PORTUGUESE BANKING SECTOR OVERVIEW

DECEMBER 2022

ASSOCIAÇÃO PORTUGUESA DE BANCOS

JULY 2023

INDEX

I. RECENT EVOLUTION AND MAIN INDICATORS

- **In 2022, the Portuguese banking sector recorded a significant increase in profitability**, mainly due to the increase in total operating income and the decrease in the flow of credit impairments. The improvement in total operating income is explained largely by the rise in net interest income, which reflected the normalisation of monetary policy and the increase in interest rates.

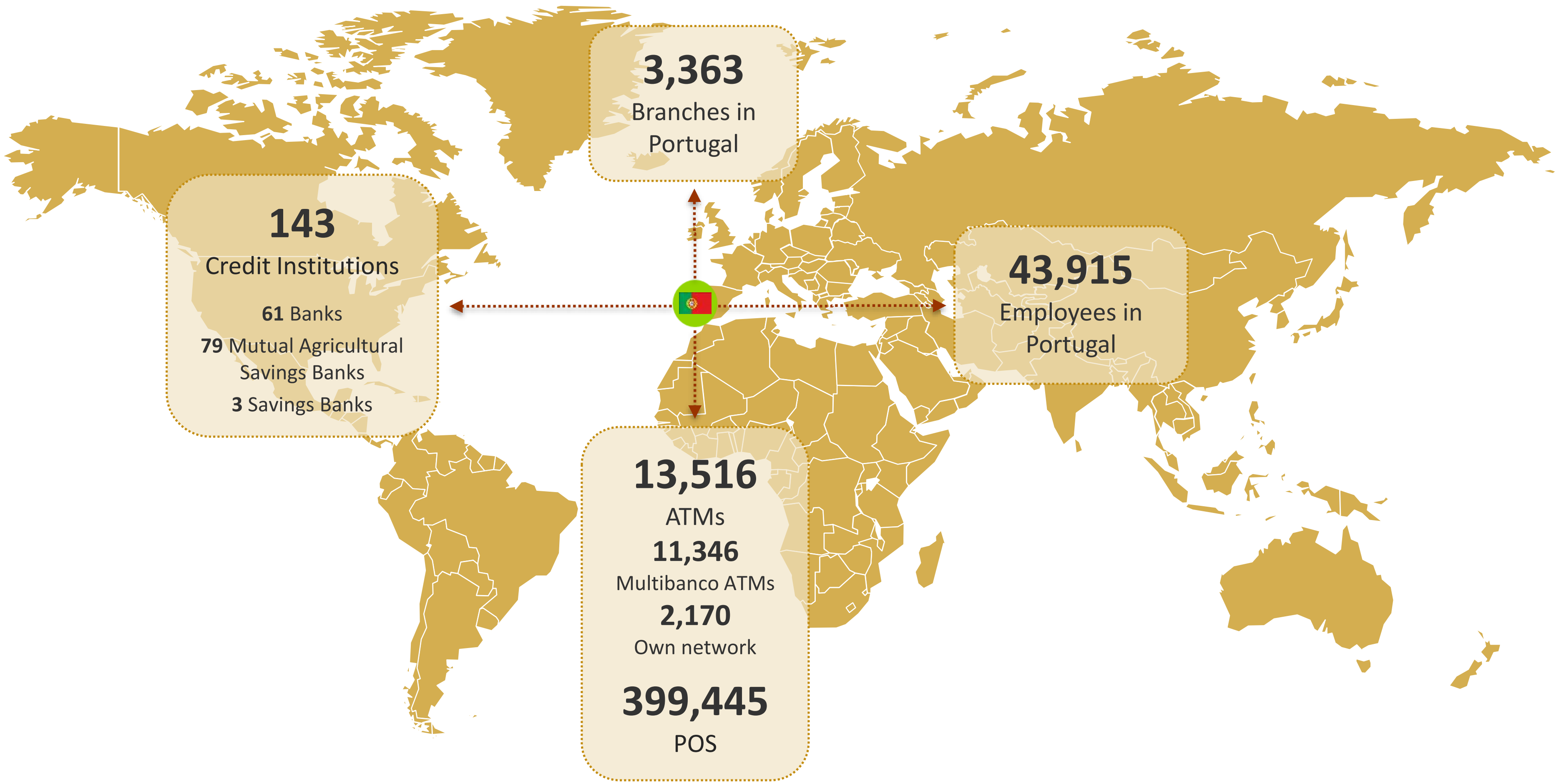
- Despite the annual increase in net loans to customers (+6.1 billion euros; +2.5%), **the sector's total assets fell slightly (-0.5%) compared to December 2021 and reversed the upward trend observed in recent years,** mainly due to the reduction in cash balances at central banks (-10.1 billion euros).

- **On the liabilities side, deposits continued to increase. On the other hand, recourse to wholesale funding continued to be negligible in the banking sector's funding structure, and there was a significant reduction in funding from the Eurosystem** since banks made a significant early repayment of part of these loans in response to changes in the rates applicable to TLTRO III loans.

- **Despite a very slight decrease in Solvency ratios** (in line with the Euro Area trend)**, they remain at very robust levels.** The system is well capitalised and has greater capacity to accommodate a possible deterioration in credit risk and an increase in non-performing assets.

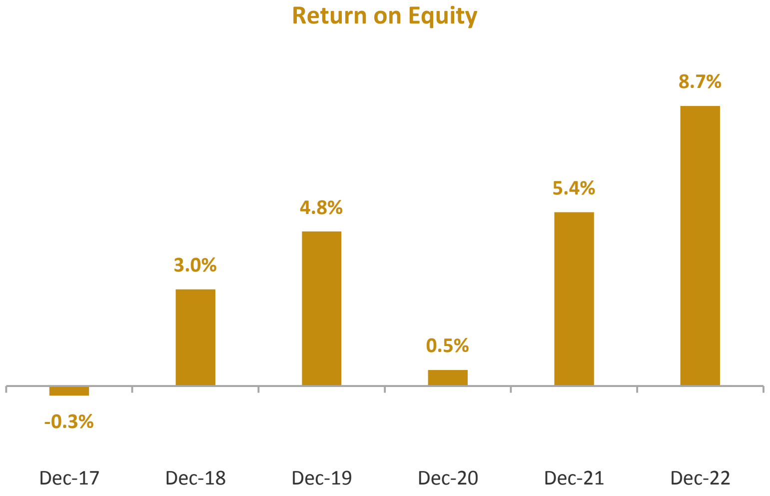
- **The banking sector continued to show resilience and responding efficiently to the economy's financing needs despite the adverse shocks caused by the persistence of geopolitical tensions, inflationary pressures, high interest rates and increased turbulence in the financial markets. However, the banking sector is likely to continue to face complex challenges.** In the current context, the risk of credit default by the most vulnerable households and companies and the materialisation of market risk have increased. Consequently, this may result in greater recognition of impairments, which nevertheless may be partially offset by an increase in net interest income. In addition, funding conditions for banks may become more difficult, and the real estate market may slow down, which would impact the value of real estate assets and the collateralized value of loans.

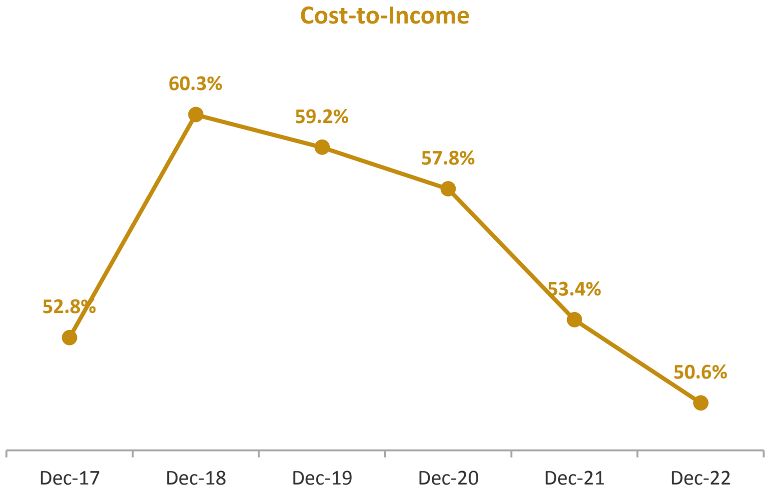
I. RECENT EVOLUTION AND MAIN INDICATORS

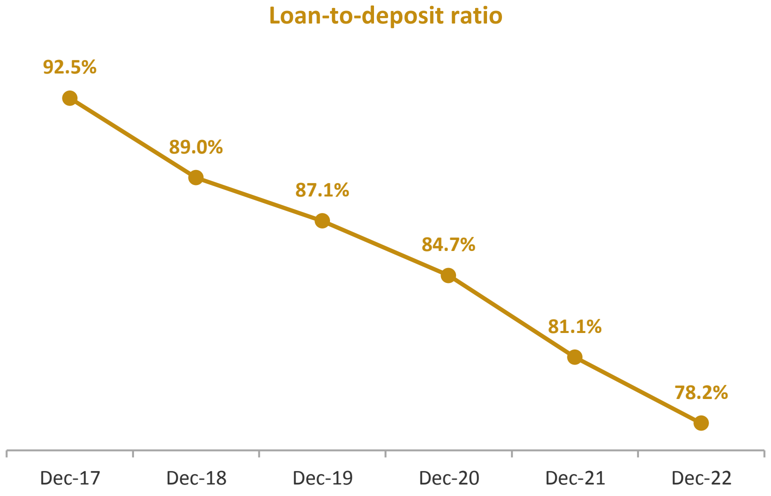


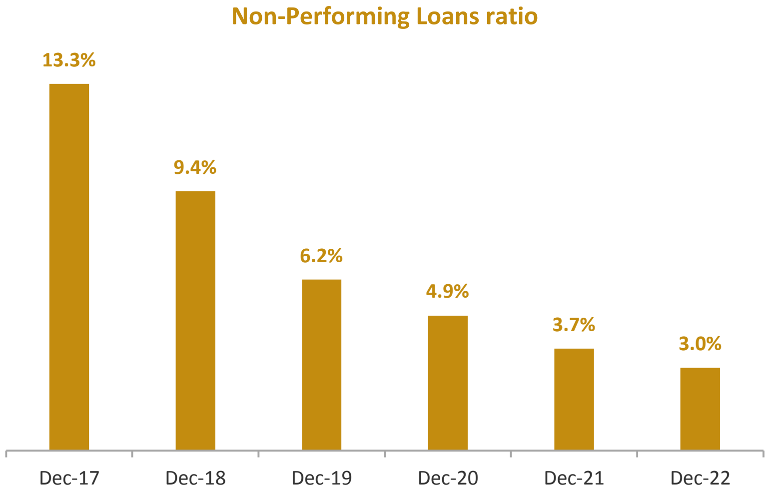
Source: APB's associates (branches. employees. and payment systems) and Banco de Portugal (credit institutions)

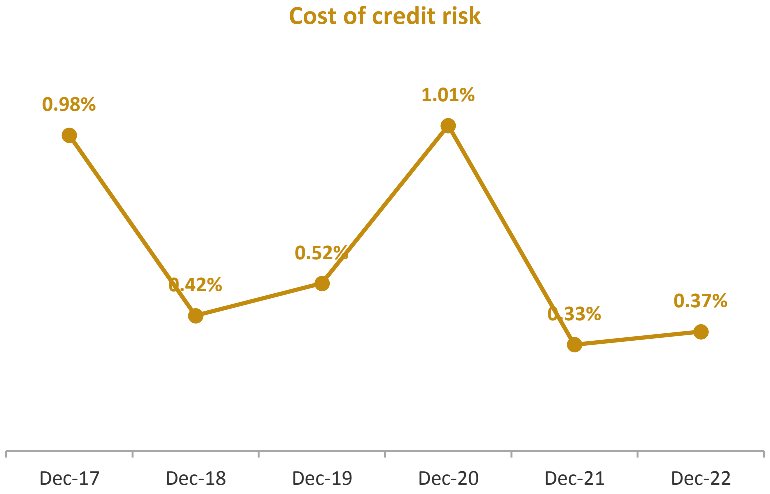
In 2022, the Portuguese banking sector continued to show resilience and to be well prepared, especially in terms of liquidity and solvency, to face the shocks that occurred in the context of high inflation and the process of normalising monetary policy.

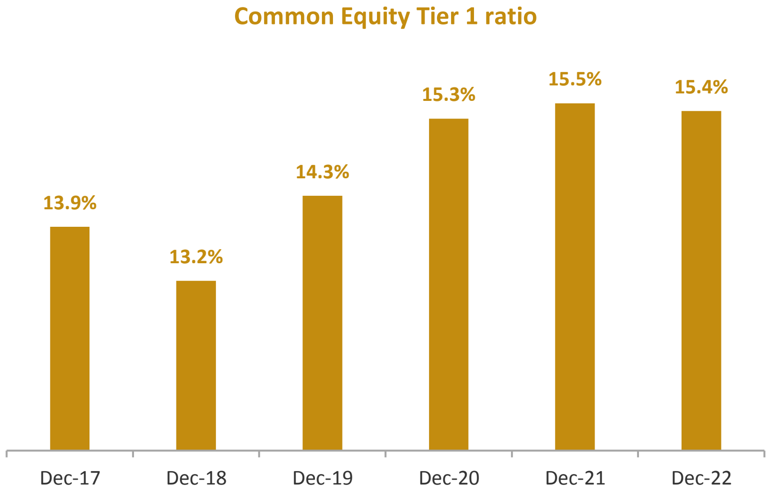








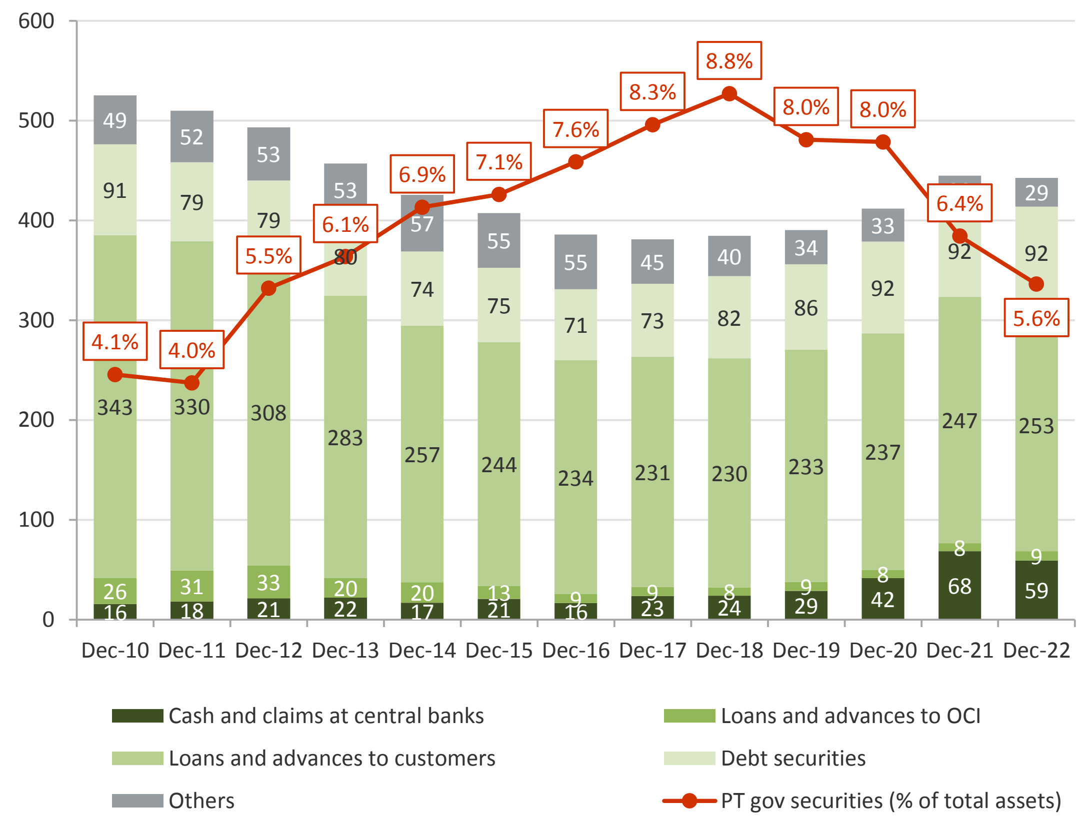




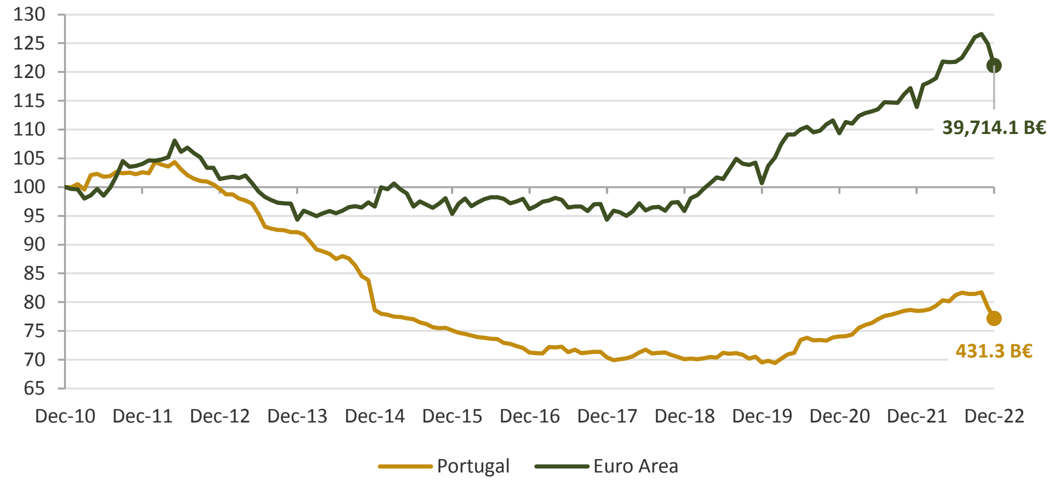
Source: Banco de Portugal (consolidated data). Return on Equity is calculated based on net income after tax and before minority interests and average equity.

