PORTUGUESE BANKING SECTOR OVERVIEW

ASSOCIAÇÃO PORTUGUESA DE BANCOS

JUNE 2020

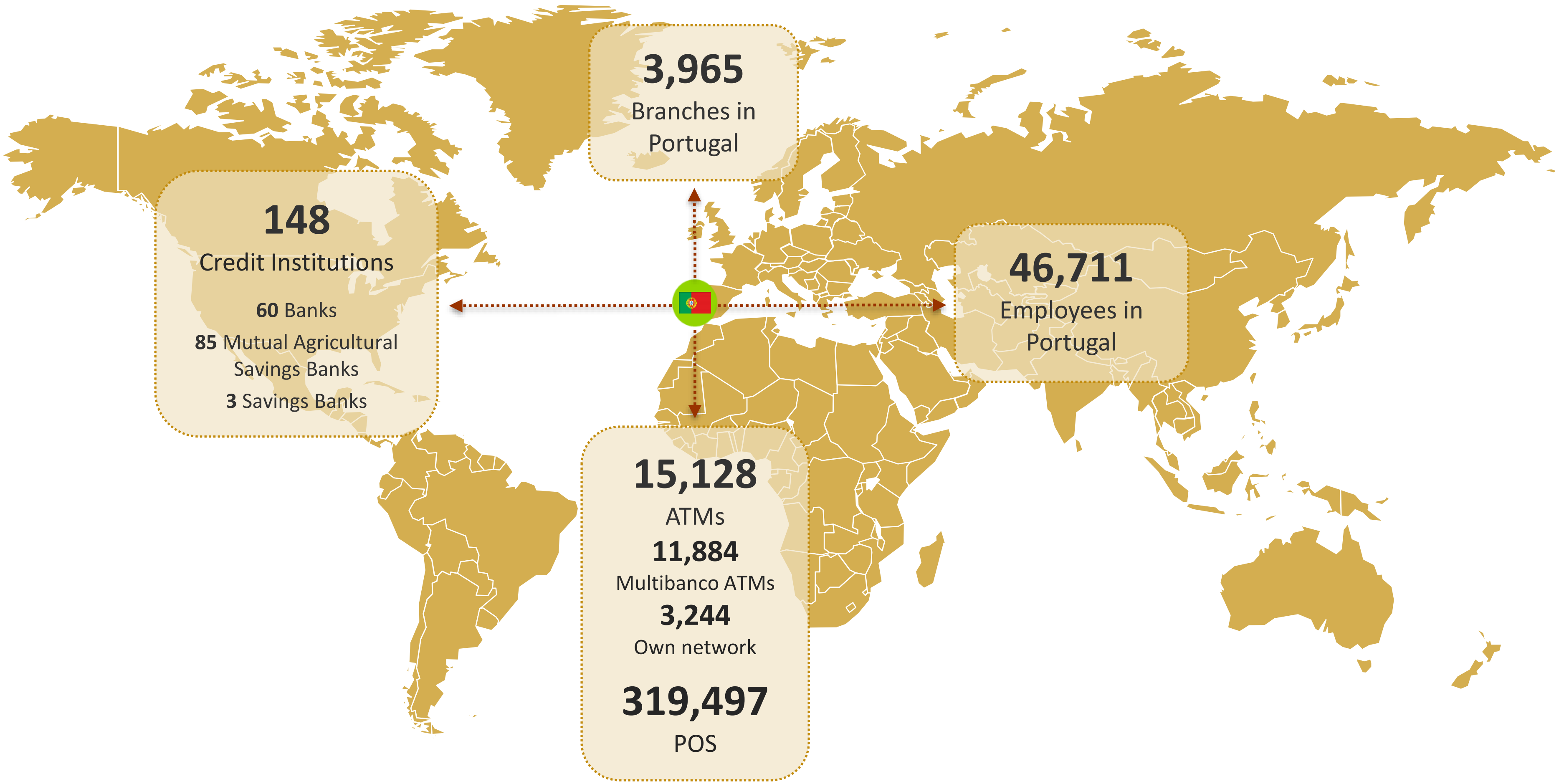
INDEX

I. Recent Evolution and Main Indicators

RECENT EVOLUTION AND MAIN INDICATORS

- **The COVID-19 pandemic crisis generated an unprecedented economic shock and high levels of uncertainty.** The coordinated implementation of monetary, fiscal, and regulatory policy measures was crucial in providing support to the economy and mitigating the impacts on economic agents.
- **The progress made by the Portuguese banking sector since the great financial crisis is of extreme importance in the current context of the pandemic crisis.** The sector is better prepared and more resilient, especially in terms of liquidity and solvency, and has been playing a critical role in supporting the economy's financing and liquidity needs.
- In the first half of the year, on the asset side, it is worth highlighting the **positive evolution of the stock of loans to customers**, reflecting, mostly, **the response to corporate liquidity needs and the slowdown in the pace of NPL reduction**.
- On the liability side, **deposits continued to rise** due to the increase in savings as a consequence of reduced consumption, related with the mobility restrictions imposed by the pandemic, and the high uncertainty regarding the duration of the crisis and its impacts.
- As a result of the attractive monetary policy measures, reinforced in this period of crisis, **funding from the Eurosystem increased significantly, maintaining the system's liquidity at extremely comfortable levels.**
- **The profitability of the Portuguese banking system decreased significantly, mainly penalized by the need to increase provisioning, contributing to a further widening of the gap between ROE and the cost of capital.**
- **In terms of solvency**, the system is more resilient than in the previous crisis, with greater capacity to accommodate a possible deterioration in credit risk and an increase in non-performing assets.
- **The potential effects of the COVID-19 pandemic and the measures needed to control it pose critical challenges for the banking sector, which already faced significant pressure before the pandemic shock.** Among these challenges, the following stand out: the deep economic recession; the high level of uncertainty regarding the recovery; the maintenance of a low interest rate environment; the high indebtedness level of the non-financial sector; and the potential increase in defaults.

RECENT EVOLUTION AND MAIN INDICATORS

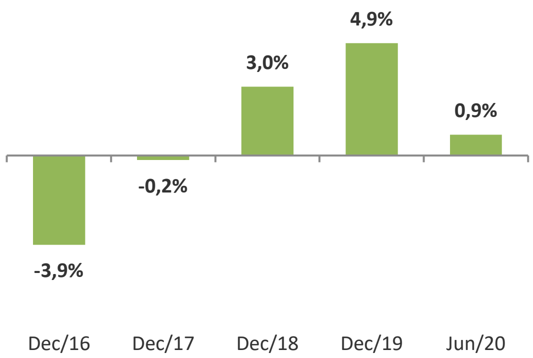


Source: APB's associates (branches, employees and payment systems) and Banco de Portugal (credit institutions).

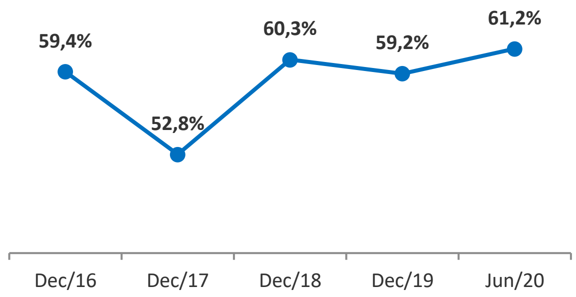
RECENT EVOLUTION AND MAIN INDICATORS

The Portuguese banking sector is better prepared and more resilient to face the shock caused by the COVID-19 pandemic than it was in the global financial crisis of 2008, especially in terms of liquidity and solvency.

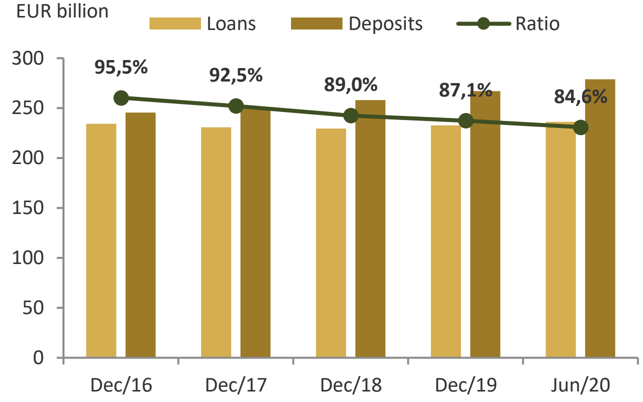
Return on Equity



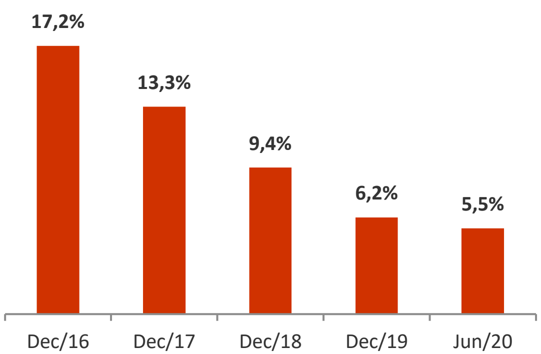
Cost-to-Income



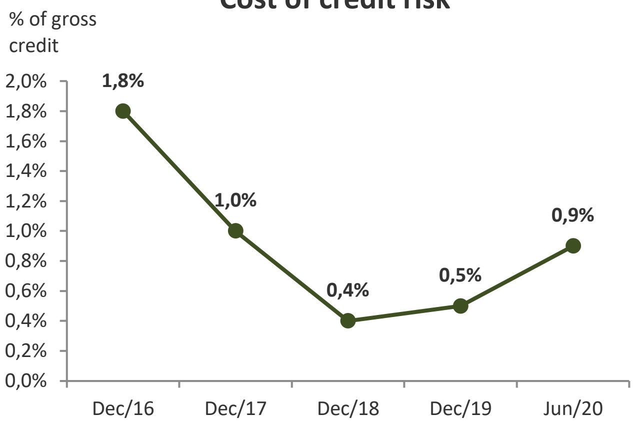
Loan-to-deposit ratio



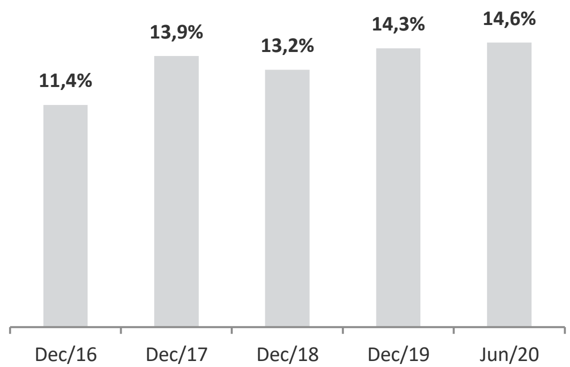
Non-Performing Loans ratio



Cost of credit risk



Common Equity Tier 1 ratio



Source: Banco de Portugal (consolidated data).

II. Financial Position

Lending

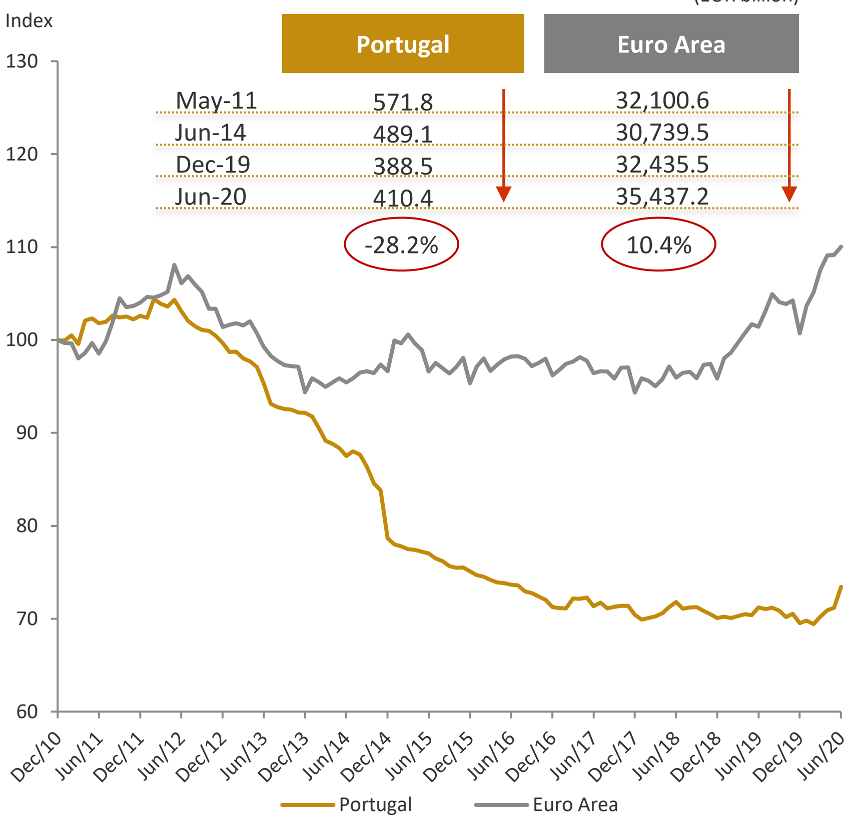
FINANCIAL POSITION

The measures taken to face the crisis arising from the COVID-19 pandemic led to a significant increase in assets. Despite this evolution, the banking sector's share of GDP remains at significantly lower levels than before the sovereign debt crisis due to the economy's deleveraging process registered in subsequent years.

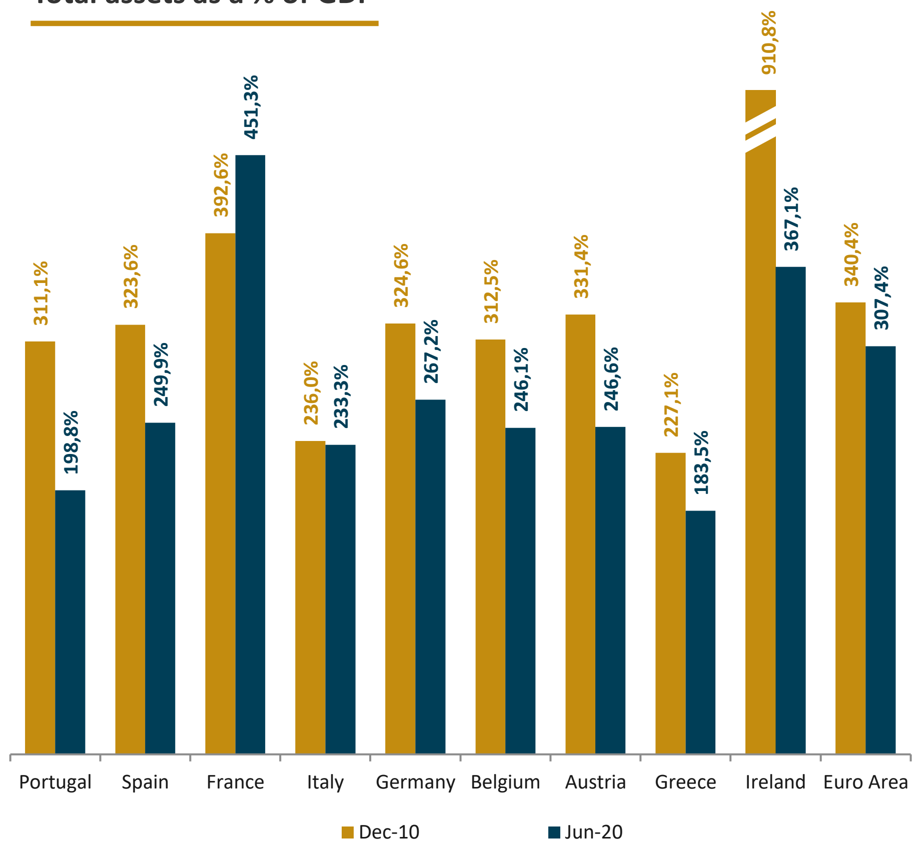
Total assets evolution (Dec-10=100)

(EUR billion)

	Portugal	Euro Area
May-11	571.8	32,100.6
Jun-14	489.1	30,739.5
Dec-19	388.5	32,435.5
Jun-20	410.4	35,437.2
	-28.2%	10.4%



Total assets as a % of GDP

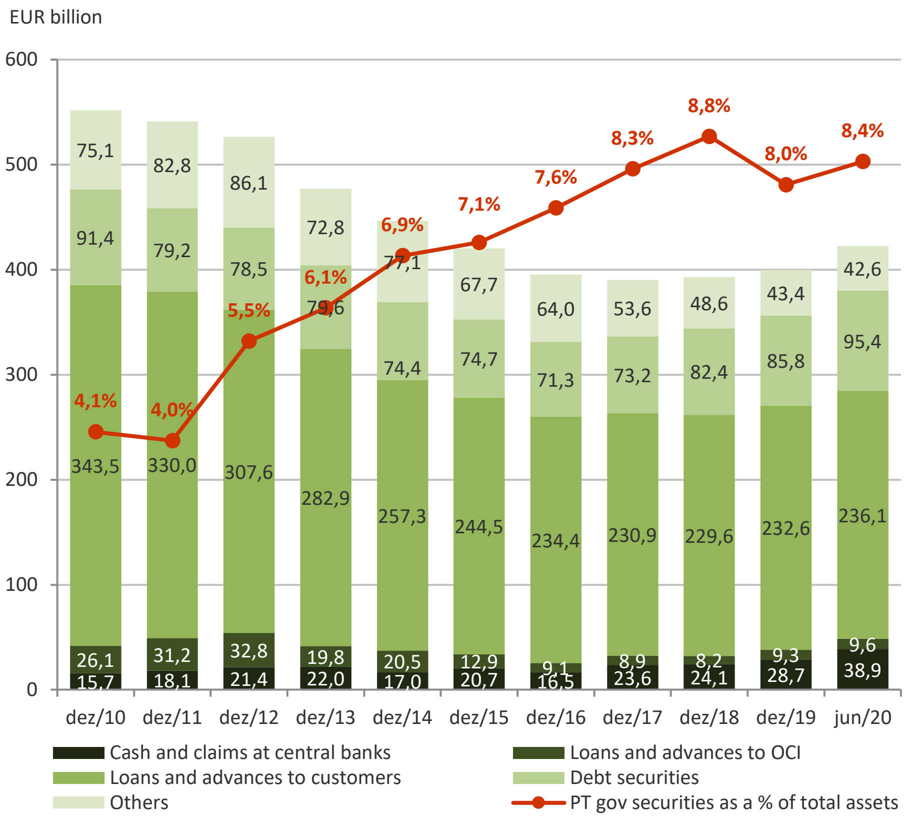


Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Eurostat.

