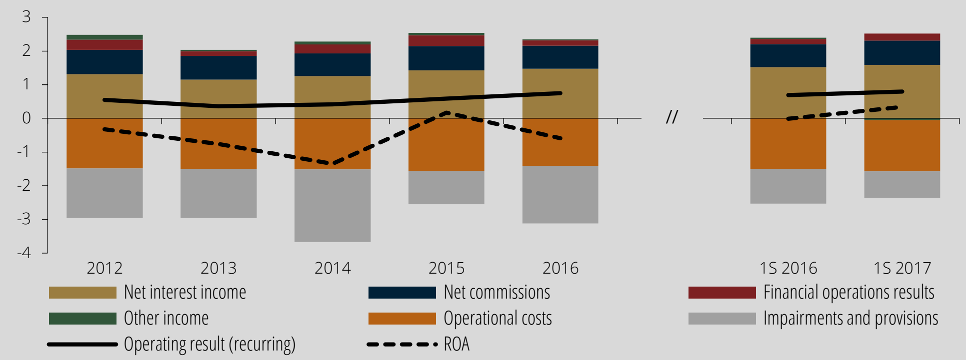
Chart 13 • ROE and ROA, in % | Value in the period



Source: Banco de Portugal.
Note: Return is measured by profit or loss before tax. Intra-annual returns are annualised.

- The return on equity and the return on assets were positive in 2017 H1, which contrasts with the virtually nil values observed in the same period of the previous year. On a year-on-year basis, the return on equity grew by 3.9 p.p., whilst the return on assets increased by 0.3 p.p.
- In the context of a slight decrease in gross income, the rise in profitability vis-à-vis 2016 H1 reflects a considerable decrease in the flow of impairments, especially for credit impairments.

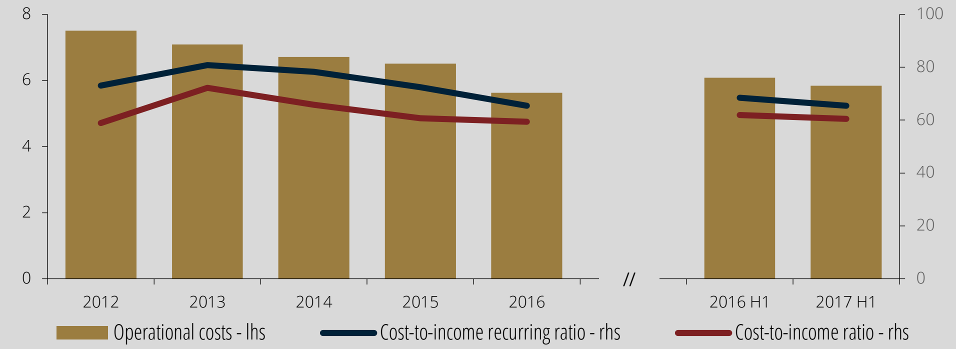
Chart 14 • Income and costs, in % of average total assets | Value in the period



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.

- Net interest income remained virtually unchanged vis-à-vis 2016 H1, reflecting similar reductions in interest income and in interest expenses. Notwithstanding, its contribution to ROA increased slightly given the decrease in total assets.

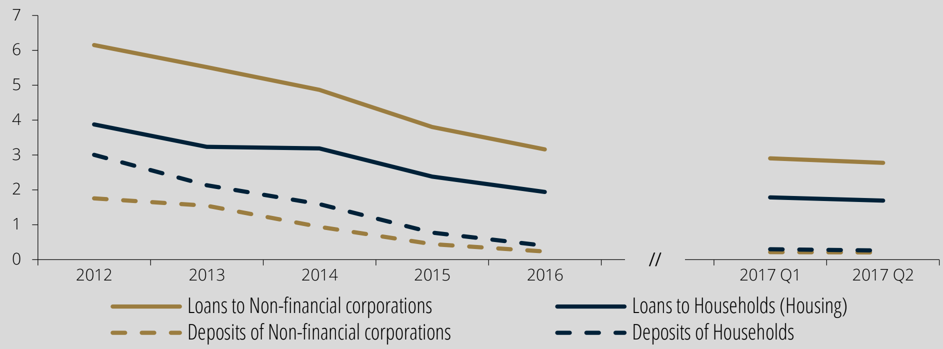
Chart 15 • Operational costs and Cost-to-income, in €Bn and in % | Value in the period