In December 2022, the total assets of the Portuguese banking sector fell slightly (-0.5%) compared to December 2021 and reversed the upward trend observed in recent years. This evolution was mainly due to the reduction in cash balances at central banks (-10.1 billion euros), which was not totally offset by the increase in loans to customers (+6.1 billion euros; +2.5%).

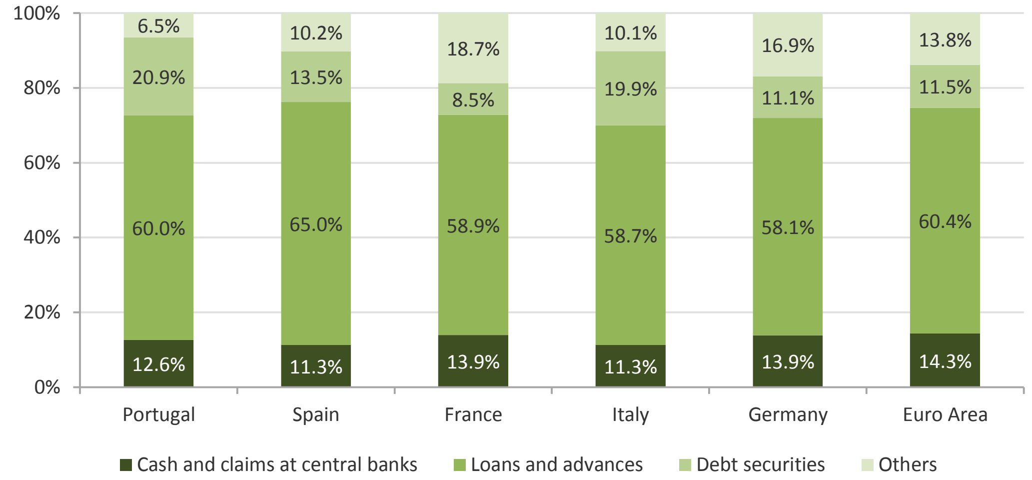
Total assets breakdown (EUR billion)



Total assets evolution – Domestic activity (Dec-10 = 100)



Total assets breakdown: Portugal vs. Euro Area (Dec-22)

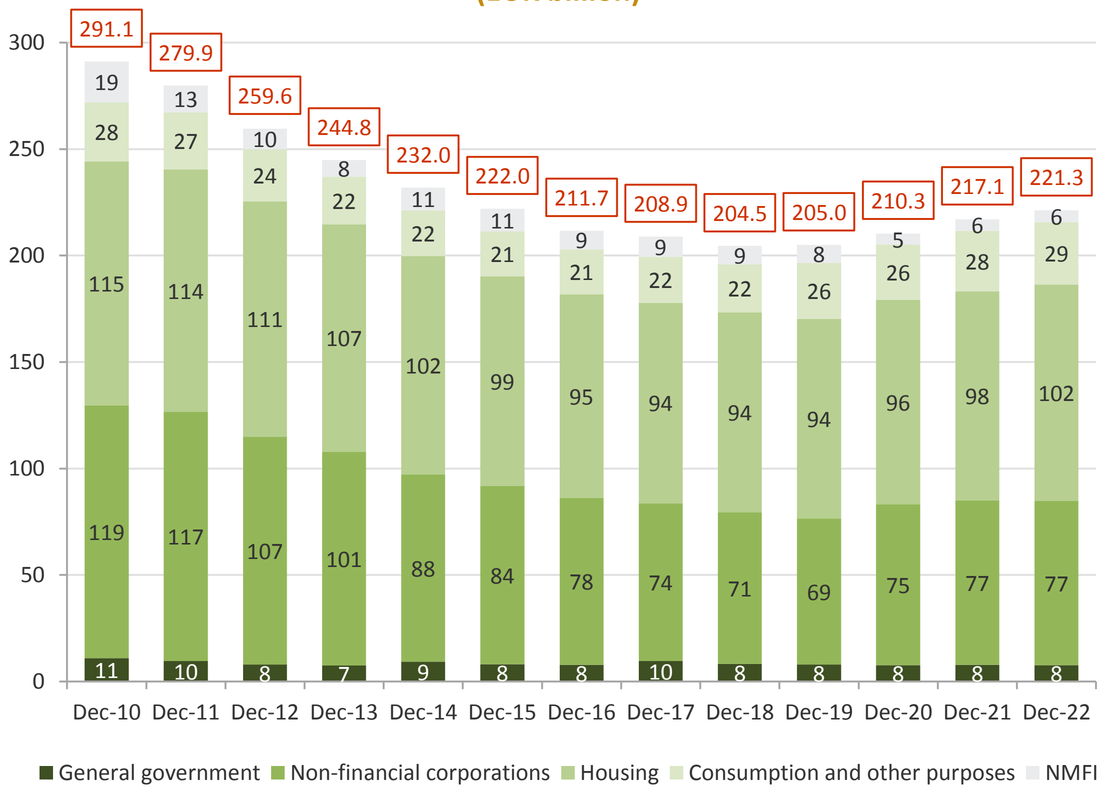


Source: Banco de Portugal (consolidated data) and ECB – MFI Balance Sheet Items (Monetary and Financial Statistics).

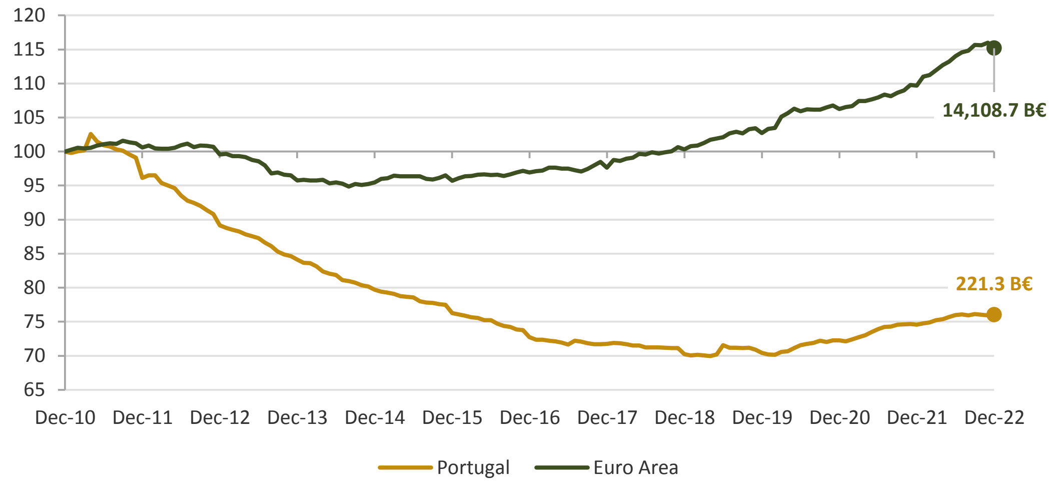
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Consolidated Banking Data and Eurostat.

Loans to households continued to rise but slowed slightly towards the end of the year. Loans to NFCs maintained a positive trajectory but, similar to the previous year, also showed a decelerating trend.

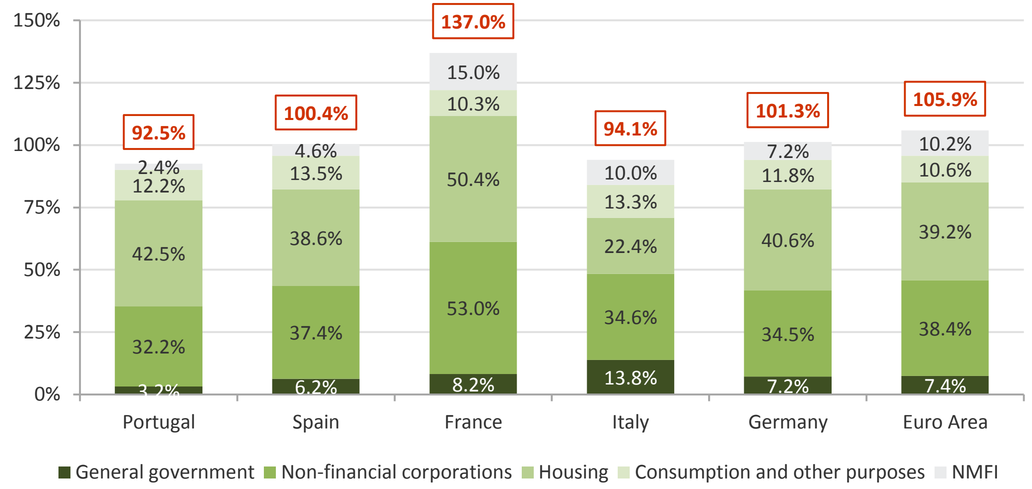
Loans to customers by institutional sector (EUR billion)



Loans to customers evolution (Dec-10 = 100)



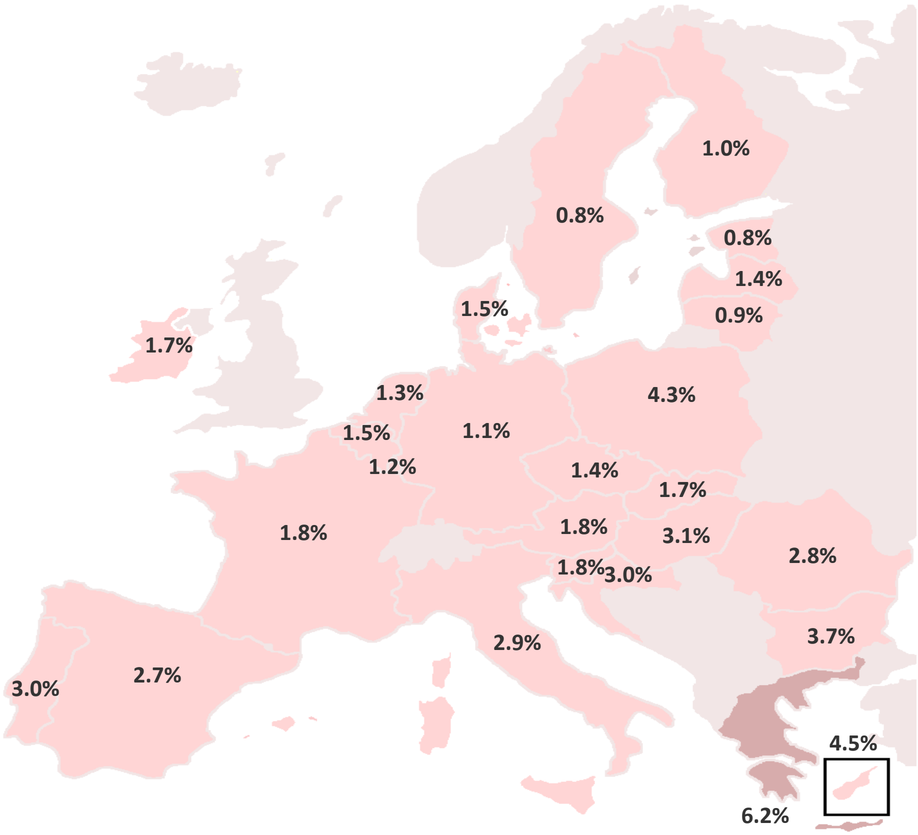
Loans to customers by institutional sector as a % of GDP (Dec-22)



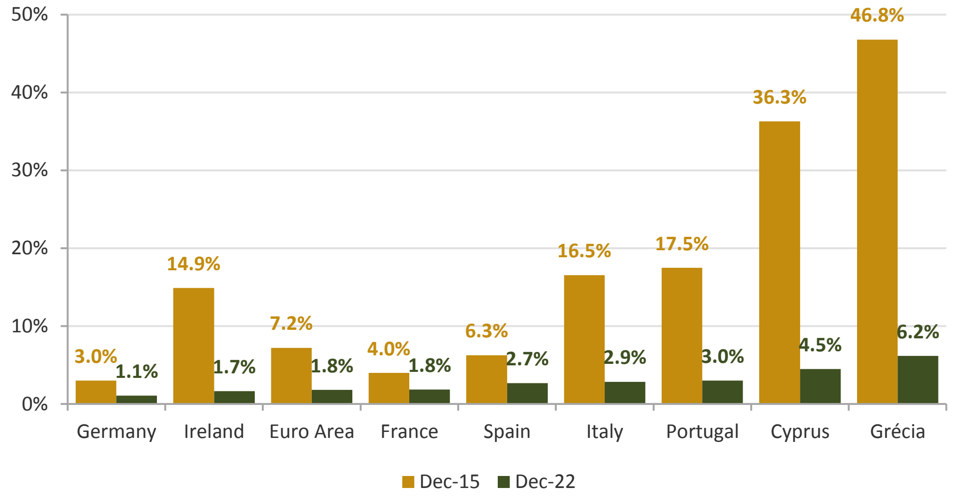
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Eurostat. Loans and advances to customers in the domestic activity; counterpart: residents in the Euro Area. NMFI = Non-Monetary Financial Institutions, which include Other Financial Intermediaries, Financial Auxiliaries, Insurance Corporations, and Pension Funds.

In 2022, despite the rise in interest rates, there was no deterioration in credit quality, with the NPL ratio falling to 3%, which compares to 1.8% in the Euro Area. The NPL impairment coverage ratio increased again and continues to compare favourably with the Euro Area average, reaching 55.4% (+2.9 pp YoY).

