PORTUGUESE BANKING SECTOR OVERVIEW

ASSOCIAÇÃO PORTUGUESA DE BANCOS

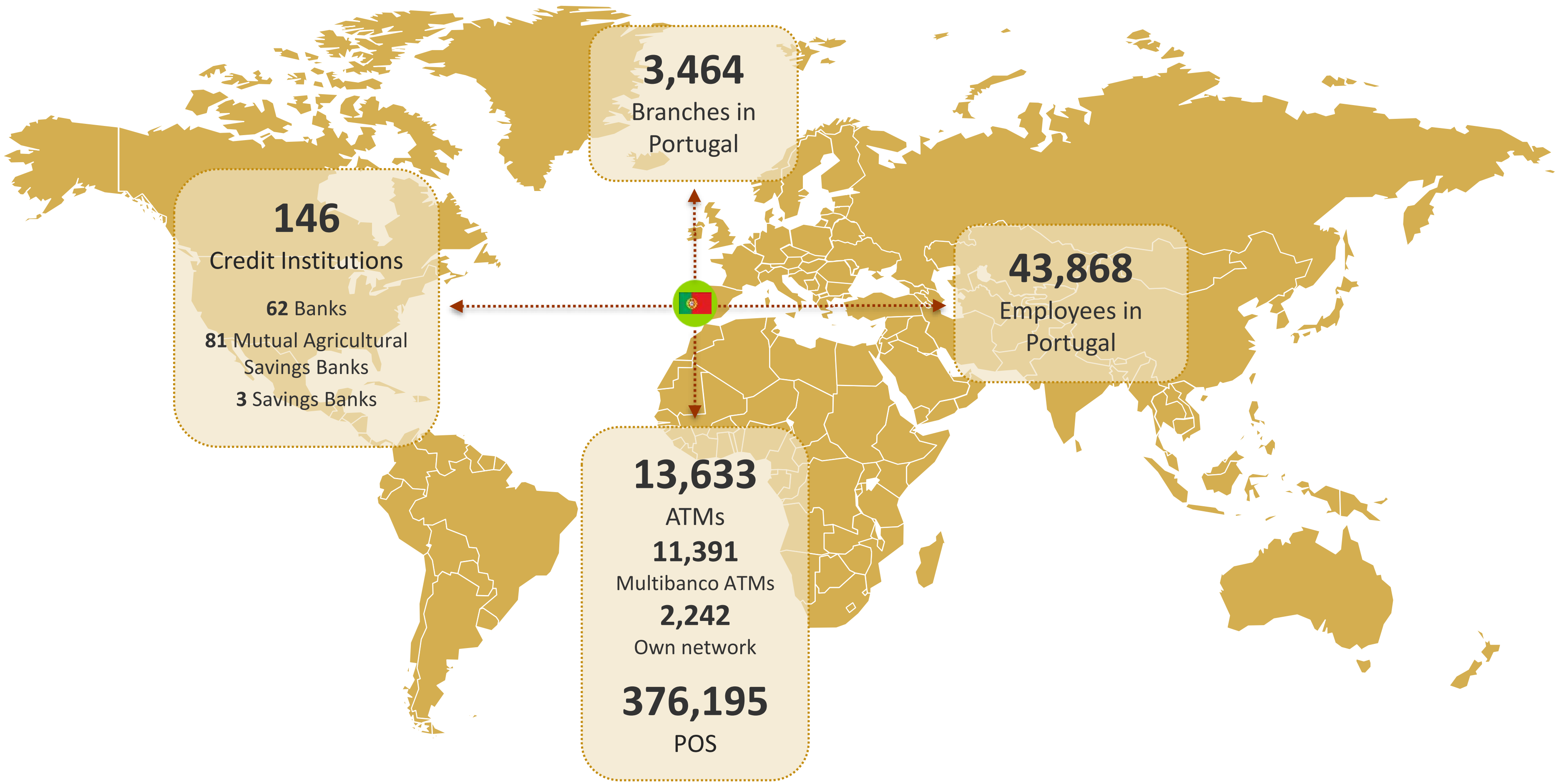
JUNE 2022

INDEX

I. RECENT EVOLUTION AND MAIN INDICATORS

- Despite the significant adverse shocks that have occurred recently, which are negatively impacting economic growth prospects, the banking sector continues to show resilience and is responding efficiently to the economy's financing needs.
- **The profitability of the Portuguese banking sector continued to show signs of improvement** essentially due to the decrease in credit impairments flows, that had been registered to accommodate the impact of the pandemic crisis, and to the increase in total operating income.
- **In the first half of 2022, the total assets of the Portuguese banking sector increased by 3% compared to December 2021,** following the positive evolution of loans to customers (net) and an increase in cash balances at central banks.
- On the liability side, **deposits continued to rise significantly.** The risks of very high inflation led to a change in monetary policy stance, which has already translated into a **reduction, although not very significant, of funding from the Eurosystem** in the first half of 2022.
- Solvency ratios remained at very robust levels despite having decreased slightly in the first half of 2022 (in line with the trend in the Euro Area). The sector is well capitalised and has **greater capacity to accommodate a possible deterioration of credit risk and an increase in non-performing assets.**
- **The challenges faced by banks are even more complex in the context of further deterioration in economic growth prospects as the invasion of Ukraine continues.** A higher materialisation of market and credit risks is expected, which may translate into the need for greater recognition of impairments. However, this could be partially offset by the increase in net interest income. Banks have ample liquidity reserves, but rising interest rates will also likely translate into more demanding future financing conditions.

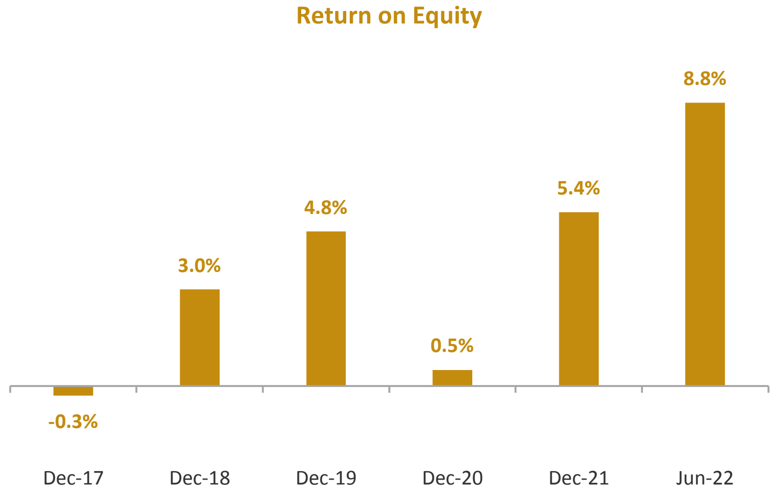
I. RECENT EVOLUTION AND MAIN INDICATORS

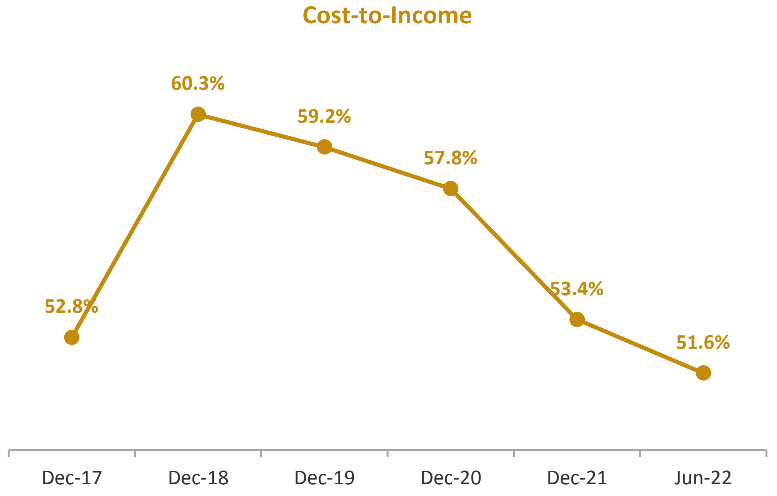


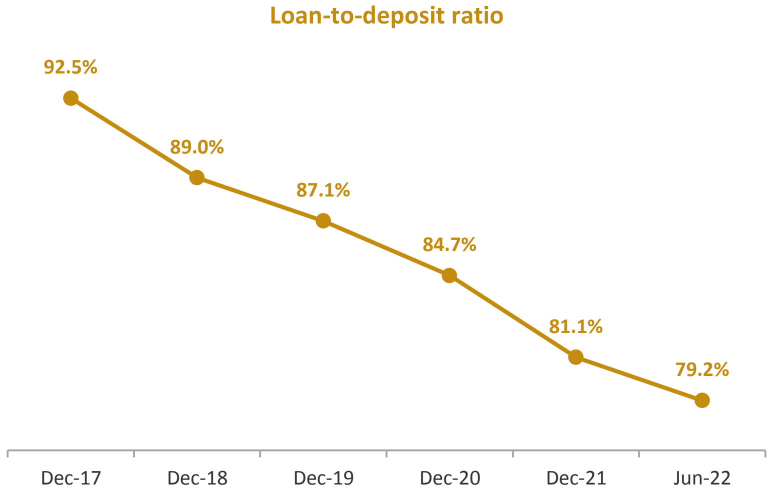
Source: APB's associates (branches, employees, and payment systems) and Banco de Portugal (credit institutions)

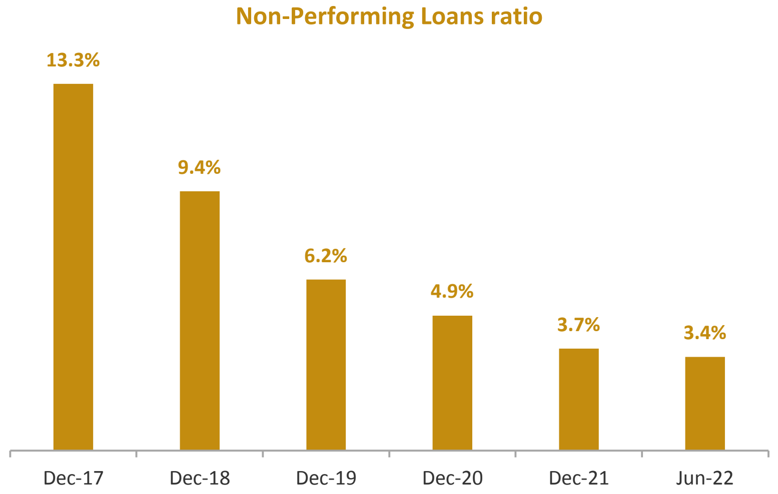
I. RECENT EVOLUTION AND MAIN INDICATORS

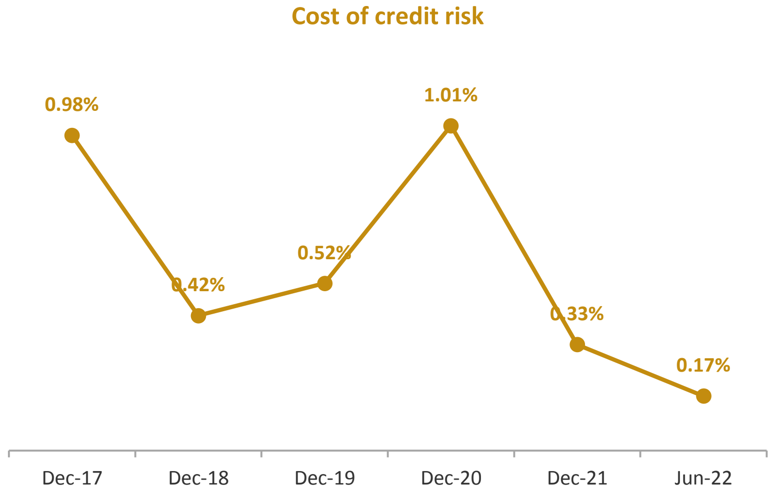
The Portuguese banking sector has shown to be resilient and well prepared, especially in terms of liquidity and solvency, to face recent adverse shocks that have occurred recently, in particular the COVID-19 pandemic shock as well as the shock caused by the impact of the invasion of Ukraine by Russia.

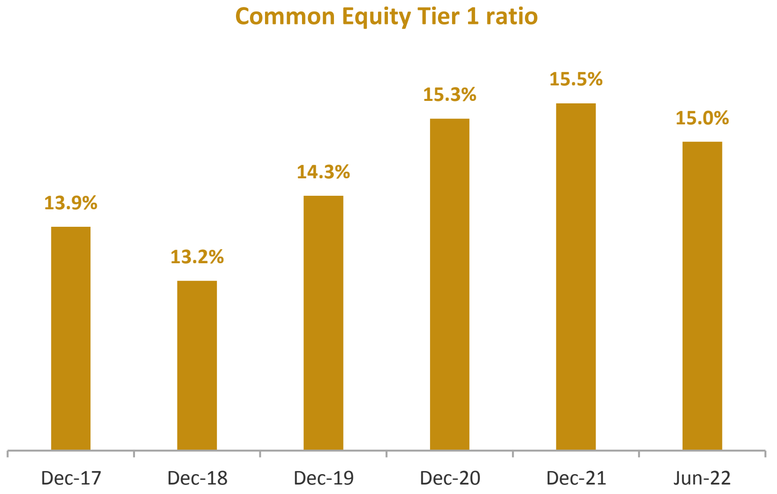








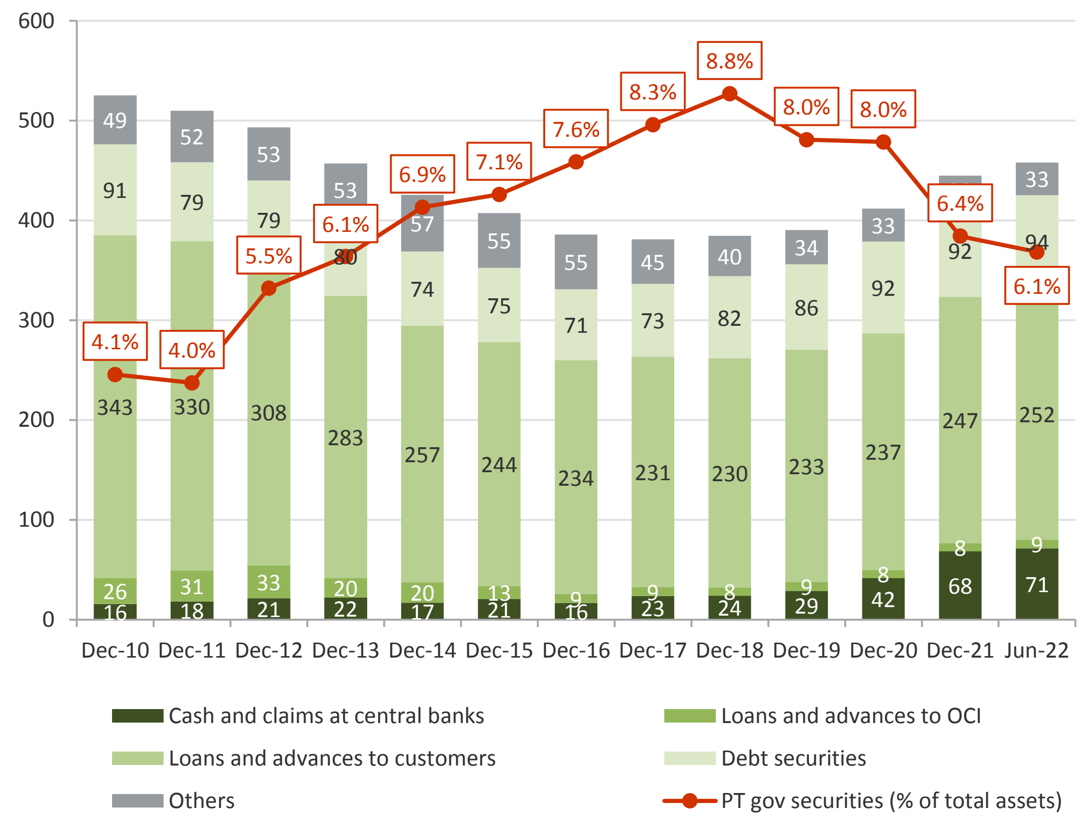




Source: Banco de Portugal (consolidated data). Return on Equity is calculated based on net income after tax and before minority interests and average equity.

