Portuguese Banking System: latest developments

4th quarter 2017

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EUROSYSTEM

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Prepared with data available up to 20th March of 2018.
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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1 Portuguese Banking System – Main Highlights

Balance sheet

Banking system's total assets decreased in the fourth quarter of 2017. This development reflects a decrease in several items, in particular debt securities, and the increase in cash balances at central banks. Loans to customers (net of impairments) remained virtually unchanged, despite different developments in its components.

Liquidity and funding

The reduction of the central banks' financing became more marked in the last quarter of 2017, standing at the lowest level since the first quarter of 2010.
Liquidity indicators remained at high levels and, in general, have improved.

Asset quality

Asset quality improved in the fourth quarter of 2017, with a decline of the non-performing loans (NPL) ratio. This development continued to reflect the decrease of the numerator (NPL stock), in particular in the Non-financial corporations segment. Additionally, the NPL coverage ratio has increased in the same period.

Profitability

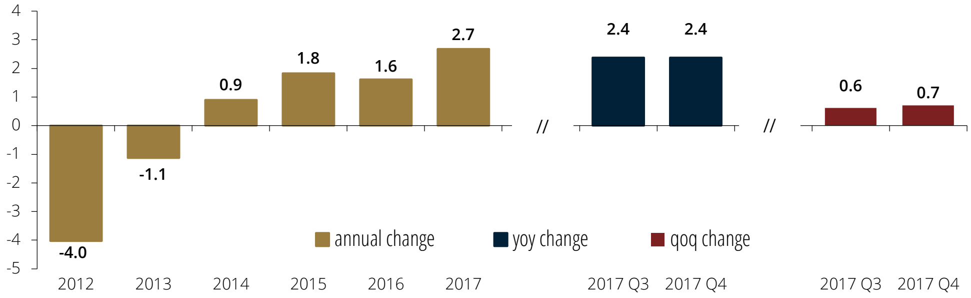
Banking system profitability was positive in 2017, in contrast with the negative value in 2016.
Comparing to 2016, the improvement in profitability reflects a significant reduction in the flow of impairments, particularly in the last quarter.

Solvency

Banking system's own funds ratios increased in the last quarter of 2017 due to the increment of capital.

2 Macroeconomic and Financial Indicators

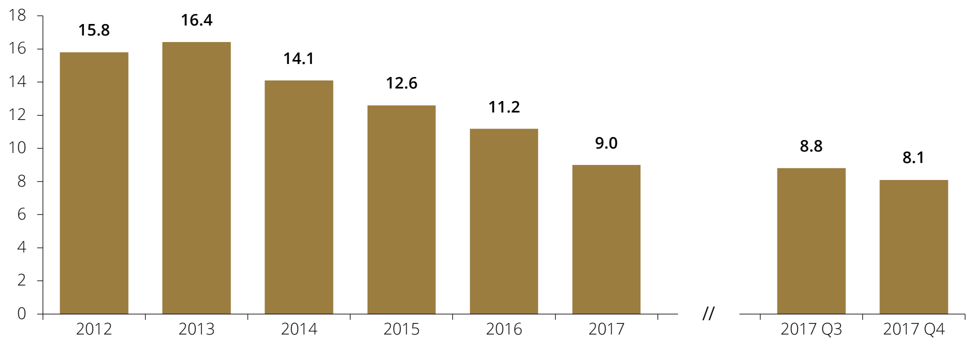
Chart 2.1 • GDP growth rate, in % | Volume



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, GDP grew by 2.7%, 1.1 p.p. above the figure for 2016.
- GDP year-on-year growth rate stood at 2.4%, similar to the previous quarter. GDP quarter-on-quarter growth rate was 0.7%, a slight acceleration from 2017 Q3 (0.6%).

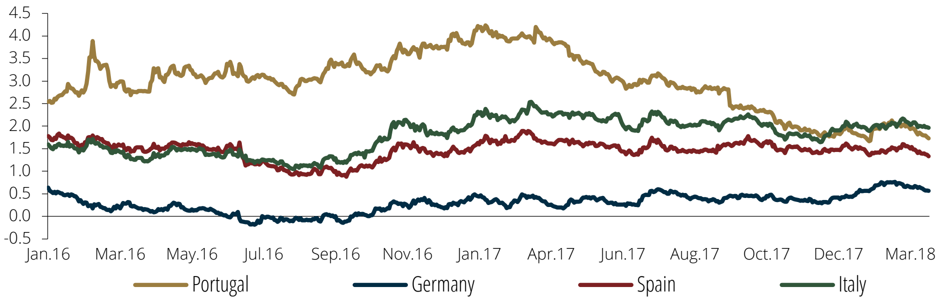
Chart 2.2 • Unemployment rate, % of active population



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 8.1% in 2017 Q4, decreasing by 0.7 p.p. vis-à-vis the previous quarter.
- In 2017, the unemployment rate was 9.0%, a decline of 2.2 p.p. from 2016.

