Portuguese Banking System: latest developments

3rd quarter 2017

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EUROSYSTEM

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Prepared with data available up to 18th December of 2017 for macroeconomic and financial market indicators, and up to 14th December of 2017 for the banking system data.

Moreover, macroeconomic indicators and banking system data are quarterly and are presented until the last quarter available, while financial market indicators, whose frequency is daily, are presented until the last day of available information.

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Balance sheet

Banking system's total assets increased in the third quarter of 2017. This development reflects an increase in cash balances at central banks and in loans to the general government, which was partially offset by the reduction in the sovereign debt securities' portfolio.

Liquidity and funding

Financing from the Eurosystem declined in the third quarter of 2017, standing at a level close to that observed by end-2016.
Banking system's liquidity indicators remained at high levels, despite a slight decrease in the quarter.

Asset quality

Asset quality improved in the third quarter of 2017, continuing to reflect, to a large extent, positive developments in the Non-financial corporations segment.

Profitability

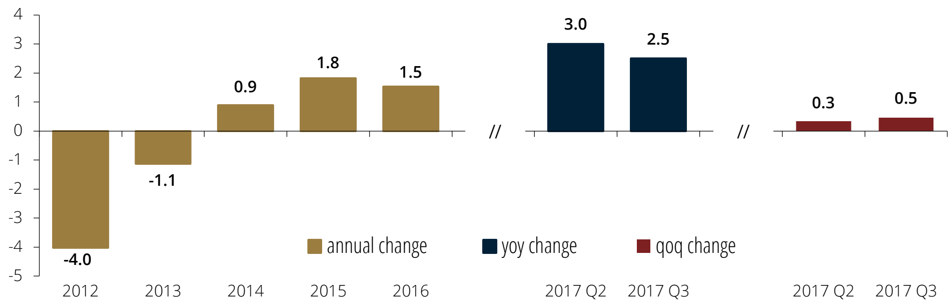
The profitability of the banking system in the first three quarters of 2017 was positive and higher than in the same period of the previous year.
The improvement in profitability vis-à-vis the same period of the previous year was mainly driven by a substantial decline in the flow of credit impairments.

Solvency

Banking system's solvency levels increased in the third quarter of 2017 reflecting the growth of own funds and the decrease of the risk-weighted assets.

2. Macroeconomic and Financial Indicators

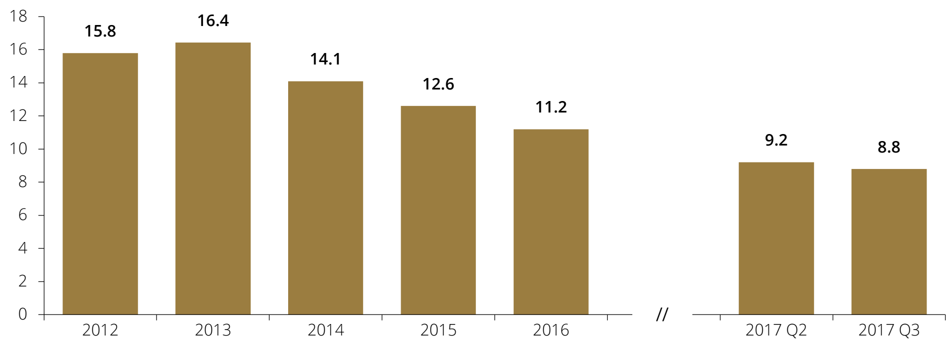
Chart 1 • GDP growth rate, in % | Volume



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 Q3, GDP grew 2.5% year-on-year, which compares to 3.0% in the previous quarter.
- GDP quarter-on-quarter growth stood at 0.5%, which represents an acceleration from the previous quarter (0.3%).

