PORTUGUESE BANKING SECTOR OVERVIEW

JUNE 2024

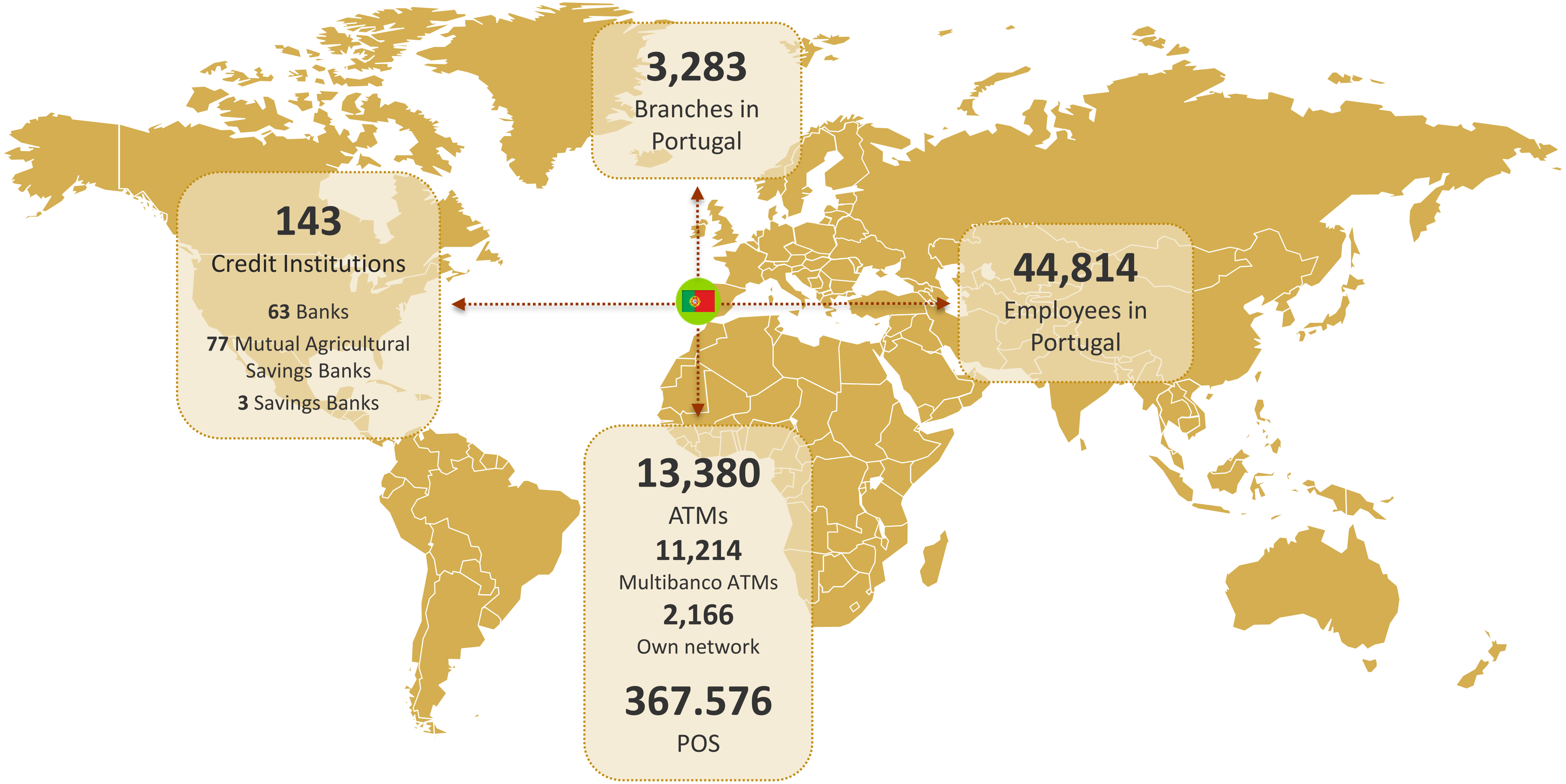
ASSOCIAÇÃO PORTUGUESA DE BANCOS

DECEMBER 2024

INDEX

I. RECENT EVOLUTION AND MAIN INDICATORS

- **In the first half of 2024, the profitability of the banking sector improved further**, reflecting the positive contribution of total operating income and net provisions and impairments, which more than offset the negative contribution of operating costs. The more moderate growth in net interest income resulted from the significant rise in interest expenses, mainly due to increasing interest rates on household deposits. The rise in interest income was due to the positive evolution of the customer loans portfolio, which benefited from the transmission of market interest rates observed in 2023, and the debt securities portfolio.
- **The Portuguese banking sector's total assets increased by 4.4% compared to December 2023**, mainly due to the increased exposure of the debt securities portfolio, mostly made up of public debt securities (68%), which rose by around 16% (+15.9 billion euros), and reflecting the sector's robust liquidity situation. Cash and claims on central banks rose 4.2% (+2.2 billion euros) and loans and advances to customers increased 0.9% (+2.2 billion euros).
- **On the liabilities side, customer deposits rose 4.6% compared to December 2023**, with an increase in term deposits, especially in the household segment, in the context of a rise in the average remuneration offered on these products. **In turn, the share of financing obtained from the Eurosystem represented just 0.3% of the sector's total assets.** This share has been decreasing since 2021 with the repayment of TLTRO III loan operations by banks. **Recourse to market funding sources continued to be insignificant in the banking sector's funding structure.**
- **The Portuguese banking sector's solvency strengthened further** and reached historically high levels. The total own funds and Common Equity Tier 1 (CET1) ratios stood at 20.5% and 17.8%, respectively, above the Euro Area average. In turn, the leverage ratio rose to 7.5%, remaining considerably higher than the European Union average and the regulatory reference minimum (3%).
- **The Portuguese banking sector continued to improve profitability** in a context of great political uncertainty at a global level, inflation and economic slowdown, **with capital reaching historically high levels and above the Euro Area, while liquidity remained robust. In this way, the sector strengthened its resilience and ability to continue to respond efficiently to the economy's financing needs**, should any adverse shocks materialise, particularly those that may result from the current geopolitical tensions.
- In the current extremely challenging economic, regulatory and competitive context, **it is also essential to continue the digital transformation of financial services, the transition to a sustainable economy and the incorporation of these challenges into risk management, as well as strengthening operational resilience in the face of threats arising from increasingly sophisticated cyber-attacks. Climate change represents another critical challenge for the financial system** due to the risks involved, namely transition risks, related to the devaluation of assets in fossil fuel-intensive sectors, and physical risks, related to direct damage from extreme weather events that occur with greater frequency and severity.