Chart 2.3 • Sovereign debt yields 10Y, in %

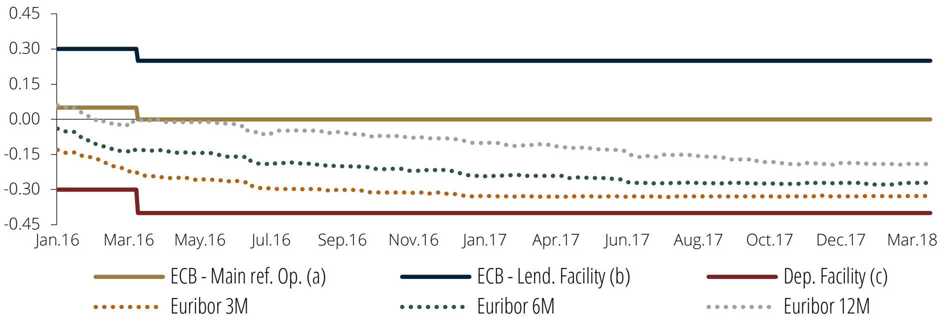


Source: Thomson Reuters.

Note: The last observation is dated 19 March 2018. Daily data.

- The 10-year Portuguese sovereign bond yield dropped 42 basis points between 29 September and 29 December of 2017. The spread vis-à-vis the 10-year German sovereign bond yield decreased by 45 basis points in the same period.
- The downward trajectory of the 10-year Portuguese sovereign bond yield was maintained in the beginning of 2018 and its level has stabilised below 2%. The disclosure of positive macroeconomic and budget execution data might have contributed to this development.

Chart 2.4 • Euro area interest rates, in %



Source: European Central Bank.

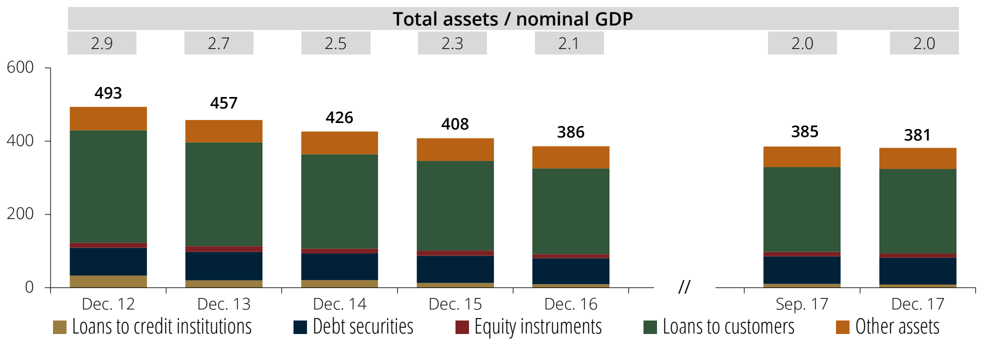
Note: The last observation is dated 19 March 2018. Daily data. (a) Corresponds to the Eurosystem official interest rate on the main refinancing operations (b) Corresponds to the Eurosystem official interest rate on the marginal lending facility (c) Corresponds to the Eurosystem official interest rate on the deposit facility.

- European Central Bank (ECB) interest rates remained 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%.
- In 2017, the euro area interbank market rates (EURIBOR) remained negative, reflecting the banking systems' favourable financing conditions in the context of ECB's accommodative monetary policy.

