Portuguese Banking System: latest developments

3rd quarter 2018

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EUROSYSTEM

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Prepared with data available up to 19th December 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

Total assets of the banking system decreased in the third quarter of 2018. This essentially reflects the reduction in cash balances at central banks.

Funding and liquidity

Central bank financing continued its downward trend, recording a new low since the first quarter of 2010.

The liquidity indicators remained at comfortable levels.

Asset quality

In the third quarter of 2018, banking system's asset quality continued to improve favourably, with a continuing decline in the stock and non-performing loans (NPL) ratio. The impairment coverage ratio of NPLs increased slightly compared to the previous quarter.

Profitability

Banking system's profitability increased significantly in the first three quarters of 2018, year-on-year, reflecting a reduction in the flow of impairments and provisions, especially for credit, as well as a reduction in staff costs.

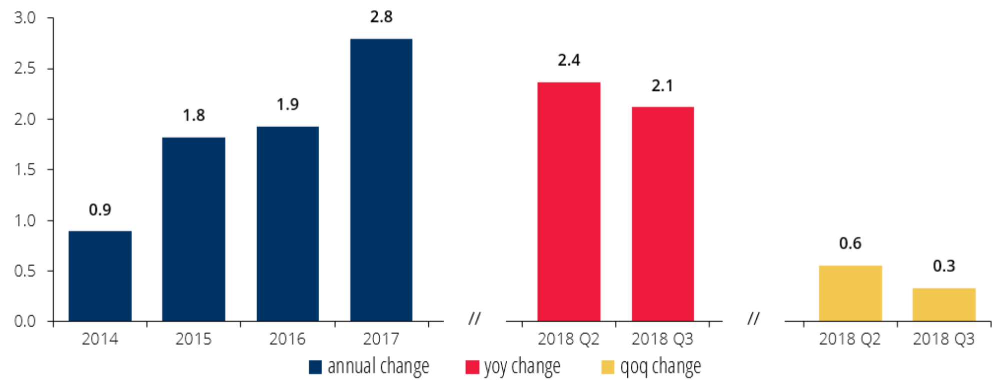
Solvency

The total capital ratio increased slightly in the third quarter of 2018 as a result of a reduction in risk-weighted assets.

The average risk weight decreased slightly.

2 Macroeconomic and Financial Indicators

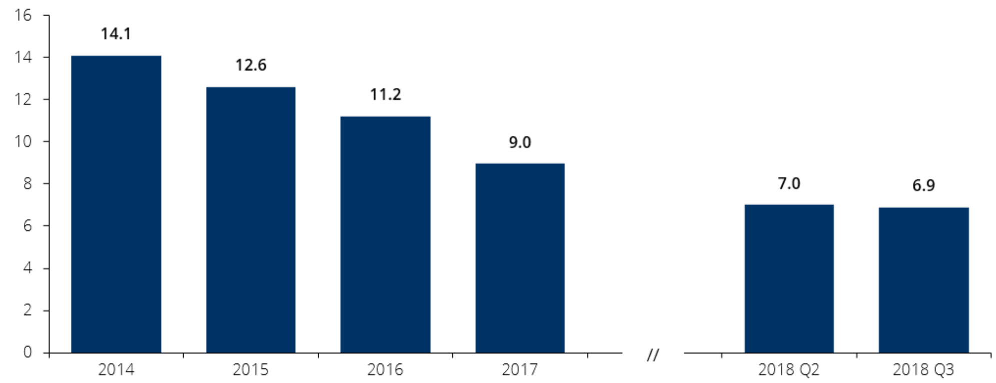
Chart 2.1 • GDP growth rate (volume) | Per cent



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

- Year-on-year, GDP grew by 2.1% in the third quarter of 2018, compared to a growth rate of 2.4% in the previous quarter.
- GDP quarter-on-quarter growth rate stood at 0.3%, down from the figure recorded in the second quarter of 2018 (0.6%).