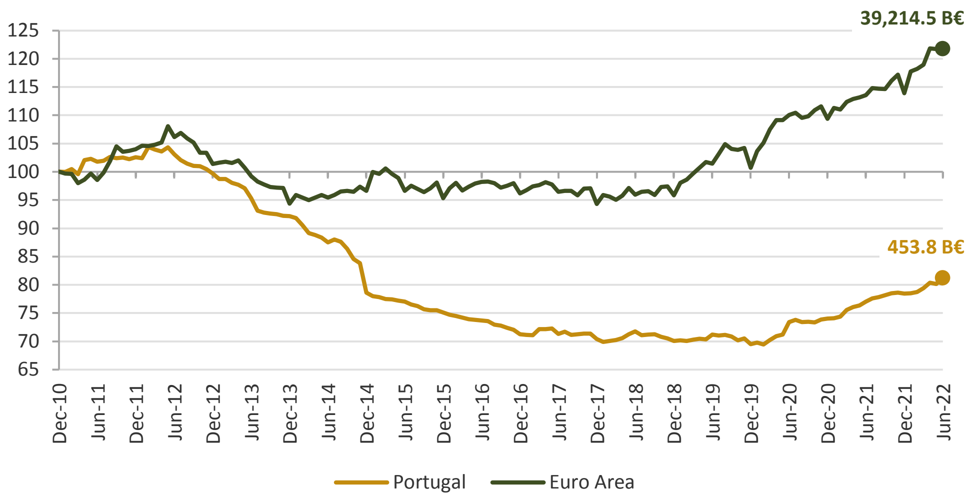
In the first half of 2022, the total assets of the Portuguese banking sector increased by 3% compared to December 2021, mainly due to a positive evolution of loans to customers (+ 4.9 billion euros, +2%) and an increase in cash balances at central banks (+3.3 billion euros; around +5%)

Total assets breakdown (EUR billion)

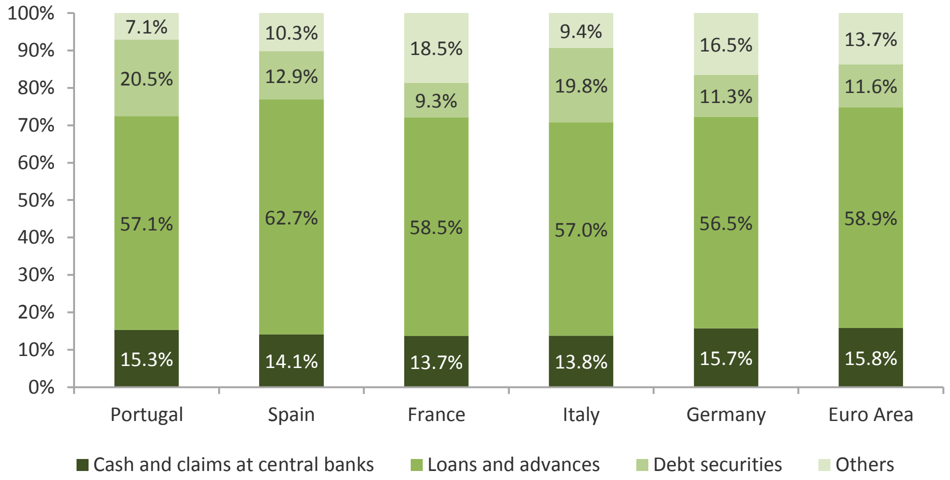


Source: Banco de Portugal (consolidated data) and ECB – MFI Balance Sheet Items (Monetary and Financial Statistics).

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



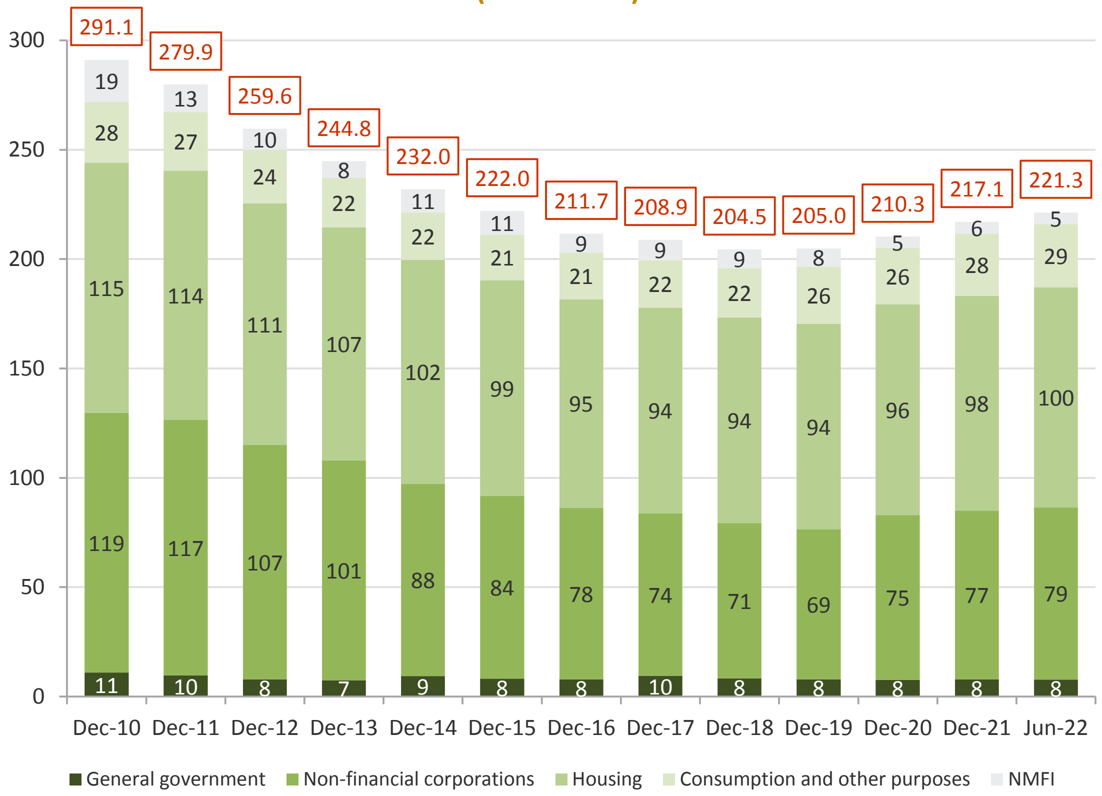
Total assets breakdown: Portugal vs. Euro Area (Jun-22)



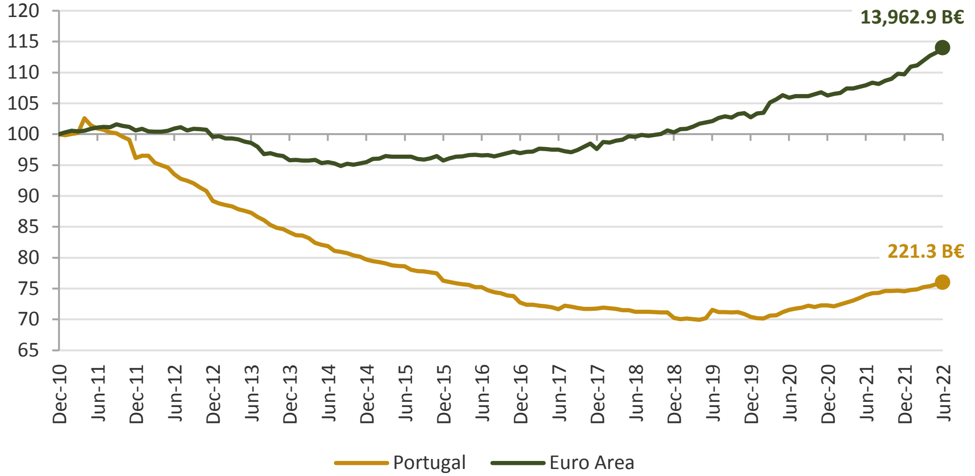
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Consolidated Banking Data and Eurostat.

Loans to households continued to rise, with an acceleration in consumer credit, while loans to NFCs showed a positive dynamic but maintaining a decelerating trend.

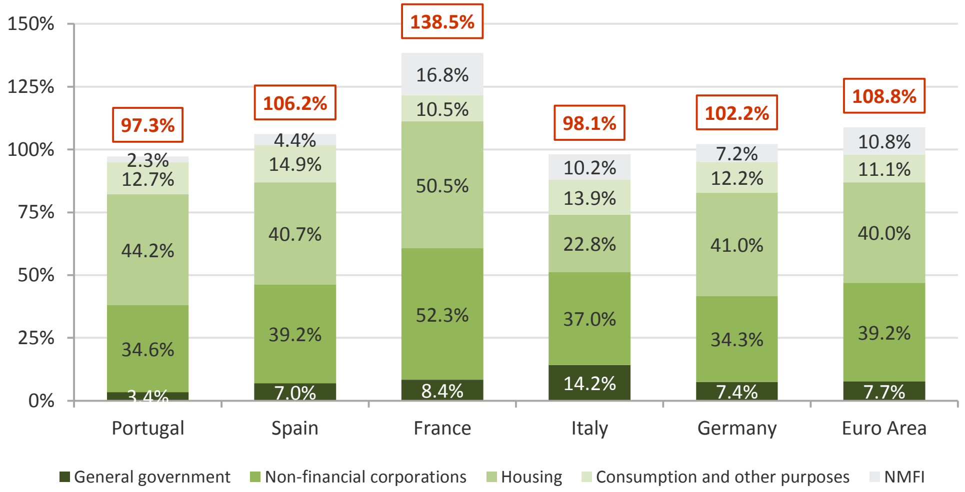
Loans to customers by institutional sector (EUR billion)



Loans to customers evolution (Dec-10 = 100)



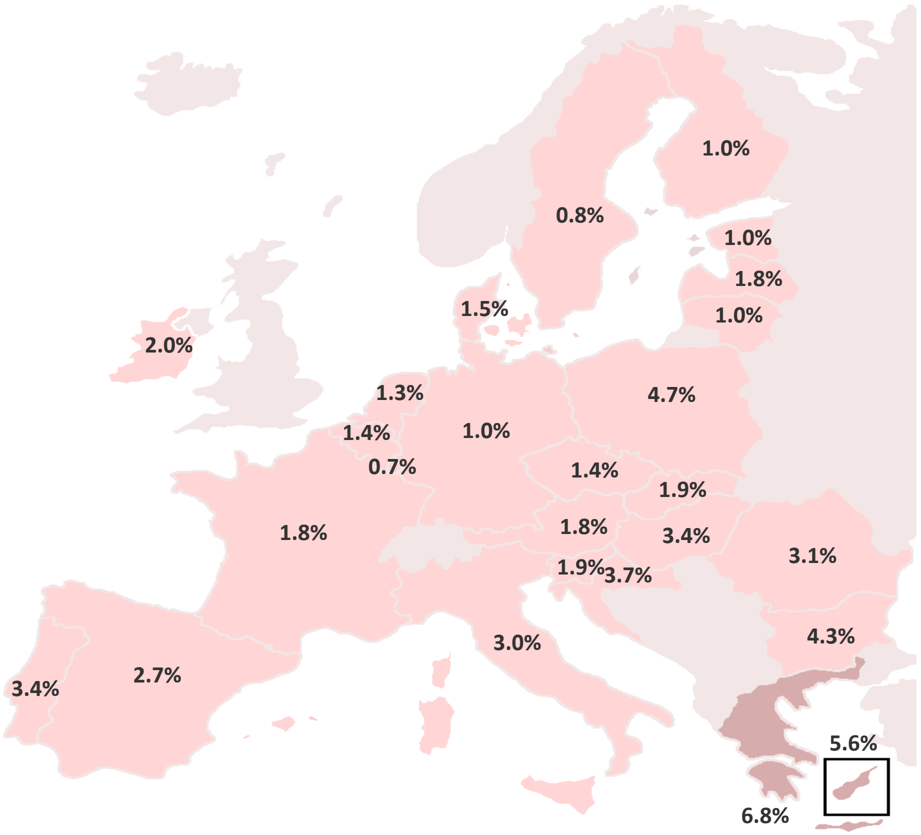
Loans to customers by institutional sector as a % of GDP (Jun-22)



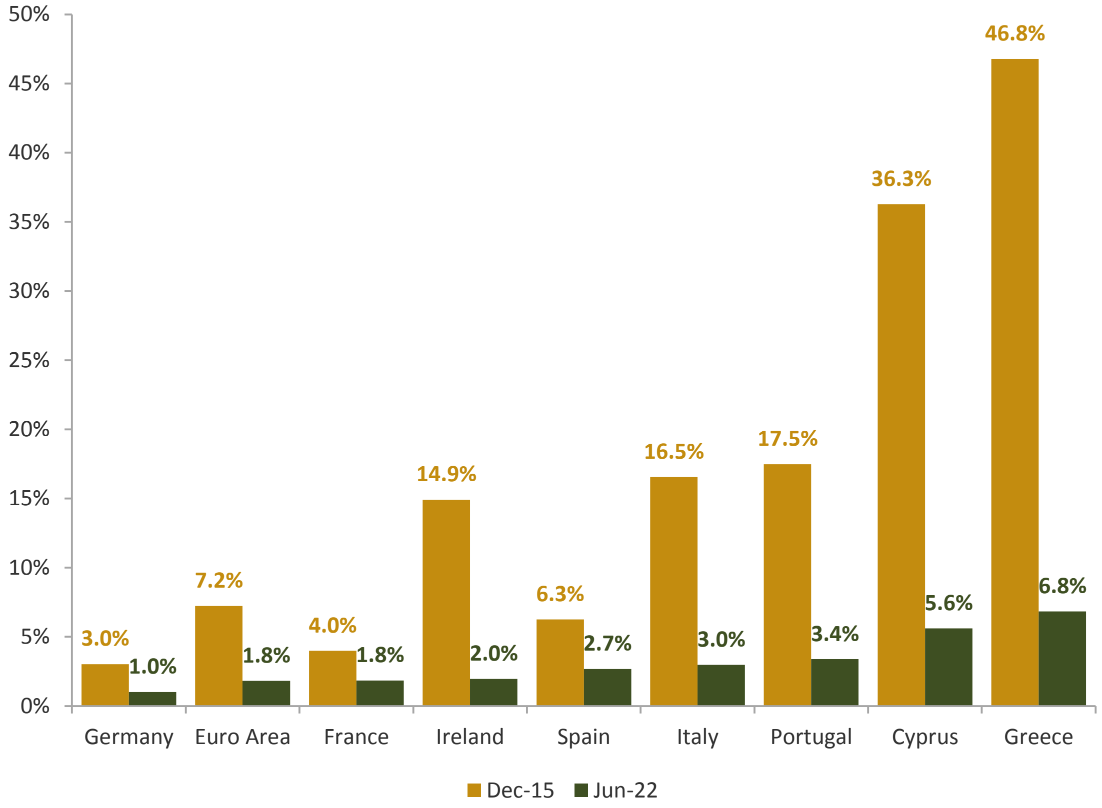
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Eurostat. Loans and advances to customers in the domestic activity; counterpart: residents in the Euro Area. NMFI = Non-Monetary Financial Institutions, which include Other Financial Intermediaries, Financial Auxiliaries, Insurance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

In the first half of 2022, despite the extremely challenging environment, the Portuguese banking sector continued to progress in reducing the NPL stock, although the decrease was not very significant. Since December 2015, the reduction has already exceeded 38 billion euros.

NPL ratio



NPL ratio evolution

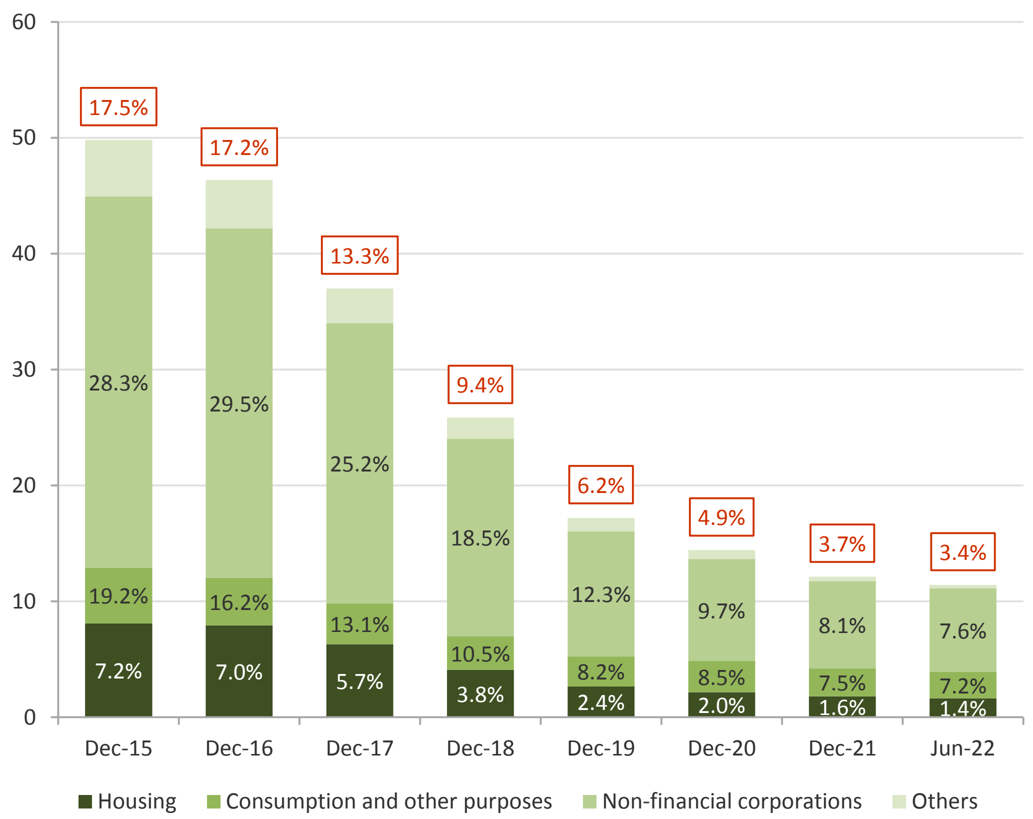


Source: ECB – Consolidated Banking Data.