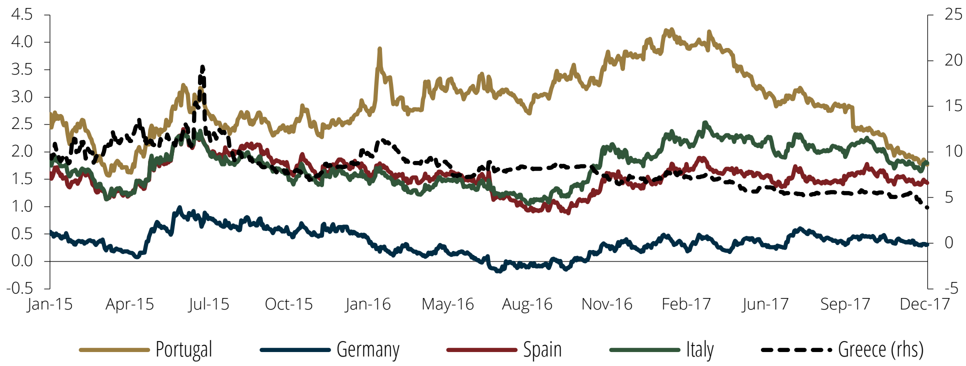
Chart 2 • Unemployment rate, % of active population



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 8.8% in 2017 Q3, decreasing by 0.4 p.p. vis-à-vis the previous quarter.
- On a year-on-year basis, the unemployment rate declined by 2.1 p.p.

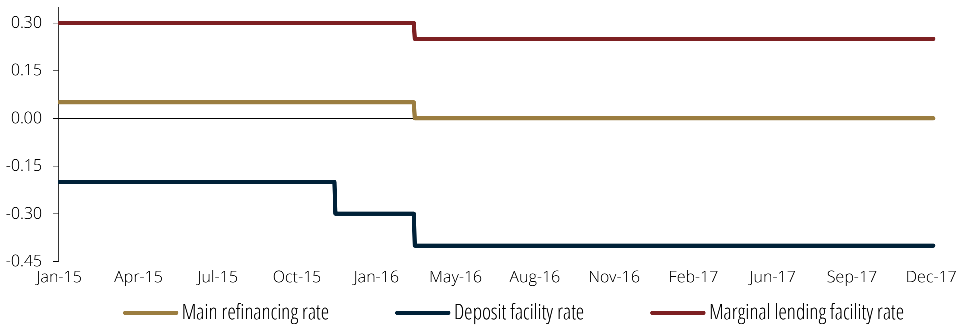
Chart 3 • Sovereign debt yields 10Y, in %



Source: Thomson Reuters.
Note: The last observation is dated 18 December 2017.

- The Portuguese 10-year government bond yield dropped by more than 60 basis points between 30 June 2017 and 29 September 2017, as well as the spread vis-à-vis the German 10-year government bond yield.
- The downward movement of the Portuguese 10-year government bond has persisted throughout the fourth quarter of 2017, as the yield declined by 62 basis points between 29 September 2017 and 18 December 2017. This latest development was supported, inter alia, by the increase to an investment grade rating level by Standard & Poor's in mid-September 2017 and, in 15 December 2017, by FITCH (this agency upgraded the rating of the Portuguese Republic by two notches, from BB+ to BBB).

Chart 4 • ECB rates, in %



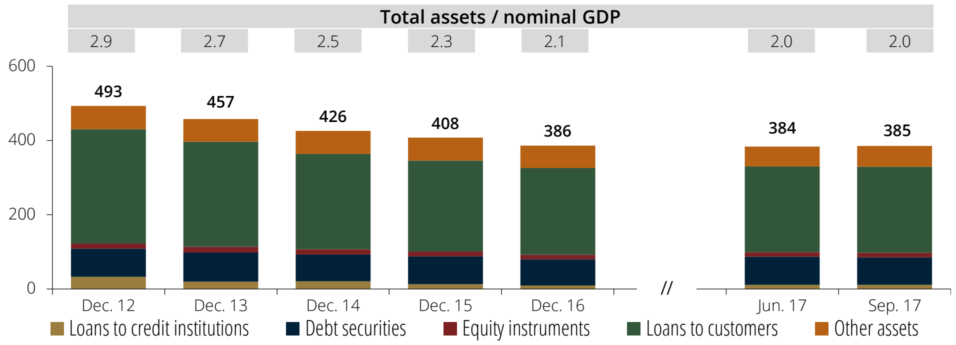
Source: ECB.
Note: The last observation is dated 18 December 2017.

