

Portuguese Banking System: latest developments

2nd quarter 2018



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Prepared with data available up to 26th September 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 increased in the second quarter of 2018, reversing the downward trend seen in recent years. This development essentially reflects the growth in cash balances at central banks and in the portfolio of public debt securities, in particular those issued by the domestic sovereign.

Funding and liquidity

Customer deposits increased significantly in the second quarter of 2018, particularly in the in the non-financial corporations (NFC) segment, leading to a reduction in the loan-to-deposit ratio. In turn, central banks' funding continued its downward path in the second quarter of 2018, standing at its lowest level since the first quarter of 2010. Liquidity indicators remained at high levels, having improved in all maturity scales.

Asset quality

Asset quality continued to improve in the second quarter of 2018, with a decline of the non-performing loans (NPL) ratio. This development continued to reflect the decrease of the NPL stock, in particular in the NFC segment. The NPL coverage by impairments ratio increased slightly vis-à-vis the previous quarter.

Profitability

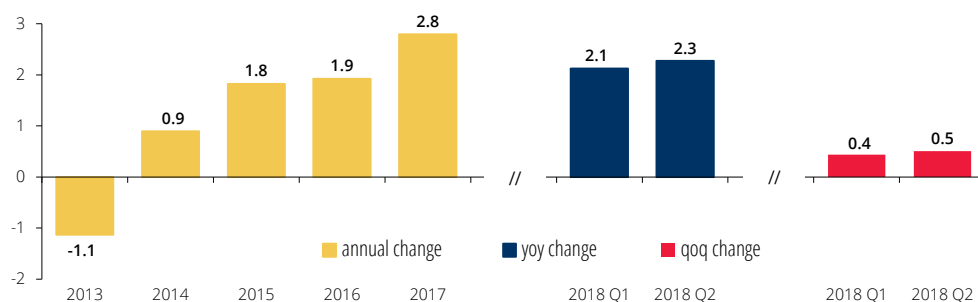
Banking system's profitability increased sharply in the first half of 2018 year-on-year, reflecting a decline in the flow of impairments, especially for credit, as well as a reduction in staff costs.

Solvency

Banking system's CET 1 ratio decreased marginally in the second quarter of 2018, driven by a slight reduction in common equity tier 1 capital and an increase in risk weighted assets.

2 Macroeconomic and Financial Indicators

Chart 2.1 • GDP growth rate, in % | Volume

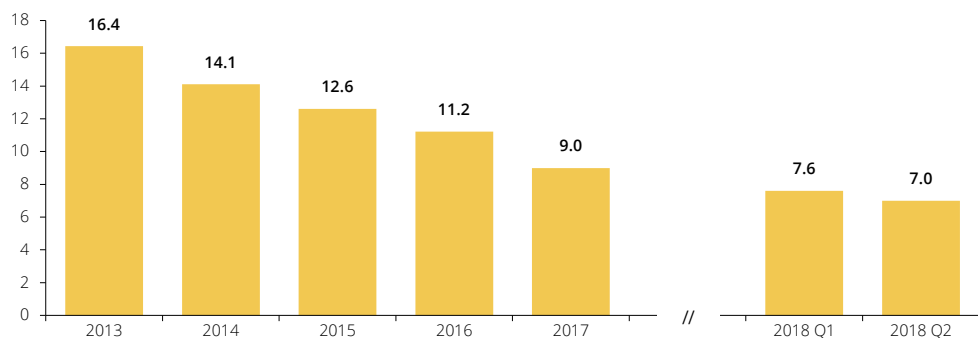


Source: INE.

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

- In 2018 Q2, GDP grew by 2.3% year-on-year, which compares with a 2.1% growth rate in the previous quarter.
- GDP quarter-on-quarter growth rate was 0.5%, which represents an increase vis-à-vis 2018 Q1 (0.4%).

