

PORTUGUESE BANKING SECTOR OVERVIEW

JUNE 2023

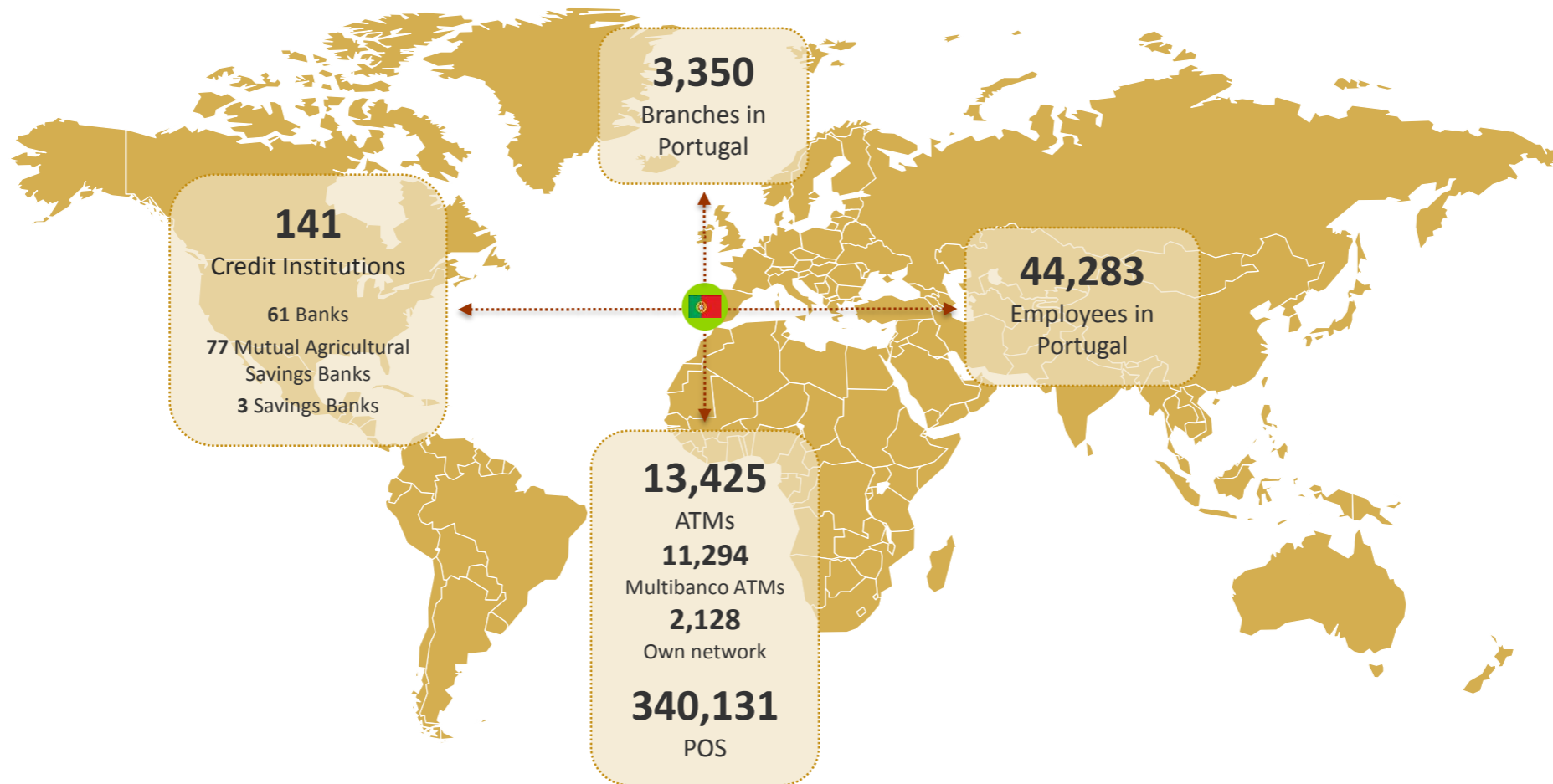
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- II. Financial Position
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- ❑ **In the first half of 2023, the banking sector's profitability improved again significantly.** This evolution was broadly explained by the strong rise in net interest income, which was mainly caused by the sharp increase in interest rates reflecting the monetary policy normalisation process. This improvement occurred despite an increase in the flow of credit impairments, operating costs and taxes.
- ❑ **The sector's total assets fell 1.8% compared to December 2022** despite the increase in sovereign debt securities by 5.5 billion euros (+5.9%). This reduction is mainly related to the decrease in cash/liquidity with a reduction in cash balances at central banks of 10.6 billion euros (-19.7%) and in deposits in other credit institutions of 993 million euros (-19.3%). Loans to customers in net terms decreased by 1.1 billion euros (-0.4%).
- ❑ **On the liabilities side, customer deposits decreased in the first half of 2023**, mainly due to the decrease of deposits from households that were reallocated to the subscription of savings certificates (public debt) and used to repay debt. 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.
- ❑ **Solvency ratios strengthen in the first half of 2023** mostly due to retained earnings. The Common Equity Tier 1 ratio rose to 16.4%, and the leverage ratio to 6.9% and stood at a considerably higher level than the EU average and the minimum regulatory benchmark (3%).
- ❑ **The banking sector continued to show resilience and to respond efficiently to the economy's financing needs. However, the banking sector should 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

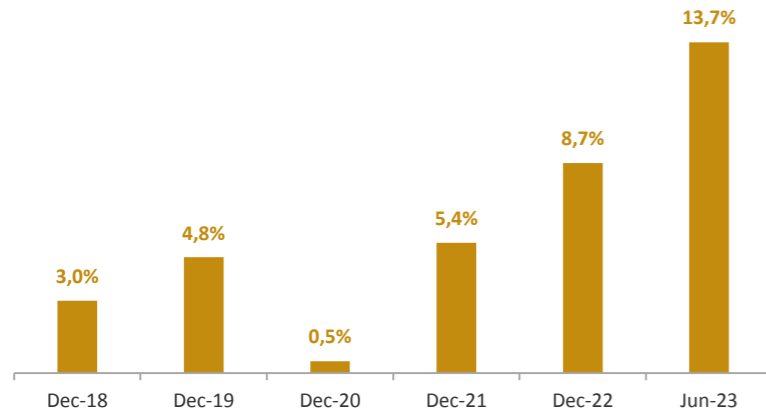


Source: APB's associates (branches, employees and payment systems) and Banco de Portugal (credit institutions).

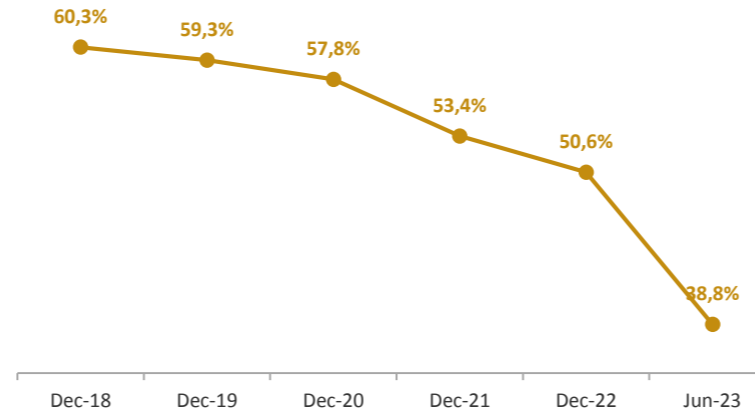
I. RECENT EVOLUTION AND MAIN INDICATORS

Despite the context of persistent geopolitical tensions, given the effects of Russia's invasion of Ukraine, inflationary pressures, higher interest rates and the consequent negative impact on the outlook for economic growth, the banking sector demonstrated robustness and resilience and continued to respond efficiently to the economy's financing needs.

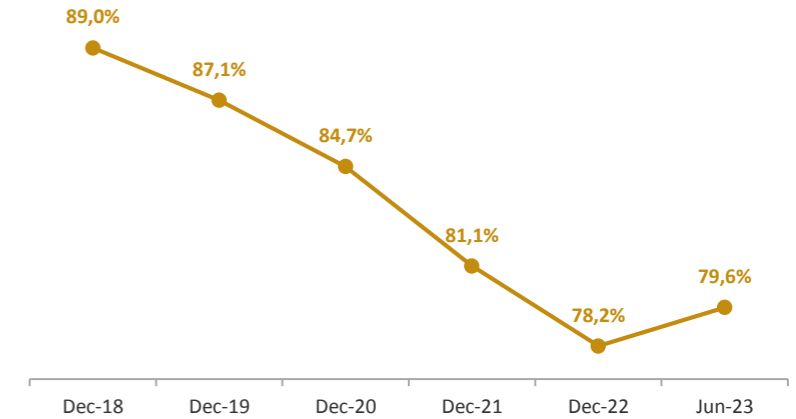
Return on Equity



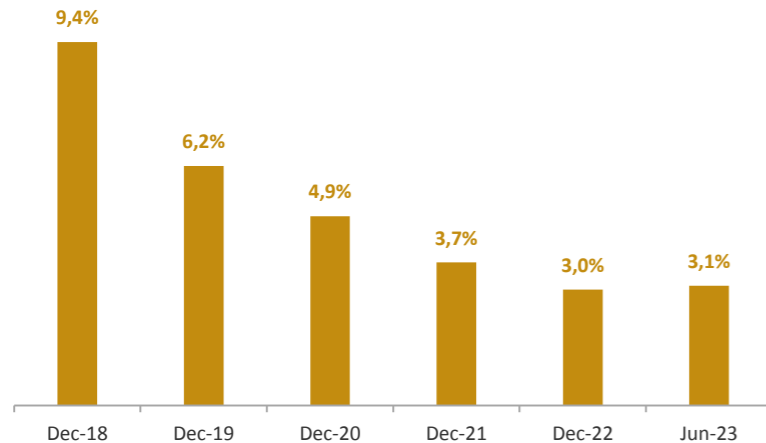
Cost-to-Income



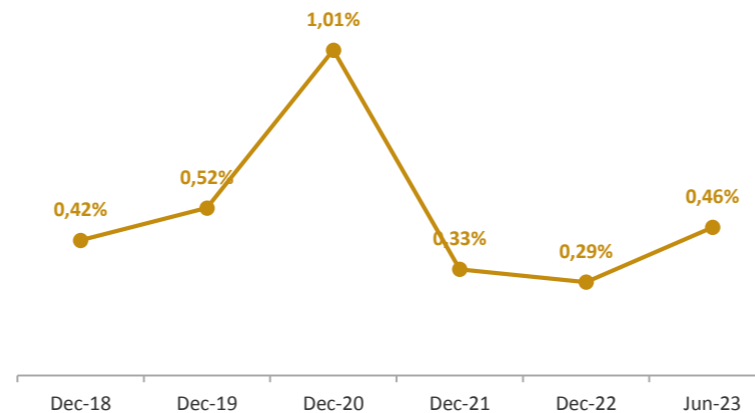
Loan-to-deposit ratio



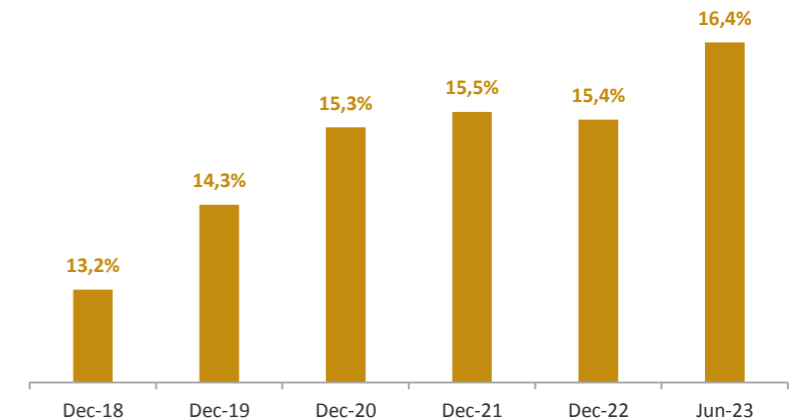
Non-Performing Loans ratio



Cost of credit risk



Common Equity Tier 1 ratio

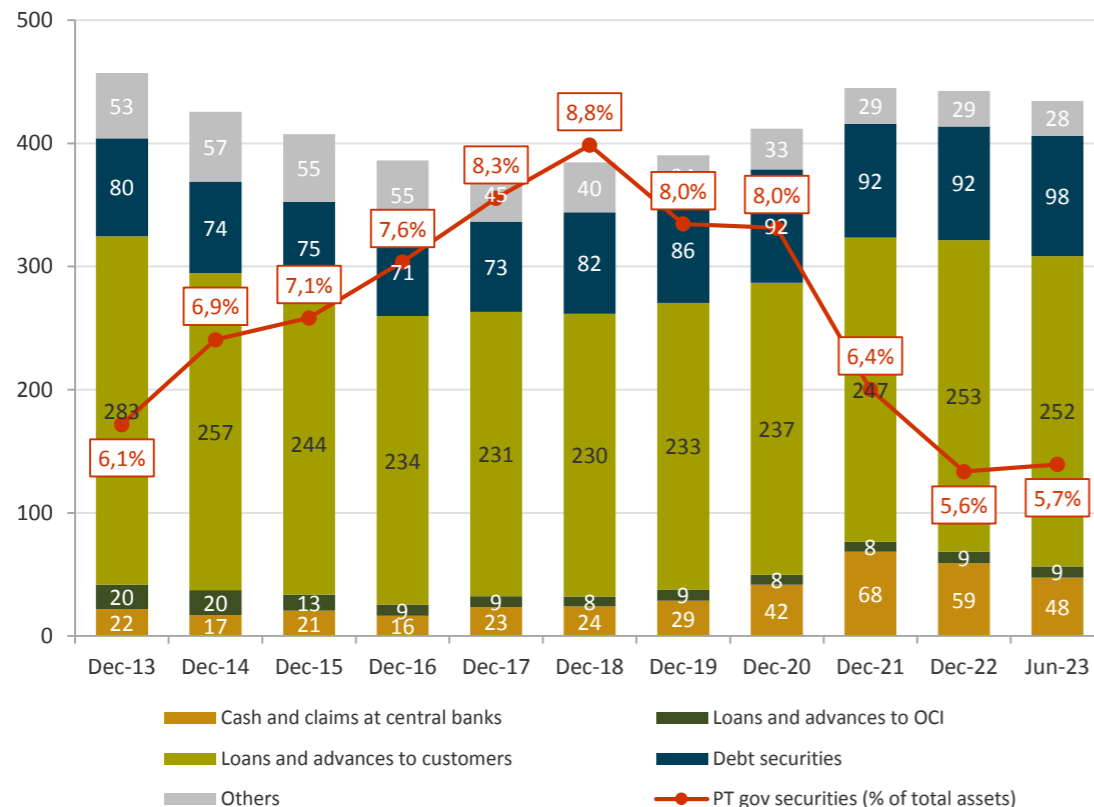


Source: Banco de Portugal (consolidated data). Return on Equity is calculated based on net income after tax and before minority interests and average equity.

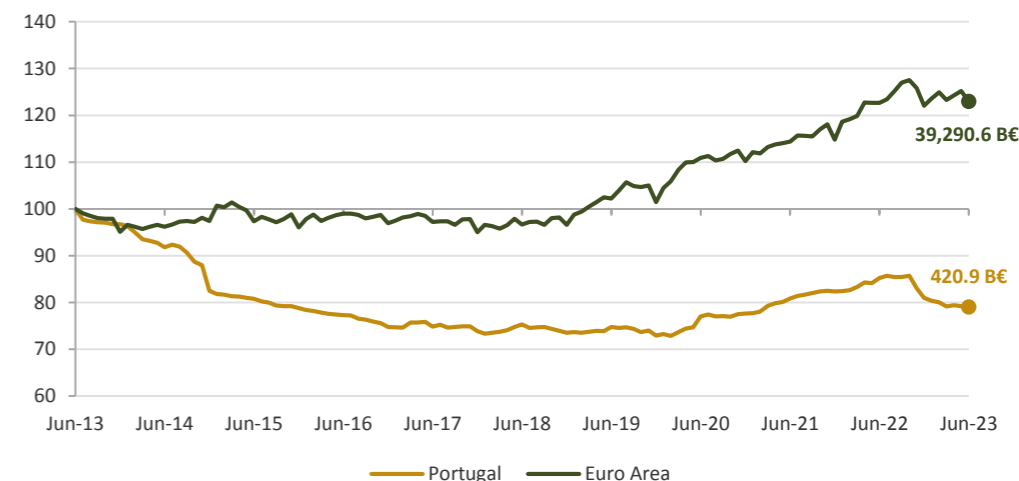
II. FINANCIAL POSITION

In the first half of 2023, the Portuguese banking sector's total assets continued their downward trend, falling by 1.8% compared to December 2022, despite an increase in debt securities of 5.5 billion euros (+5.9%). This decrease resulted from the reduction in cash and claims at central banks with a decrease in deposits held with central banks of 10.6 billion euros (-19.7%) and deposits held with other credit institutions of 993 million euros (-19.3%). Loans to customers in net terms fell by 1.1 billion euros (-0.4%).