FINANCIAL POSITION

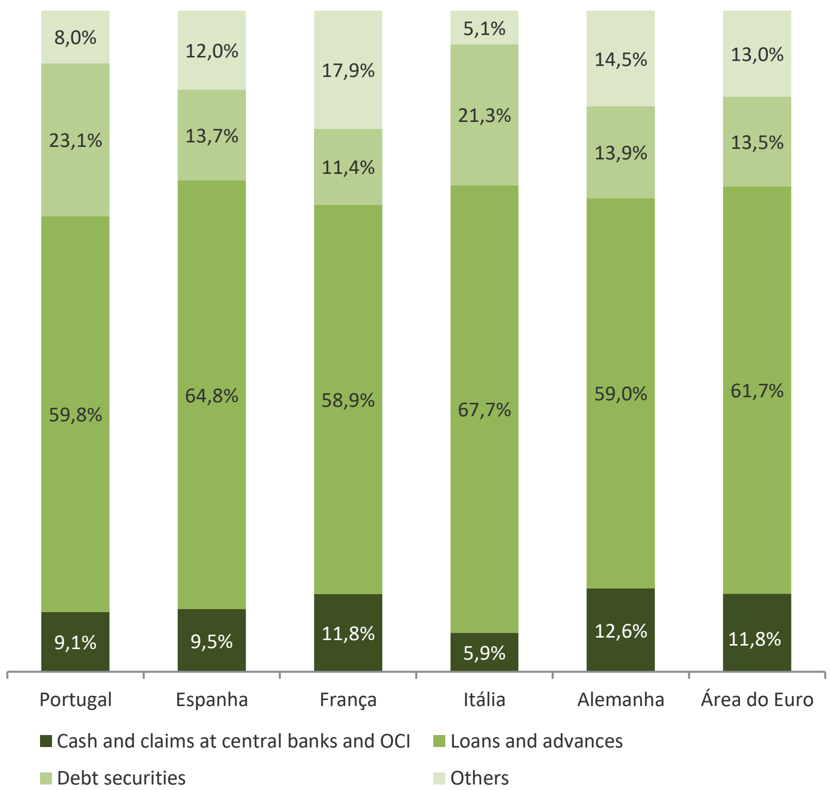
The increase in the Portuguese banking system assets is, to a large extent, explained by the increase in cash and claims at central banks, debt securities, and loans to customers. The increase in loans was essentially due to the strong corporate liquidity needs experienced during the pandemic crisis.

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

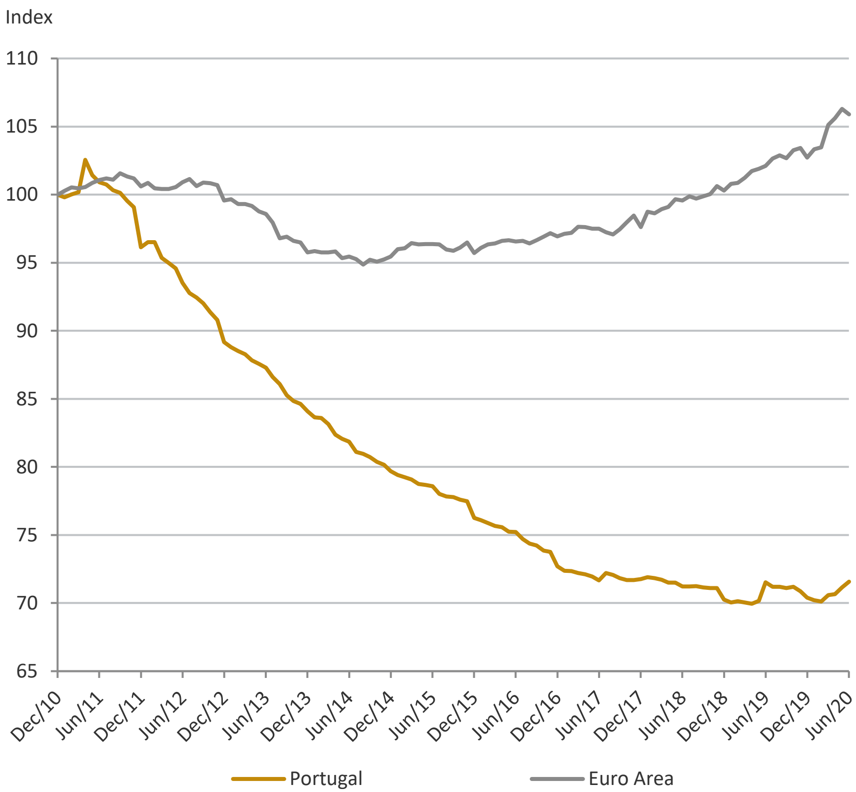


Source: ECB – Consolidated Banking Data.

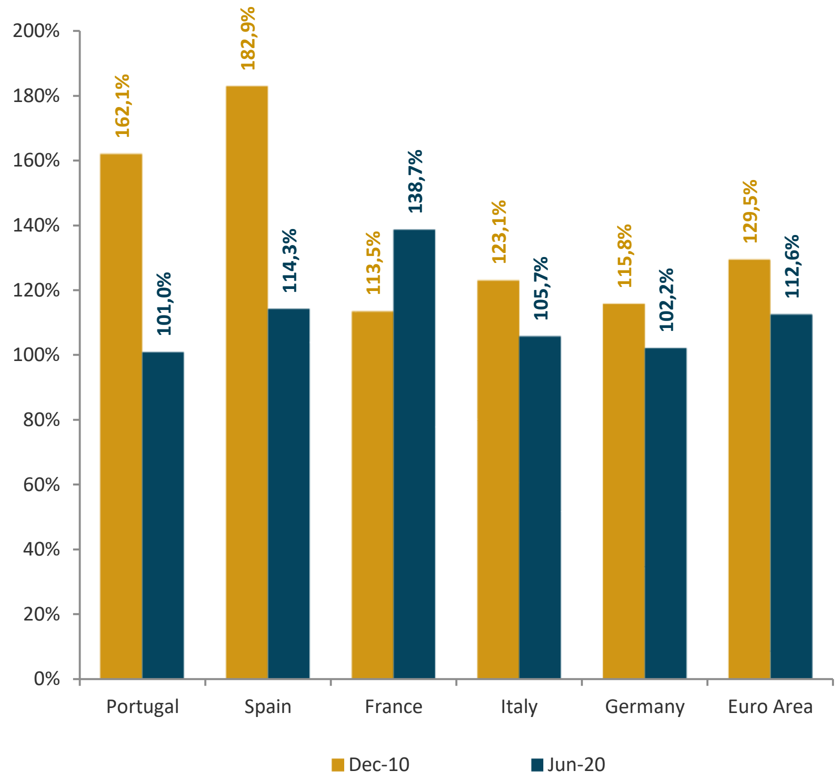
LENDING

The stock of loans to customers increased by 1.7% over December 2019, largely reflecting the greater volume of new loans backed by public guarantee schemes granted to the corporate sector, within the framework of the economic support measures adopted by the authorities in response to the pandemic crisis.

Loans to customers (Dec-10=100)



Loans to customers as a % of GDP

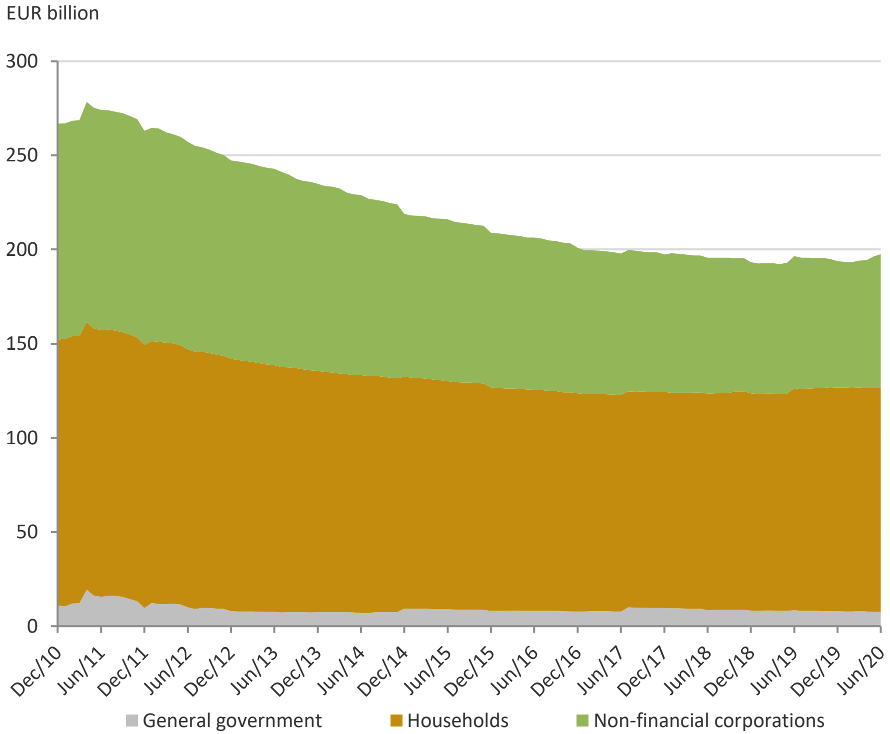


Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Eurostat. Loans granted to the non-monetary sector (end of period balances). Gross figures.

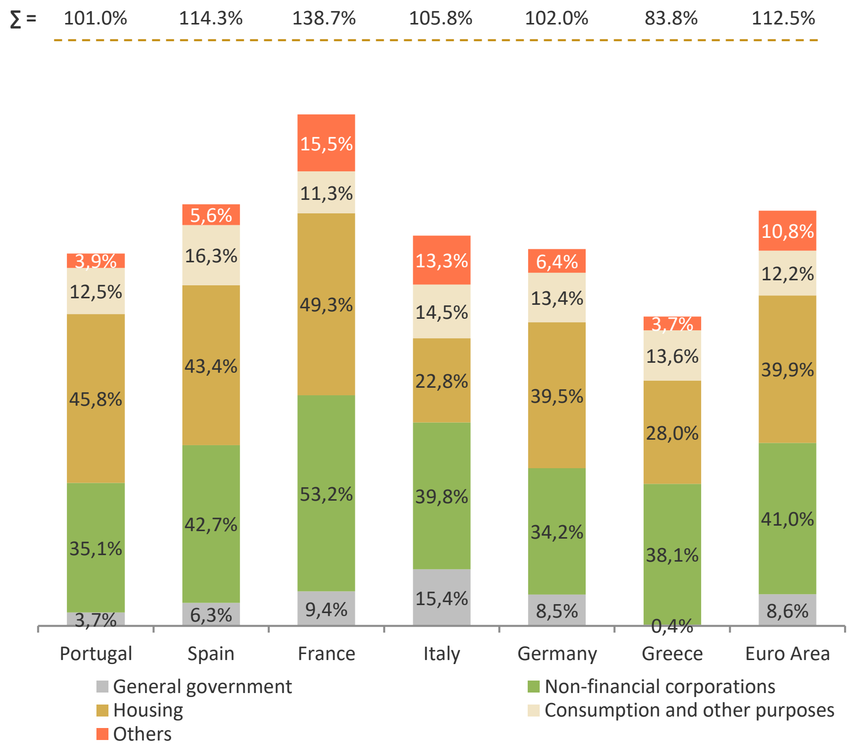
LENDING

In the first half of 2020, the stock of loans to companies increased by 6.3%[1] YoY. In this period, the sectors most affected by the pandemic represented 20% of the stock of loans to companies (4% of the system's total assets). The stock of loans to households increased 1.1%[1], mainly due to the growth in new lending for house purchase and the reduction in repayments, reflecting the effects of the moratoria.

Loans by institutional sector



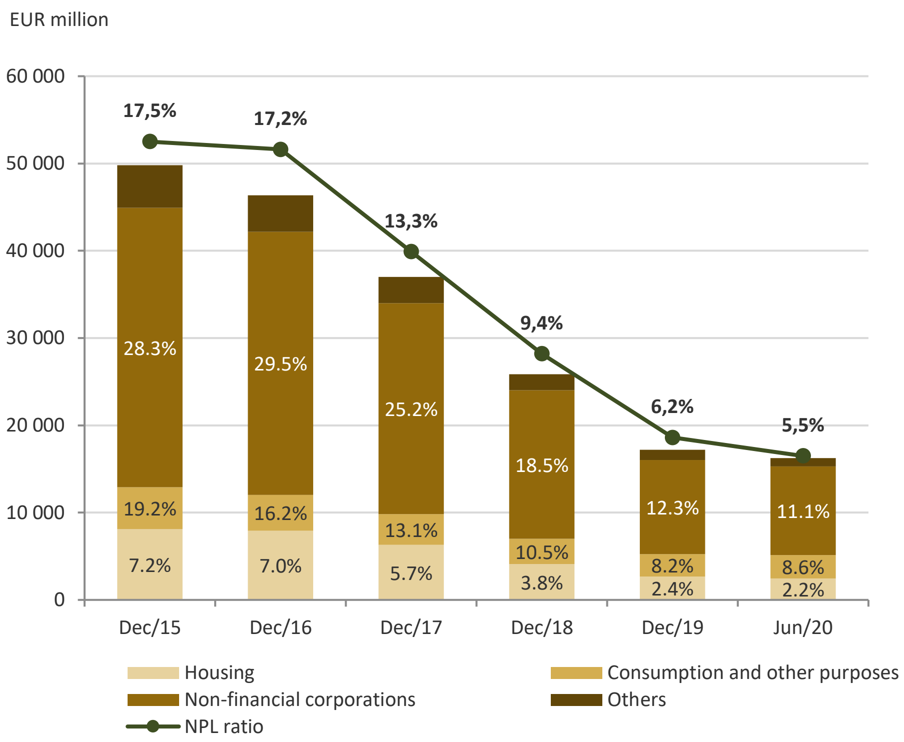
Loans by institutional sector as a % of GDP



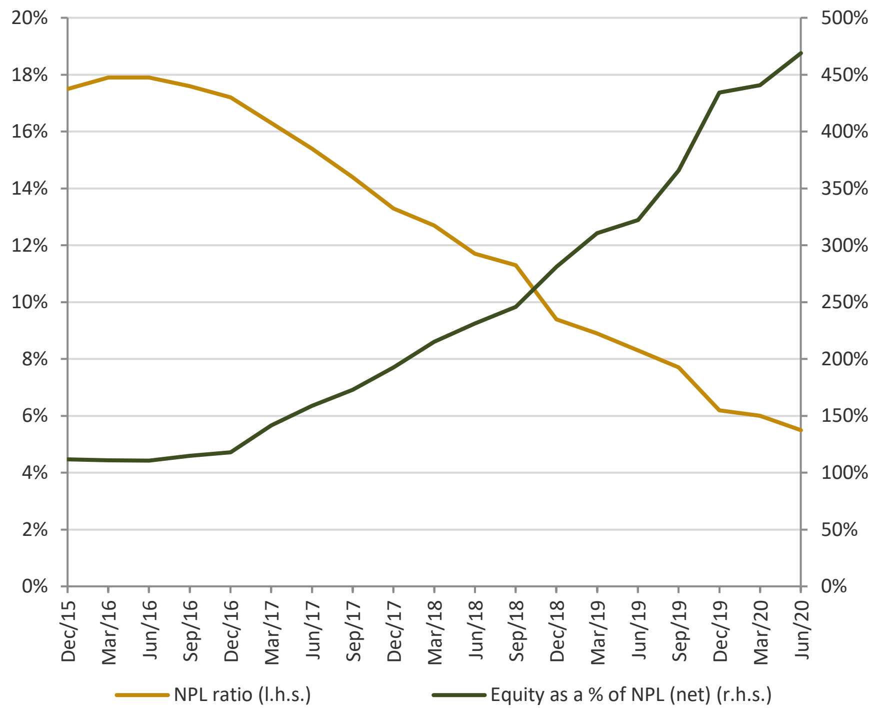
[1] Annual rate of change adjusted for securitization and liquidity-providing operations.
Source: Banco de Portugal (Monetary and Financial Statistics), ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Eurostat. Others include Non-Monetary Financial Institutions: Other Financial Intermediaries, Financial Auxiliaries, Insurance Companies and Pension Funds.