- 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 levels of benchmark interbank interest rates continue to reflect the accommodative monetary policy, namely the ECB's asset purchase programme.

3. Portuguese Banking System

3.1. Balance sheet

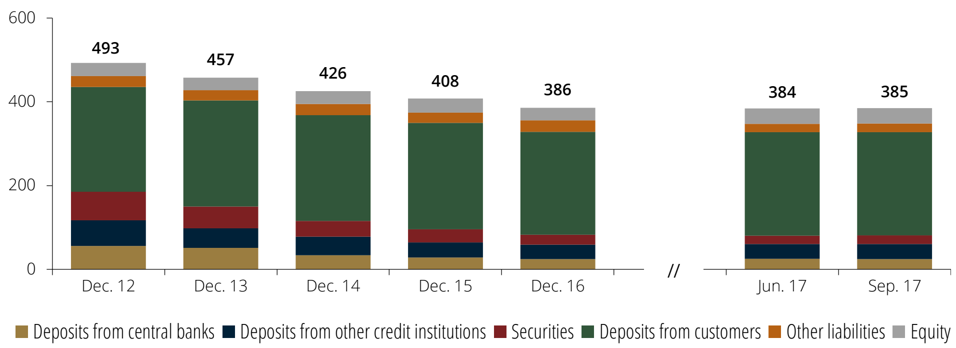
Chart 5 • Asset structure, in €Bn



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.

- Portuguese banking system's total assets increased by 0.3% in 2017 Q3, standing at approximately 385 €Bn.
- This increment in total assets reflects an increase in cash balances at central banks and in loans to customers (namely to the general government), which was partially offset by a decrease in sovereign debt securities held by the banking system.
- Loans to Non-financial corporations continued to decline, whilst loans to Households remained stable in 2017 Q3.

Chart 6 • Bank financing structure, in €Bn



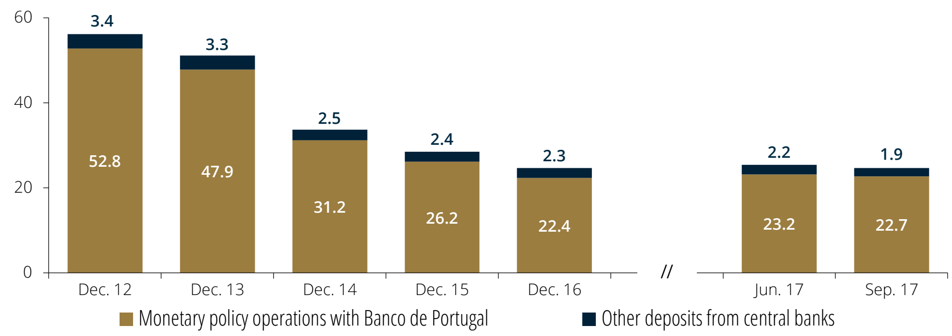
Source: Banco de Portugal.
Note: The Other liabilities item includes derivatives, short positions and other liabilities.

- Net interbank funding grew in 2017 Q3 due to an increase in deposits from other credit institutions. Equity and Other liabilities also increased.

- Customer deposits diminished in the period, led by the domestic activity, chiefly reflecting the decrease of Household deposits, which was partially offset by an increase in Non-financial corporations deposits.

3.2. Liquidity and funding

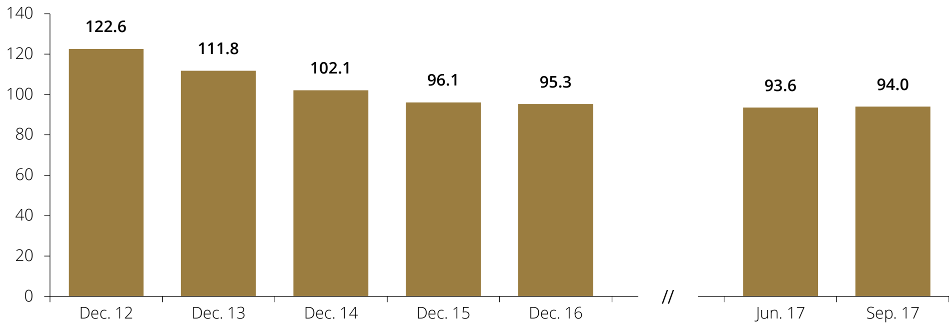
Chart 7 • Central banks' funding, in €Bn



Source: Banco de Portugal.