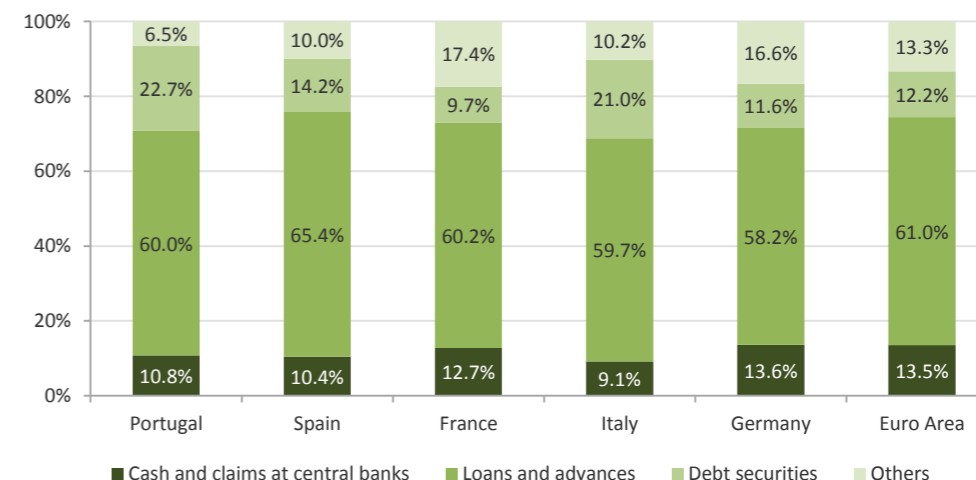
Total assets breakdown (EUR billion)



Total assets evolution – domestic activity (Jun-13 = 100)



Total assets breakdown: Portugal vs. Euro Area (Jun-23)



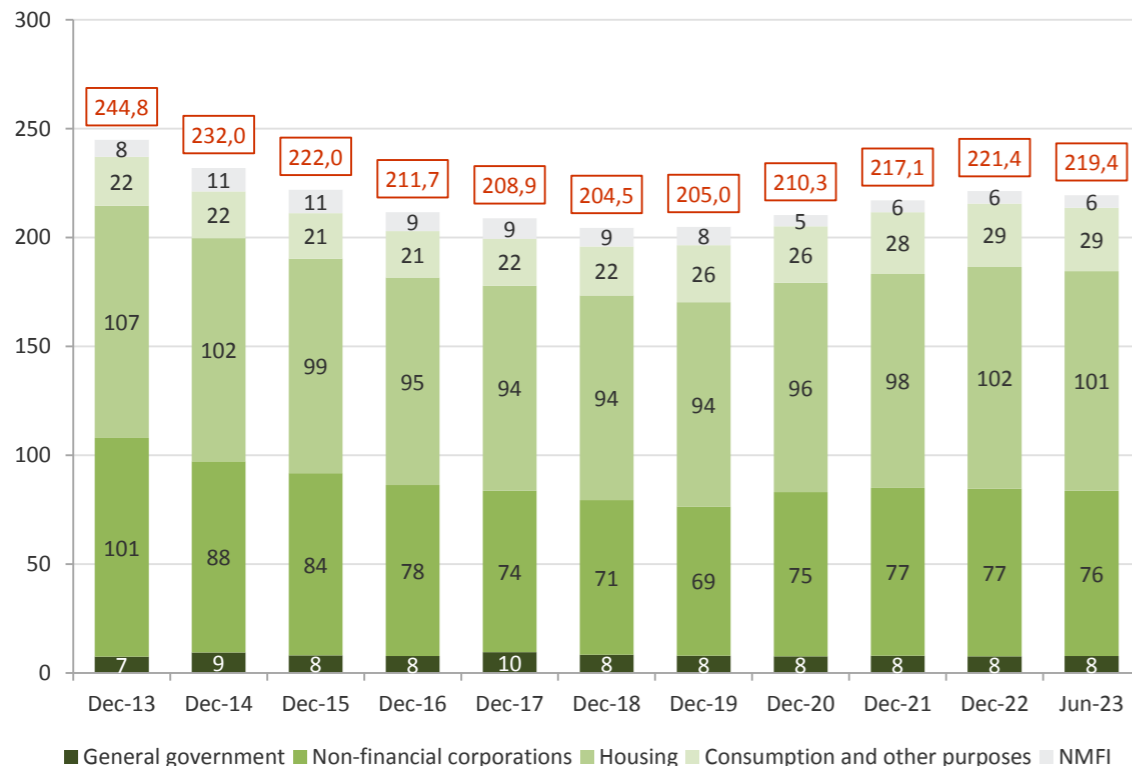
Source: Banco de Portugal (consolidated data) and ECB – MFI Balance Sheet Items (Monetary and Financial Statistics).

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

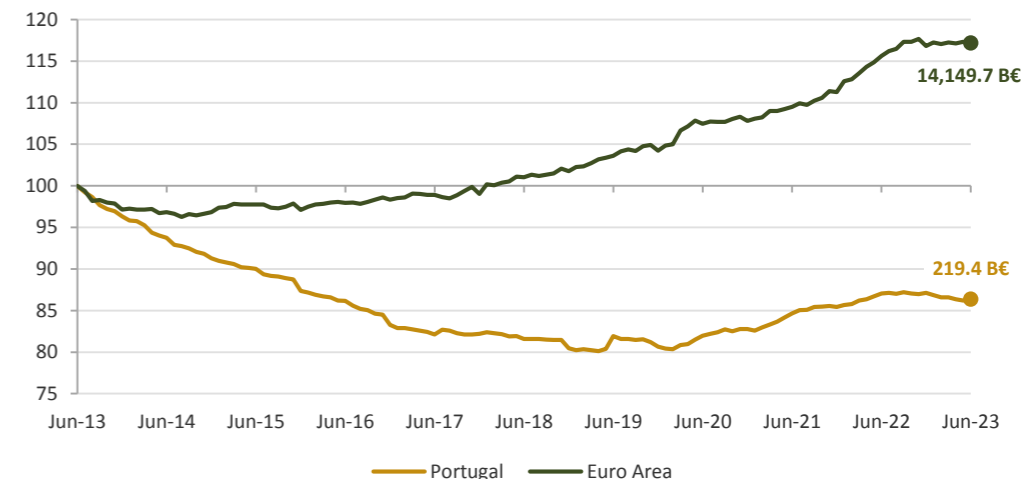
II. LENDING

In the first half of 2023, loans to household continued the downward trend that began at the end of 2022, and lending to non-financial corporations (NFCs) even recorded a negative variation, which increased throughout the six-month period, and which is justified by the reduction in demand due to the decline in consumer confidence, the general level of interest rates and the tightening of credit standards.

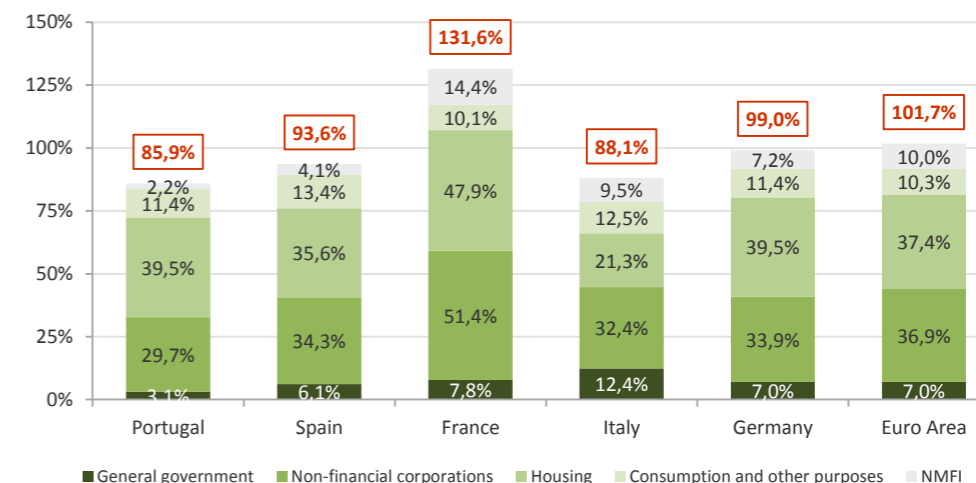
Loans to customers by institutional sector (EUR billion)



Loans to customers evolution (Jun-13 = 100)



Loans to customers by institutional sector as a % of GDP (Jun-23)

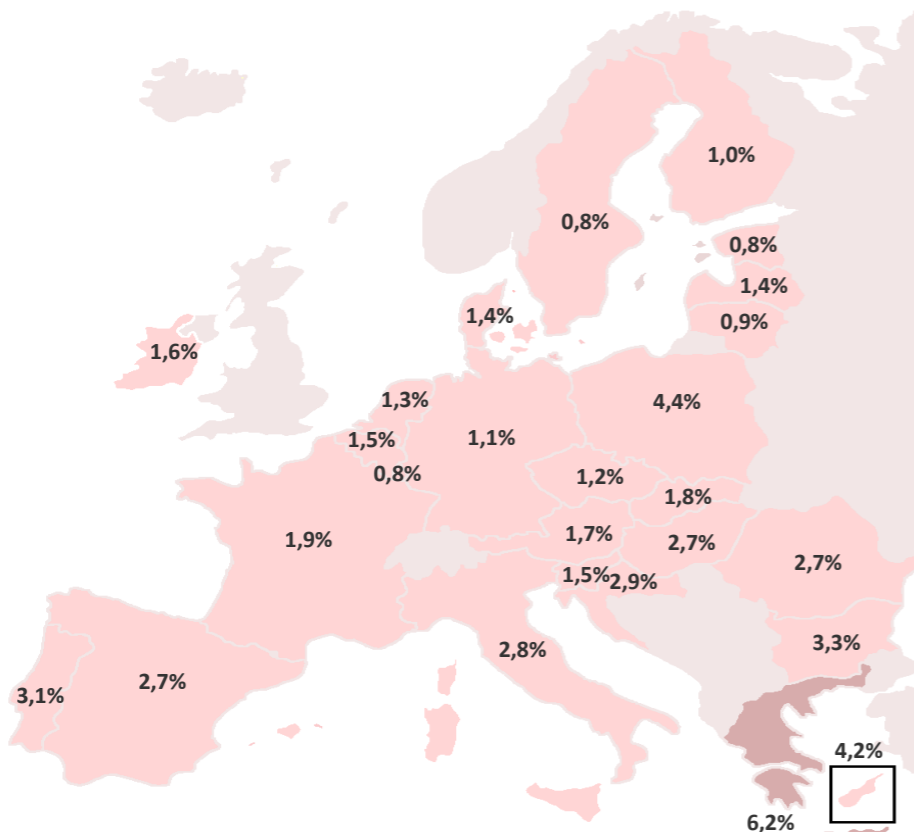


Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Eurostat. Loans and advances to customers in the domestic activity; counterpart: residents in the Euro Area. NMFI = Non-Monetary Financial Institutions, which include Other Financial Intermediaries, Financial Auxiliaries, Insurance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

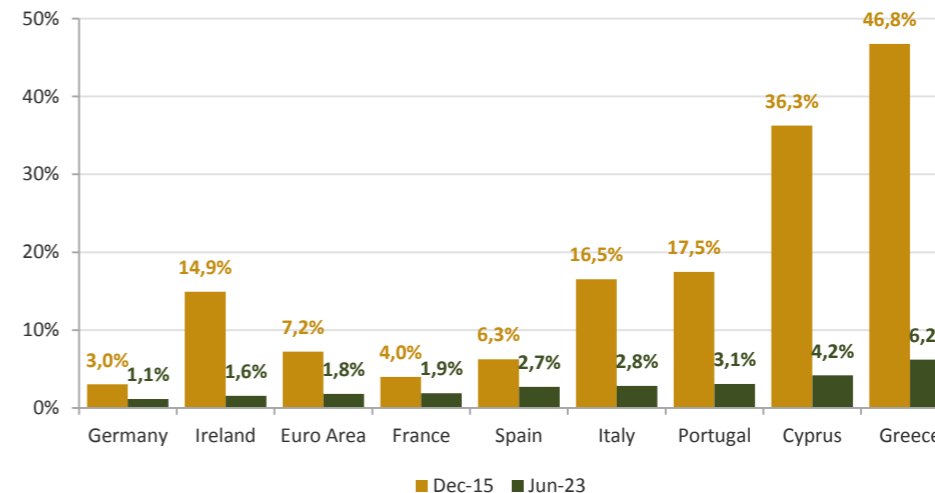
II. LENDING

Despite the reduction in NPLs in absolute terms (-1.7% compared to December 2022), the ratio recorded a marginal increase of 0.1 pp due to the reduction in the denominator, fundamentally explained by the decrease in deposits held with central banks. The impairment coverage ratio increased again to 57.1% (+1.6 pp) and continues to compare favourably with the Euro Area average, which fell to 44.3% (-0.6 pp).

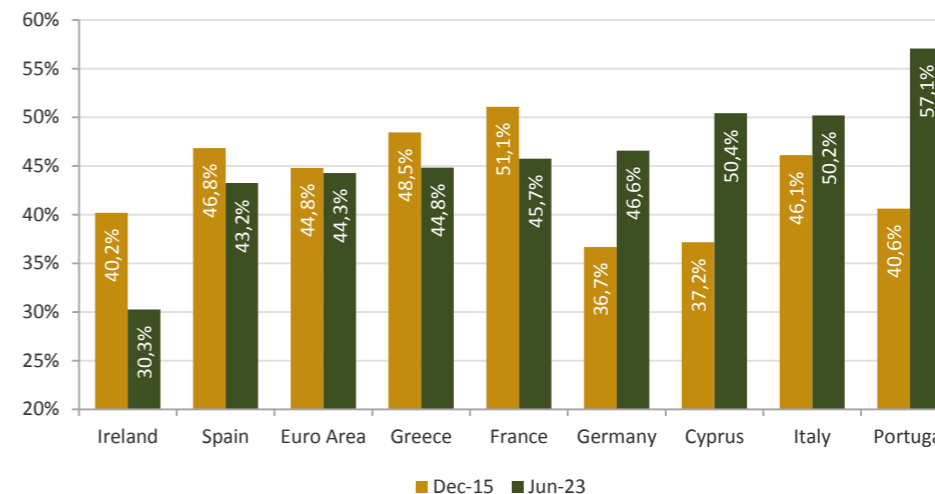
NPL ratio



NPL ratio evolution



Impairment coverage ratio

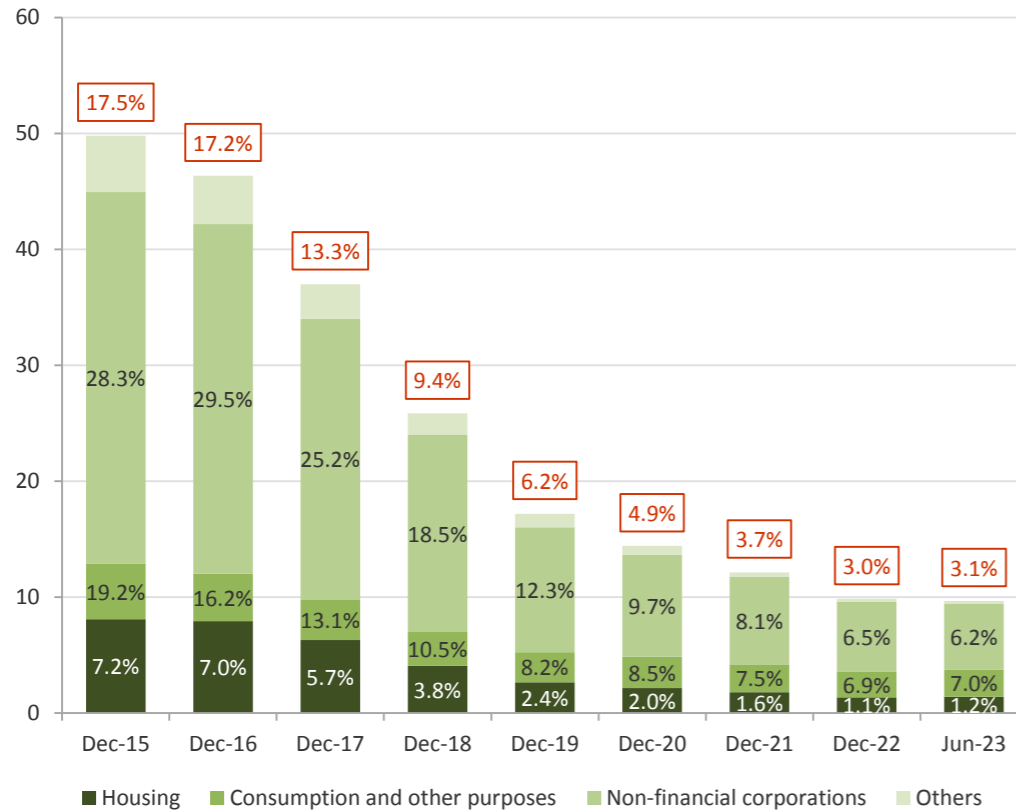


Source: ECB – Consolidated Banking Data. The impairment coverage ratio refers to non-performing loans and debt securities.