3 Portuguese Banking System

3.1 Balance sheet

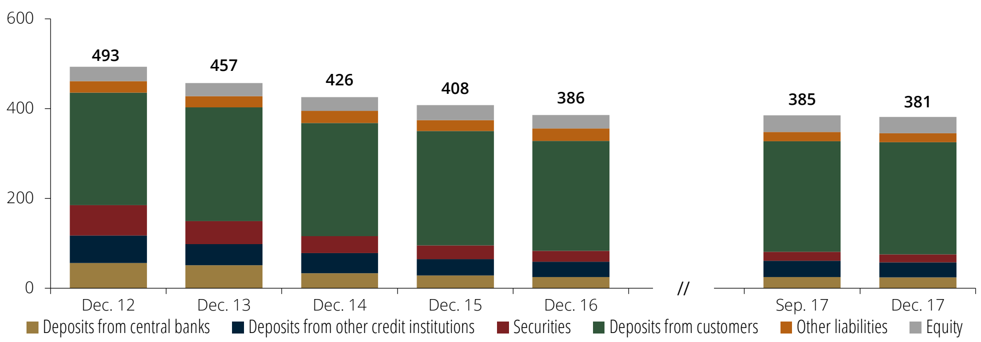
Chart 3.1 • Asset structure, in €Bn



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.

- Banking system's total assets returned to a downward trajectory, decreasing by 1.1% in 2017 Q4 to 381 €Bn.
- In 2017 Q4, the development in total assets reflected the decline in several items, in particular the reduction of the exposure to Portuguese public debt securities and the decrease in loans to credit institutions. This was partly offset by a significant increase in cash balances at central banks. Loans to customers (net of impairments) remained virtually unchanged, despite the different developments of its components.

Chart 3.2 • Bank financing structure, in €Bn



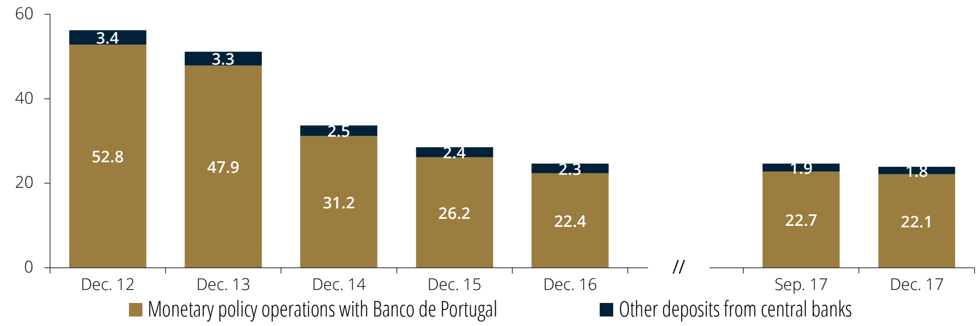
Source: Banco de Portugal.
Note: The Other liabilities item includes derivatives, short positions and other liabilities.

- Deposits from other credit institutions declined in 2017 Q4 (and as a result net interbank funding also decreased). Deposits from central banks and securities also diminished in this period.

- Customer deposits increased sharply in 2017 Q4, reflecting the growth in the Non-financial corporations and Households segments, which more than offset the decline in the public sector deposits.

3.2 Liquidity and funding

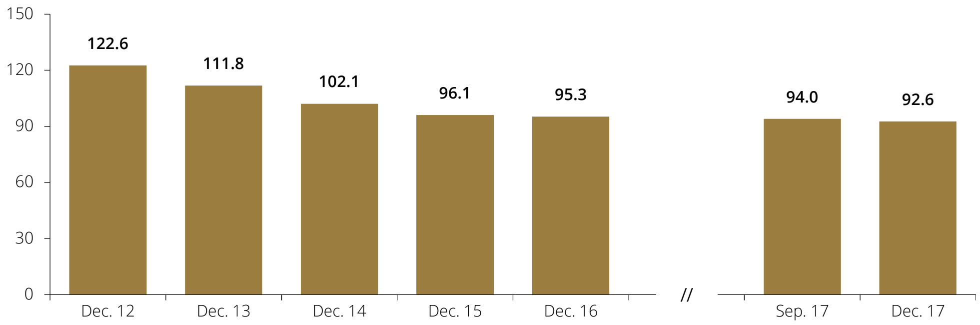
Chart 3.3 • Central banks' funding, in €Bn



Source: Banco de Portugal.

- Central bank's funding declined further in 2017 Q4, albeit more sharply (-3.3%) than in the previous two quarters, reaching its lowest level since 2010 Q1.
- Long-term refinancing operations (LTRO) have become more prevalent in relation to the main refinancing operations (MRO) – which are very residual at this point – and to other type of funding from central banks.