- Central bank's funding decreased by 2.8% in 2017 Q3, standing at a level close to that observed by end-2016. Vis-à-vis December 2016, this funding source has a larger component of Long-term refinancing operations (LTRO), to the detriment of Main refinancing operations (MRO) and other type of funds from central banks.

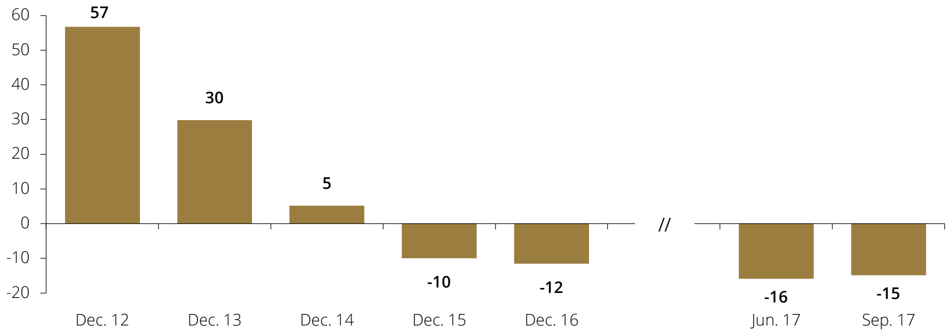
Chart 8 • Loan-to-deposit ratio, in %



Source: Banco de Portugal.

- The loan-to-deposit ratio increased slightly in 2017 Q3.

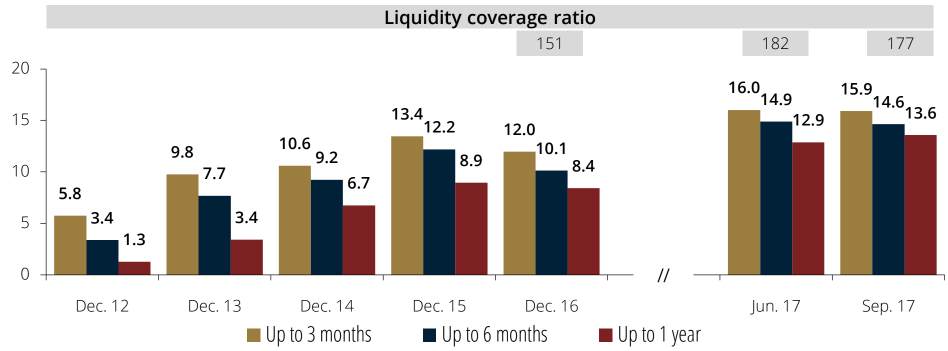
Chart 9 • Commercial gap, in €Bn



Source: Banco de Portugal.

- The commercial gap (loans minus deposits) increased 1 €Bn in 2017 Q3.

Chart 10 • Liquidity gaps for domestic institutions[(a)] and Liquidity Coverage Ratio (LCR)[(b)], in %