Source: Banco de Portugal.
Note: The recurring cost-to-income 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 around 61% in 2017 H1, which represents a decrease of 1.4 p.p. on a year-on-year basis. This development reflects a greater reduction in operating costs than in gross income.
- In 2017 H1, the cost-to-income recurring ratio decreased approximately 3 p.p. on a year-on-year basis, standing at about 65%. This decline chiefly reflects a reduction in operating costs.

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

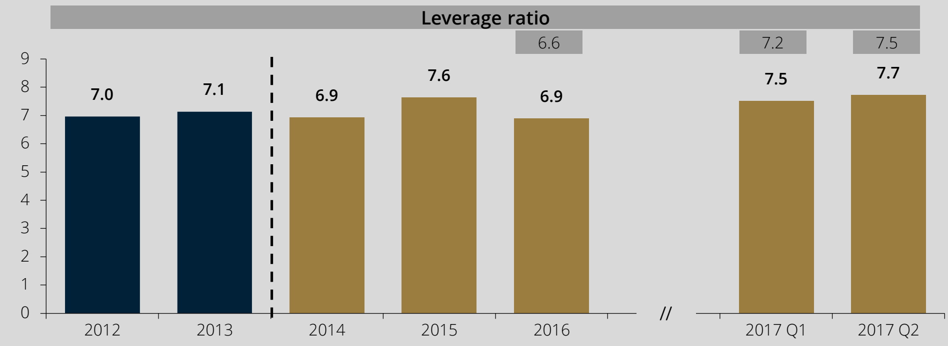


Source: Banco de Portugal.

- As in the previous quarters, interest rates on new loans to Households (Housing) and to NFC decreased in 2017 Q2. For Households (Housing) the interest rate decreased by 9 basis points and for NFC the interest rate decreased by 13 basis points.
- The cost of new deposits decreased again in the quarter under review, by 3 basis points in the Households segment and by 1 basis point in the Non-financial corporations segment, standing very close to zero.

3.5. Solvency [(a)]

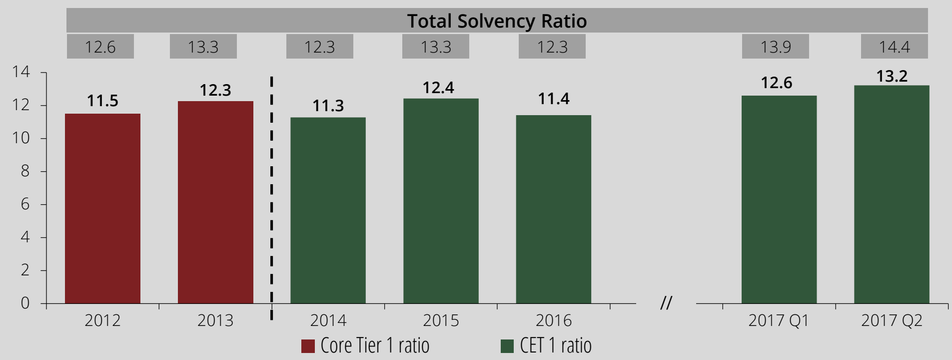
Chart 17 • Tier 1 capital to total assets ratio and Leverage ratio, in % | Value at end of period



Source: Banco de Portugal.
Note: The Tier 1 capital to total assets ratio is 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 ratio between Tier 1 capital and total assets rose by 0.2 p.p. in 2017 Q2, reflecting, above all, the banking system's capital increase.
- The leverage ratio grew by 0.3 p.p. to 7.5% in the quarter under review, mainly due to the abovementioned capital increase.

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



Source: Banco de Portugal.

- The total solvency ratio stood at 14.4% in 2017 Q2, representing an increase of 0.5 p.p. vis-à-vis the previous quarter.
- The Common Equity Tier 1 ratio (CET 1) stood at 13.2%, which represents a 0.6 p.p. increase in the quarter under analysis reflecting an increase in CET 1 capital and a reduction 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.