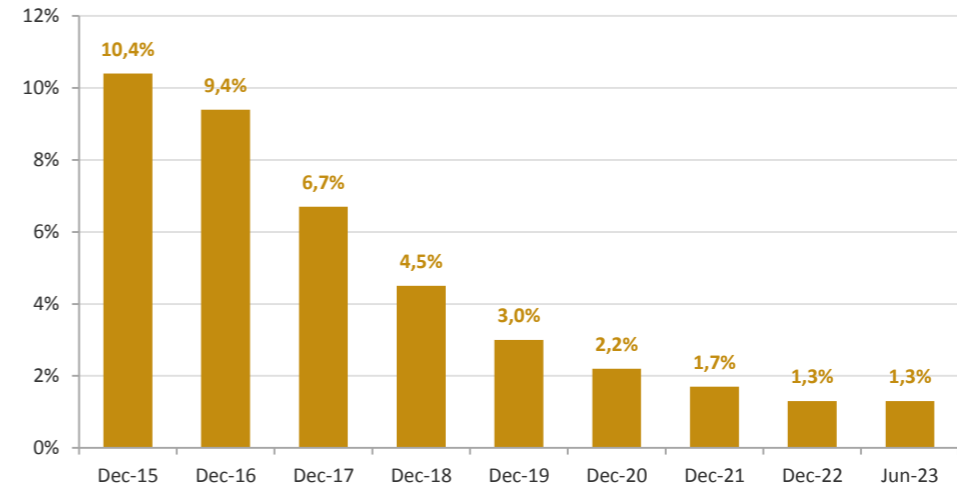
II. LENDING

The NPL ratio for housing loans remained at residual levels (1.2%), and in the non-financial corporations segment fell to 6.2%. The ratio of Stage 2 loans rose slightly to 10.7% (+0.4 pp). The NPL ratio net of impairments ended the half-year unchanged from December 2022, and stood at 1.3%.

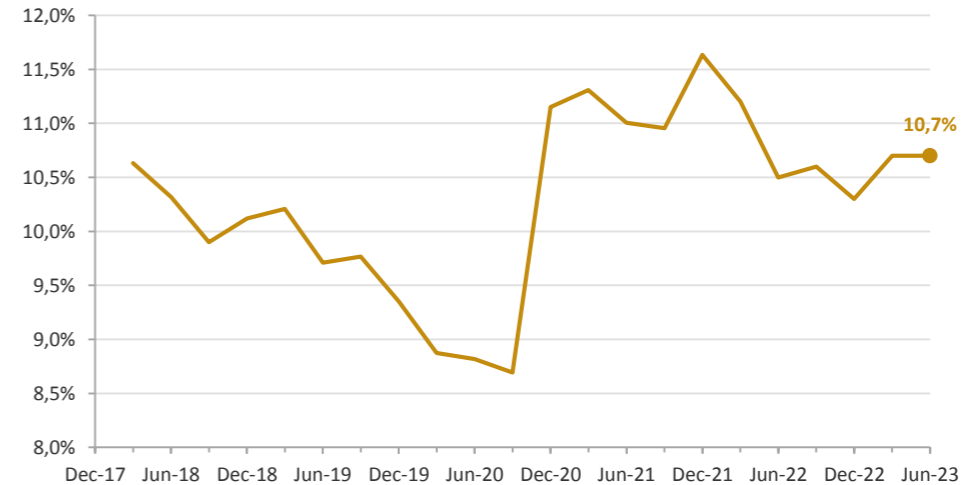
NPL amount and ratio in Portugal (EUR billion)



NPL ratio net of impairments in Portugal



Stage 2 loans ratio in Portugal

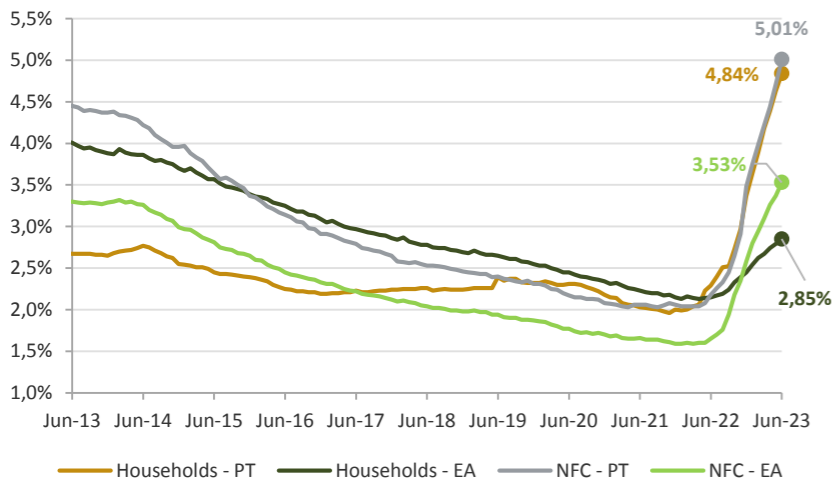


Source: Banco de Portugal (consolidated data).

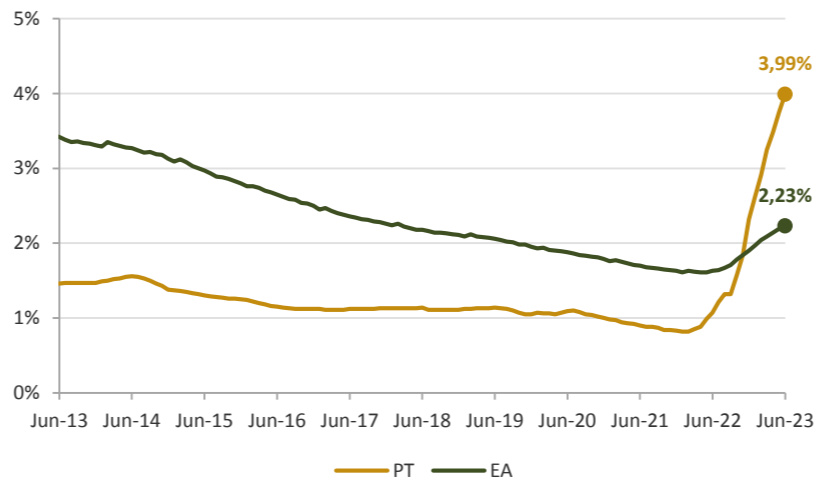
II. LENDING | LOAN CONDITIONS | INTEREST RATES

The interest rate on new loans to non-financial companies in Portugal is rising since April 2022. However, the interest rate on housing loans, unlike the last ten years, is now higher than the Euro Area average as the vast majority of housing loans in Portugal was granted at variable rates.

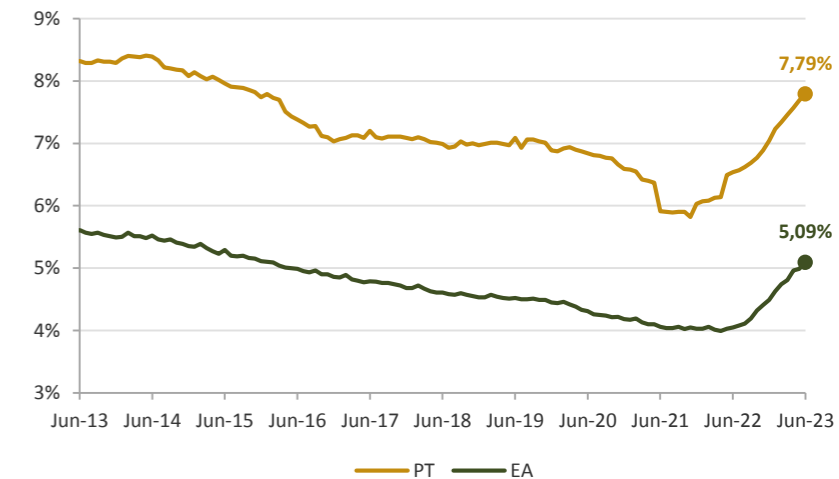
Total - Stock



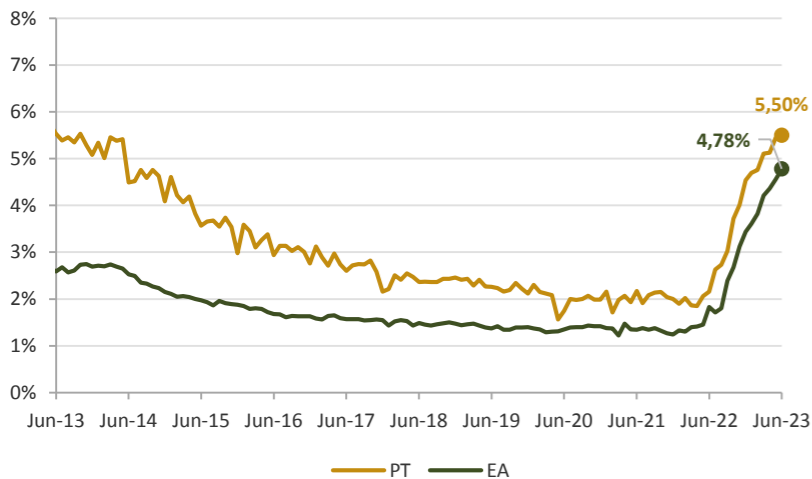
Housing - Stock



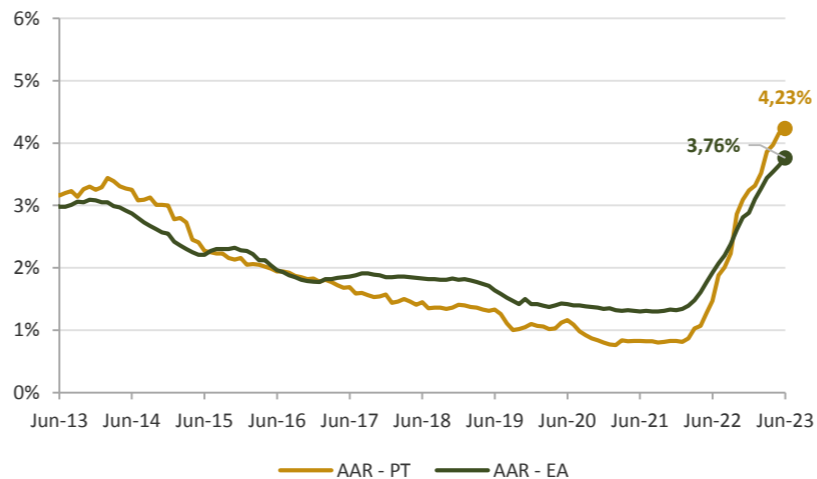
Consumption - Stock



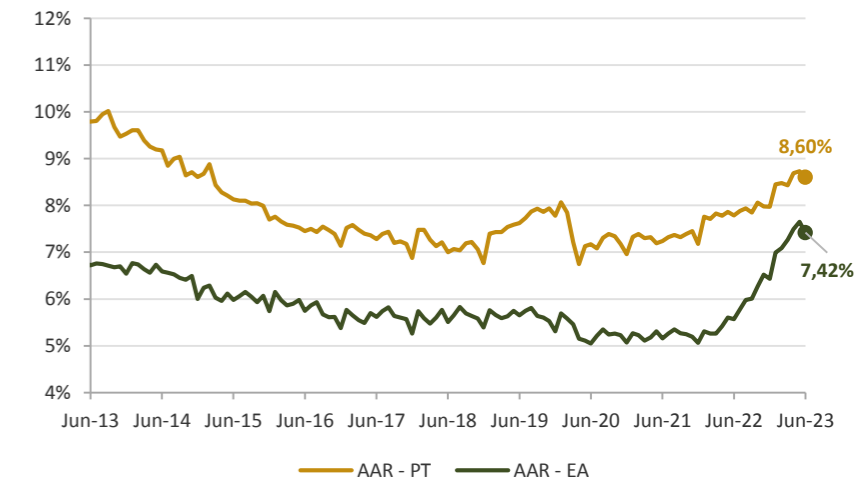
New business - NFC



New business - Housing



New business - Consumption

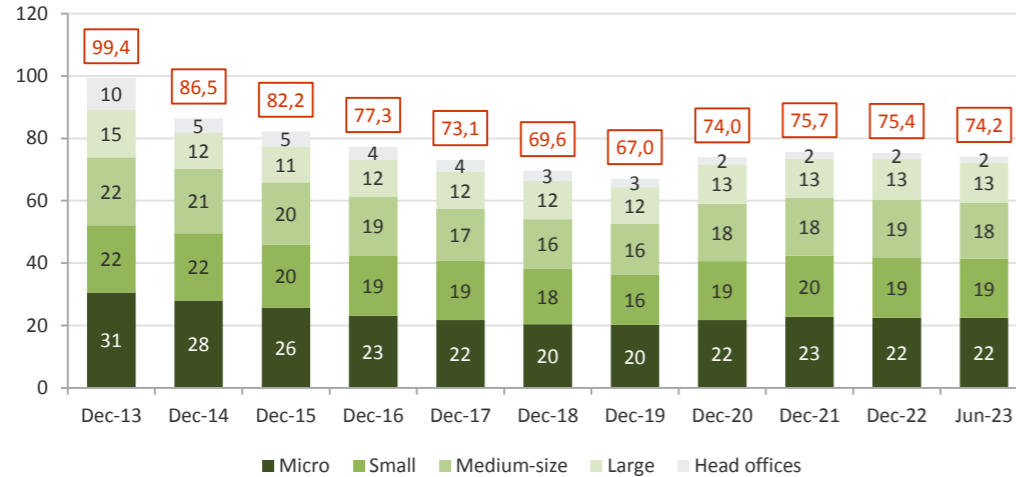


Source: ECB – MFI Interest Rate Statistics.

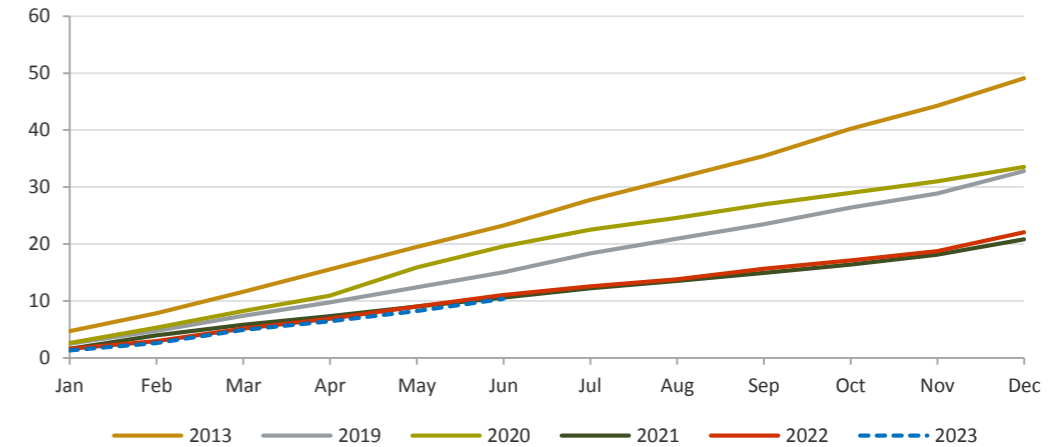
II. LENDING | NON-FINANCIAL CORPORATIONS

The annual rate of change in the stock of bank loans to non-financial companies fell into negative territory at the beginning of the year, a trend more pronounced throughout the first half of 2023 (-2.7% in June). The micro-corporate segment was the only segment that continued to grow but at a lower pace. In terms of sectors of activity, there was also a general deceleration. The amount of new business, excluding renegotiations, decreased 14.8% in the first half of 2023.