Chart 2.2 • Unemployment rate, % of active population

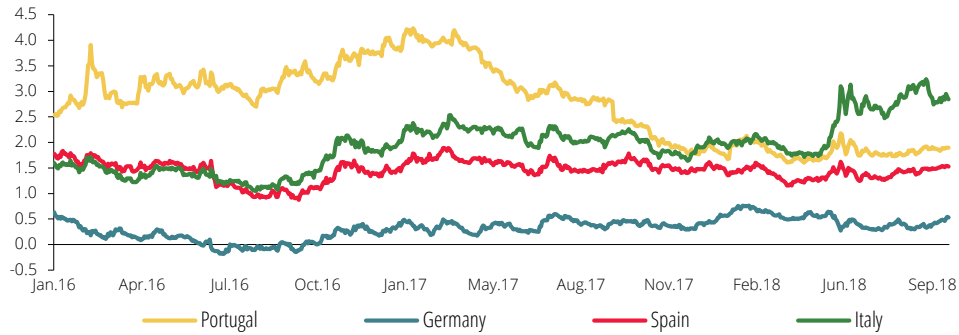


Sources: Banco de Portugal and INE.

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 7.0% in 2018 Q2, decreasing by 0.6 percentage points (pp) from the previous quarter.
- In year-on-year terms, the unemployment rate declined 2.2 pp.

Chart 2.3 • Sovereign debt yields 10Y, in %

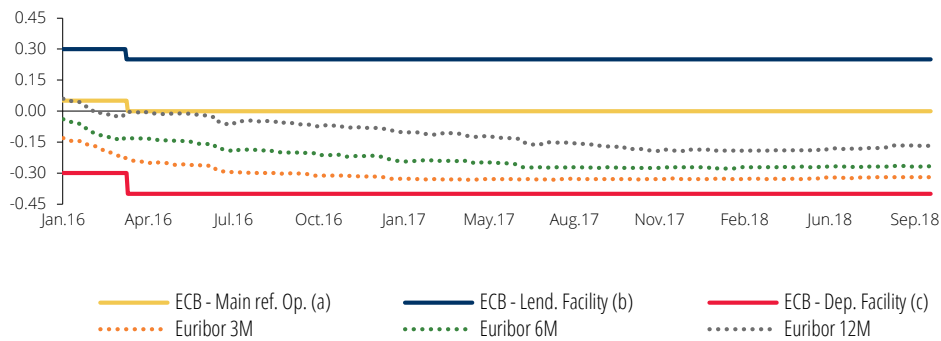


Source: Thomson Reuters.

Notes: The last observation is dated 26 September 2018. Daily data.

- During 2018 Q2 the 10-year Portuguese sovereign bond yield increased by 18 basis points (bp) to 1.79%. In the same period, the spread vis-à-vis the German sovereign debt increased by 37 bp.
- 2018 Q2 was marked by increased volatility in the sovereign debt market, a phenomenon that persisted throughout the 3rd quarter and that might be particularly related to the political context in Italy. Since the end of the 1st quarter, Italian and Portuguese sovereign bond yields increased by 106 bp and 29 bp, respectively. Thus, there was a significant increase in the spread between Italian and Portuguese bonds.

Chart 2.4 • Euro area interest rates, in %



Source: European Central Bank.

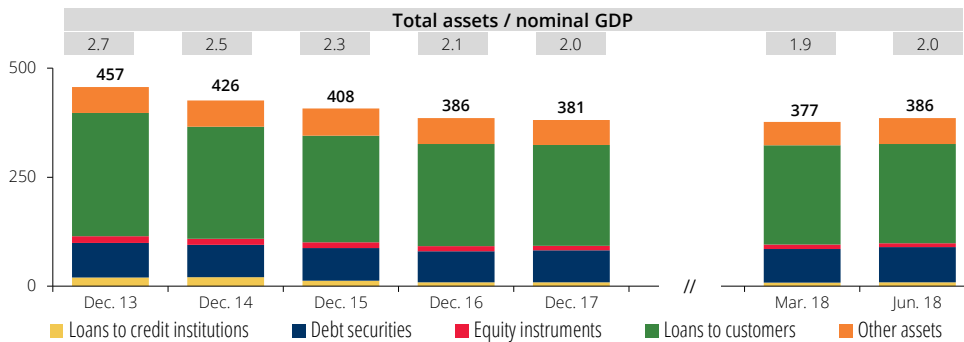
Notes: The last observation is dated 26 September 2018. Daily data. (a) Corresponds to the Eurosystem official interest rate on the main refinancing operations (b) Corresponds to the Eurosystem official interest rate on the marginal lending facility (c) Corresponds to the Eurosystem official interest 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 Q2, EURIBOR rates remained negative and fairly stable vis-à-vis the previous quarter. This tendency did not change during the 3rd quarter, reflecting the maintenance of the banking system's financing conditions in the context of the ECB's accommodative monetary policy.