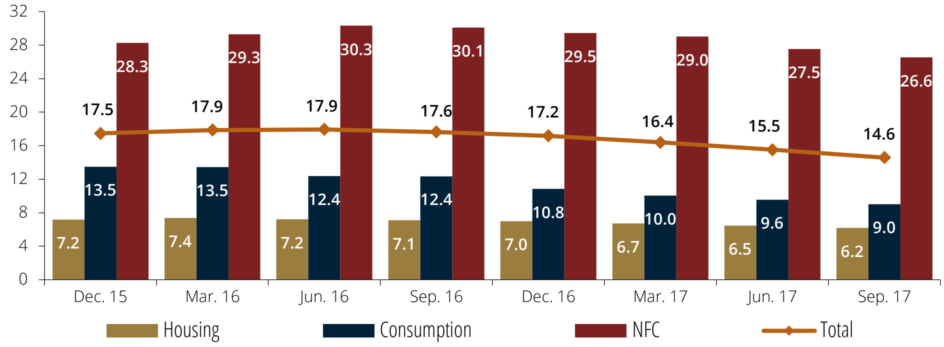


Source: Banco de Portugal.
Notes: a) The liquidity gap is defined as the difference between liquid assets and volatile liabilities in proportion of the difference between total assets and liquid assets, for each cumulative maturity scale. An increase of this indicator reflects an improvement of banks' 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 remained at comfortable levels, even with slight reductions in the liquidity coverage ratio (banking system) and in the liquidity gaps (domestic institutions), for two of the maturity scales.
- Liquid assets held by the banking system increased somewhat and are essentially comprised of sovereign debt securities, cash balances at central banks and cash.

3.3. Asset quality

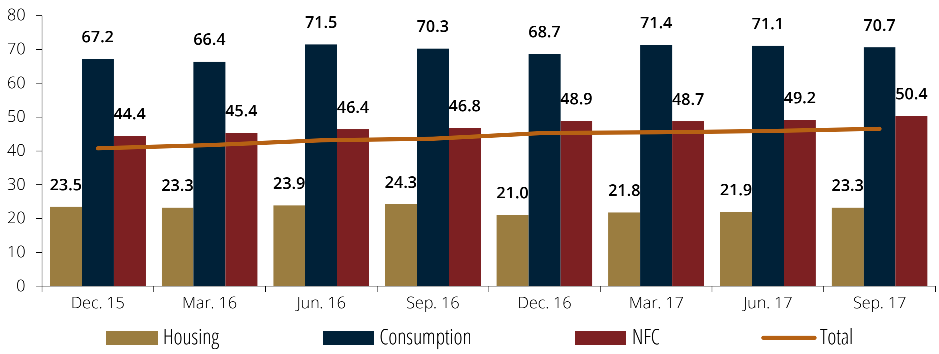
Chart 11 • Non-performing loans ratio, in %



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 2017 Q3, banking system's non-performing loans remained on a downward trajectory, declining 2.3 €Bn vis-à-vis June 2017 and 10.5 €Bn vis-à-vis June 2016.
- The non-performing loans ratio stood at 14.6% as a result of the above-mentioned decline in non-performing loans and, to a less extent, to an increase in total loans.
- In spite of the positive contributions of all segments, the developments observed in the quarter reflect mostly the decrease in the non-performing loans of Non-financial corporations, which decreased by 5.2% (1.4 € Bn) comparing to June 2017.

Chart 12 • Non-performing loans coverage ratios, in %

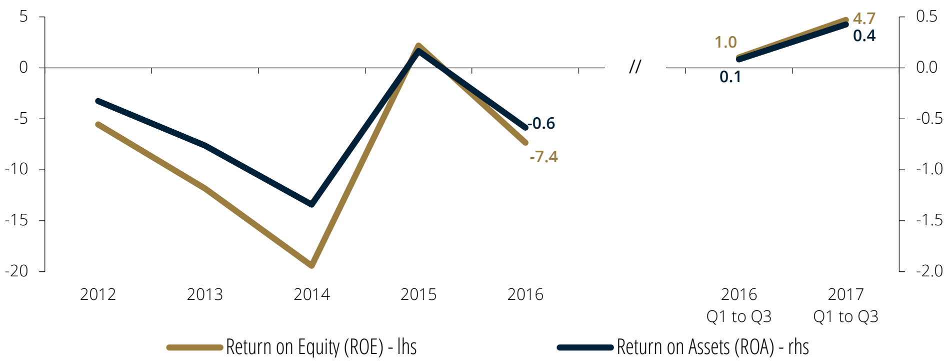


Source: Banco de Portugal.
Note: The coverage ratio is the percentage of non-performing loans that is covered by impairments.

- In September 2017, the non-performing loans coverage by impairments ratio stood at 47% as a result of a 0.6 p.p. increase in the quarter. This development reflected a 1.2 p.p. increase of the Non-financial corporations' coverage ratio.

