Portuguese Banking System: latest developments

1st quarter 2018

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EUROSYSTEM

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Prepared with data available up to 27th June 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

Assets

Banking system's total assets decreased in the first quarter of 2018. In the context of an increase in the public debt securities portfolio, this development reflects a decline in some items, in particular cash balances at central banks.

Funding and liquidity

Central banks' funding continued its downward path in the first quarter of 2018, standing at the lowest level since the first quarter of 2010.
Liquidity indicators remained at high levels and have, in general, improved.

Asset quality

Asset quality continued improving in the first quarter of 2018, 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. Moreover, the NPL coverage by impairments ratio continued to increase in this period.

Profitability

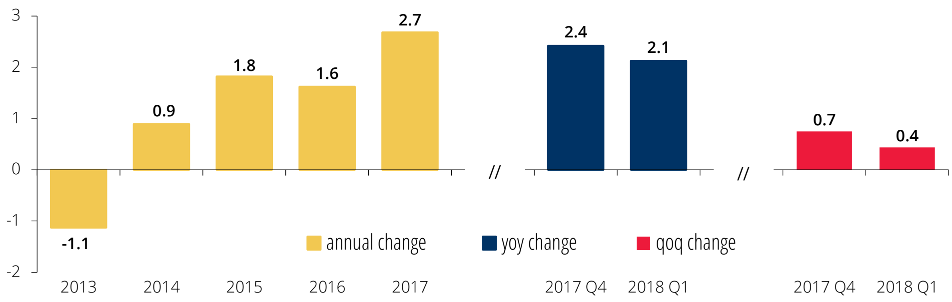
Banking system's profitability increased sharply in the first quarter of 2018, reflecting a significant reduction in the flow of impairments, especially for credit, vis-à-vis the first quarter of 2017.

Solvency

Banking system's own funds ratios decreased marginally in the first quarter of 2018, driven by a larger decrease in capital than in risk weighted assets.

2 Macroeconomic and Financial Indicators

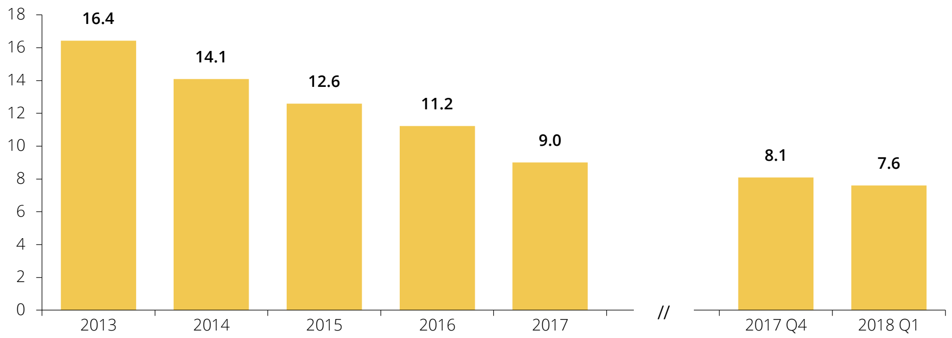
Chart 2.1 • GDP growth rate, in % | Volume



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

- In 2018 Q1, GDP grew by 2.1% year-on-year, which compares with a 2.4% growth rate recorded in the previous quarter.
- GDP quarter-on-quarter growth rate was 0.4%, a slight deceleration vis-à-vis 2017 Q4 (0.7%).

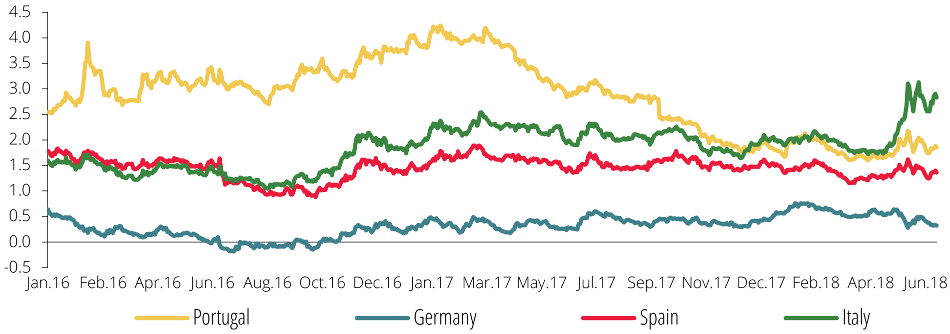
Chart 2.2 • Unemployment rate, % of active population



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 7.6% in 2018 Q1, decreasing by 0.5 p.p. from the previous quarter.
- In year-on-year terms, the unemployment rate declined 2.3 p.p.