In the first half of 2020, the pace of NPL reduction, which has been occurring since 2016, slowed down. This downward trend may be interrupted, owing to the probable increase in default levels on the back of the COVID-19 crisis.

NPL amount and ratio in Portugal



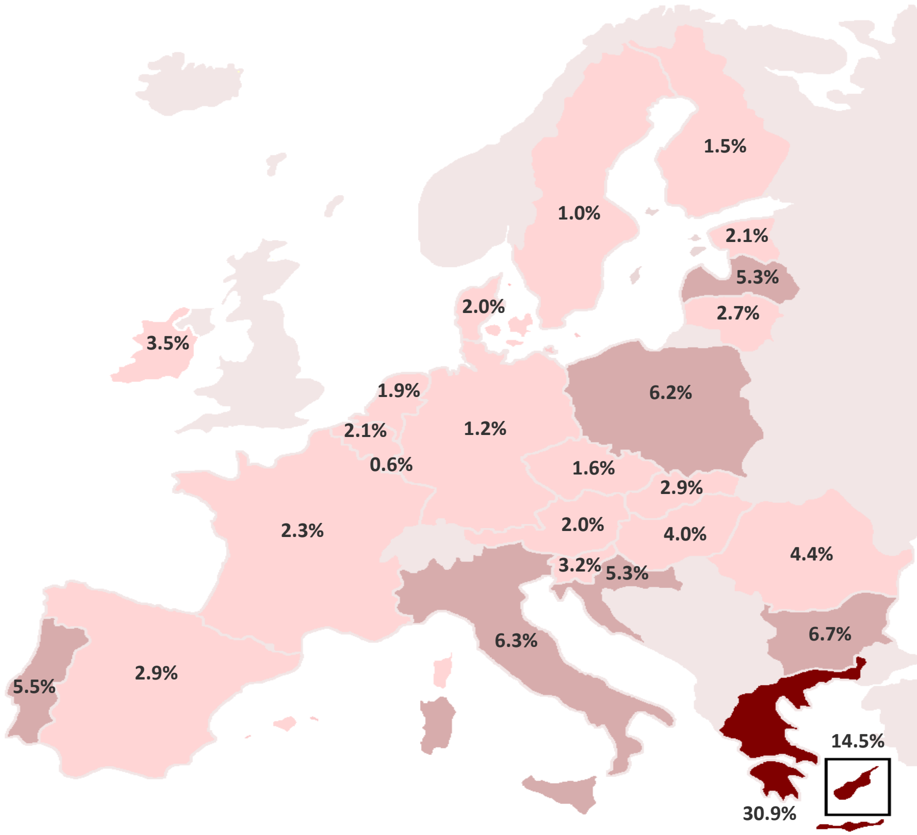
Equity vs. NPL (net)



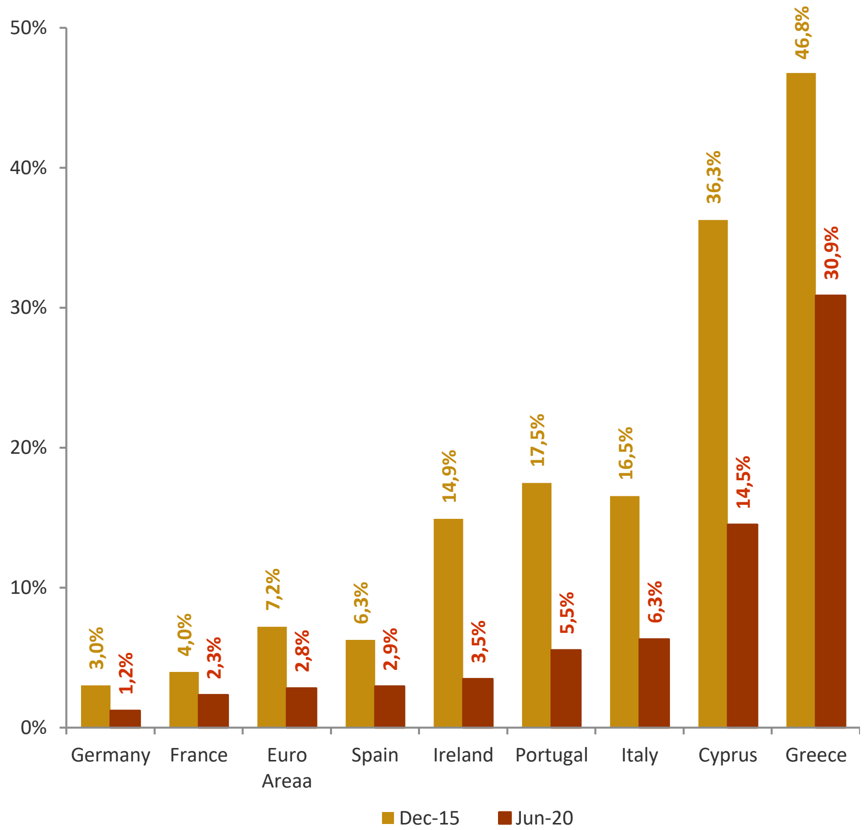
Non-Performing Loans – Loans that comply with at least one of the following conditions: i) material exposures that are more than 90 days past-due; ii) the debtor is assessed as unlikely to pay its obligations in full without realization of collateral; iii) impaired assets; except incurred but not reported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

The reduction of the NPL stock remains a priority for the Portuguese banking sector. However, in the current context of deteriorating economic activity, the preservation of credit quality represents a significant challenge.

NPL ratio in the EU



Evolution of the NPL ratio in the EU

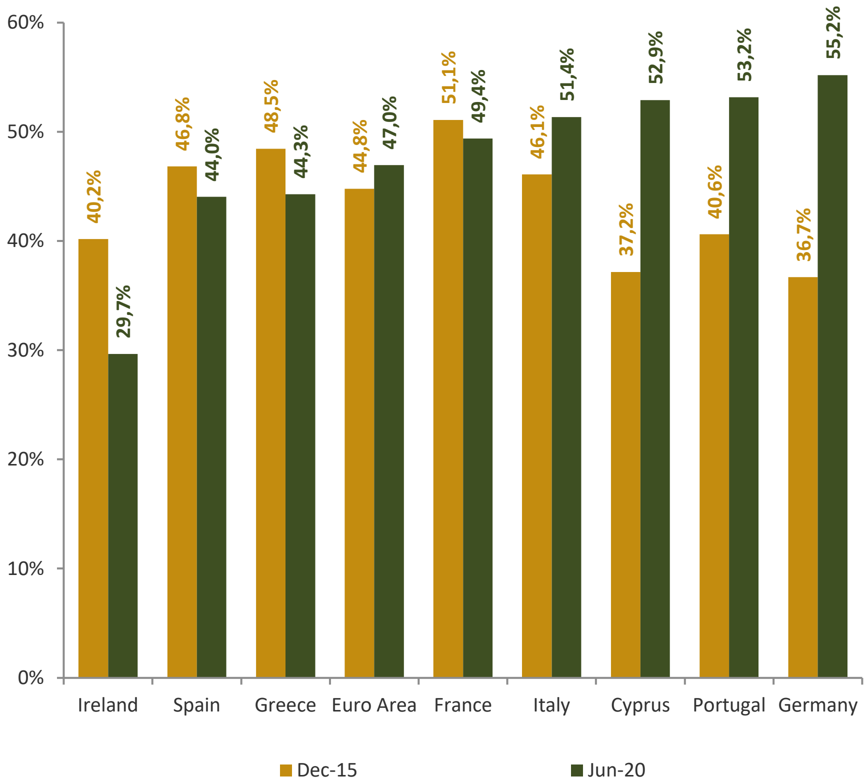


Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data.

LENDING

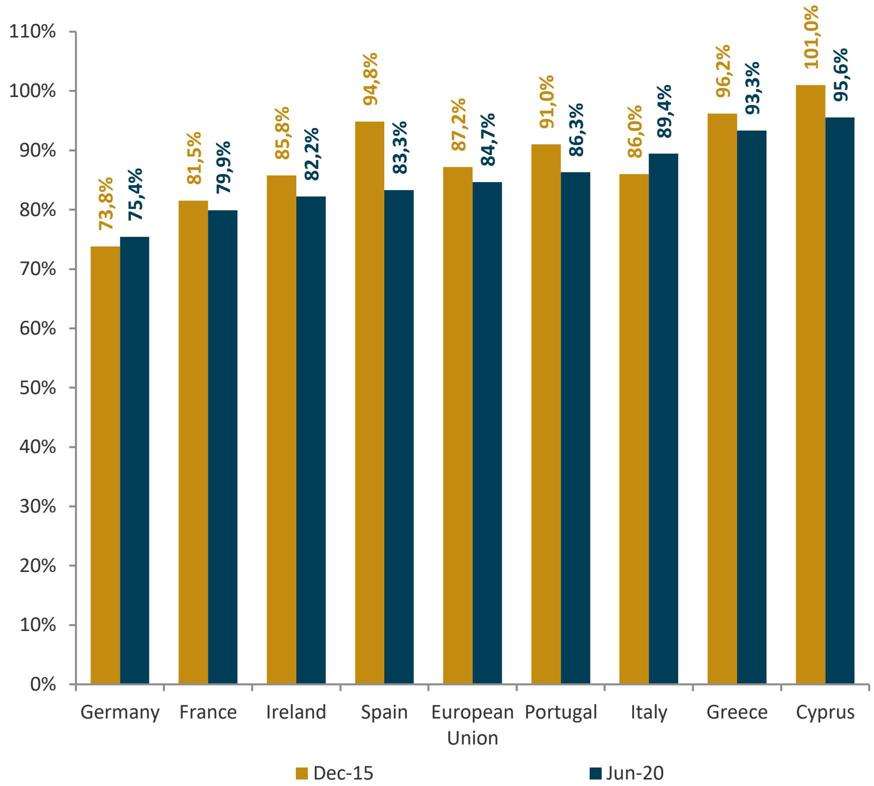
The NPL impairment and total coverage ratios continue to compare favorably with the EU average.

Impairment coverage ratio



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

Total NPL coverage ratio

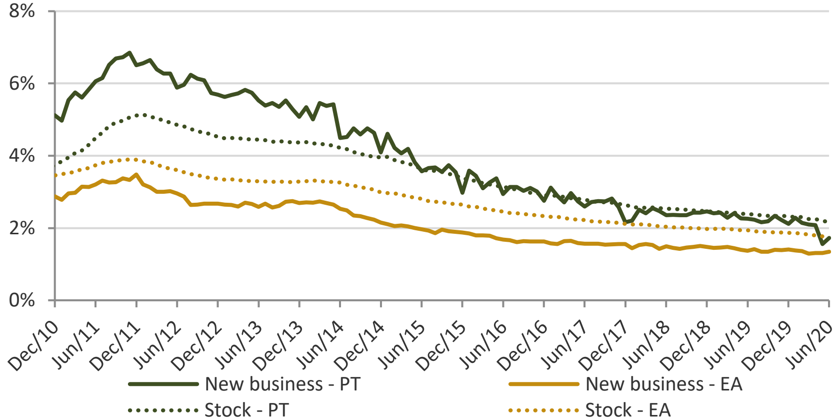


Source: EBA – EU-wide transparency exercise. Total coverage ratio includes cumulative impairments, collateral, and financial guarantees associated with non-performing loans. EBA sample includes 127 banks for Jun-20 (Portugal: BCP, CCCAM, CGD, LSF Nani Investments and Montepio).

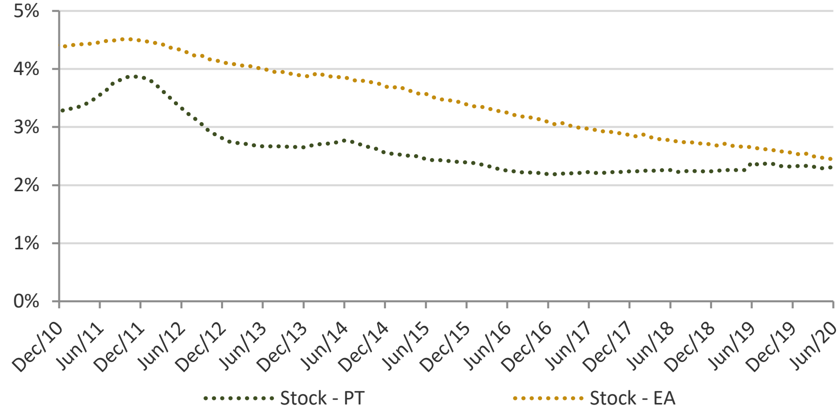
LENDING | LOAN CONDITIONS

Interest rates on loans have been in a downward path and converging towards the Euro Area average. The most significant reduction observed, up to May, in interest rates on new lending to non-financial corporations (NFC) is explained by the weight of the credits granted under the public guarantee schemes implemented in response to the pandemic crisis.