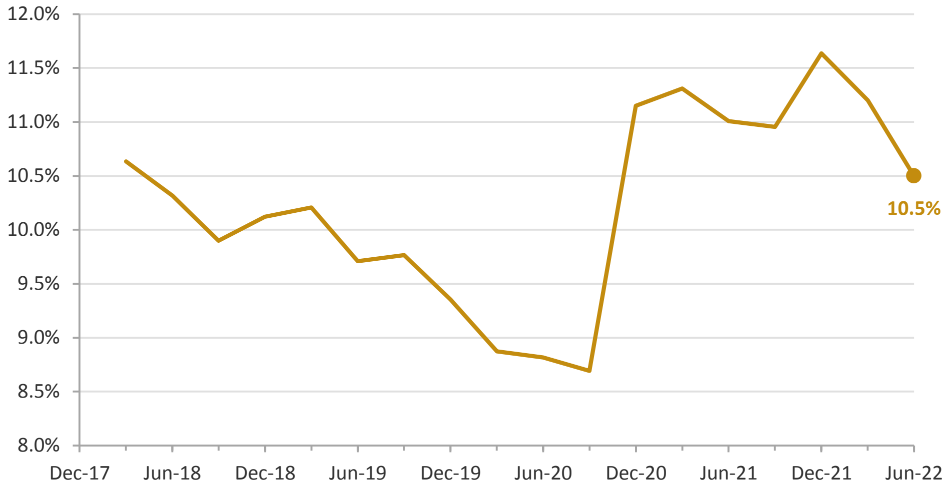
II. LENDING

The NPL ratio fell further, to 3.4% (-0.3 pp year-on-year), mainly due to the decrease in the unlikely to pay component but also, to a lesser extent, to the increase in performing loans. In net terms, the NPL ratio fell to 1.6% (-0.2 pp). The ratio of Stage 2 loans fell to 10.5% after reaching its highest value in December 2021 (11.6%) but remains above the pre-pandemic period. The NPL impairment coverage ratio continues to compare favourably with the EU average.

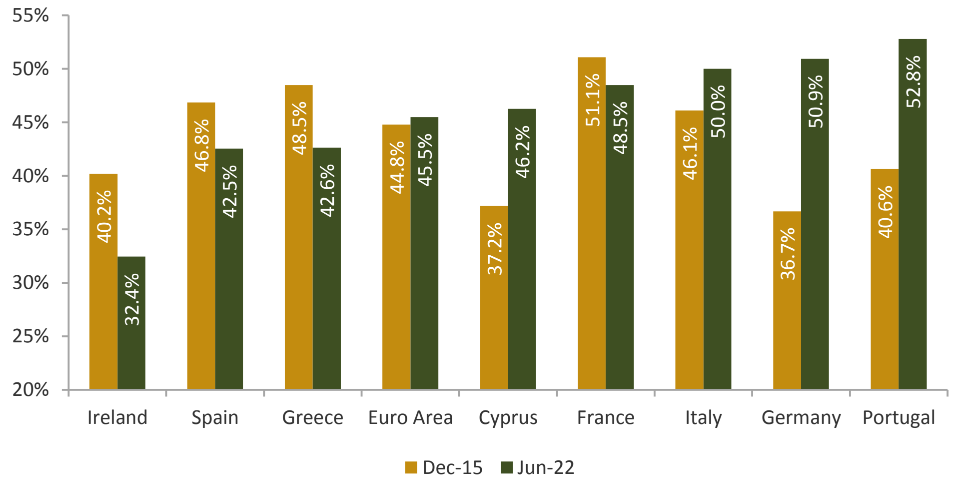
NPL amount and ratio in Portugal (EUR billion)



Stage 2 loans ratio in Portugal



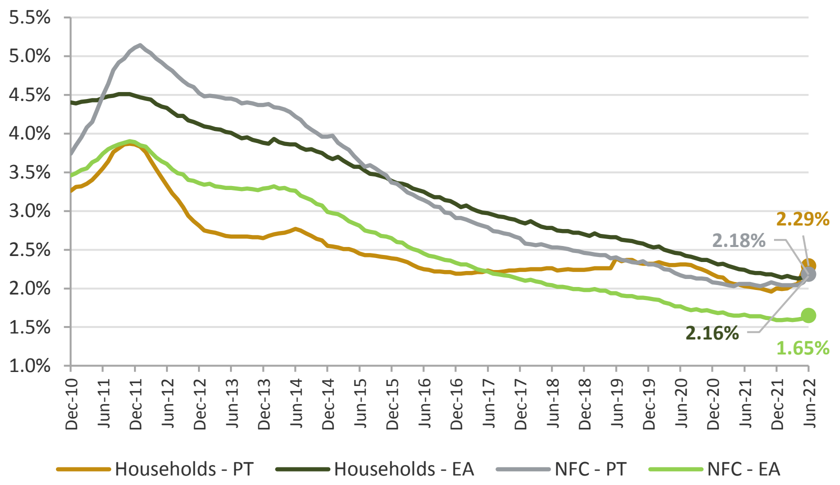
Impairment coverage ratio



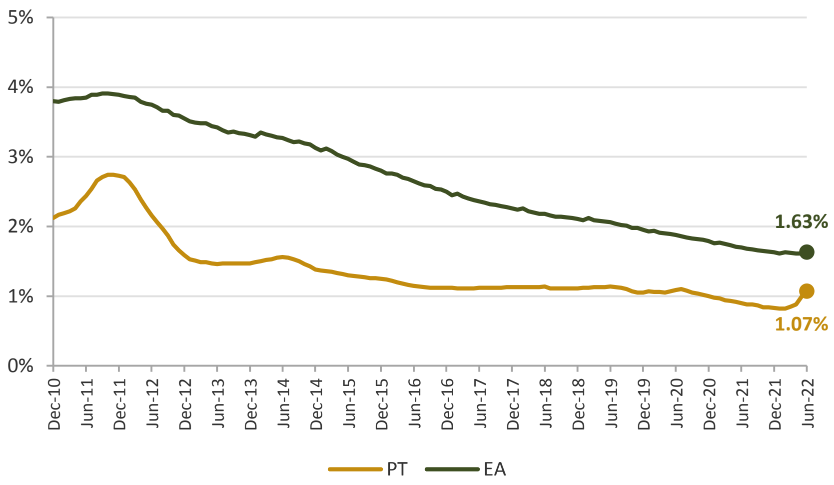
Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data. The Impairment coverage ratio refers to non-performing loans and debt securities.

The average interest rate on loans to non-financial companies (NFCs) in Portugal have been converging towards the Euro Area average, while the average interest rate on housing loans continues below the Euro Area average, despite its recent increase.

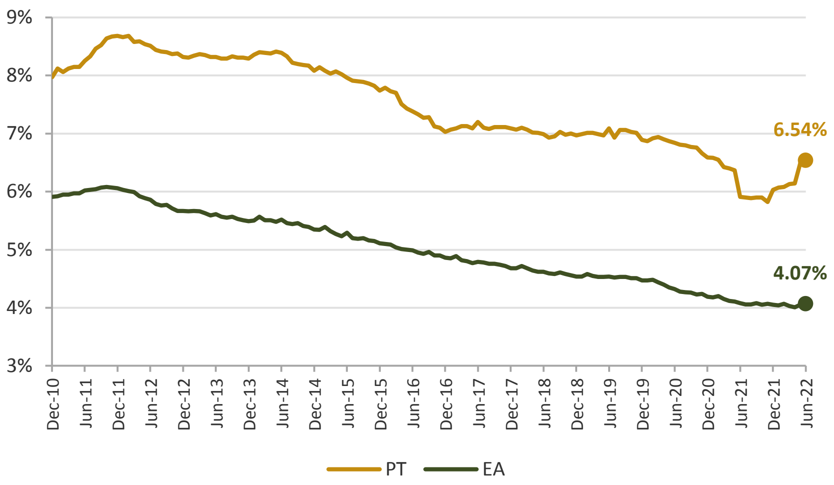
Total - Stock



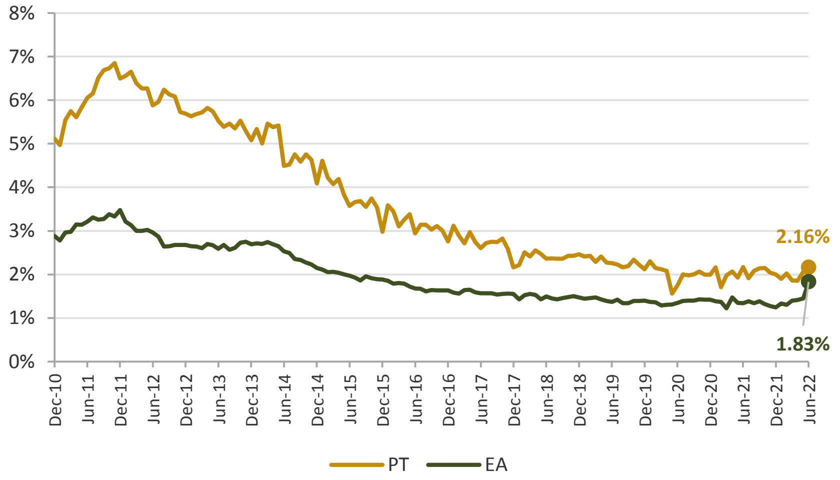
Housing - Stock



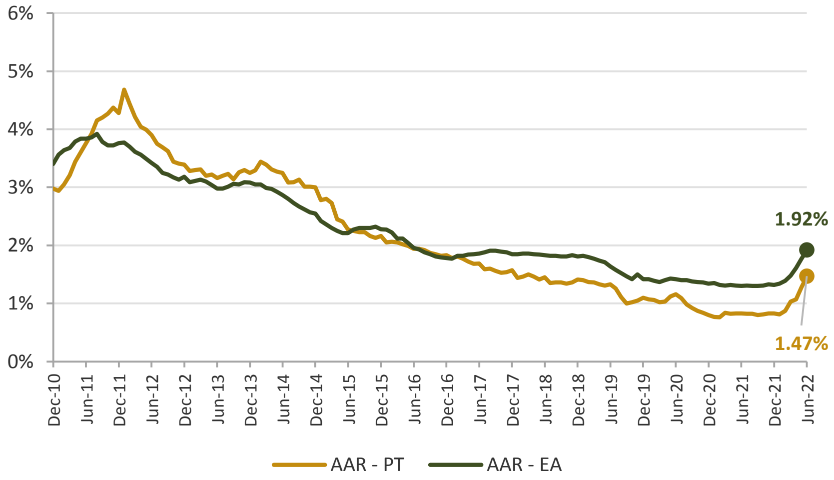
Consumption - Stock



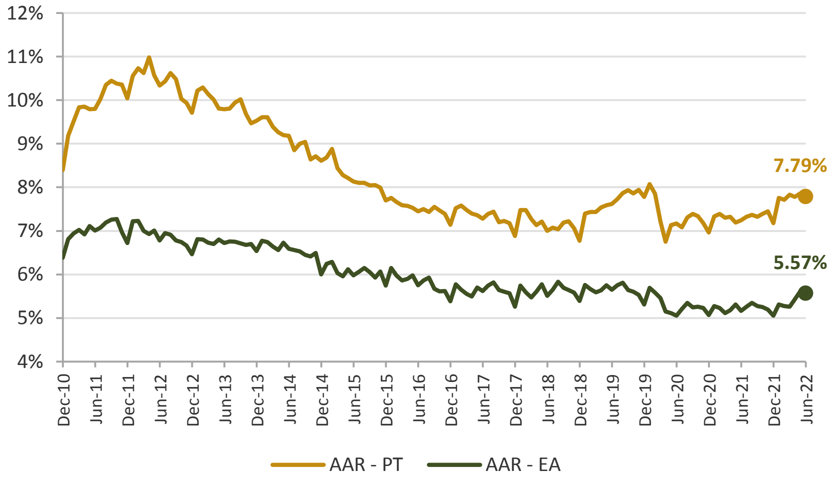
New business - NFC



New business - Housing



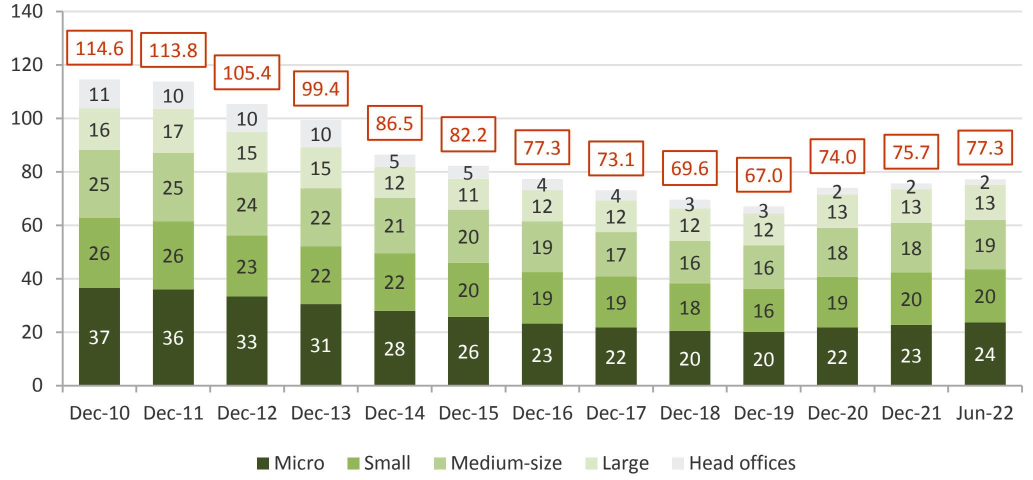
New business - Consumption



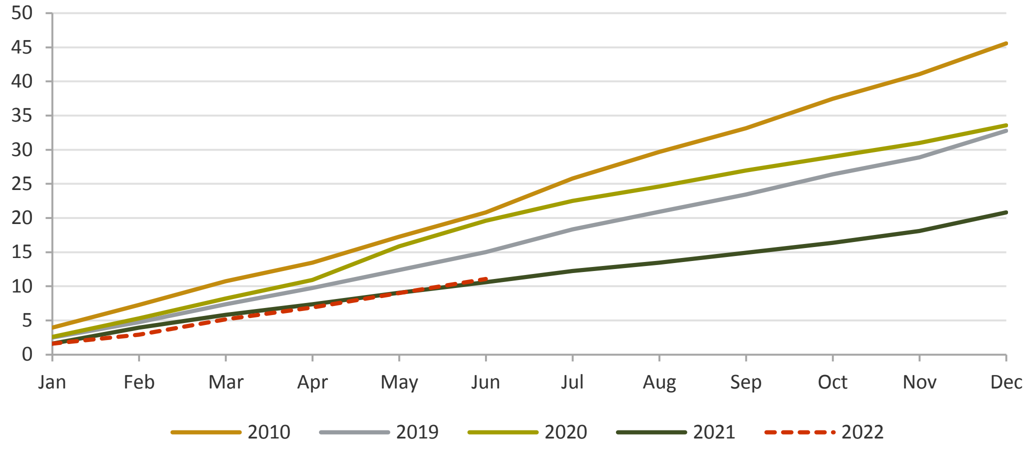
Source: ECB – MFI Interest Rate Statistics. AAR = Annualised agreed rate.

The growth rate of the stock of loans to non-financial corporations (NFCs) has been slowing down, with the deceleration being more marked in the SME segment and the sectors most affected by the pandemic crisis, particularly accommodation and food service activities. In the Euro Area, there has been an acceleration in the annual rate of change of loans to NFCs.