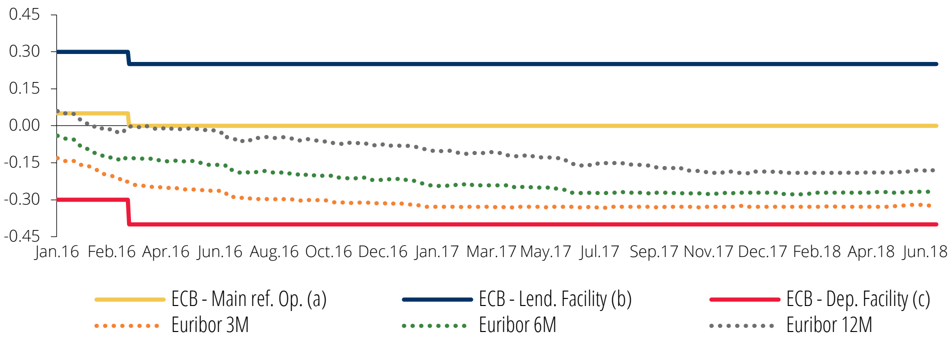
Chart 2.3 • Sovereign debt yields 10Y, in %



Source: Thomson Reuters.
Note: The last observation is dated 27 June 2018. Daily data.

- The 10-year Portuguese sovereign bond yield dropped 32 basis points between 29 December of 2017 and 30 March of 2018, standing at 1.61%. The spread vis-à-vis the 10-year German sovereign bond yield decreased by 39 basis points in the same period.
- In 2018 Q2, there was an increase in the volatility of the sovereign debt market, which might be related to the political context in Spain and, more importantly, in Italy. It should be noted that the spread between the 10-year Italian and Portuguese bonds increased considerably.

Chart 2.4 • Euro area interest rates, in %



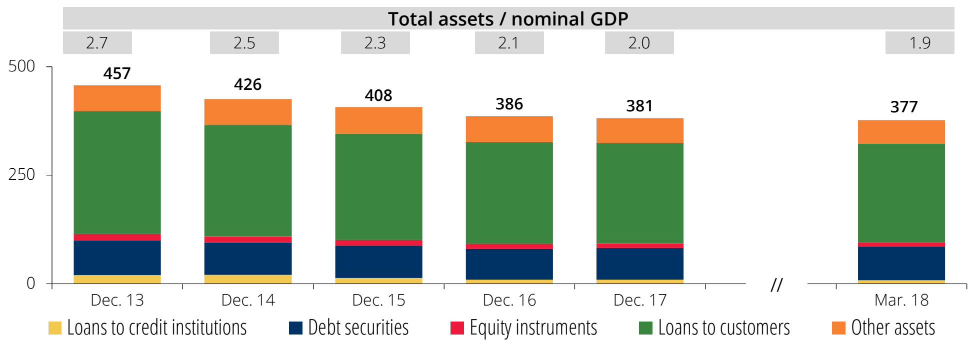
Source: European Central Bank.
Note: The last observation is dated 27 June 2018. Daily data. (a) Corresponds to the Eurosystem official interest rate on the main refinancing operations (b) Corresponds to the Eurosystem official interest rate on the marginal lending facility (c) Corresponds to the Eurosystem official interest rate on the deposit facility.

- European Central Bank (ECB) interest rates remain 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%.
- In 2018 Q1, euro area interbank market rates (EURIBOR) remained negative and fairly stable vis-à-vis the previous quarter, reflecting the banking system's favourable financing conditions in the context of ECB's accommodative monetary policy. This tendency did not change in the second quarter of the year.