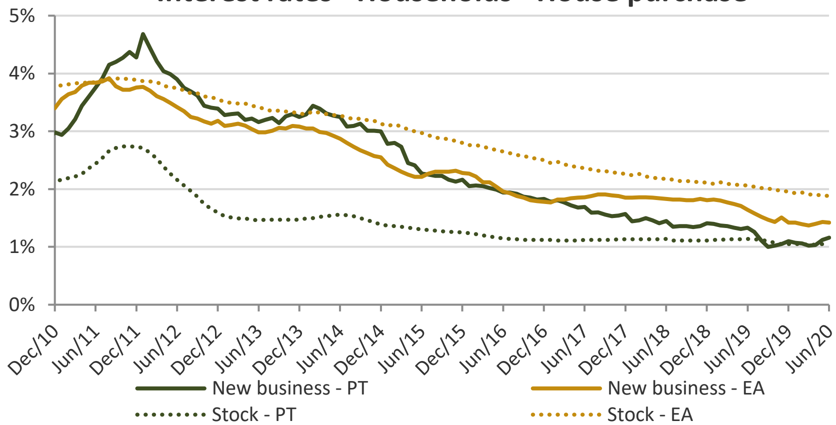
Interest rates - NFC



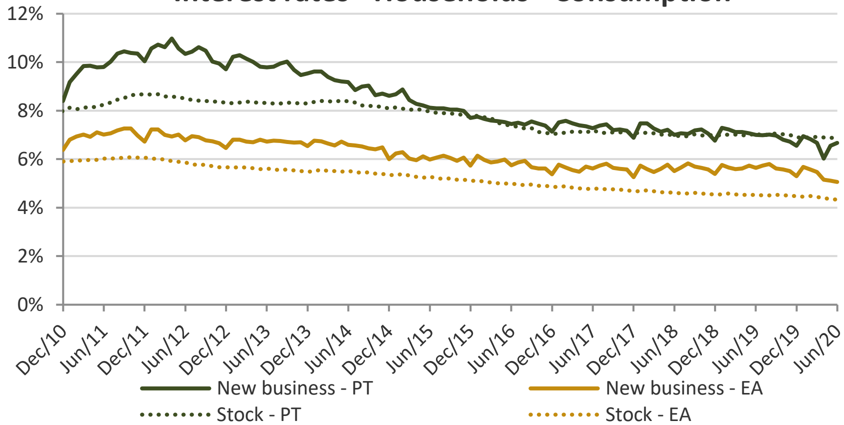
Interest rates - Households



Interest rates - Households - House purchase



Interest rates - Households - Consumption

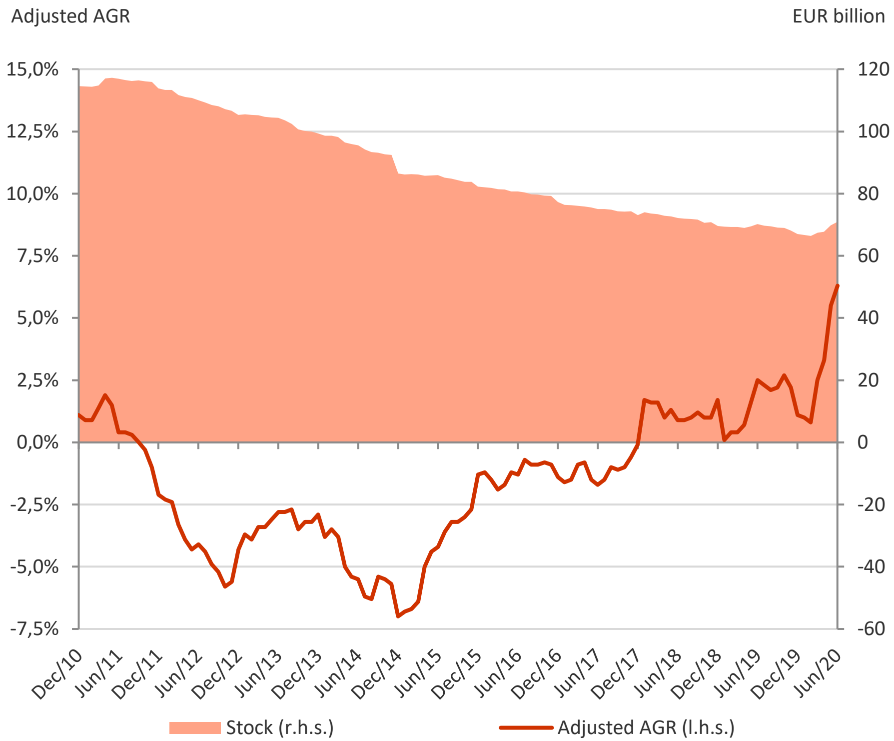


Source: ECB – MFI Interest Rate Statistics.

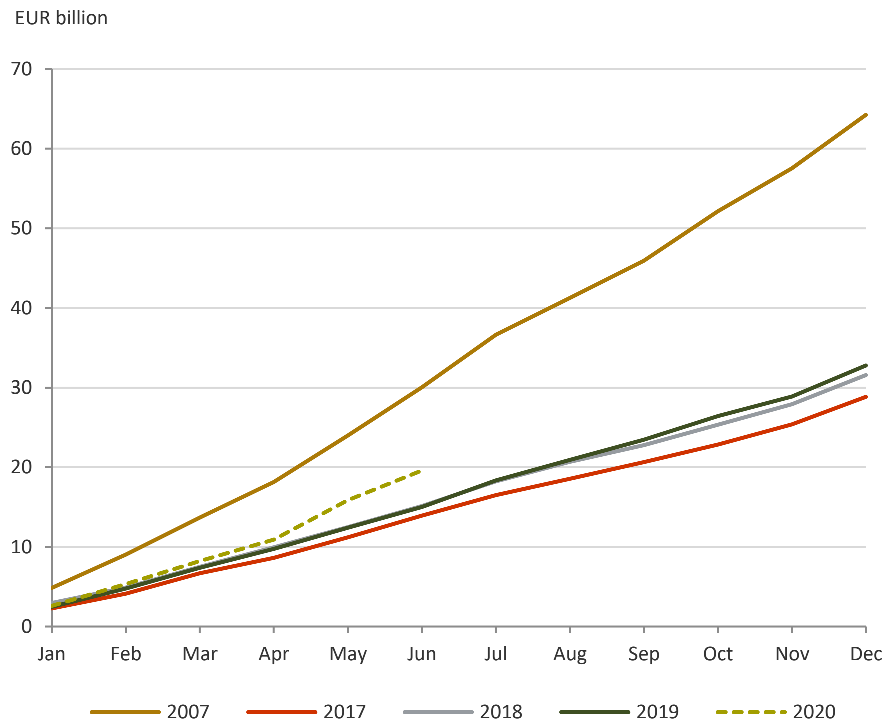
LENDING | NFC

The evolution of the stock of loans to non-financial corporations has been penalized by the effort to reduce NPL. However, in the first half of 2020, new lending to NFCs rose 30% YoY, largely due to the public credit guaranteed schemes implemented in response to the pandemic crisis.

Stock of loans to NFCs



New business lending to NFC (accumulated amounts)

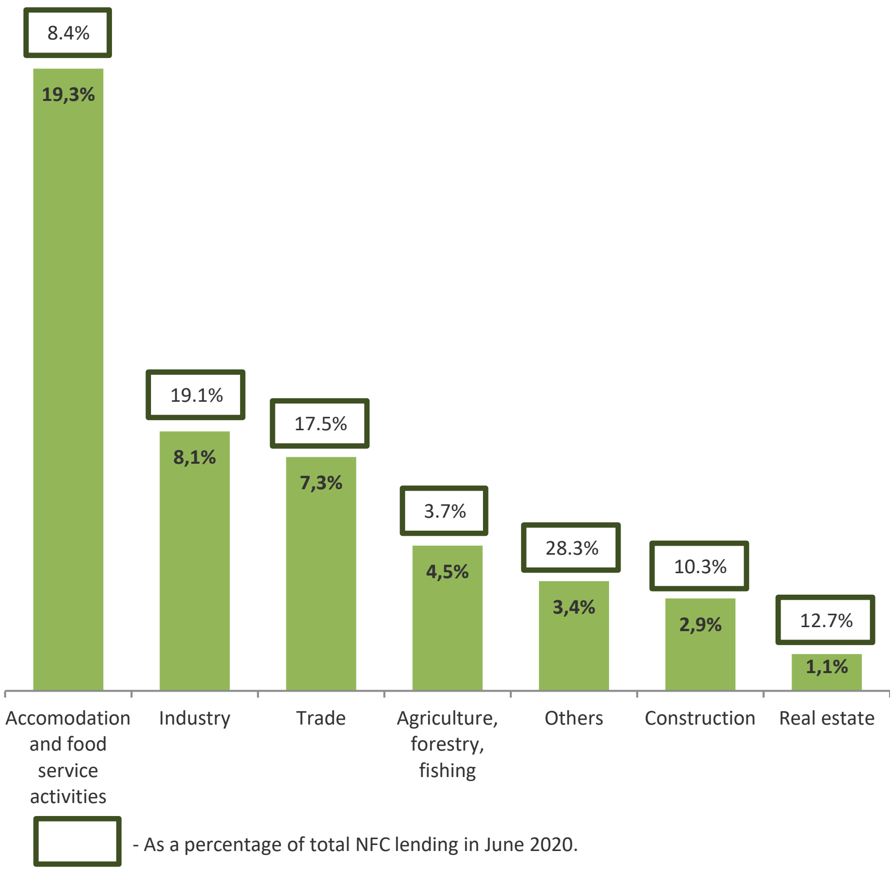


Source: Banco de Portugal (Monetary and Financial Statistics). Adjusted AGR = Annual growth rates (AGR) adjusted for securitization and liquidity-providing operations.

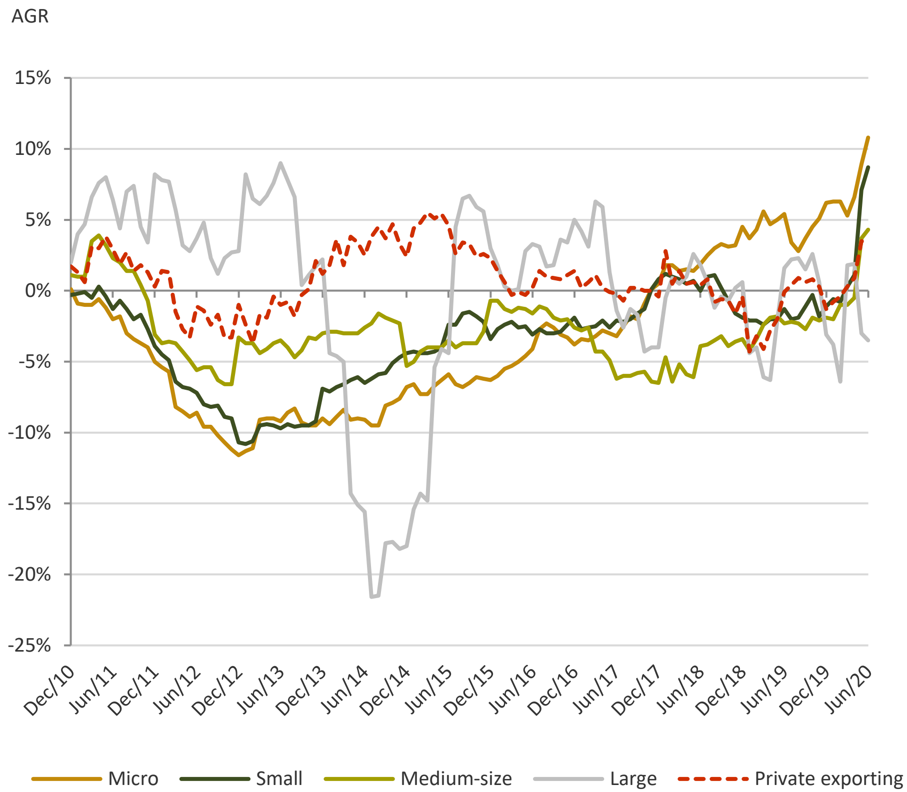
LENDING | NFC

In the first half of 2020, there was an increase of the loans granted to the sectors most affected by the pandemic, among which stand out accommodation and food service activities and trade, and, in terms of size, to micro, small and medium-sized enterprises (SMEs).

Change of the stock of loans to NFCs by sector (Dec-19 - Jun-20)



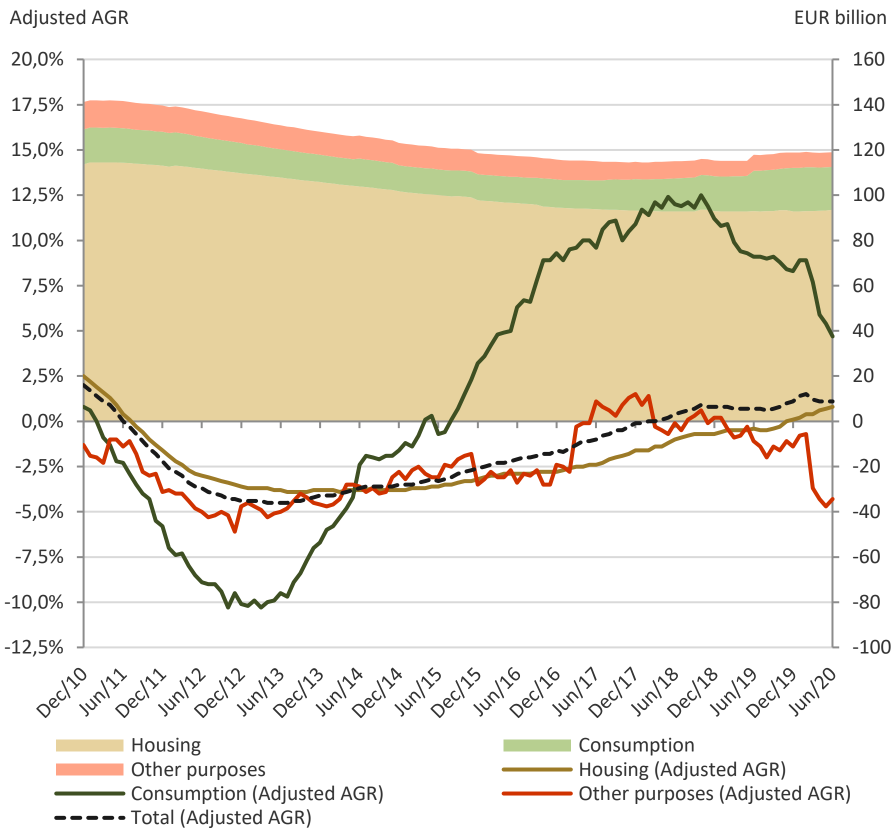
AGR of loans to NFCs by size



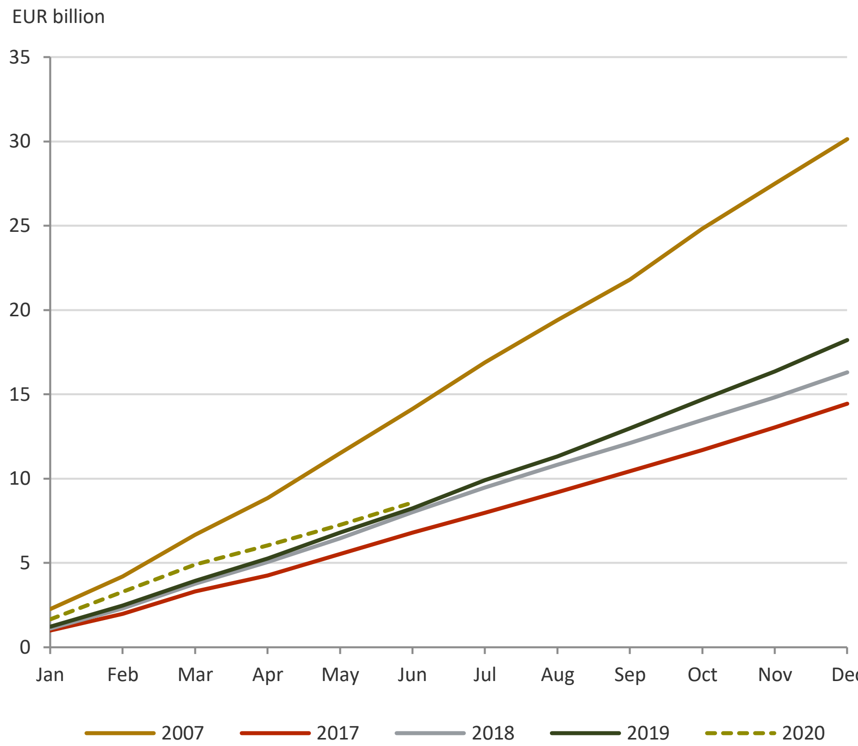
Source: Banco de Portugal (Monetary and Financial Statistics). AGR = Annual growth rate.

In the first half of 2020, the annual growth rate of the stock of consumer credit decreased, interrupting the dynamism observed in this segment of loans to households. Moreover, the stock of mortgage loans maintained the recovery path initiated in 2019.