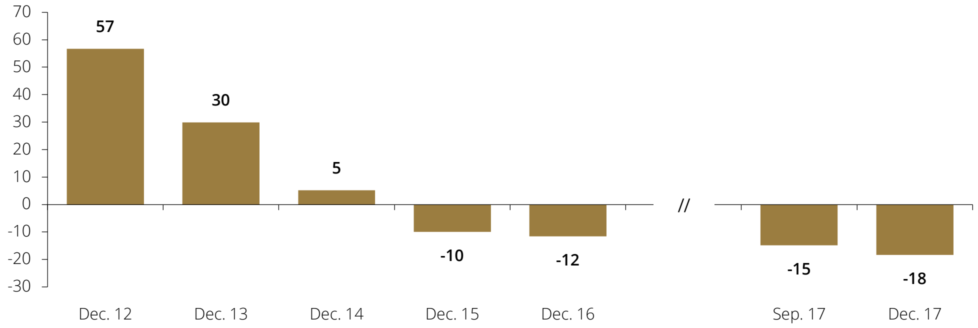
Chart 3.4 • Loan-to-deposit ratio, in %



Source: Banco de Portugal.

- The loan-to-deposit ratio declined slightly in 2017 Q4, mainly reflecting the growth in deposits.

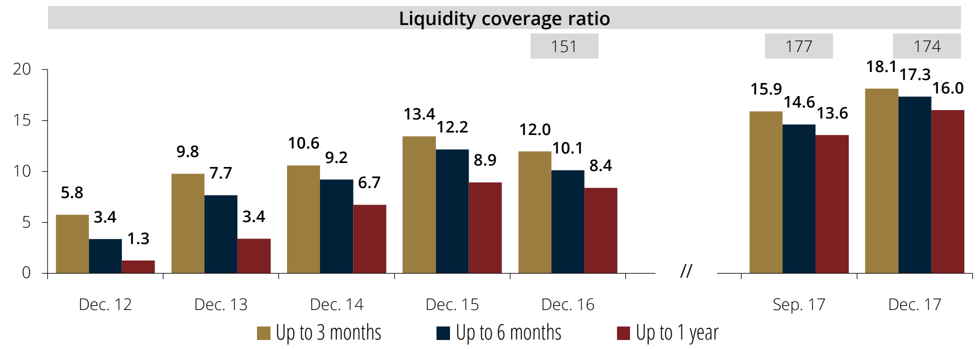
Chart 3.5 • Commercial gap, in €Bn



Source: Banco de Portugal.

- The commercial gap (loans subtracted from customer deposits) has become more negative, by 3 €Bn, in 2017 Q4.

Chart 3.6 • Liquidity gaps for domestic institutions[(a)] and Liquidity Coverage Ratio (LCR)[(b)], in %



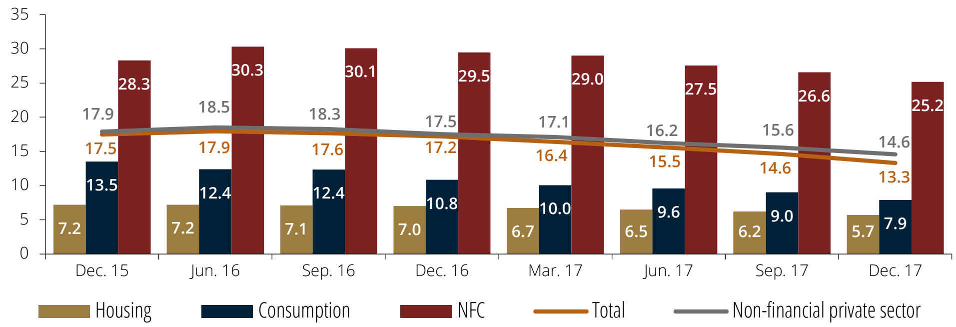
Source: Banco de Portugal.
Notes: a) The liquidity gap is defined as the difference between liquid assets and volatile liabilities in proportion of the difference between total assets and liquid assets, for each cumulative maturity scale. An increase of this indicator reflects an improvement of banks' 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 continued to stand at a comfortable level. Even though the liquidity coverage ratio declined slightly in the last quarter of 2017, it remained at a level higher than in the end of 2016, well above the 100% regulatory minimum required as from 1 January 2018.

- Liquidity gaps of domestic institutions increased for all maturity scales. In the shorter maturities, this evolution mainly reflected the positive development of cash balances at central banks, which more than offset the increase in volatile liabilities. In the remaining maturities (up to 6 months and up to 1 year), both the increase in liquid assets and the reduction in volatile liabilities contributed to this indicator's increase.

