

PORTUGUESE BANKING SECTOR OVERVIEW

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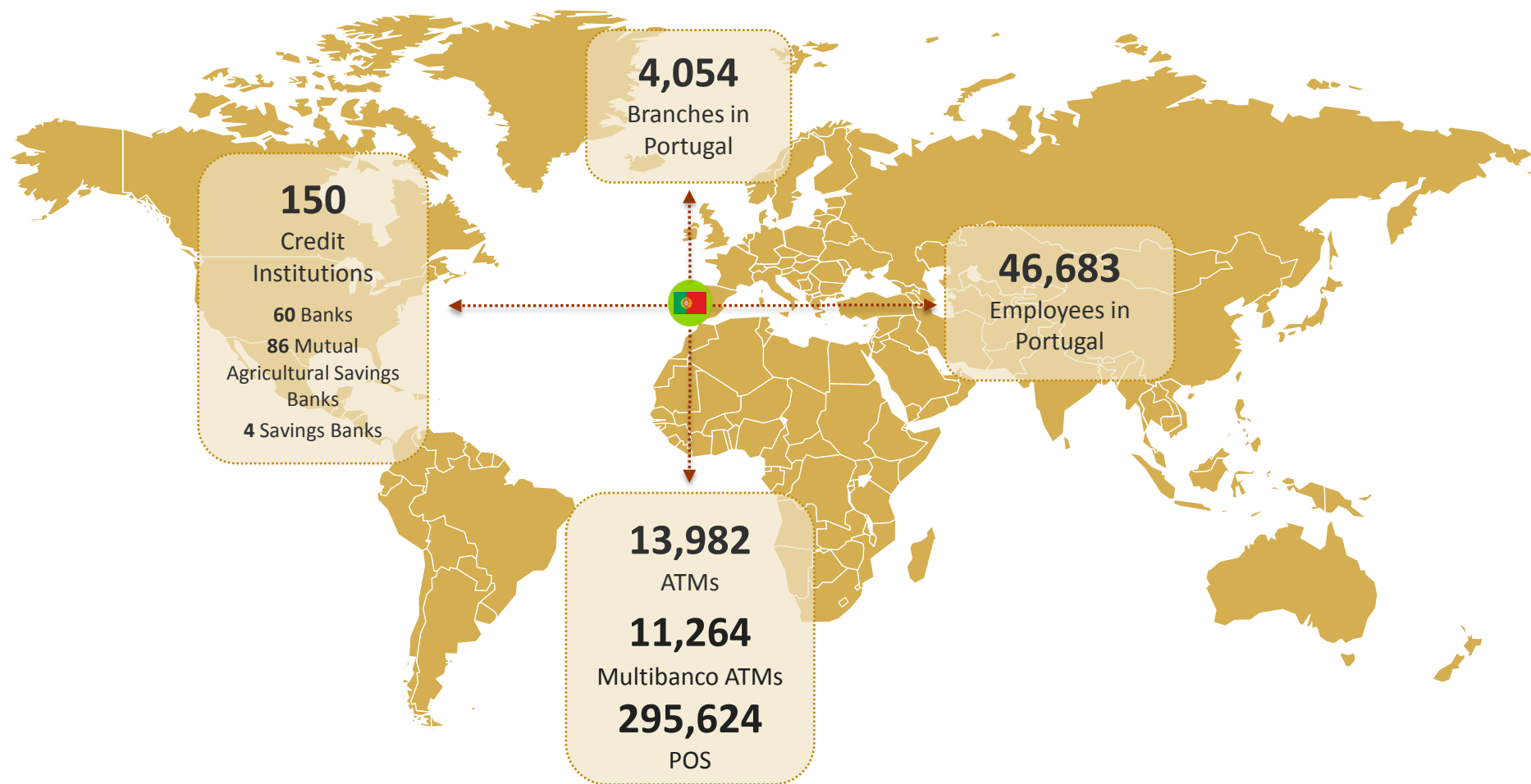
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I. Portuguese Banking Sector



- ❑ **The Portuguese banking sector is more resilient and better prepared to deal with potential adverse shocks.** Significant progress has been achieved in terms of solvency, liquidity, asset quality, efficiency and profitability.
- ❑ **In 2018, the stock of loans to customers continued to decline, but at a lower rate than in previous years.** Currently, deleveraging reflects mainly the reduction of non-performing loans (NPL), while performing loans show a positive evolution.
- ❑ **Strong progress in NPL reduction.** Since the peak reached in June 2016, NPLs have decreased by 24.6 billion euros. In that period, the NPL ratio decreased by 8.5 pp to 9.4% and the impairment coverage ratio increased by 8.7 pp to 51.9%.
- ❑ **There has been a reinforcement of customer deposits as the main source of funding,** despite the very low interest rate environment.
- ❑ **In 2018, profitability recovered,** mostly reflecting a decrease in impairments, as a result of a continued reduction of non-performing assets.
- ❑ **Liquidity remains at comfortable levels:** the funding gap has been declining, the loan-to-deposit ratio has continued its downward trend (it decreased approximately 70 pp from the peak reached in June 2010), and the liquidity coverage ratio has been increasing, being considerably above the required minimum requirement of 100%.
- ❑ **Solvency has been improving,** reflecting the strengthening of own funds, the favorable evolution of risk-weighted assets, and improved profitability.

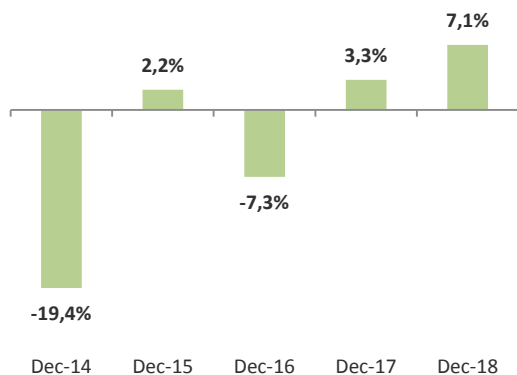


Source: APB's Associates (branches, employees and payment systems) and Banco de Portugal (credit institutions).

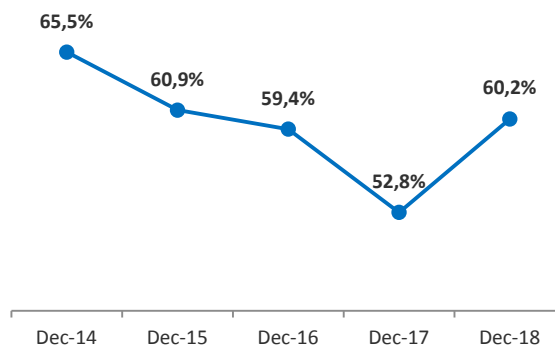
PORTUGUESE BANKING SECTOR

The Portuguese banking sector is more resilient compared to the pre-crisis period, showing considerable progress in terms of solvency, liquidity, asset quality, efficiency and profitability.

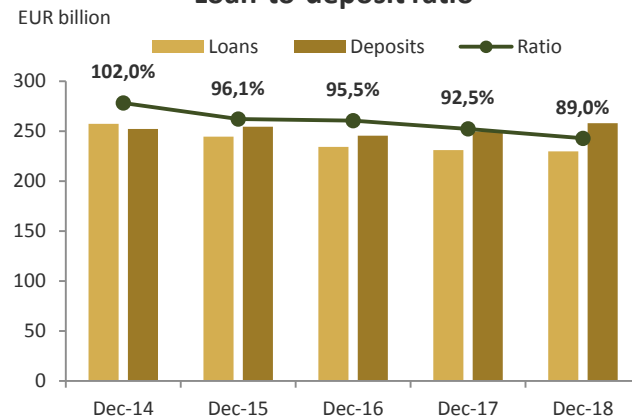
Return on Equity



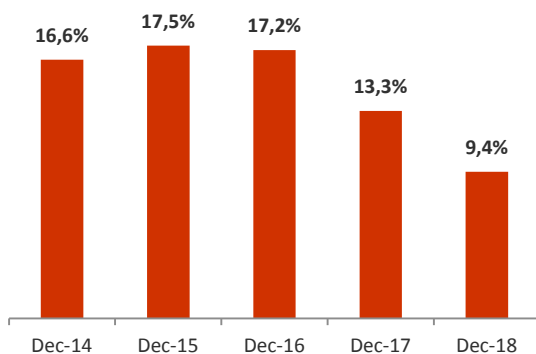
Cost-to-Income



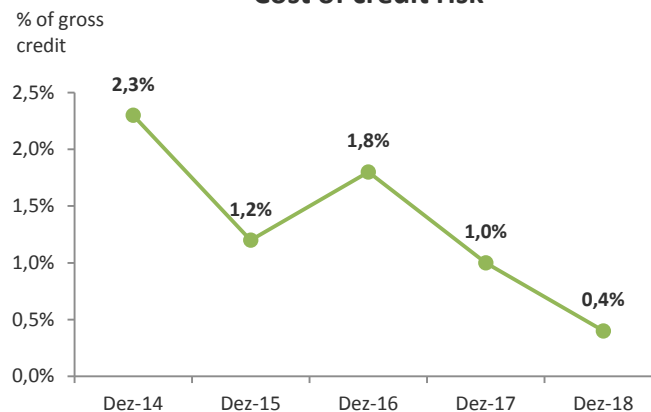
Loan-to-deposit ratio



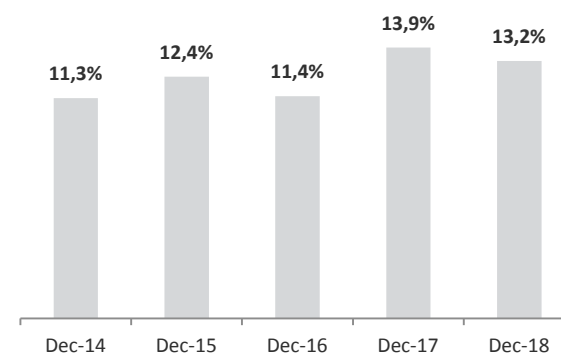
Non-Performing Loans ratio



Cost of credit risk



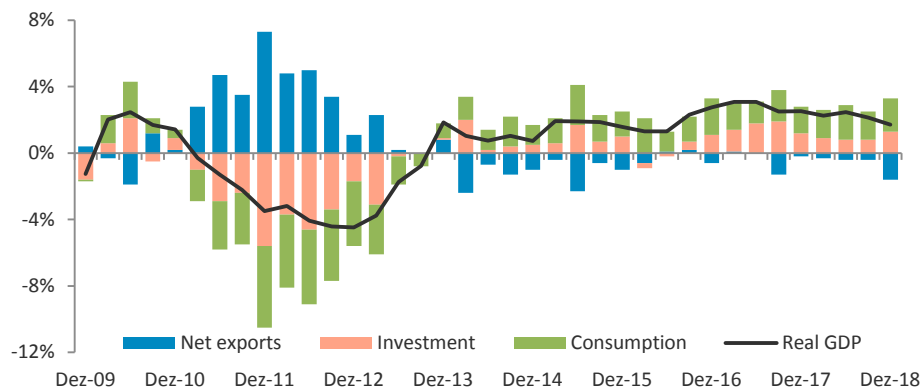
Common Equity Tier 1 ratio



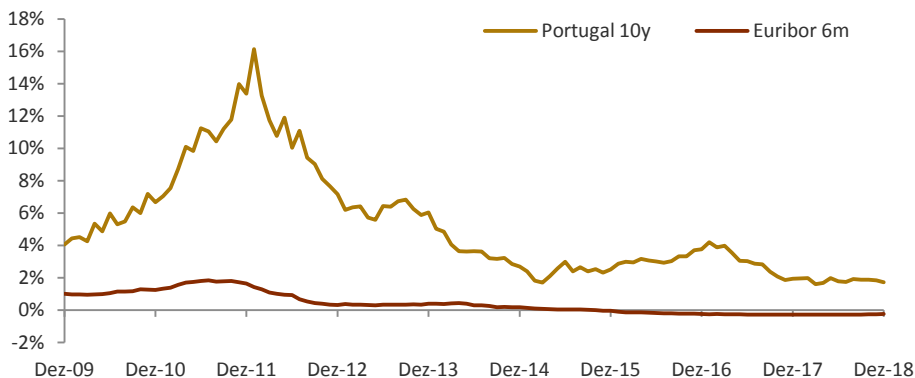
Source: Banco de Portugal (consolidated data). Return on Equity calculated based on earnings before tax.

Banking activity has benefited from a favorable economic environment. However, economic growth has been showing signs of slowdown.

The Portuguese economy started to show positive signs of growth from Q3 2013 onwards



Interest rates remain at low levels



But a deceleration is expected in the 2018-2020 horizon

		2018	2019F	2020F
Gross Domestic Product	agr	2.1	1.9	1.9
Private consumption	agr	2.6	1.8	1.8
Public consumption	agr	0.8	0.2	0.6
Investment (GFCF)	agr	4.5	5.3	4.9
Exports	agr	3.7	3.8	3.8
Imports	agr	4.9	3.9	3.9
Contribution to year-on-year GDP change				
Domestic demand	pp	2.8	2.1	2.1
Net external demand	pp	-0.7	-0.2	-0.2
Net lending	% GDP	0.2	0.4	0.5
Unemployment rate	%	7.0	6.6	6.3
Harmonised Index of Consumer Prices	agr	1.2	1.4	1.5
Budget balance	% GDP	-0.5	0.2	0.3
Gross public debt	% GDP	121.5	118.6	115.2

Note: agr – annual growth rate, pp – percentage points, % GDP – percentage of GDP, % – percentage.

Source: INE – Statistics Portugal. Estimates for 2019 and 2020 based on the Stability Programme 2019-2023.

As a result of the recapitalization measures undertaken since the financial crisis, shareholder structures of the main financial institutions have changed significantly.

2012 - 2013

- Recapitalization of CGD, BCP, BPI, and Banif.

2014

- Resolution of BES and establishment of bridge bank - Novo Banco (EUR 4.3 bn in public funding).

2015

- Resolution of Banif (EUR 2.25 bn in public funding).
- Acquisition of BES's investment arm (BESI) by Haitong Bank.

2016

- Start of Novo Banco's sale process.
- Start of CGD's recapitalization process.
- Takeover offer for BPI by CaixaBank.
- Investment by Fosun in BCP.

2017

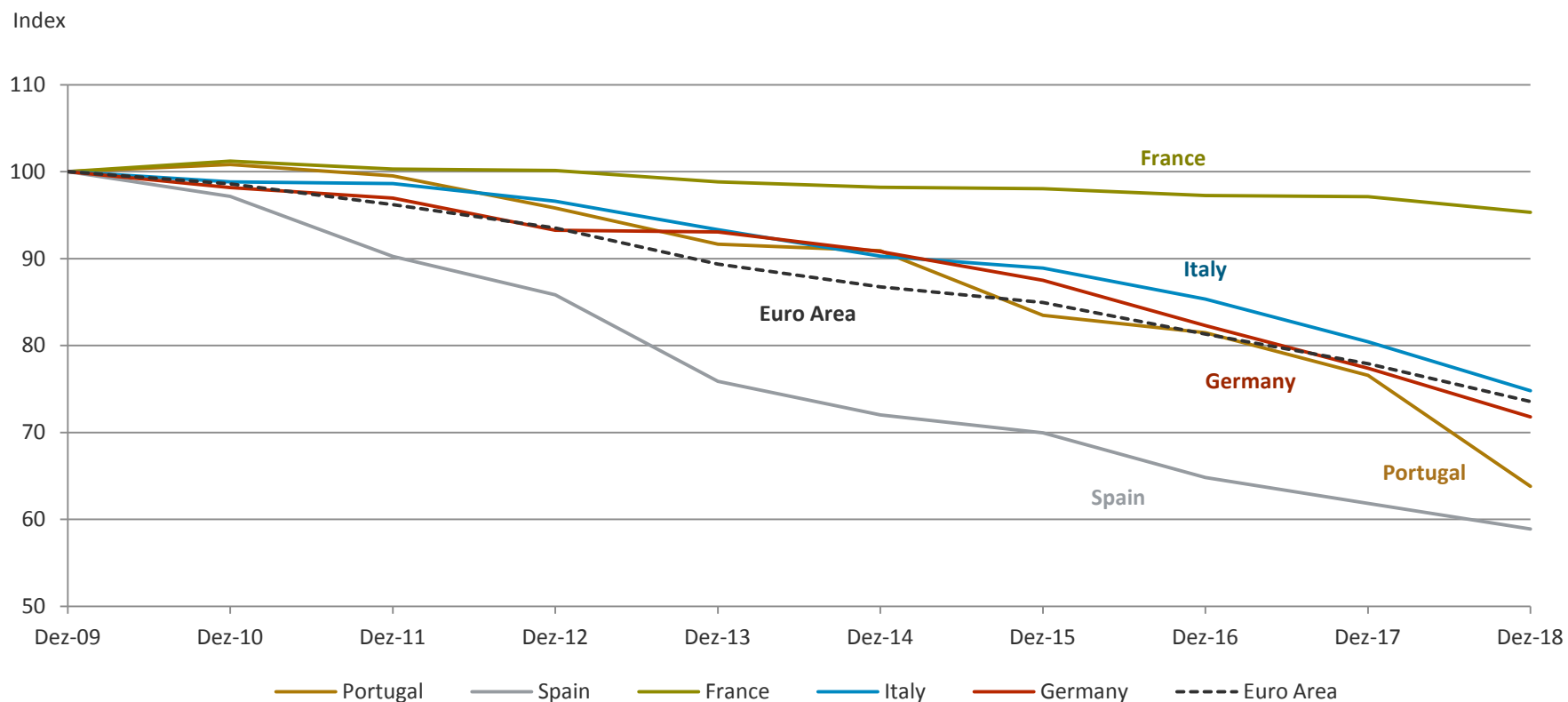
- BCP share capital increase (EUR 1.3 bn).
- CGD recapitalization totalling EUR 4.44 bn (EUR 3.94 bn through share capital increase; EUR 500 mn through Additional Tier 1 instruments).
- Conclusion of CaixaBank's public offer over BPI.
- Montepio share capital increase (EUR 250 million).
- Sale of Banco Popular to Banco Santander S.A. as part of a resolution measure adopted with regard to the former.
- Conclusion of the sale of Novo Banco to Lone Star.

2018

- Completion of the last phase of CGD's recapitalization plan: issue of EUR 500 million Tier 2 securities.

Furthermore, the several restructuring and consolidation processes implemented led to a significant resizing of the sector distribution network in Portugal.