Stock of loans to households



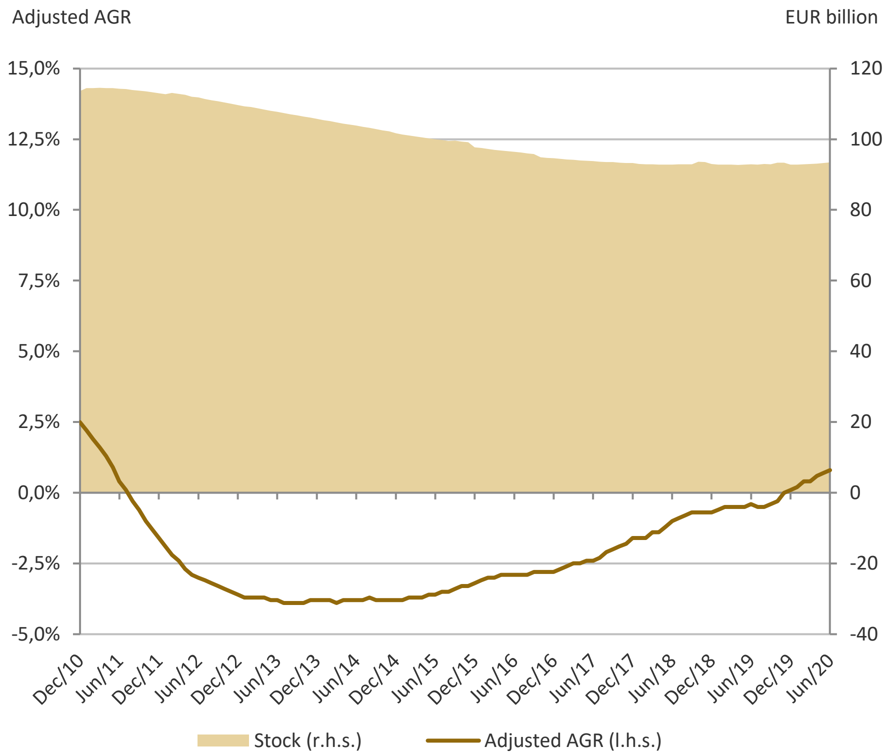
New business lending to households (accumulated amounts)



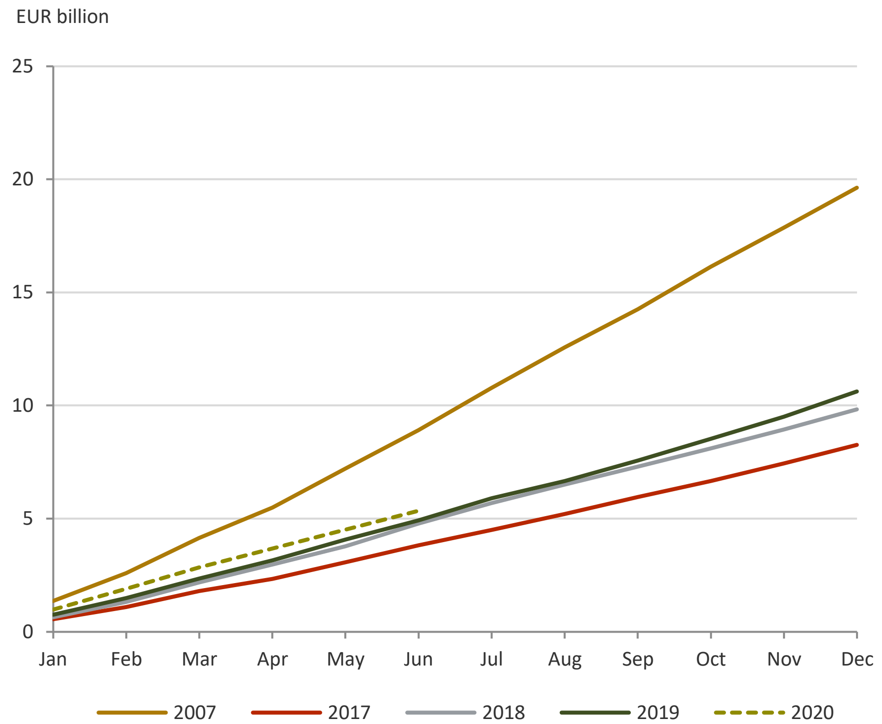
Source: Banco de Portugal (Monetary and Financial Statistics). Adjusted AGR = Annual growth rates (AGR) adjusted for securitization and liquidity-providing operations.

The increase in the flow of new mortgage loans, although still below the pre sovereign crisis levels, coupled with a decrease in repayments contributed to a positive evolution of the stock of mortgage loans since the end of 2019. The decrease in repayments is partly explained by the effect of moratoria on loan repayments.

Stock of loans for house purchase



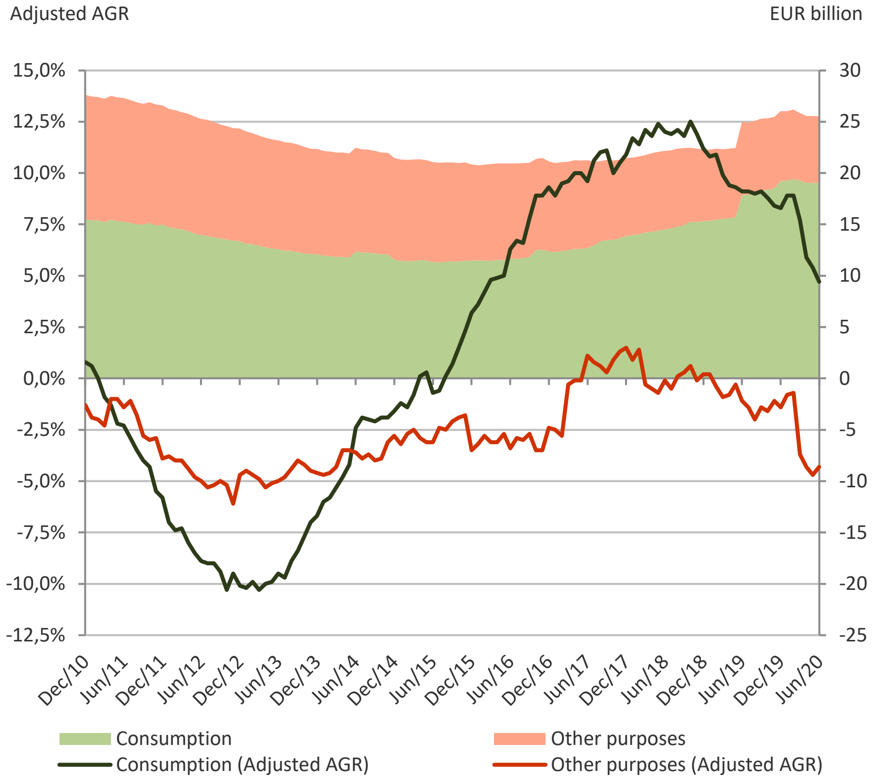
New business lending for house purchase (accumulated amounts)



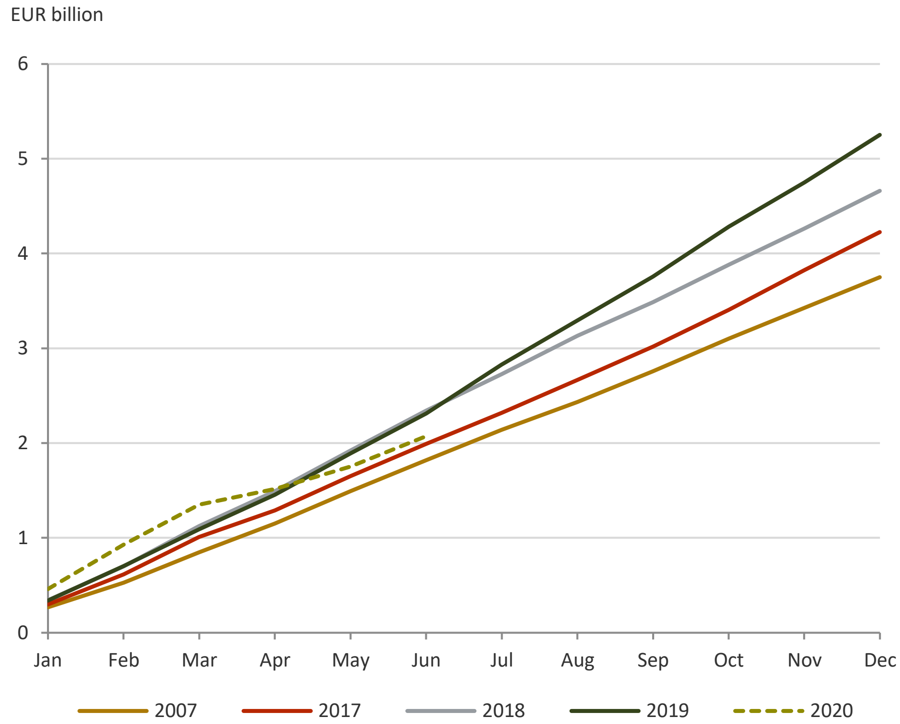
Source: Banco de Portugal (Monetary and Financial Statistics). Adjusted AGR = Annual growth rates (AGR) adjusted for securitization and liquidity-providing operations.

The stock of consumer credit, which has been growing since 2015, was strongly affected by the pandemic crisis. New lending in the first half of 2020 suffered a significant drop (10.4% YoY).

Stock of loans for consumption and other purposes



New business lending for consumption (accumulated amounts)



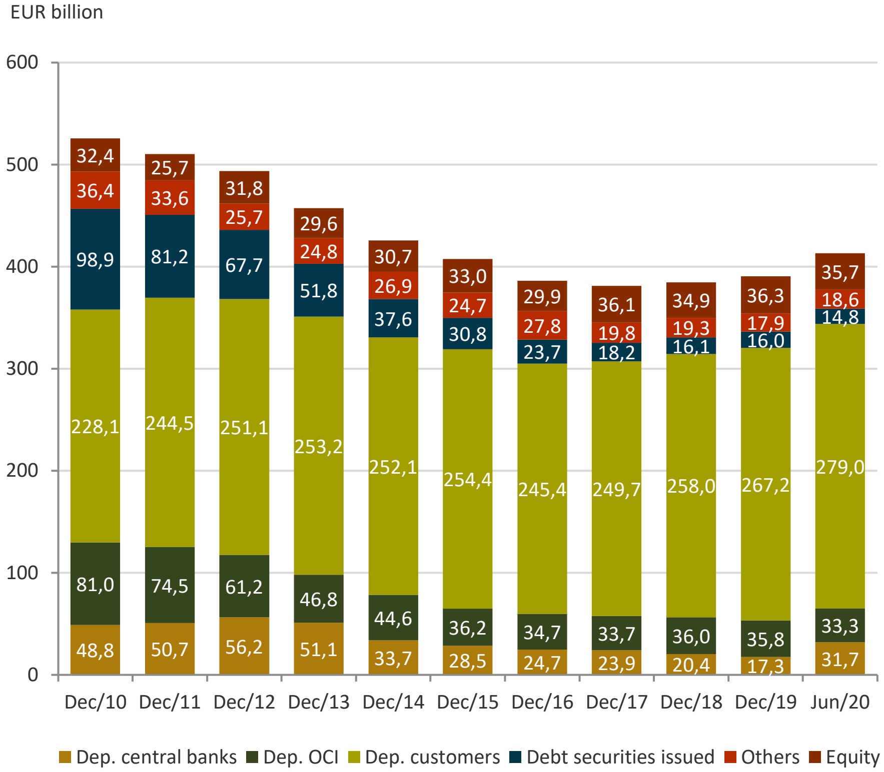
Source: Banco de Portugal (Monetary and Financial Statistics). Adjusted AGR = Annual growth rate (AGR) adjusted for securitization and liquidity-providing operations.

III. Funding and Liquidity Structure

FUNDING AND LIQUIDITY STRUCTURE

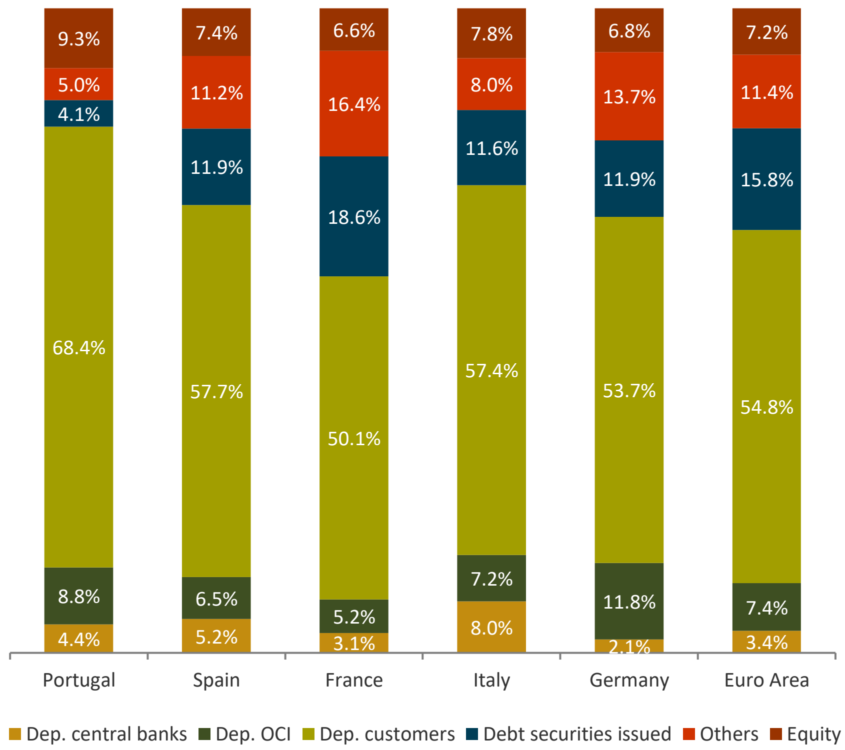
The evolution of liabilities has reflected the reinforcement of customer deposits as the main source of funding. At the end of June 2020, as a result of the attractive monetary policy measures that were strengthened in this period, funding from the Eurosystem rose to 8.4%, an increase of 3.5 pp compared to December 2019.

Funding structure



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

Portugal vs. Euro Area (Dec-19)

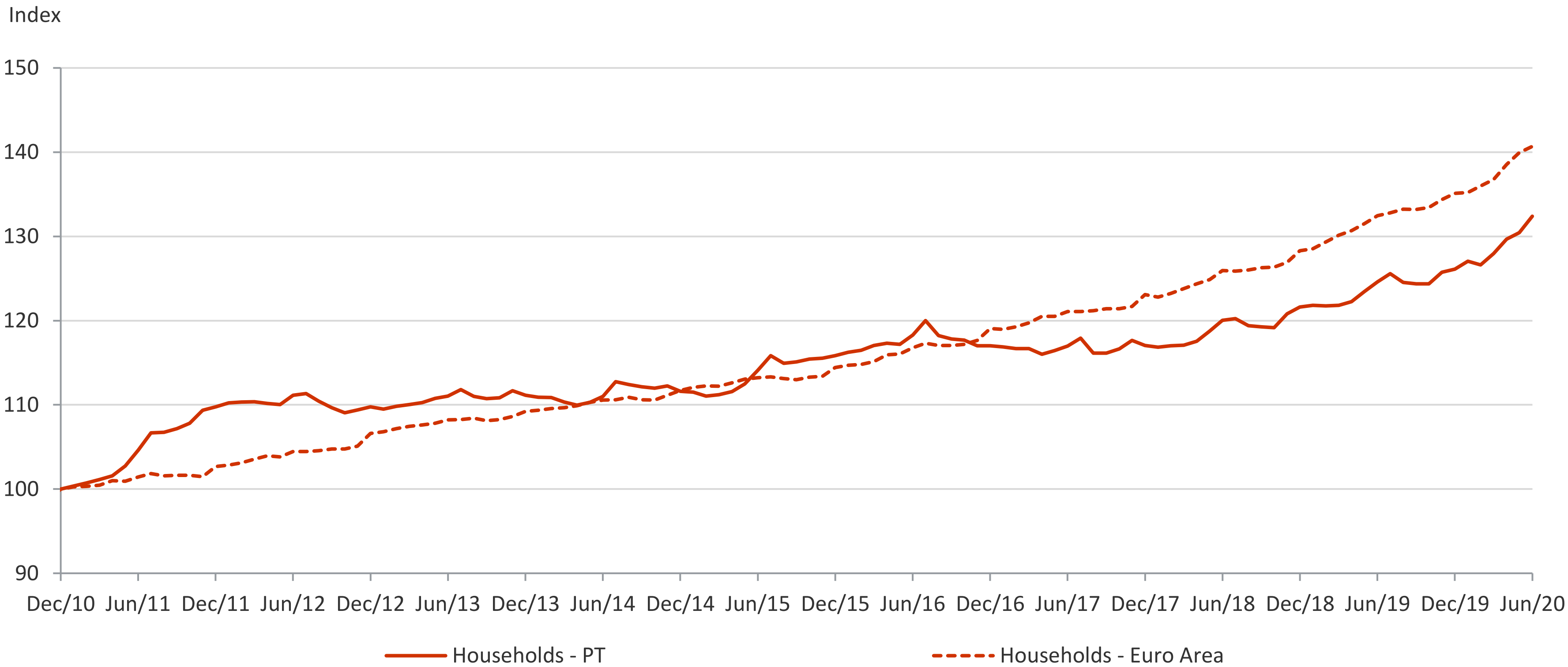


Source: ECB – Consolidated Banking Data.

FUNDING AND LIQUIDITY STRUCTURE

With the outbreak of the pandemic crisis and the increase in savings as a result of reduced consumption and high uncertainty regarding the duration of the crisis and its impacts, customer deposits, which already showed a high level of resilience, increased significantly, reaching a maximum value of 157.5 billion euros in June 2020.