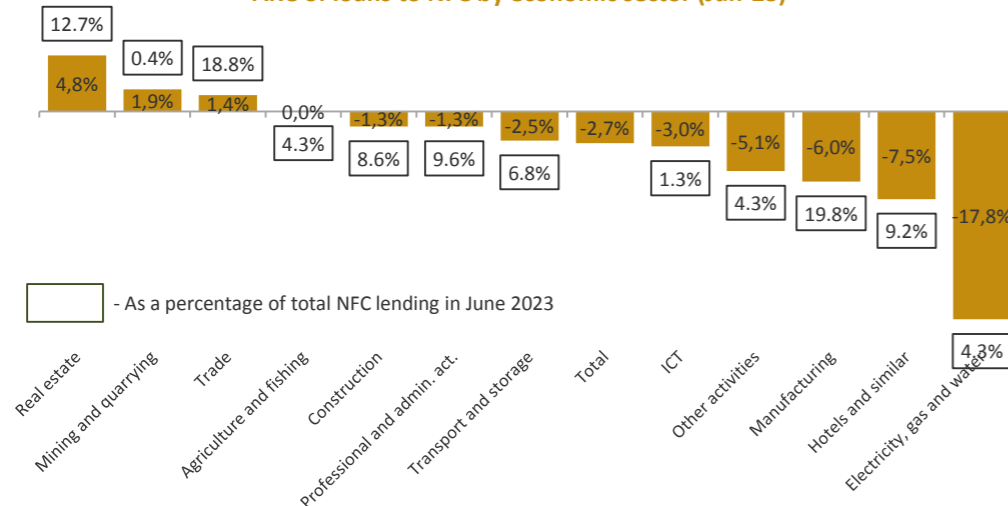
Stock of loans to NFC (EUR billion)



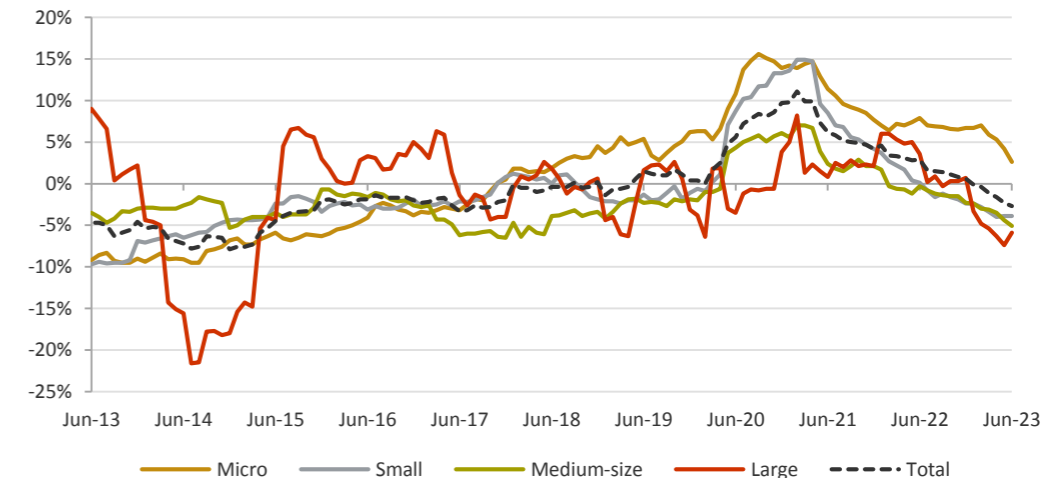
New business lending to NFC (cumulated amounts, EUR billion)



ARC of loans to NFC by economic sector (Jun-23)



ARC of loans to NFC by dimension class

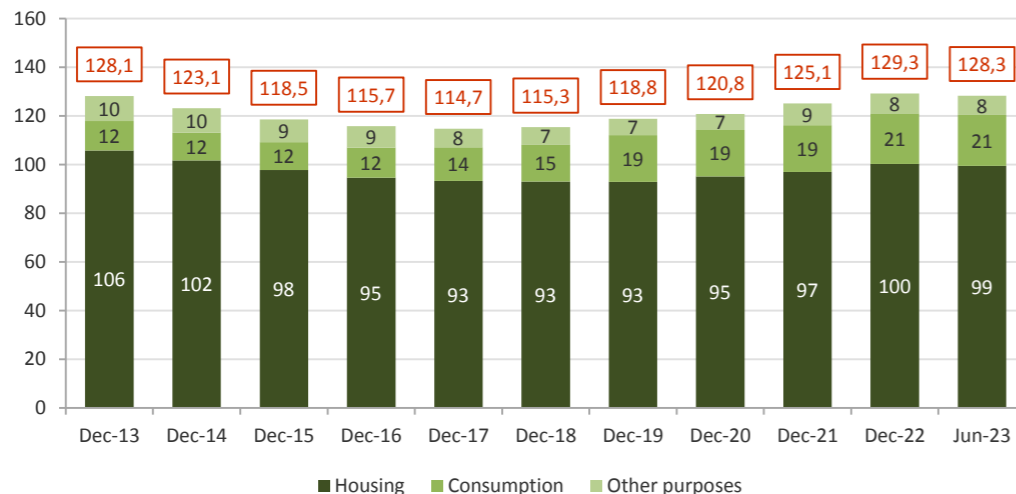


Source: Banco de Portugal (Monetary and Financial Statistics). Loans to NFCs in the domestic activity; counterpart: residents in Portugal. ARC = Annual rate of change. New business loans include new loans, loan transfers between banks and renegotiations without default.

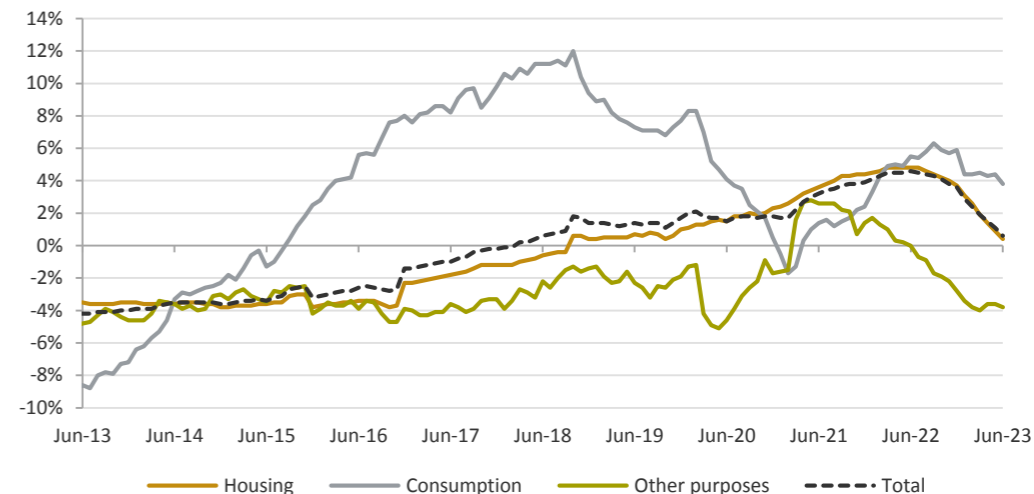
II. LENDING | HOUSEHOLDS

The deceleration in loans to households initiated in the first half of 2022 continued in the first semester of 2023. This evolution is explained, on the one hand, by the increase of earlier redemptions in loans for house purchase due to the increase in market interest rates and rise in the household saving rate during the pandemic and, on the other hand, by the annual decrease in new loans for house purchase excluding renegotiations (-24.7%).

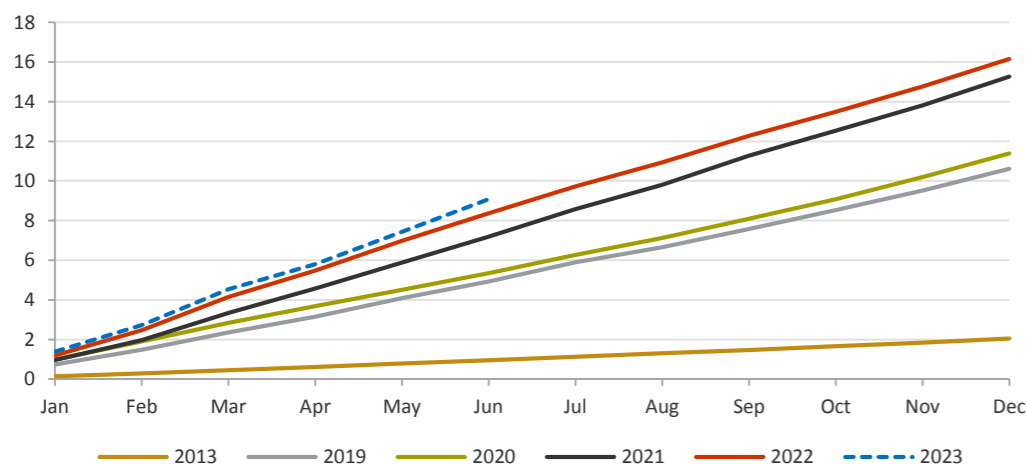
Stock of loans to NFC (EUR billions)



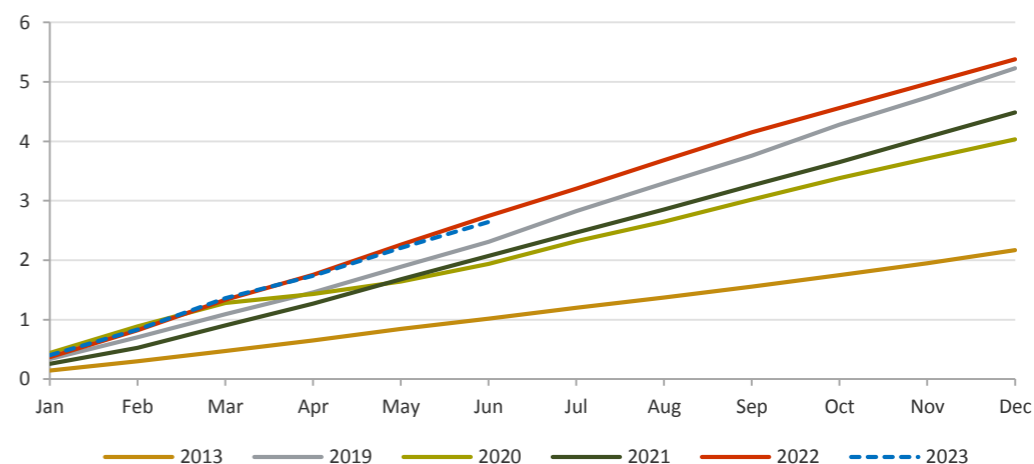
ARC of loans to households



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



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

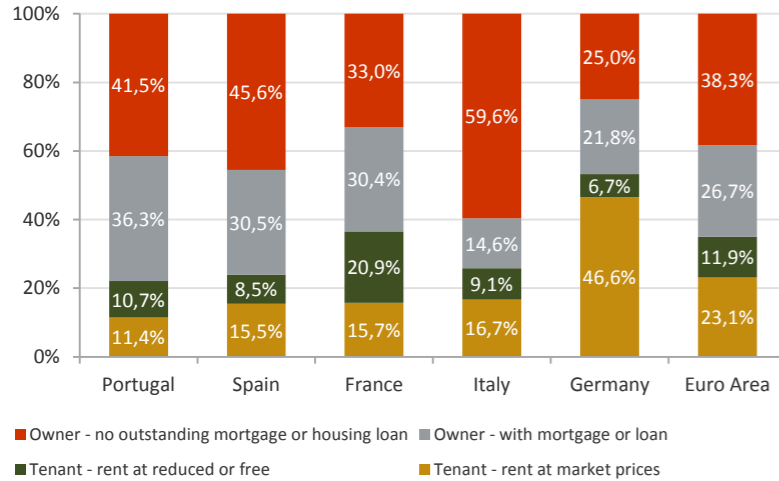


Source: Banco de Portugal (Monetary and Financial Statistics). Loans to households in the domestic activity; counterpart: residents in Portugal. ARC = Annual rate of change. New business loans include new loans, loan transfers between banks and renegotiations without default.

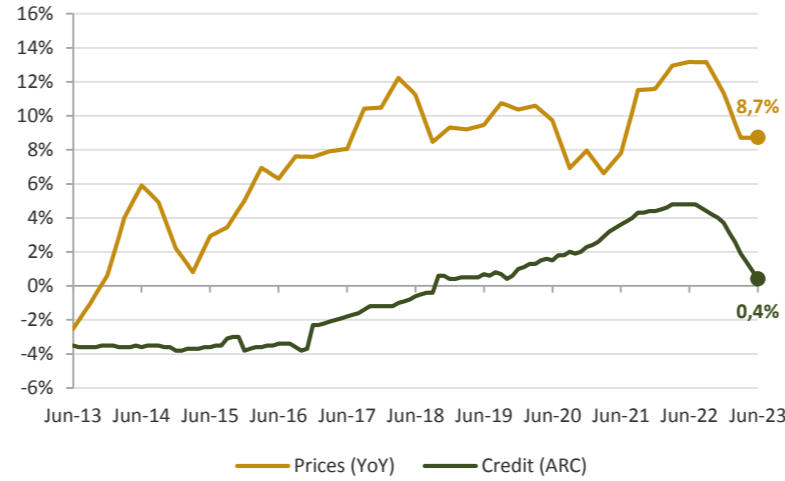
II. MAIN INDICATORS | LENDING FOR HOUSE PURCHASE

Residential property prices grew significantly in the last years but the deceleration of lending for house purchase mitigates the impact of a potential price correction over the economy and the banking sector. Also, there has been an improvement in new borrowers' risk profile. Furthermore, in June 2023, 92% of the stock of housing loans granted to households had an LTV of 80% or less, which shows the capacity to accommodate a potential fall in residential property prices without incurring high losses.

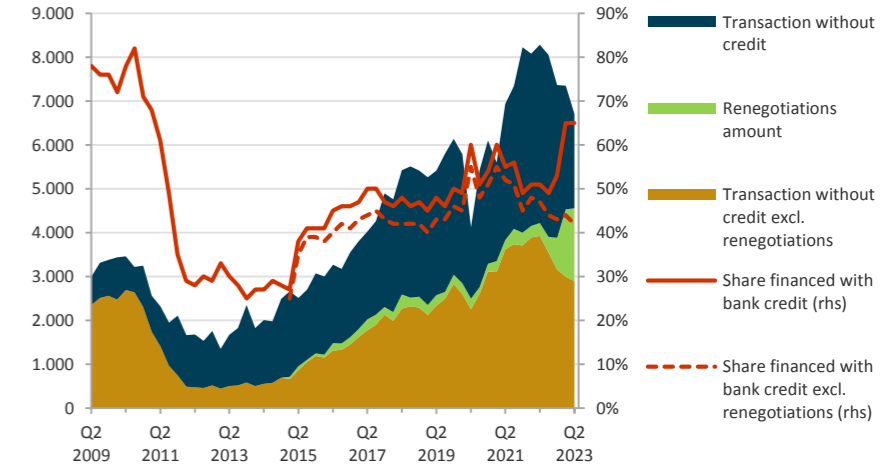
Distribution of population by tenure status (2022)



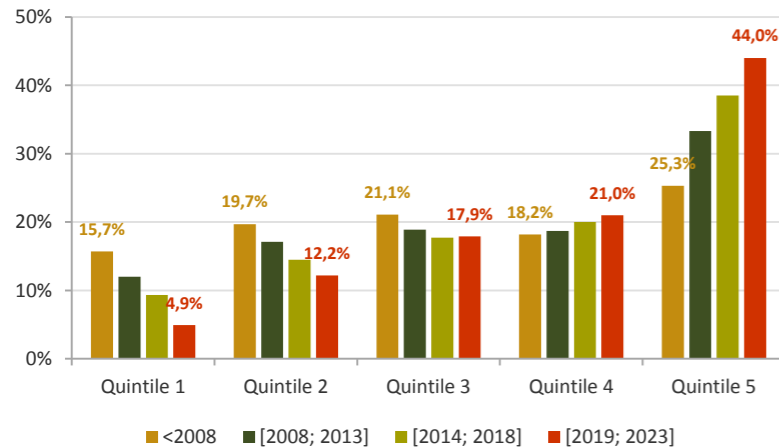
House prices vs. Credit for house purchase