3 Portuguese Banking System

3.1 Assets

Chart 3.1 • Asset structure, in €Bn



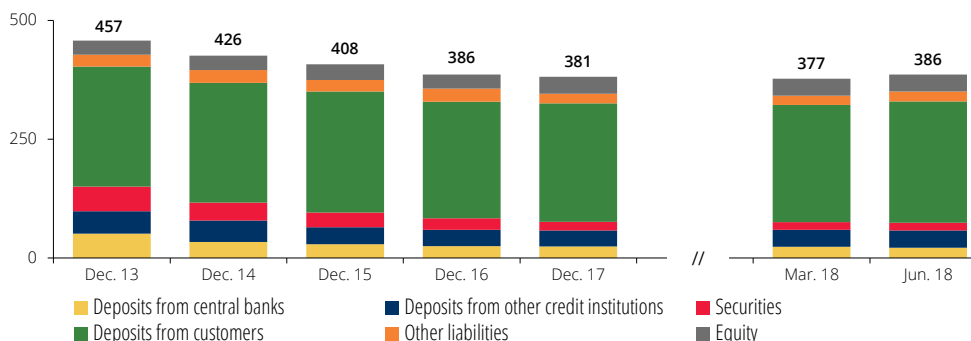
Source: Banco de Portugal.

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 Q2, banking system's total assets reversed the downward trend observed over the last few years, having increased by 2.2% from the previous quarter. This development reflected a significant growth in cash balances at central banks (included in the "Other assets" item) and, to a lesser extent, in the debt securities portfolio, predominantly securities issued by Portuguese and Spanish general governments.
- These balance sheet items' increases were partially offset by a slight reduction in the loans to customers' portfolio (0.2%), which was driven by some of the system's largest institutions, particularly in the NFC segment (0.5 %).

3.2 Funding and liquidity

Chart 3.2 • Bank financing structure, in €Bn

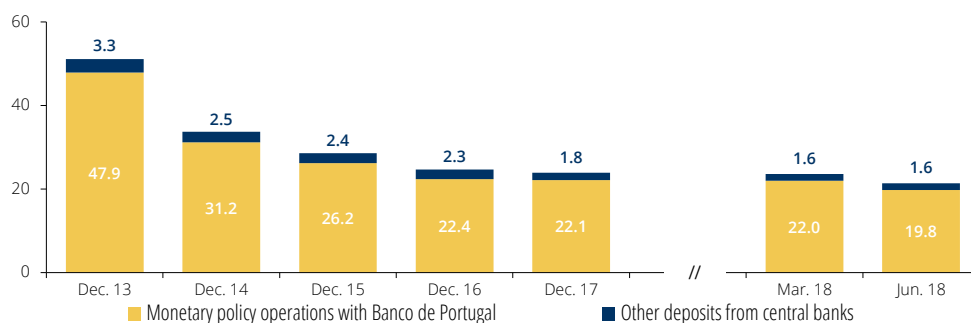


Source: Banco de Portugal.

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

- In 2018 Q2, customer deposits augmented 3.6%, and this increase was common to the most significant institutions in the system. This development was more relevant in the NFC segment and in the other financial corporations segment (i.e. excluding credit institutions), which recorded increases of 4.1 €Bn and 2.5 €Bn, respectively.
- Interbank funding (net of assets in other credit institutions) increased, as in the previous quarter, via an increase in other credit institutions resources.

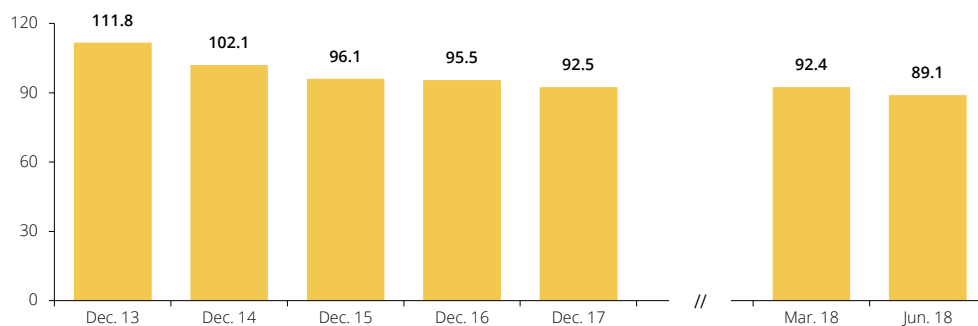
Chart 3.3 • Central banks' funding, in €Bn



Source: Banco de Portugal.