3.3 Asset quality

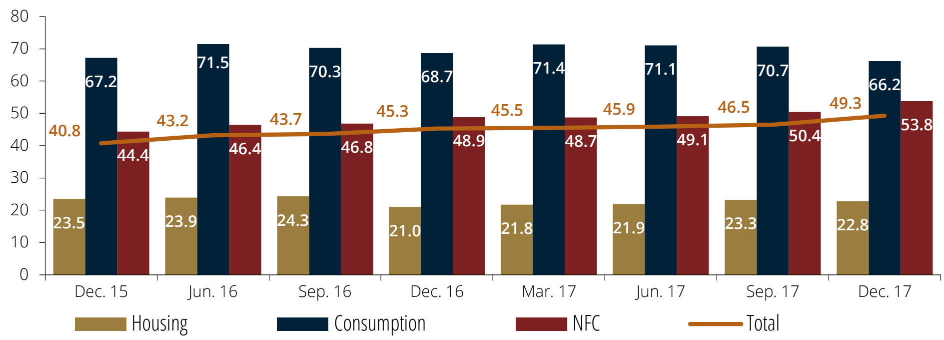
Chart 3.7 • Non-performing loans ratio, in %



Source: Banco de Portugal.
Notes: The non-performing loans ratio is the amount of non-performing loans in relation to total loans, according to EBA's ITS on Supervisory Reporting. The non-financial private sector comprises the Non-financial corporations and Households.

- Non-performing loan (NPL) stock continued to decline in 2017 Q4. This 2.9 €Bn drop was the largest quarterly reduction since the publication of this data series based on the EBA's ITS (December 2015). The NPL stock decreased by 9.3 €Bn vis-à-vis December 2016 and by 13.5 €Bn in comparison to its peak in June 2016.
- The NPL ratio decreased by 1.3 p.p. in this quarter, standing at 13.3%, which represents a 3.9 p.p. reduction in comparison to the end of 2016 and a 4.6 p.p. decline vis-à-vis June 2016. In turn, the Non-financial private sector NPL ratio decreased by 1 p.p. compared to September 2017.
- Despite the positive contribution of all segments, the developments observed in 2017 Q4 mostly reflect a 1.6 €Bn decline in the NPL stock of Non-financial corporations. This stock decreased by 5.9 €Bn and by 8.9 €Bn comparing to December and June 2016 respectively.

Chart 3.8 • Non-performing loans coverage ratios, in %

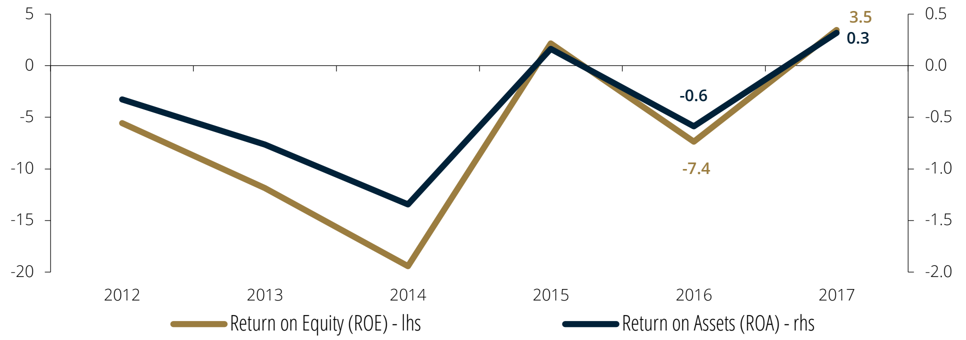


Source: Banco de Portugal.
Note: The coverage ratio is the percentage of non-performing loans that is covered by impairments.

- In December 2017, the NPL coverage by impairments ratio stood at 49.3%, increasing 2.8 p.p. vis-à-vis the previous quarter. This development was driven by a 3.4 p.p. increase of Non-financial corporations' coverage ratio. In turn, the NPL coverage ratio of the Non-financial private sector increased by 2.4 p.p. compared to September 2017.