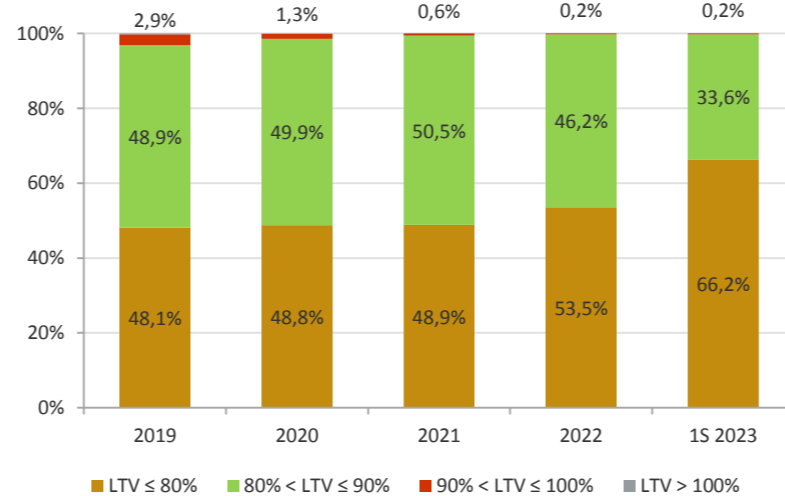
Transaction in dwellings vs. New domestic housing loans (EUR millions)



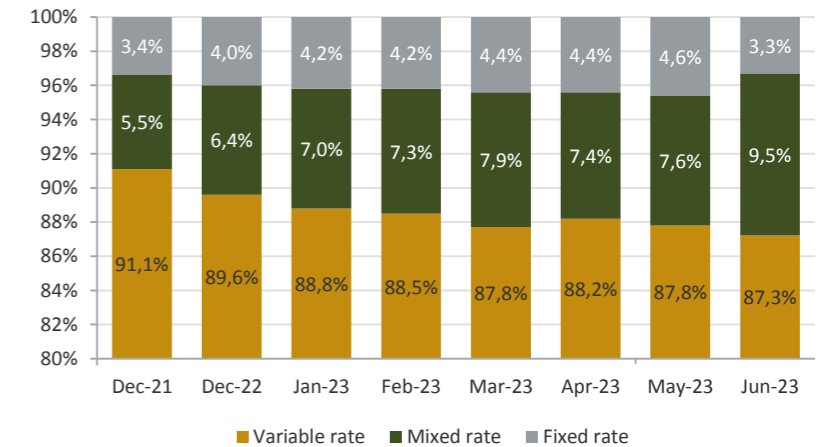
Stock of loans for house purchase by income quintile and year of loan initiation



Distribution of new credit for house purchase by LTV ratio



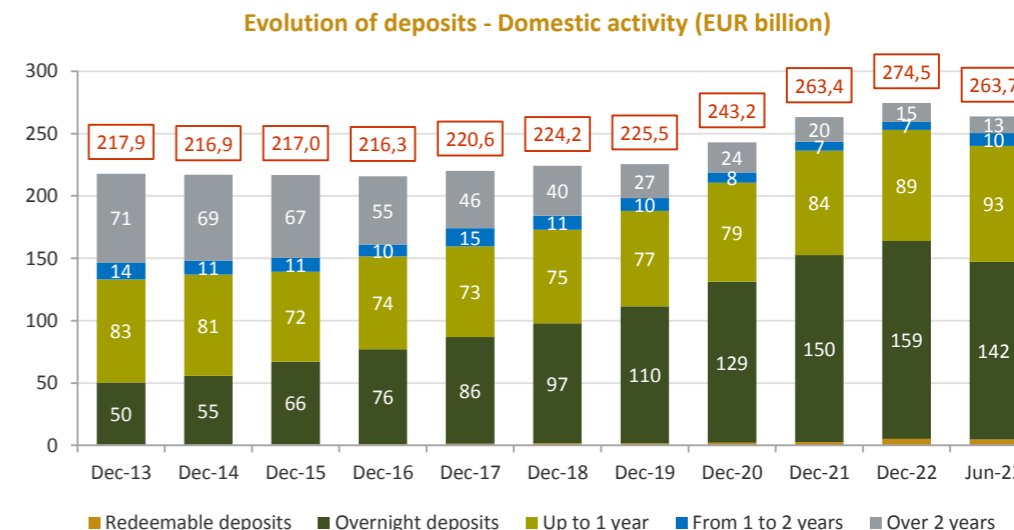
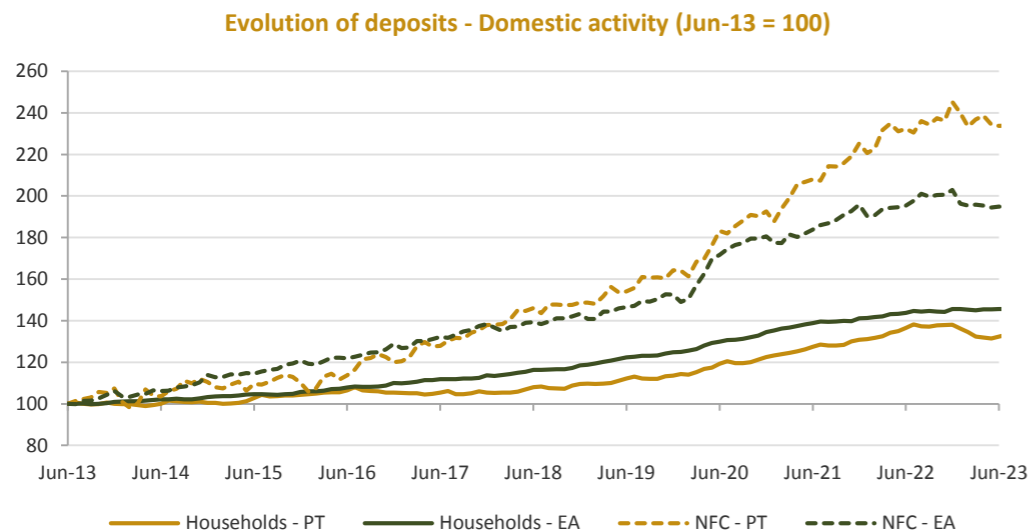
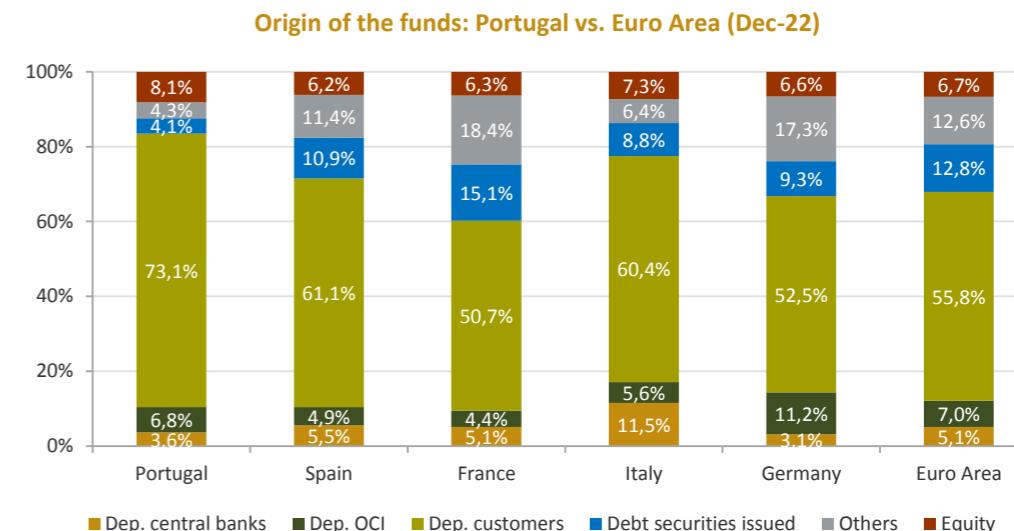
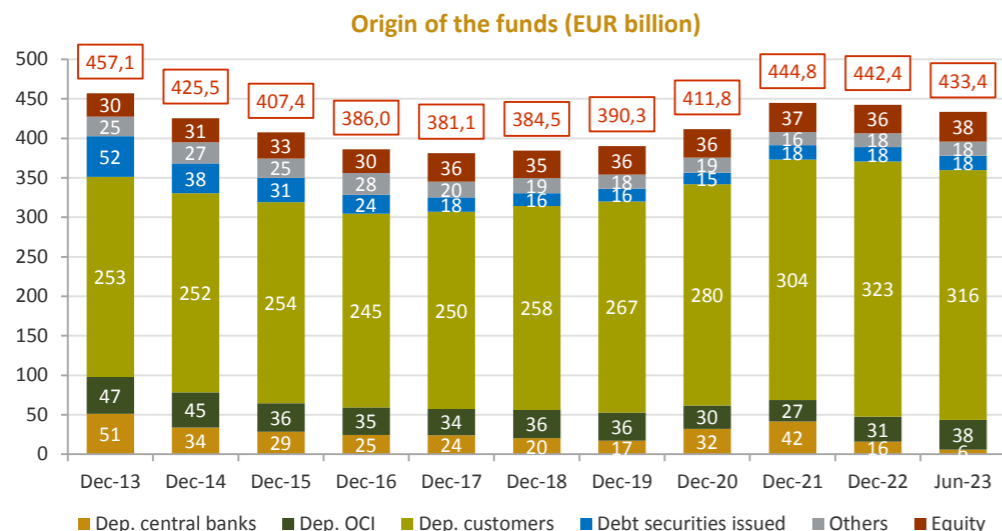
Stock of loans for permanent residential property, by type of rate



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

III. ORIGIN OF THE FUNDS AND LIQUIDITY

Customer deposits decreased in the first half of 2023, mainly due to the decrease of deposits from households that were reallocated to the subscription of savings certificates (public debt) and used to repay debt.

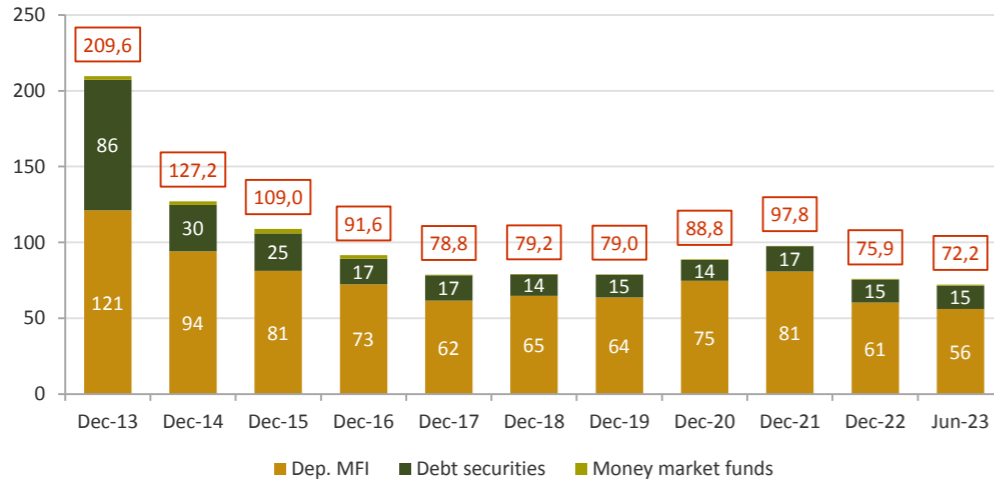


Source: Banco de Portugal (consolidated data and Monetary and Financial Statistics) and ECB – Consolidated Banking Data (consolidated data reported in FINREP format) and MFI Balance Sheet Items (Monetary and Financial Statistics). OCI = Other Credit Institutions.

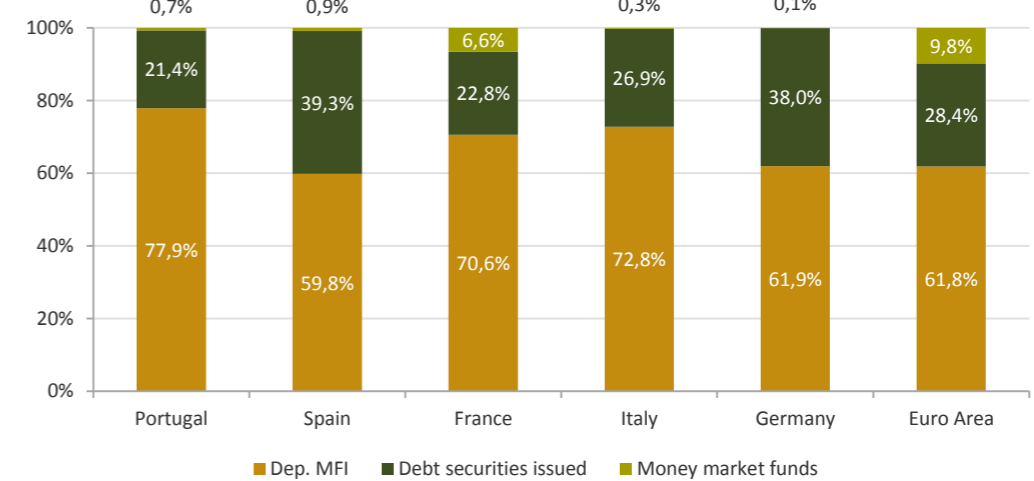
III. ORIGIN OF THE FUNDS AND LIQUIDITY

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, that in 2022 started to be indexed to the evolution of key interest rates, banks repaid a significant part of these loans early.

Origin of wholesale funds (EUR billion)



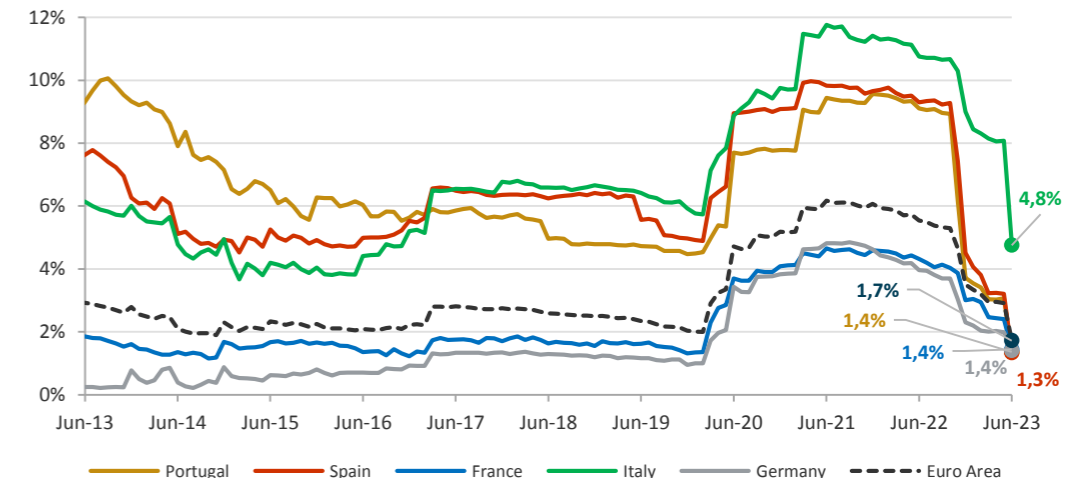
Origin of wholesale funds: Portugal vs. Euro Area (Jun-23)



Borrowing from the ECB (EUR billion)



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

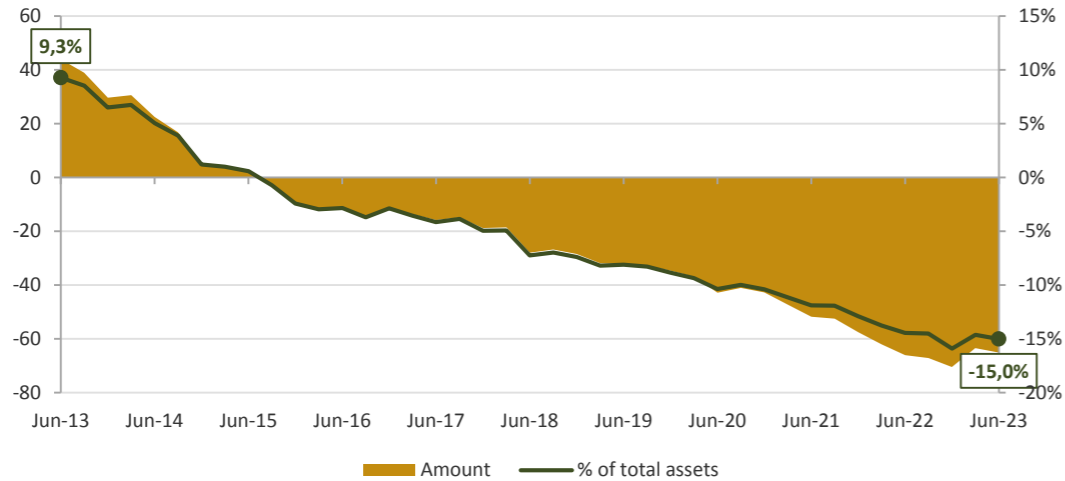


Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics). Origin of wholesale funds from domestic activity. Monetary and Financial Institutions (MFI) include Central Banks and Other Monetary and Financial Institutions (OMFI).