3 Portuguese Banking System

3.1 Assets

Chart 3.1 • Asset structure, in €Bn



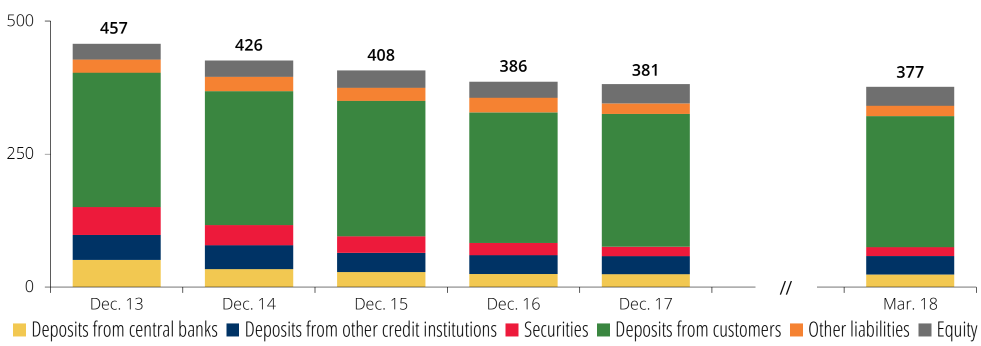
Source: Banco de Portugal.

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.

- In 2018 Q1, banking system's total assets continued on the downward trend observed in recent years, having decreased by around 1% from the previous quarter. This development reflected a significant decrease in cash balances at central banks (included in the "Other assets" item) and, to a lesser extent, in the portfolio of loans to customers. These declines were partially offset by an increase in the sovereign debt portfolio, mostly Portuguese debt.
- Balance sheet items' development was affected by the selling process of Deutsche Bank's retail operation in Portugal, which entailed the reclassification of the large majority of the loans to customers' portfolio to the "Other assets" item. Excluding this reclassification, the loans to customers' portfolio remained virtually stable (-0.3%), instead of declining by 1.3%.

3.2 Funding and liquidity

Chart 3.2 • Bank financing structure, in €Bn

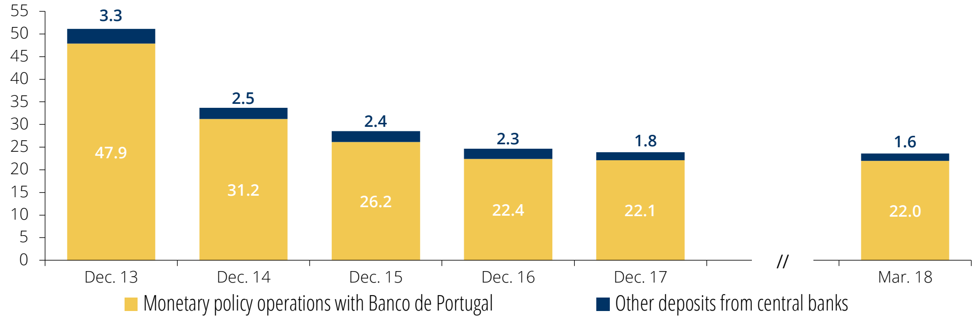


Source: Banco de Portugal.

Note: The Other liabilities item includes derivatives, short positions and other liabilities.

• In 2018 Q1, customer deposits decreased 1%, in line with total assets. In turn, the liabilities represented by securities continued on a downward trend observed in recent years, in relative and in absolute terms. Moreover, interbank funding (net of assets in other credit institutions) increased in this quarter, via an increase in other credit institutions resources.

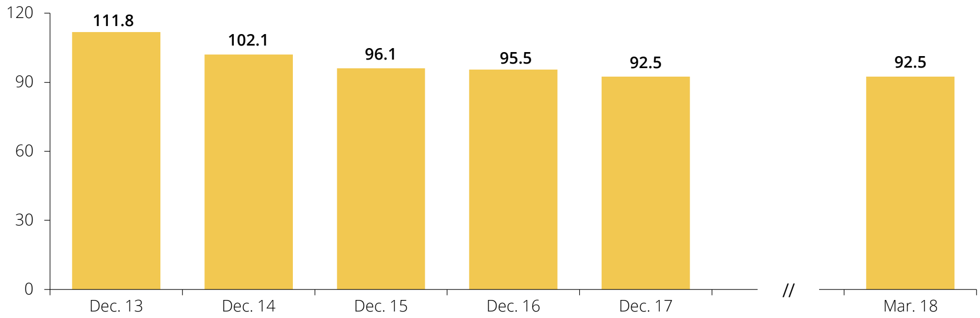
Chart 3.3 • Central banks' funding, in €Bn



Source: Banco de Portugal.