Evolution of households' deposits (Dec-10=100)

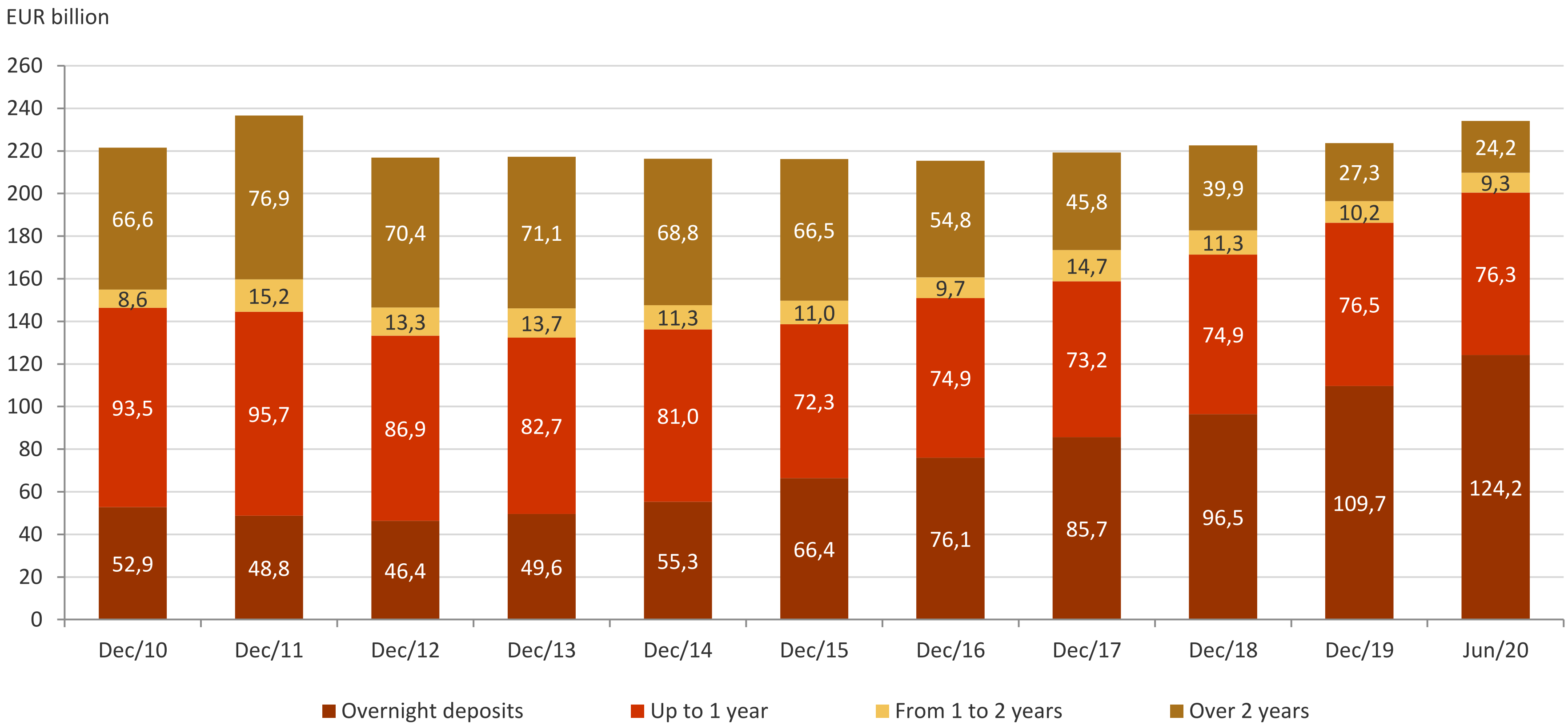


Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics). Deposits of households include emigrants.

FUNDING AND LIQUIDITY STRUCTURE

The weight of time deposits has decreased in contrast to the weight of overnight deposits, as a result of the ECB's accommodative monetary policy and the very low interest rates context.

Evolution of time deposits

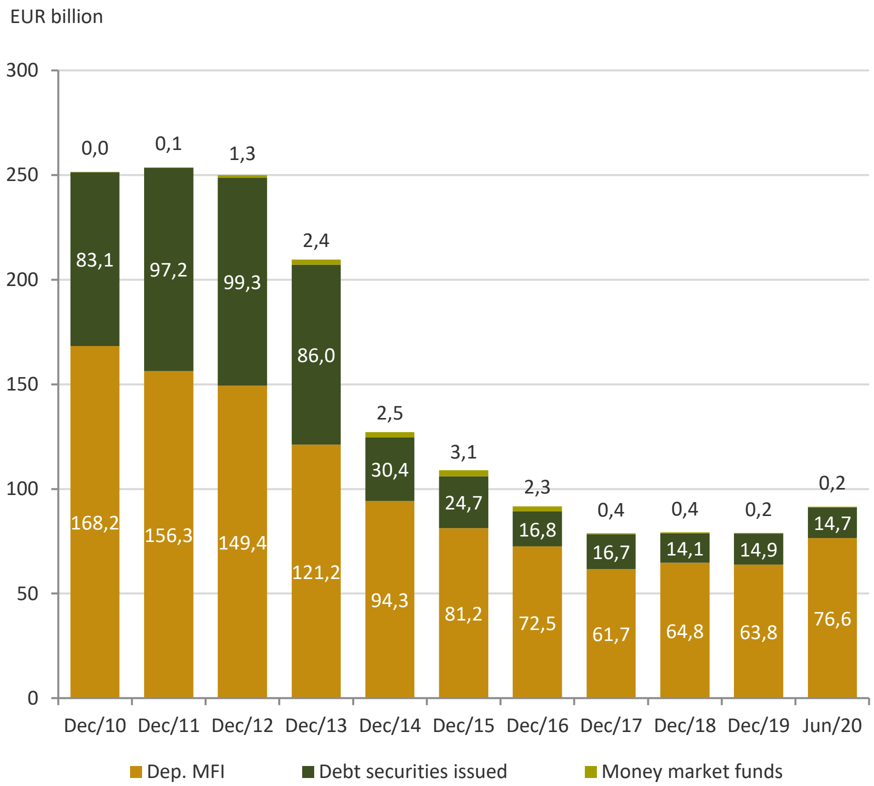


Source: Banco de Portugal (Monetary and Financial Statistics). Deposits from the non-monetary sector (end-of-period balances).

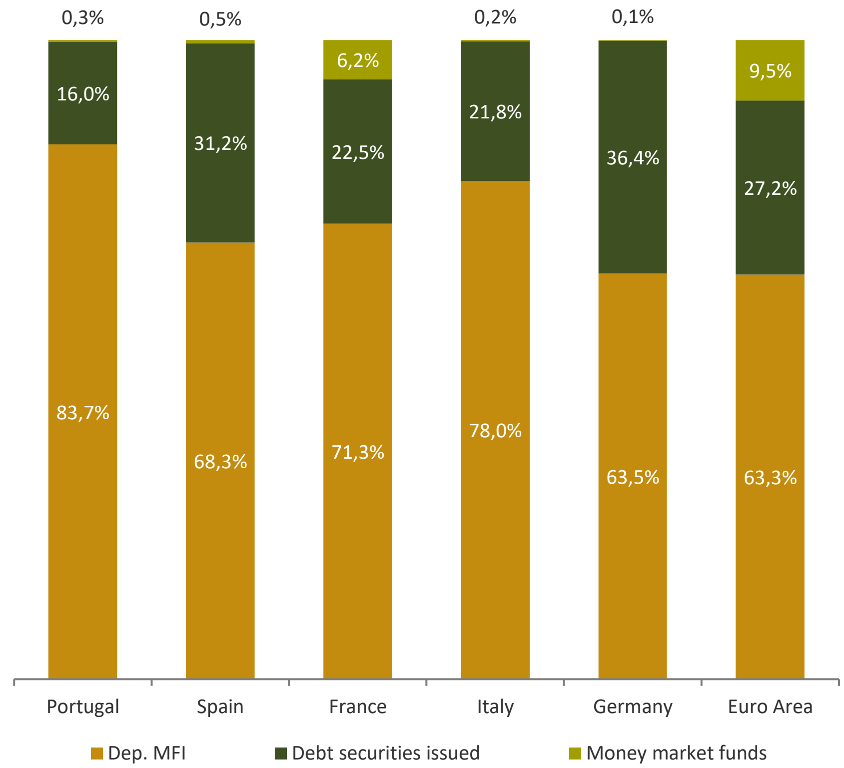
FUNDING AND LIQUIDITY STRUCTURE

Recourse to wholesale funding is currently not very significant in the Portuguese banking sector. Deposits from the monetary sector is the main component of wholesale funding of the Portuguese banking sector, similarly to the Euro Area.

Wholesale funding structure



Portugal vs. Euro Area

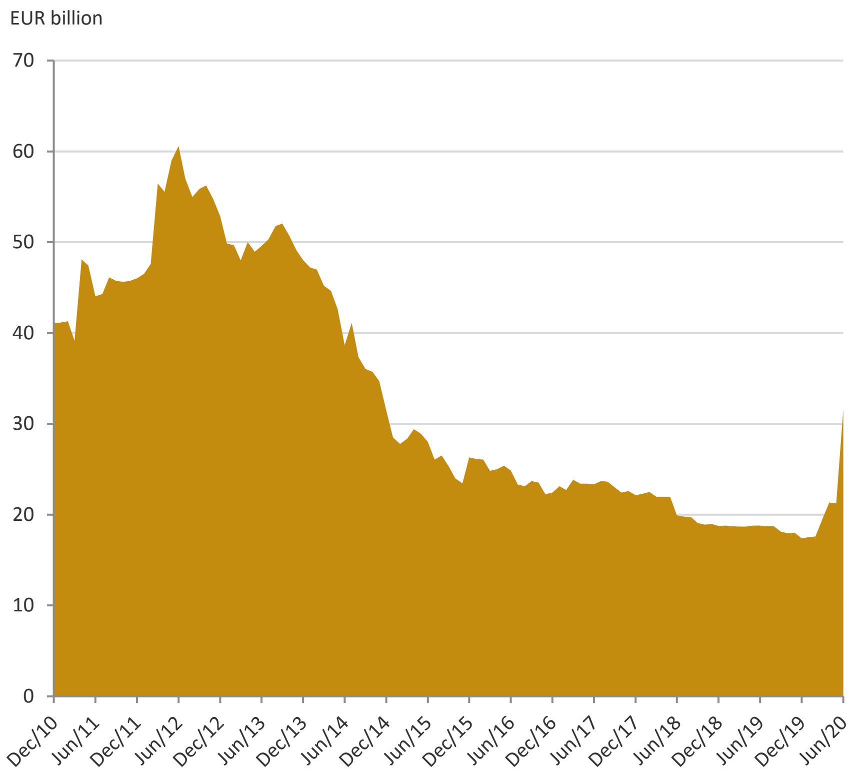


Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics).
Monetary Financial Institutions (MFI) include the Central Bank and Other Monetary Financial Institutions (OMFI).

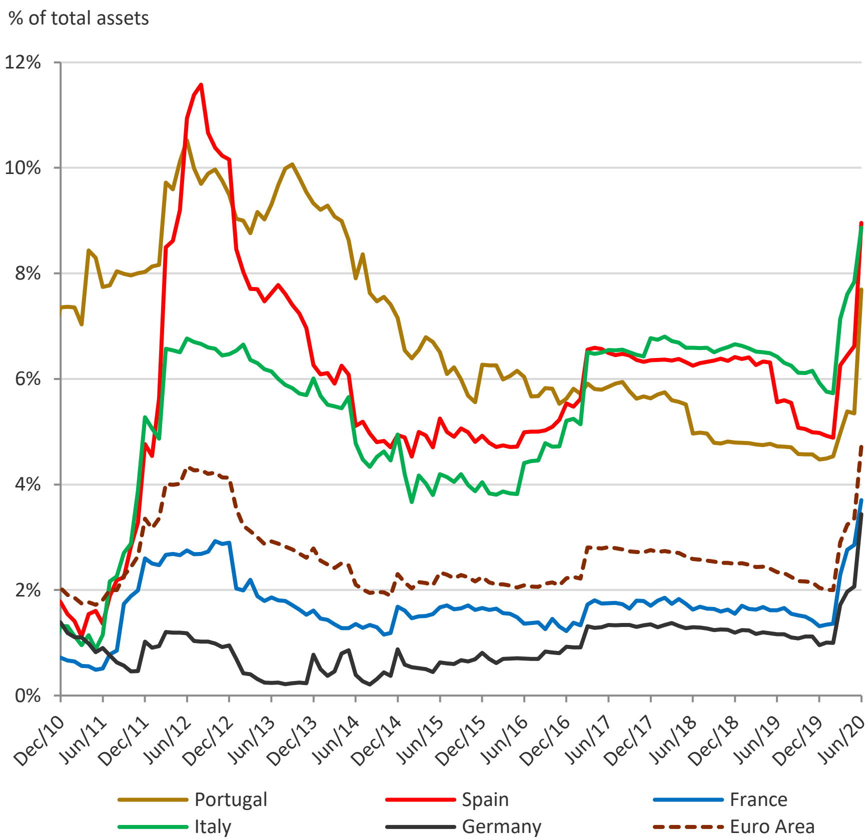
FUNDING AND LIQUIDITY STRUCTURE

At the end of June 2020, funding from the Eurosystem, which has declined since 2012, increased 3.3 pp compared to December 2019, representing 7.7% of assets. This movement was transversal to the Portuguese and European banking systems as a consequence of the monetary policy measures adopted in response to the crisis.

Borrowing from the European Central Bank



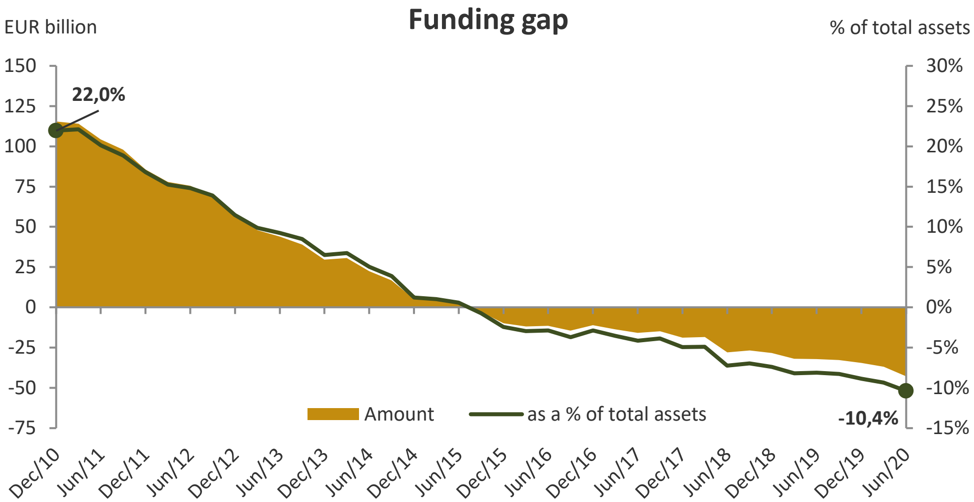
Portugal vs. Euro Area as a % of total assets

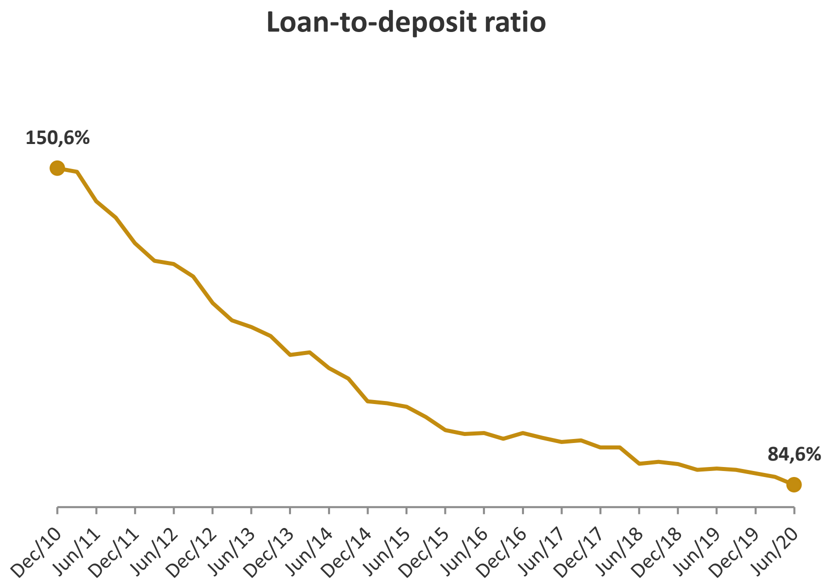


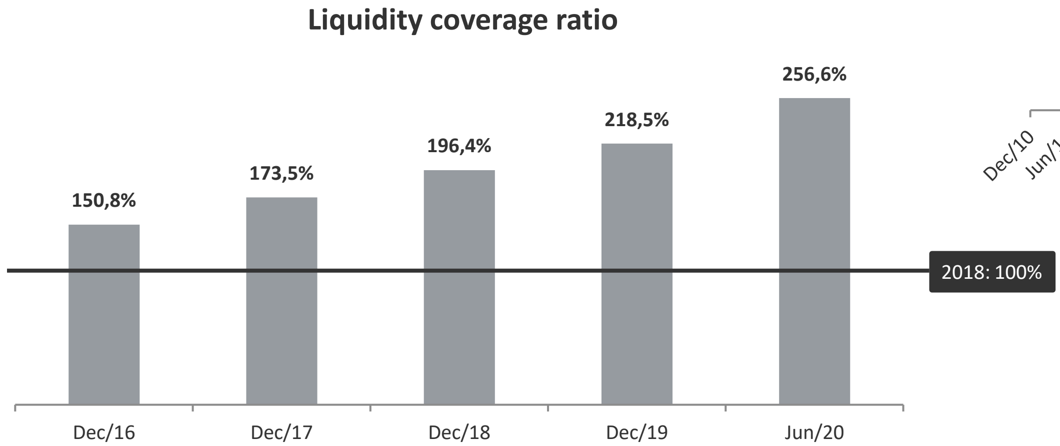
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics).