Number of branches evolution – domestic activity (Dec-09=100)

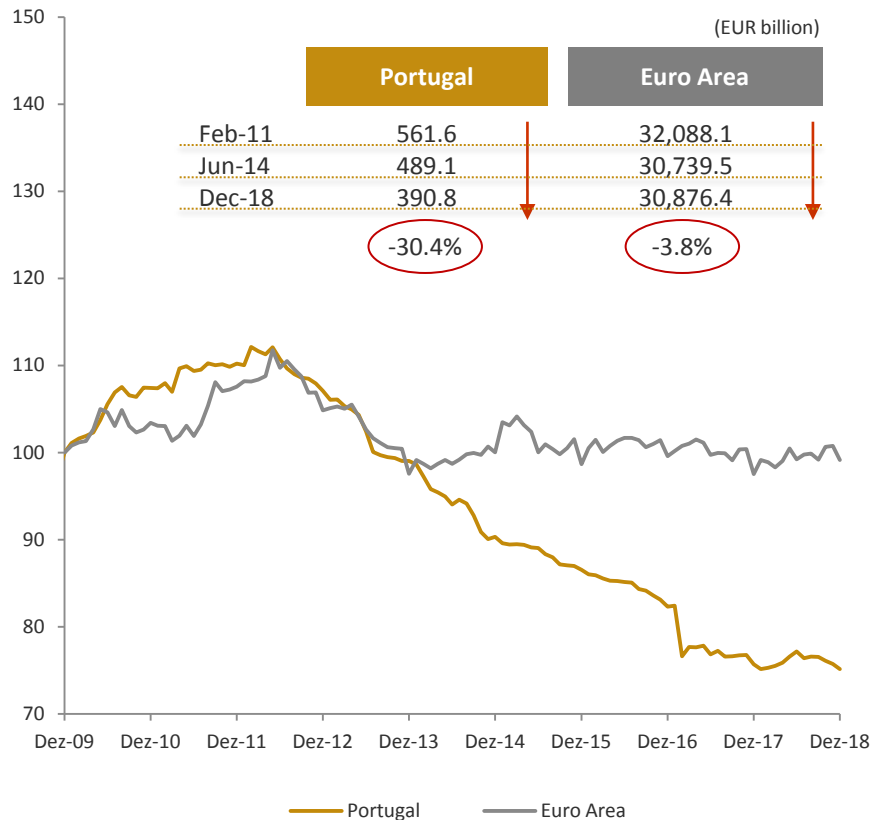


Source: ECB – Banking Structural Financial Indicators.

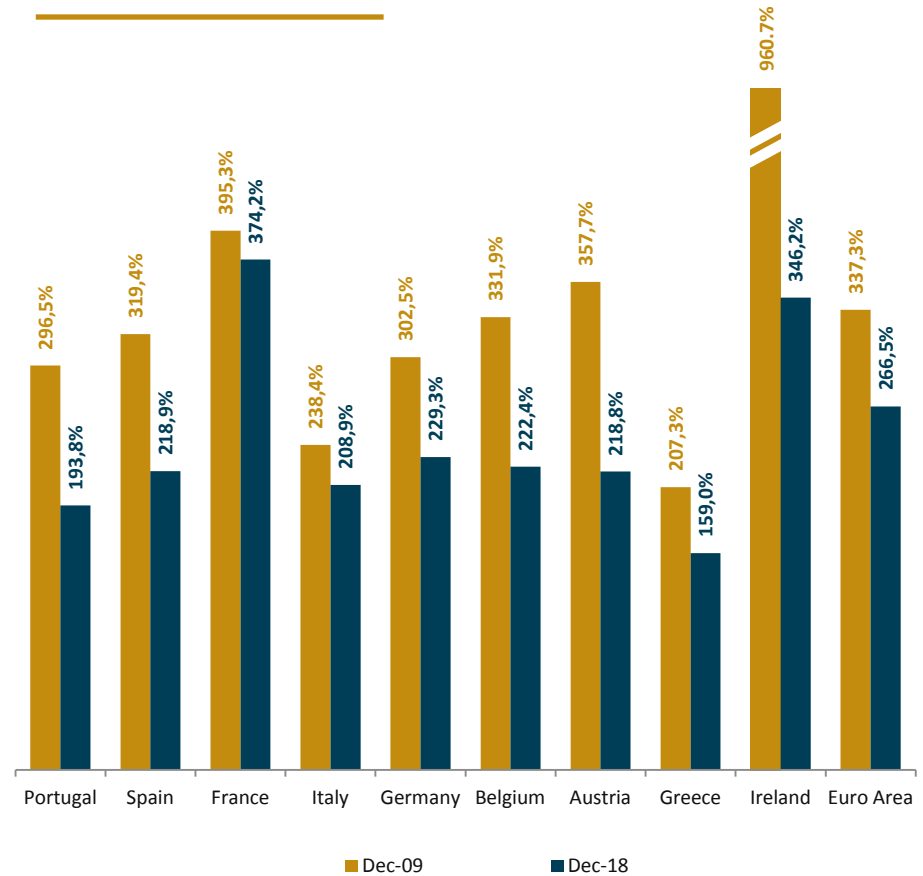
PORTUGUESE BANKING SECTOR

The adjustment process in the banking sector together with the deleveraging process contributed to a decline in the weight of total assets to GDP.

Total assets evolution (Dec-09=100)



Total assets as a % of GDP



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

II. Financial Position

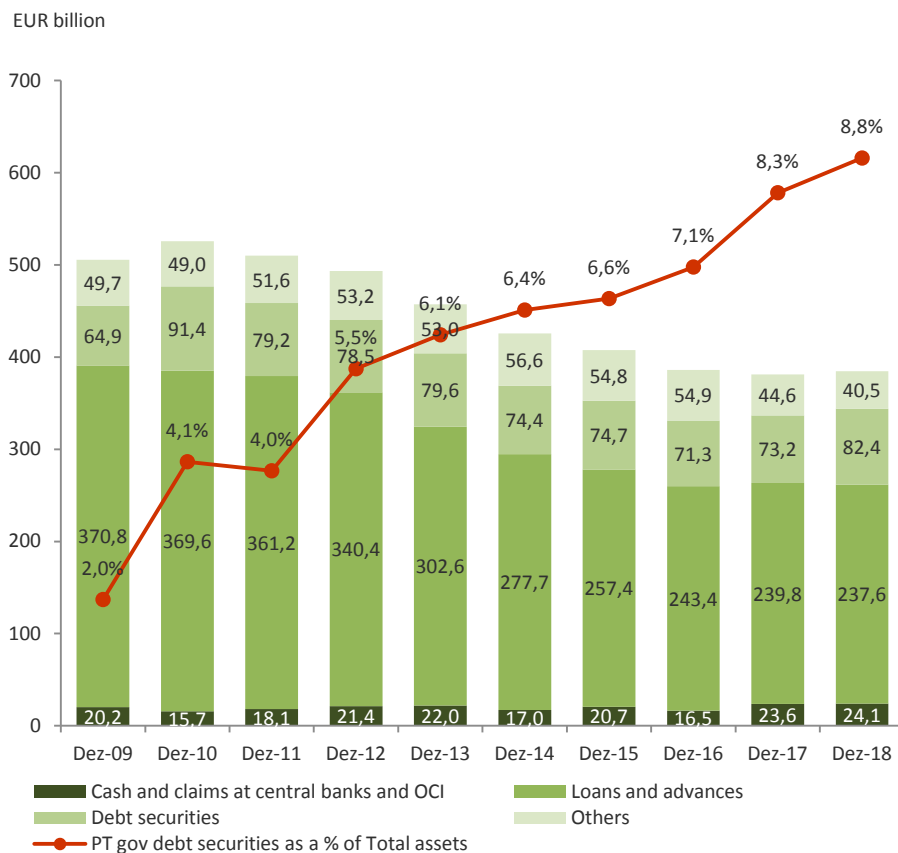
Lending



FINANCIAL POSITION

The significant reduction in the banking sector's total assets was mainly driven by the contraction in loans to customers. The exposure to Portuguese sovereign debt has been increasing.

Total assets breakdown



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

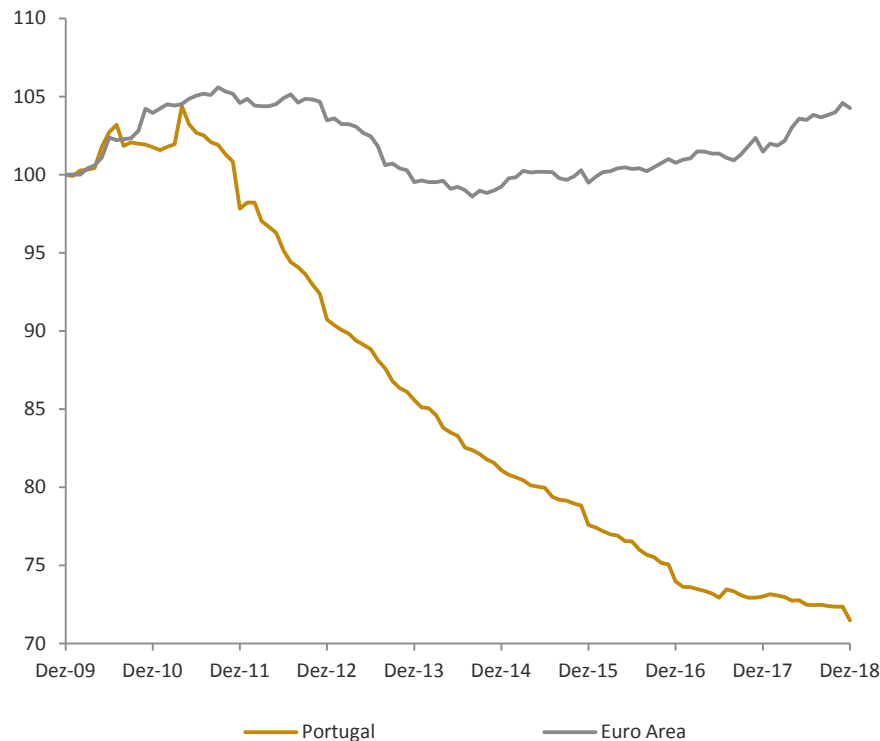
Portugal vs. Euro Area as a % of total assets



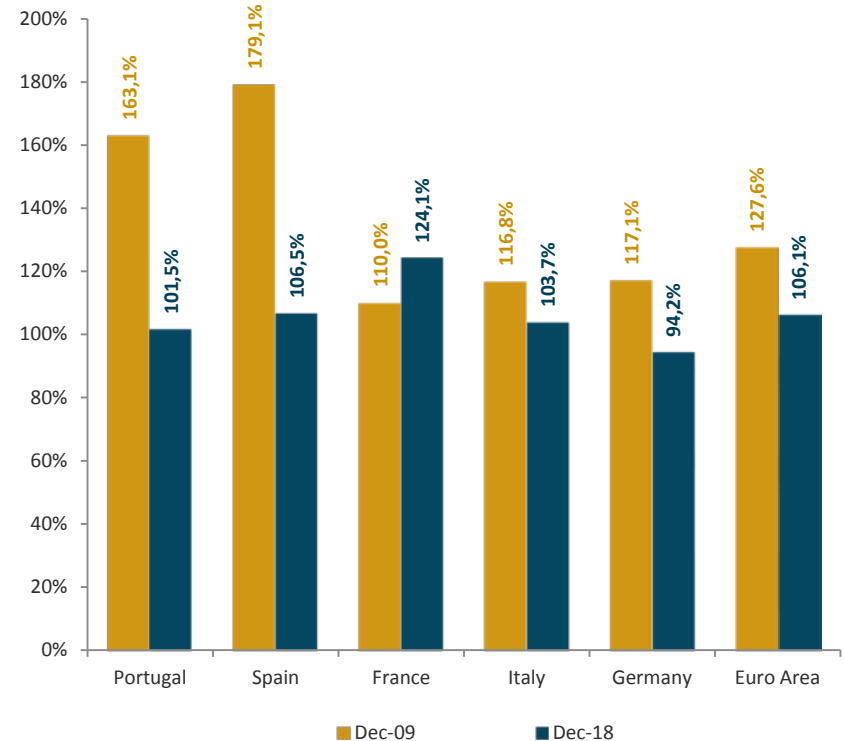
Source: ECB – Consolidated Banking Data.

The stock of loans to customers, as a percentage of GDP, progressively converged towards the Euro Area average. Currently, deleveraging is less pronounced and mainly reflects the reduction of the stock of NPL, while performing loans already show a positive evolution.

Total loans (Dec-09=100)



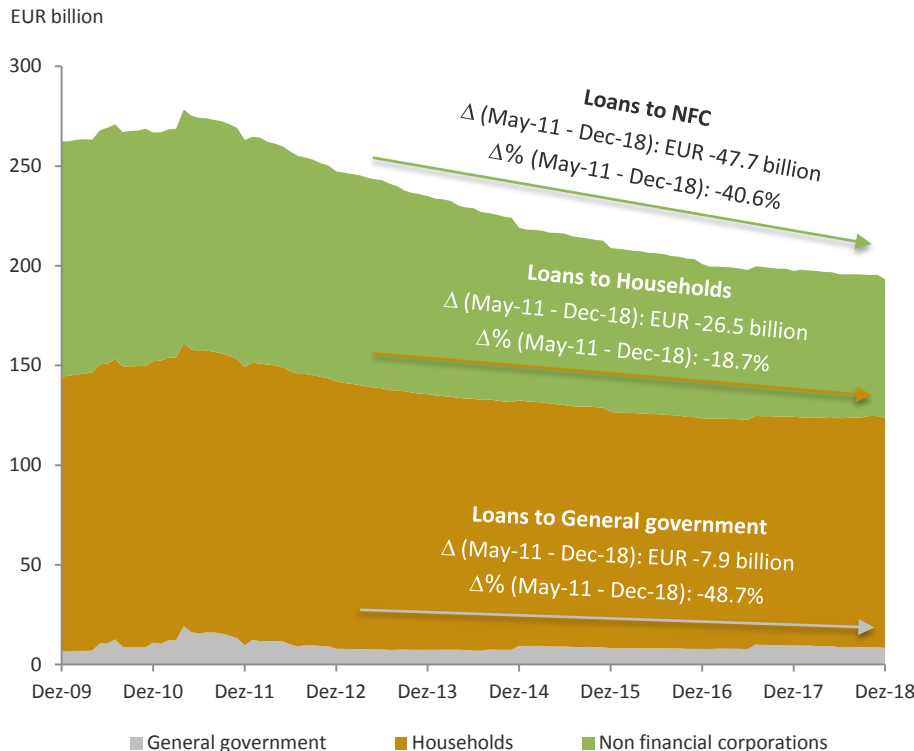
Total loans as a % of GDP



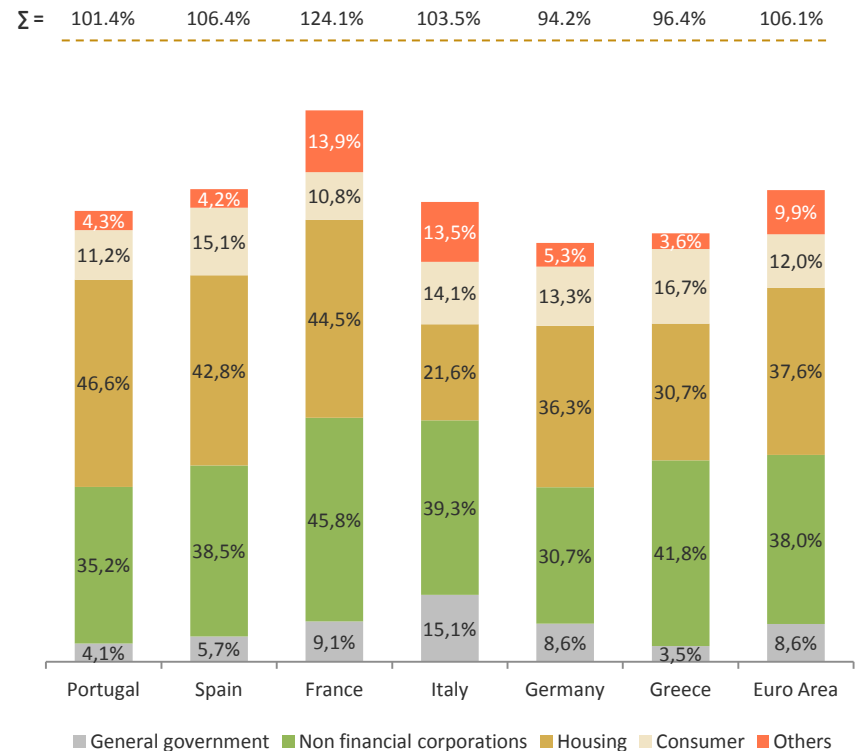
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Eurostat. Total loans granted to the non-monetary sector (end of period balances). Gross figures.

The deleverage has been considerably intense on the non-financial corporations (NFCs) segment. Loans to households is the only segment in which the weight in GDP is above the Euro Area average.

Loans per institutional sector



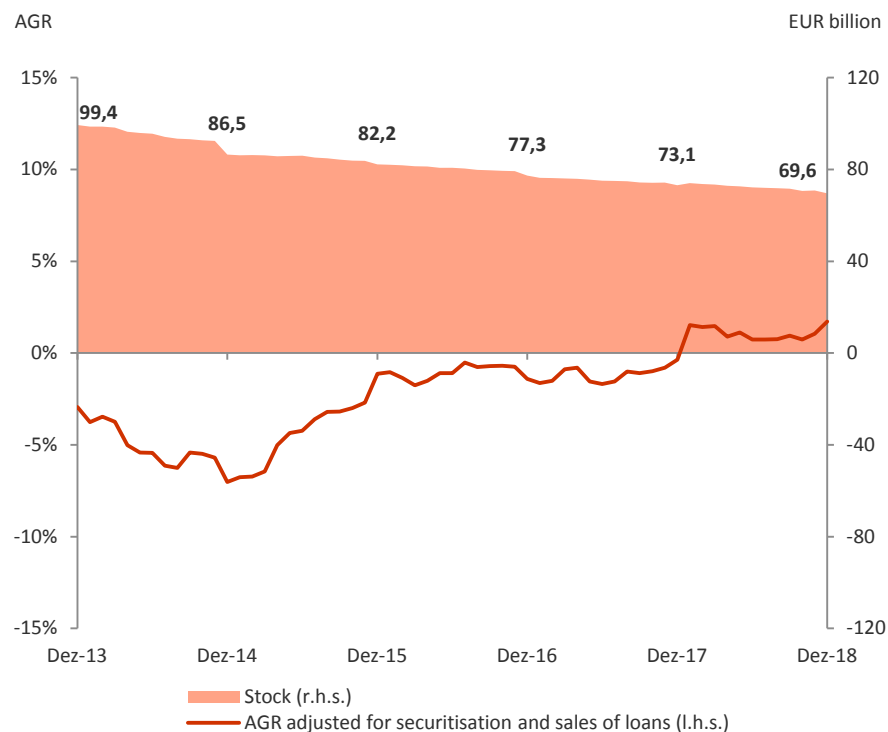
Loans per institutional sector as a % of GDP



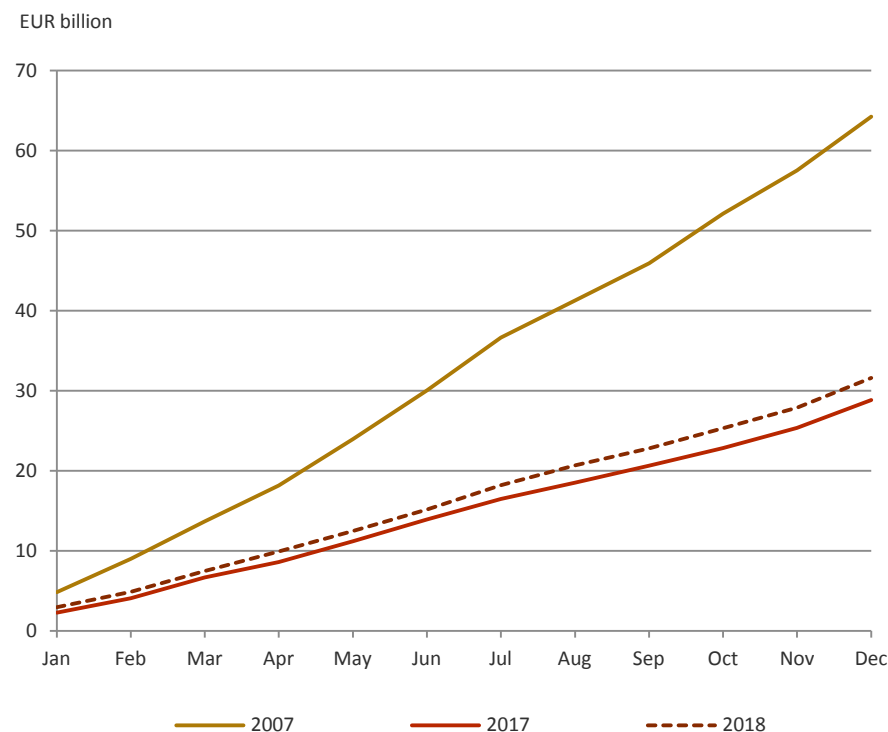
Source: Banco de Portugal (Monetary and Financial Statistics), ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Eurostat. Non-financial corporations include Private corporations and Public corporations not included in general government. Others include Non-monetary financial institutions: Other Financial Intermediaries, Financial Auxiliaries, Insurance Companies and Pension Funds.