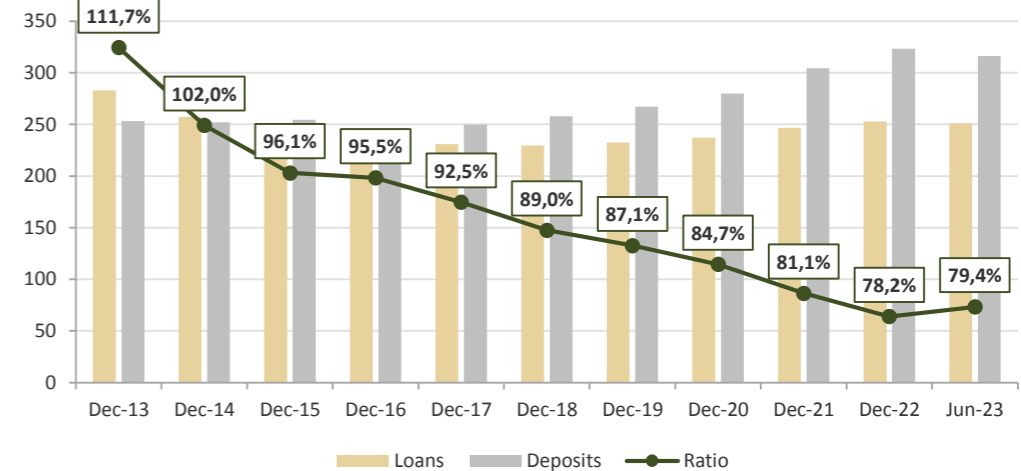
III. ORIGIN OF THE FUNDS AND LIQUIDITY

Despite the reduction in customer deposits, the Portuguese banking sector maintained its high liquidity levels. There was a marginal increase in the loan-to-deposit ratio (+1,4 pp over December 2022) as loans to customers also fell. The liquidity coverage ratio fell significantly due to the reduction in cash balances at central banks, but remained very high and considerably above the minimum regulatory requirement.

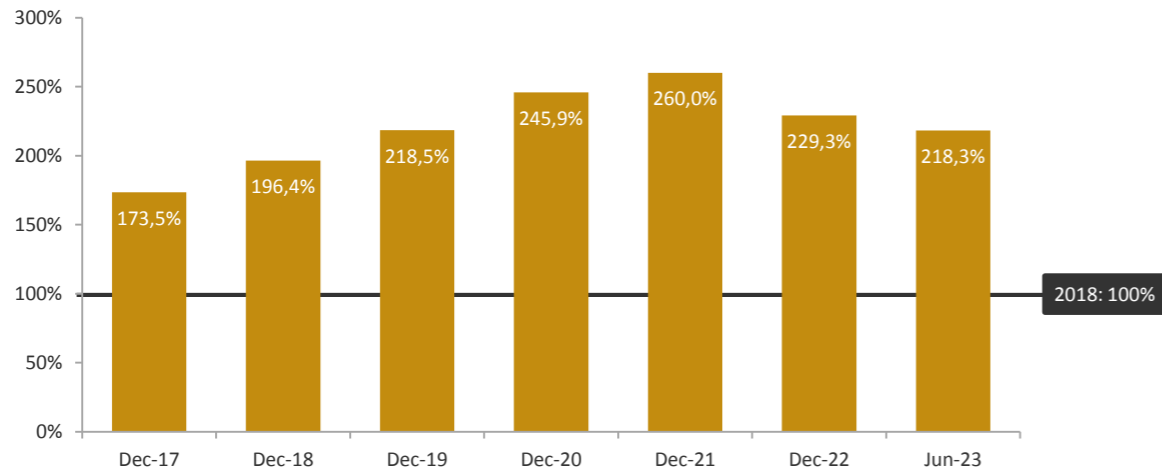
Funding gap (EUR billion and % of total assets)



Loan-to-deposit ratio (EUR billion)



Liquidity Coverage Ratio



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

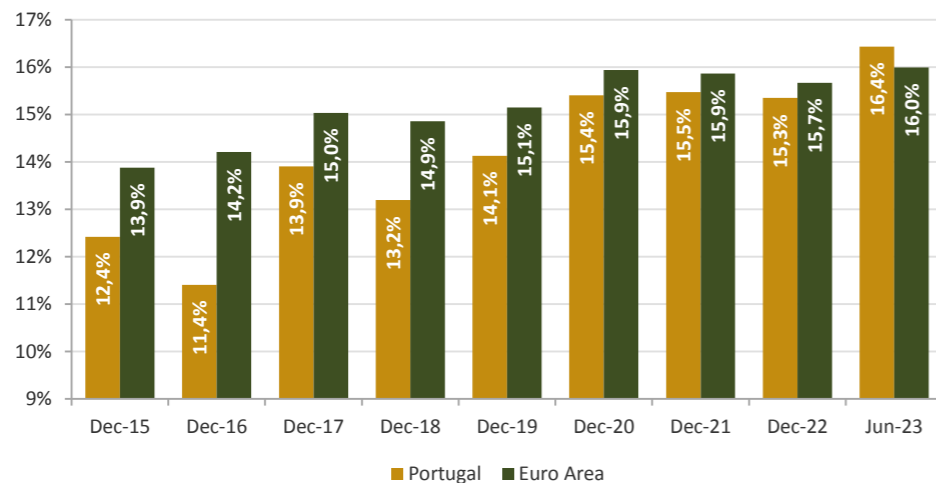


Source: Banco de Portugal (consolidated data).

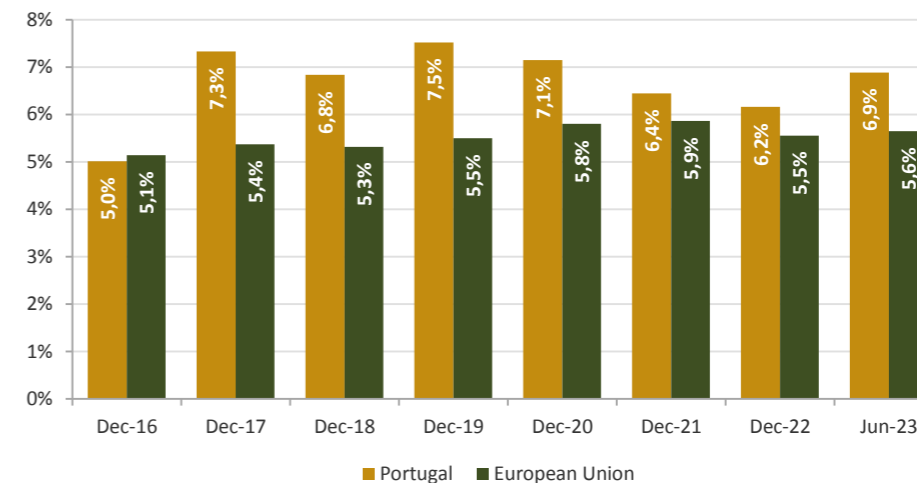
IV. SOLVENCY

Solvency ratios strengthen in the first half of 2023, mostly due to retained earnings. The Common Equity Tier 1 ratio rose to 16.4%, and the leverage ratio to 6.9% and stood at a considerably higher level than the EU average and the minimum regulatory benchmark (3%). The reduction in CET2 capital resulted from the earlier redemption of the respective instruments by a large financial institution.

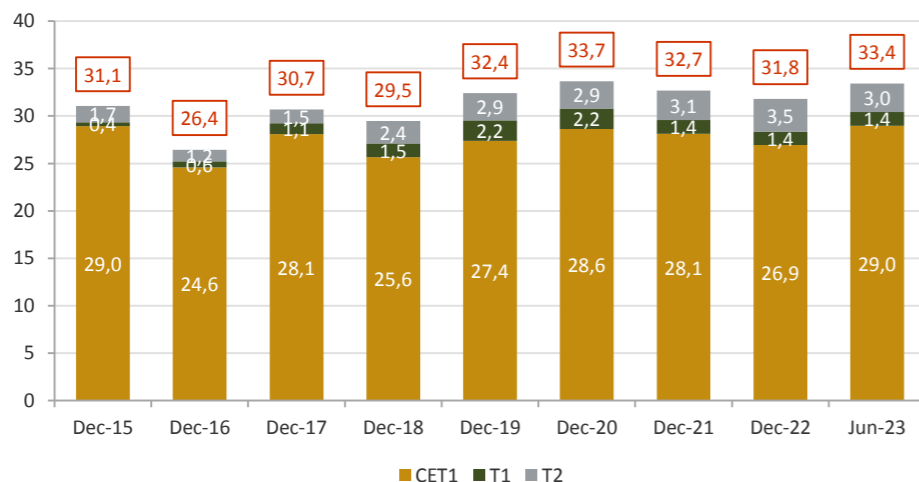
Common Equity Tier 1 ratio



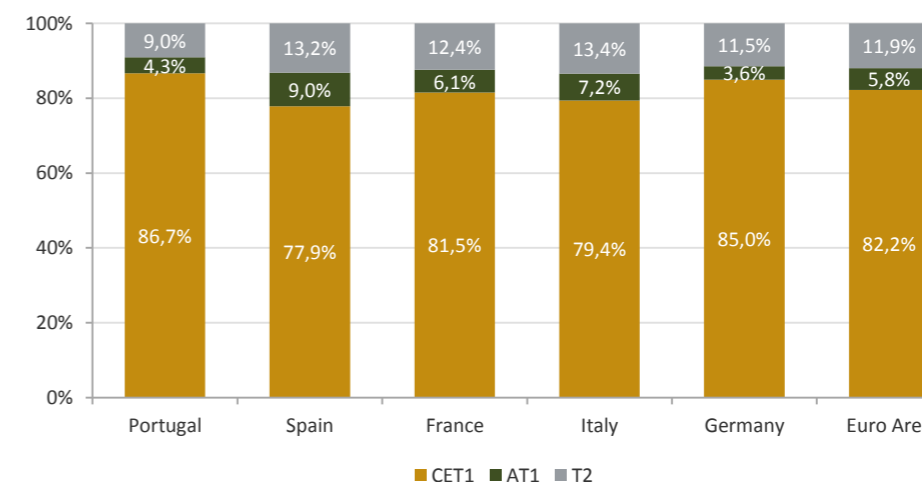
Leverage ratio



Evolution of the structure of own funds (EUR billion)



Structure of own funds: Portugal vs. Euro Area (Jun-23)

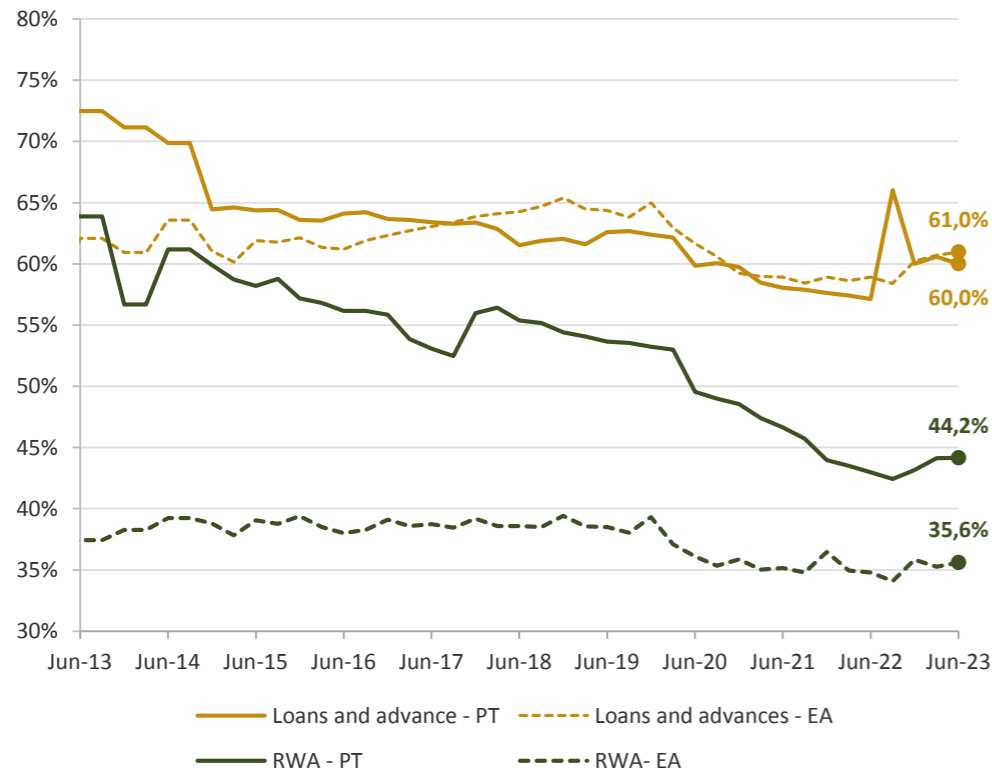


Source: BCE – Consolidated Banking Data (consolidated data) and EBA – Risk Dashboard (leverage ratio – fully phased-in definition of Tier 1). In June 2023, the EBA sample included 144 European banks, 30 of which are subsidiaries, covering more than 80% the EU/EEA banking sector (sample for Portugal: BCP, CGD, LSF Nani Investments and Santander Totta).

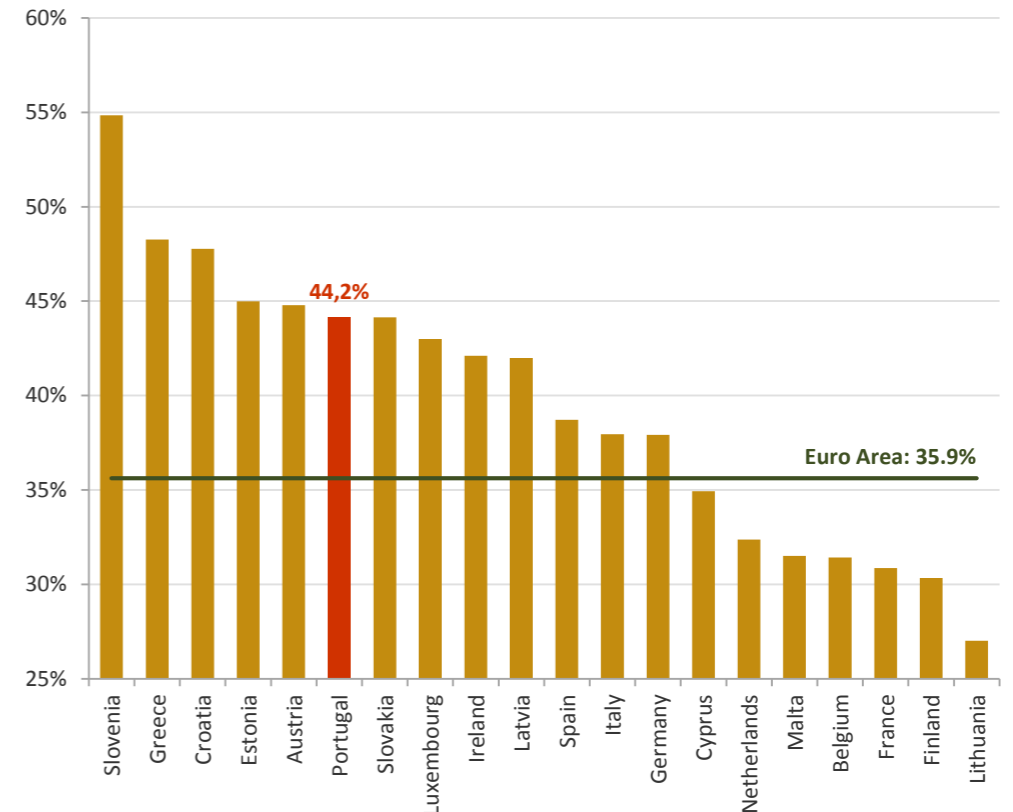
IV. SOLVENCY

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. The recent increase in RWA as a percentage of total assets results from increasing credit risk/counterparties' exposure, only partially offset by falling market risk exposure (exchange risk) and other risk exposures.