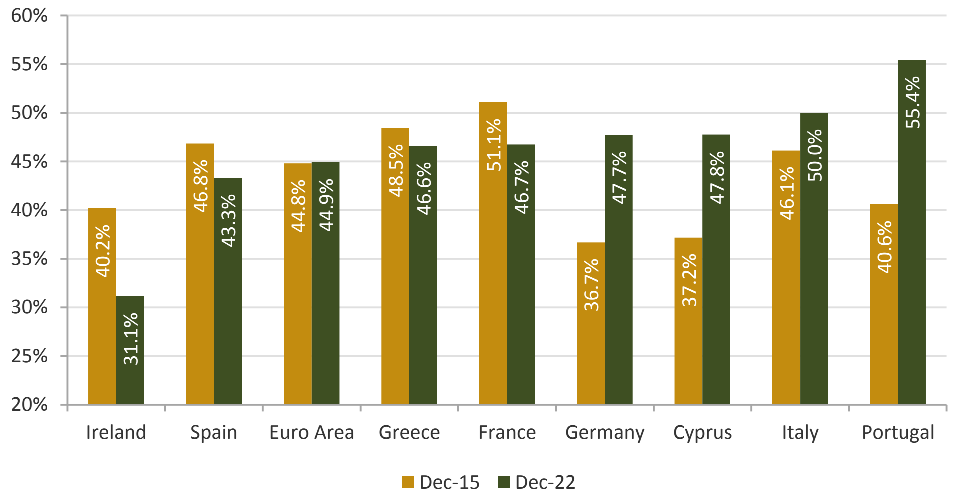
NPL ratio



NPL ratio evolution



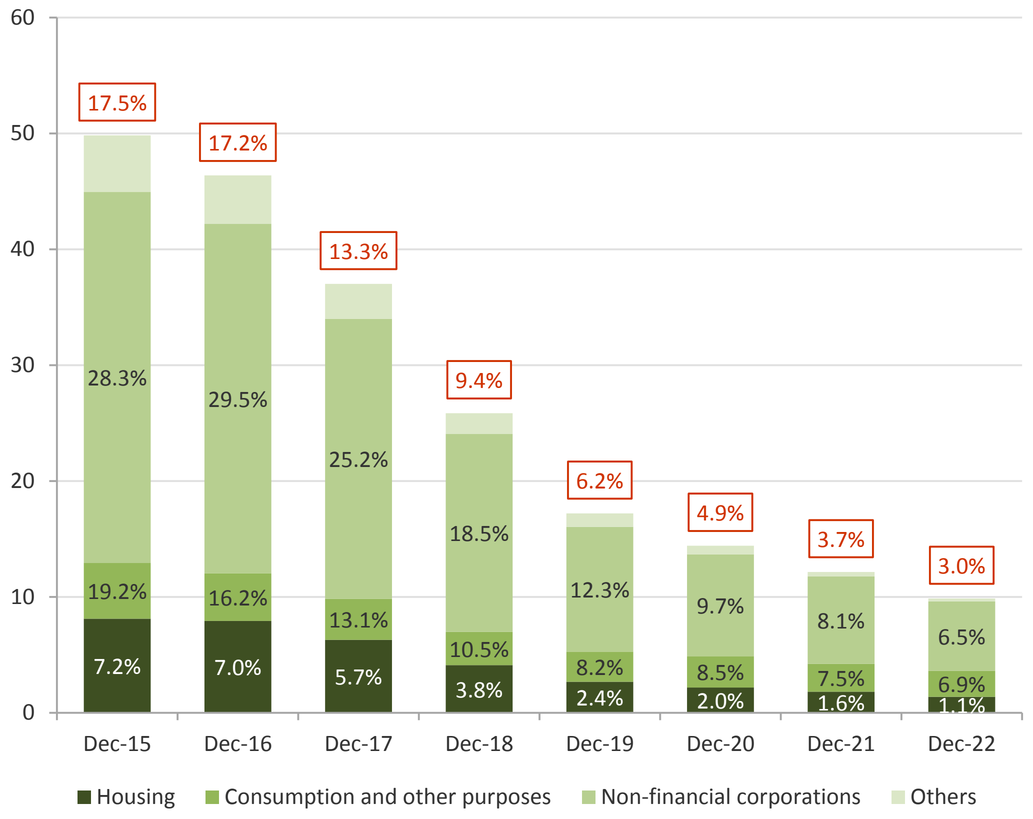
NPL impairment coverage ratio



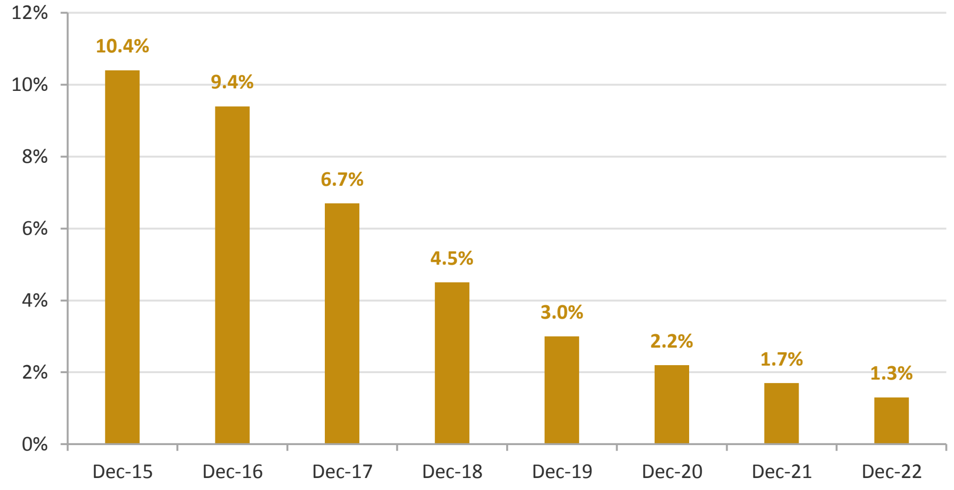
Source: ECB – Consolidated Banking Data. The NPL impairment coverage ratio refers to non-performing loans and debt securities.

The favourable evolution of the NPL ratio is explained by the decrease in non-performing loans unlikely to pay and by more than 90 days overdue. While the NPL ratio for housing loans remained at residual levels, there was a further reduction in the NPL ratio for non-financial corporations to 6.5%. Additionally, the ratio of Stage 2 loans, after reaching its highest value in December 2021 (11.6%), fell to 10.3% (-1.4 pp), although it is still above the pre-pandemic period. The NPL ratio net of impairments continued its downward trajectory and stood at 1.3%.

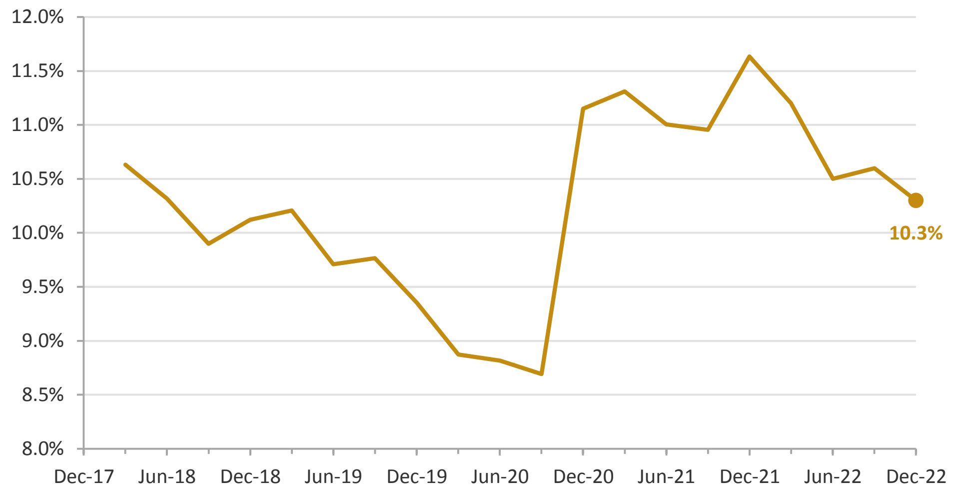
NPL amount and ratio in Portugal (EUR billion)



NPL ratio net of impairments in Portugal

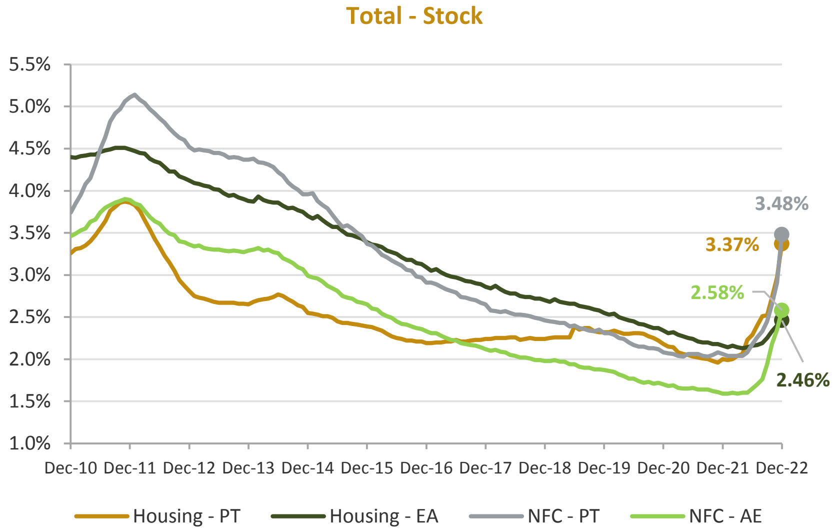


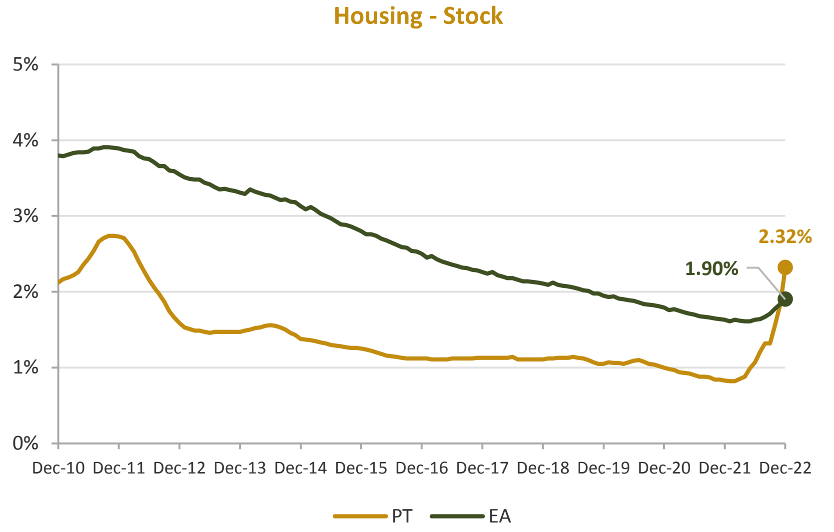
Stage 2 loans ratio in Portugal

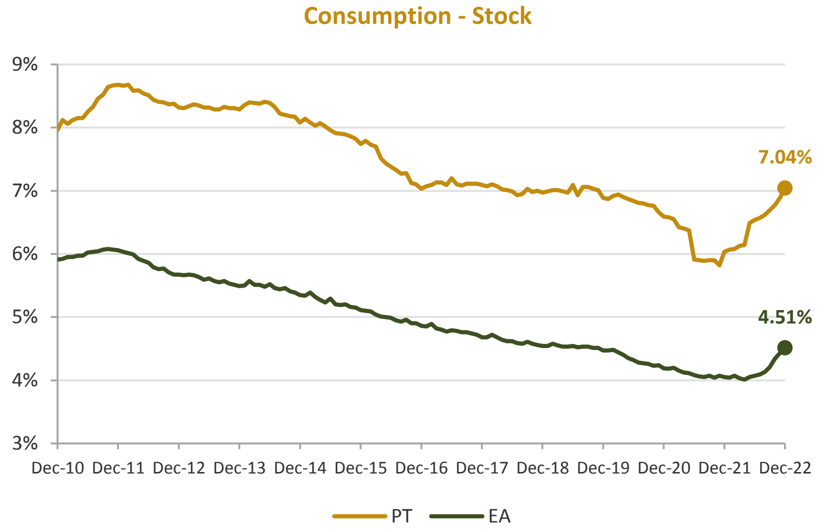


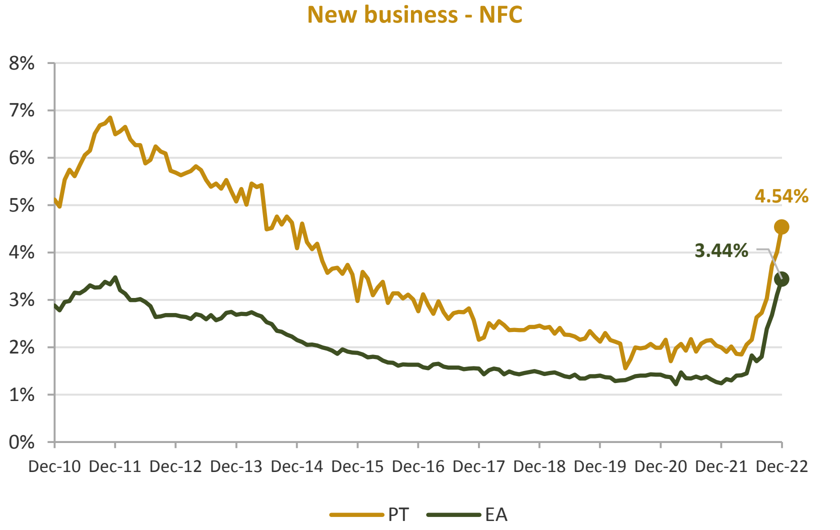
Source: Banco de Portugal (consolidated data).

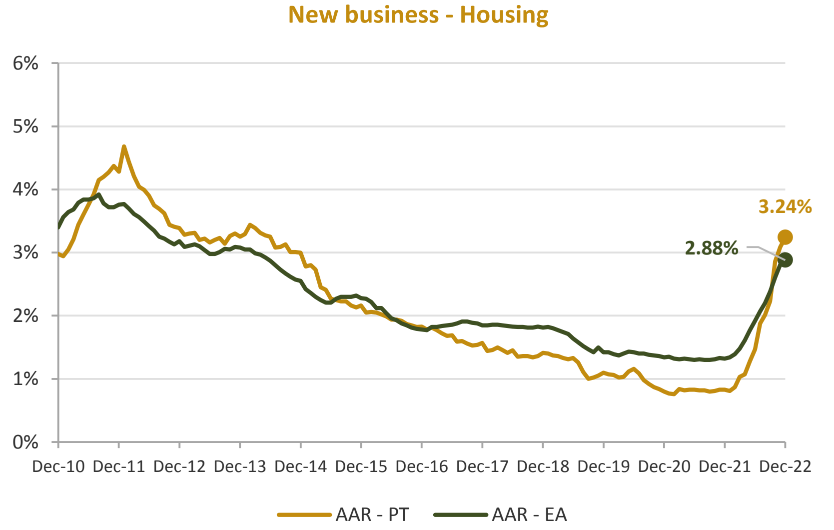
The interest rate on new loans to non-financial companies (NFCs) in Portugal has risen since April 2022. The interest rate on housing loans also increased and is higher than the Euro Area average since October 2022.

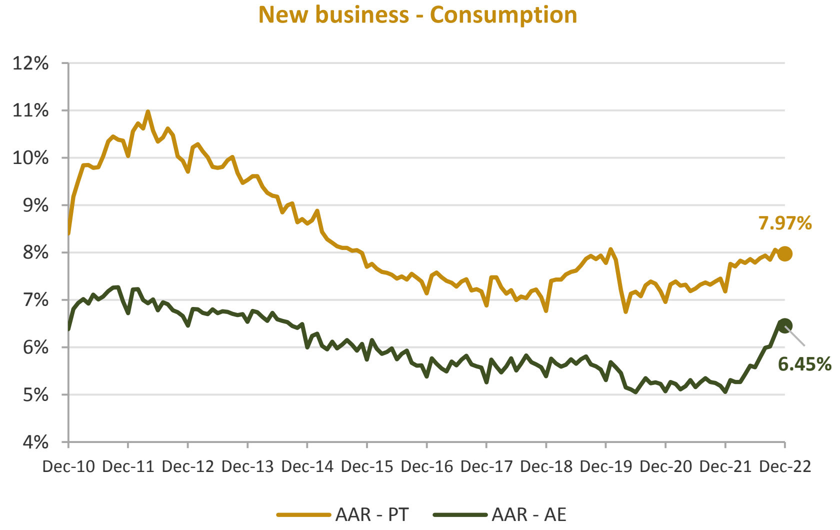








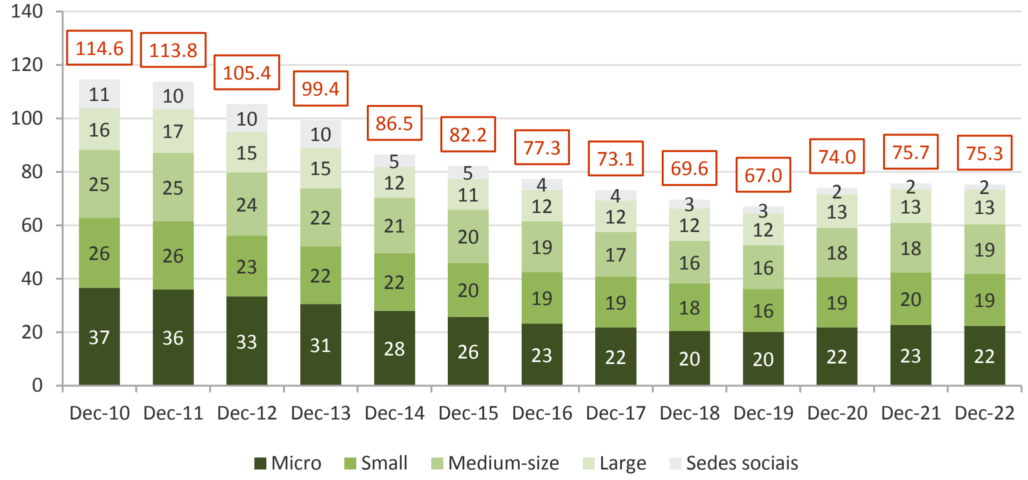




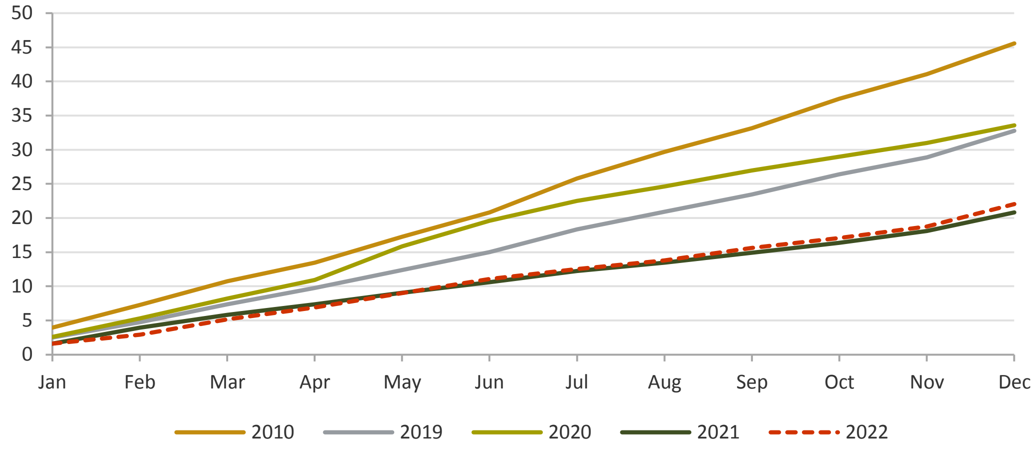
Source: ECB – MFI Interest Rate Statistics. AAR = Annualised agreed rate.

The slowdown in the growth rate of the stock of loans to NFCs continued (+0.6% in 2022). While the micro-corporate segment saw a significant increase (6.7%), there was a decrease in loans to small and medium-sized corporates (-2%). In sectoral terms, we highlight the increases in loans for real estate and trade and the reduction in restaurants, hotels and similar accommodation.