The evolution of the stock of loans to NFCs has been penalized by the strong efforts to reduce NPLs. However, performing loans show a positive evolution since the beginning of 2018. New business lending is still lower than before the financial crisis, but higher than in 2016 and 2017.

Stock of loans to NFCs



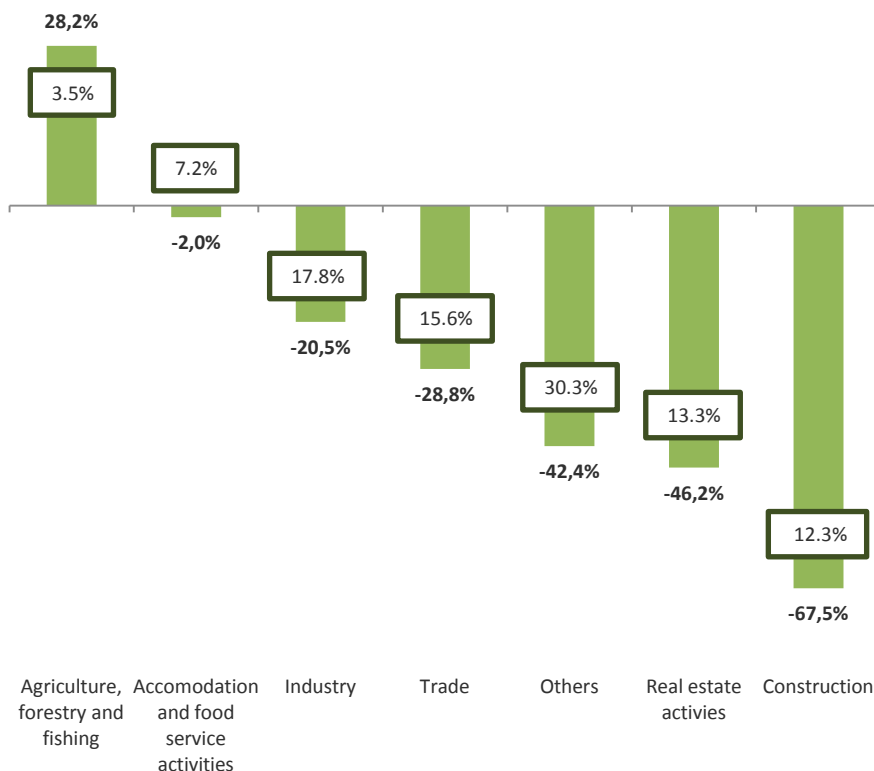
New business lending to NFCs (accumulated amounts)



Source: Banco de Portugal – Monetary and Financial Statistics. AGR = Annual growth rate.

The reduction of the exposure to the construction and real estate sectors continues.

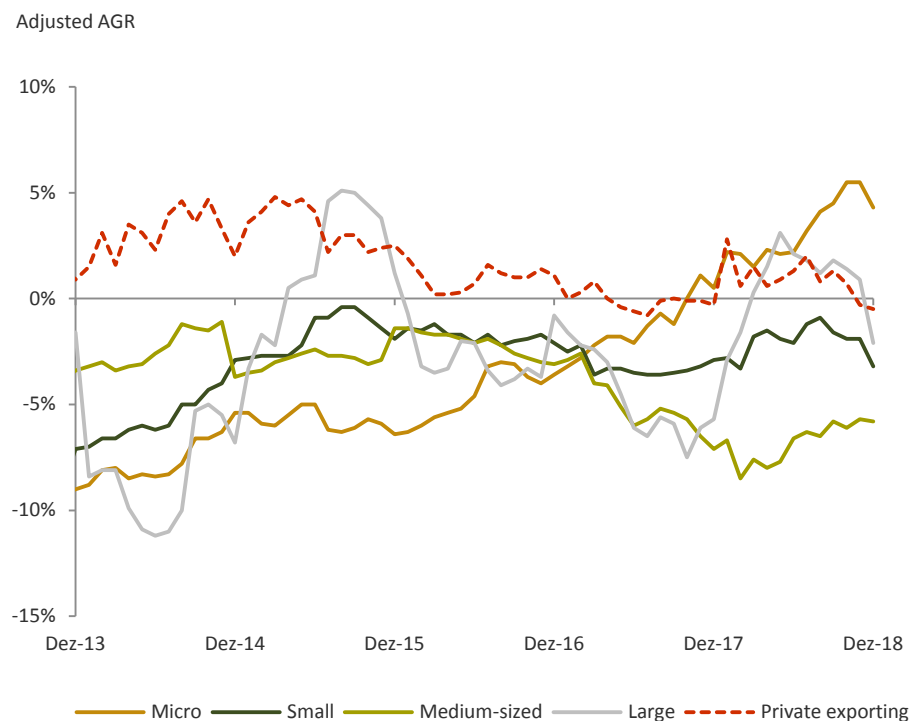
Change of the stock of loans to NFCs by sector (2009-2018)



 - As a percentage of total NFC lending in December 2018

Source: Banco de Portugal – Monetary and Financial Statistics. Loans granted by Other Monetary Financial Institutions (OMFI).

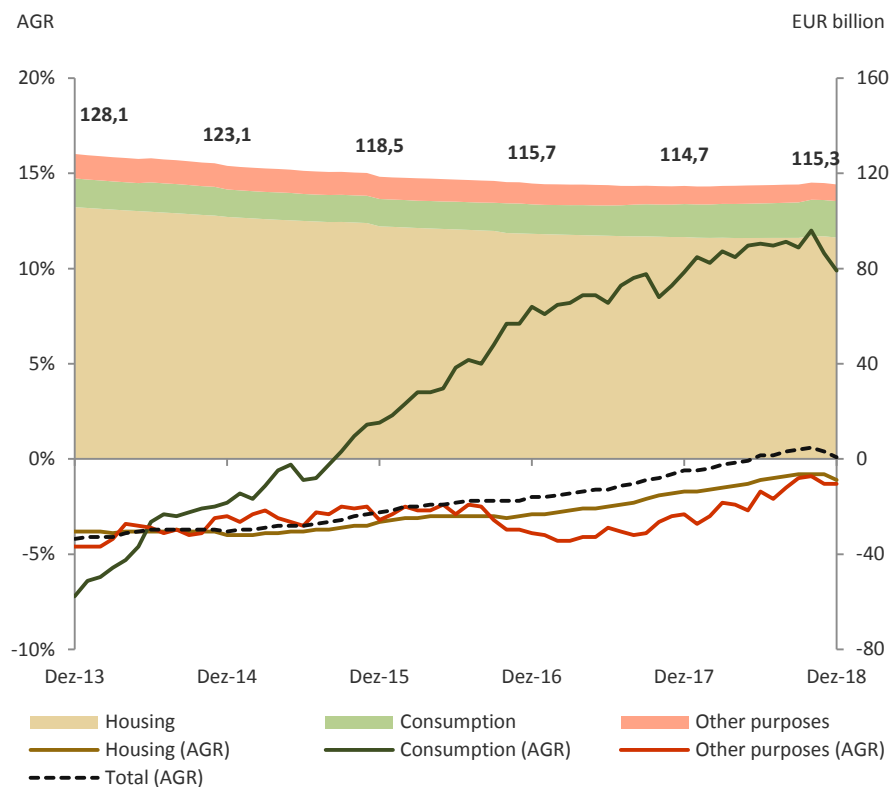
Adjusted AGR of loans to NFCs by size



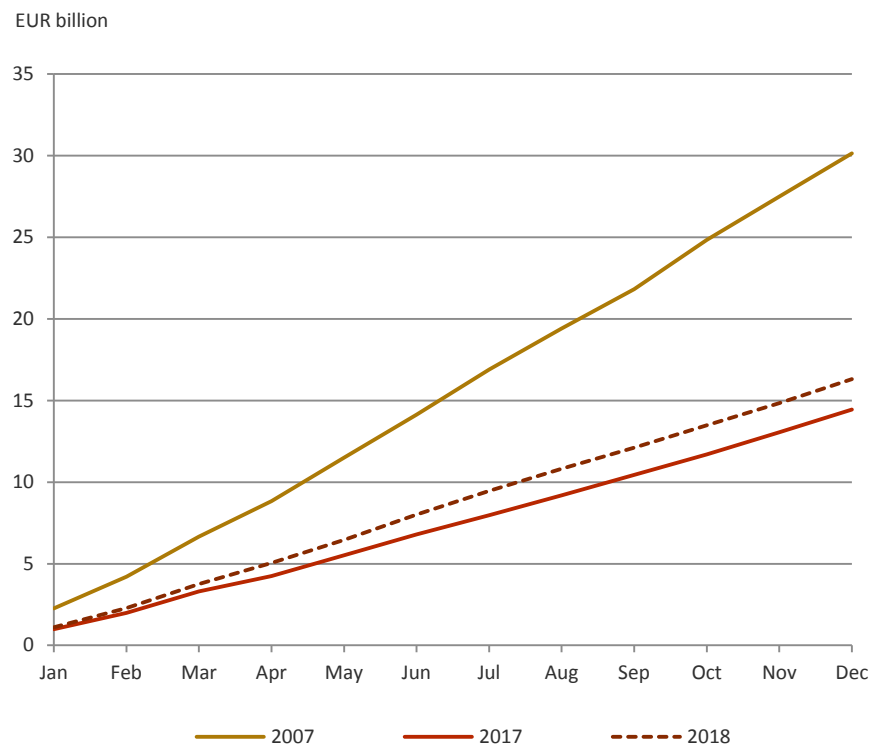
Source: Banco de Portugal – Monetary and Financial Statistics. Loans granted by the resident financial sector. Adjusted AGR calculated according to Banco de Portugal criteria.

The evolution of the stock of loans to private individuals mainly reflects the progressive recovery of housing loans and the dynamism of consumer credit, as a result of a better economic environment, improvement of housing market perspectives and the maintenance of the low interest rate environment.

Stock of loans to Private individuals



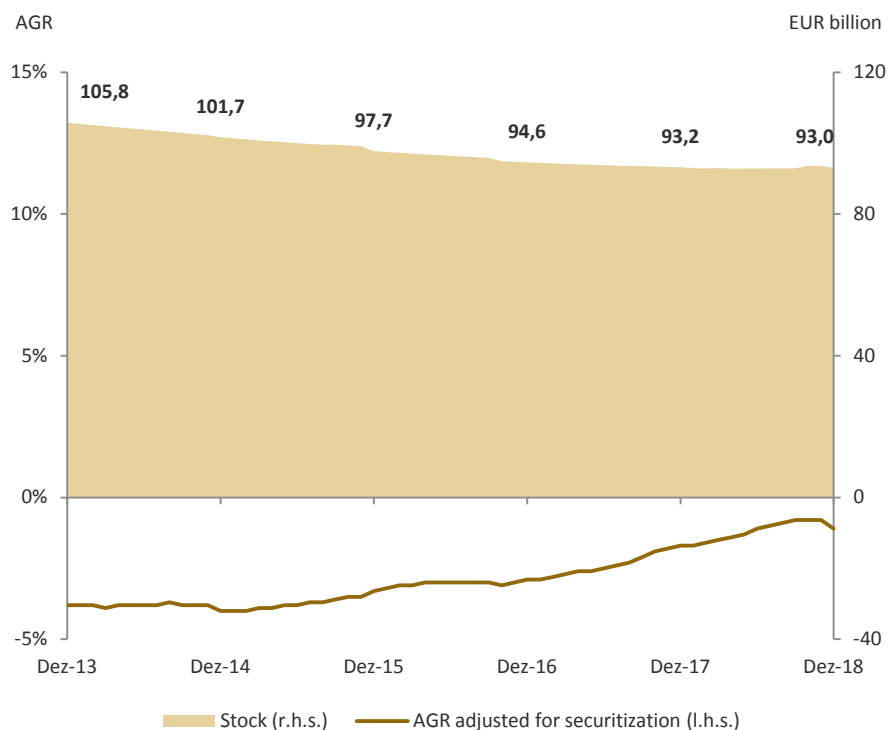
New business lending to Private individuals (accumulated amounts)



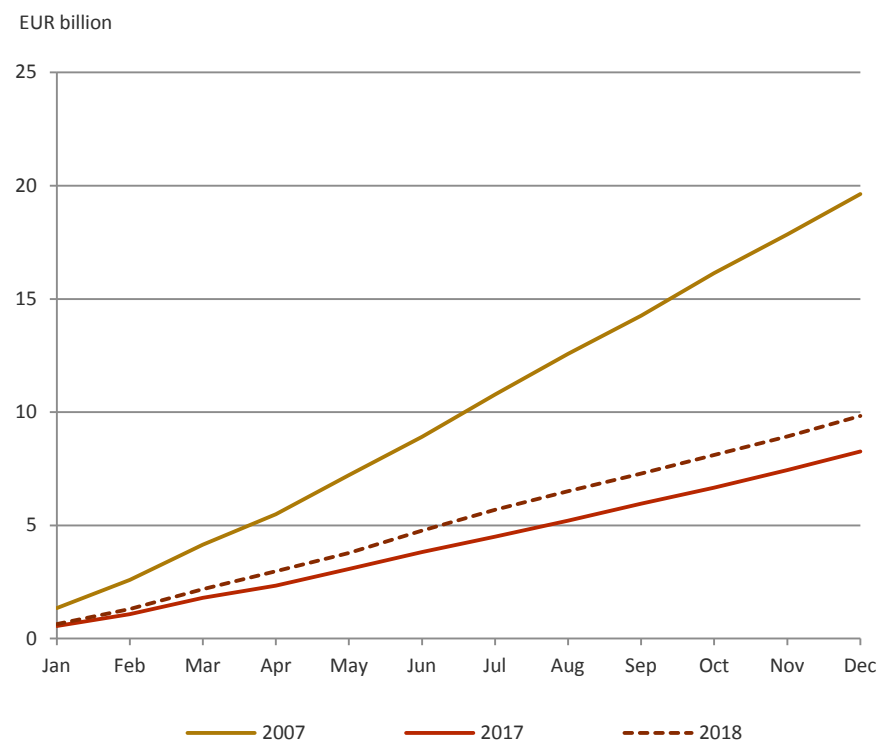
Source: Banco de Portugal – Monetary and Financial Statistics. Annual growth rates (AGR) adjusted for securitisation operations calculated according to Banco de Portugal criteria.

Flows of new home loans, although still below the pre-financial crisis level, increased strongly and contributed to a less negative evolution of the stock of these loans.

Stock of loans for house purchase



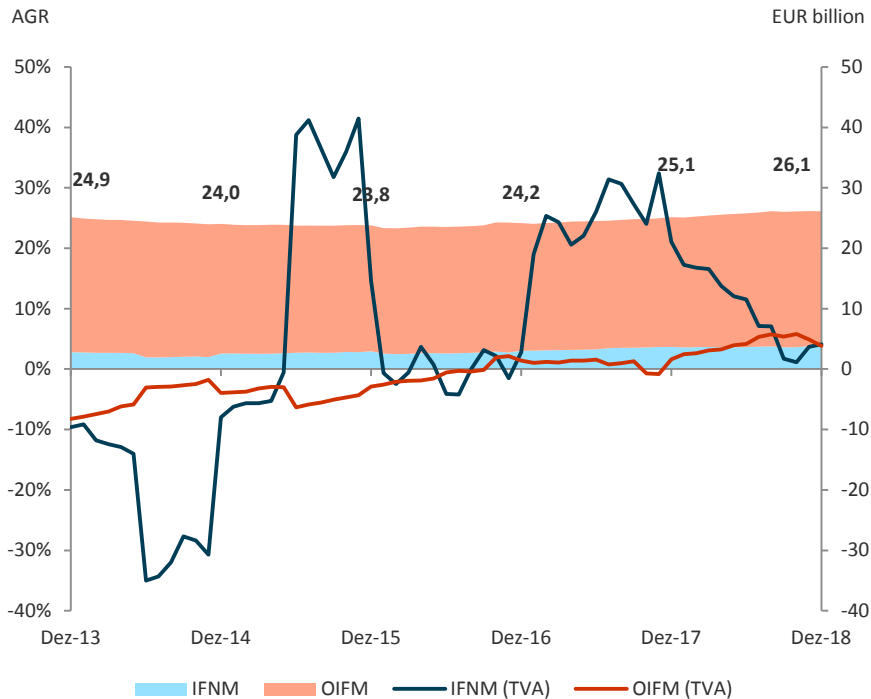
New business lending for house purchase (accumulated amounts)



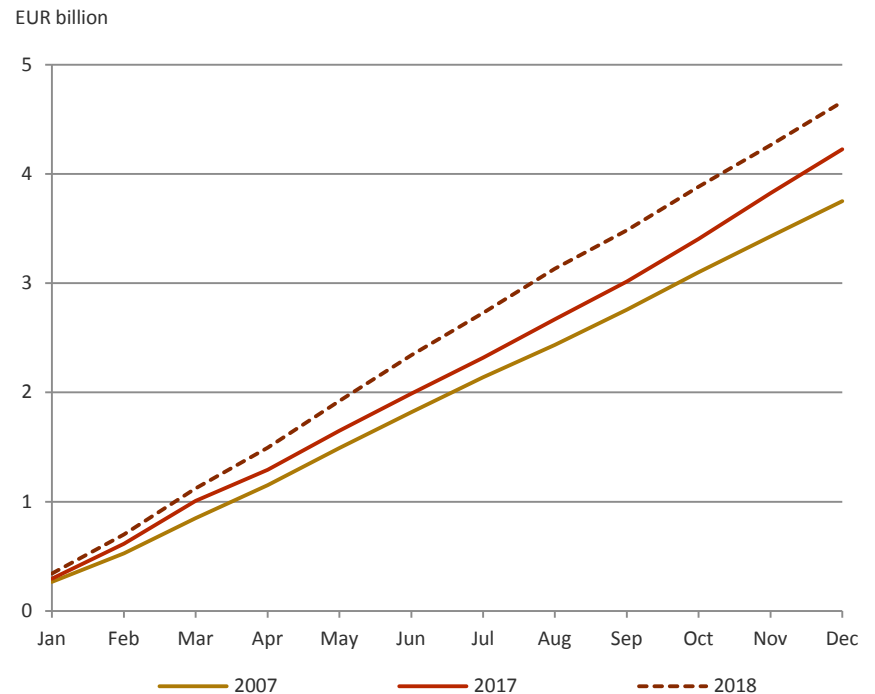
Source: Banco de Portugal – Monetary and Financial Statistics. Annual growth rates (AGR) adjusted for securitisation operations calculated according to Banco de Portugal criteria.