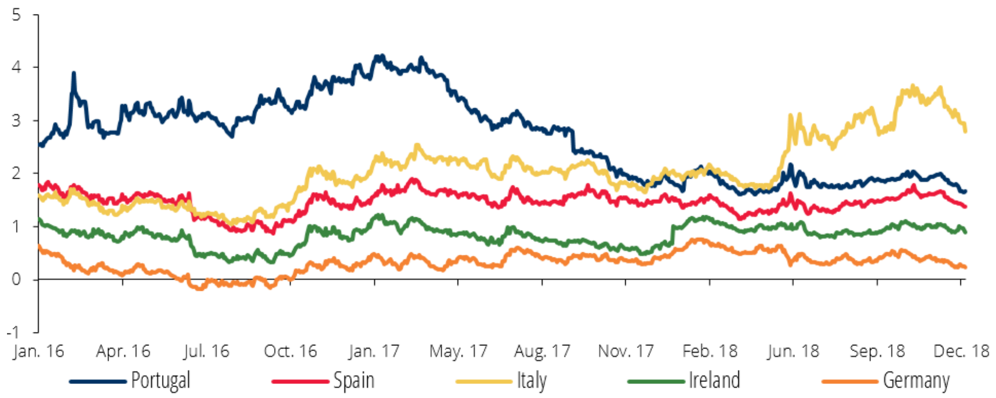
Chart 2.2 • Unemployment rate | Percentage of active population



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 6.9% in 2018 Q3, decreasing by 0.1 percentage points (p.p.) from the previous quarter.
- In year-on-year terms, the unemployment rate declined 1.8 p.p.

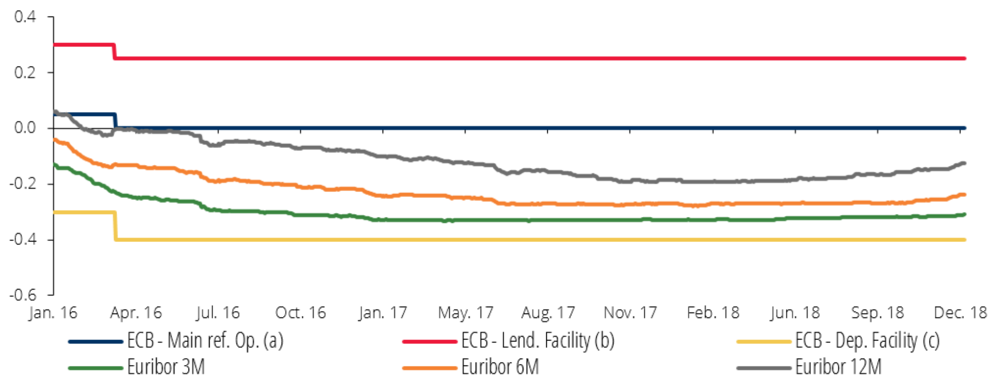
Chart 2.3 • Sovereign debt yields 10Y | Per cent



Source: Thomson Reuters.
Notes: The last observation is dated 19 December 2018. Daily data.

- During the third quarter of 2018, the 10-year yield on the 10-year Portuguese government debt increased by 9 basis points (bp) to 1.88% at the end of September. However, the spread vis-à-vis German public debt declined by 8 bp.
- Political and economic uncertainty in Italy has resulted in a significant increase in sovereign bond yields of this country in all maturities. So far, the contagion to the yields of other euro area economies, namely Portugal, has been contained.

Chart 2.4 • Euro area interest rates | Per cent



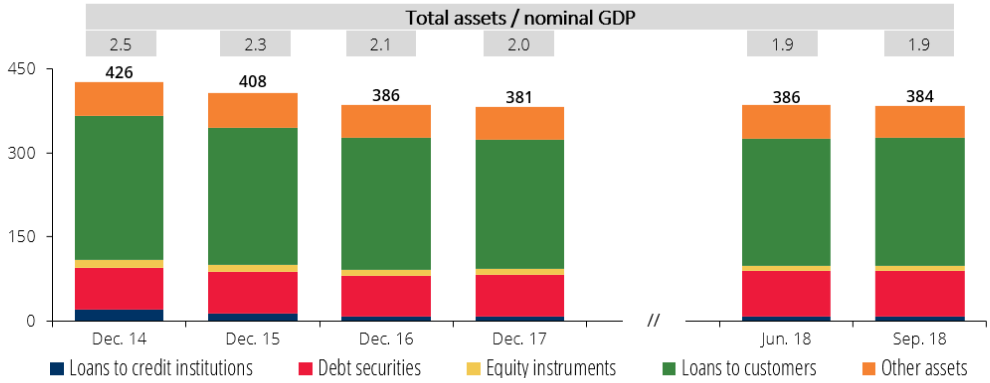
Source: European Central Bank.
Notes: The last observation is dated 19 Decembrer 2018. Daily data. (a) Corresponds to the Eurosystem official interest rate on the main refinancing operations (b) Corresponds to the Eurosystem official interest rate on the marginal lending facility (c) Corresponds to the 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 Q3, EURIBOR rates remained negative and fairly stable vis-à-vis the previous quarter. This tendency did not change during the fourth 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 | EUR billion