- Central bank's funding declined by 9.6% in 2018 Q2, maintaining the reduction dynamics observed in recent years and reaching its lowest level since 2010 Q1. This type of funding is almost in its entirety based on long-term refinancing operations (LTRO).

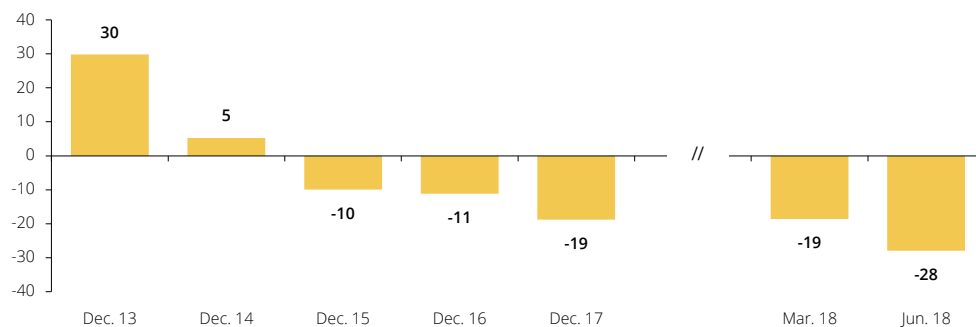
Chart 3.4 • Loan-to-deposit ratio, in %



Source: Banco de Portugal.

- The loan-to-deposit ratio decreased in 2018 Q2, reflecting essentially the abovementioned growth in customer deposits.

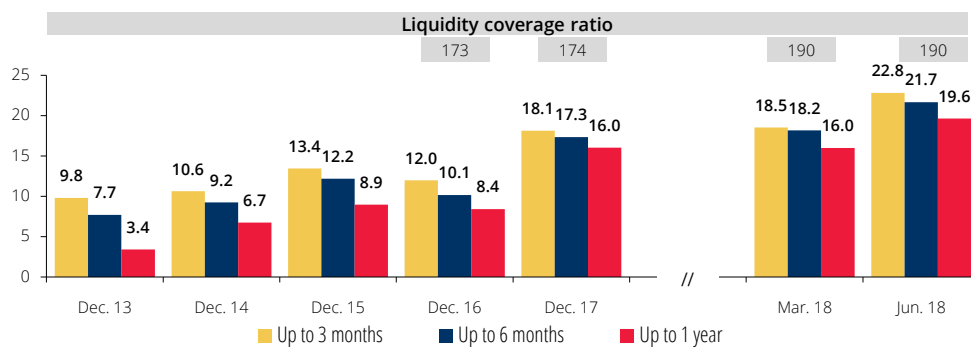
Chart 3.5 • Commercial gap, in €Bn



Source: Banco de Portugal.

- The commercial gap (customer loans minus customer deposits) was more negative than in the previous quarter, standing at approximately -28 €Bn.

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



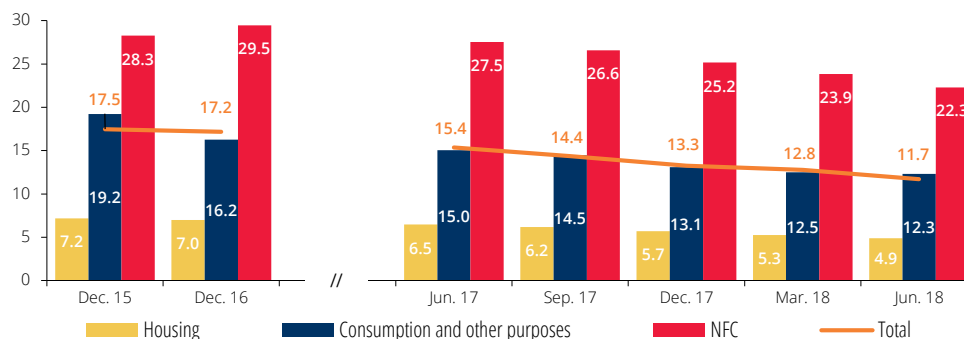
Source: Banco de Portugal.