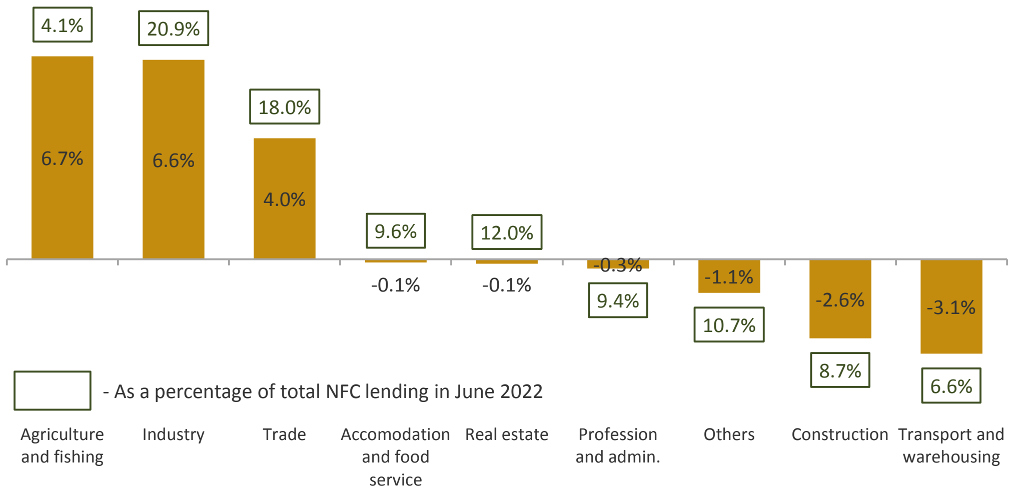
Stock of loans to NFCs (EUR billion)



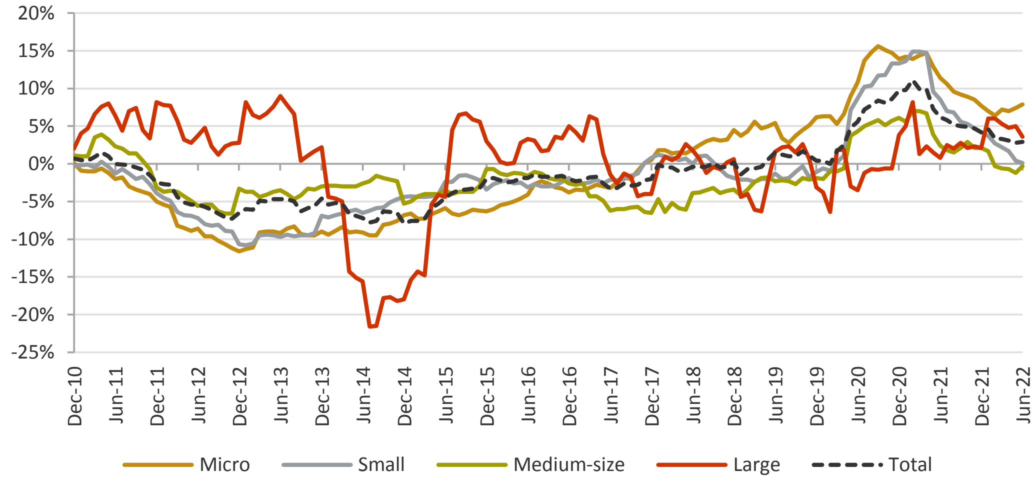
New business lending to NFCs (cumulated amounts, EUR billion)



Year-on-year rate of change of the stock of loans to NFCs (Jun-22)



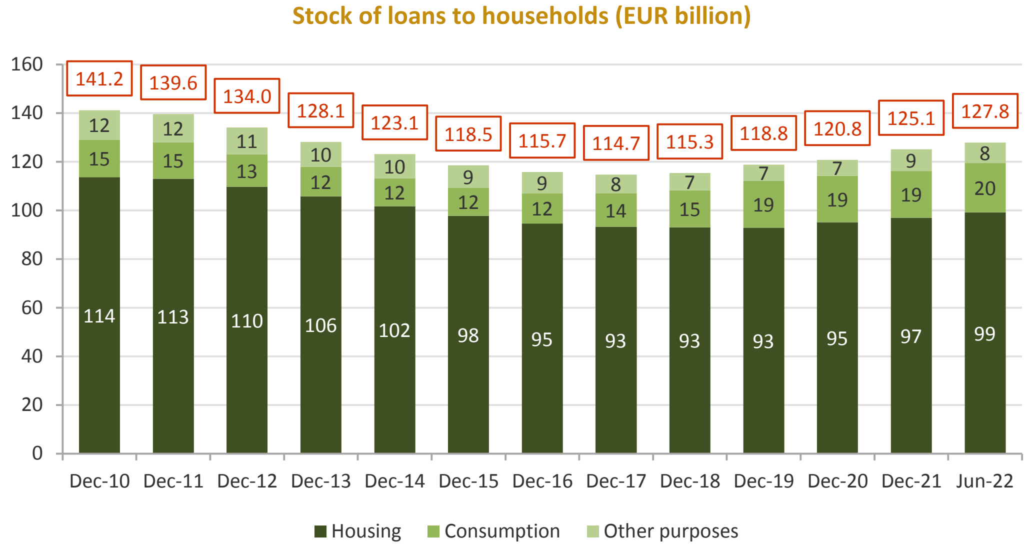
ARC of loans to NFCs

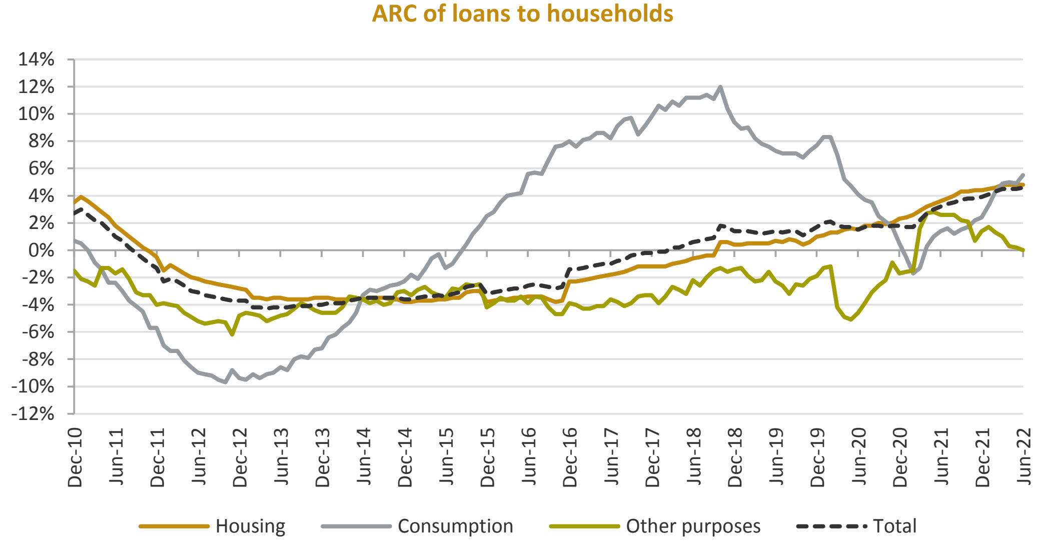


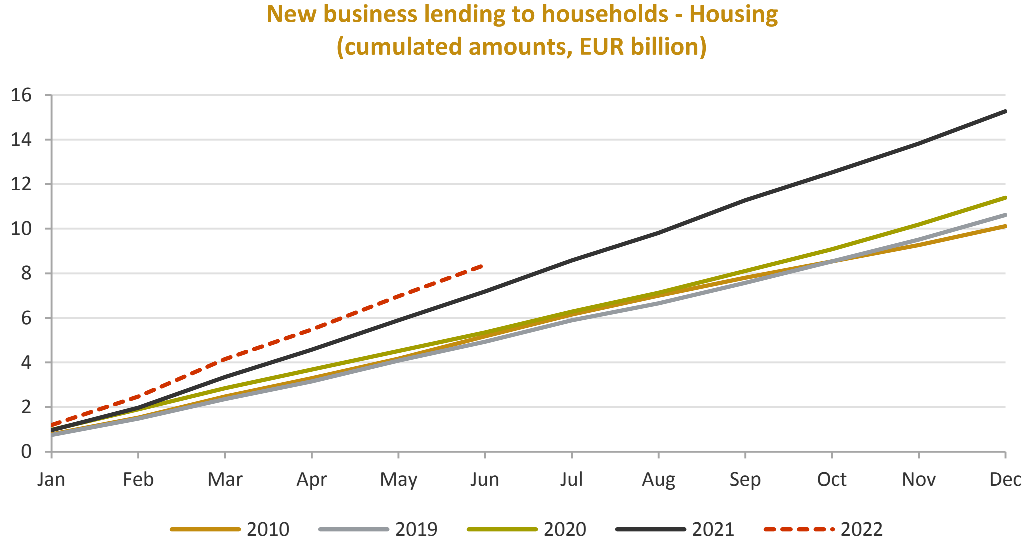
Source: Banco de Portugal (Monetary and Financial Statistics). Loans to NFCs in the domestic activity; counterpart: residents in Portugal. ARC = Annual rate of change.

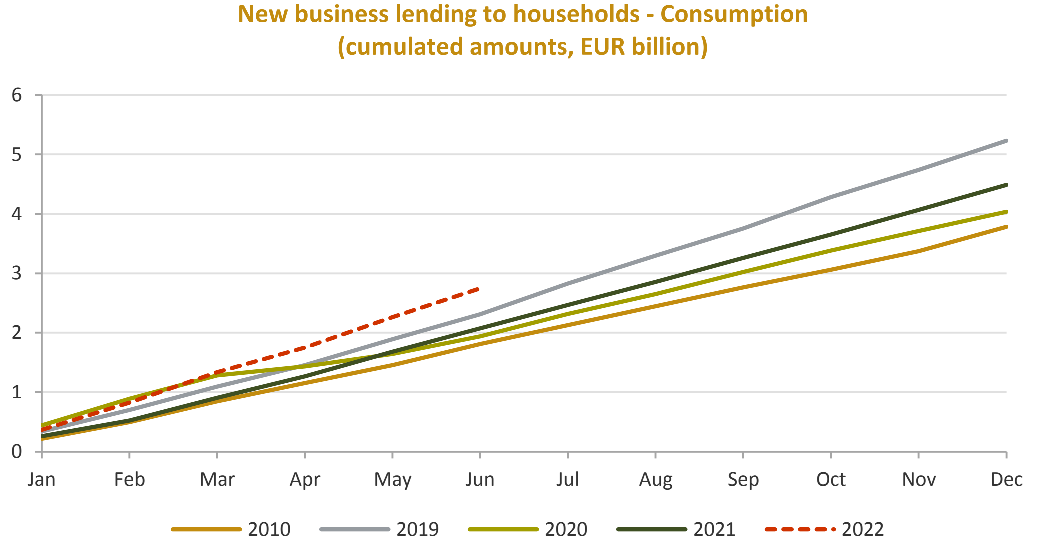
II. LENDING | HOUSEHOLDS

In the first half of 2022, loans to households continued to increase, with an acceleration in consumer credit. In turn, the share of loans to households secured by real estate in the banks' balance sheets decreased to 25% of total assets. The entry into force of the Banco de Portugal's Macroprudential Recommendation in 2018 and the adoption by banks of more prudent lending practices have reinforced the improvement in the risk profile of borrowers and the safety margin to cope with an increase in interest rates or reduction in income.







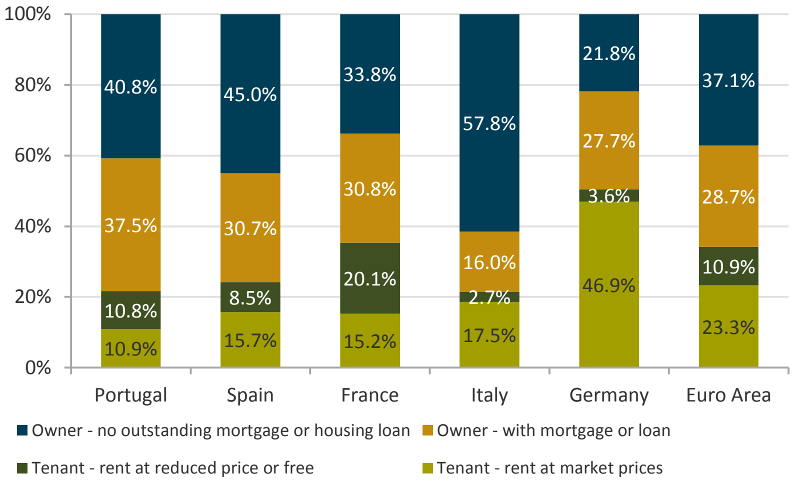


Source: Banco de Portugal (Monetary and Financial Statistics). Loans to households in the domestic activity; counterpart: residents in Portugal. ARC = Annual rate of change.

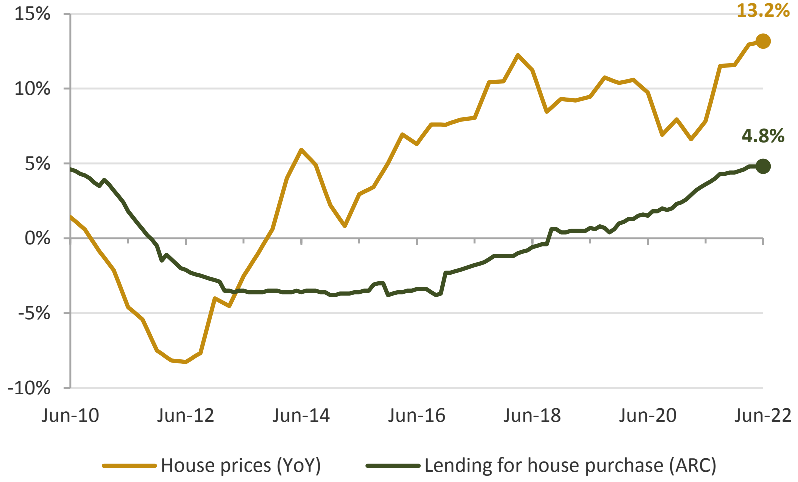
II. LENDING | HOUSEHOLDS | LENDING FOR HOUSE PURCHASE

The higher percentage of homeowners with mortgages (37.5% in Portugal), compared to the average in the Euro Area (28.7%), seems to be associated with the incipient rental housing market. There has been a very significant reduction in the debt service ratio since 2008, explained not only by the decrease in interest rates, but also due to the meaningful reduction in spreads. Domestic bank credit has not been the main factor behind the rise in house prices, as it has been growing at a slower rate, with an increasing percentage of transactions done without recourse to credit.

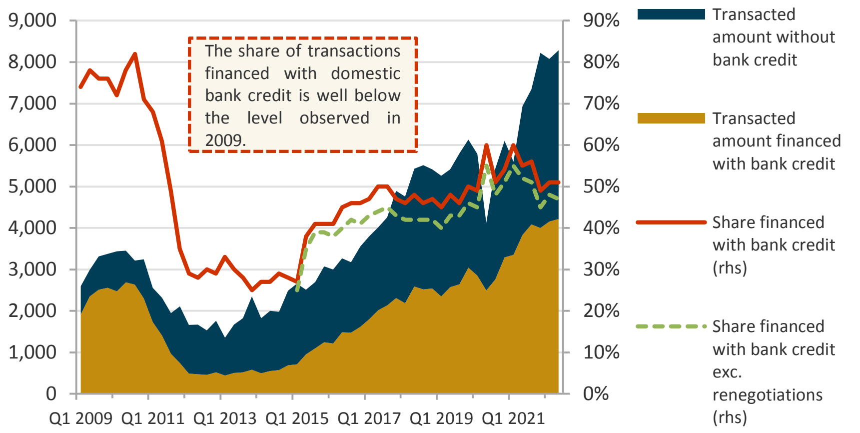
Distribution of population by tenure status (2021)



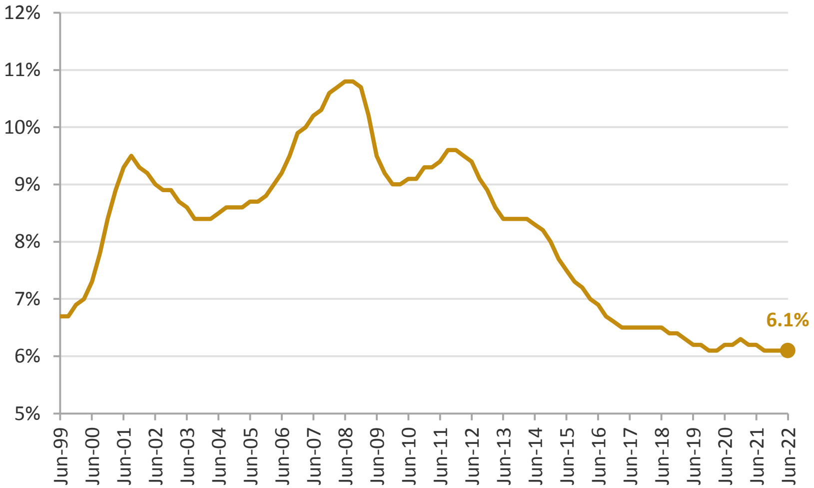
Prices vs. Credit



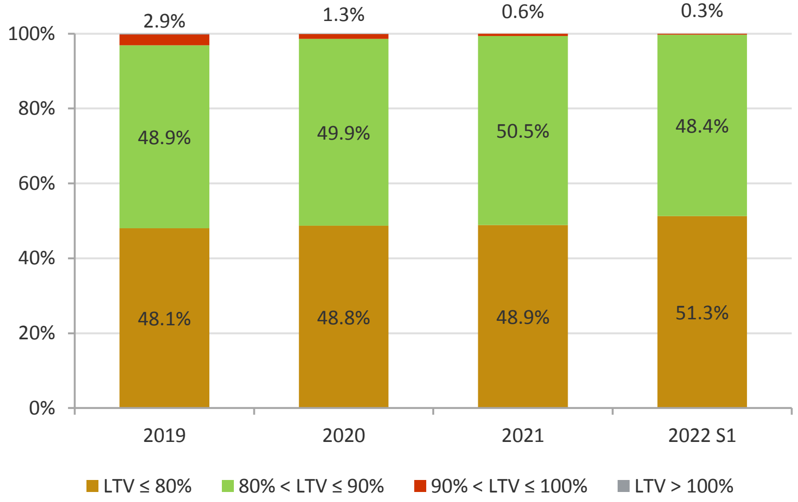
Transactions in dwellings vs. New domestic housing loans (EUR million)