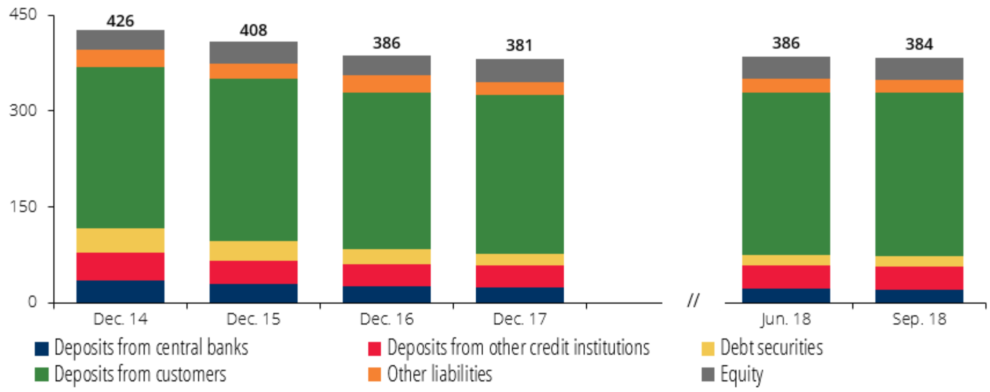


Source: Banco de Portugal.
Note: The Other assets item includes cash and cash balances at central banks, cash balances at other credit institutions, derivatives, tangible and intangible assets, and other assets.

- In the third quarter of 2018, banking system's total assets decreased by 0.5% *vis-à-vis* the previous quarter. These developments reflected a reduction of around 11% in cash balances at central banks (included under "Other assets") and, to a lesser extent, in credit institutions.
- In turn, there was an increase in the value of the loans to customers (net of impairments) and debt securities portfolio.

3.2 Funding and liquidity

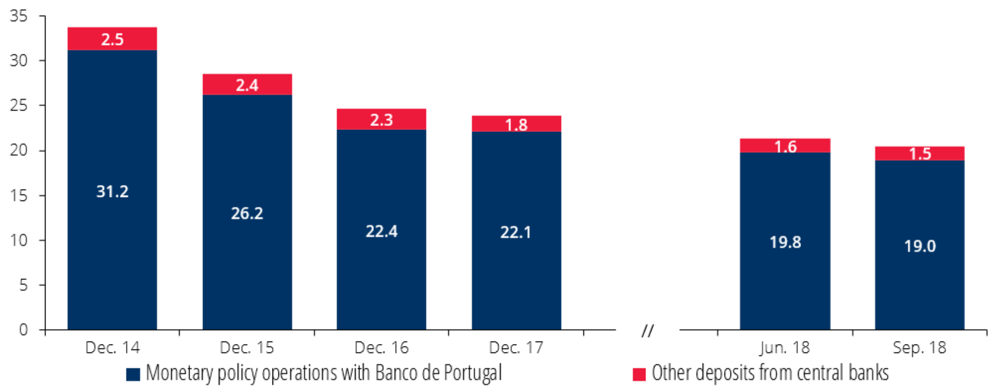
Chart 3.2 • Bank financing structure | EUR billion



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

- In the third quarter of 2018, customer deposits and interbank financing (net of assets in other credit institutions) remained stable.
- "Other liabilities" decreased 5% due to reductions in the value of trading derivatives, short-term liabilities and other financial liabilities.

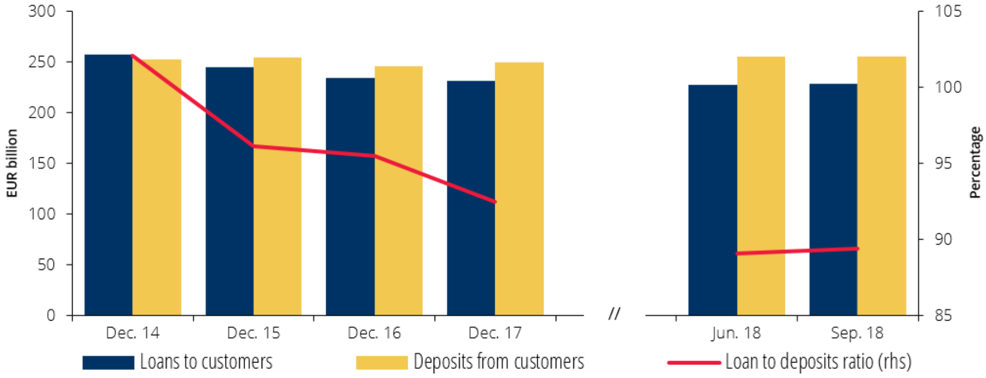
Chart 3.3 • Central banks' funding | EUR billion



Source: Banco de Portugal.