The credit for consumption, which has been increasing since early 2016, is associated with a better economic environment. However, its weight is still low both in terms of total indebtedness (< 20%) as well as in terms of loans granted by banks and other CIs (14%).

Credit for consumption and other purposes



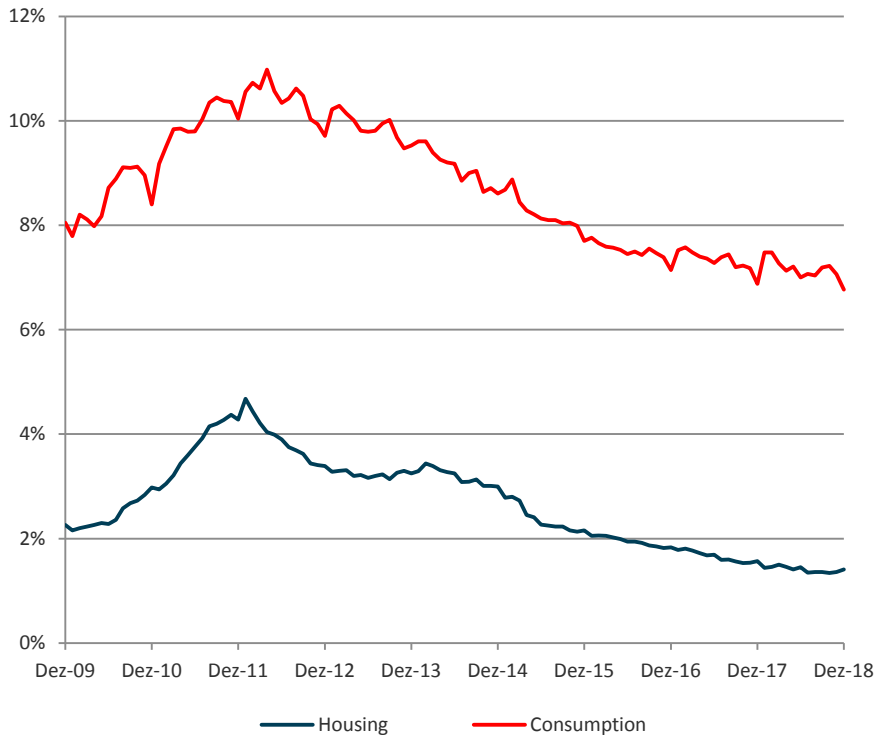
New business lending for consumption from MFIs (accumulated amounts)



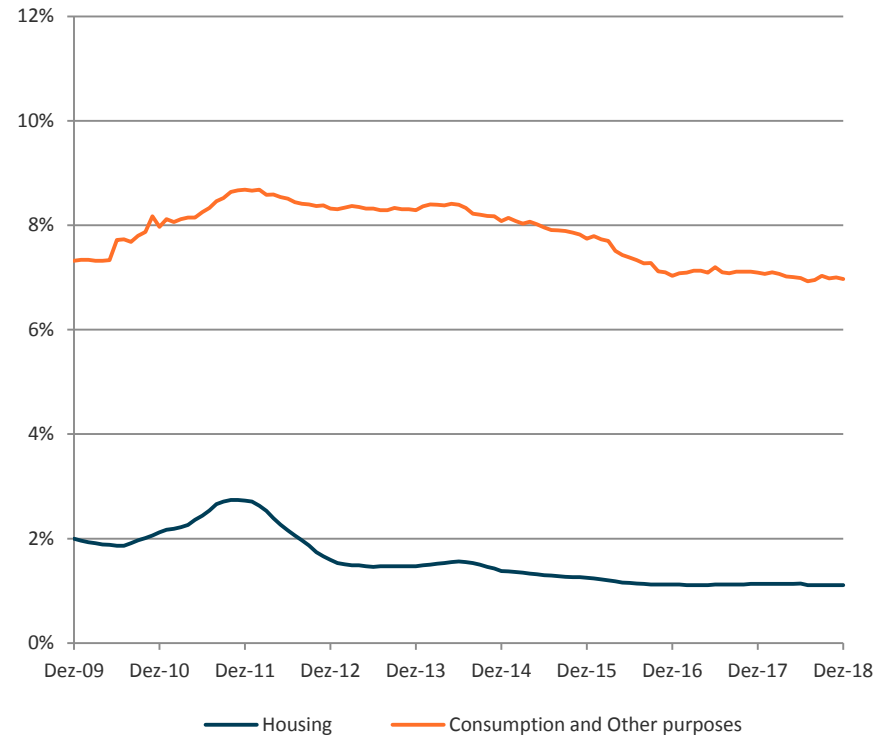
Source: Banco de Portugal – Monetary and Financial Statistics. Other monetary financial institutions (OMFIs) are composed by banks, saving Banks, mutual agricultural savings banks and money market funds. Non-monetary financial institutions (NMFIs) include credit financial institutions, credit-purchase financing companies, leasing and factoring companies and mutual guarantee societies.

Repricing capacity in terms of the interest rates on housing loans is rather limited given that a substantial amount of these loans is linked to Euribor, with long maturities and fixed spreads. The interest rate on loans for consumption is experiencing a deceleration trend.

Interest rate on new loans to Private individuals



Interest rate on stock of loans to Private individuals



Source: ECB – MFI Interest Rate Statistics.

In July 2018, a new macroprudential measure came into force aiming at mitigating the risk of interaction between housing prices and the loans granted by the Portuguese financial system in order to enhance the resilience of the financial sector. This measure corresponds to a Recommendation having a preventive stance.

LTV limits	<ul style="list-style-type: none"> ▪ LTV ≤ 90% to credit for the purchase or construction of own and permanent residence ▪ LTV ≤ 80% to credit for other purposes ▪ LTV ≤ 100% for credit relating to residential immovable property and credit secured by a mortgage or equivalent guarantee for purchasing immovable property held by the institutions themselves. ▪ Calculated through the minimum between the purchase price and the appraisal value
DSTI Limites	<ul style="list-style-type: none"> ▪ DSTI ≤ 50% ▪ For the calculation of the DSTI, monthly instalments of new loans are assumed constant over the entire period of the loan. For variable and mixed interest rate agreements, the impact of an interest rise should be considered. The DSTI should also take into account the impact of a reduction in the borrower's income, if the borrower's age at the term of the loan agreement is higher than 70 years old, except if the borrower is already retired at the time of the creditworthiness assessment.
Exceptions to DSTI limits	<p>Exceptions on the total amount of credit granted by each institution:</p> <ul style="list-style-type: none"> ▪ Up to 20%: DSTI ≤ 60%; ▪ Up to 5%: No DSTI limit.
Limits to maturity	<p>For credits relating to residential immovable property or credit secured by a mortgage or equivalent guarantee:</p> <ul style="list-style-type: none"> ▪ Maturity of new credit agreements ≤ 40 years; ▪ Average maturity of new credit agreements should gradually converge to 30 years until the end of 2022; <p>For consumer credit agreements: maturity of new loans ≤ 10 years.</p>
Requirement of regular payments	<ul style="list-style-type: none"> ▪ New loans should be granted with regular payments of interest and capital.

Source: Banco de Portugal. LTV = Loan-to-value ratio, that corresponds to the ratio between housing loan(s) and the minimum between the purchase price and the appraisal value of the house granted as collateral. DSTI = Debt service-to-income ratio, that corresponds to the ratio between monthly instalments of total credit agreements and the borrower's income, net of taxes and contributions to social security.

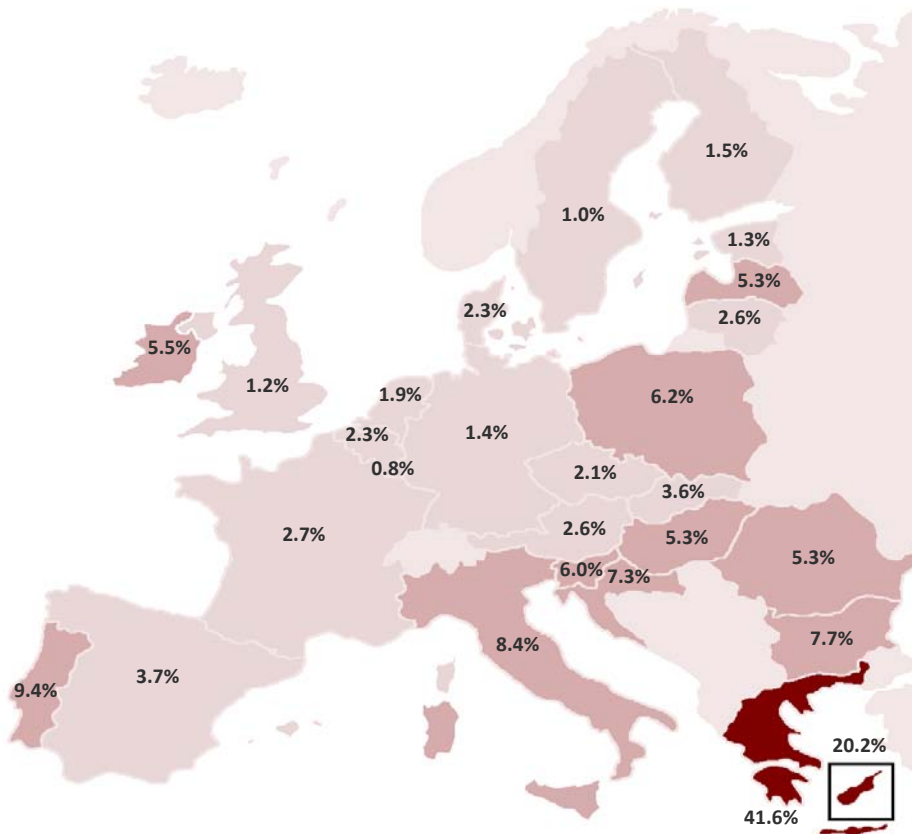
Countercyclical capital buffer – established by Banco de Portugal, on a quarterly basis, and currently remains at 0%.

Countercyclical capital buffer

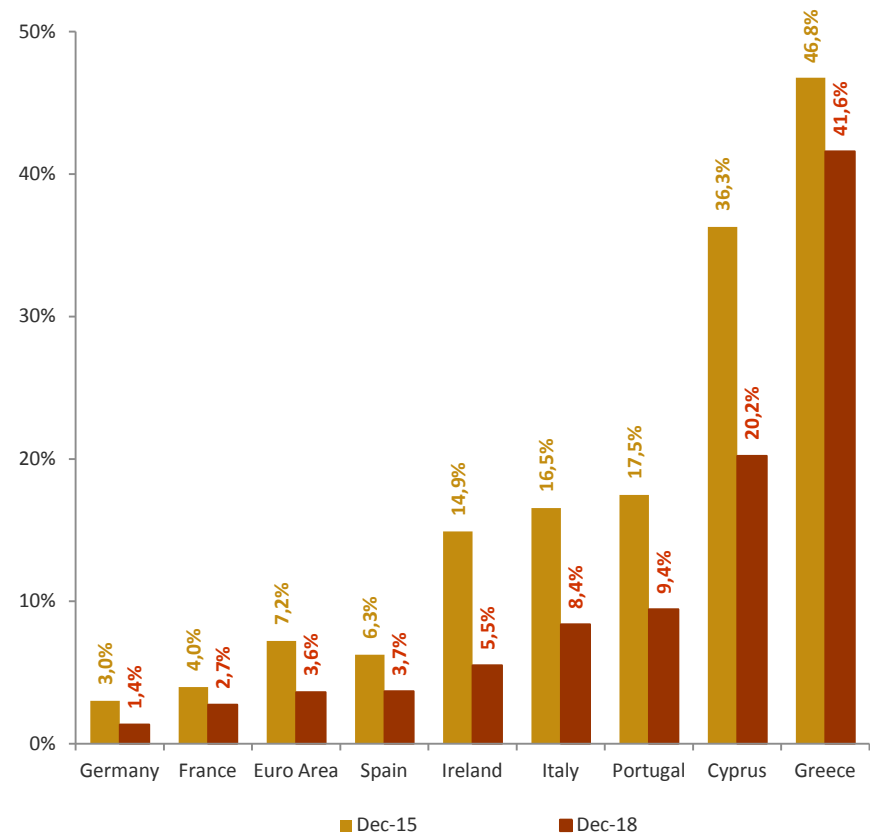
- Should be built up to protect the banking sector in periods when risks of system-wide stress are growing due to excessive credit growth. When risks materialize or recede, such an additional capital buffer ensures that the banking sector is better equipped to absorb losses and remain solvent while continuing to provide credit to the real economy.
- Banco de Portugal is responsible for setting and disclosing, on a quarterly basis, the countercyclical buffer rate that applies to all credit institutions and investment firms with credit exposures to the domestic private non-financial sector. The rate shall be set between 0% and 2.5% (of the total risk exposure amount), unless exceptional circumstances justify the setting of a higher rate.
- The countercyclical capital buffer in place for the 3rd quarter of 2019 was set at 0%.

NPLs represent one of the most serious problems that have emerged from the global financial crisis, and its resolution remains a priority for the European Authorities. In December 2018, NPLs totalled 632.7 billion euros in the Euro Area, corresponding to 3.6% of credit.

NPL ratio in the EU



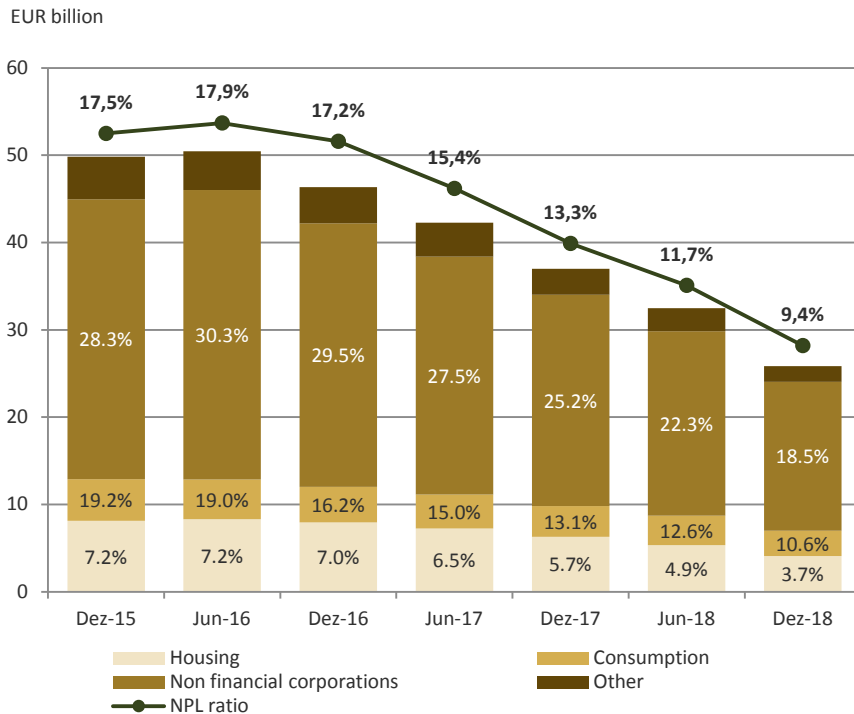
Evolution of NPL ratio in the EU



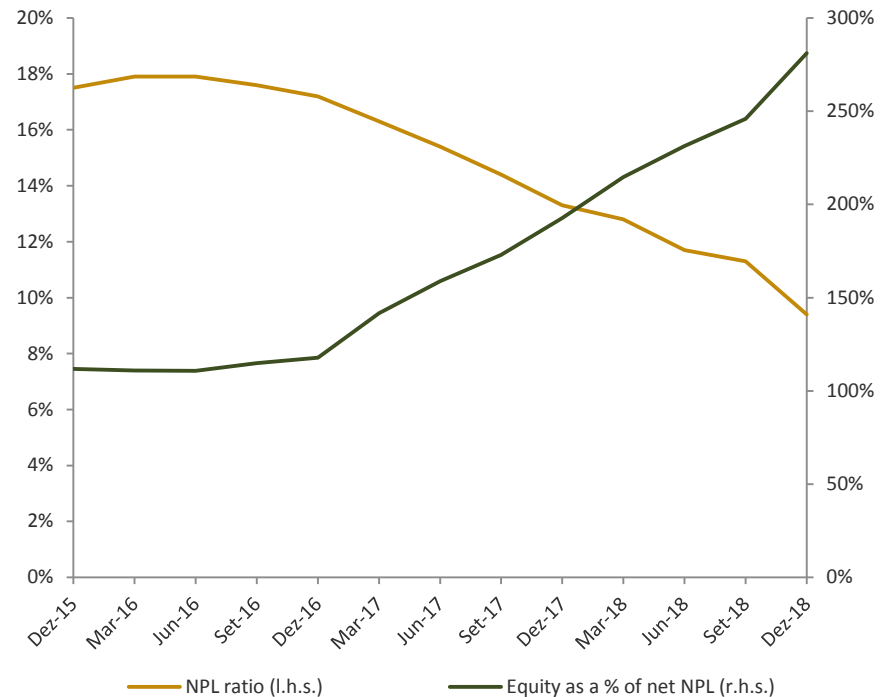
Source: ECB – Consolidated Banking Data.

In Portugal, progress in reducing NPLs has been quite significant. NPLs have decreased by 24.6 billion euros since June 2016. Despite the scale of the crisis, the composition of NPLs demonstrate households resilience.