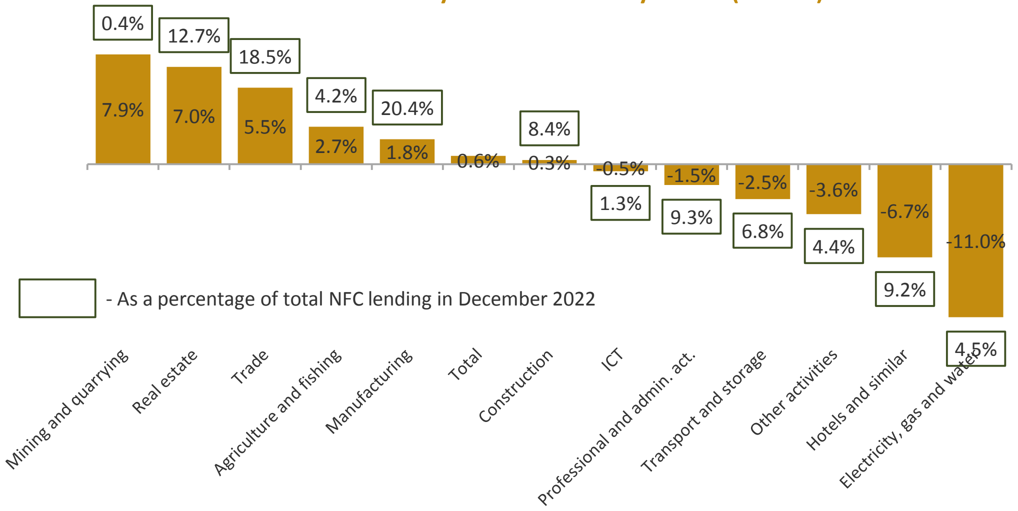
Stock of loans to NFC (EUR billion)



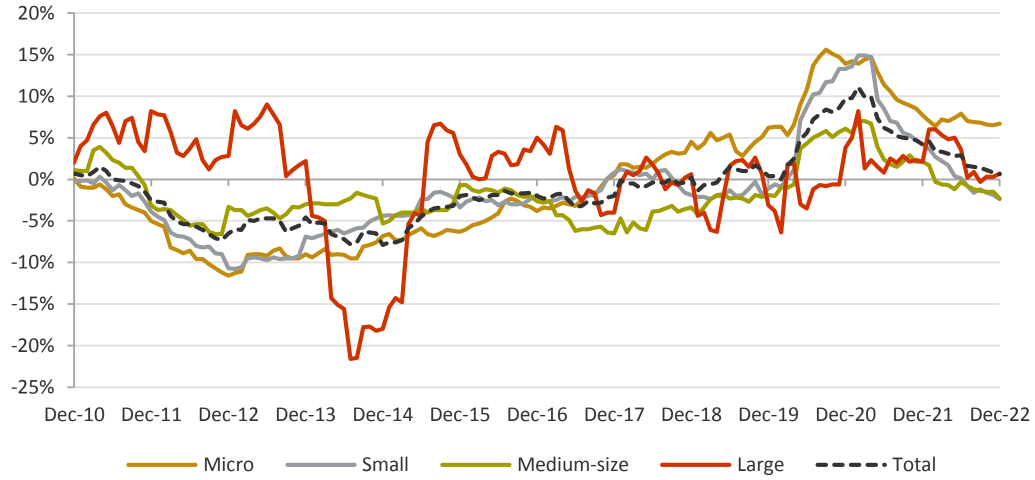
New business lending to NFC (cumulated amounts, EUR billion)



ARC of loans to NFC by economic activity sector (Dec-22)



ARC of loans to NFC by dimension class

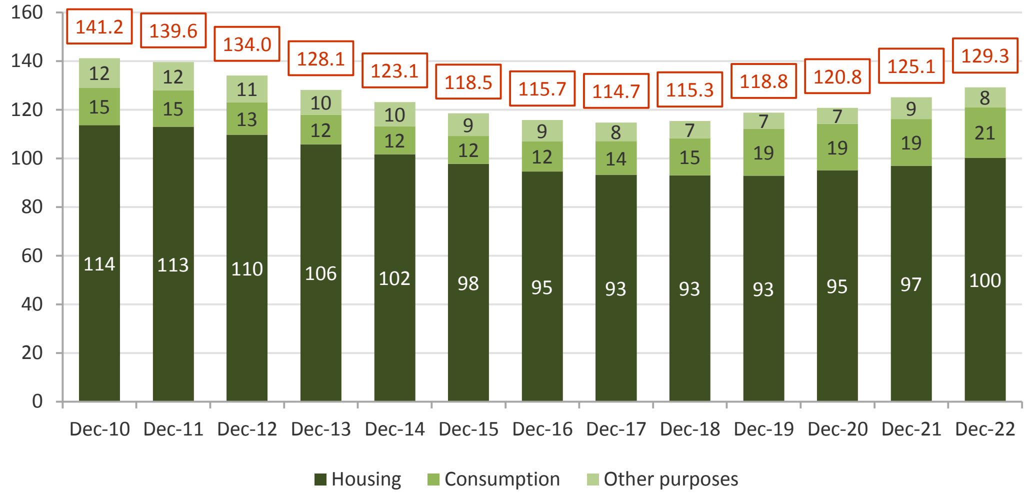


Source: Banco de Portugal (Monetary and Financial Statistics). Loans to NFCs in the domestic activity; counterpart: residents in Portugal. ARC = Annual rate of change.

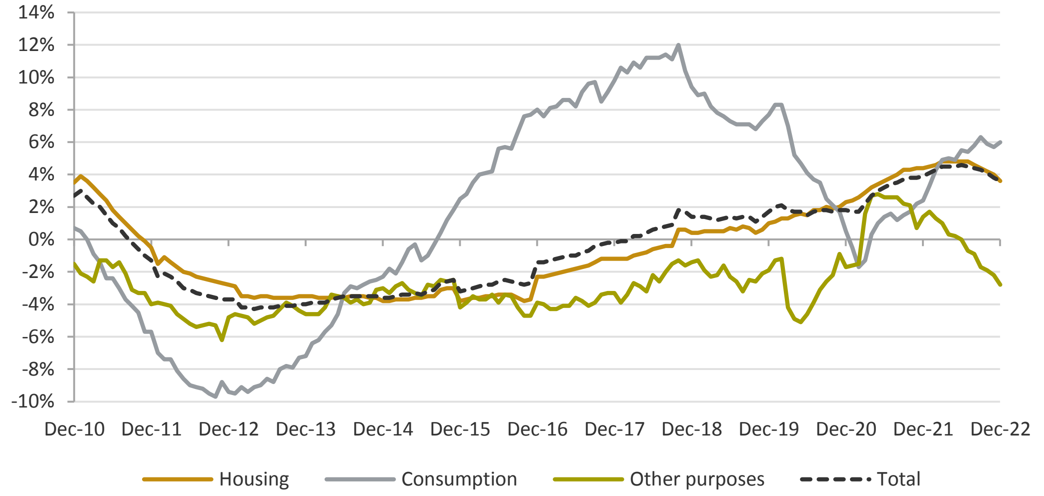
II. LENDING | HOUSEHOLDS

At the end of 2022, there was some deceleration in loans to households (+3.6%) despite the acceleration in consumer credit. The amount of new loans for house purchase, excluding renegotiations, showed a downward trend from March onwards, with year-on-year decreases from July onwards, but still higher than the 2019 year-end figure. In turn, the share of loans to households secured by real estate on the banks' balance sheets stood at 26% of total assets (25.3% in 2021).

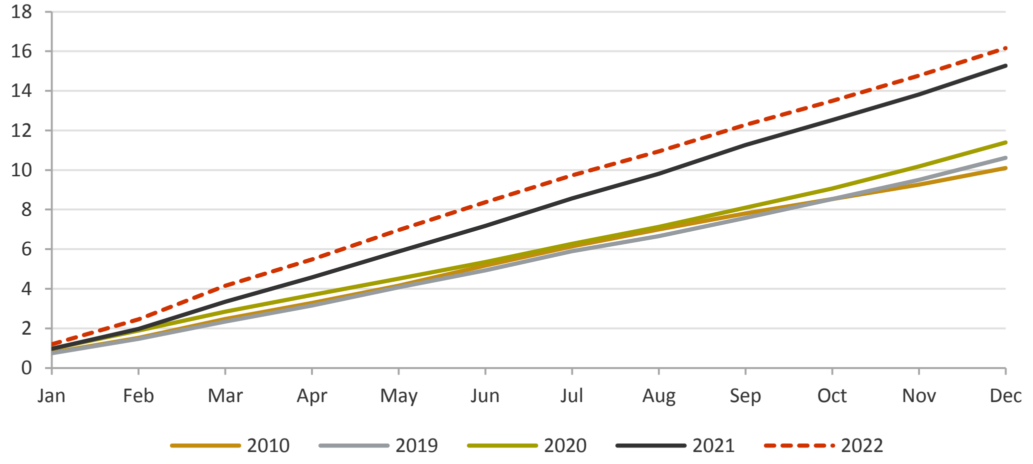
Stock of loans to households (EUR billion)



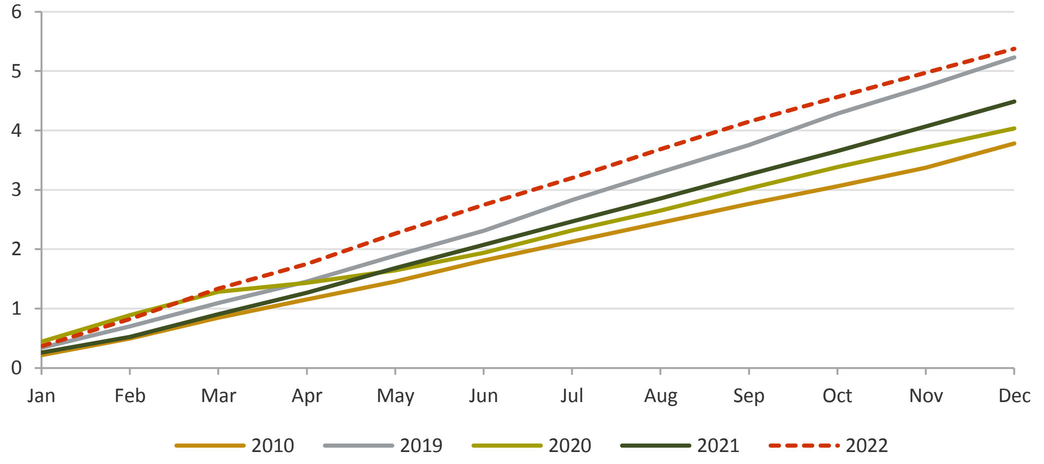
ARC of loans to households



New business loans to households - Housing (cumulated amounts, EUR billion)



New business loans to households - Consumption (cumulated amounts, EUR billion)

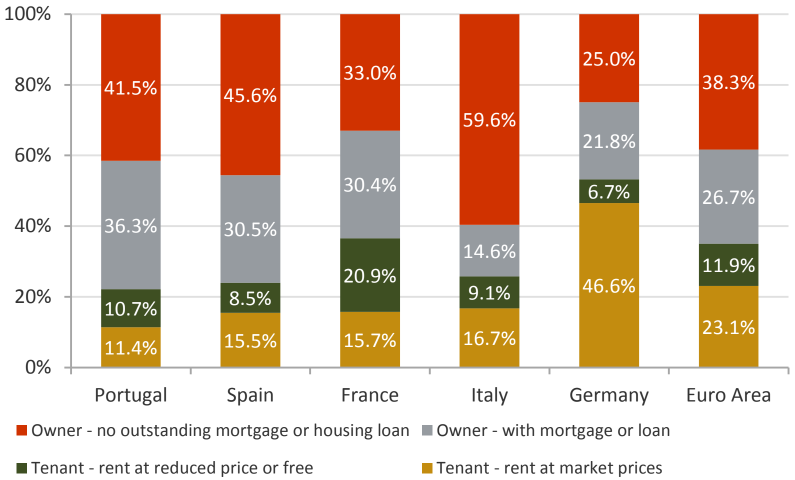


Source: Banco de Portugal (Monetary and Financial Statistics). Loans to households in the domestic activity; counterpart: residents in Portugal. ARC = Annual rate of change.

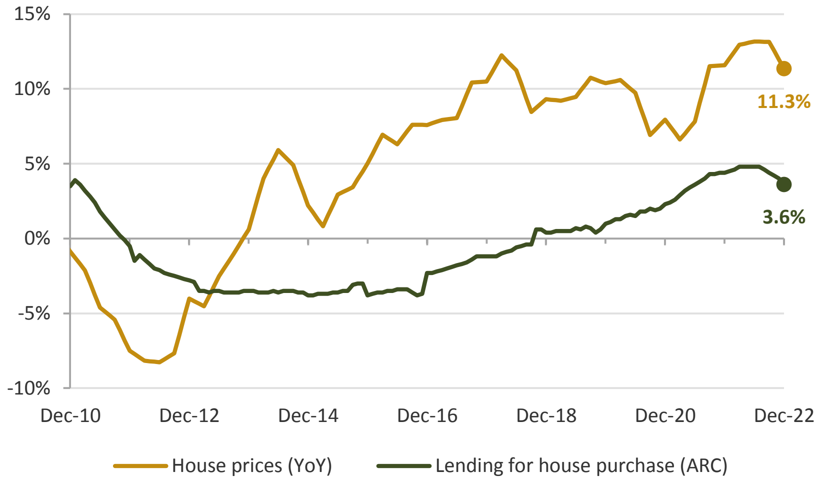
II. LENDING | HOUSEHOLDS | LENDING FOR HOUSE PURCHASE

The current environment could contribute to a moderation in the growth of residential property prices or even a correction. However, the housing loan portfolio continues to show capacity to accommodate a potential fall in residential property prices without incurring high losses since, in 2022, around 94% of the stock of housing loans granted to households had an LTV of 80% or less.

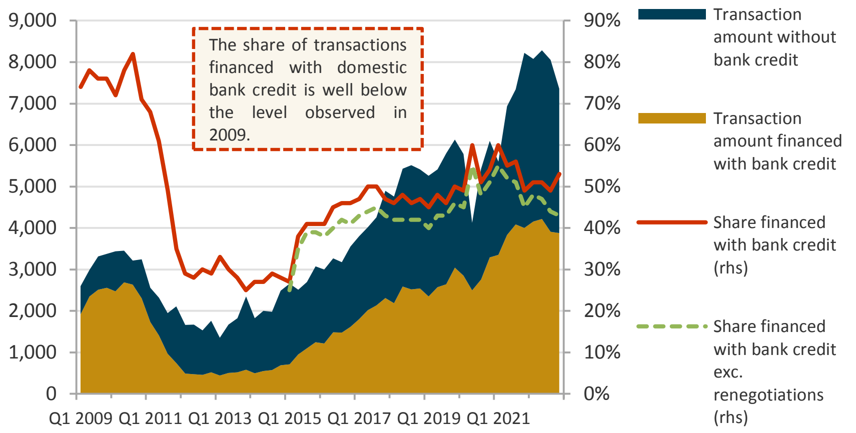
Distribution of population by tenure status (2022)



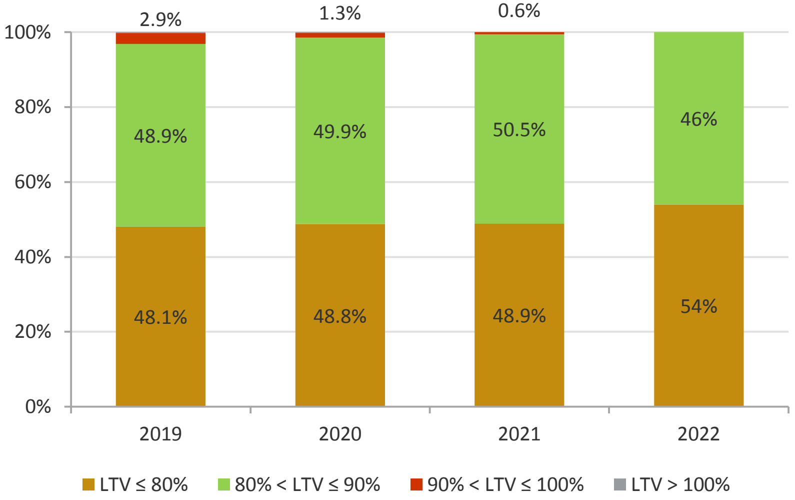
Prices vs. Credit



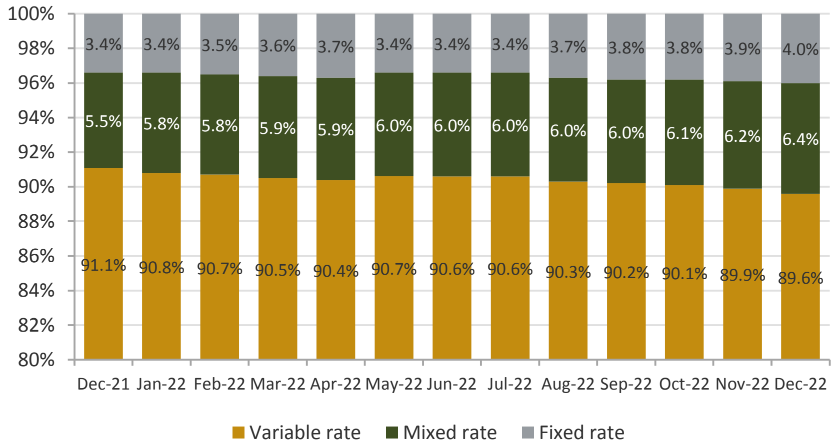
Transactions in dwellings vs. New domestic housing loans (EUR million)