• Central bank's funding declined further in 2018 Q1, albeit less sharply than in recent quarters, reaching its lowest level since 2010 Q1. It should be noted that this type of funding is mainly based on long-term refinancing operations (LTRO).

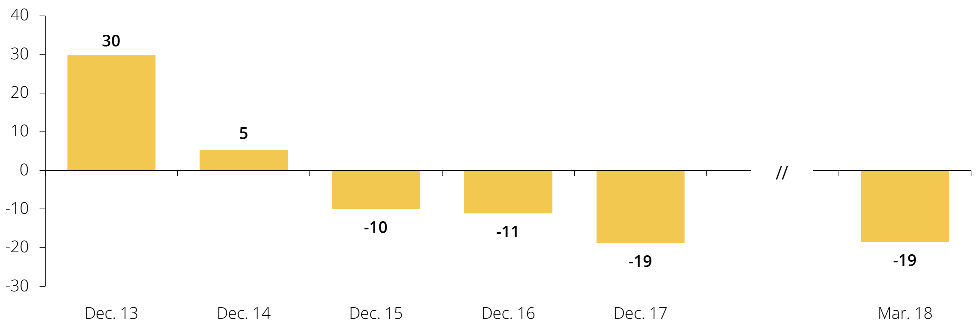
Chart 3.4 • Loan-to-deposit ratio, in %



Source: Banco de Portugal.

• The loan-to-deposit ratio remained stable in 2018 Q1, reflecting both the decline in customers' loans and deposits.

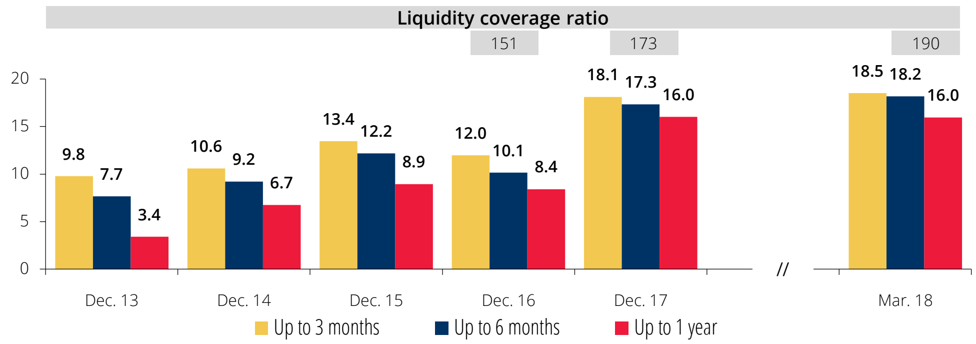
Chart 3.5 • Commercial gap, in €Bn



Source: Banco de Portugal.

- The commercial gap (customer loans subtracted from customer deposits) remained unchanged vis-à-vis 2017 Q4, standing at approximately -19 €Bn.

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



Source: Banco de Portugal.

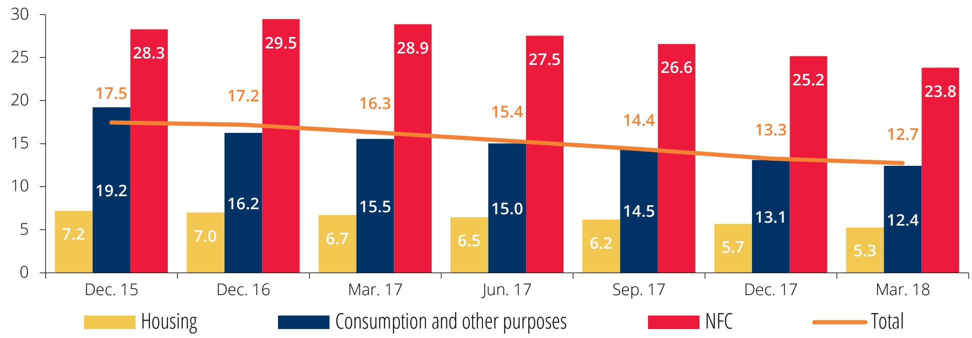
Notes: a) The liquidity gap is defined as the difference between liquid assets and volatile liabilities in proportion of the difference between total assets and liquid assets, for each cumulative maturity scale. An increase of this indicator reflects an improvement of banks' liquidity position; b) The 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.