- In the third quarter of 2018, financing from central banks decreased by 4.2%, maintaining the reduction dynamics observed in recent years and reaching the lowest value since the first quarter of 2010.
- Currently, this type of financing relies almost entirely on long-term refinancing operations (LTRO).

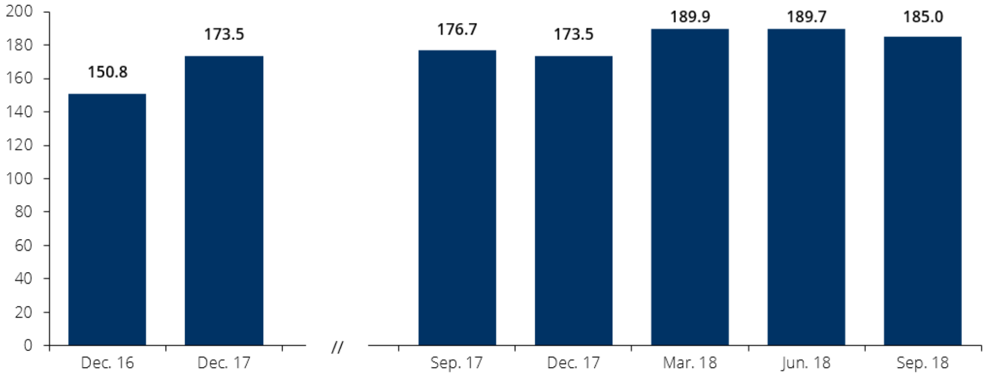
Chart 3.4 • Loan-to-deposit ratio



Source: Banco de Portugal.

- The customer loan-to-deposit ratio remained relatively stable in the third quarter of 2018 (around 89%), reflecting little variation in both items.

Chart 3.5 • Liquidity Coverage Ratio | Per cent



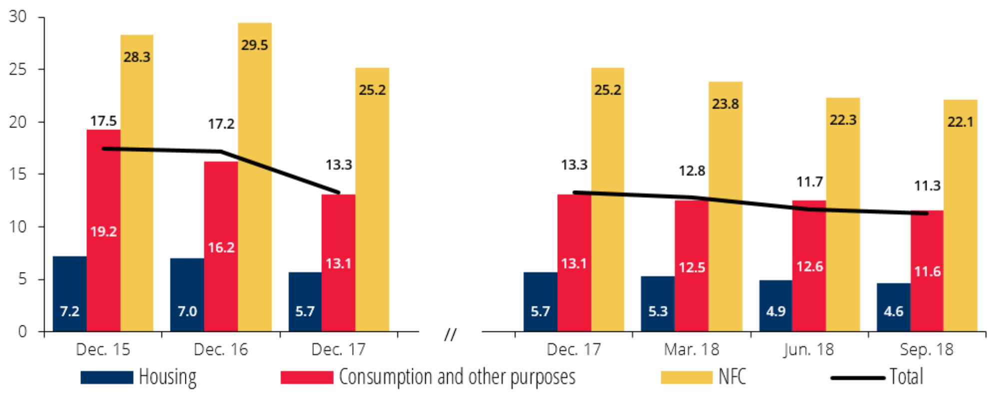
Source: Banco de Portugal.
Note: The liquidity coverage ratio is obtained by dividing high-quality liquid unencumbered assets by total net cash outflows over a 30-day stress period.

- The liquidity coverage ratio (LCR) decreased 4.7 p.p. in the third quarter, reflecting a 2.5% reduction in the liquidity buffer.

- However, the LCR of the banking system remains at levels well above the 100% regulatory minimum.