3.4. Profitability

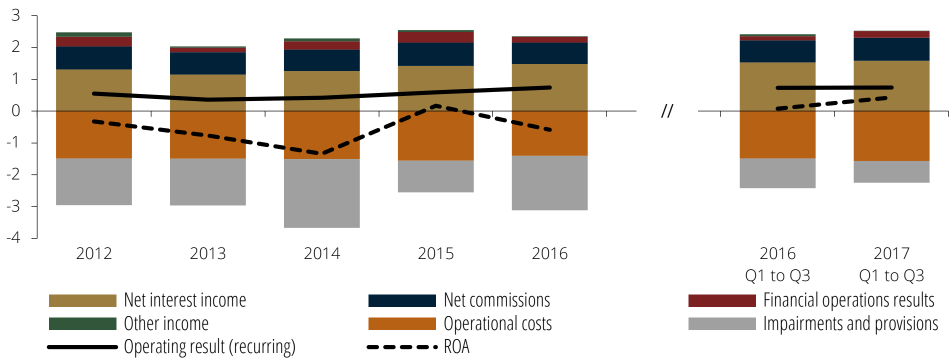
Chart 13 • ROE and ROA, in %



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 increased in the first three quarters of 2017, on a year-on-year basis. The return on equity grew by 3.7 p.p., whilst the return on assets increased by 0.3 p.p.
- The rise in profitability vis-à-vis the first three quarters of 2016 reflects the growth in income from financial operations and, above all, a substantial decrease in the flow of impairments, especially of credit impairments.

Chart 14 • Income and costs, in % of average total assets

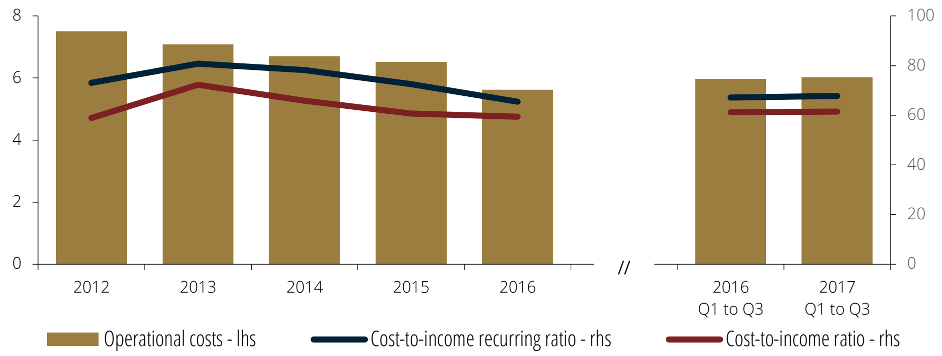


Source: Banco de Portugal.
Note: Recurring operating result corresponds to the sum of net interest margin and net commissions minus operational costs, as a percentage of average total assets.

- In the context of a reduction in interest income and in interest expenses (by similar amounts), net interest income contribution to ROA increased slightly vis-à-vis the first three quarters of 2016, given the year-on-year decrease in total assets.
- Operational costs remained virtually unchanged in the first three quarters of 2017 when compared to the same period of 2016. Nevertheless, in this period there was a significant but non-recurring increase in staff costs, which offset the substantial decrease in general and administrative expenses.

Staff costs have been negatively affected by the ongoing restructuring processes in some major institutions.

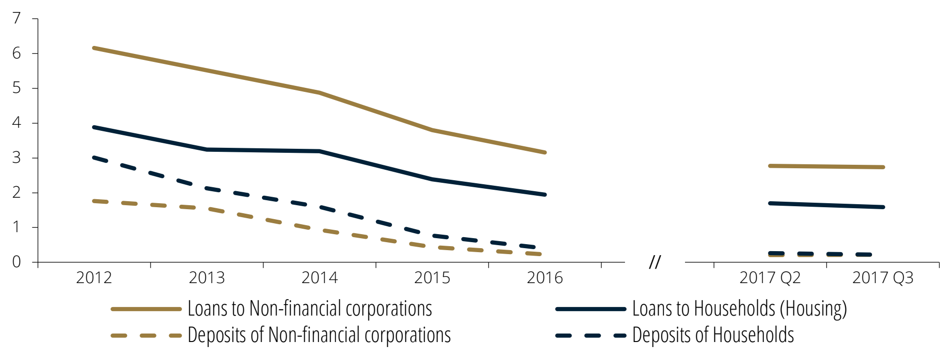
Chart 15 • Operational costs and Cost-to-income, in €Bn and in %