FUNDING AND LIQUIDITY STRUCTURE

Liquidity indicators have registered a very positive evolution. This extraordinarily comfortable position of the Portuguese banking system in terms of liquidity has allowed it to play an essential role in mitigating the impacts of the COVID-19 crisis on companies and families.







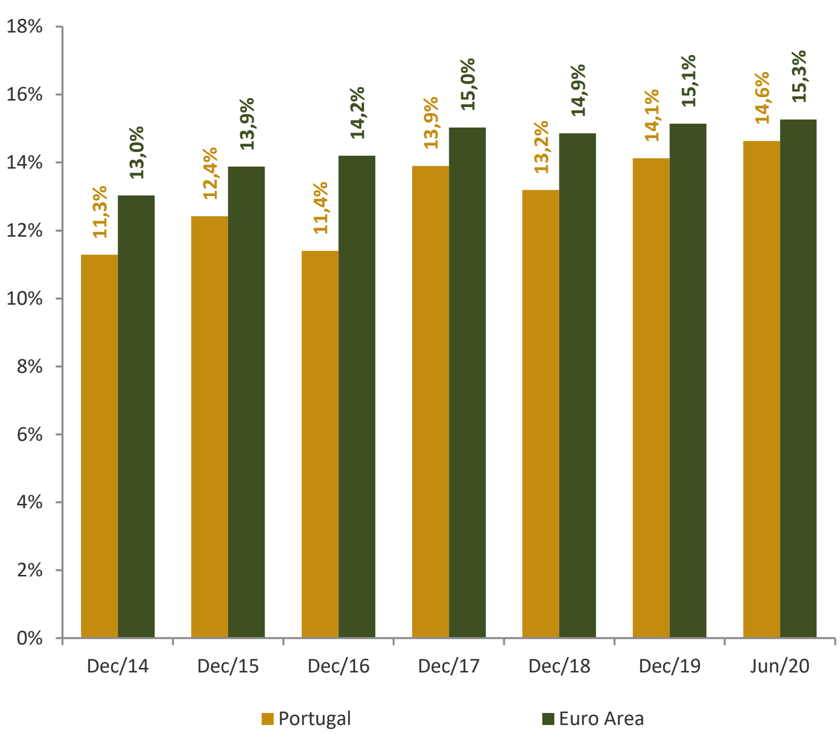
Source: Banco de Portugal (consolidated data).

IV. Solvency

SOLVENCY

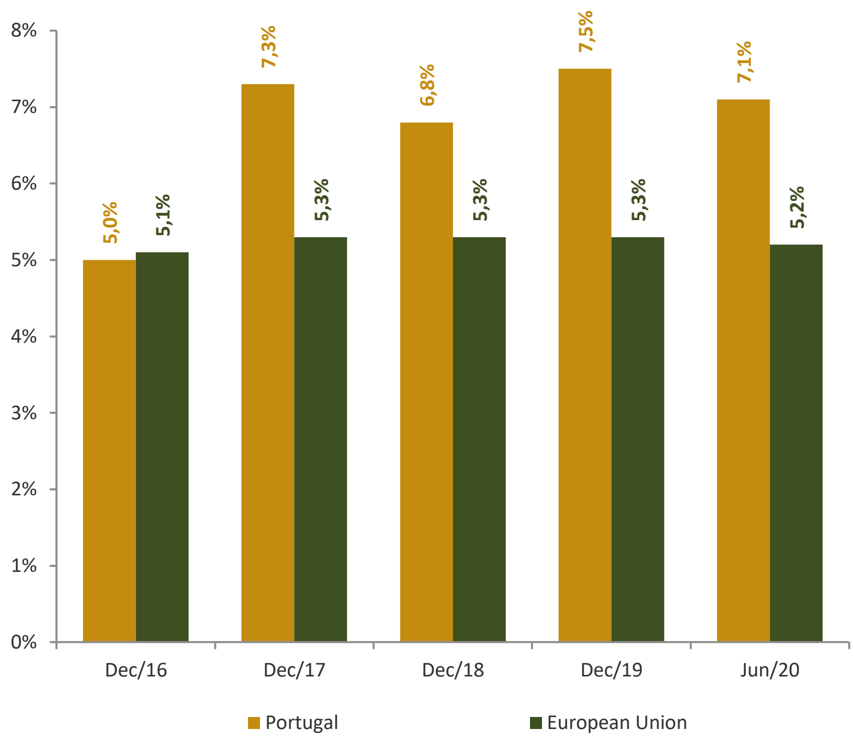
Solvency has been improving, reflecting the reinforcement of own funds by several financial institutions and the favourable evolution of risk-weighted assets. The leverage ratio is considerably higher than the EU average and the minimum reference (3%). Together with the favourable liquidity position, the system's solvency levels allow it to respond effectively to the economy's financing needs, in the current context, and accommodate a possible deterioration in credit risk and an increase in NPL.

Common Equity Tier 1 (CET1) ratio



Source: ECB – Consolidated Banking Data.

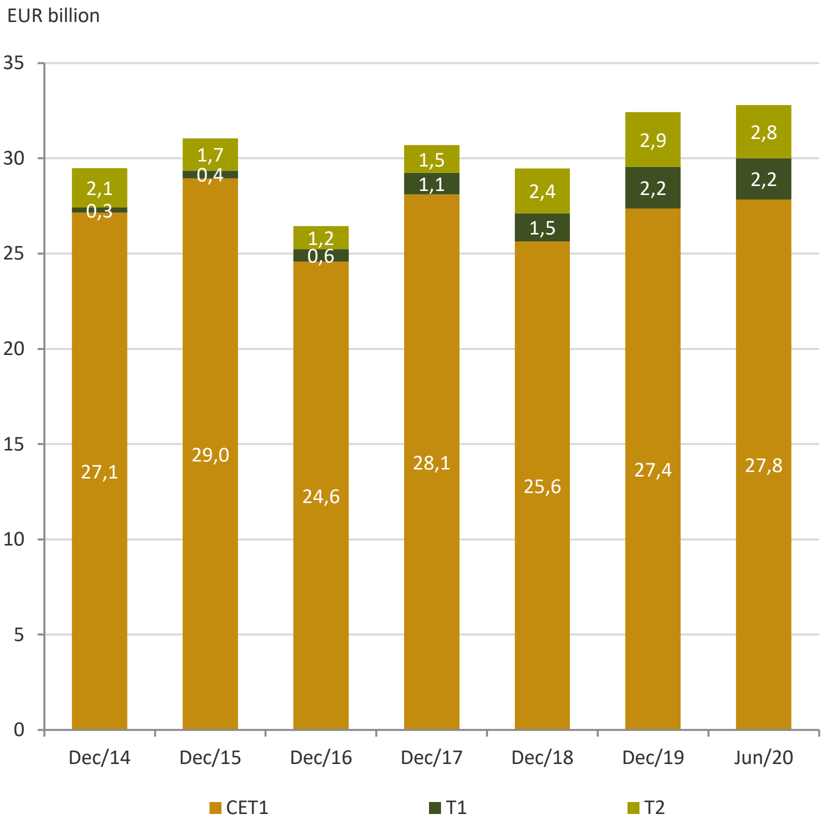
Leverage ratio



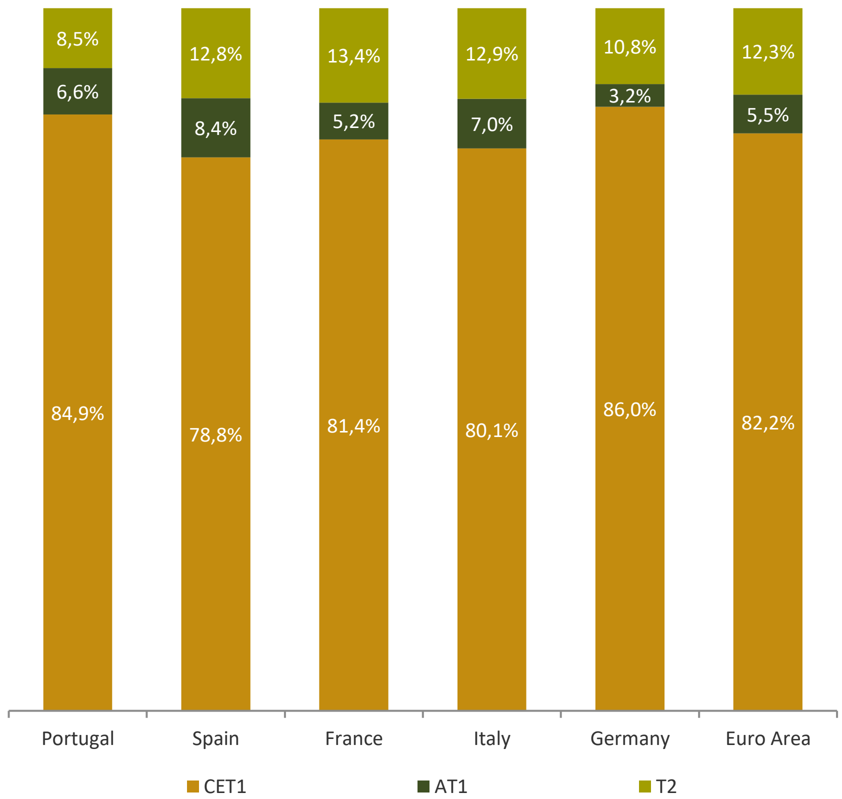
Source: EBA – Risk Dashboard (fully phased-in definition of Tier 1 in the Leverage ratio).

The weight of Common Equity Tier 1 (CET1) in the own funds' structure is above the Euro Area average. Net income retention in the pandemic period contributed to the increase in CET1 capital.

Evolution and structure of own funds



Portugal vs. Euro Area

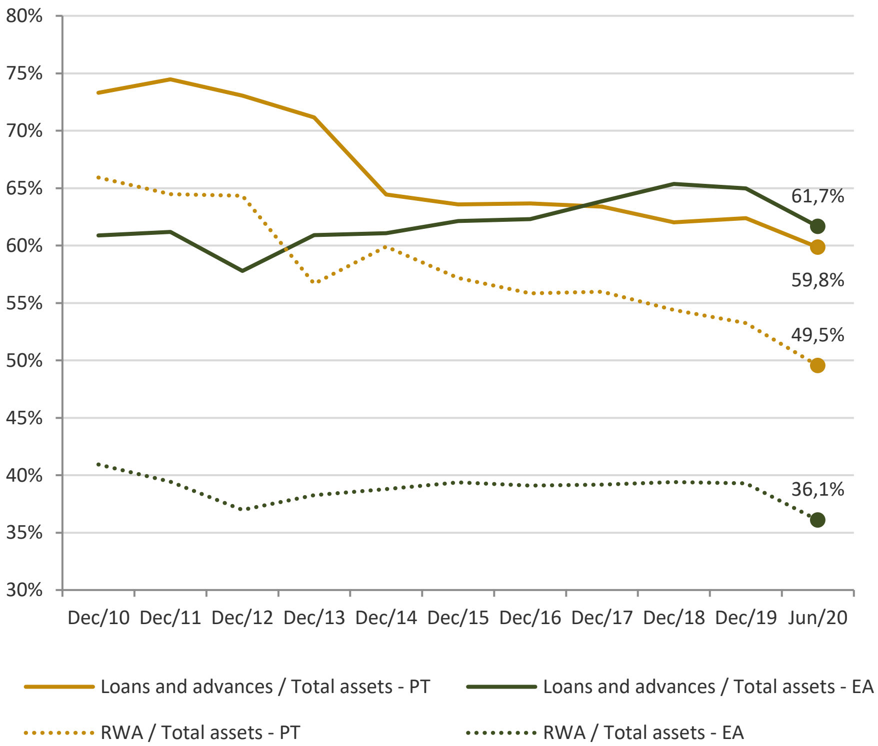


Source: ECB – Consolidated Banking Data.

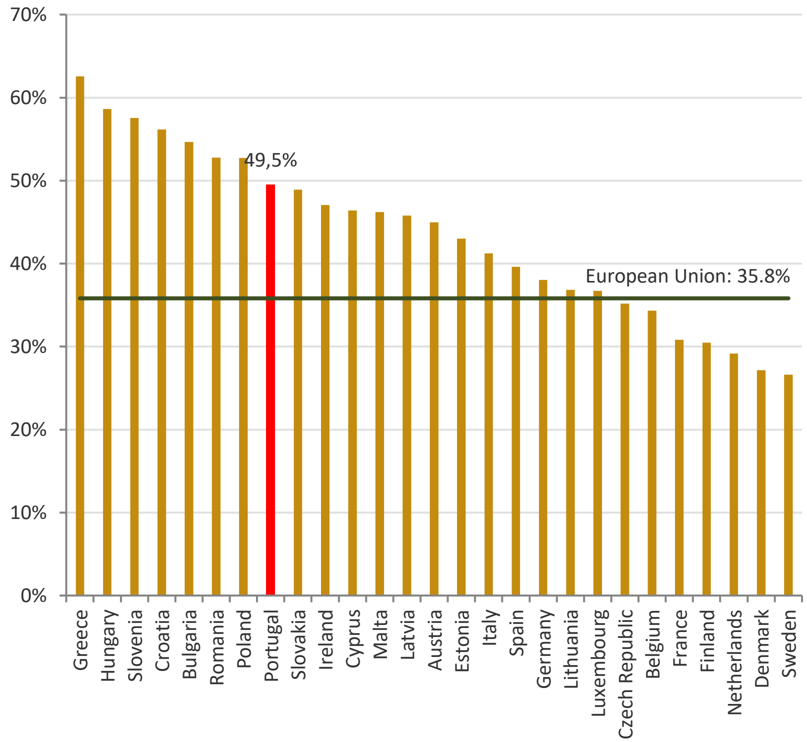
SOLVENCY

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

Portugal vs. Euro Area



RWA as a % of total assets, by country



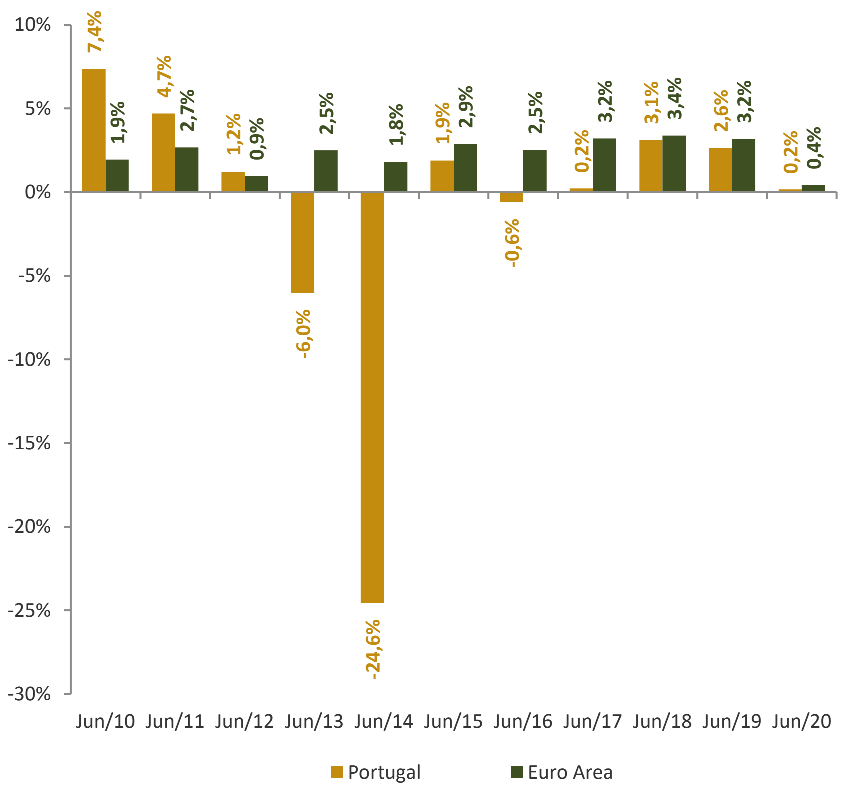
Source: ECB – Consolidated Banking Data.