3.3 Asset quality

Chart 3.6 • Non-performing loans ratio | Per cent

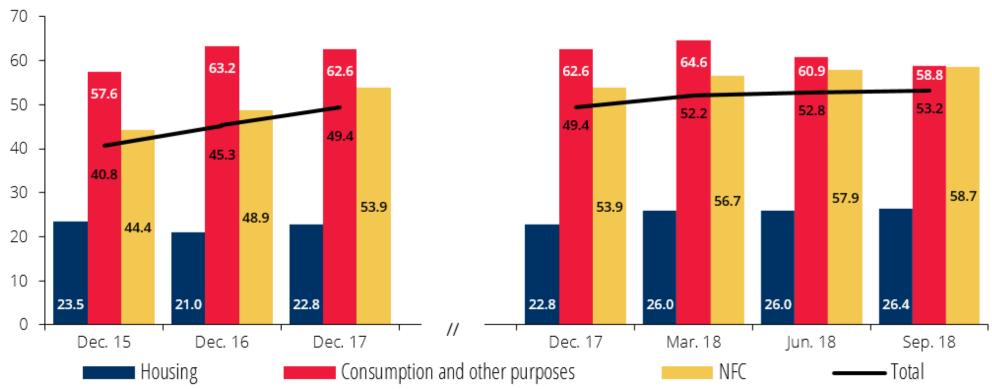


Source: Banco de Portugal.
Notes: The non-performing loans ratio is the amount of non-performing loans in relation to total loans, according to EBA's ITS on Supervisory Reporting.

- In the third quarter of 2018, the NPL ratio decreased 0.4 p.p. to 11.3%, benefiting from a reduction of non-performing loan stock by 1.3 €Bn (4%). The reduction of this ratio was more significant in the households segment (housing purpose), whose NPL stock decreased by 269 €Mn (5%) in the quarter.

- From the historical peak observed in June 2016, the NPL ratio decreased by 6.6 p.p. (SNF: -8.1 p.p., households: -3.2 p.p.) reflecting a 38% reduction in total NPL stock (NFC: -37%, households: -36%), corresponding to 19.2 €Bn (SNF: -12.2 €Bn, households: -4.6 €Bn).

Chart 3.7 • Non-performing loans coverage ratios | Per cent



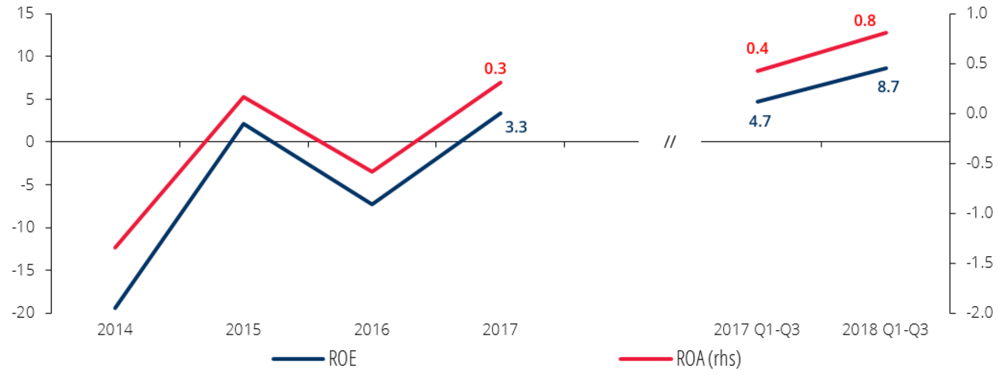
Source: Banco de Portugal.
Note: The coverage ratio is the amount of impairments for non-performing loans as a percentage of non-performing loans.

- In the third quarter of 2018, the NPL impairment coverage ratio increased by 0.3 p.p. compared to the previous quarter, standing at 53.2%. This figure is 10 p.p. above that observed in June 2016, when the NPL ratio reached its maximum value.

- The quarterly variation was mainly due to an increase of 0.8 p.p. in the impairment coverage ratio of the SNF segment, which stood at 58.7%. The coverage ratio of the consumption and other purposes segment decreased by 2.1 p.p., mainly reflecting a reduction of the accumulated impairments for NPL in this segment.