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-23)

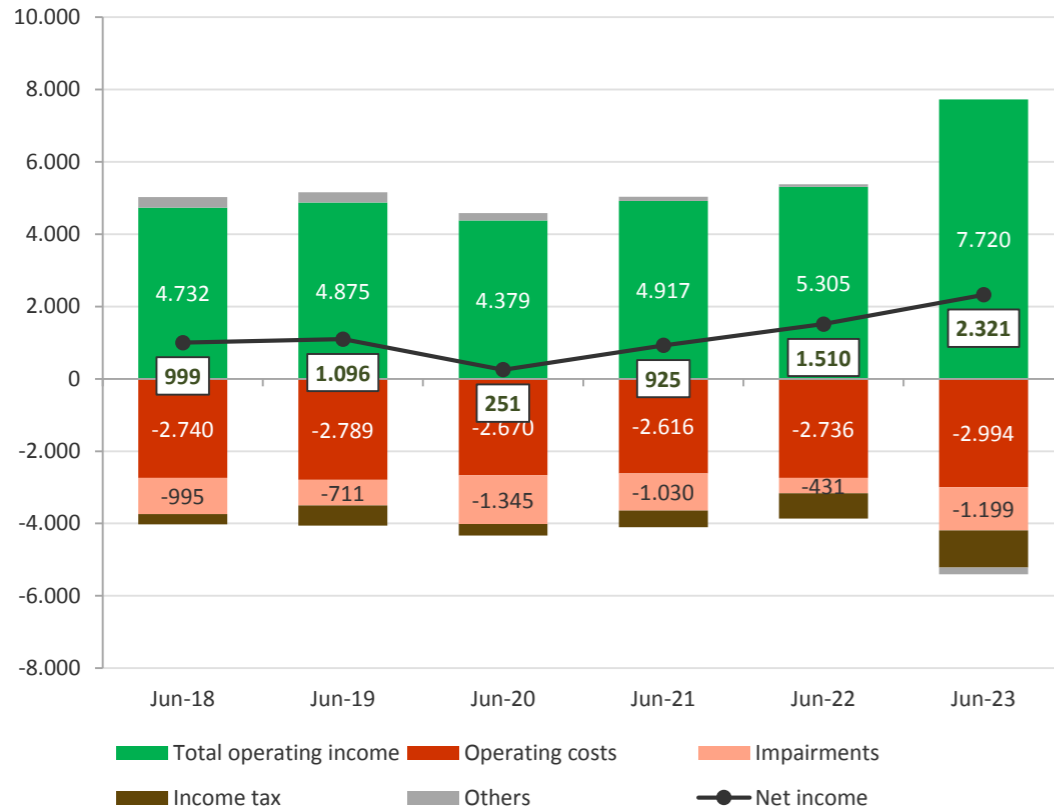


Source: ECB – Consolidated Banking Data.

V. PROFITABILITY

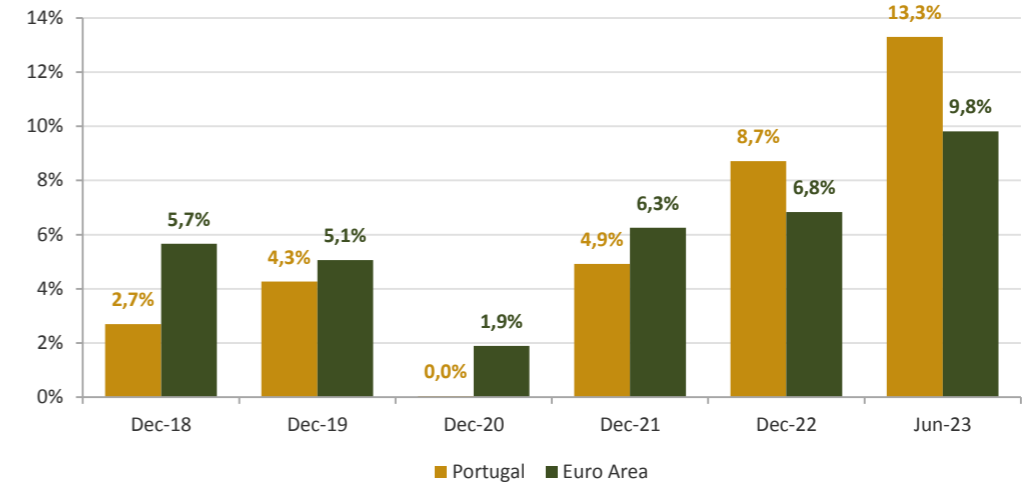
In the first half of 2023, the banking sector's profitability improved again (13.3%), mainly due to the increase in total operating income, while the flow of credit impairments, operating costs, and taxes increased. In the current economic and financial context of rising interest rates, the potential materialisation of market and credit risks represents increased challenges for the sector's profitability.

Net interest income breakdown (EUR million)

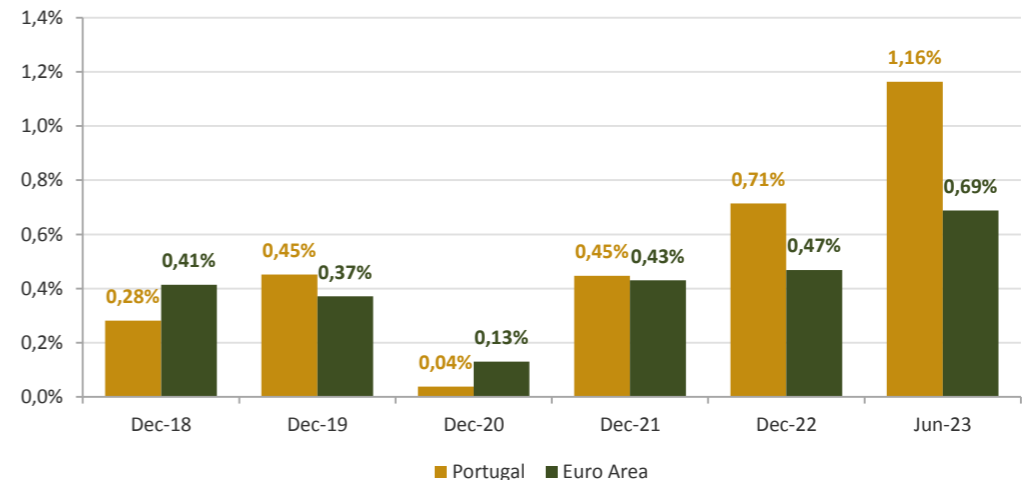


Source: Banco de Portugal (consolidated data).

Return on Equity (ROE)



Return on Assets (ROA)

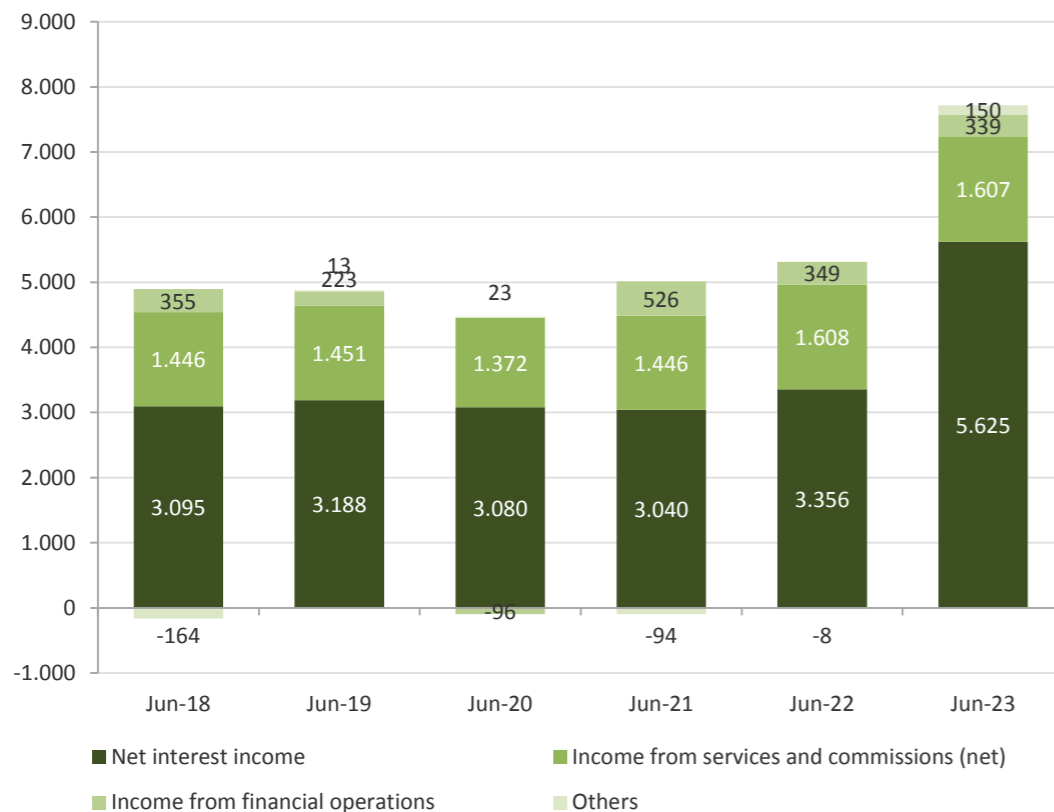


Source: ECB – Consolidated Banking Data. Calculated based on net interest income after tax and before minority interests and on end-of-period equity and total assets. Return on Equity excludes branches of foreign banks. Annualised values for Jun-23.

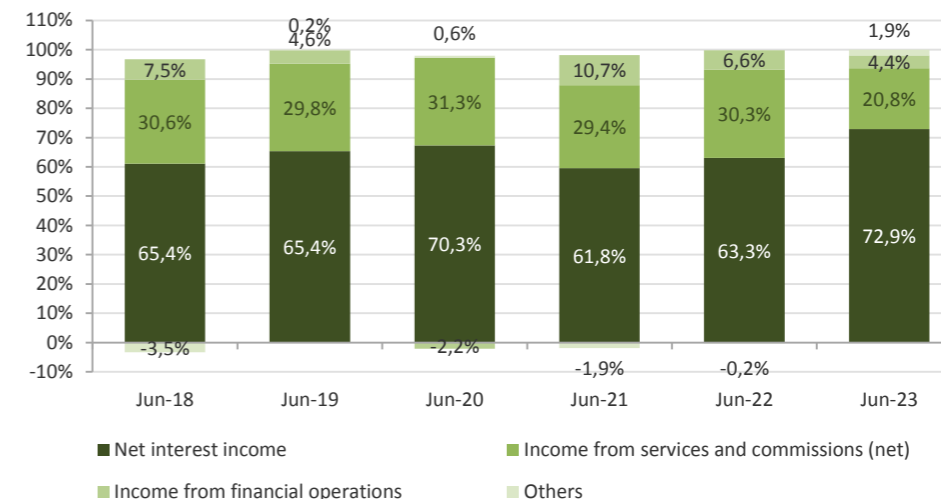
V. PROFITABILITY

The improvement in total operating income is explained mainly by the strong increase in net interest income mainly caused by the sharp interest rate increases and the different pace of pass-through to borrowers and depositors, respectively, which has been slower for the latter.

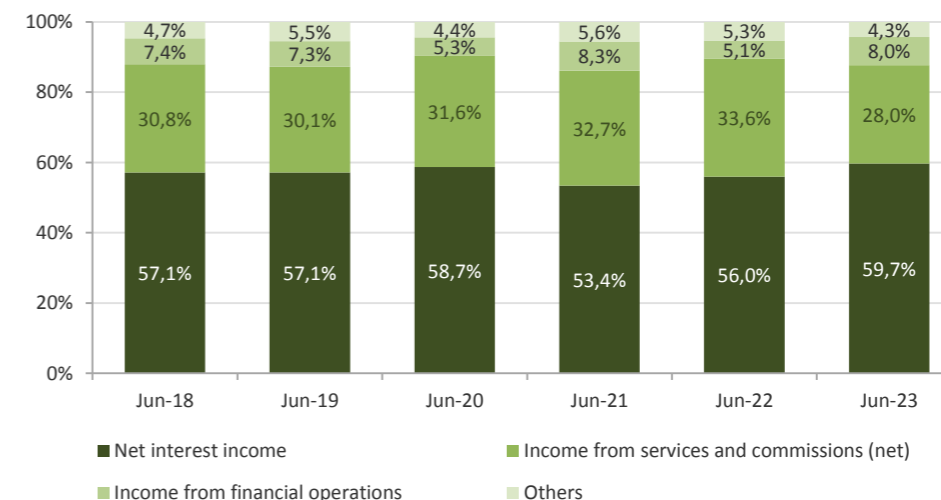
Total operating income breakdown (EUR million)



Total operating income breakdown: Portugal



Total operating income breakdown: Euro Area

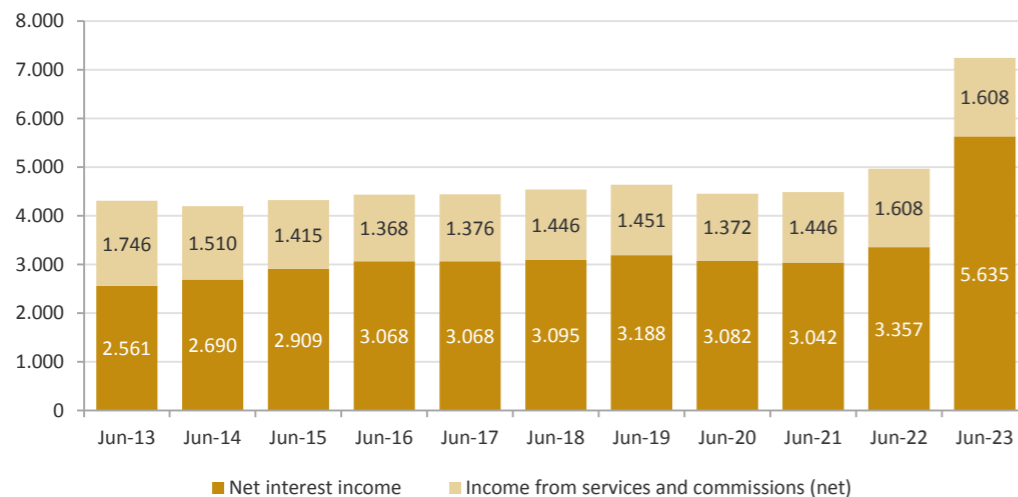


Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data (Euro Area).

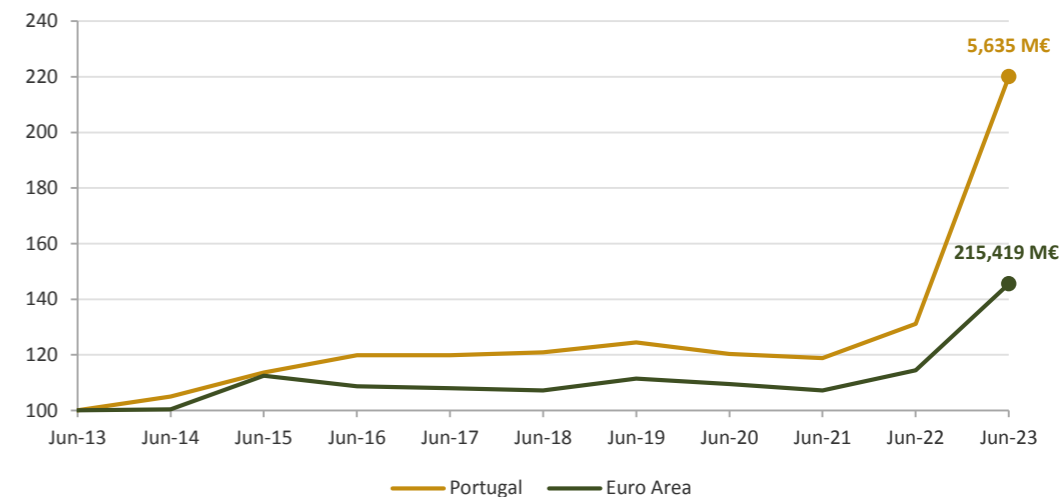
V. PROFITABILITY

The evolution of net interest income in this semester reflected mainly the increase in interest rates on the asset side, while commissions were flat over the same period.