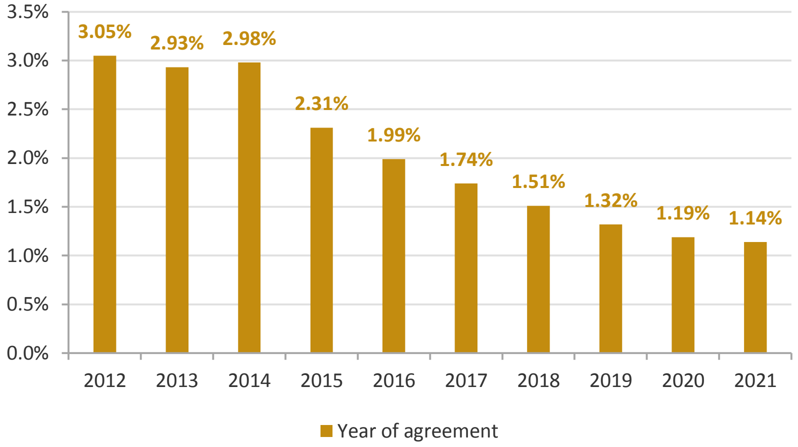
Households debt service ratio



Distribution of new credit for house purchase by LTV ratio



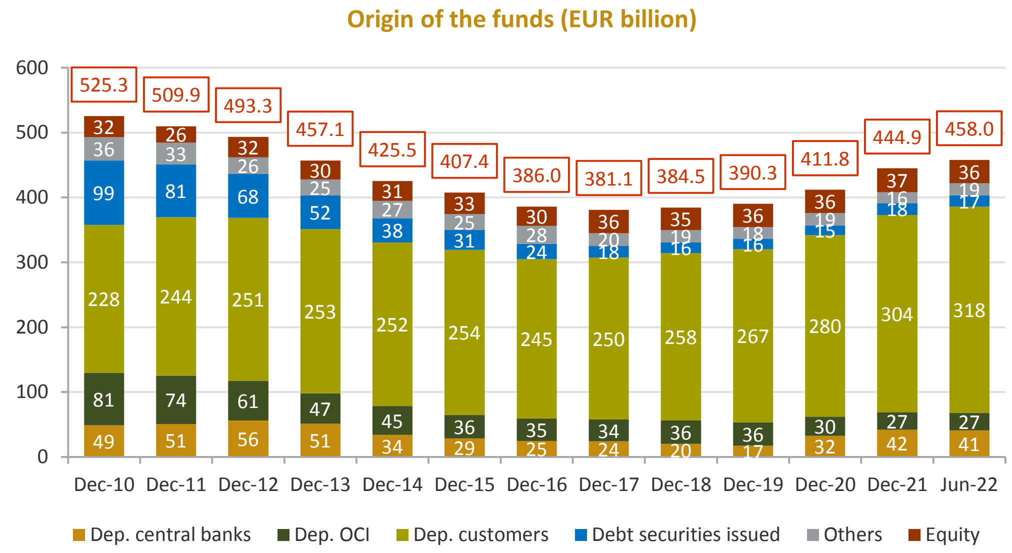
Weighted average spread in variable interest rate contracts indexed to the 3, 6 and 12-month Euribor

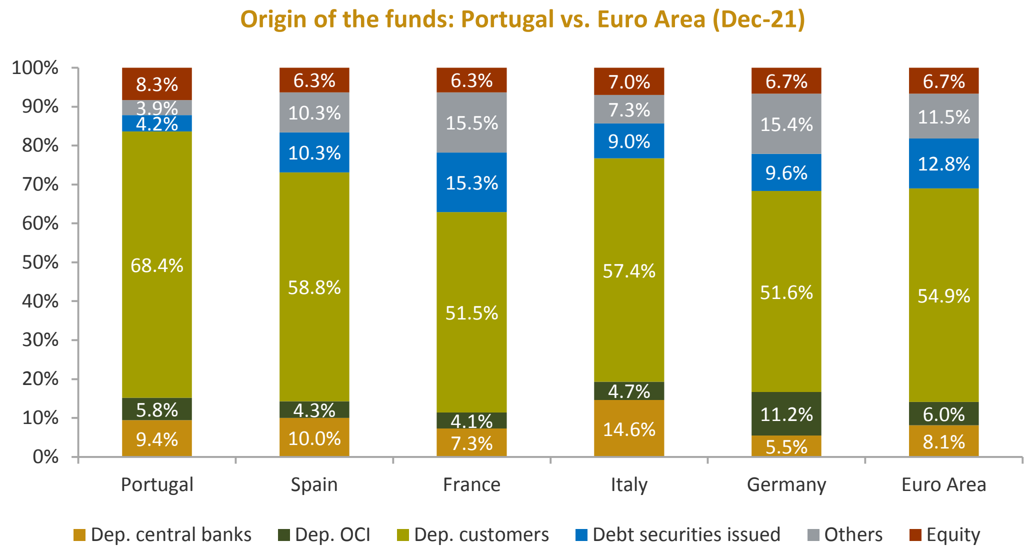


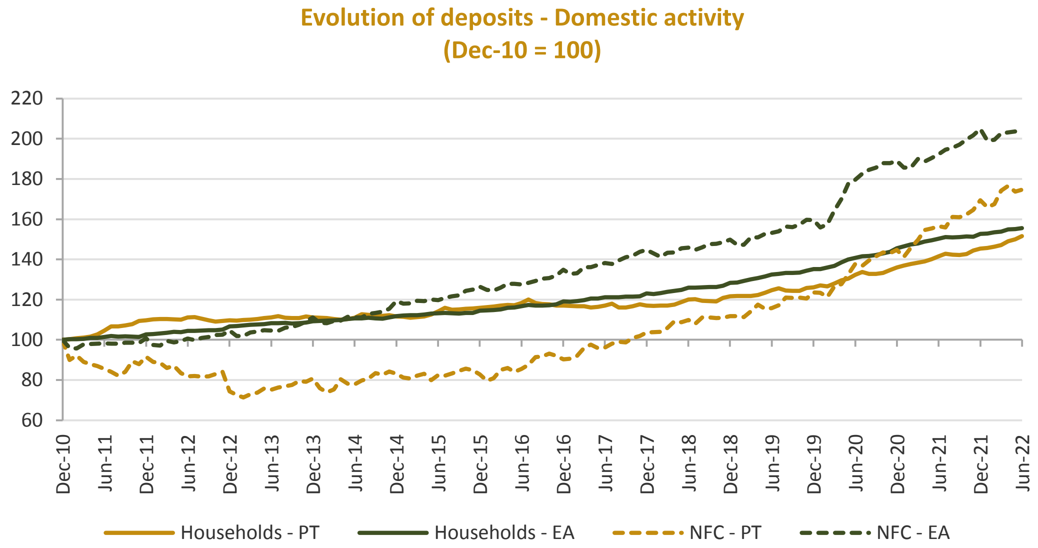
Source: Eurostat, Banco de Portugal, INE – Statistics Portugal and BIS. YoY = Year-on-year rate of change. ARC = Annual rate of change.

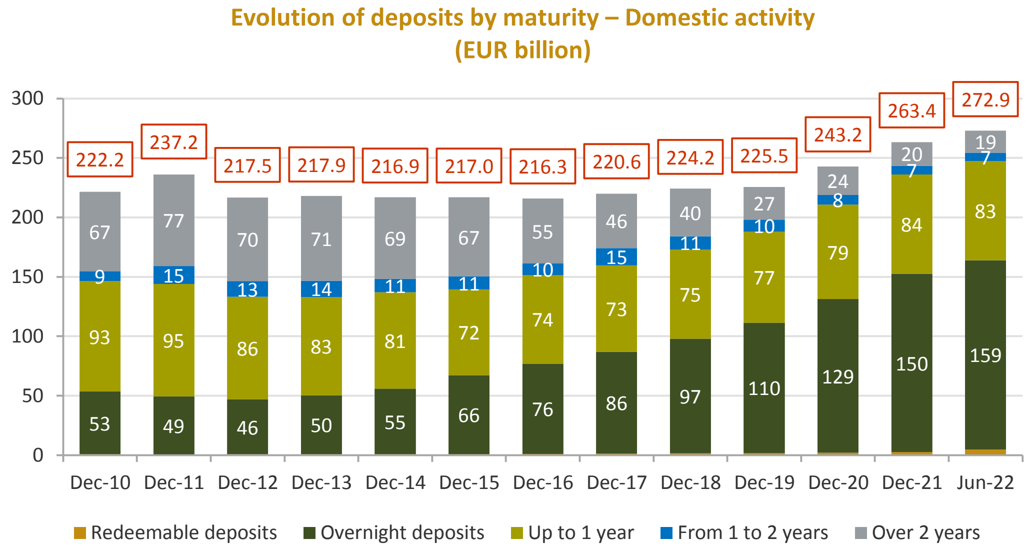
III. ORIGIN OF THE FUNDS AND LIQUIDITY

In the first half of 2022, customer deposits continued to increase significantly. The decrease trend in the share of term deposits and increase in the weight of overnight deposits also remained in place.







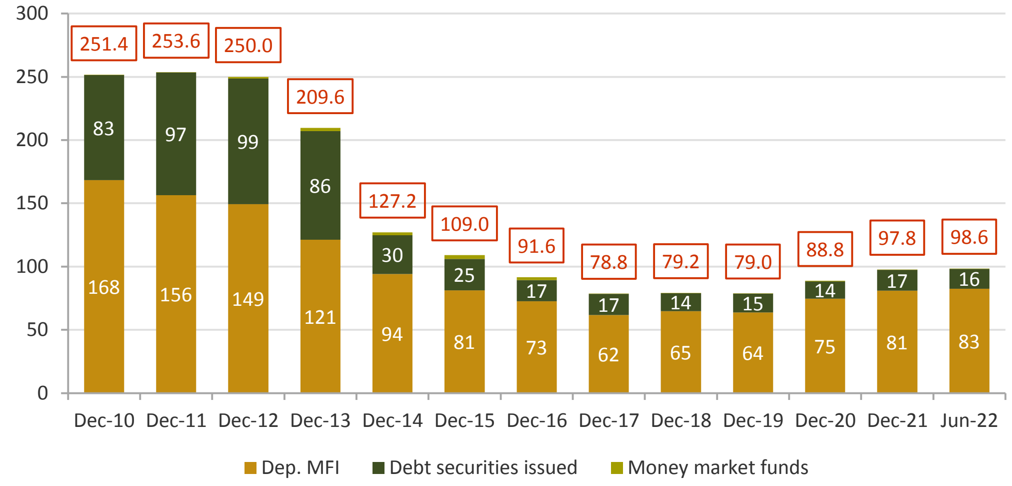


Source: Banco de Portugal (consolidated data and Monetary and Financial Statistics) and ECB – Consolidated Banking Data (consolidated data reported in FINREP format) and MFI Balance Sheet Items (Monetary and Financial Statistics). OCI = Other Credit Institutions.

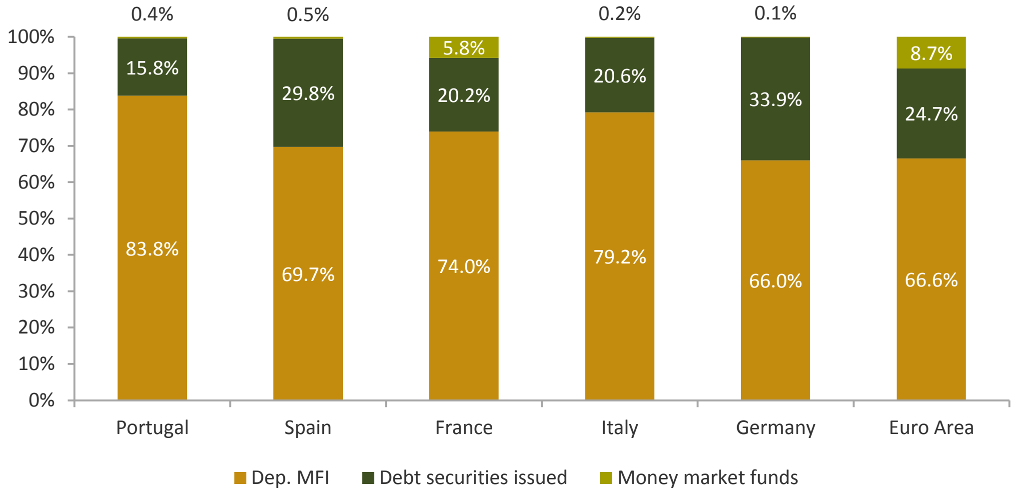
III. ORIGIN OF THE FUNDS AND LIQUIDITY

Recourse to wholesale funding is not very expressive in the banking sector's funding structure. Changes in monetary policy due to very high inflation have already translated into a reduction of borrowing from the Eurosystem during the first half of the year, albeit not very significant.

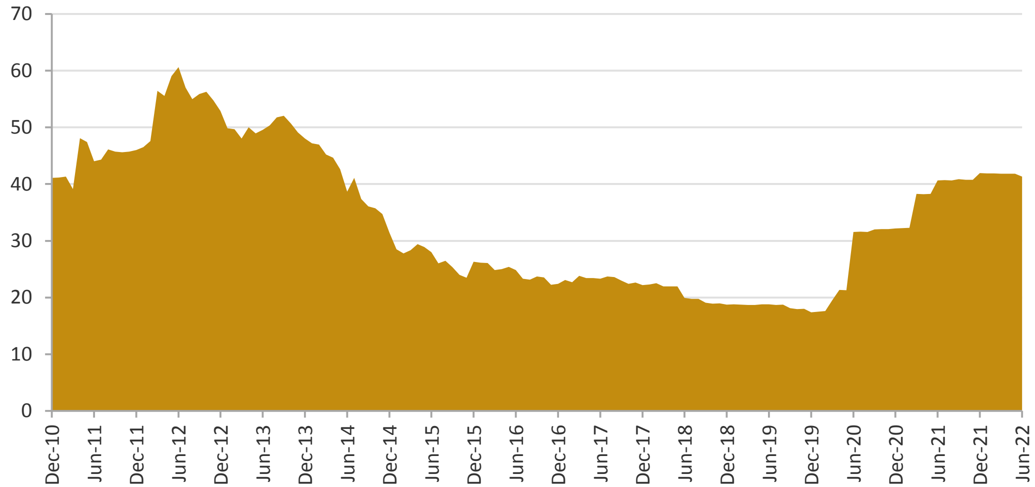
Origin of wholesale funds (EUR billion)



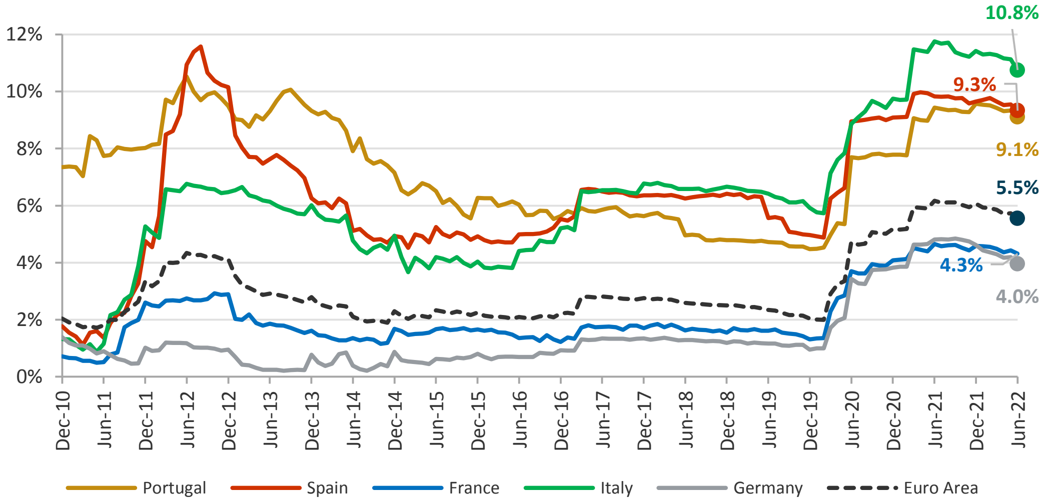
Origin of wholesale funds: Portugal vs. Euro Area (Jun-22)



Borrowing from the ECB (EUR billion)



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

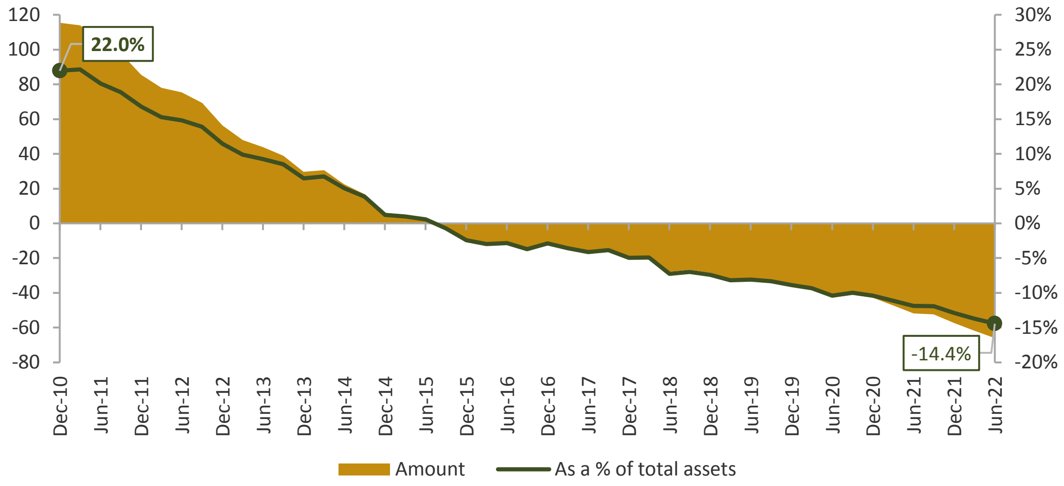


Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics). Origin of wholesale funds from domestic activity. Monetary Financial Institutions (MFI) include Central Banks and Other Monetary and Financial Institutions (OMFI).