3.4 Profitability

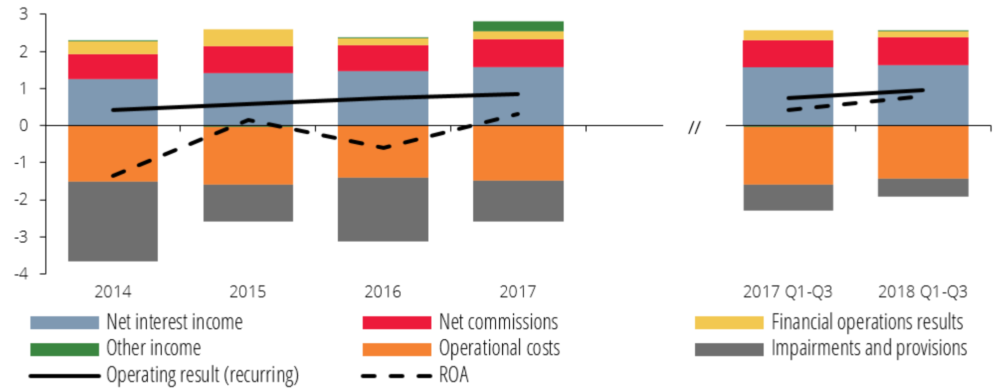
Chart 3.8 • Return on Equity (ROE) and Return on Assets (ROA) | Per cent



Source: Banco de Portugal.
Notes: Return is measured by profit or loss before tax, as a percentage of average assets (ROA) or average equity (ROE). The figures concerning to first three quarters of 2017 and 2018 are annualised.

- In the first three quarters of 2018, the profitability of the banking system increased significantly compared to the same period last year: return on equity rose 3.9 p.p. and profitability increased by 0.4 p.p.

Chart 3.9 • Income and costs | Percentage of average total assets



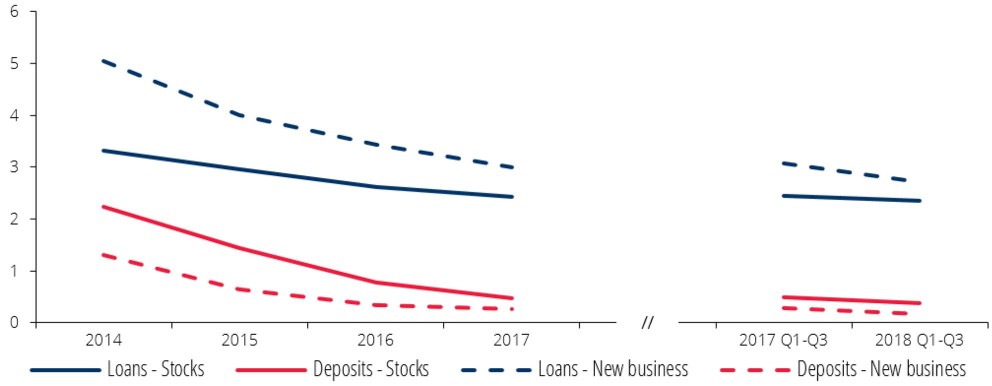
Source: Banco de Portugal.
Notes: Recurring operating result corresponds to the sum of net interest margin and net commissions minus operational costs, as a percentage of average total assets. The figures concerning to first three quarters of 2017 and 2018 are annualised.

- The positive evolution of profitability in the first three quarters of 2018 compared to the same period of the previous year mainly reflected a decrease in provisions and impairments (-644 €Mn , -32%) and, to a lesser extent, a reduction of operational costs (-398 M €, -9%).

- The reduction in costs with impairments and provisions contributed by around 22 bps to the increase in ROA year on year, with the reduction in operational costs contributing 14 bps.

- The contribution of net interest income to the ROA remained relatively stable over the same period, as did the contribution of net commissions.

Chart 3.10 • Banking interest rates on private non-financial sector (average value of the period) | Per cent

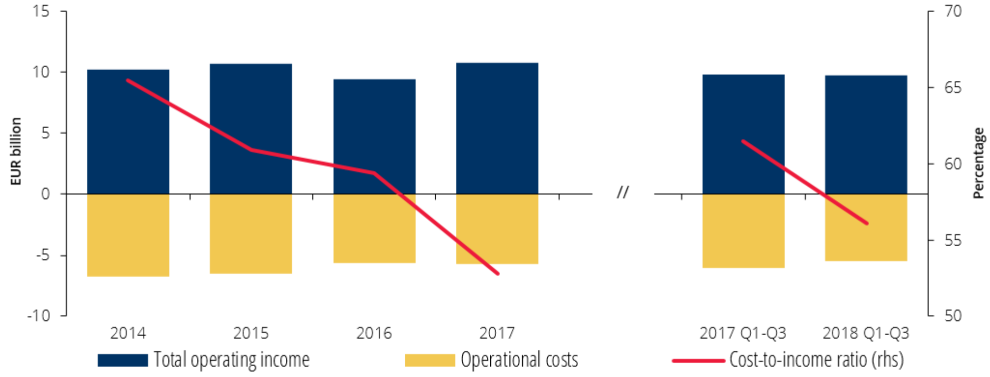


Source: Banco de Portugal.