Amount and NPL ratio in Portugal



Equity vs. NPLs

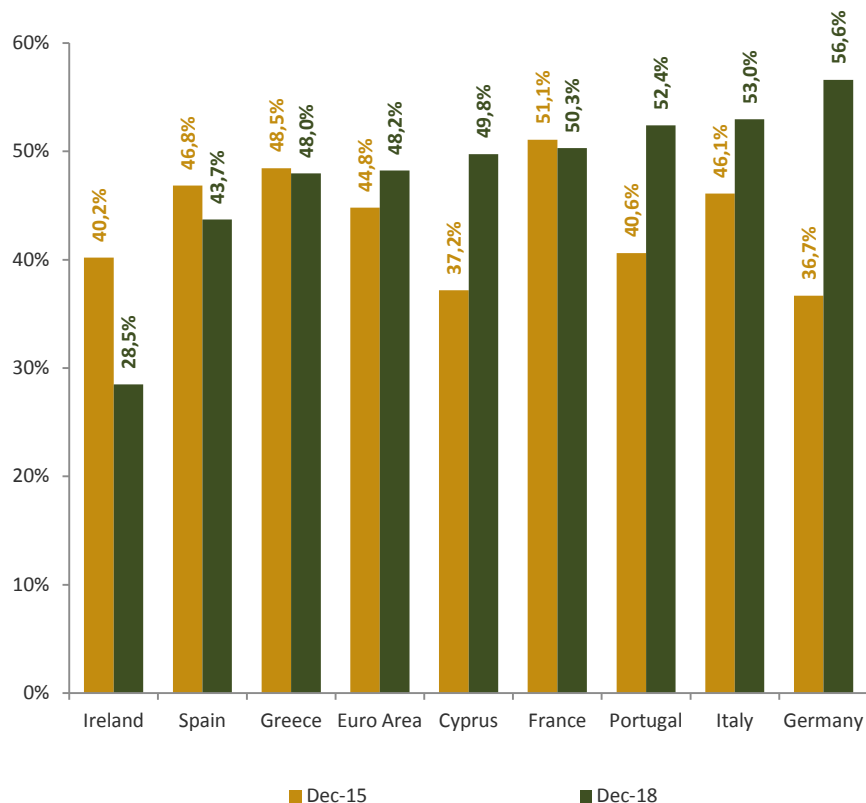


Non-Performing Loans – Loans that comply with at least one of the following conditions: i) material exposures that are more than 90 days past-due; ii) the debtor is assessed as unlikely to pay its obligations in full without realisation of collateral; iii) impaired assets, except incurred but not reported (IBNR) impairments; and iv) defaulted credit, in accordance with the CRR prudential concept.

Source: Banco de Portugal (consolidated data).

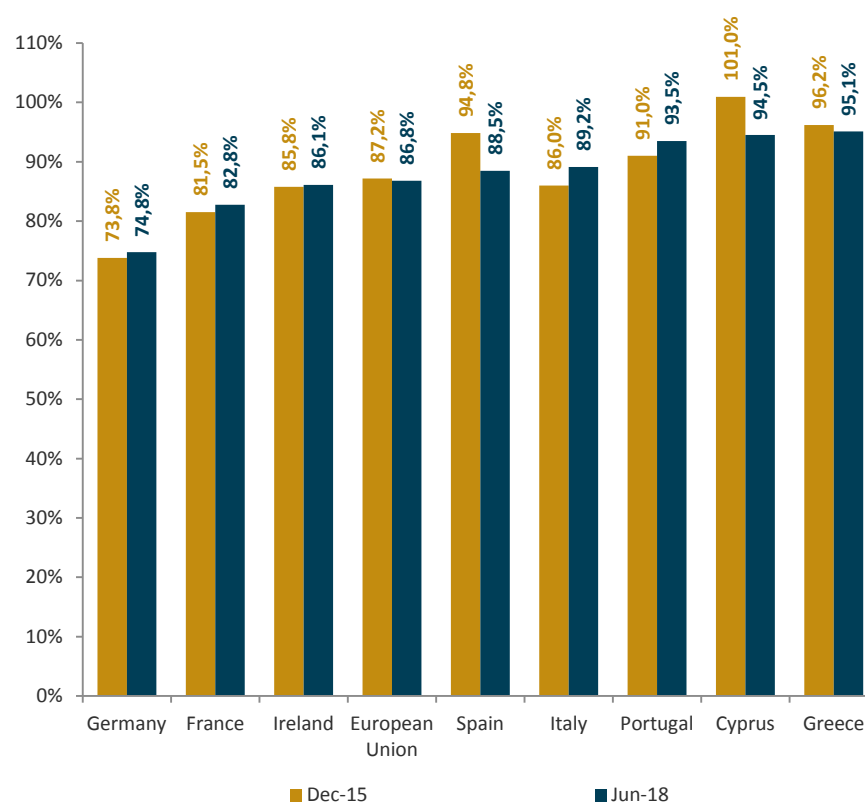
The NPL impairment coverage ratio and total coverage ratio are evolving positively and compare favourably with the Euro Area average.

Impairment coverage ratio



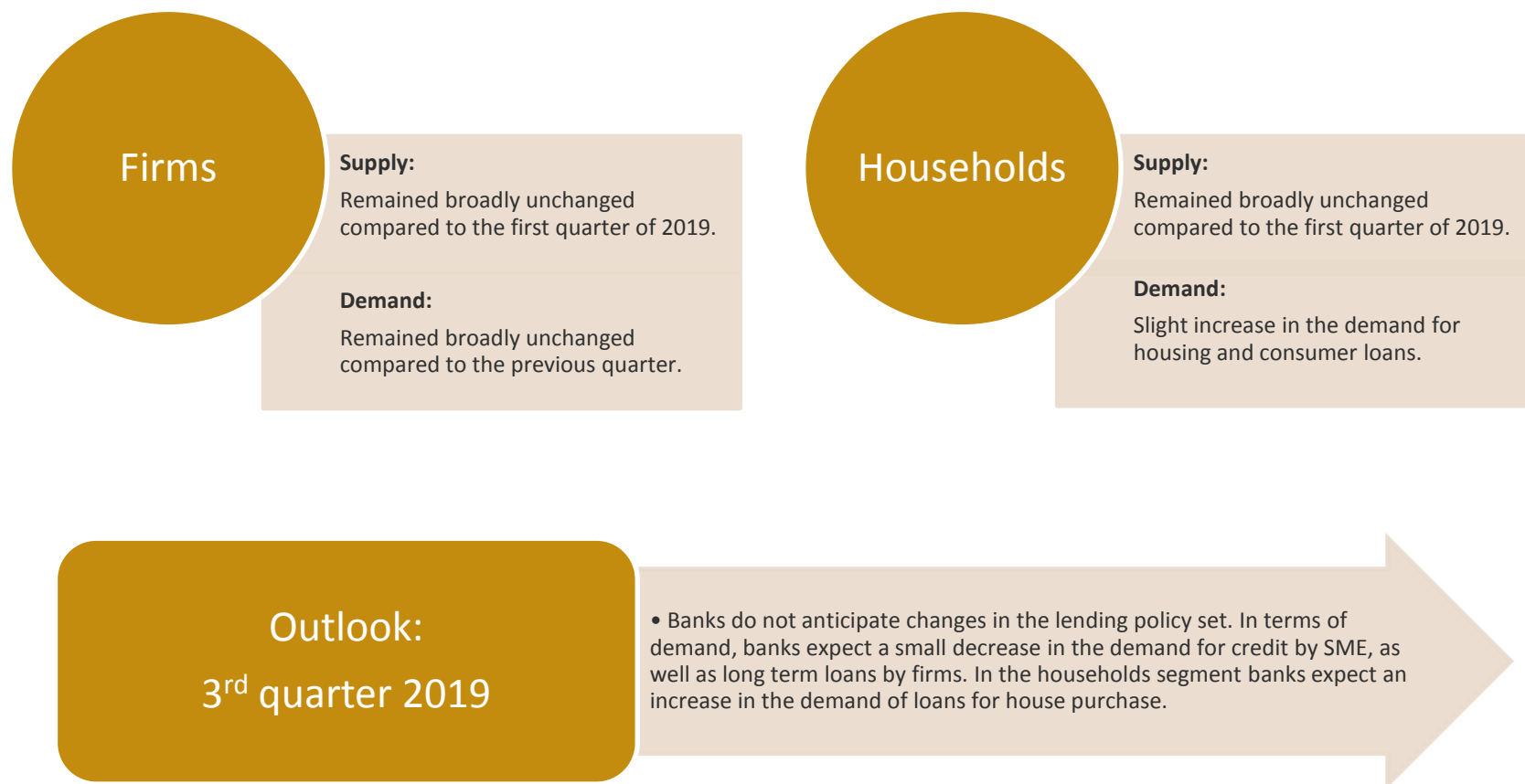
Source: ECB – Consolidated Banking Data. Impairment coverage ratio refers to non-performing loans and debt securities.

Total NPL coverage ratio



Source: EBA – EU-wide transparency exercise. Total coverage ratio includes cumulative impairments, collateral and financial guarantees associated to non-performing loans. EBA sample includes 131 banks (Portugal: BCP, Crédito Agrícola, Montepio, CGD e Novo Banco).

According to the Bank Lending Survey, in the second quarter of 2019 the lending policy set for the second quarter of 2019 remained broadly unchanged compared to the previous quarter. Demand for credit remained unchanged for firm loans and slightly increased for housing and consumer loans.



Source: Banco de Portugal – Bank Lending Survey.

Bank Lending Survey | Main conclusions

		Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019 <i>Outlook</i>
Supply	Firms	Unchanged	Unchanged	Unchanged	Unchanged	Unchanged
	Households	More restrictive lending policy for housing and consumer loans (compliance with new macroprudential measure)	Unchanged	Unchanged	Unchanged	Unchanged
Demand	Firms	Unchanged	Slight ↑ in SME and large enterprises, mainly for long-term loans	Unchanged	Unchanged	↓ in SME and long-term loans
	Households	↑ in lending for house purchase	Slight ↑ in housing and consumer lending	Slight ↓ in lending for house purchase	Slight ↑ in housing and consumer lending	↑ in lending for house purchase

Source: Banco de Portugal – Bank Lending Survey.

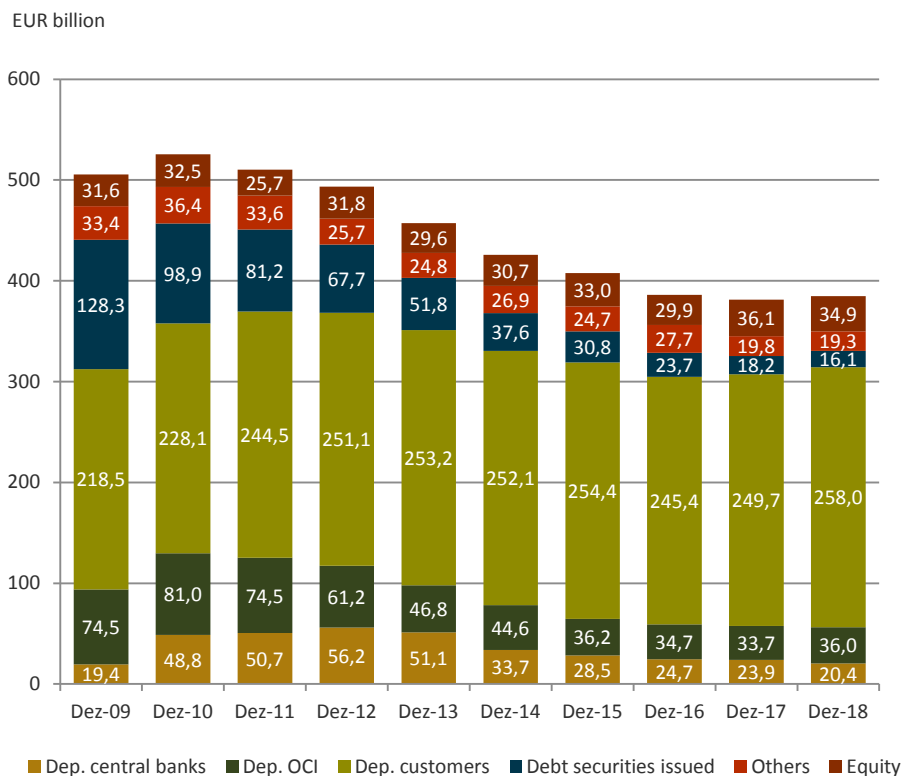
III. Funding and Liquidity



FUNDING AND LIQUIDITY

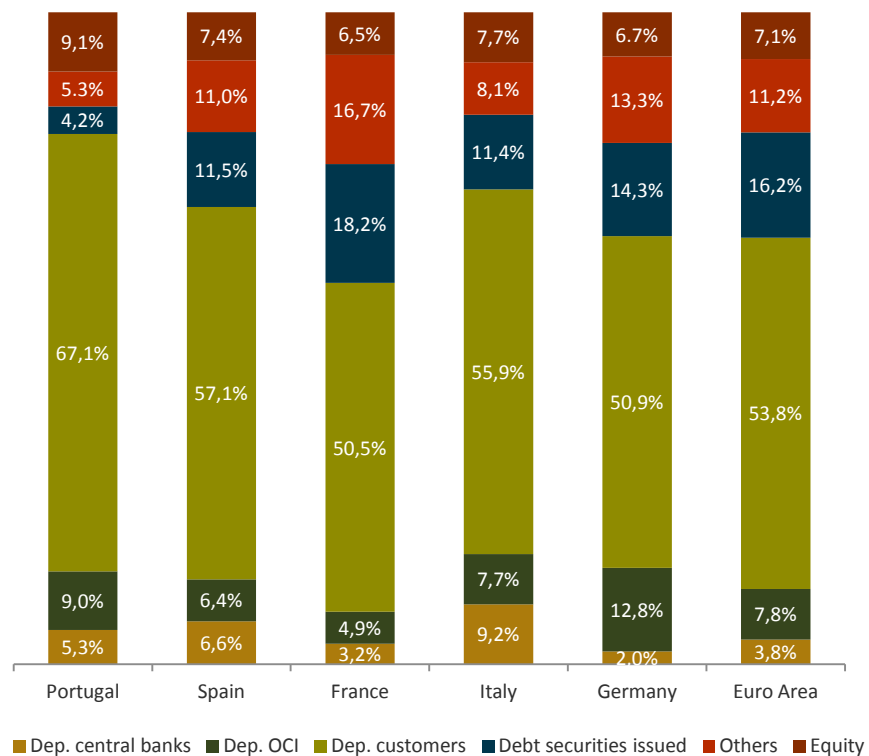
The evolution of liabilities reflects the reinforcement of customer deposits as the main source of funding, which is above the Euro Area average. Furthermore, there has been a decrease in terms of market funding sources.

Funding structure



Source: Banco de Portugal (consolidated data). OCI = Other Credit Institutions.

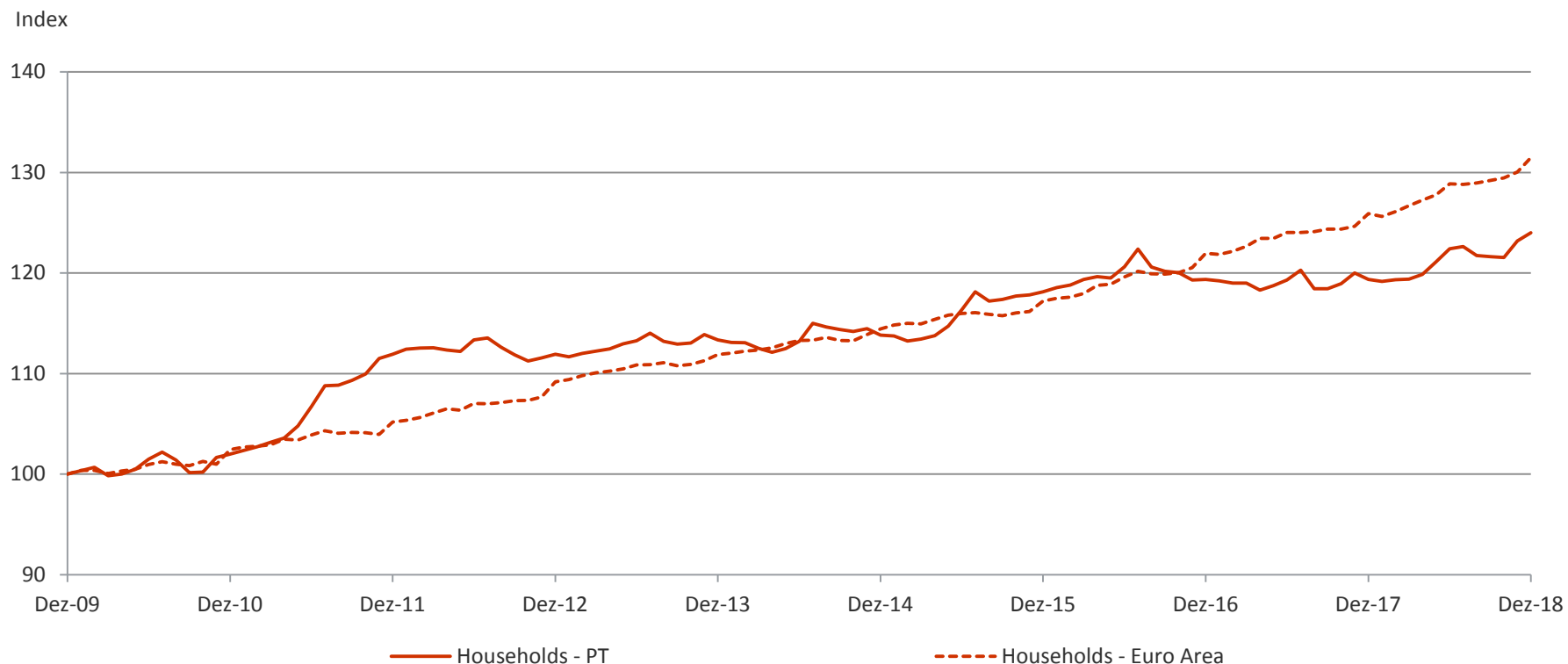
Portugal vs. Euro Area



Source: ECB – Consolidated Banking Data.

Despite the austerity programme imposed by the EFAP, depositors confidence in the banking system has not been affected. Household deposits reached their highest level ever in December 2018.