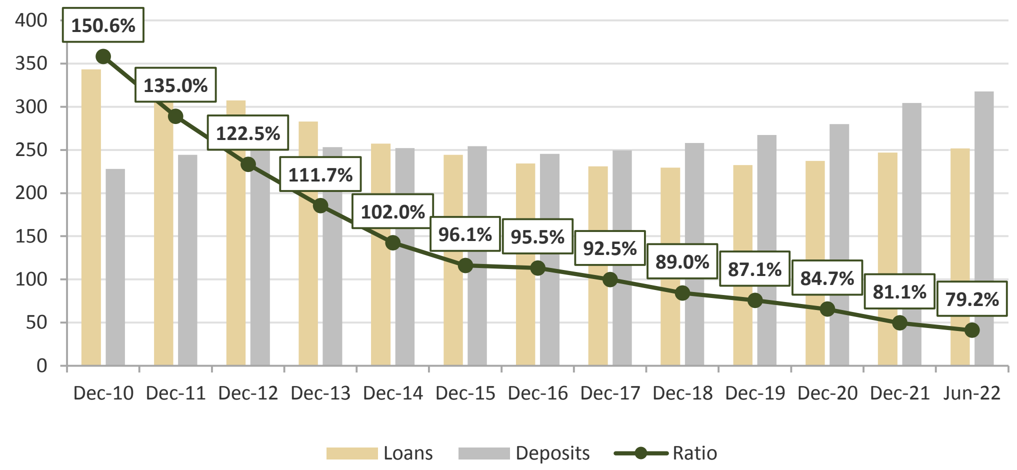
III. ORIGIN OF THE FUNDS AND LIQUIDITY

The Portuguese banking sector has strengthened its extremely comfortable position in terms of liquidity, enabling it to play a critical role in mitigating the impacts of the adverse shocks that have recently affected households and companies. The significant increase in deposits in the first half of 2022, higher than that observed in loans to customers, resulted in a further reduction of the loan-to-deposit ratio.

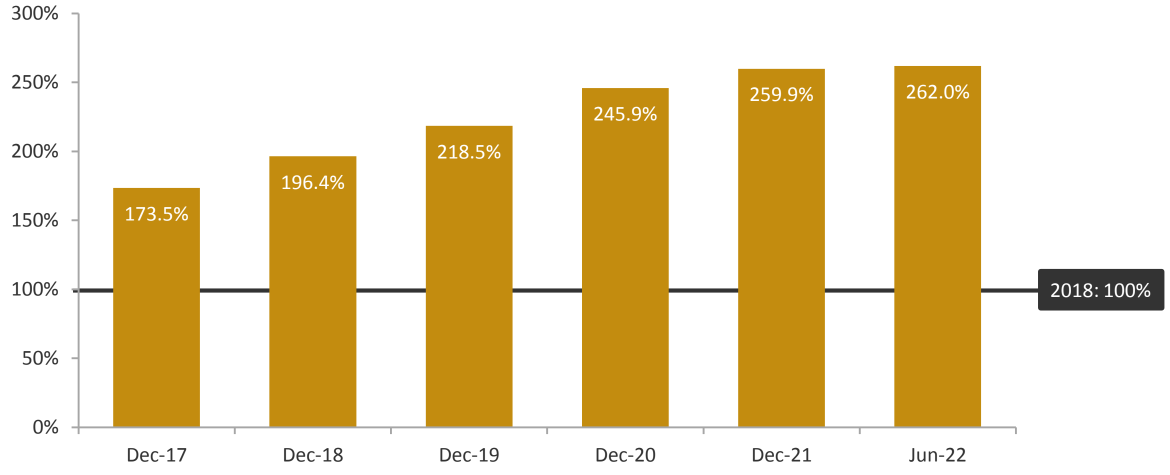
Funding gap (EUR billion and % of total assets)



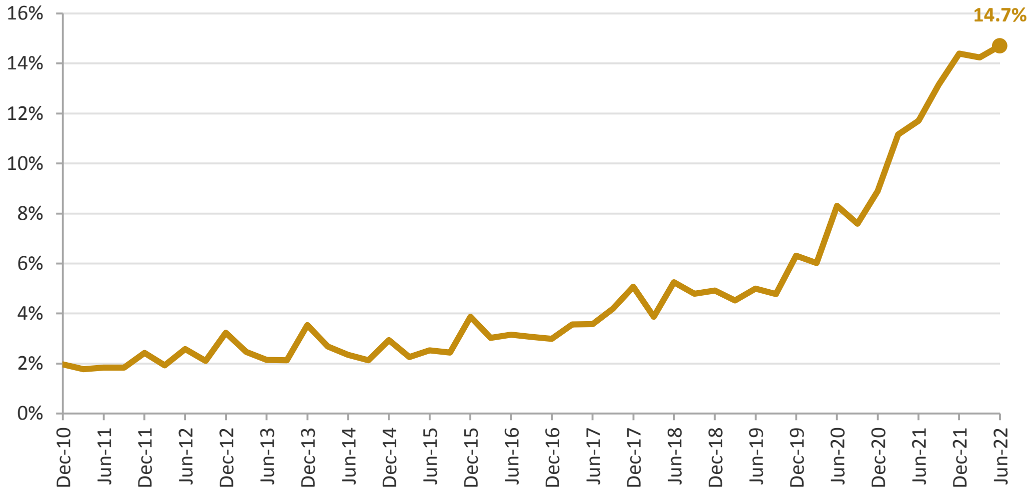
Loan-to-deposit ratio (EUR billion)



Liquidity Coverage Ratio



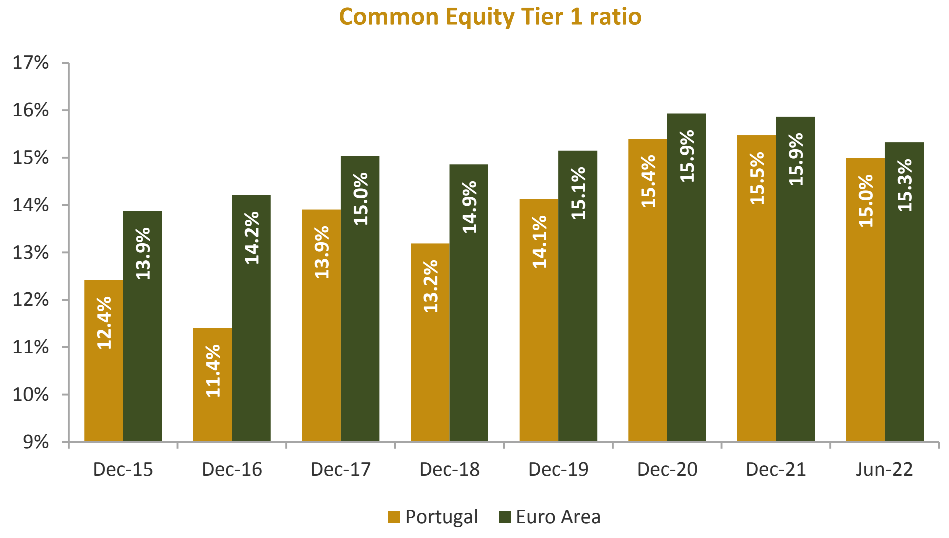
Cash and claims at central banks (% of total assets)

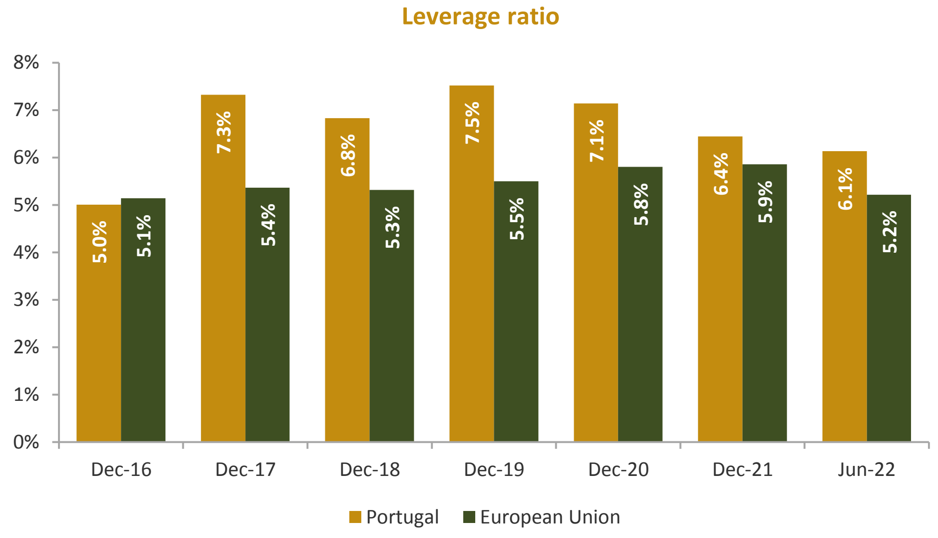


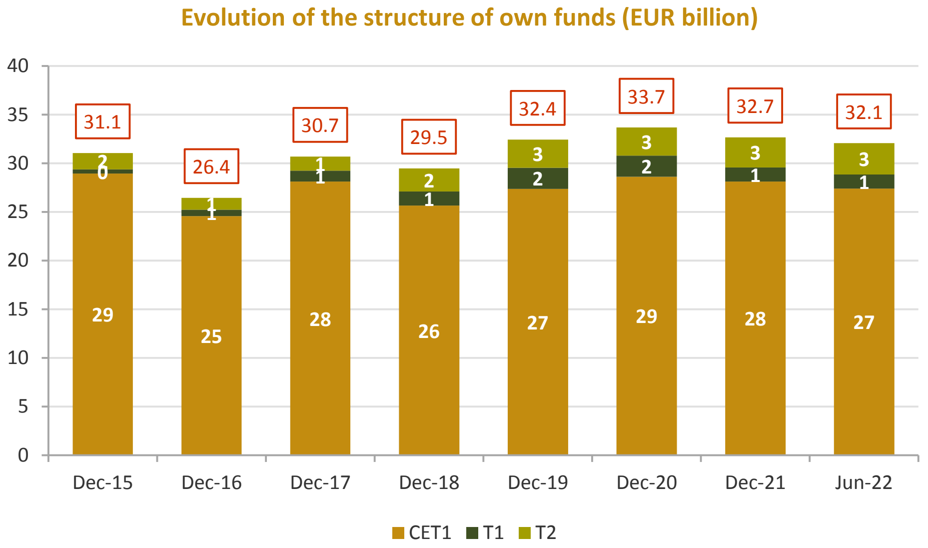
Source: Banco de Portugal (consolidated data).

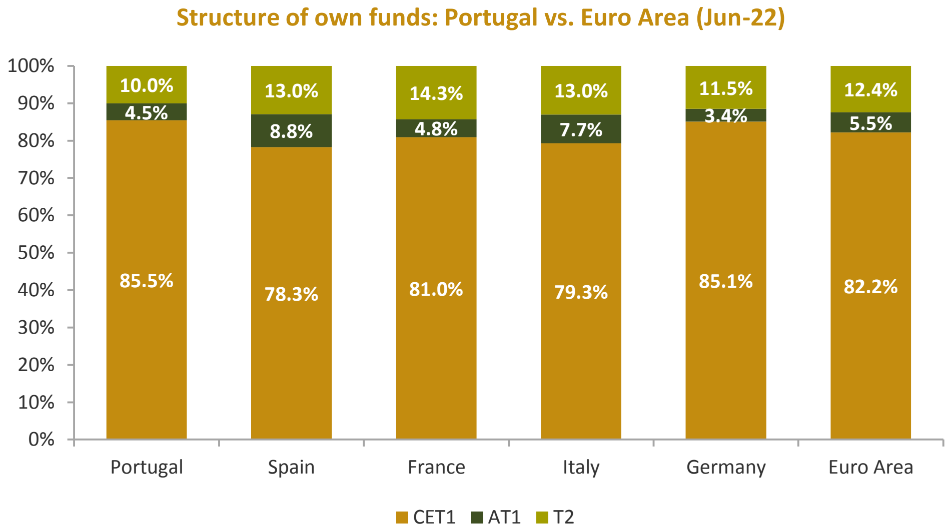
IV. SOLVENCY

The solvency ratios fell in the first half of 2022, but remained at very robust levels owing to the the improvements achieved over the last few years. The leverage ratio also decreased but is considerably higher than the EU average and the regulatory minimum benchmark (3%).







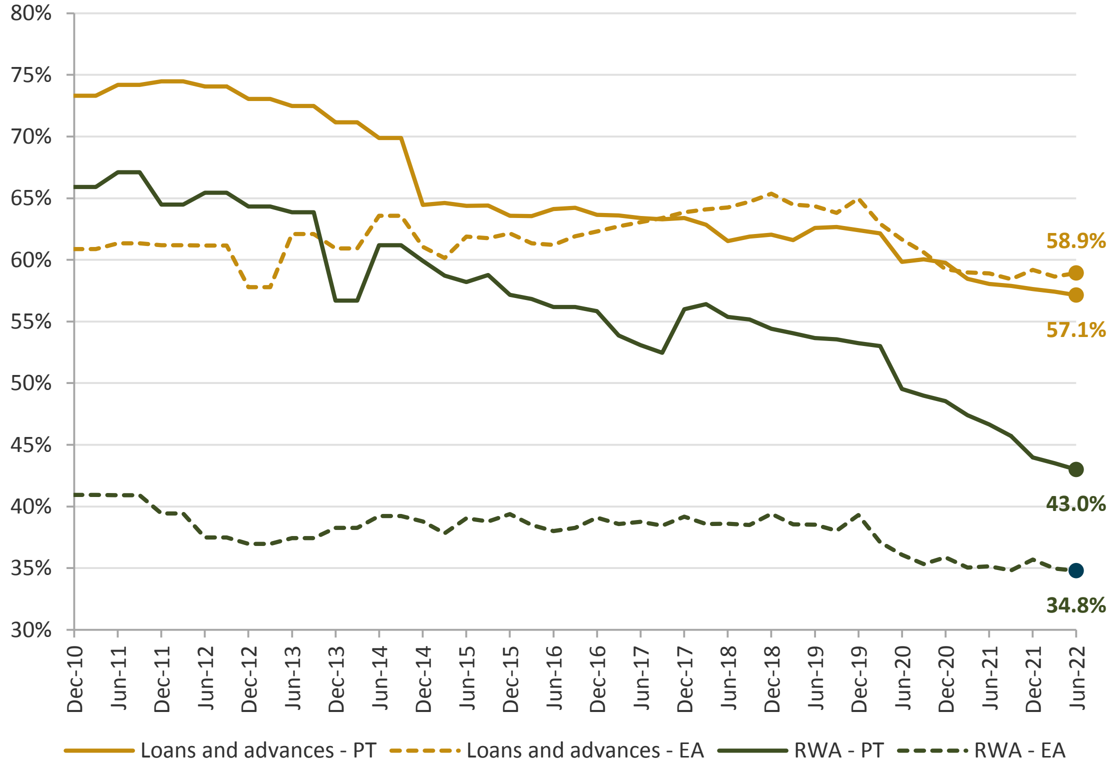


Source: ECB – Consolidated Banking Data and EBA – Risk Dashboard (leverage ratio – fully phased-in definition of Tier 1).

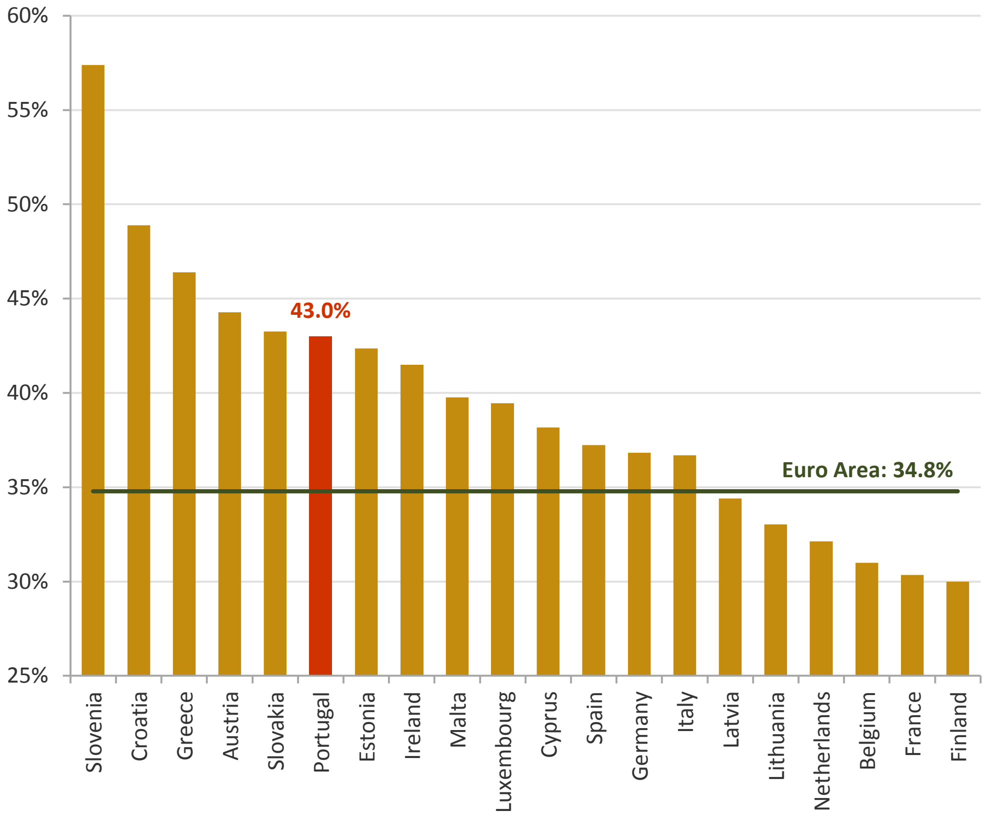
IV. SOLVENCY

The ratio of risk-weighted assets (RWA) per unit of assets for the Portuguese banking sector maintained its downward trajectory, although it 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