- In the first three quarters of 2018 the average interest rate on new loans declined by 35 basis points (bps) compared to the same period in 2017, approaching the average interest rate on outstanding loans, which stood at 2.36%.

- The spread between the average interest rate on outstanding deposits and the average interest rate on new deposits remained stable, due to similar decreases in both rates (11 bps and 12 bps respectively).

Chart 3.11 • Operational costs and Cost-to-income



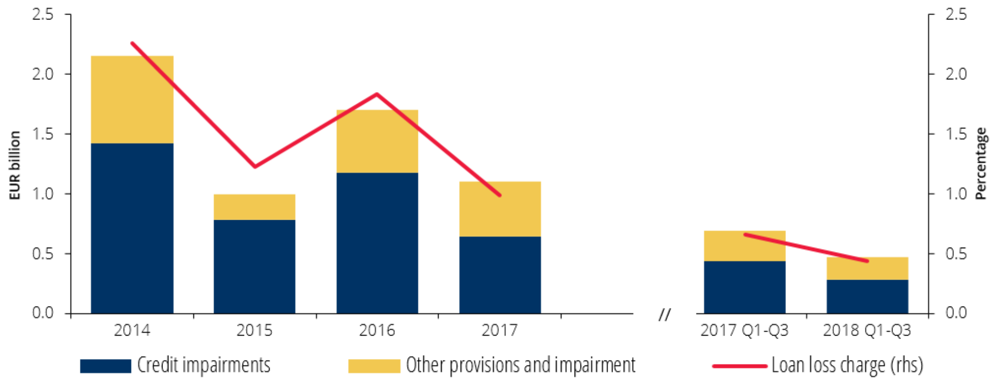
Source: Banco de Portugal.
Notes: Cost-to-income corresponds to the ratio between operational costs and total operating income. The figures concerning to first three quarters of 2017 and 2018 are annualised.

- The decrease in operational costs was transversal to all its components, although it was mainly explained by staff costs, which decreased by 12.5% year-on-year.

- The cost-to-income ratio stood at 56.1%, recording a 5.4 p.p. reduction vis-à-vis the same period of the previous year. This evolution reflected exclusively the decrease in operational costs, as the total operating income decreased slightly.

- In recent years, the cost-to-income ratio has been affected by non-recurring effects associated with the restructuring processes that have been implemented, especially by larger institutions. The evolution of the cost-to-income ratio in the first three quarters of 2018 reflects, in part, the dissipation of base effects related to the increase in operating costs resulting from these restructuring processes in the same period.

Chart 3.12 • Impairments, provisions and loan loss charge



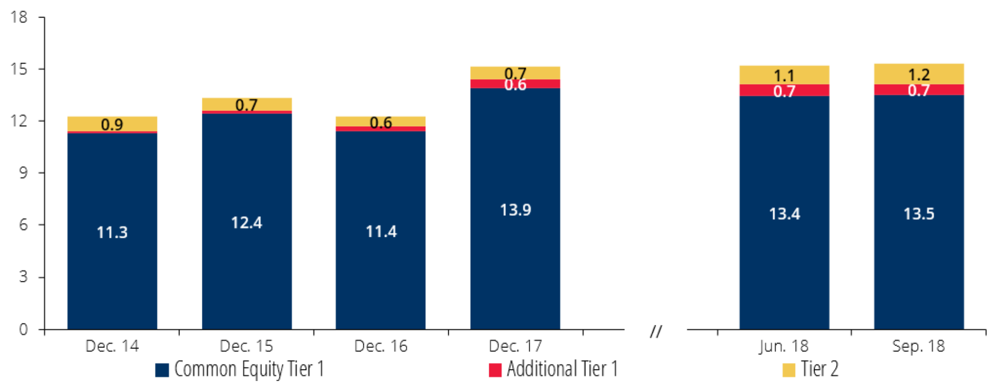
Source: Banco de Portugal.
Notes: The loan loss charge corresponds to the flow of credit impairments and provisions as a percentage of total average gross credit granted to customers. The figures concerning to first three quarters of 2017 and 2018 are annualised.