Evolution of deposits in Portugal (Dec-09=100)



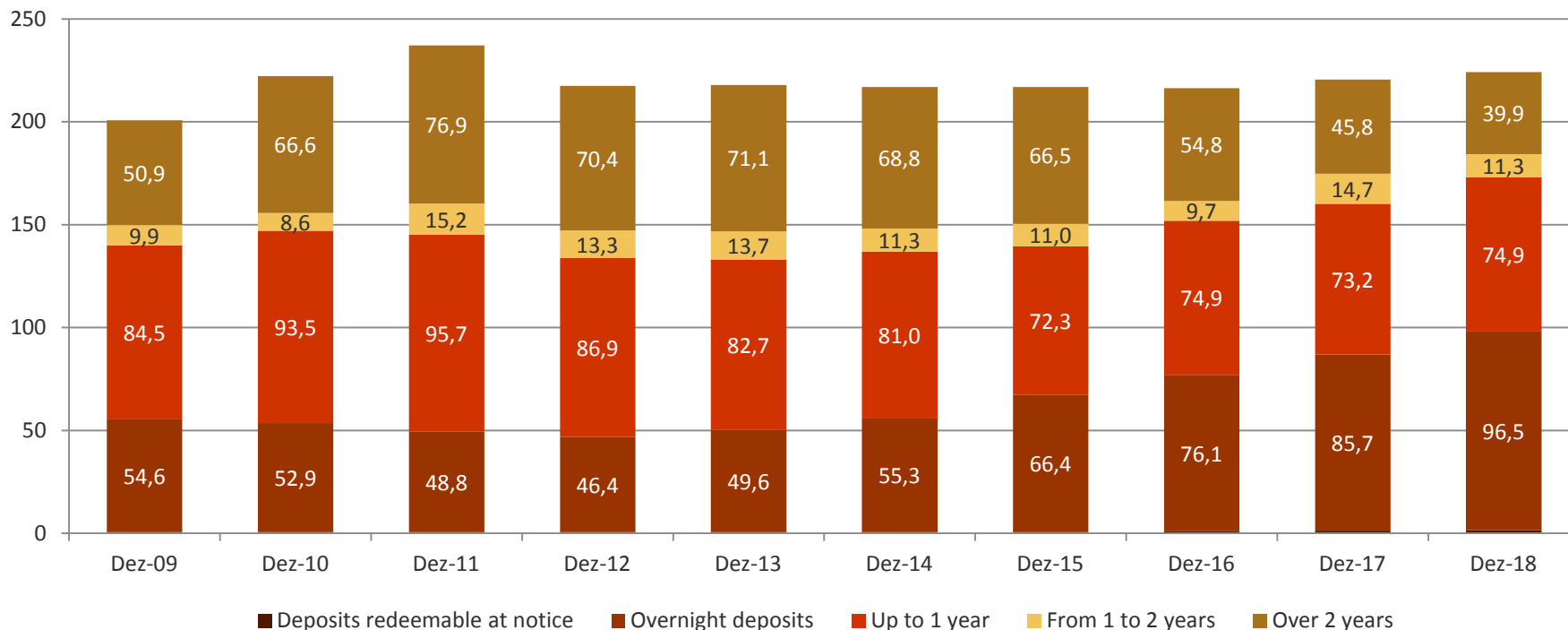
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics). Deposits of Households include emigrants.

FUNDING AND LIQUIDITY

In a context of low interest rates on deposits, as a consequence of ECB's accommodative monetary policy, time deposits continued to fall while demand deposits continued to increase.

Evolution of time deposits

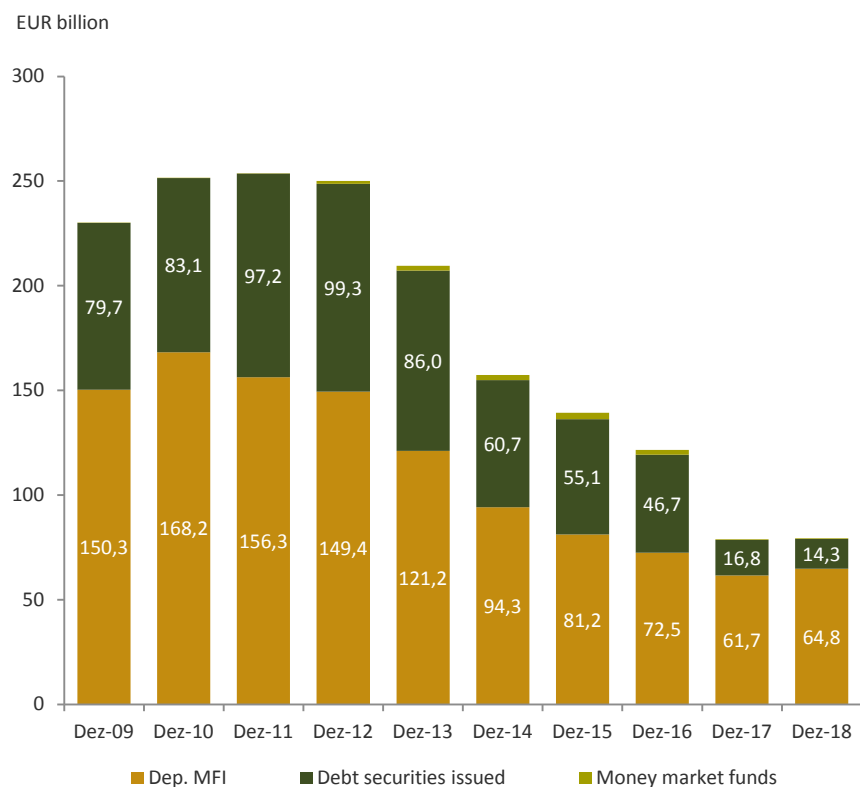
EUR billion



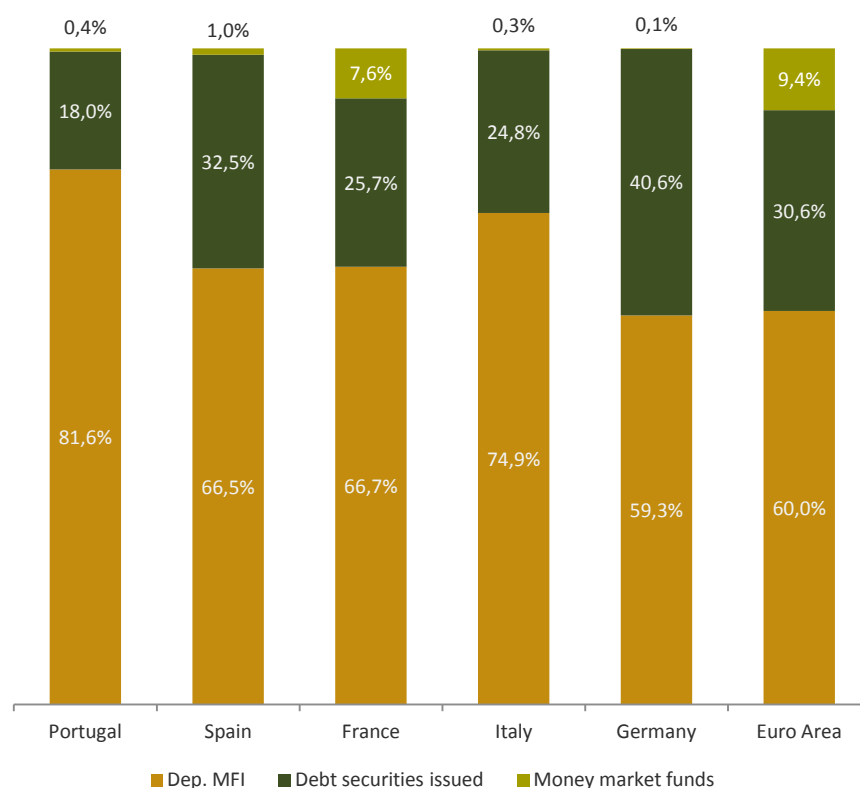
Source: Banco de Portugal (Monetary and Financial Statistics). Deposits from the non-monetary sector (end-of-period balances).

Recourse to wholesale funding has decreased substantially. Both in Portugal and in the Euro Area, deposits from the monetary sector are the main component of wholesale funding of the banking sector.

Wholesale funding structure



Portugal vs. Euro Area



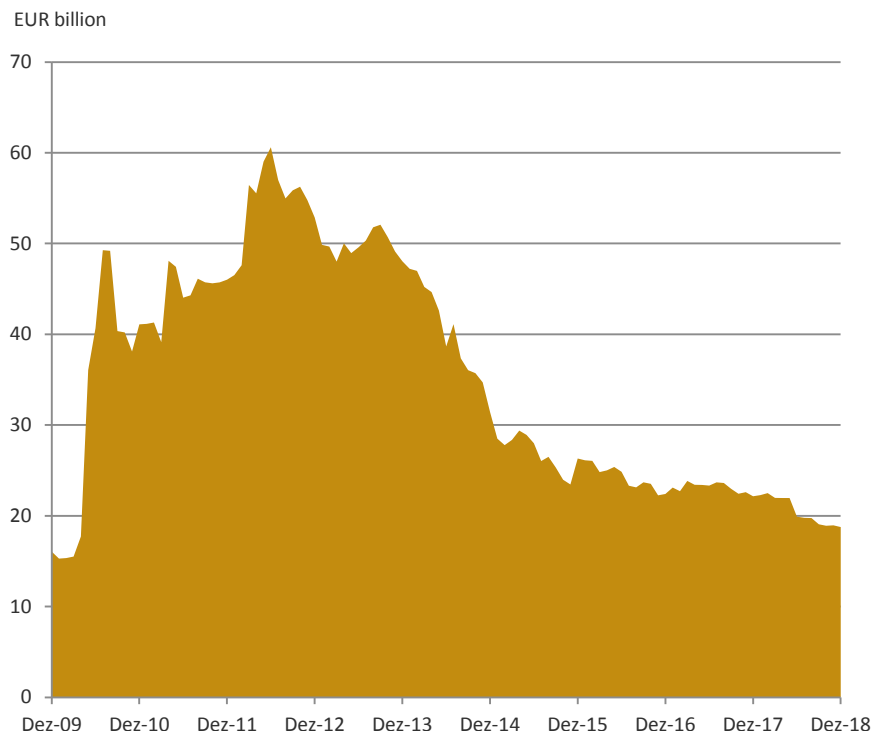
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics).

Monetary Financial Institutions (MFI) include the Central Bank and Other Monetary Financial Institutions (OMFI).

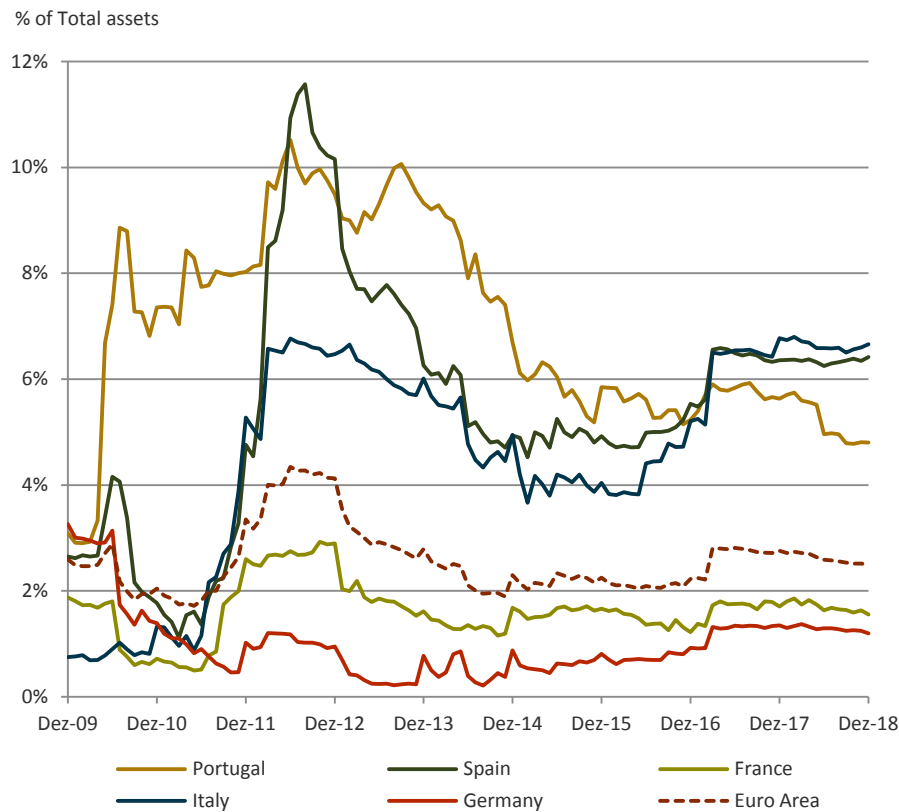
FUNDING AND LIQUIDITY

The reliance on ECB funding has been decreasing steadily since the maximum level attained in June 2012. In this period, the weight of this funding source in total assets has decreased significantly from 10.5% to 4.8%.

Borrowing from the European Central Bank



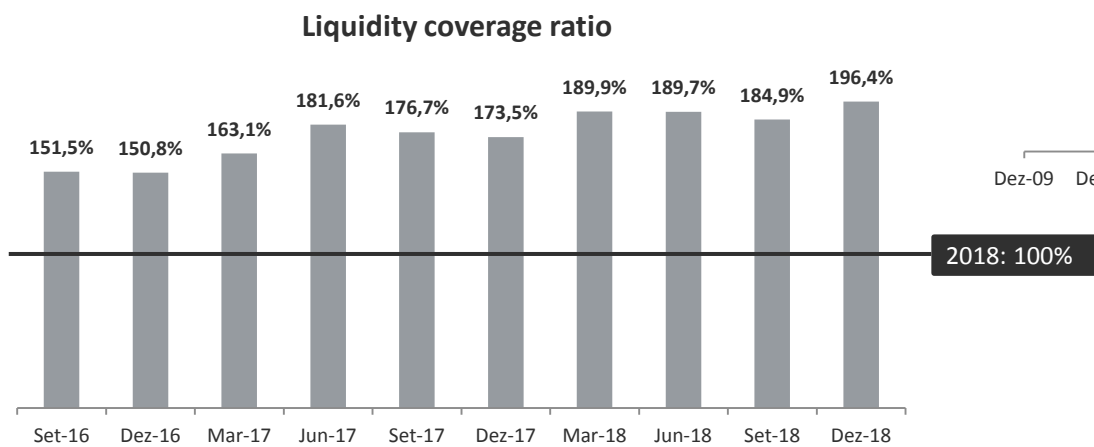
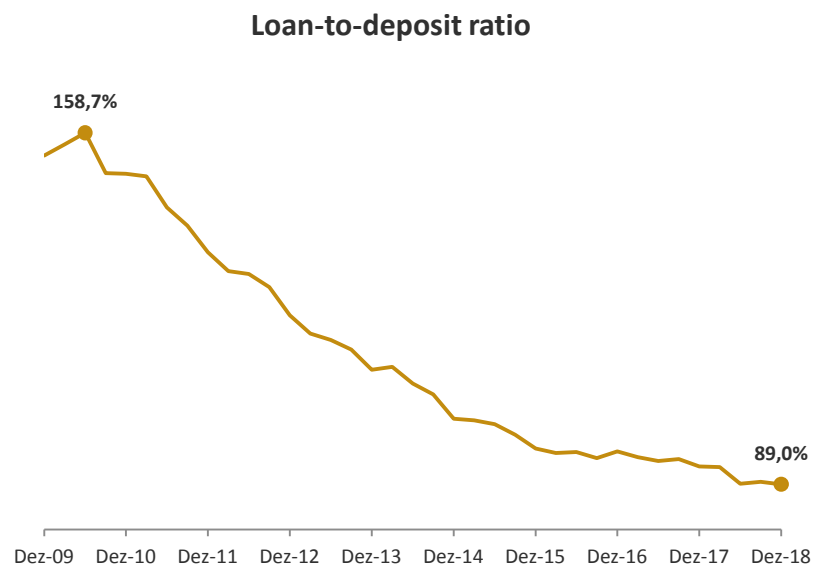
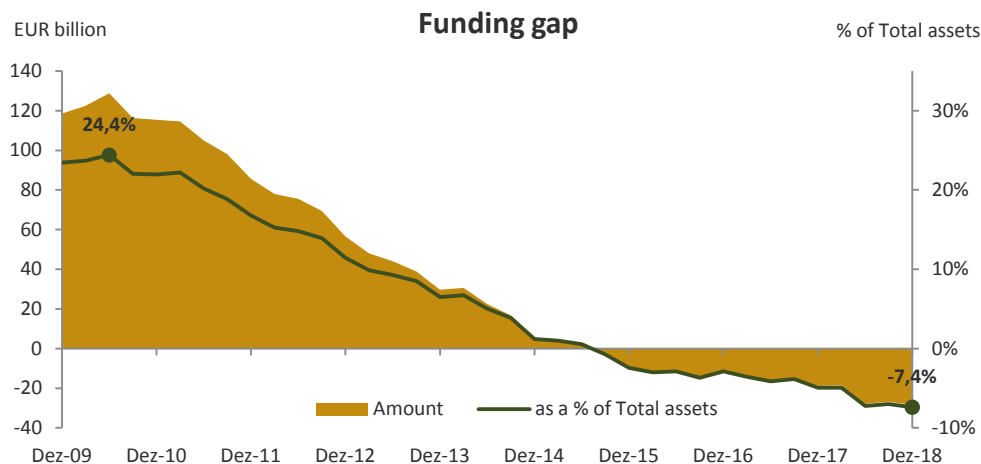
Portugal vs. Euro Area as a % of total assets



Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics).

FUNDING AND LIQUIDITY

Liquidity remains at comfortable levels: the funding gap has been declining, the loan-to-deposit ratio has continued its downward trend, and the liquidity coverage ratio (LCR) has been increasing.



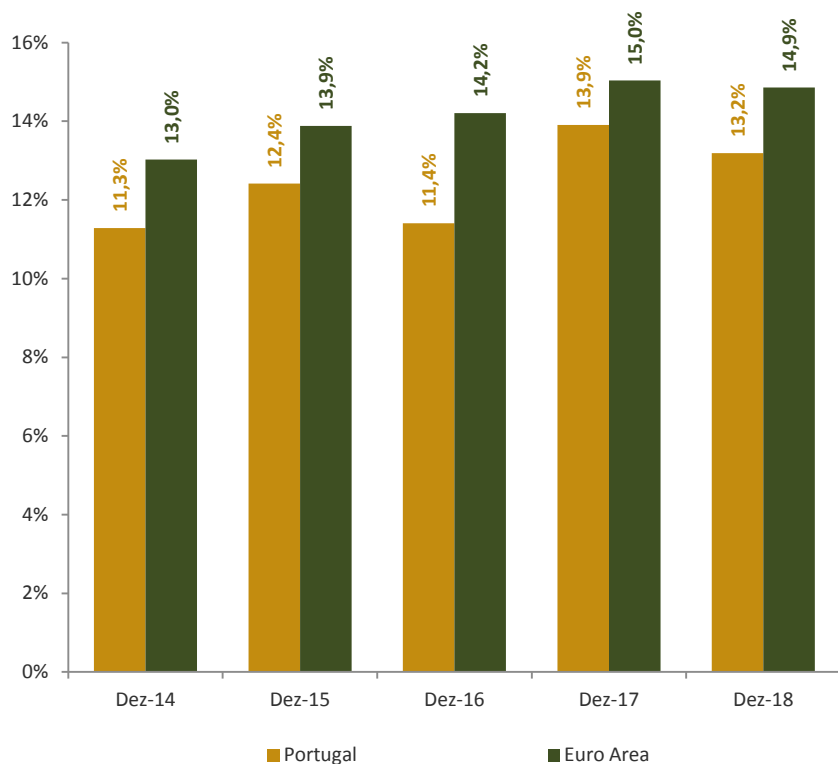
Source: Banco de Portugal (consolidated data).