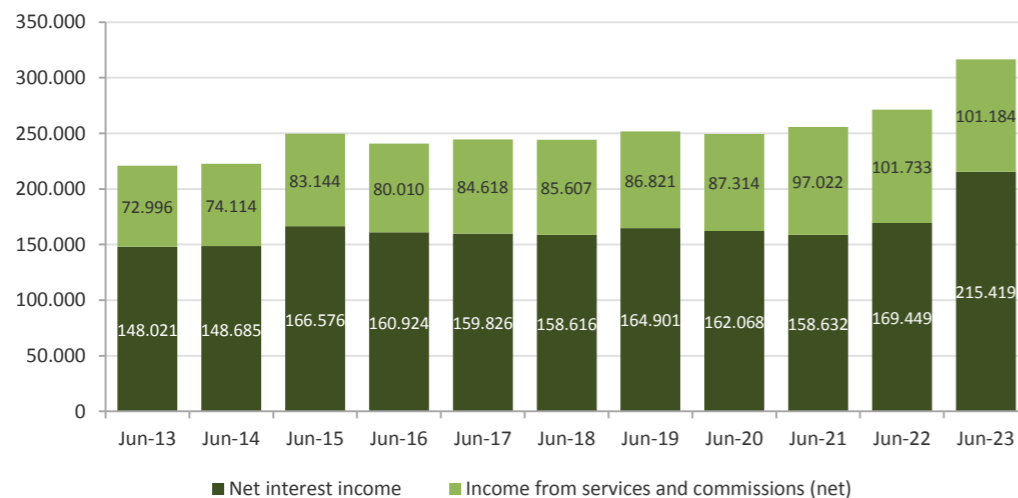
Net interest income and Commissions (EUR million) – Portugal



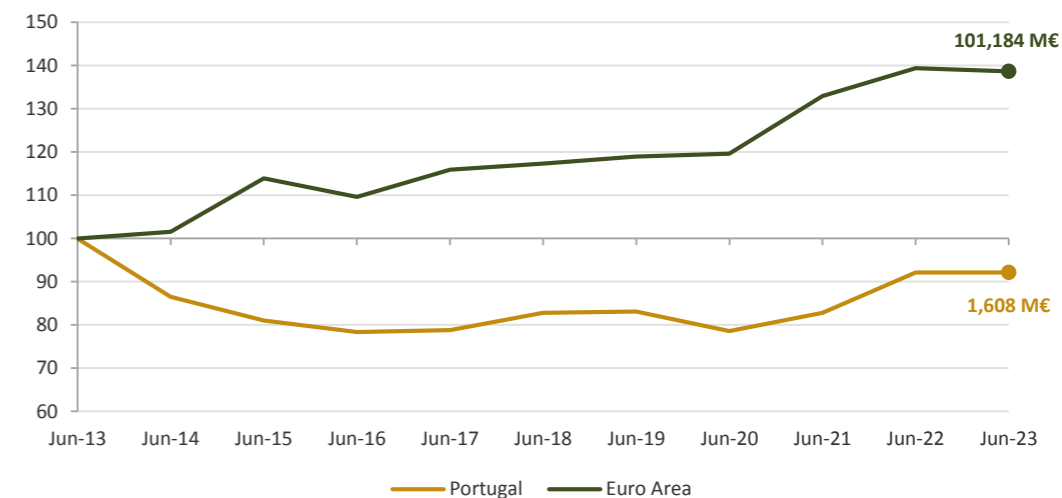
Net interest income (Jun-13 = 100)



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



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

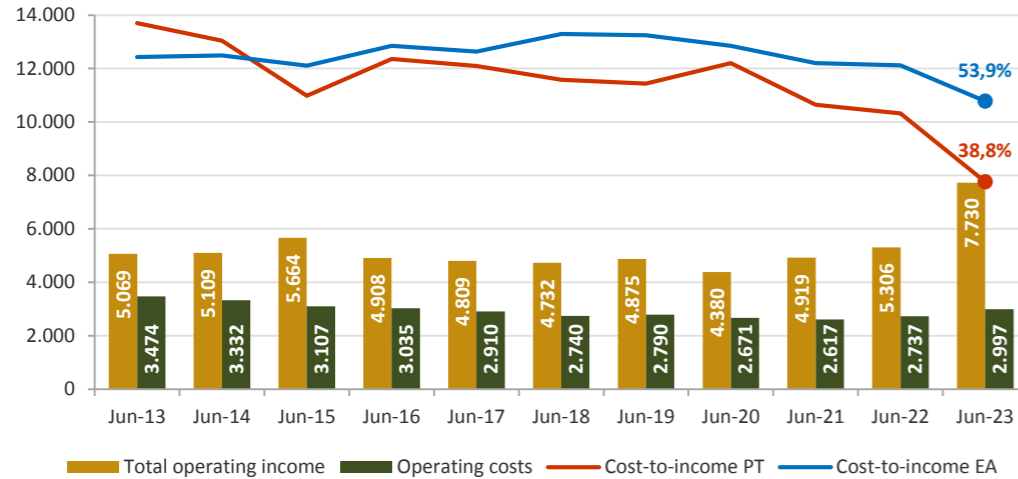


Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data (Euro Area). The ECB's data on Services and commissions is only available from 2013 onwards.

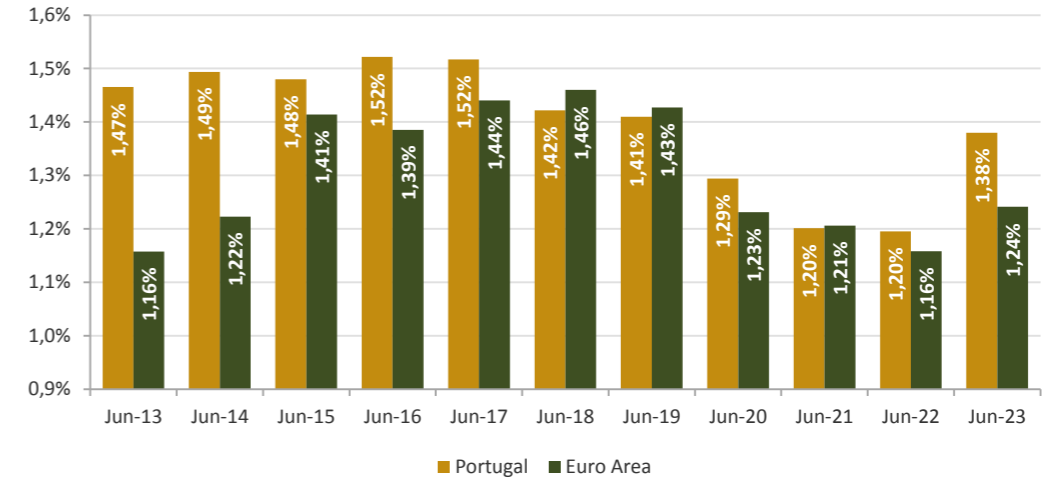
V. PROFITABILITY

In the first half of 2023, there was a further improvement in the sector's efficiency, with the cost-to-income ratio falling by 12.8 pp to 38.8% due to a rise in total operating income higher than that of operating costs. In turn, the cost of credit risk rose year-on-year, due to the increase in credit impairments as rising interest rates amplifies conditions for the materialisation of credit risks.

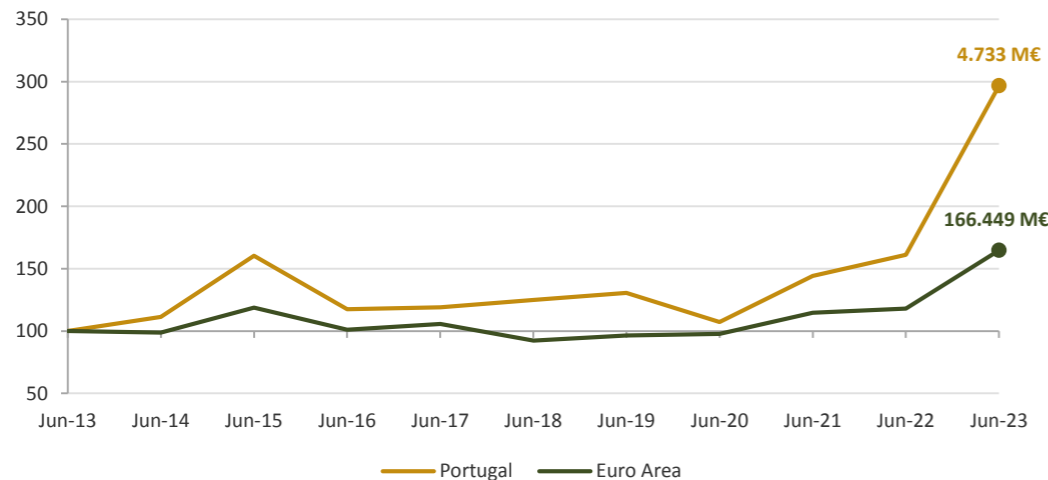
Cost-to-income breakdown (EUR million) – Portugal



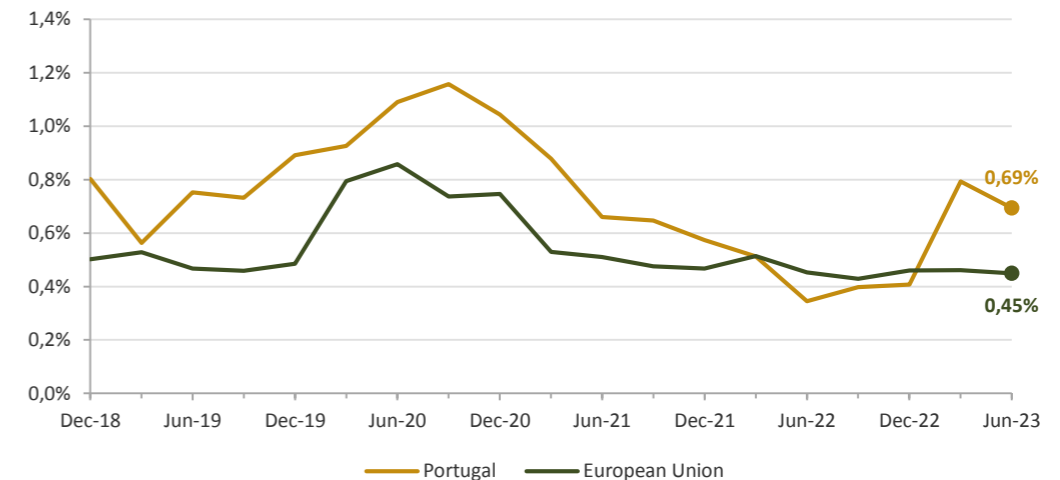
Operating costs as a % of total assets



Net operating income (Jun-13 = 100)



Cost of credit risk

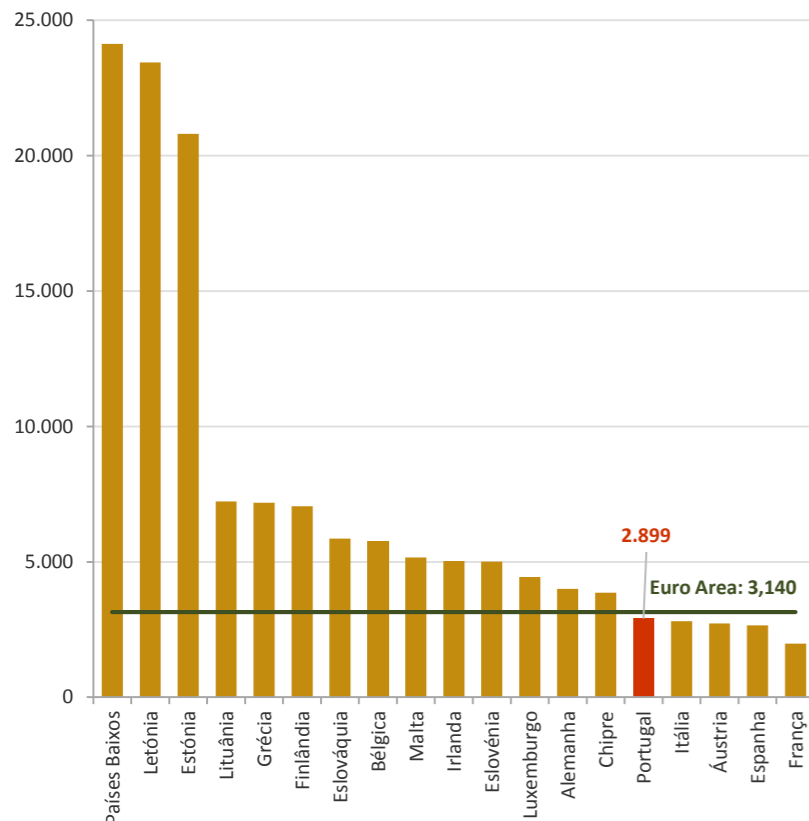


Source: Banco de Portugal (consolidated data), ECB – Consolidated Banking Data (Euro Area) and EBA – Risk Dashboard (cost of credit risk). In June 2023, the EBA sample included 144 European banks, 30 of which are subsidiaries, covering more than 80% the EU/EEA banking sector (sample for Portugal: BCP, CGD, LSF Nani Investments and Santander Totta). 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).

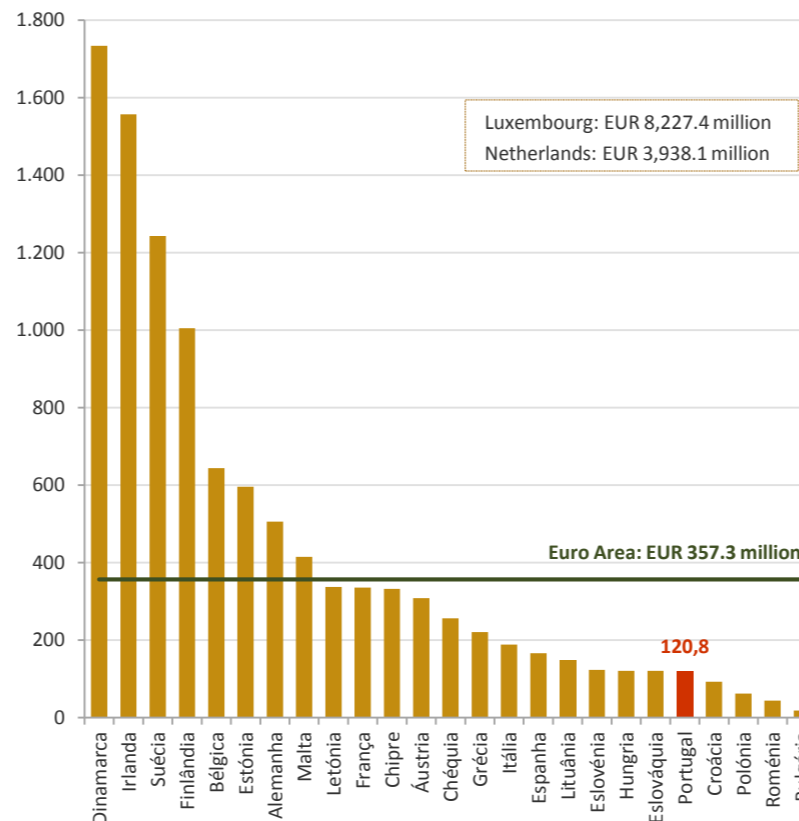
VI. PRODUCTIVITY

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 concerning assets generated per branch and assets generated per employee remains significantly below the European average.

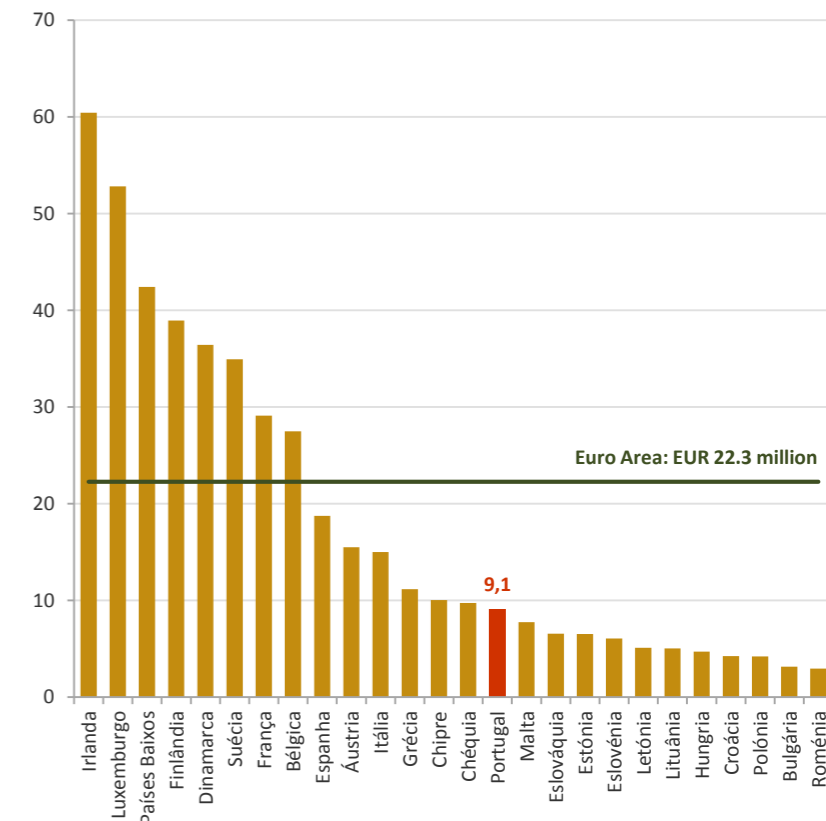
Residents per branch (Dec-22)



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.

- 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, the 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 2 November 2023.

PORTUGUESE BANKING SECTOR OVERVIEW

JUNE 2023