

## **A banking sector serving the economy and citizens**

1 - Our banking system indicators were broadly in line with the European average at the end of 2018.

It was a difficult ride after facing a nearly simultaneous set of intense shocks. There was a deep, prolonged recession resulting from the financial and sovereign debt crises and the disruptive changes these caused, with falling household incomes after four decades of continued increase, and the difficulties of businesses, particularly the most indebted ones, to service their debts, resulting in impairments and NPLs. There were regulatory and technological revolutions. There was reputational loss, caused by the banking sectors own mistakes and those of others. There was a monetary policy of very low (or negative) interest rates. There were changes in behaviour and preferences of citizens / customers. There was populism, left- and right-wing, that took advantage of the crisis.

The banking sector's recovery and renewal were remarkable. Our banks have much more capital, which allows them to absorb losses, and they are stronger, more efficient and more profitable (albeit with profitability below the cost of capital). They are also developing business models that are adjusted to new realities and are addressing the demands and opportunities opened by digital technology. Governance, risk management policy and practices have been made more thorough and strengthened.

The sector is more resilient and better prepared. The path taken should be better recognized and valued, knowing that there is still some way to go on the path of modernization.

2 - The operating conditions of the sector are still a cause for concern.

Demand (solvent) is less than the capacity of national banks to finance the economy, citizens and institutions. Excess liquidity has difficulty finding

placement with a reasonable interest rate. The financial margin is crushed by the low interest rate policy and the complementary source of revenue - commissions for services - is always under pressure, largely due to banking services being wrongly considered as free public services, when banking is an economic and competitive activity like the others.

Cost reduction is claimed to be essential (and it is), but at the same time there are increased costs to meet regulatory, supervisory and resolution requirements, to support ongoing restructuring, in particular to compensate laid-off workers, to strengthen the training and requalification of employees, to make the necessary investments in digitization and modernization.

Note that the average cost-to-income ratio of national banks is about 10% better than the Euro Area average.

### 3 - Where will the banking sector go to and how will it do this?

Understanding reality and acting lucidly and in a timely manner are crucial for strengthening the banking system.

The medium-term future of the banking sector has the following main constraints:

- the customer, their needs and expectations, their behaviours and preferences;
- technological innovation, at an overwhelming rate, the ability to absorb its advances and to reinvent;
- competition, focusing on new players, external and internal to the sector;
- the political, geopolitical and economic environment (US-China trade and technology war, Brexit, tensions in the Middle East and others, oil prices);
- regulation and supervision, the efficiency, recalibration and stabilization of which are increasingly required.

Looking to the future in a shorter time horizon, the following focus of actions and challenges arise:

- deepening relationship management with clients, central focus of banking activity;
- financing prosperity-generating economic growth;
- Compliance with the current regulatory framework, including new requirements, such as MREL;
- enhancing profitability, aiming at strengthening banks and motivating investors in the sector, with a fair remuneration;
- acceleration of advances in digital transformation and data processing and maximum attention to cybersecurity;
- deepening governance, including behavioural issues;
- proactive response solutions to competition from new players;
- mobilization and encouragement of all bank workers to understand and act correctly and effectively in the new digital age, which involves their requalification and over-qualification and the attraction of talent;
- the active contribution of the sector to environmental and social concerns, including through sustainable finance.

4 - Meeting citizens' expectations in terms of improved living conditions and prosperity definitely means increased wealth creation.

Historically, in Portugal, banks have been and will continue to be the engines of the economy. The scarcity of national capital and the limitations of the capital market force the banking sector to remain the economy's major financier.

Basically, a banking sector serving the citizen and sustainability in its various dimensions: sustainability of the planet, the economy and the sector itself.

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