- Banking system's liquidity improved in 2018 Q1 with the liquidity coverage ratio increasing by 17 p.p., standing well above the current regulatory minimum (100%). This development chiefly reflects a decline in the ratio's denominator.

- The liquidity of domestic institutions, measured by the liquidity gaps, increased for all maturity scales.

3.3 Asset quality

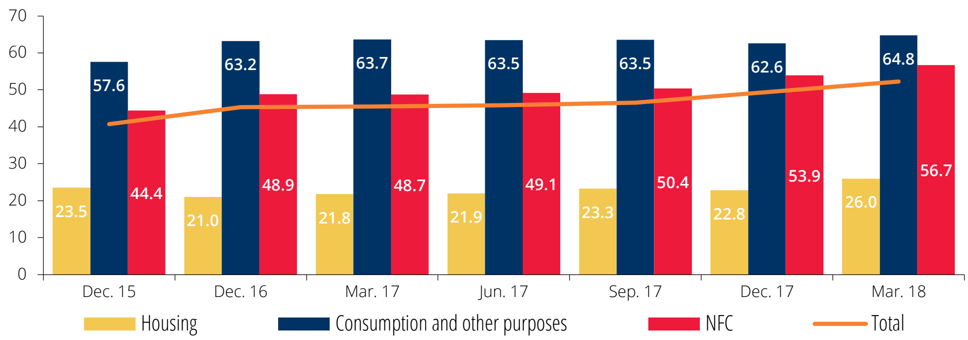
Chart 3.7 • Non-performing loans ratio, in %



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.

- The NPL stock decreased by 6.4% in 2018 Q1, reflecting declines in the Non-financial corporations (NFC) and Household segments (-6% and -8%, respectively). This development contributed to a quarterly decrease of more than 0.5 p.p. in NPL ratio, to 13.0%. However, the contribution of the NPL stock decrease to the ratio's variation was partially offset by a decrease in the loan portfolio (denominator effect).
- NPL ratio declined by 5.2 p.p. from its peak in June 2016 (NFC: -6.5 p.p., Household: -2.6 p.p.) reflecting a reduction of the total NPL stock by 31% (NFC: -31%, Household: -30%) or 16 €Bn (NFC: -10 €Bn, Household: -4 €Bn).

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

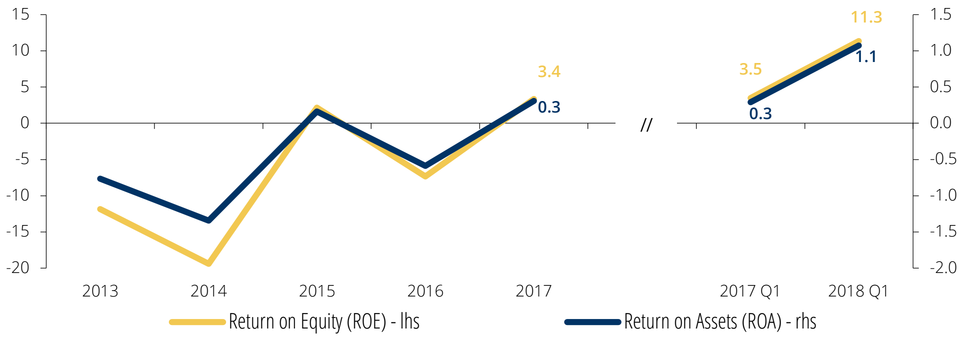


Source: Banco de Portugal.
Note: The coverage ratio is the percentage of non-performing loans that is covered by impairments.

- In 2018 Q1, the NPL coverage by impairments ratio stood at 52.2%, increasing by 2.8 p.p. vis-à-vis the previous quarter. This development was chiefly driven by a 2.8 p.p. increase of Non-financial corporations' coverage ratio, to 56.7%.