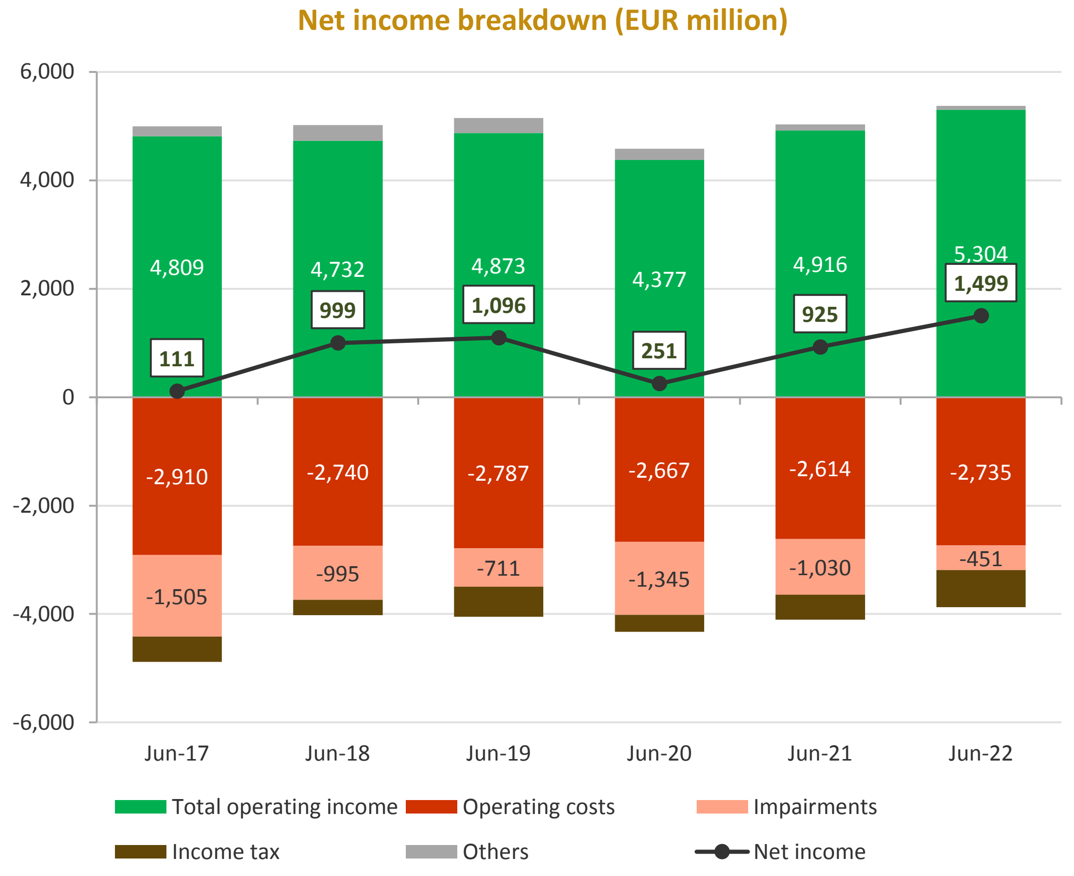
RWA as a % of total assets by country (Jun-22)



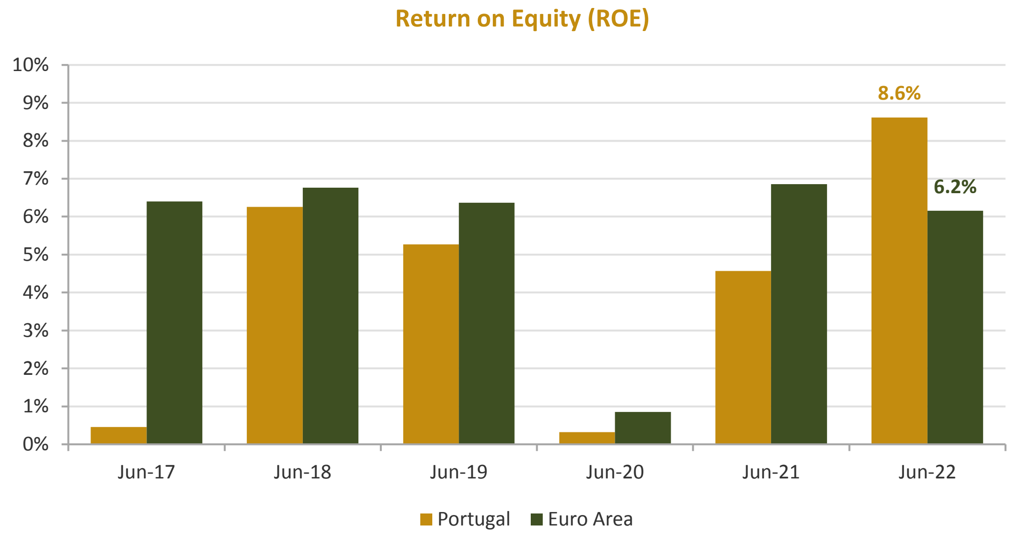
Source: ECB – Consolidated Banking Data.

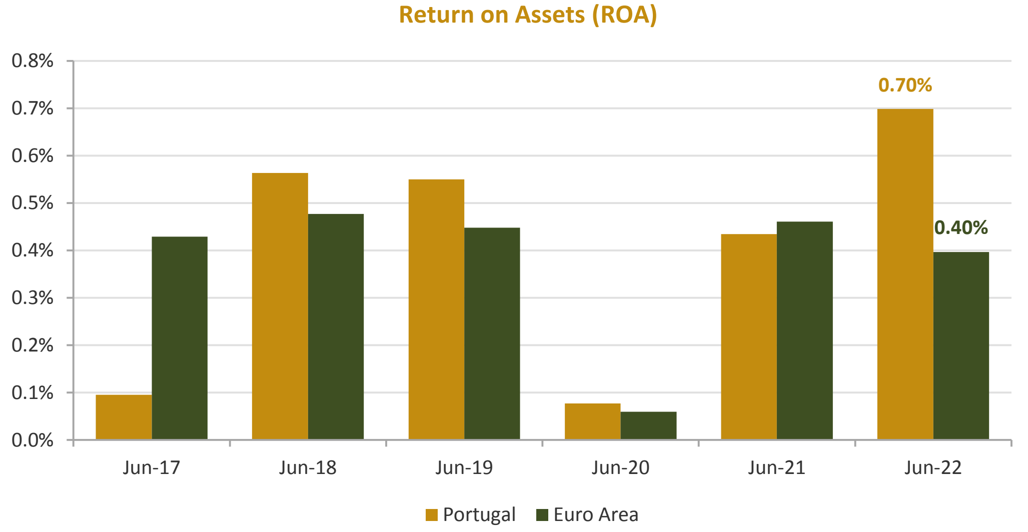
V. PROFITABILITY

The increase in the sector's profitability, in year-on-year terms, was mainly due to the decrease in the flow of credit impairments to accommodate the effects of the pandemic crisis and to the increase in total operating income. Despite the positive evolution, the profitability of the sector (ROE) remains a challenge, considering the high level of uncertainty arising from the current context of the prolonged invasion of Ukraine.



Source: Banco de Portugal (consolidated data).

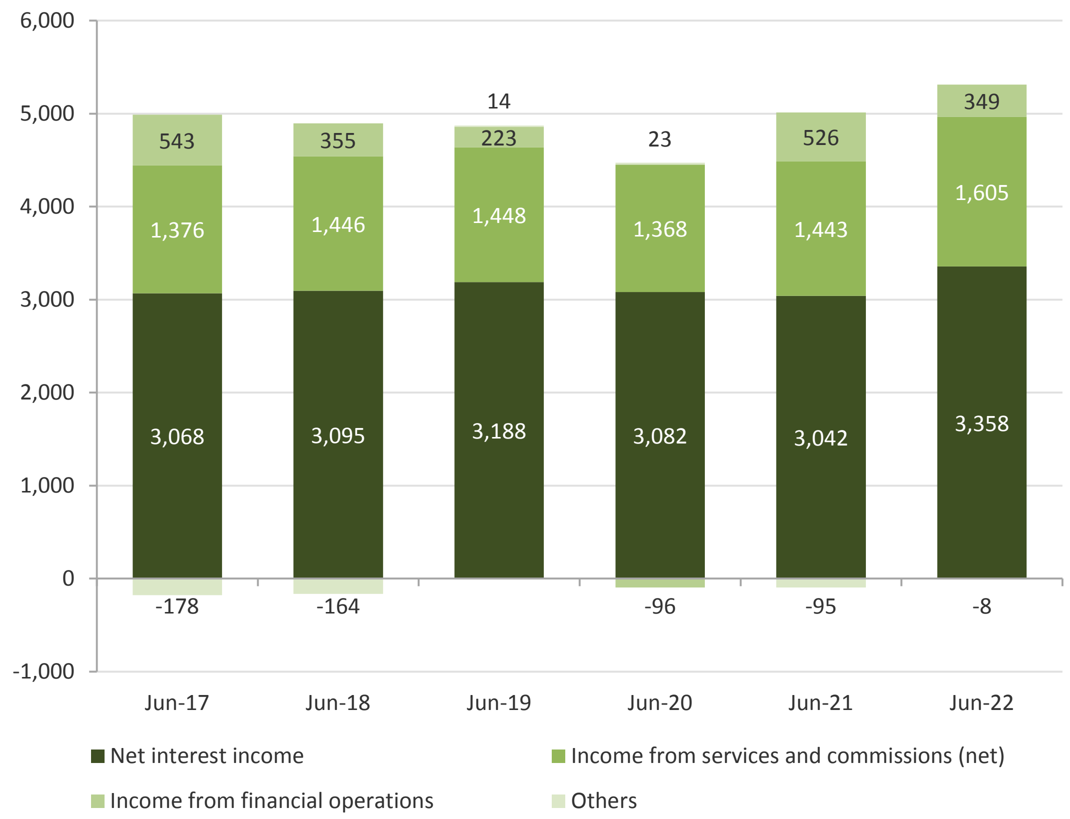




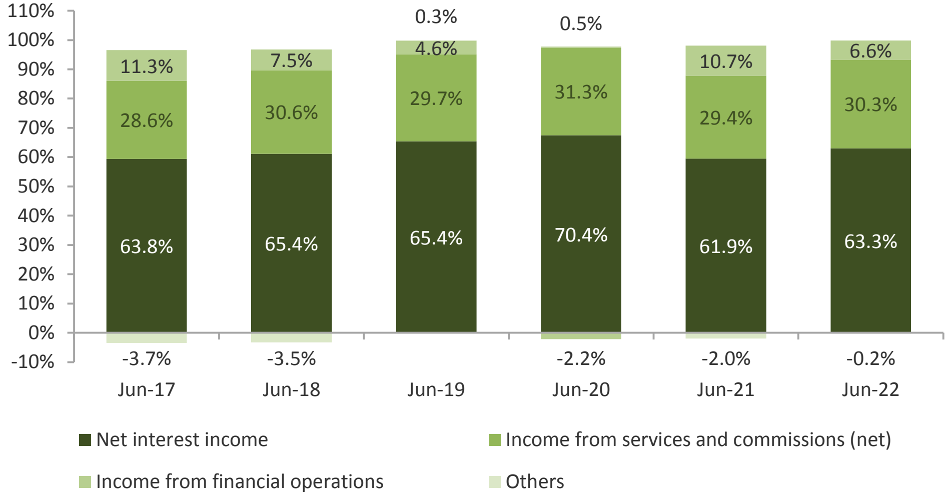
Source: ECB – Consolidated Banking Data. Calculated based on net income after tax and before minority interests and on end-of-period equity and total assets. Return on Equity excludes branches of foreign banks. Annualised data.

The increase in total operating income was explained mainly by the increase in net interest income and, to a lesser extent, by the increase in commissions, which more than offsetted the significant reduction in income from financial operations.

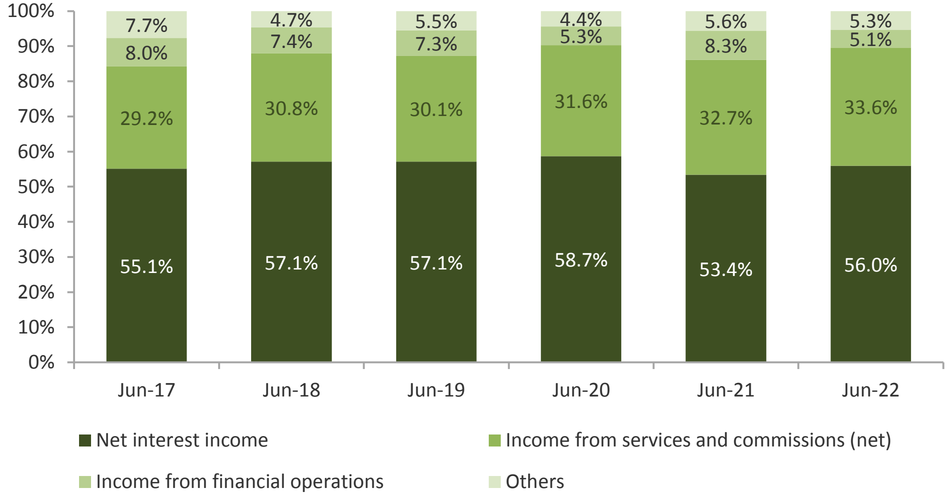
Total operating income breakdown (EUR million)



Total operating income breakdown: Portugal



Total operating income breakdown: Euro Area

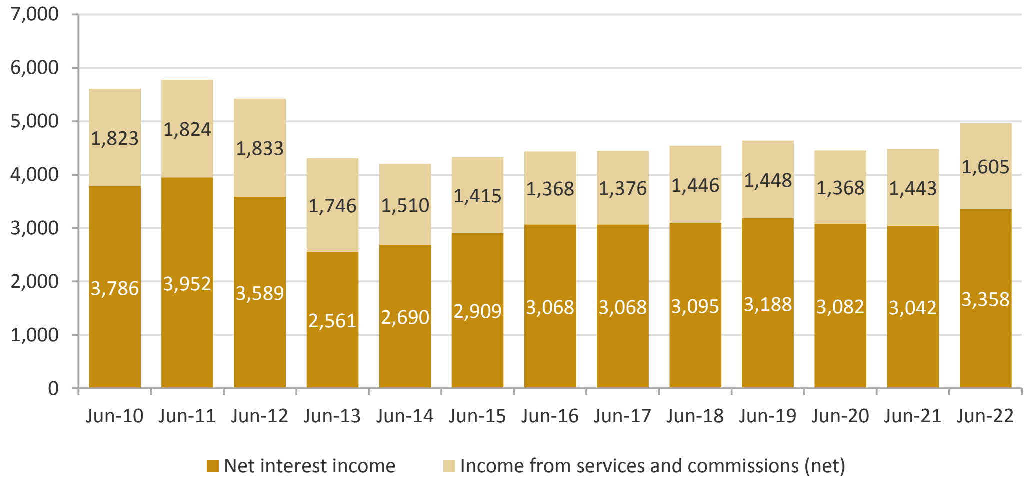


Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data (Euro Area).

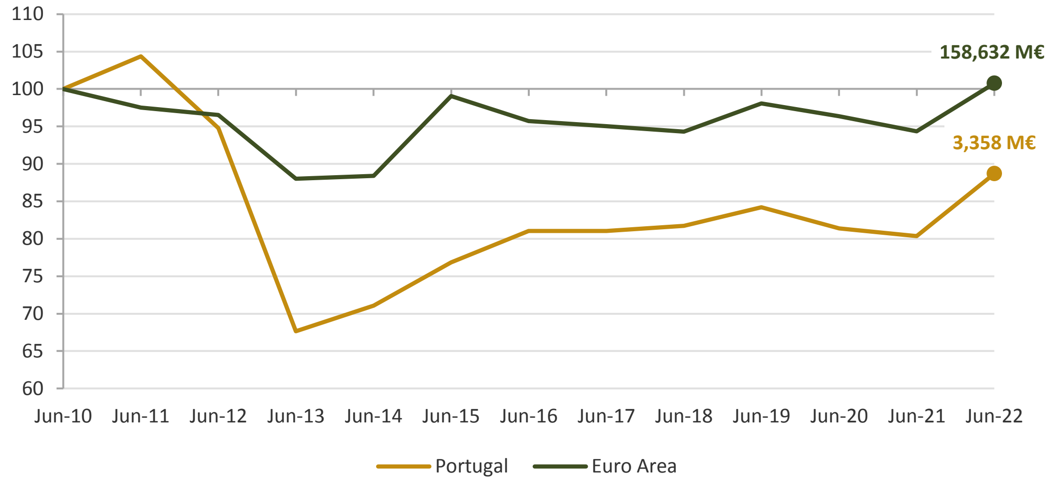
V. PROFITABILITY

Net interest income increased by about 10%, mainly due to the increase in interest income and the volume of performing loans. The evolution of commissions was due to a higher volume of transactions and greater diversification in the application of customers' resources, namely in investment products, following the recovery of economic activity. However, the share of services and commissions in total operating income remains below the European average.