IV. Solvency

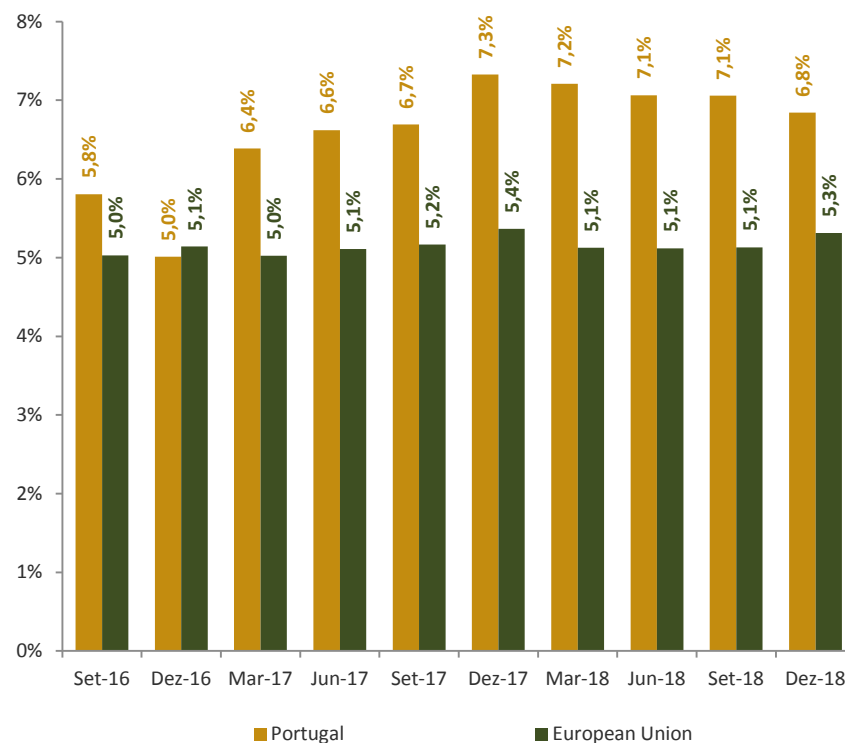


Solvency has been improving, reflecting the strengthening of own funds by several institutions, favorable evolution of risk-weighted assets, and improved profitability.

Common Equity Tier 1 (CET1) ratio



Leverage ratio

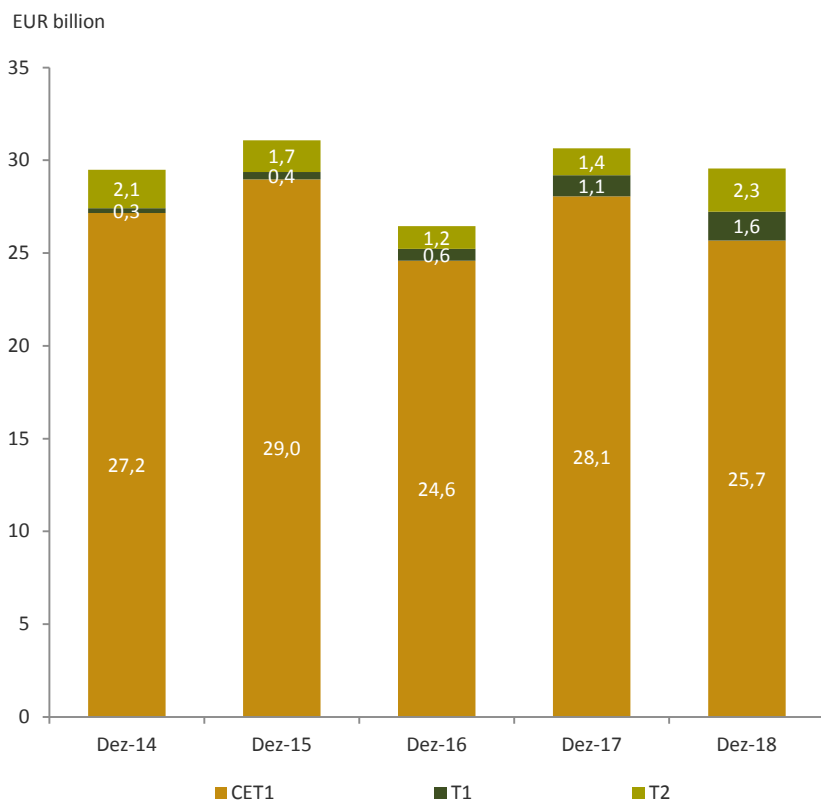


Source: ECB – Consolidated Banking Data.

Source: EBA – Risk Dashboard.

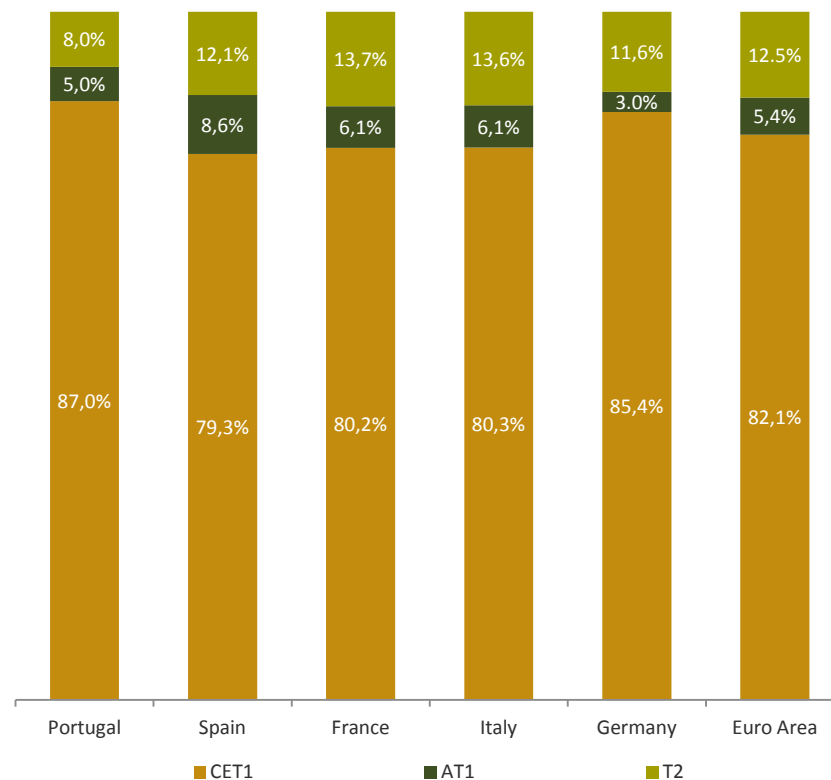
In Portugal, the weight of Common Equity Tier 1 (CET1) in the own funds structure is above the Euro Area average and there has been an increase in additional tier 1 (AT1) and tier 2 (T2) capital as a result of issuances by several institutions.

Evolution and structure of own funds



Source: Banco de Portugal (consolidated data).

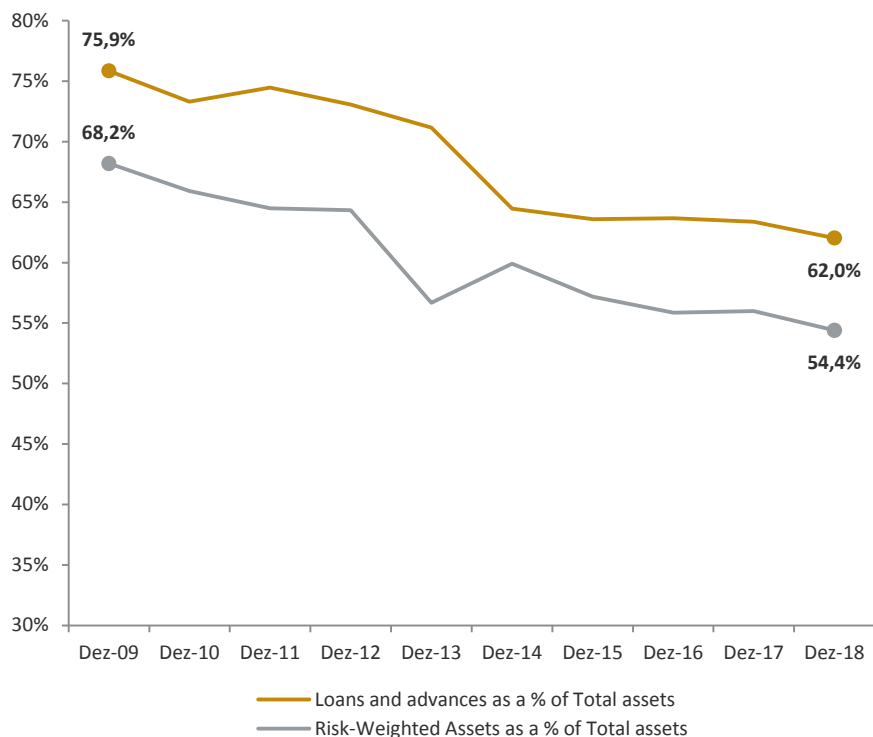
Portugal vs. Euro Area



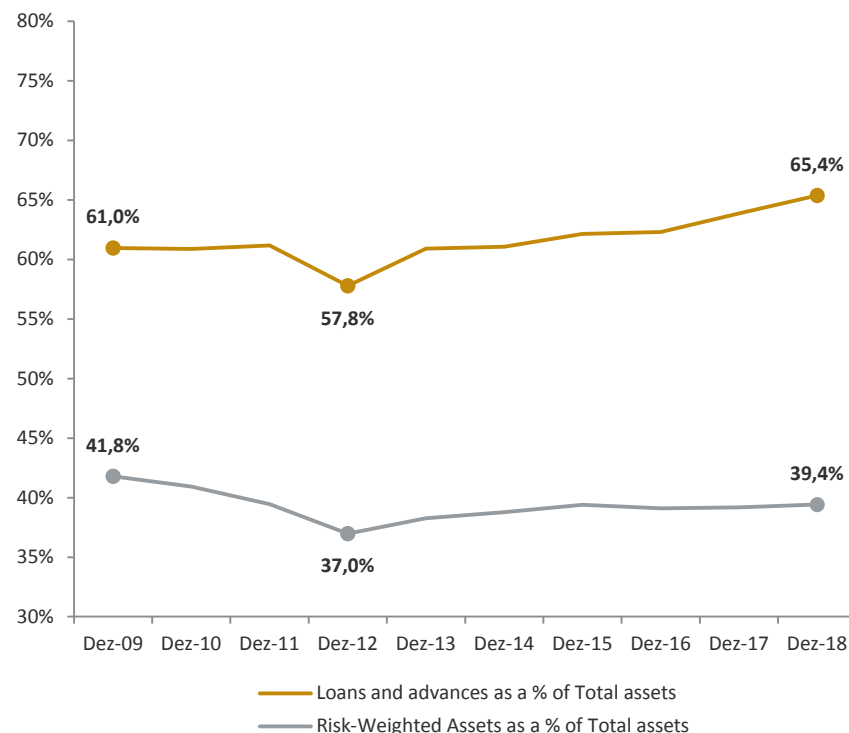
Source: ECB – Consolidated Banking Data.

The ratio of risk-weighted assets (RWAs) per unit of assets continues to compare unfavorably to the Euro Area, despite the reduction experienced in the last years.

Portugal



Euro Area



Source: ECB – Consolidated Banking Data.

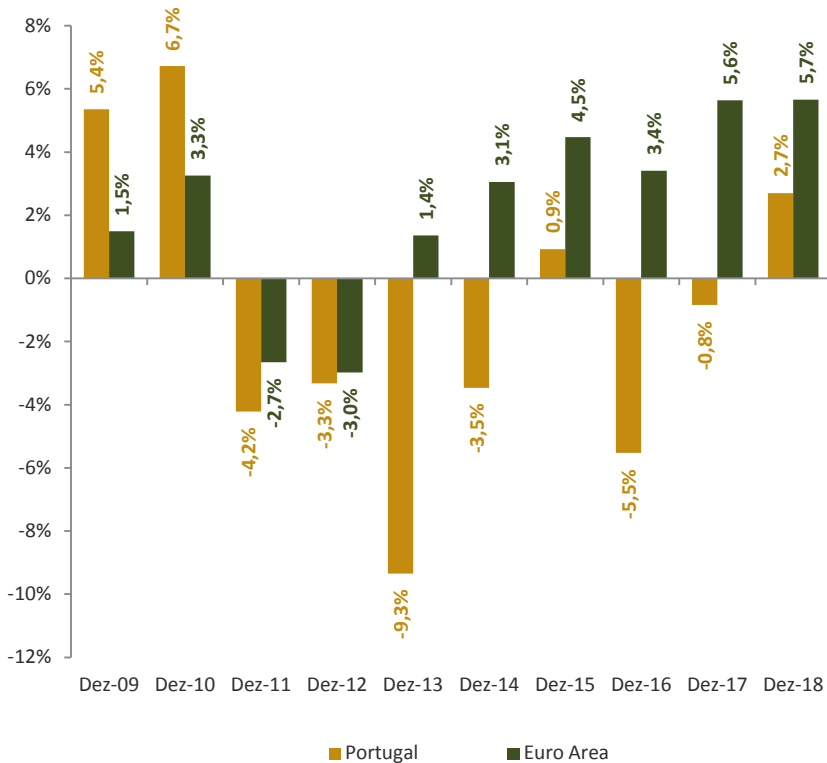
V. Profitability



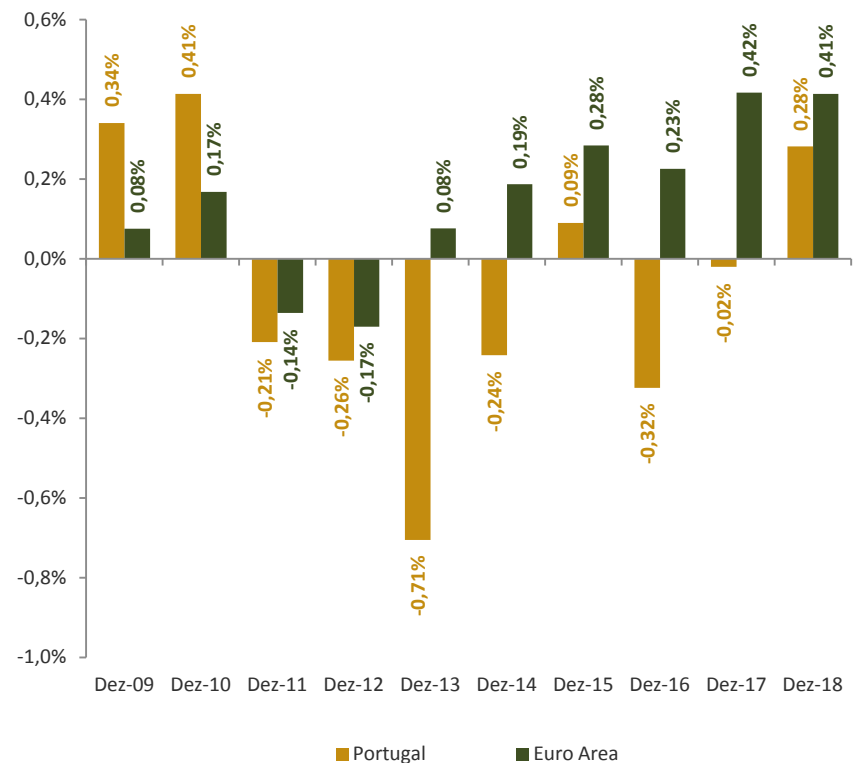
PROFITABILITY

From 2010 onwards, the sector profitability has been penalized by the high level of flow of impairments, low level of interest rates and costs related to restructuring processes.

Return on Equity (ROE)



Return on Assets (ROA)

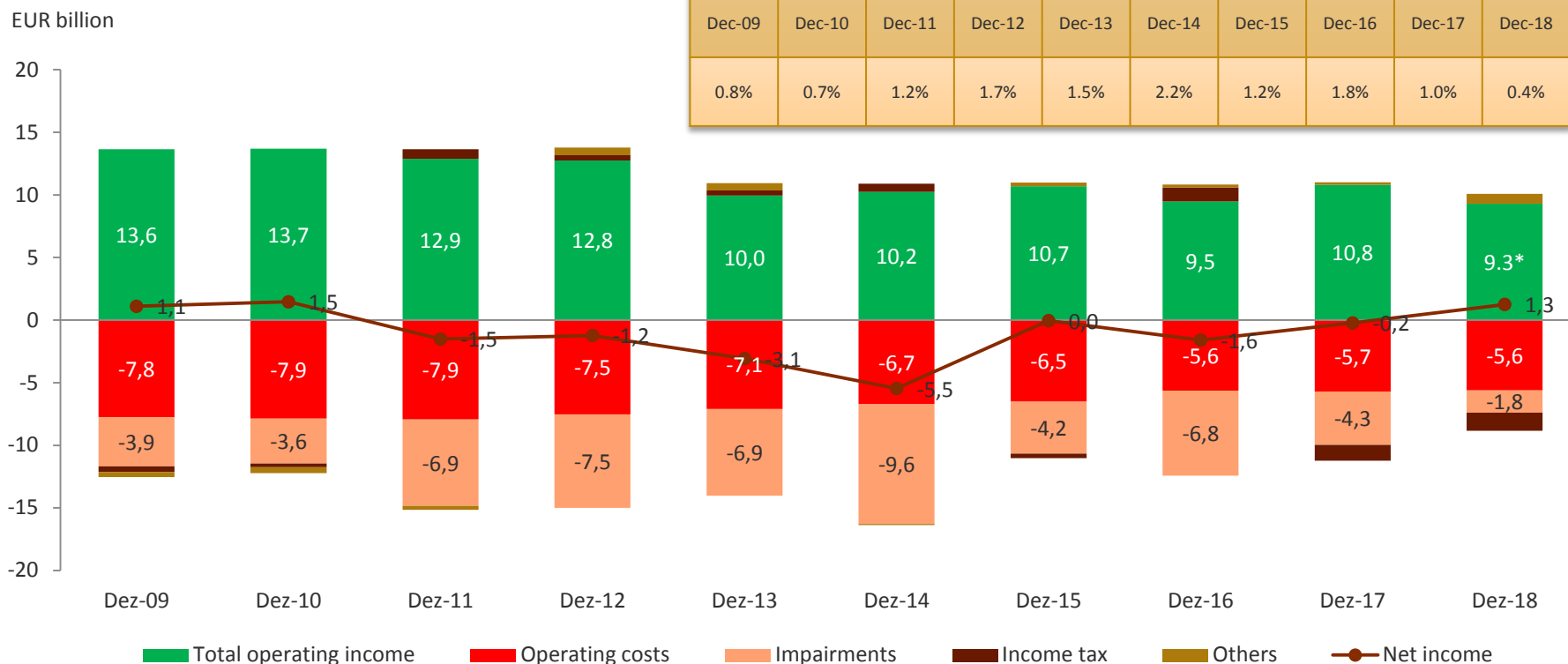


Source: ECB – Consolidated Banking Data.