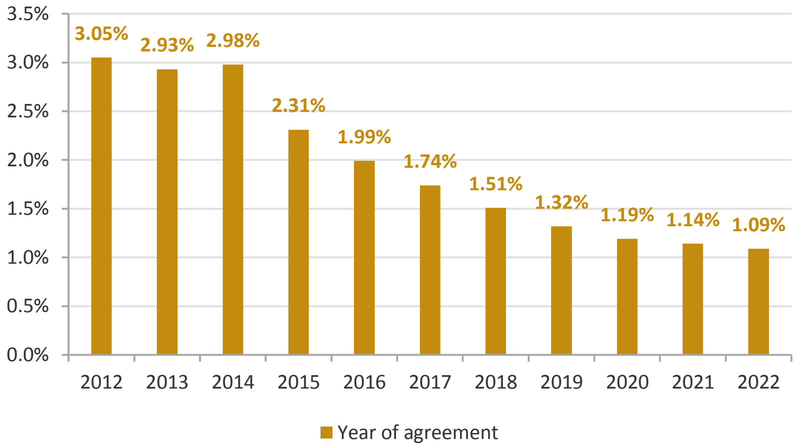
Distribution of new credit for house purchase by LTV ratio



Stock of loans for permanent residential property, by type of rate



Weighted average spread in variable interest rate contracts indexed to the 3, 6 and 12-month Euribor

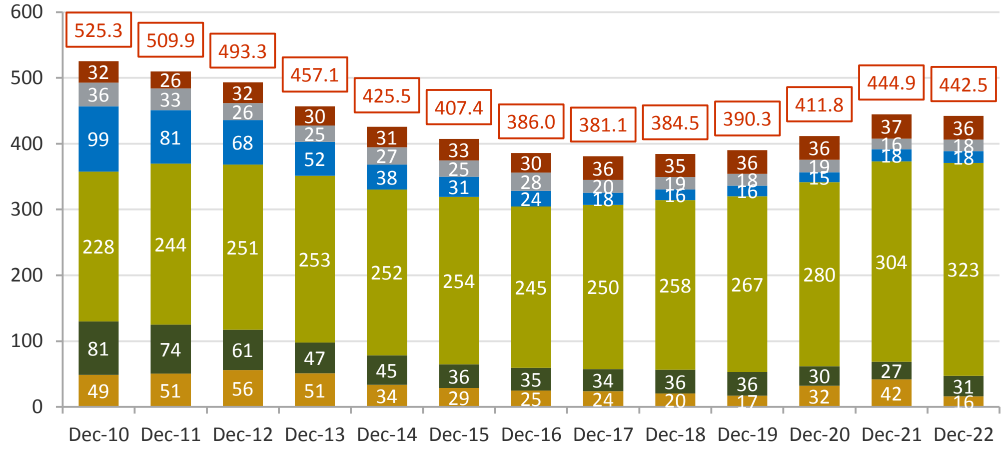


Source: Eurostat. Banco de Portugal and INE – Statistics Portugal. YoY = Year-on-year rate of change. ARC = Annual rate of change.

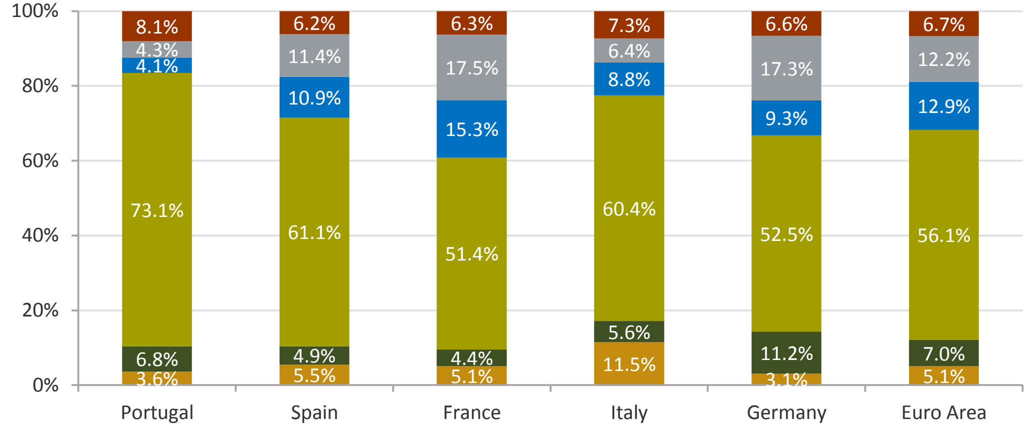
III. ORIGIN OF THE FUNDS AND LIQUIDITY

In 2022, there was still an increase in deposits, and the trend of decrease in the share of term deposits and increase in demand deposits remained in place. In the last decade, against a backdrop of interest rates falling to very low levels, which mostly affected the returns on term deposits, demand deposits (deposits redeemable at notice and overnight deposits) increased their weight from around 25% in 2012 to 60% in 2022, a trend that should be reversed due to the higher opportunity cost of holding them.

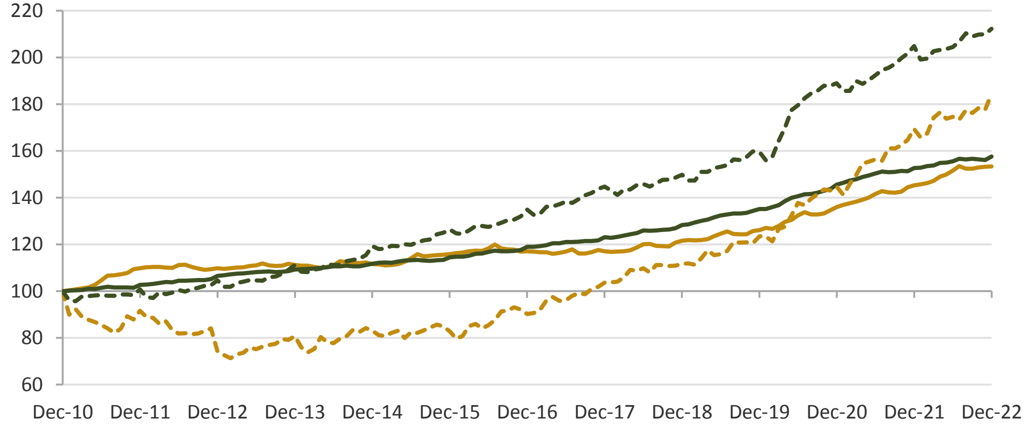
Origin of the funds (EUR billion)



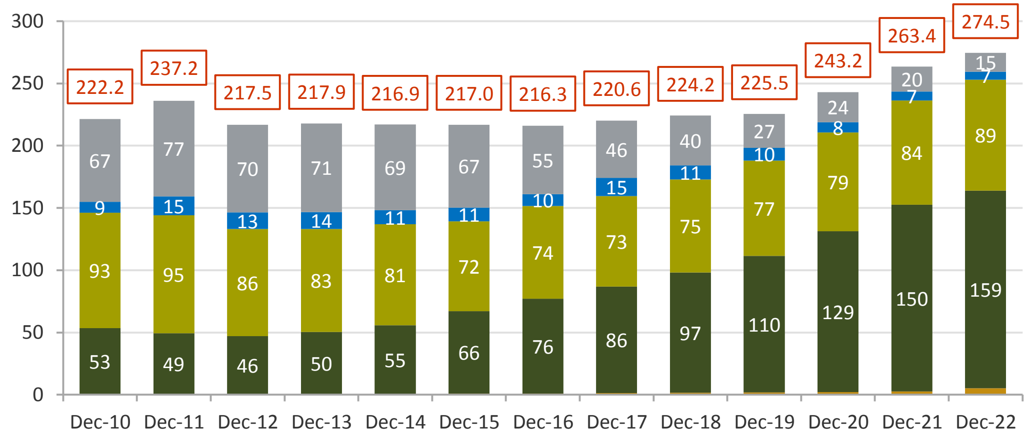
Origin of the funds: Portugal vs. Euro Area (Dec-22)



Evolution of deposits - Domestic activity (Dec-10 = 100)



Evolution of deposits by maturity – Domestic activity (EUR billion)

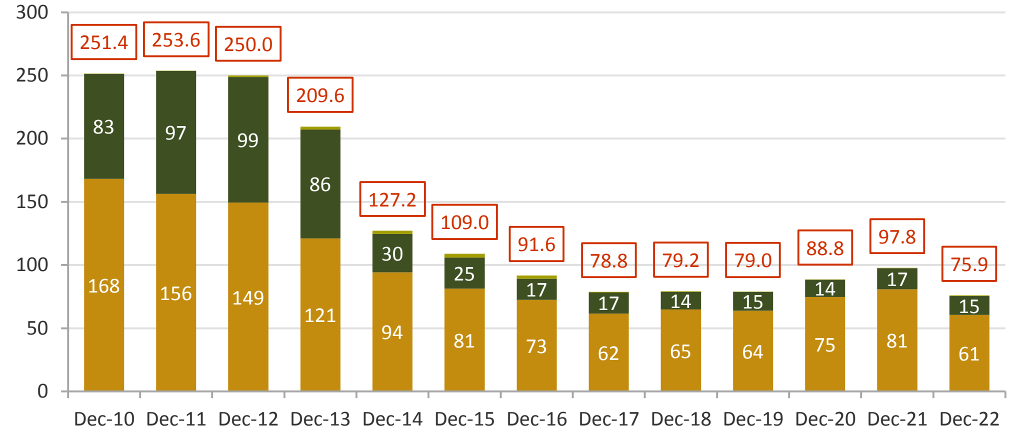


Source: Banco de Portugal (consolidated data and Monetary and Financial Statistics) and ECB – Consolidated Banking Data (consolidated data reported in FINREP format) and MFI Balance Sheet Items (Monetary and Financial Statistics). OCI = Other Credit Institutions.

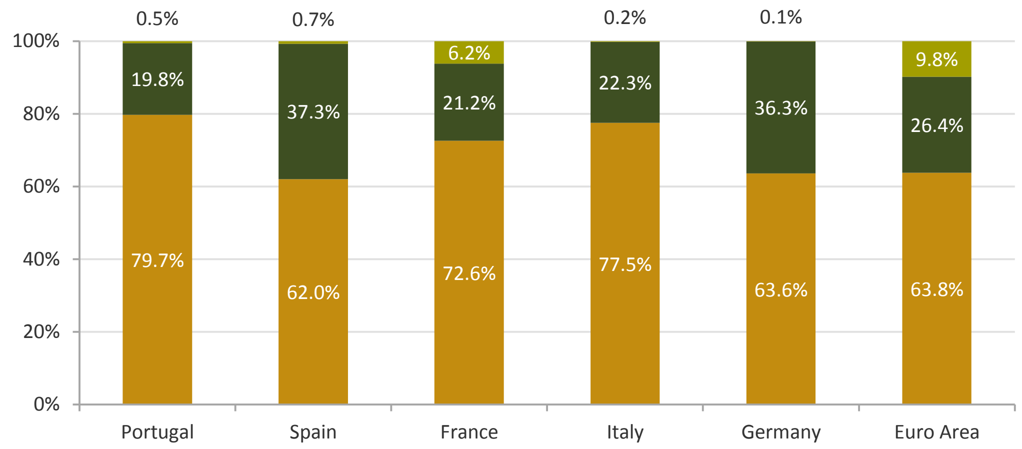
III. ORIGIN OF THE FUNDS AND LIQUIDITY

Recourse to wholesale funding continued to be limited in the banking sector's financing structure. In addition, there was a significant reduction in funding from the Eurosystem. In response to the changes in the rates applicable to TLTRO III loans, which from 23 November were indexed to the evolution of key interest rates, banks repaid a significant part of these loans early.

Origin of wholesale funds (EUR billion)

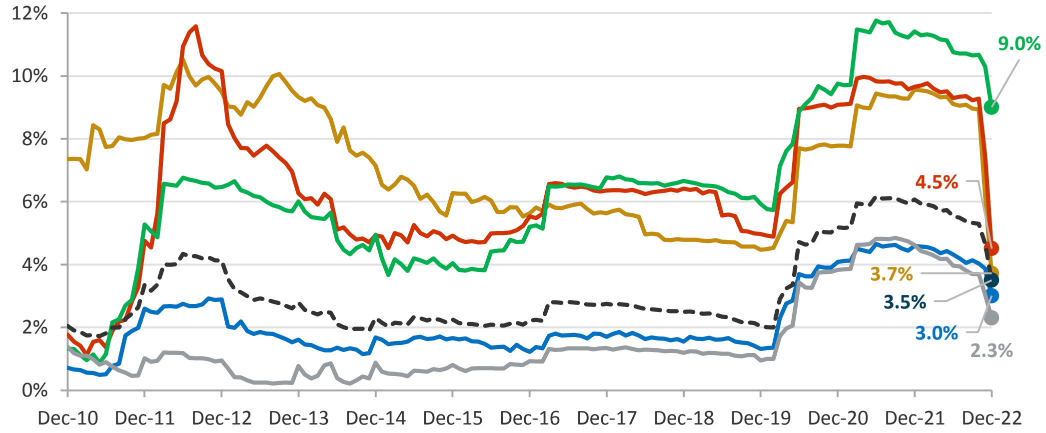


Origin of wholesale funds: Portugal vs. Euro Area (Dec-22)



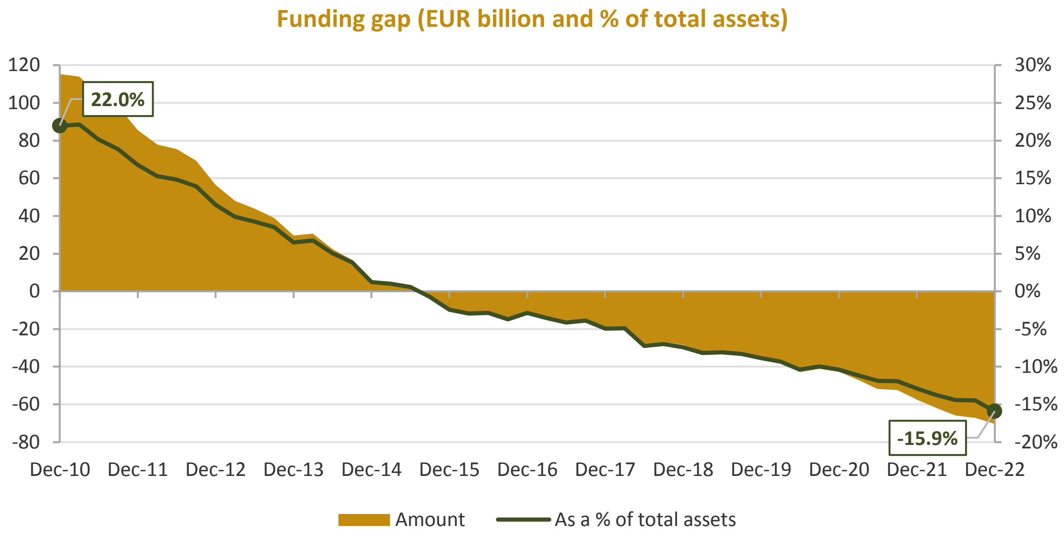
Borrowing from the ECB (EUR billion)

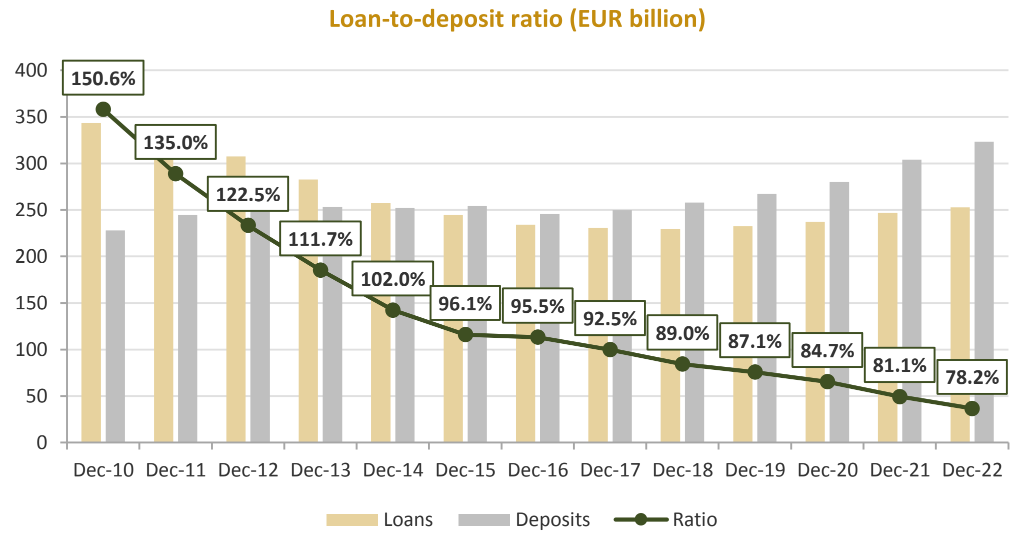
Borrowing from the ECB: Portugal vs. Euro Area (% of total assets)