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 61% in the first three quarters of 2017, remaining virtually unchanged compared to the same period of the previous year. This development reflects the relative stabilisation of operating costs given the non-recurrent increase in staff costs, incurred in the context of the ongoing restructuring processes in some of the largest institutions.

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

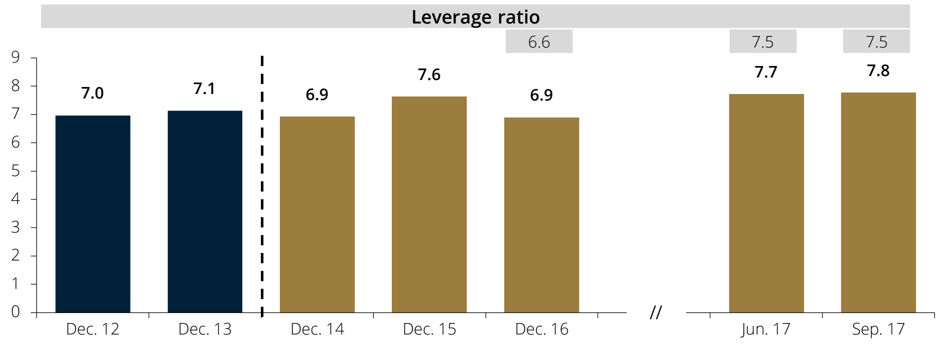


Source: Banco de Portugal.

- As in the previous quarters, interest rates on new loans to Households (Housing) and to Non-financial corporations diminished (11 basis points and 4 basis points, respectively).
- The cost of new deposits evolved in a distinct manner across segments in the quarter under review, increasing by 1 basis point in the Non-financial corporations segment and decreasing by 5 basis points in the Households segment.

3.5. Solvency [(a)]

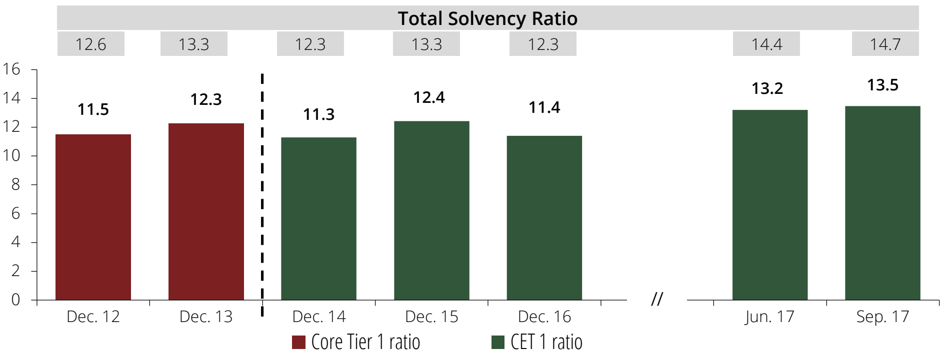
Chart 17 • Tier 1 capital to total assets ratio and Leverage ratio, in %



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, 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 recorded a marginal rise in 2017 Q3, reflecting, essentially, a slight increase of the banking system's capital.
- The leverage ratio remained virtually unchanged vis-à-vis the previous quarter, standing at 7.5%.

Chart 18 • Own funds ratios, in %



Source: Banco de Portugal.

- The total solvency ratio stood at 14.7% in 2017 Q3, representing a slight increase compared to the previous quarter.
- The Common Equity Tier 1 ratio (CET 1) stood at 13.5%, which corresponds to a 0.3 p.p. growth vis-à-vis 2017 Q2, reflecting an increase in CET 1 capital and a decrease 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.