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.

- The liquidity coverage ratio stood at 190% in 2018 Q2, as in the previous quarter, thus continuing well above the current regulatory minimum (100%).
- The liquidity of domestic institutions, measured by the liquidity gaps, increased substantially for all maturity buckets.

3.3 Asset quality

Chart 3.7 • Non-performing loans ratio, in %

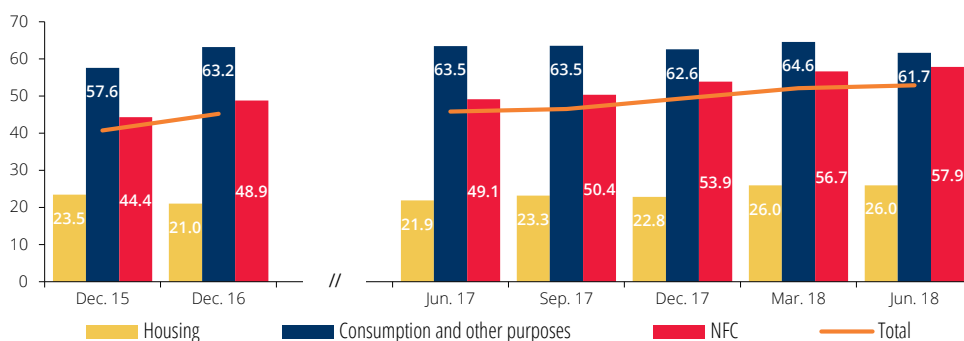


Source: Banco de Portugal.

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.

- Total NPL ratio diminished by 1 pp, to 11.7%, in 2018 Q2, driven mainly by a reduction in the stock of NPLs, which decreased by 2.3 €Bn (6.5%) and, to a lesser extent, the increase in loans not classified as NPL (ie, performing). This reduction was more significant in the NFC segment, whose NPL stock decreased by 1.7 €Bn (7.5%) in the quarter.
- NPL ratio declined by 6.2 pp from its peak in June 2016 (NFC: -8.0 pp, Household: -2.9 pp) reflecting a 36% reduction in the total stock of NPLs (NFC: -36%, Household: -33%) or 18 €Bn (NFC: -12.0 €Bn, Household: -4.2 €Bn).

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



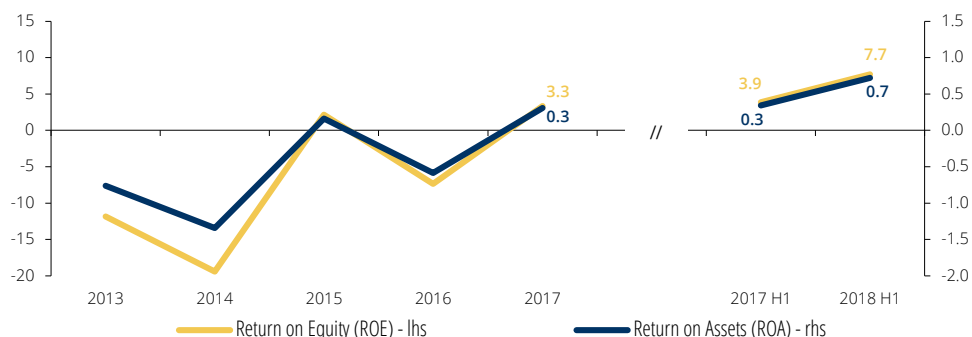
Source: Banco de Portugal.

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

- In 2018 Q2, the NPL coverage by impairments ratio increased by 0.7 pp vis-à-vis the previous quarter, standing at 52.9%. This figure is 9.7 pp above the one recorded in June 2016, when the NPL ratio reached its peak.
- This quarterly development was chiefly driven by a 1.2 pp increase in the NFC segment coverage ratio, which stood at 57.9%. The coverage ratio of the consumption and other purposes segment decreased by 3 pp, mainly reflecting a reduction of this segment's accumulated impairments.