3.4 Profitability

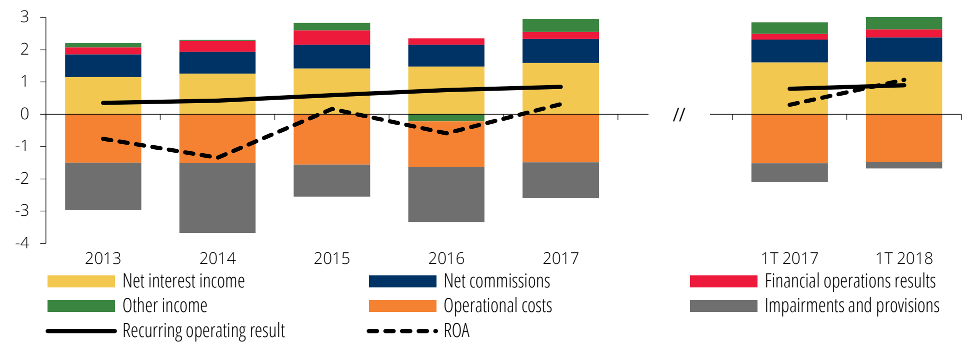
Chart 3.9 • ROE and ROA, in %



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

- The banking system's profitability increased sharply compared with 2017 Q1: the return on equity rose by 7.9 p.p. and the return on assets grew 0.8 p.p.
- The increase in profitability in 2018 Q1 reflects, above all, a significant reduction in the flow of impairments and, to a lesser extent, an increase in income from financial operations and in income from services and commissions.

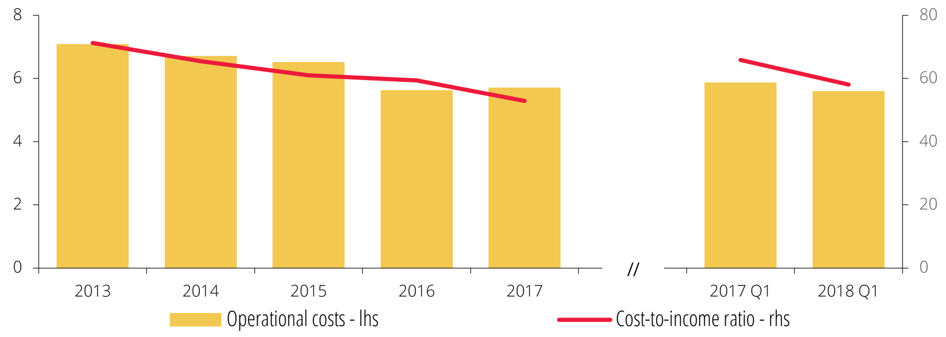
Chart 3.10 • Income and costs, in % of average total assets



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 2018 Q1, net interest income contribution to ROA stabilised vis-à-vis 2017 Q1, reflecting declines in interest expenses and in interest income of similar magnitude. In turn, the contribution of net commissions increased due to higher growth in the commissions received than in the commissions paid.
- The reduction of impairment costs contributed favourably to the increase in ROA, with the contribution of this component standing at -0.2% of assets (-0.6% in 2017 Q1). This development was mainly driven by a decrease in the flow of credit impairments.

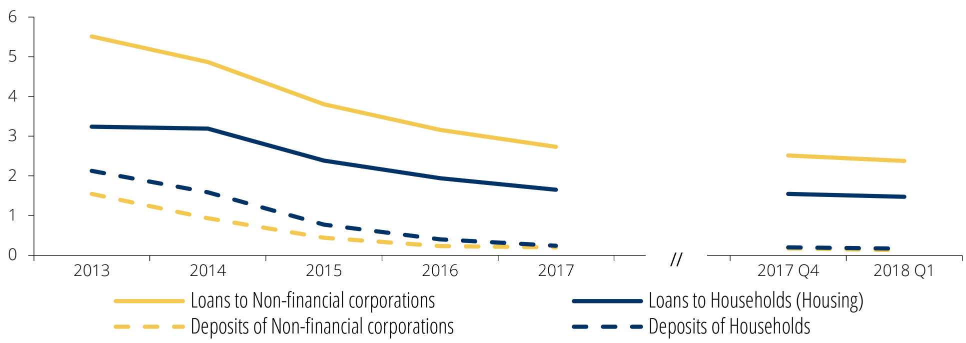
Chart 3.11 • Operational costs and Cost-to-income, in €Bn and in %



Source: Banco de Portugal.