3.4 Profitability

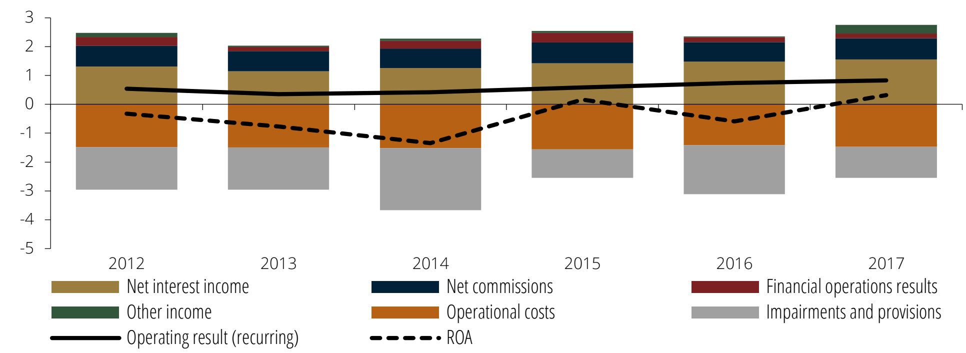
Chart 3.9 • ROE and ROA, in %



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

- The return on equity and the return on assets were positive in 2017, in contrast with the negative figures recorded in 2016. The return on equity rose by 10.8 p.p., while the return on assets grew by 0.9 p.p.
- In 2017, the rise in profitability reflects, above all, a significant reduction in the flow of impairments, due to the base effect related with the substantial increase in the flow of credit impairments recorded at the end of 2016, as well as the increase in total operating income (supported to a large extent by the triggering of the contingent capitalization scheme agreed upon the sale of Novo Banco).

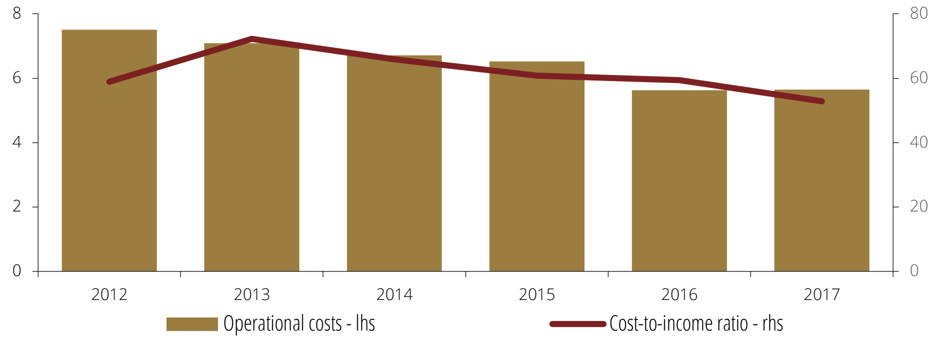
Chart 3.10 • Income and costs, in % of average total assets



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 2017, net interest income contribution to ROA increased slightly vis-à-vis the previous year, due not only to a higher decline in interest expenses than in interest income, but chiefly due to the decline of total assets (denominator effect).
- The contribution of other operating income to ROA increased in 2017, largely as a result of the triggering of the contingent capitalization scheme agreed upon the sale of Novo Banco.
- Operational costs remained virtually unchanged vis-à-vis 2016. It should be noted, however, an increase in staff costs and a decrease in general and administrative expenses of the same order of magnitude.

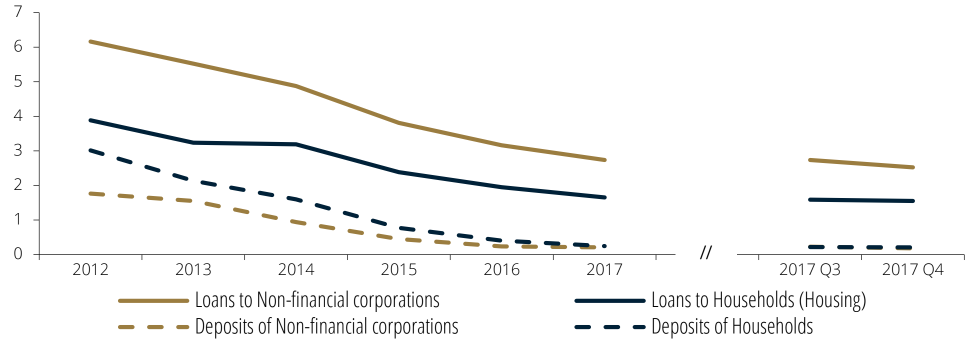
Chart 3.11 • Operational costs and Cost-to-income, in €Bn and in %



Source: Banco de Portugal.