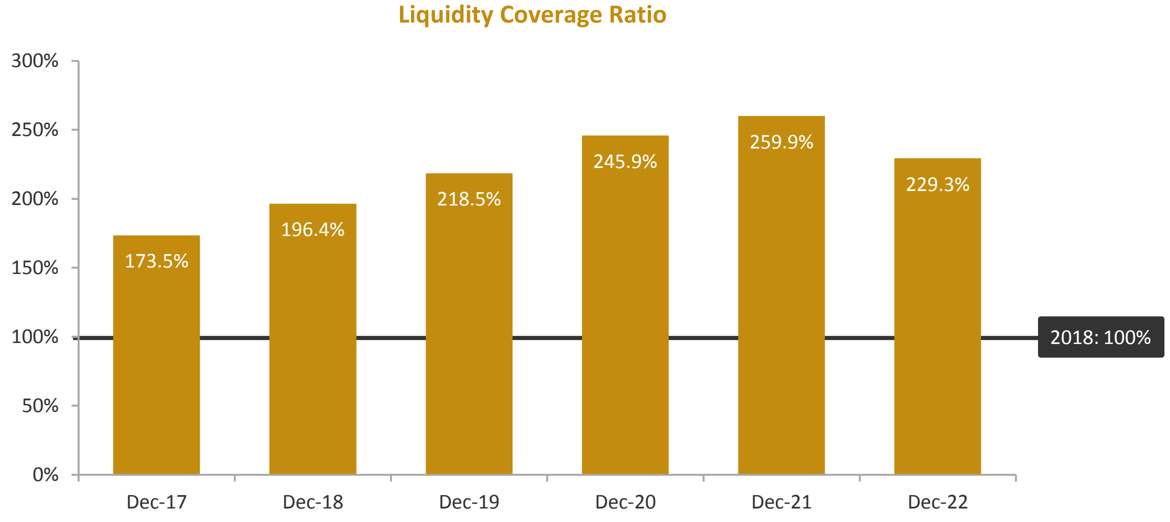


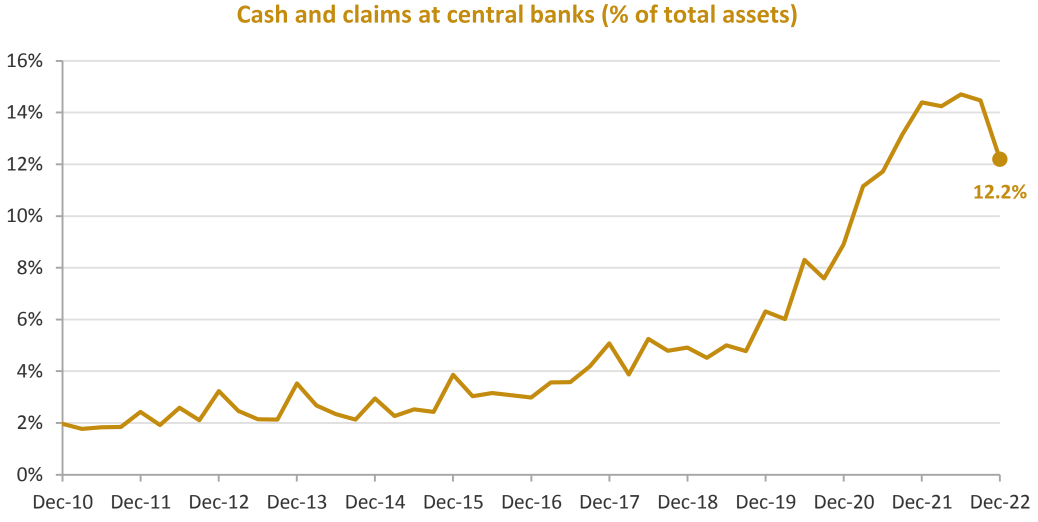
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics). Origin of wholesale funds from domestic activity. Monetary Financial Institutions (MFI) include Central Banks and Other Monetary and Financial Institutions (OMFI).

In 2022, the Portuguese banking sector maintained its high liquidity levels. The increase in customer deposits higher than loans resulted in a further reduction in the loan-to-deposit ratio. The liquidity coverage ratio fell significantly, but remained very high and considerably above the minimum regulatory requirement.





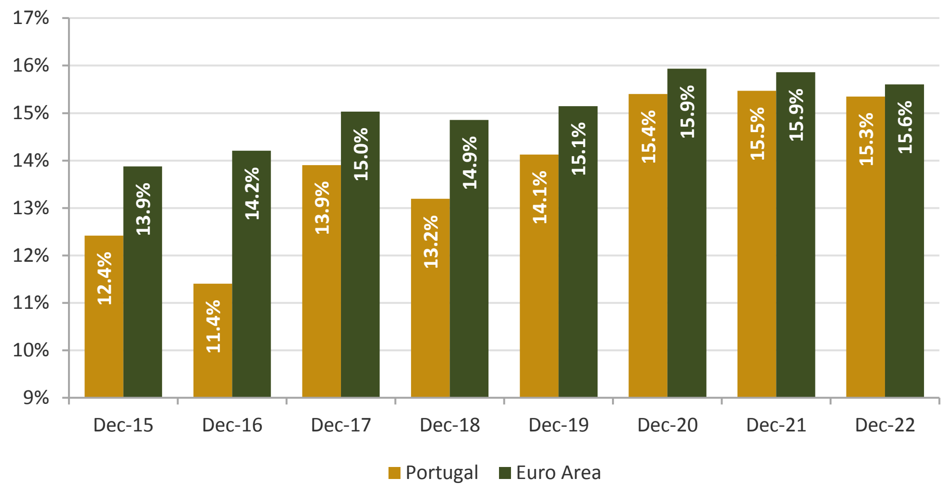




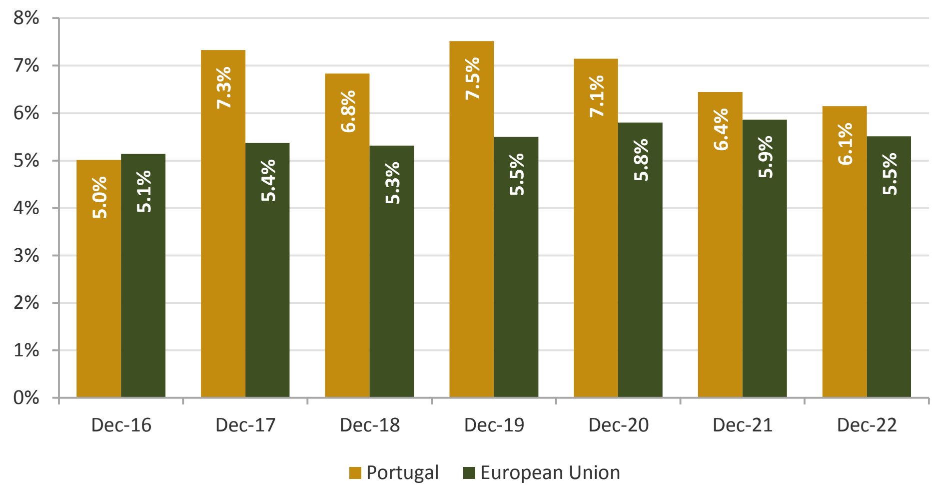
Source: Banco de Portugal (consolidated data).

Despite the slight reduction in solvency ratios in 2022, the improvements seen over the last few years mean they are at very robust levels. The leverage ratio also fell slightly (to 6.1%) but is considerably higher than the EU average and the minimum regulatory benchmark (3%).

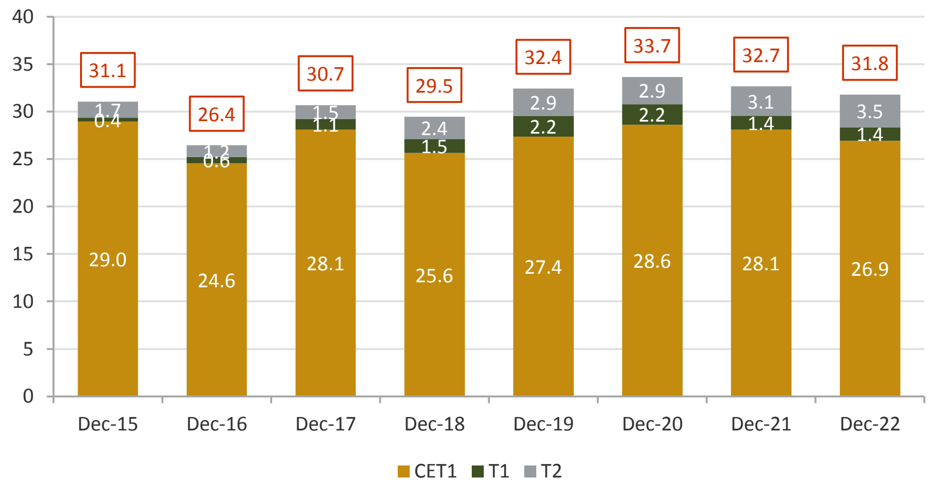
Common Equity Tier 1 ratio



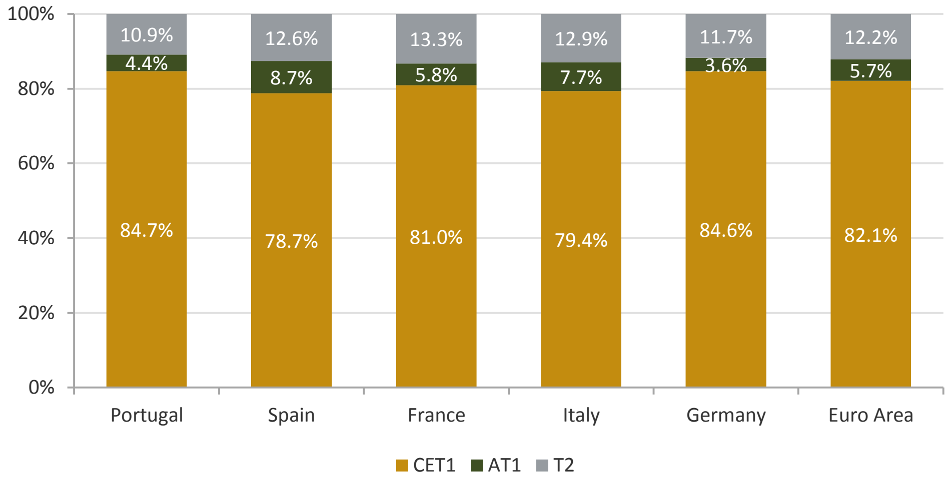
Leverage ratio



Evolution of the structure of own funds (EUR billion)



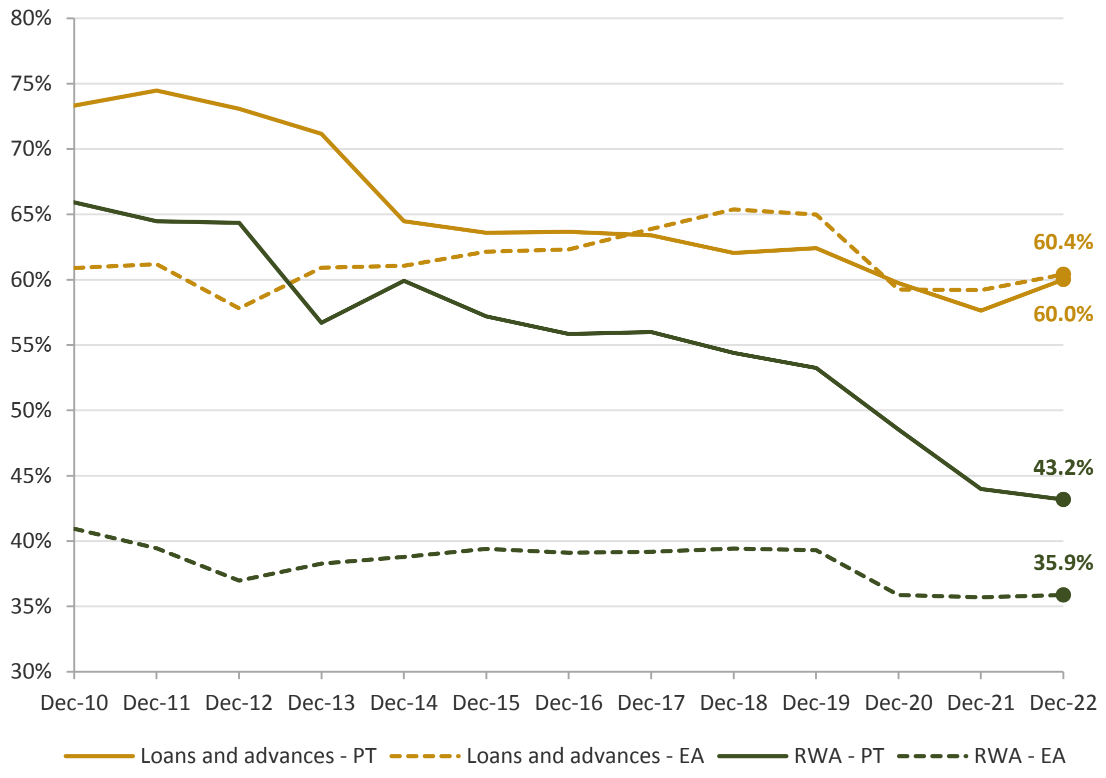
Structure of own funds: Portugal vs. Euro Area (Dec-22)



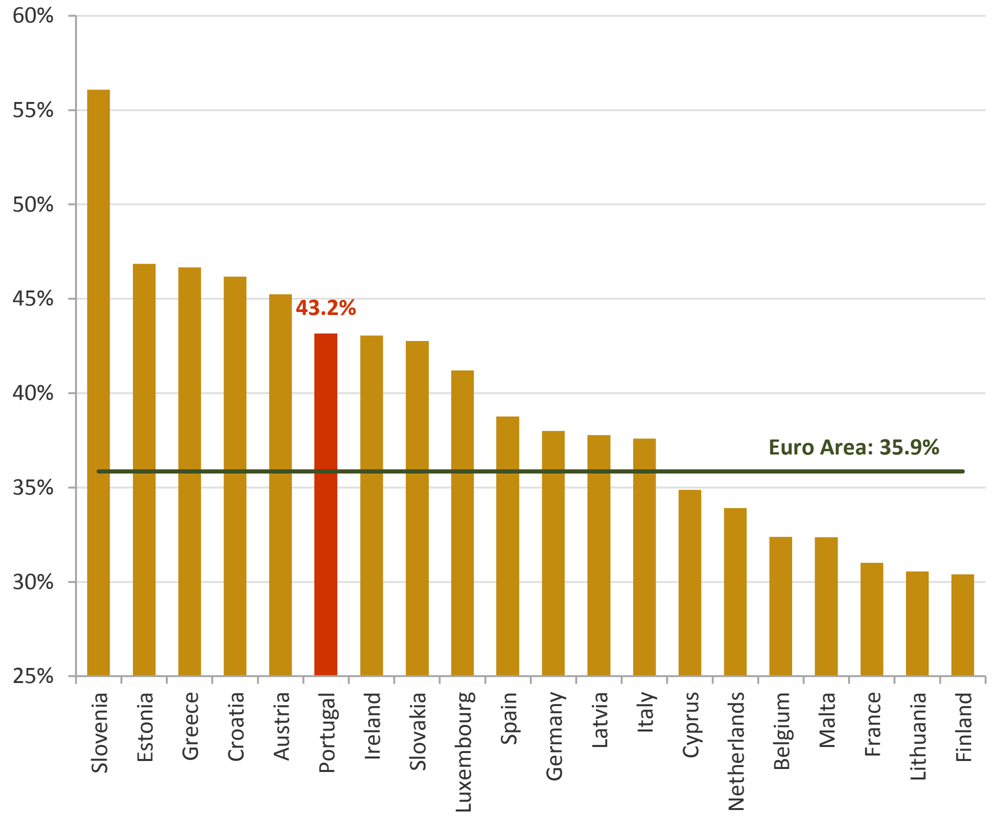
Source: ECB – Consolidated Banking Data and EBA – Risk Dashboard (leverage ratio – fully phased-in definition of Tier 1). In December 2022, the EBA sample included 161 European banks, 30 of which are subsidiaries (sample for Portugal: BCP, CGD, LSF Nani Investments and Santander Totta).

The ratio of risk-weighted assets (RWA) as a percentage of total assets continues to compare unfavourably to the European Union. That is due to the lower use of internal models to calculate capital requirements and higher levels of defaults and losses from a historical perspective, which implies capital requirements above most banks in the European Union.