- The loan loss charge was 0.4%, falling 22 bps year-on-year in the first three quarters of 2018.

- This evolution reflects a reduction of credit impairments (-35%), which was partially offset by a decrease in the gross value of the customer loan portfolio.

3.5 Solvency

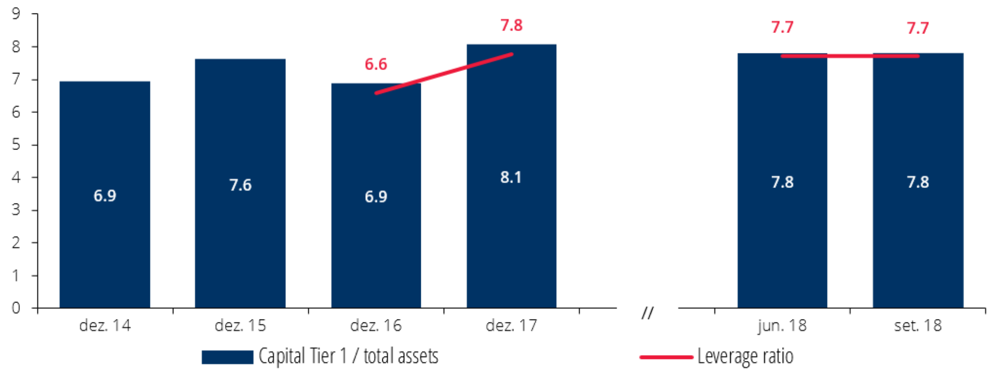
Chart 3.13 • Own funds ratios | Per cent



Source: Banco de Portugal.
Note: The total capital ratio consists of the sum of Common Equity Tier 1 (CET 1), Additional Tier 1 (AT 1) and Tier 2 capital, as a percentage of risk-weighted assets.

- The total capital ratio stood at 15.3% in September 2018, increasing 0.1 p.p. over the previous quarter. This evolution essentially reflects a decrease in risk-weighted assets.
- Although total own funds remained relatively stable, there was a slight decline in Tier 1 capital (sum of CET 1 and AT 1), almost entirely offset by the Tier 2 capital increase.

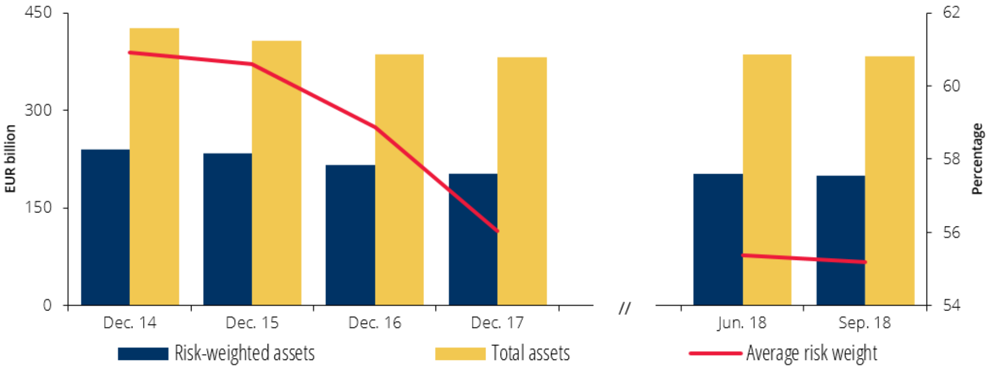
Chart 3.14 • Capital Tier 1 to Total Assets and Leverage ratio | Per cent



Source: Banco de Portugal.
Notes: The ratio of Tier 1 capital to total assets should be seen as a proxy for the leverage ratio allowing for a longer time frame. In turn, the leverage ratio is calculated by dividing own funds and total exposure of the banking system. The methodology established for calculating the components of this ratio is defined in Article 429 of Regulation (EU) No 575/2013.

- In the third quarter of 2018, the leverage ratio remained stable in relation to the previous quarter, around 7.7%, well above the benchmark defined by the Basel Committee on Banking Supervision (3%).

Chart 3.15 • Average risk weight



Source: Banco de Portugal.
Note: The average risk weight corresponds to the ratio of risk-weighted assets to total assets.

- The average risk weight decreased slightly in the third quarter of 2018, standing at 55.2% of total assets. The observed evolution was due to a decrease in risk-weighted assets higher than the decrease in total assets.

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