3.4 Profitability

Chart 3.9 • ROE and ROA, in %

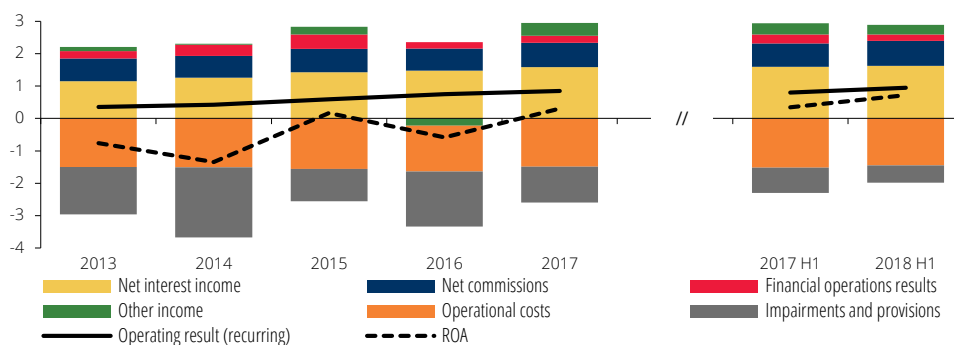


Source: Banco de Portugal.

Note: Return is measured by profit or loss before tax.

- The banking system's profitability increased sharply compared with 2017 H1: the return on equity rose by 3.8 pp and the return on assets grew by 0.4 pp.
- This 2018 H1 year-on-year increase in profitability reflects, above all, a significant reduction in the flow of impairments (-337 €Mn, -30.5%) and provisions (-157 €Mn, -39.1%) and, to a lesser extent, an increase in income from services and commissions (72 €Mn, 5.2%) and other results.

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

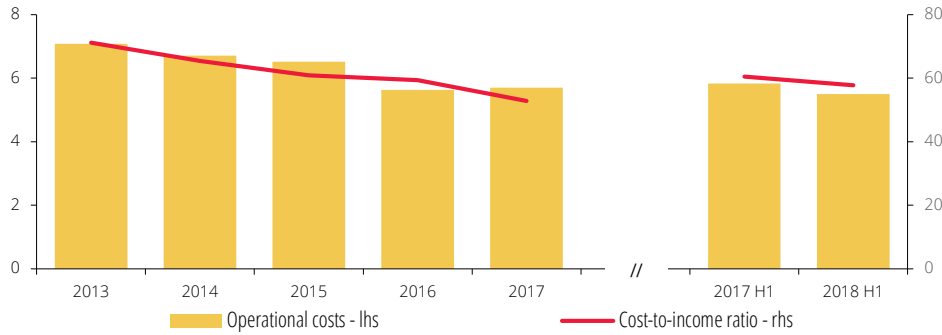


Source: Banco de Portugal.

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 H1, net interest income contribution to ROA remained stable *vis-à-vis* the same period in the previous year. 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 and provision costs had a contribution of about 25 bp to ROA's year-on-year increase. This development was mainly driven by a decrease in the flow of credit impairments.

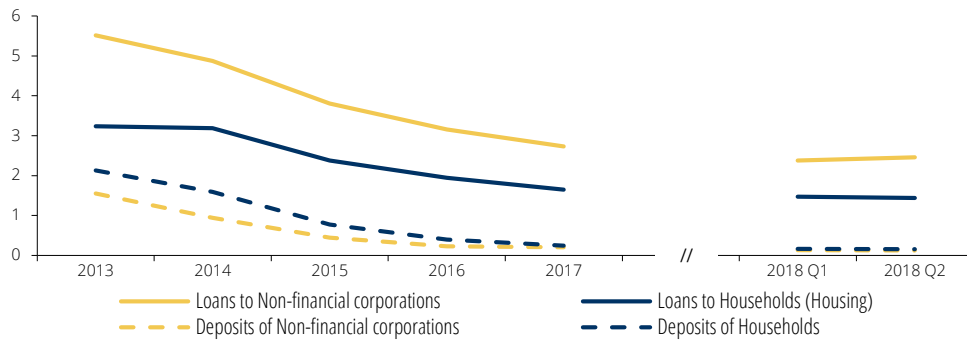
Chart 3.11 • Operational costs and Cost-to-income, in €Bn and in %



Source: Banco de Portugal.