Evolution of Loans and advances and RWA as a % of total assets: Portugal vs. Euro Area



RWA as a % of total assets by country (Dec-22)

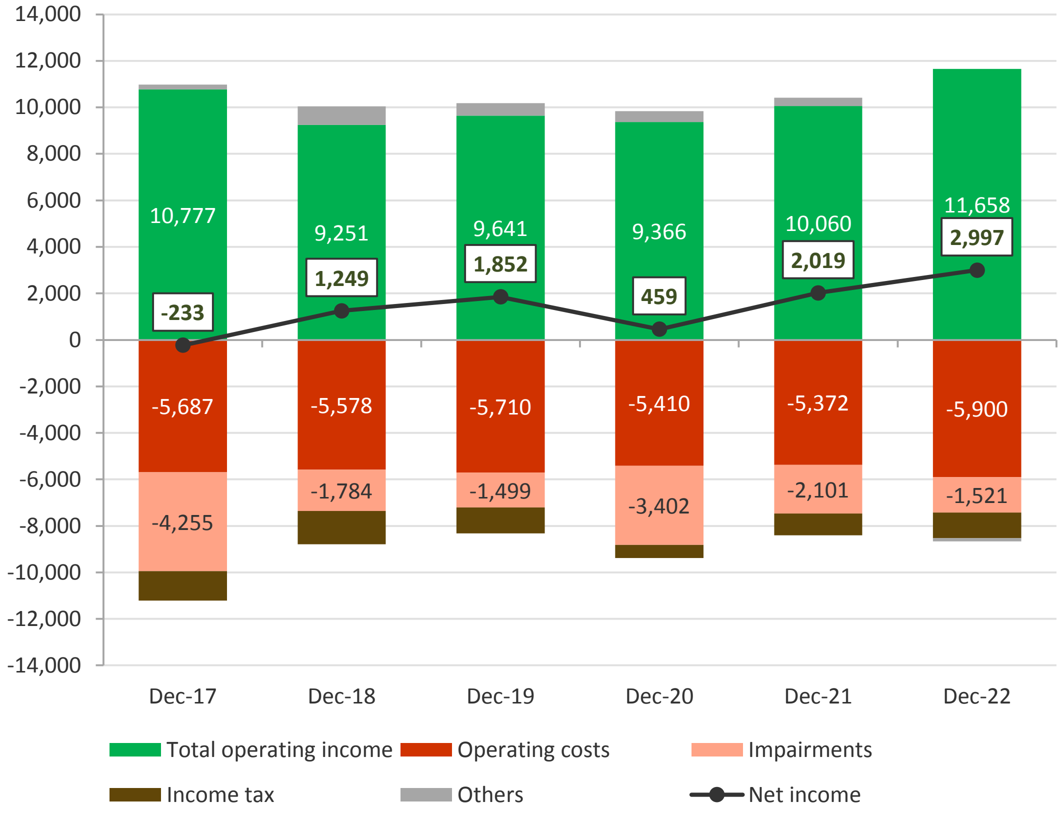


Source: ECB – Consolidated Banking Data.

V. PROFITABILITY

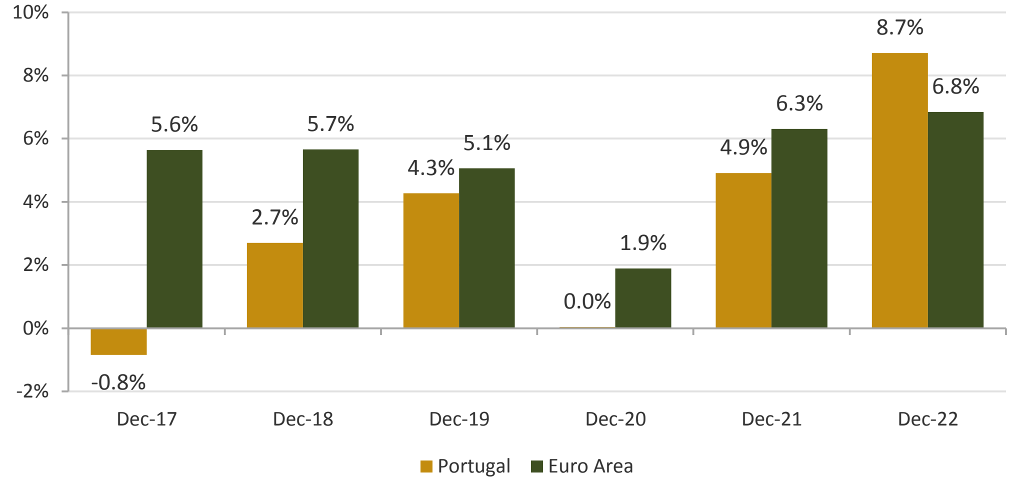
In 2022, there was a significant improvement in the banking sector's profitability, mainly due to the increase in total operating income and the decrease in the flow of credit impairments. In the current economic and financial context of rising interest rates, the potential materialisation of market and credit risks represents increased challenges for the sector's profitability.

Net income breakdown (EUR million)

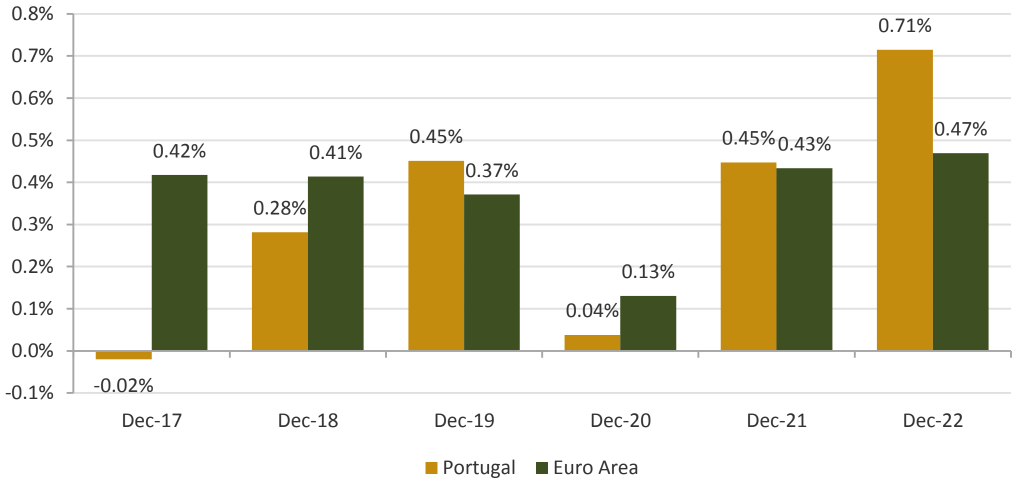


Source: Banco de Portugal (consolidated data).

Return on Equity (ROE)



Return on Assets (ROA)

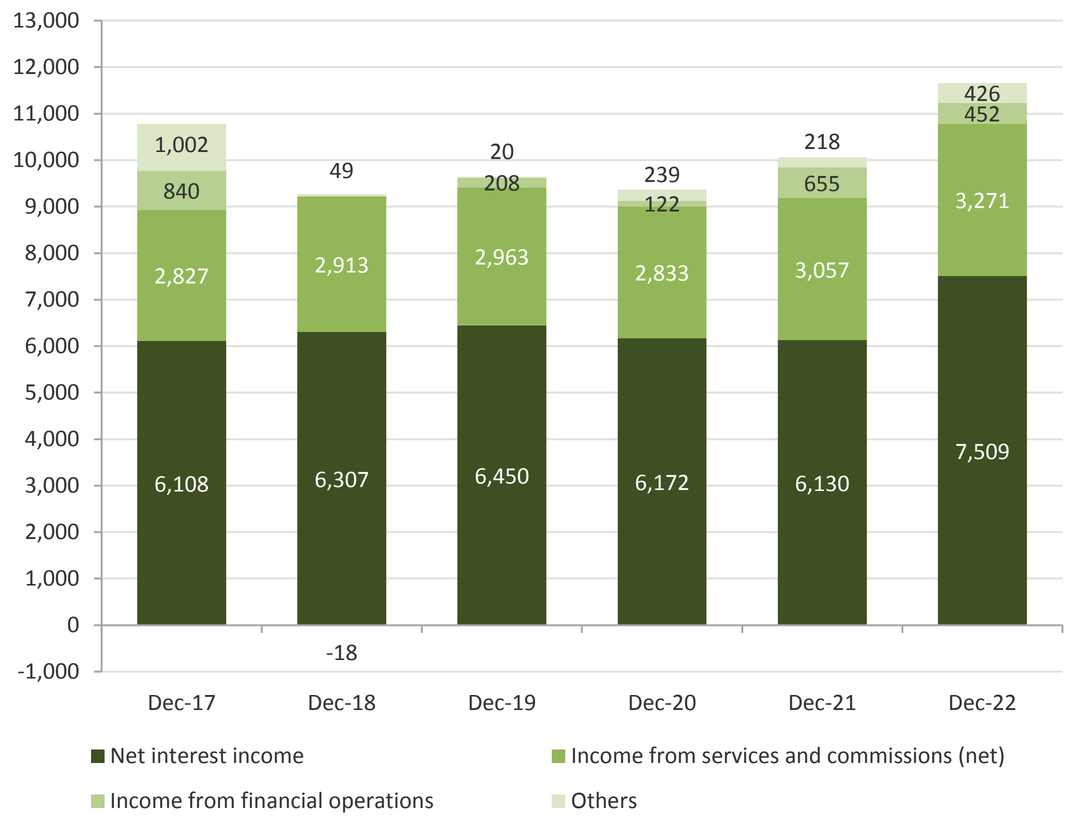


Source: ECB – Consolidated Banking Data. Calculated based on net income after tax and before minority interests and on end-of-period equity and total assets. Return on Equity excludes branches of foreign banks. Annualised data.

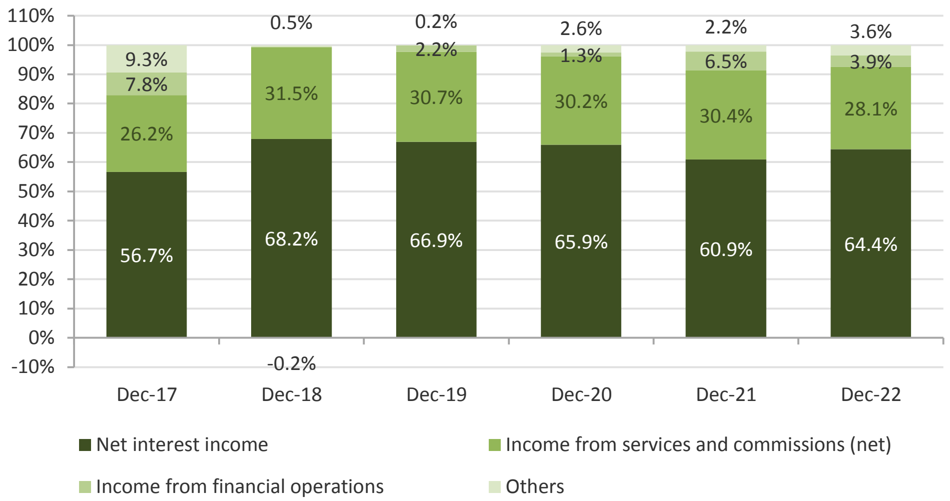
V. PROFITABILITY

The improvement in total operating income is explained mainly by the increase in net interest income and, to a lesser extent, by the increase in commissions, which more than offset the decrease in income from financial operations.

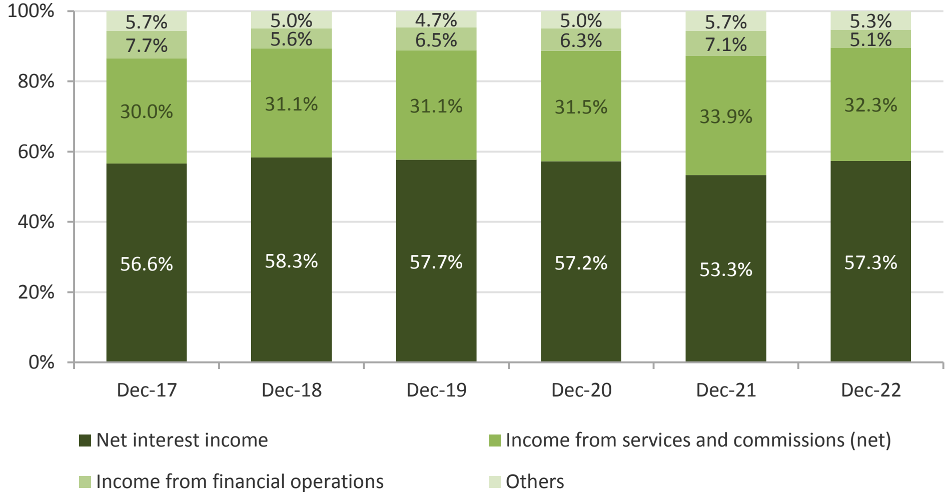
Total operating income breakdown (EUR million)



Total operating income breakdown: Portugal



Total operating income breakdown: Euro Area

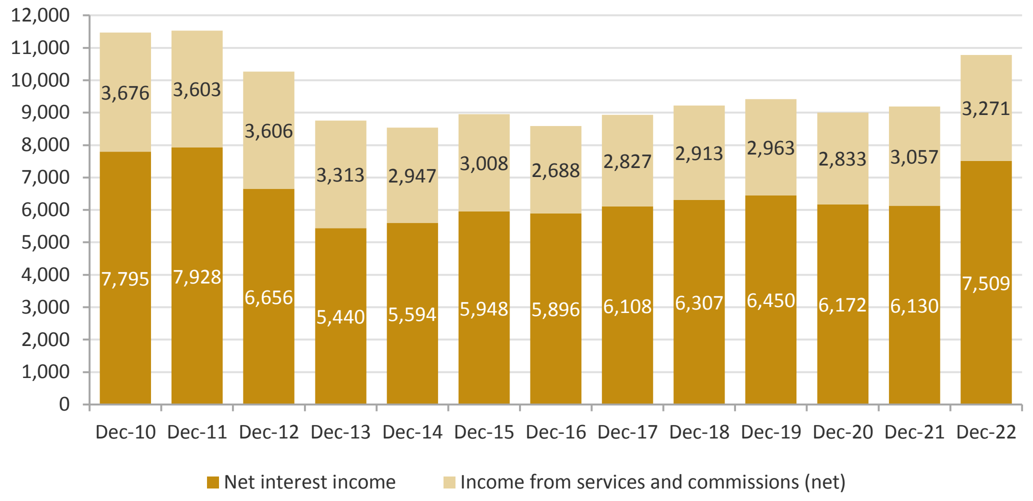


Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data (Euro Area).

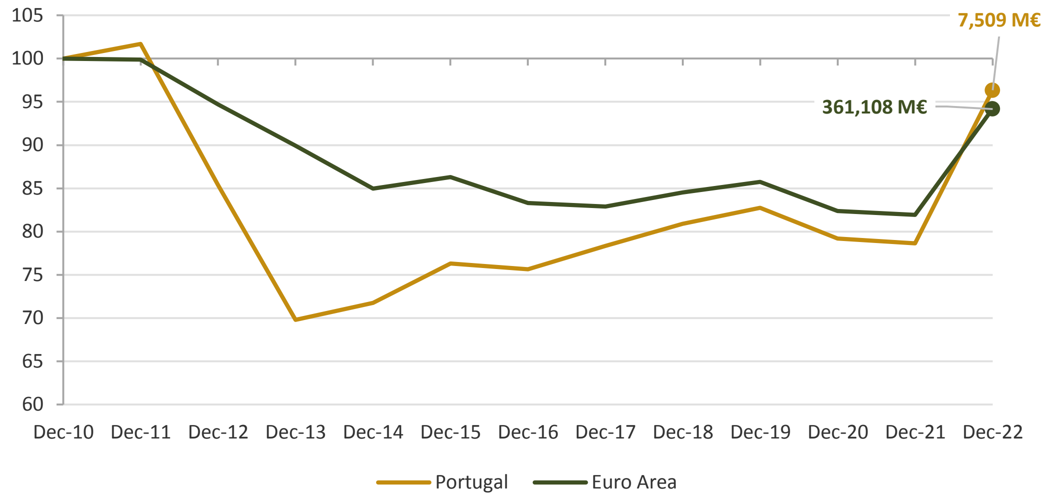
V. PROFITABILITY

In 2022, the evolution of net interest income reflected mainly the increase in interest rates on the asset side. However, it is still below pre-crisis levels. As for commissions, the recovery in Portugal has been slower than in the Euro Area.