V. Profitability

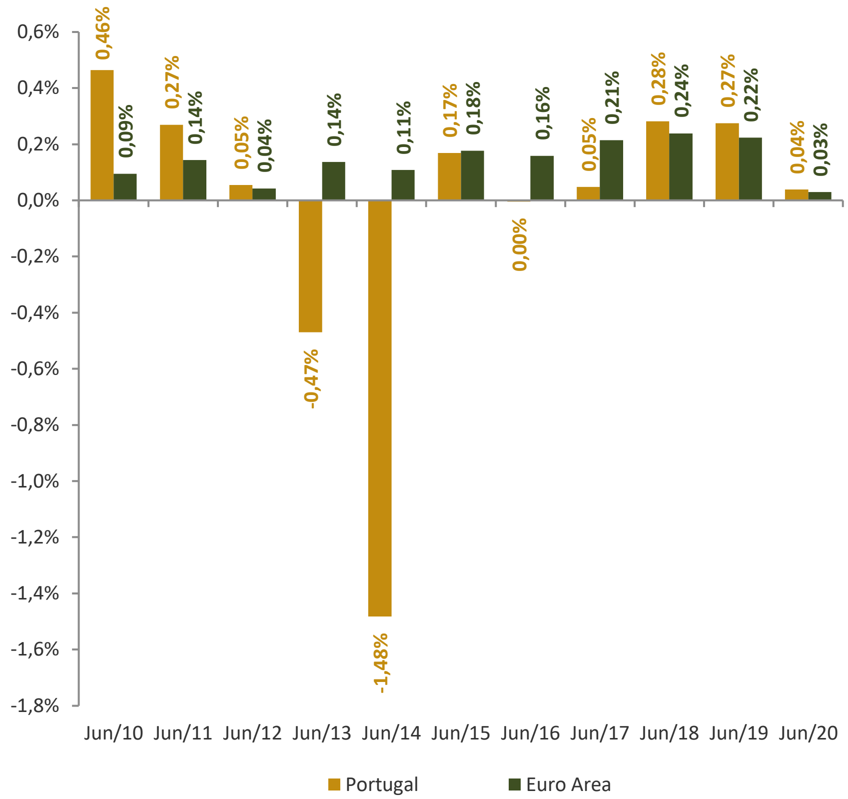
PROFITABILITY

The profitability of the banking system suffered a significant decrease, due to the COVID-19 pandemic context, becoming again under strong pressure and reversing the recovery trend that was being experienced since 2018.

Return on Equity (ROE)



Return on Assets (ROA)



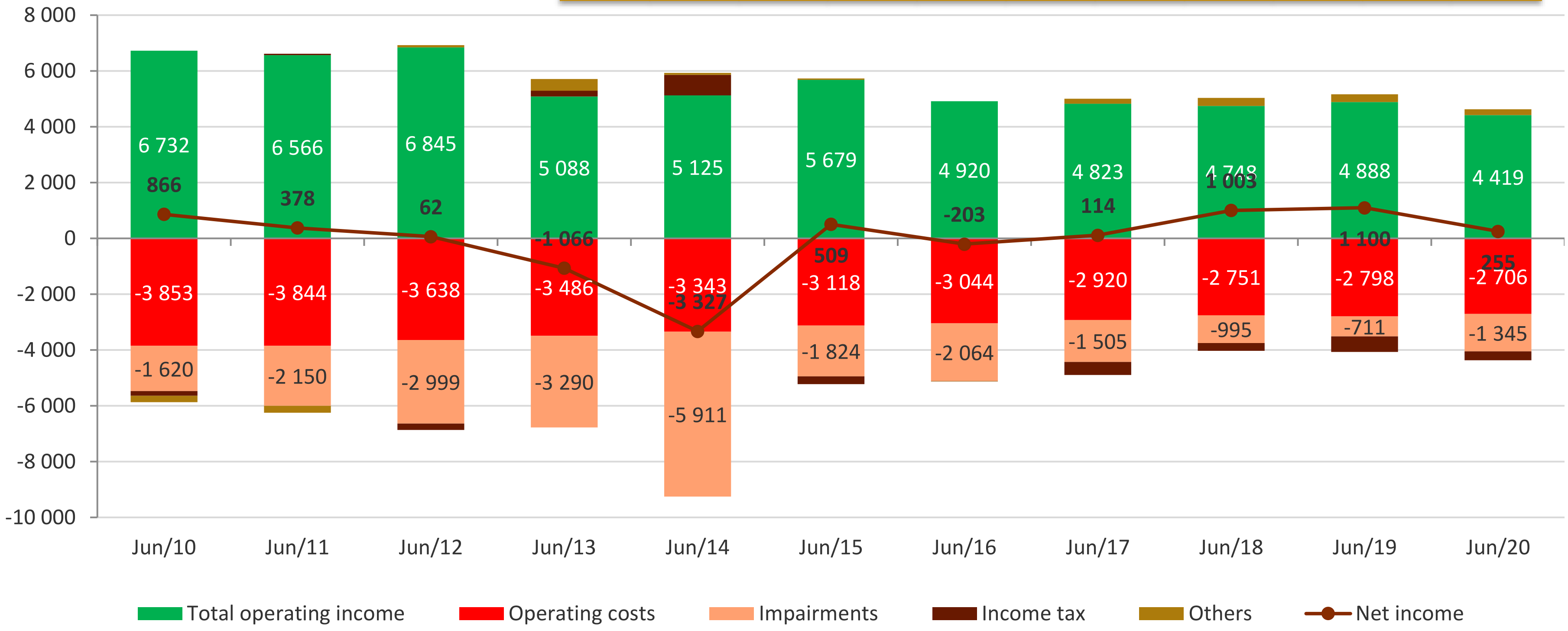
Source: ECB – Consolidated Banking Data (non-annualized data).

In the first half of 2020, the deterioration in profitability reflected not only a drop in total operating income, but, above all, a significant increase in the flow of provisions and impairments.

Net income breakdown

Cost of credit risk										
Jun-10	Jun-11	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18	Jun-19	Jun-20
0,7%	1,0%	1,5%	1,5%	2,4%	1,1%	1,2%	0,7%	0,5%	0,4%	0,9%

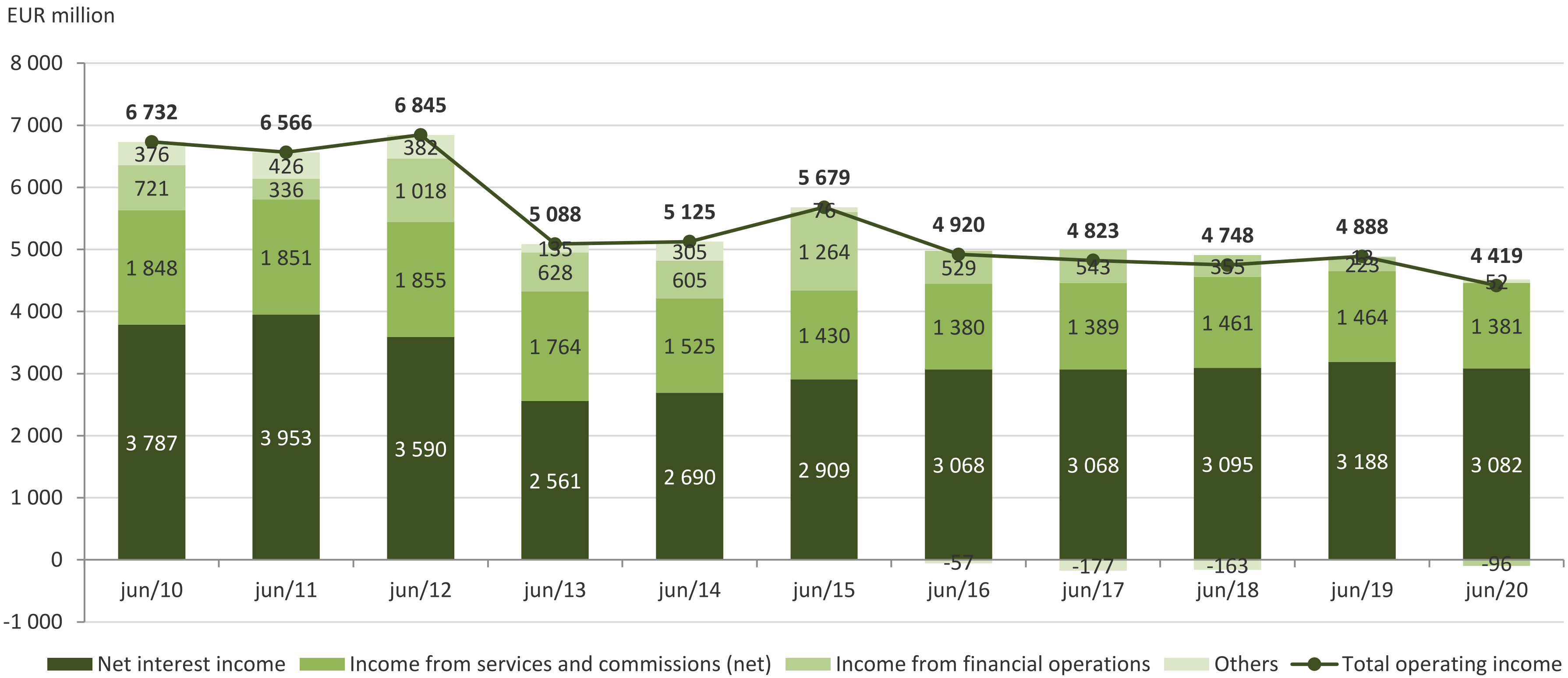
EUR million



Source: Banco de Portugal (consolidated data).

The evolution of the total operating income has been reflecting the volatility of some of its components (performance of financial markets and execution of NPL sales plans). In the first half of 2020, the total operating income posted a significant decrease in year-on-year terms (-9.6%), which reflected a negative contribution from all its components.

Total operating income breakdown

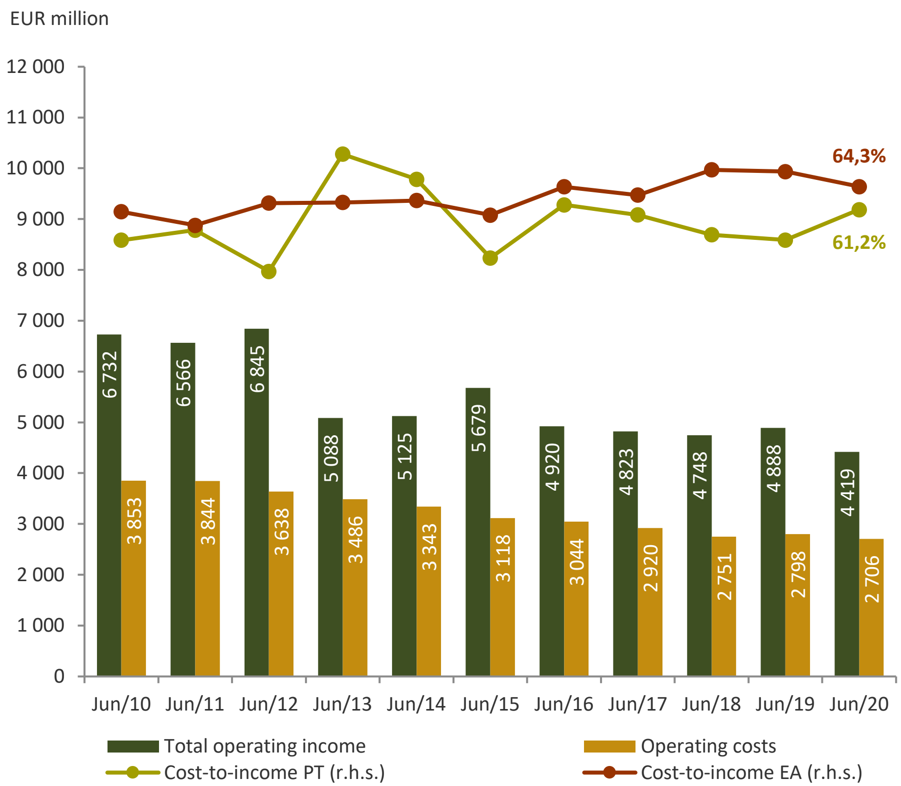


Source: Banco de Portugal (consolidated data).

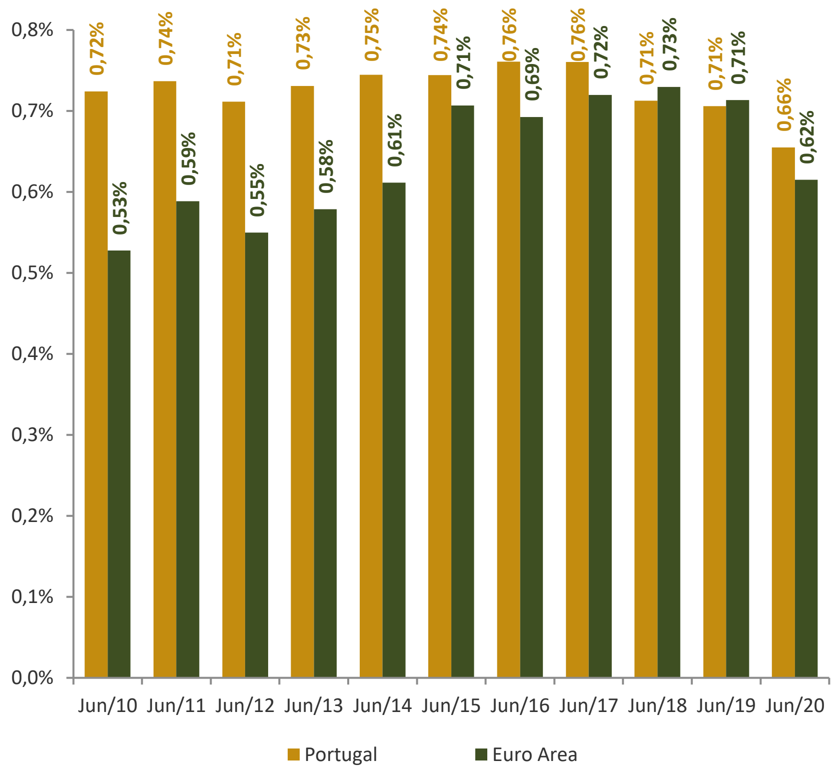
PROFITABILITY

The decrease in operating costs observed in the first half of 2020 was not enough to offset the decline in total operating income, caused by the pandemic crisis. For this reason, in June 2020, the cost-to-income ratio decreased 4.0 p.p. YoY, to 61.2%, reversing the positive evolution it had been registering since 2013.

Cost-to-income breakdown



Operating costs as a % of total assets



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

Annex I: Methodology

Methodology

- The information provided by Banco de Portugal and the ECB regarding monetary statistics differ from that provided in the context of the consolidated data of the banking system. The main differences derive fundamentally from non-coincidence in the universes surveyed and from the 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.º 1/2001, de Agosto: Instrução n.º 25/2014, de 15 de dezembro, and Sistema Bancário Português: desenvolvimentos recentes – 4.º trimestre de 2016.
- This document was published with updated information as of 22 December 2020.

PORTUGUESE BANKING SECTOR OVERVIEW

APB ASSOCIAÇÃO PORTUGUESA DE BANCOS

JUNE 2020