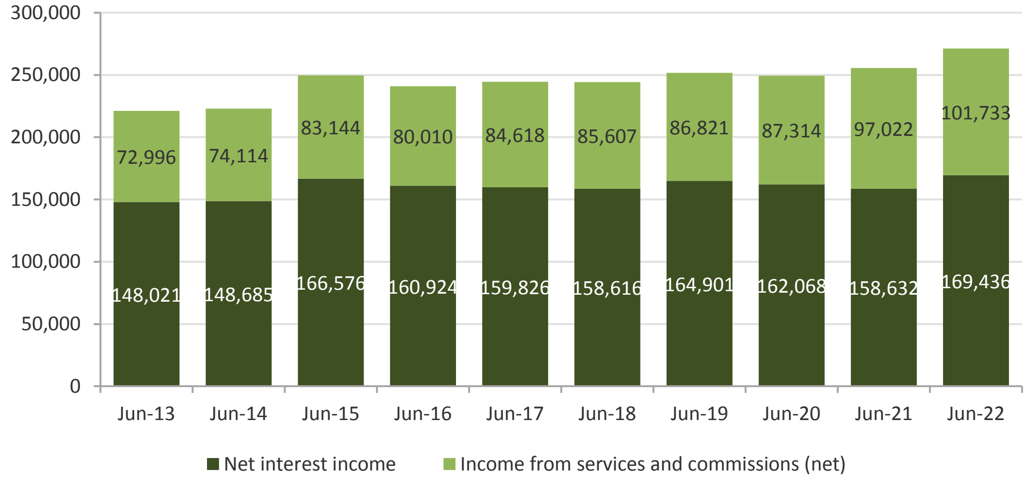
Net interest income and Commissions (EUR million) – Portugal



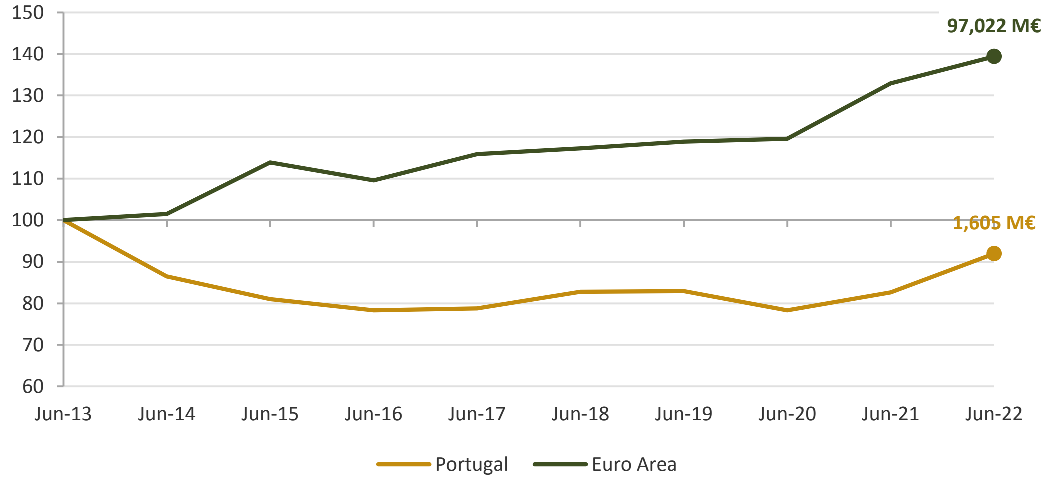
Net interest income (Jun-10 = 100)



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



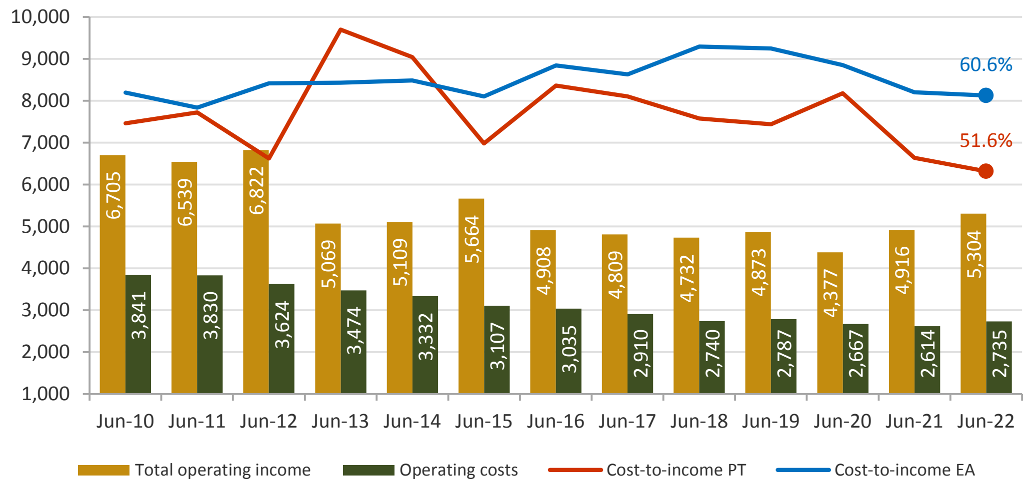
Income from services and commissions (net) (Jun-13 = 100)



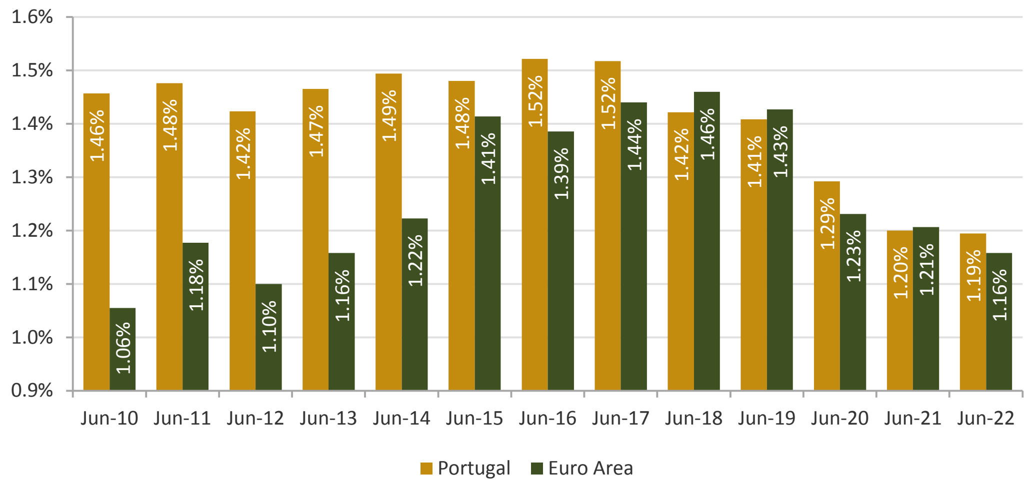
Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data (Euro Area).

In the first half of 2022, the sector's operational efficiency improved further as the cost-to-income ratio fell 1.6 pp to 51.6% due to the rise in total operating income, as operating costs rose slightly. In turn, the fall in the cost of credit risk reflected, above all, the significant decrease in credit impairments caused by the recovery in economic activity compared to the pandemic period and the increase in loans.

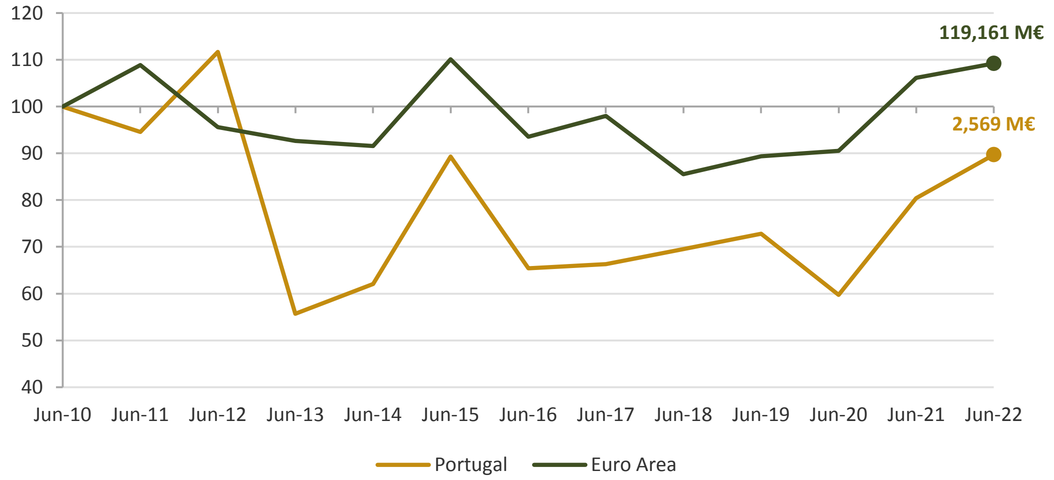
Cost-to-income breakdown (EUR million) – Portugal



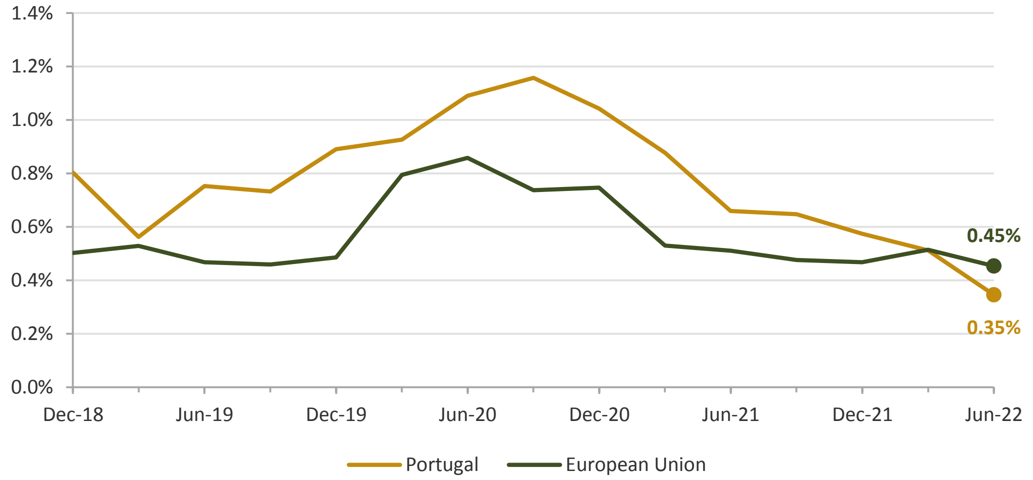
Operating costs as a % of total assets



Net operating income (Jun-10 = 100)

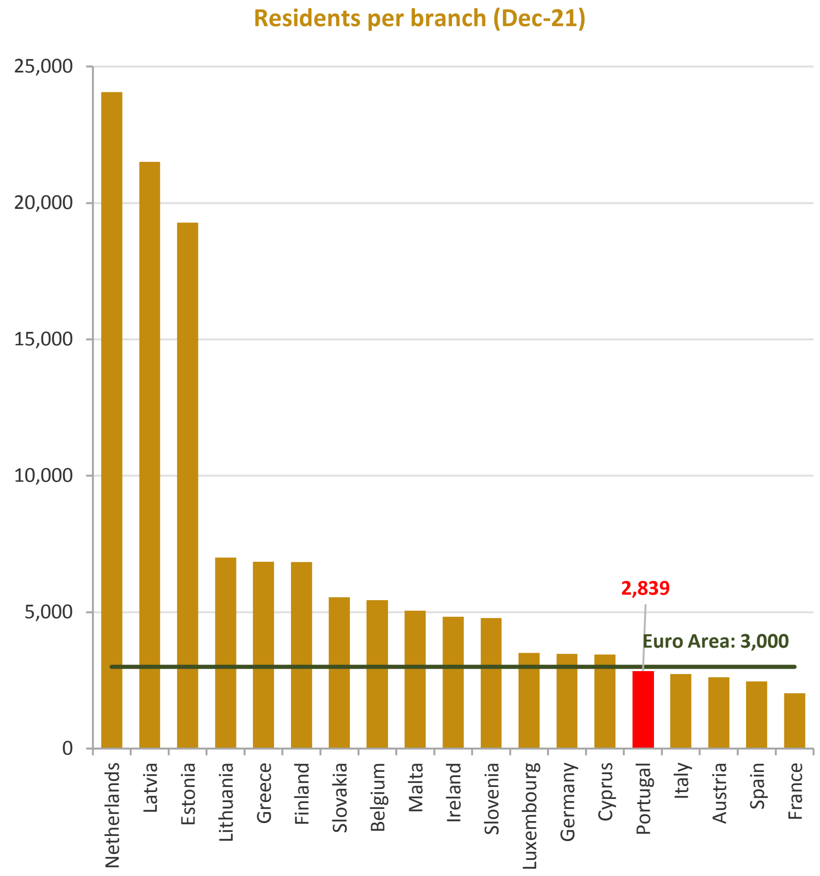


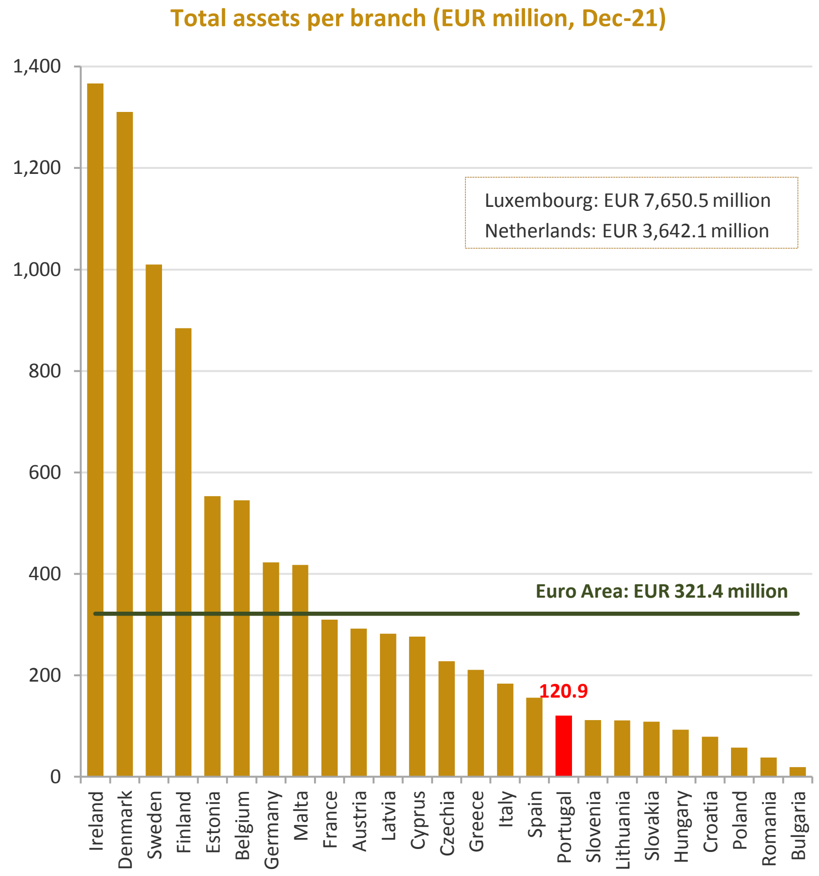
Cost of credit risk

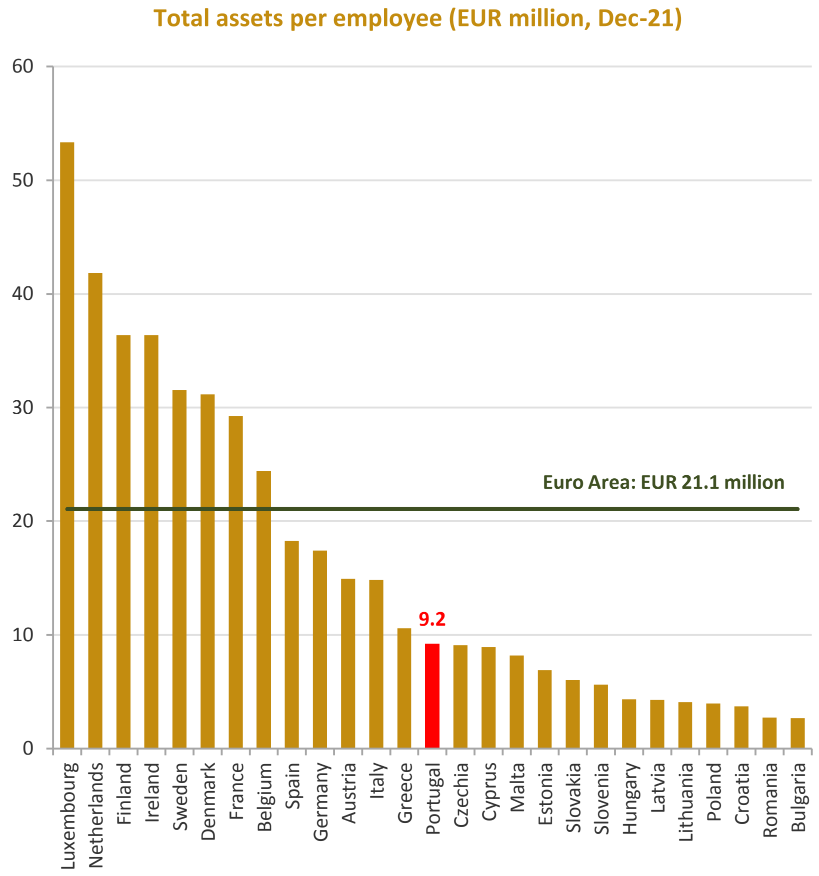


Source: Banco de Portugal (consolidated data), ECB – Consolidated Banking Data (Euro Area), and EBA – Risk Dashboard (cost of credit risk). In June 2022, EBA's sample included 161 European banks, including 30 subsidiaries (Portugal: BCP, CGD, LSF Nani Investments, and Santander). The methodology to calculate 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).

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.







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 5 December 2022.

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ASSOCIAÇÃO PORTUGUESA DE BANCOS

JUNE 2022