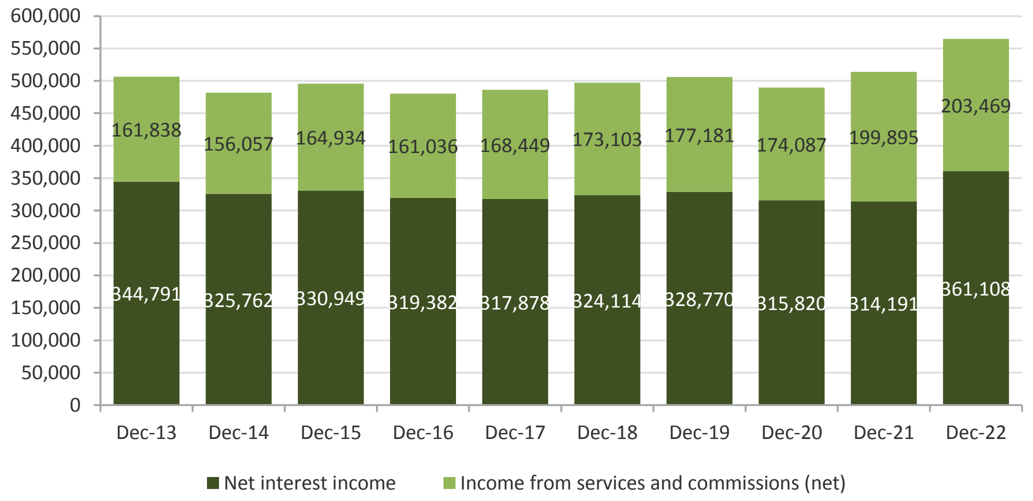
Net interest income and Commissions (EUR million) – Portugal



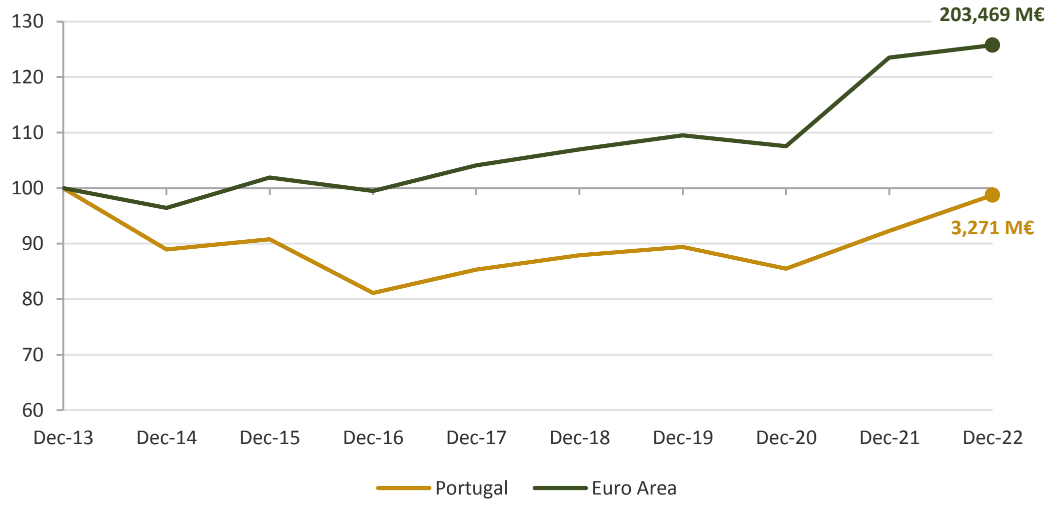
Net interest income (Dec-10 = 100)



Net interest income and Commissions (EUR million) – Euro Area



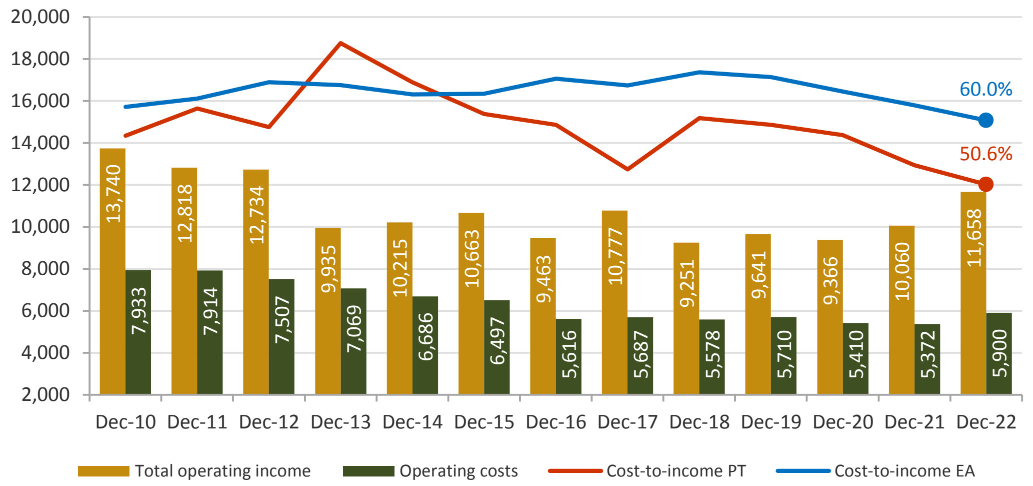
Income from services and commissions (net) (Dec-13 = 100)



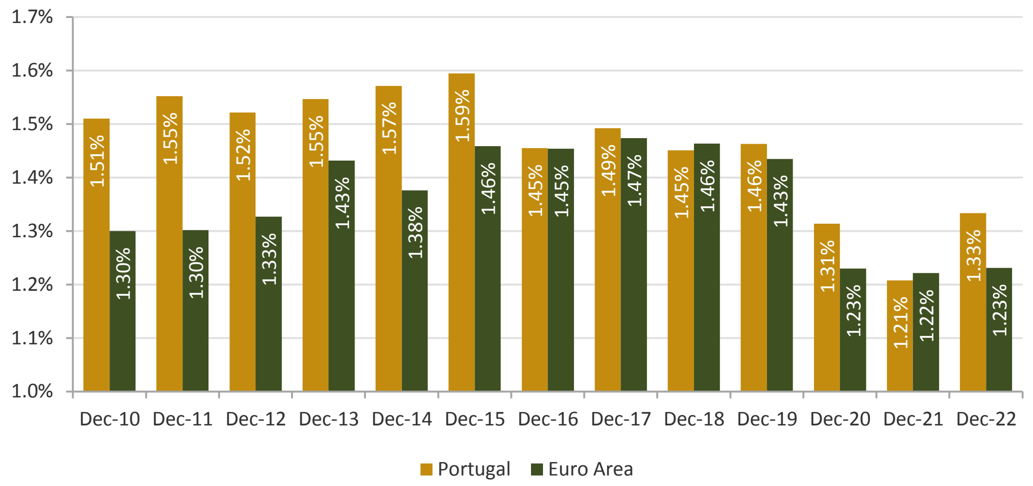
Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data (Euro Area). The ECB's data on Services and commissions is only available from 2013 onwards.

In 2022, there was a further improvement in the sector's efficiency, with the cost-to-income ratio falling by 2.8 pp to 50.6% due to a rise in total operating income higher than that of operating costs. In turn, the cost of credit risk continued to fall year-on-year, mainly due to the significant decrease in credit impairments, although also reflecting the increase in loans.

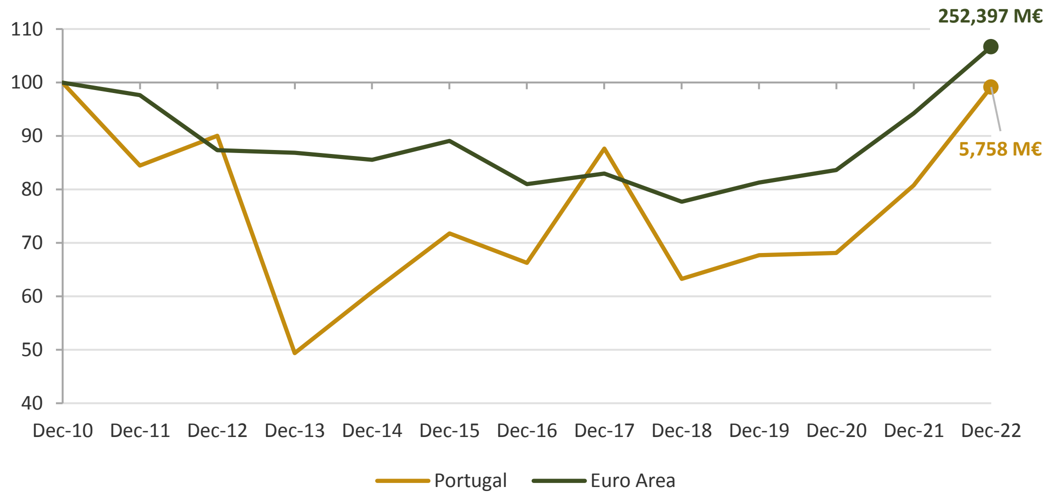
Cost-to-income breakdown (EUR million) – Portugal



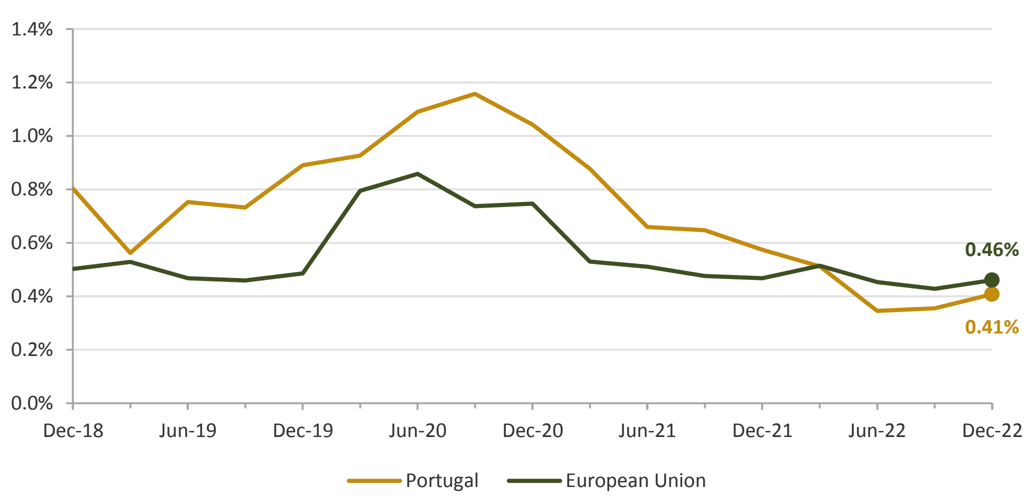
Operating costs as a % of total assets



Net operating income (Dec-10 = 100)



Cost of credit risk

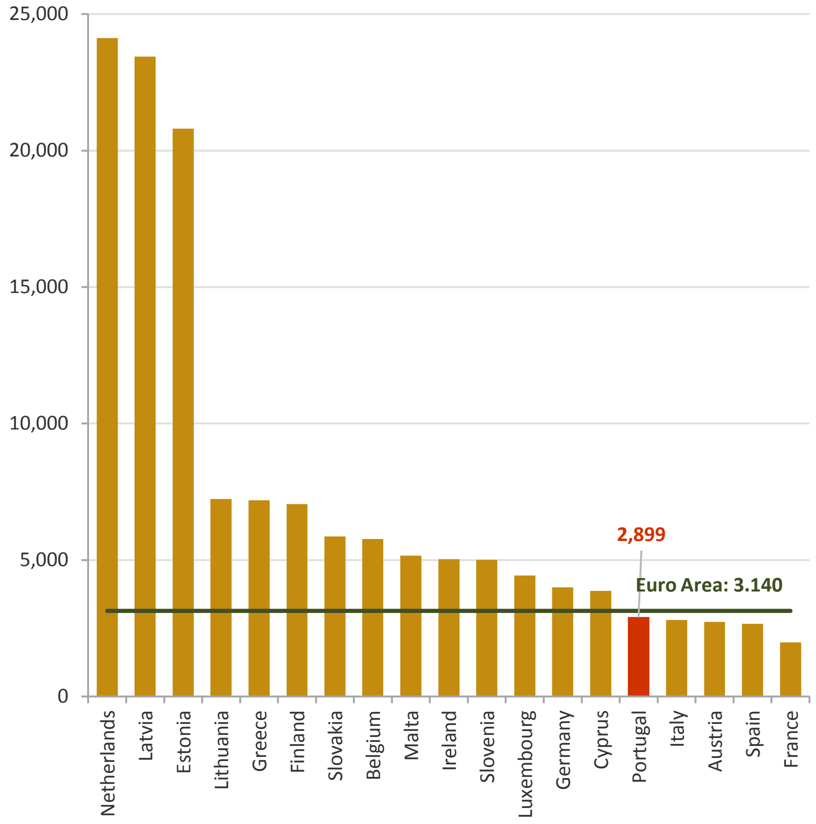


Source: Banco de Portugal (consolidated data), ECB – Consolidated Banking Data (Euro Area), and EBA – Risk Dashboard (cost of credit risk). In December 2022, EBA's sample included 161 European banks, including 30 subsidiaries (Portugal: BCP, CGD, LSF Nani Investments, and Santander). The methodology to calculate the cost of credit risk of EBA is different from that of Banco de Portugal. Both can be found in the following reports: Sistema Bancário Português - desenvolvimentos recentes (Banco de Portugal) and Risk Dashboard (EBA).

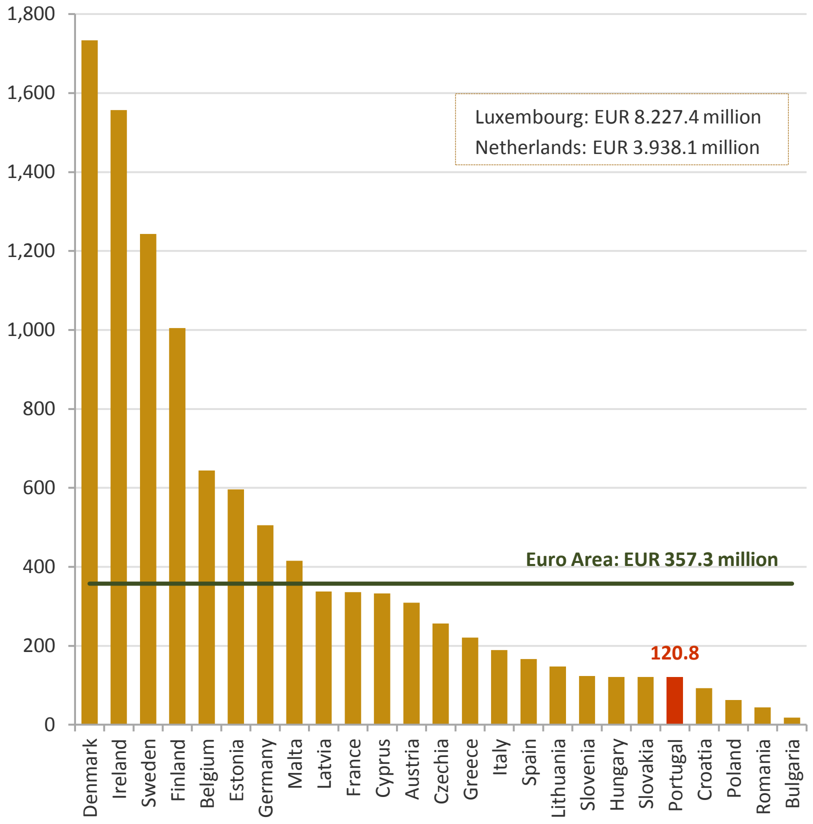
VI. PROFITABILITY

Following the implementation of restructuring plans by several institutions, the sector's number of inhabitants per branch remains close to the European average. However, productivity in terms of assets generated per branch and assets generated per employee remains significantly below the European average.

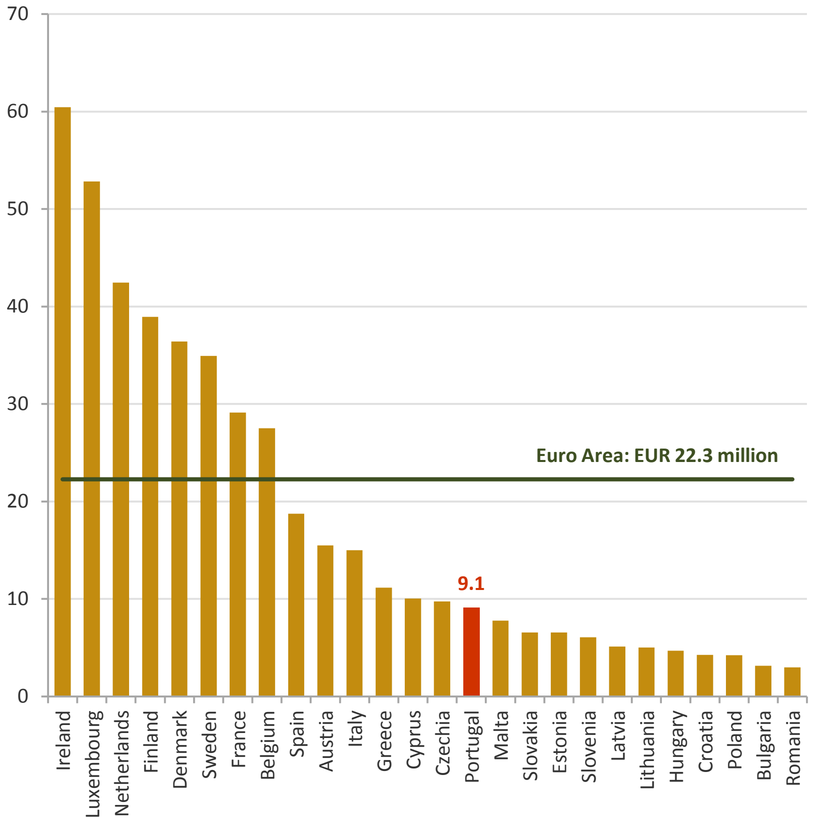
Residents per branch (Dec-22)



Total assets per branch (EUR million, Dec-22)



Total assets per employee (EUR million, Dec-22)



Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Banking Structural Financial Indicators. Domestic activity data.

VII. METHODOLOGY

- The information provided by Banco de Portugal and the ECB regarding monetary statistics differ from that provided in the context of consolidated data of the banking system. The main differences derive fundamentally from non-coincidence in the universes surveyed and from different consolidation procedures. This information is available on the Banco de Portugal and the ECB websites. Among others, the following documents may be consulted: Suplemento ao Boletim Estatístico n.º1/2001, de agosto; Instrução n.º 25/2014, de 15 de dezembro, e Sistema Bancário Português: desenvolvimentos recentes – 4.º trimestre de 2016.

- The document was published with updated information as of 22 June 2023.

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DECEMBER 2022

ASSOCIAÇÃO PORTUGUESA DE BANCOS

JULY 2023