- Operational costs decreased by 5.8% year-on-year in 2018 H1. Although this reduction was common to all operational costs' components, it mainly reflects the decrease in staff costs which fell by 7.9% year-on-year.
- Cost-to-income ratio stood at 57.7% in 2018 H1, which represents a 2.8 pp decline *vis-à-vis* the same period of the previous year. This development reflected exclusively the decline in operational costs as the total operating income decreased by 1.3% compared to the first half of 2017. 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

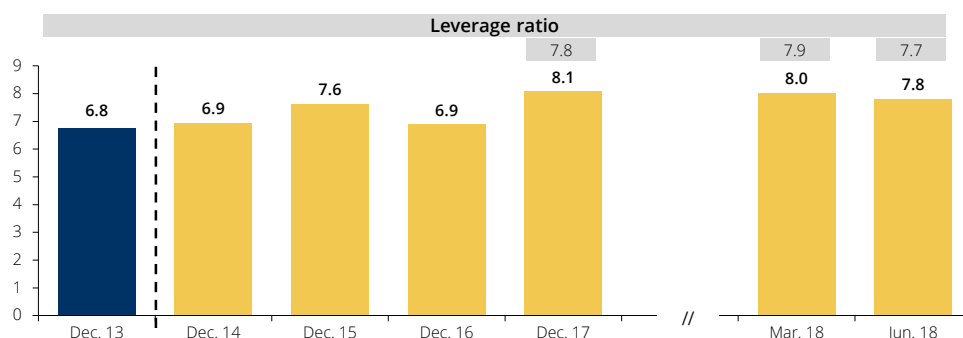


Source: Banco de Portugal.

- In 2018 Q2, the interest rate on new loans to NFC increased by 8 bp to 2.46%, whilst the interest rate on new loans to households (housing) fell by 3 bp to 1.44%.
- The cost of new deposits decreased by 1 bp in both segments, standing at 0.13% for NFC and 0.15% for Households.

3.5 Solvency^(a)

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

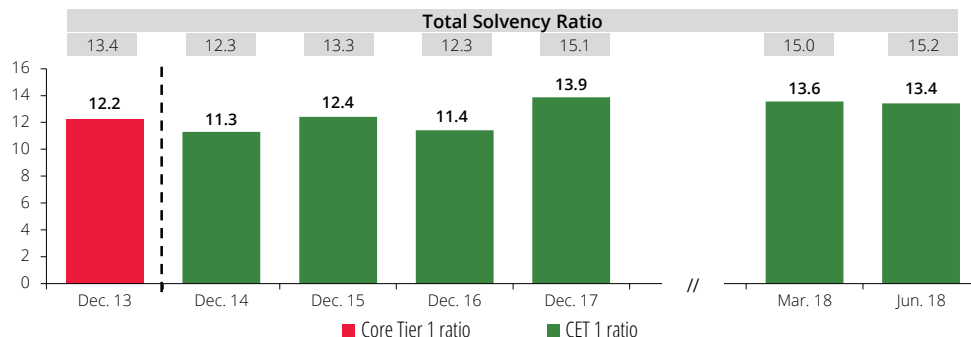


Source: Banco de Portugal.

Notes: 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 Q2, the leverage ratio decreased 0.2 pp vis-à-vis the previous quarter, standing at 7.7%, well above the minimum benchmark stipulated by the Basel Committee on Banking Supervision. This development reflected, above all, an increase in total exposure¹ as well as a slight reduction in the banking system's capital position. In turn, the ratio between Tier 1 capital and total assets diminished 0.2 pp, to 7.8%.

Chart 3.14 • Own funds ratios, in %



Source: Banco de Portugal.

- The total solvency ratio stood at 15.2% in June 2018, increasing by 0.2 pp vis-à-vis the previous quarter. The Common Equity Tier 1 (CET 1) ratio stood at 13.4%, which represents a 0.2 pp decline when compared with March 2018. This contrasting development reflects a reduction in common equity tier 1 capital and an increase in tier 2 capital. The slight increase in risk-weighted assets contributed negatively to the evolution of equity ratios.

(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 According to the Regulation (EU) No. 575/2013, 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.