- In 2018 Q1, operational costs decreased by 4.5% year-on-year. This reduction was observed in all of its components, being more pronounced in staff costs (which accounted for more than half of the operational costs variation).
- Cost-to-income ratio stood at 58% in 2018 Q1, which represents an 8 p.p. decline in comparison with the same period of the previous year. This development reflected the decline in operational costs and the growth in total operating income, with a greater contribution of the latter to the reduction of the ratio. In recent years, the cost-to-income ratio has been affected by the restructuring processes that have been implemented, particularly by the largest institutions.

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

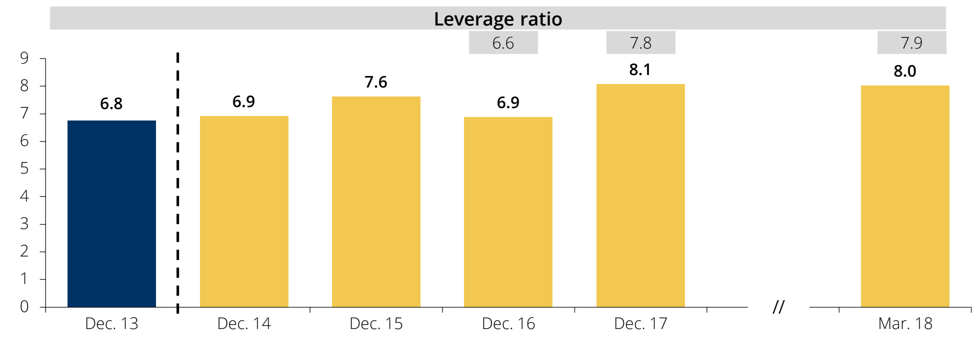


Source: Banco de Portugal.

- Interest rates on new loans to NFC and to Household (housing) fell vis-à-vis the previous quarter (14 basis points and 7 basis points, respectively), standing at 2.38% and 1.47%, respectively.
- The cost of new deposits decreased in both segments (5 basis points in the NFC segment and 3 basis points in the Household segment).

3.5 Solvency(a)

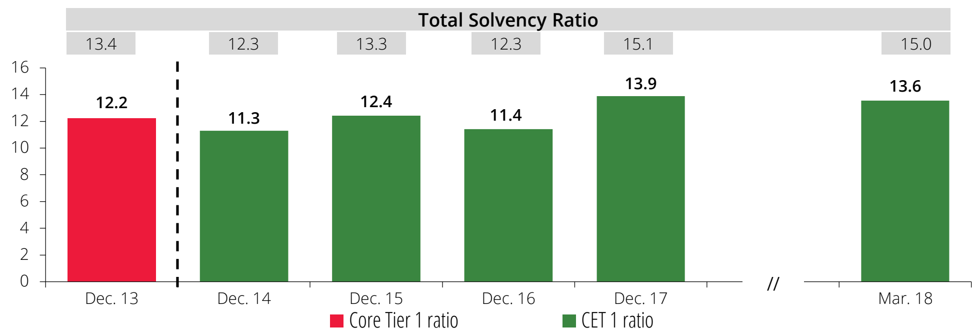
Chart 3.13 • Tier 1 capital to total assets ratio and Leverage ratio, in %



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.

- In 2018 Q1, the leverage ratio increased slightly vis-à-vis the previous quarter (0.1 p.p.), standing at 7.9%, well above the minimum benchmark stipulated by the Basel Committee on Banking Supervision. This development resulted from a decrease in total exposure[1] larger than in banking system's capital position. In turn, the ratio between Tier 1 capital and total assets declined marginally, to 8%.

Chart 3.14 • Own funds ratios, in %



Source: Banco de Portugal.

- The total solvency ratio stood at 15.0% in March 2018, decreasing by 0.1 p.p. compared to the previous quarter. The Common Equity Tier 1 (CET 1) ratio stood at 13.6%, which represents a decline of 0.3 p.p. vis-à-vis December 2017. These developments reflect a deterioration of the capital position, chiefly driven by the phasing out of the transitional provisions, which was only partially offset by the 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.

[1] The total exposure measure is the sum of the exposure values of all assets and off-balance sheet items not deducted when determining the capital measure, in this case, Tier 1 capital.