PROFITABILITY

In 2018, profitability returned to positive levels as a result of the reduction of impairments in a context of lower credit default.

Decomposition of net income

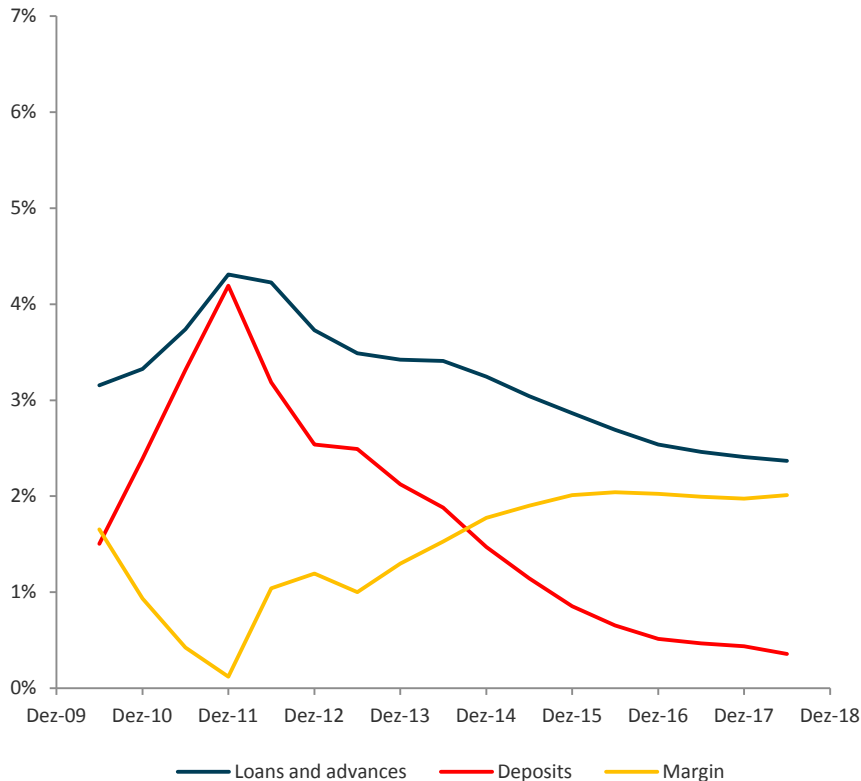


Source: Banco de Portugal (consolidated data). Total operating income was penalized by credit sales and the dissipation of the effect of the Contingent Capital Agreement (CCA) that resulted from the application of the resolution measure to one financial institution. In 2017, the activation of the CCA was recorded in other operating income and, in 2018, in other reserves and retained earnings.

PROFITABILITY

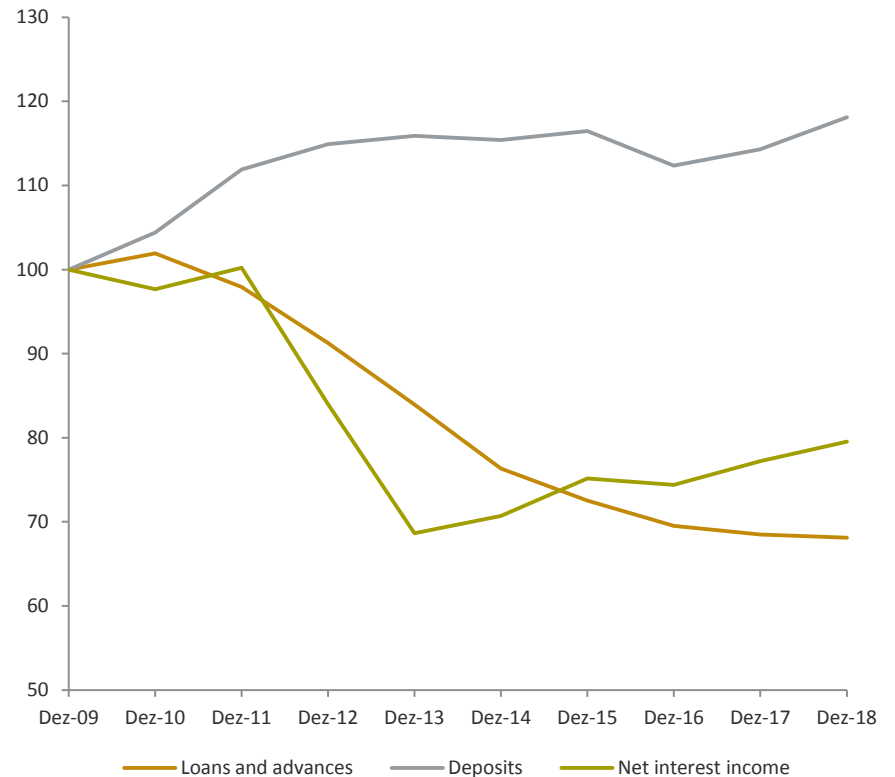
Since 2013, the evolution of net interest income has been supported by a reduction in funding costs, mainly related to deposits, and the strengthening of the weight of this funding source, which has offset the combined impact in loans of the reduction in interest rates and volumes.

Interest rates on loans and deposits (stocks)



Source: Banco de Portugal – Financial Stability Report.

Evolution of business volumes (Dec-09=100)

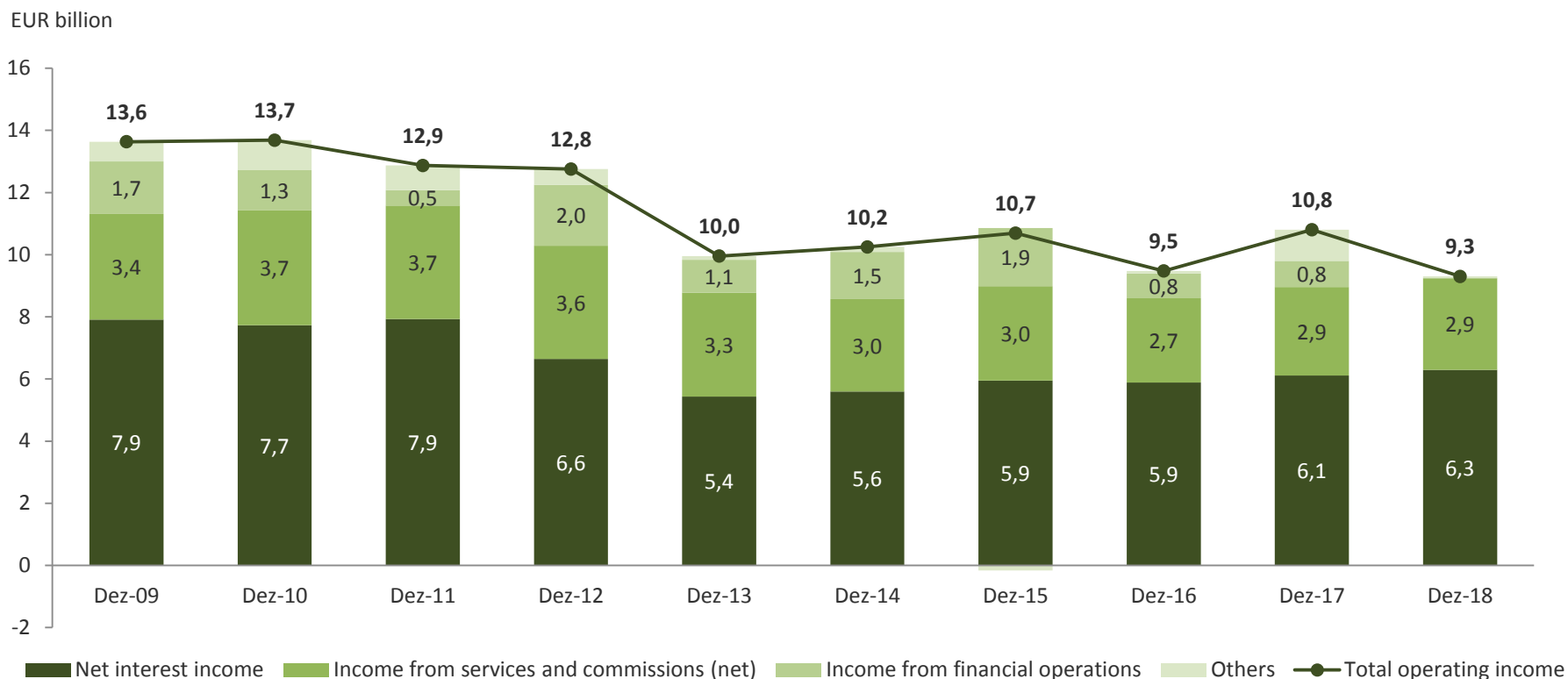


Source: Banco de Portugal (consolidated data).

PROFITABILITY

The evolution of the operating income reflects the volatility affecting some of its components (financial markets performance and execution of NPL reduction plans). In 2018, total operating income was penalized by the change in the account of the amount corresponding to the triggering of the contingent capital mechanism applied to one financial institution.

Total operating income breakdown

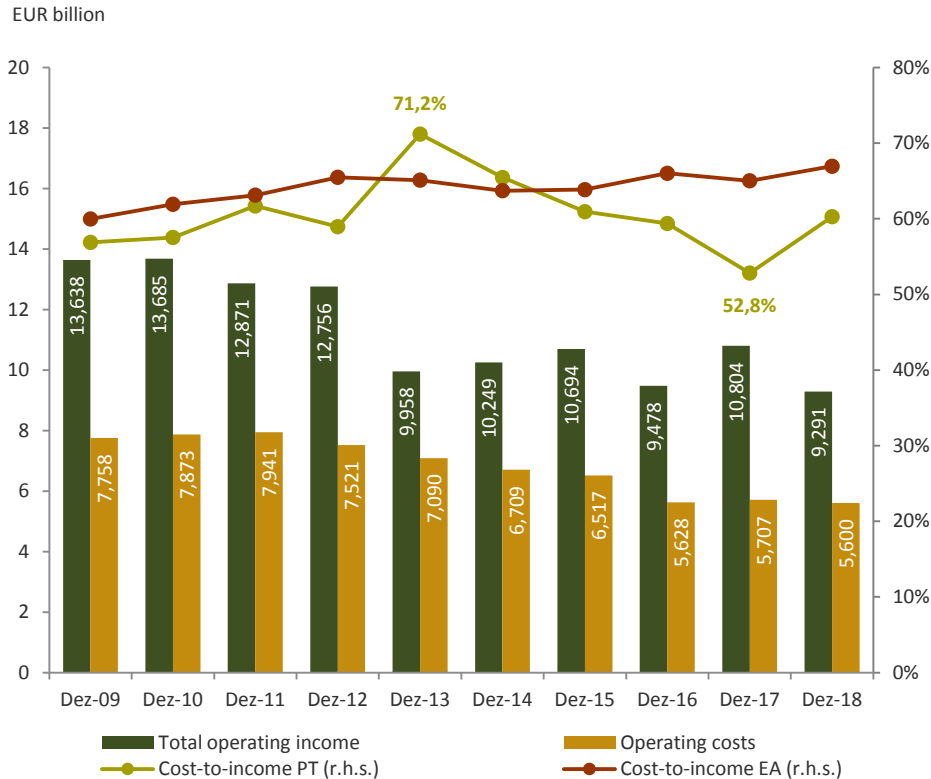


Source: Banco de Portugal (consolidated data).

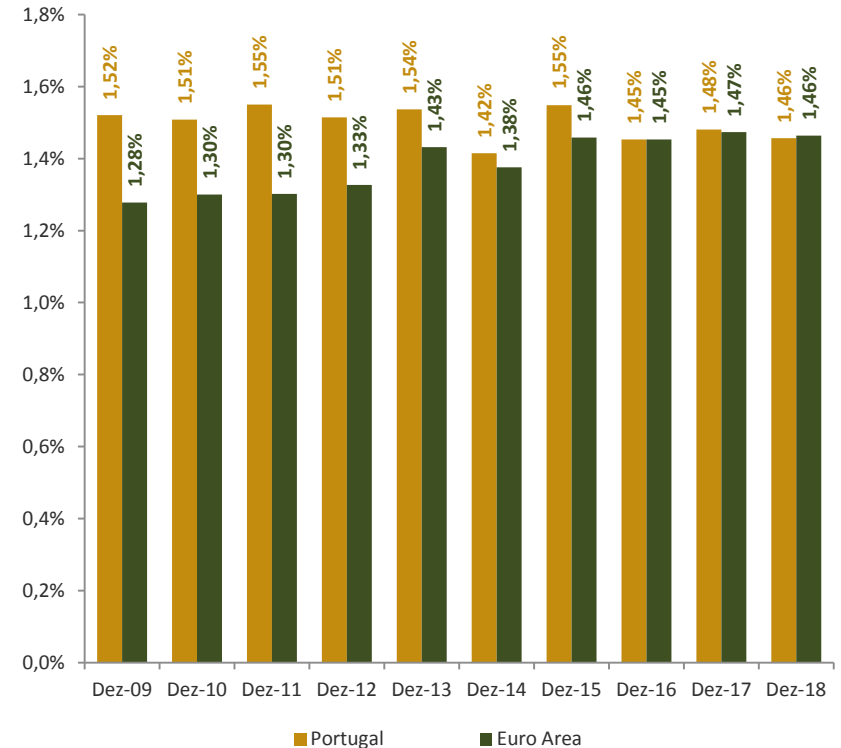
PROFITABILITY

Although the cost-to-income ratio has been penalized by restructuring processes, it has shown a positive evolution since 2013. In 2018, the reduction of operating costs was not enough to offset the drop in total operating income.

Cost-to-income breakdown



Operating costs as a % of Total assets

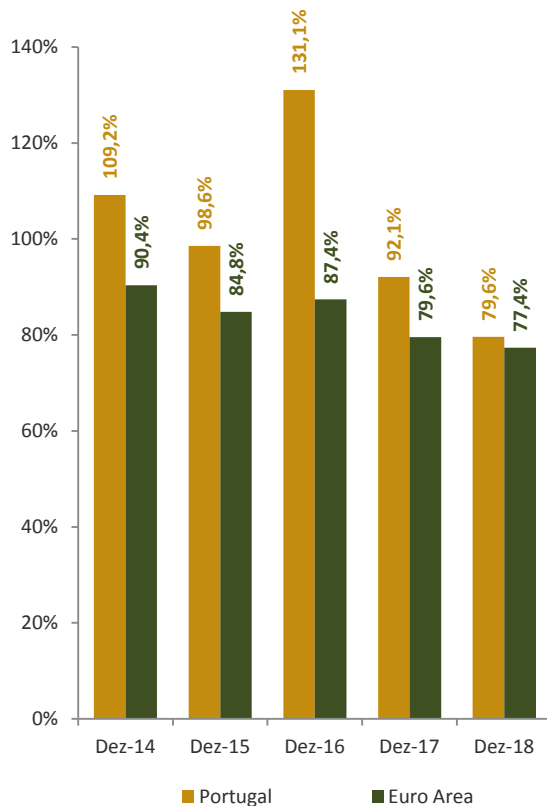


Source: Banco de Portugal (consolidated data). ECB – Consolidated Banking Data.

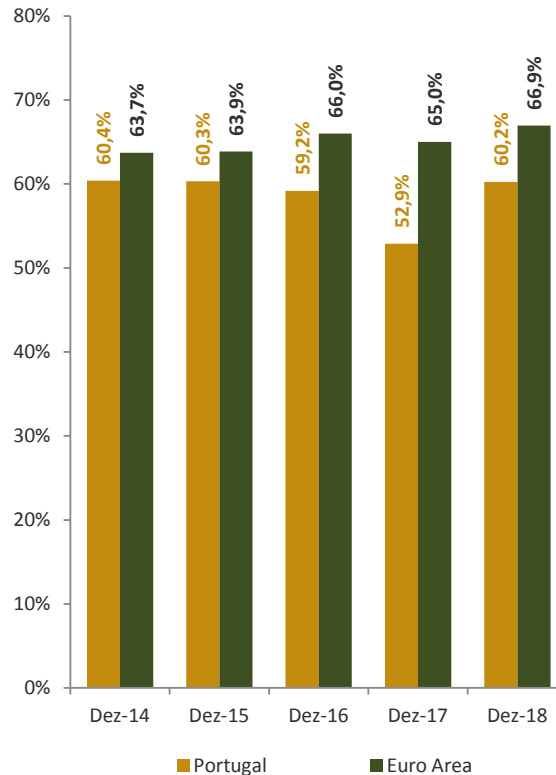
PROFITABILITY

The sector efficiency has been mainly affected by the evolution of the impairment-to-income ratio, which has offset the operational efficiency gains (measured by the cost-to-income ratio).

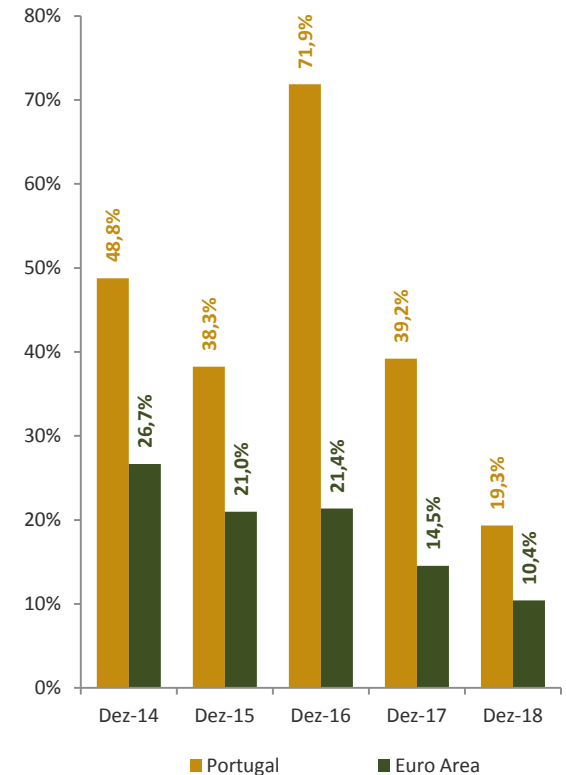
Total efficiency ratio



Cost-to-income ratio



Impairment-to-income ratio



Source: ECB – Consolidated Banking Data. Total efficiency ratio = Cost-to-income ratio + Impairment-to-income ratio.

Annex I: Methodology



Methodology

- The information provided by Banco de Portugal and the ECB regarding monetary statistics differs from that provided in the consolidated data for the financial system. The main differences are basically due to the fact that the universes surveyed are not exactly the same and to 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 de 2014 and Sistema Bancário Português: desenvolvimentos recentes - 4º trimestre de 2016.

- This document was published with updated information until 23 July 2019.

PORTUGUESE BANKING SECTOR OVERVIEW