- Cost-to-income ratio stood at 52.9% at the end of 2017, about 6 p.p. lower than in 2016. Given the relative stabilisation of operational costs, this development was mainly driven by the growth in total operating income (which in turn reflects the increase in other operating income).
- In 2017, staff costs continued to be negatively impacted by non-recurrent factors associated with the restructuring processes carried out by some of the largest institutions. This year profitability was also affected by the aforementioned triggering of the contingent capitalization scheme agreed upon the sale of Novo Banco, which impacted other operating income (and, therefore, total operating income). Excluding these non-recurrent factors, it is estimated that cost-to-income ratio would stand at 54.4%.

Chart 3.12 • Banking interest rates (new business), in % | Average value of the period

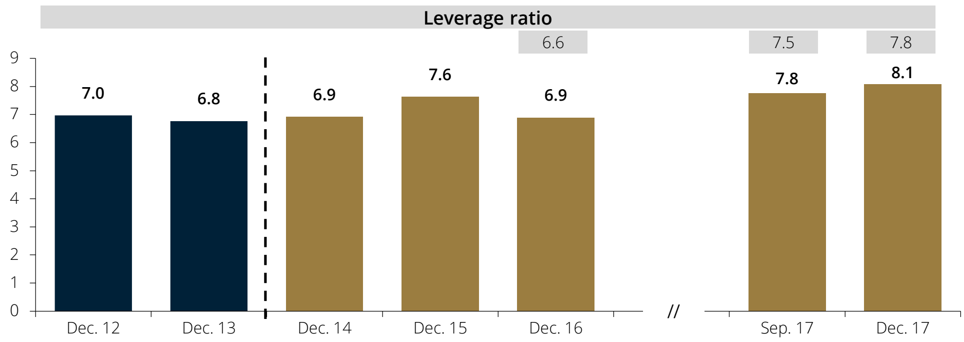


Source: Banco de Portugal.

- Interest rates on new loans to Non-financial corporations and to Households (housing) fell in 2017 Q4 (22 basis points and 4 basis points, respectively).
- The cost of new deposits decreased in both segments (4 basis points in the Non-financial corporations segment and 2 basis points in the Households segment).

3.5 Solvency[(a)]

Chart 3.13 • Tier 1 capital to total assets ratio and Leverage ratio, in %

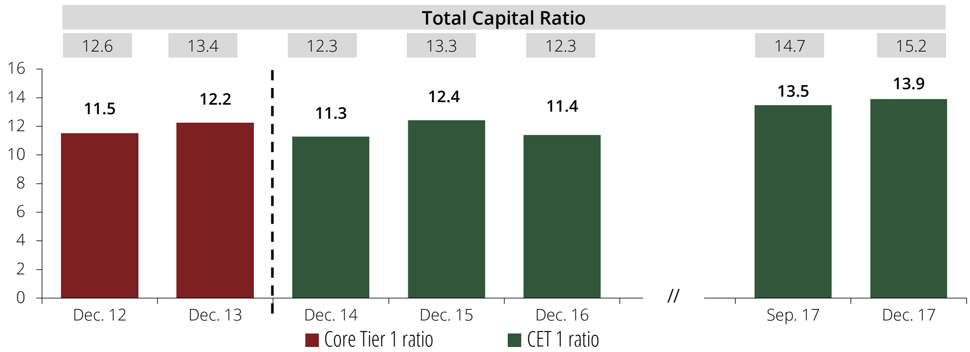


Source: Banco de Portugal.
Note: The Tier 1 capital to total assets ratio is a proxy for the leverage ratio, allowing for a more comprehensive period of analysis. The leverage ratio is calculated as the capital measure (Tier 1 capital) divided by the total exposure, in accordance with the methodology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

- The leverage ratio increased by 0.3 p.p. vis-à-vis the previous quarter, standing at 7.8%, well above the minimum benchmark defined by the Basel Committee on Banking Supervision, reflecting essentially an increment of the banking system’s capital position. In the same vein, the ratio between Tier 1 capital and total assets increased by 0.3 p.p. to 8.1%.

(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.

Chart 3.14 • Own funds ratios, in %



Source: Banco de Portugal.

- The total capital ratio stood at 15.2% in December 2017, increasing by 0.5 p.p. compared to September 2017. The Common Equity Tier 1 (CET 1) ratio stood at 13.9%, an increase of 0.4 p.p. vis-à-vis the previous quarter. These developments reflect solely an increment in the capital position.

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