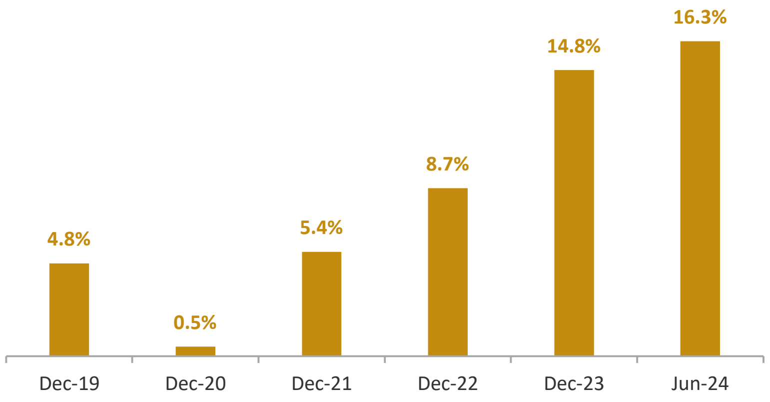


Source: APB's Associates (branches, employees and payment systems) and Banco de Portugal (credit institutions).

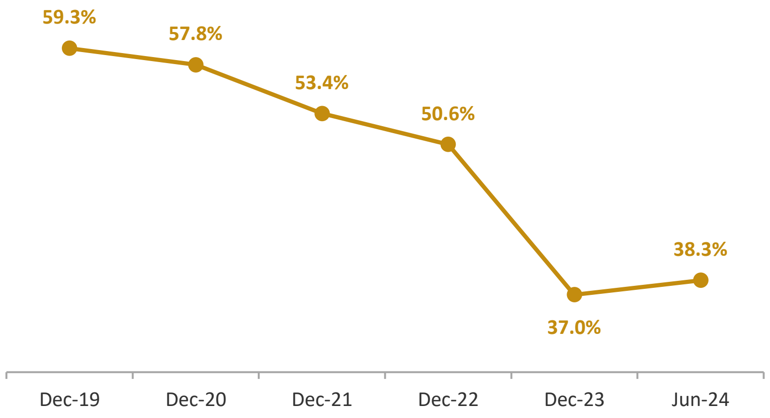
I. RECENT EVOLUTION AND MAIN INDICATORS

The Portuguese banking sector continued to improve profitability in a context of geopolitical tensions, inflation and economic slowdown, with capital reaching historically high levels and above the Euro Area, while liquidity remained robust. In this way, the sector strengthened its resilience and ability to continue to respond efficiently to the economy's financing needs.

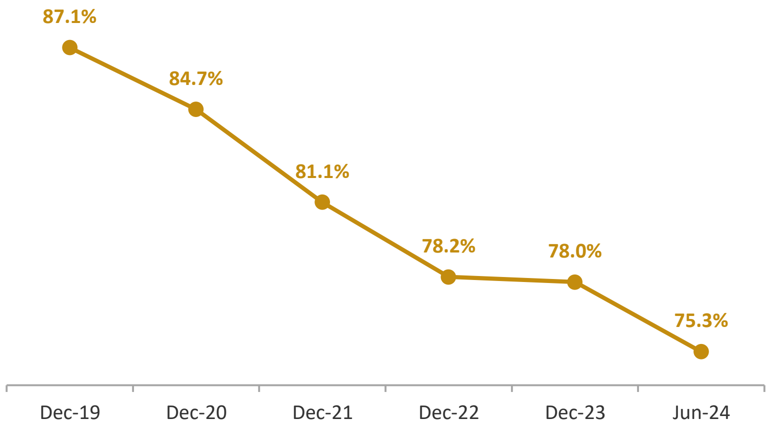
Return on Equity



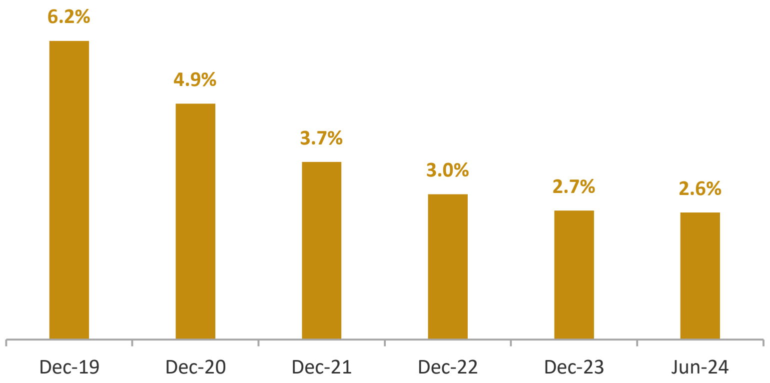
Cost-to-Income



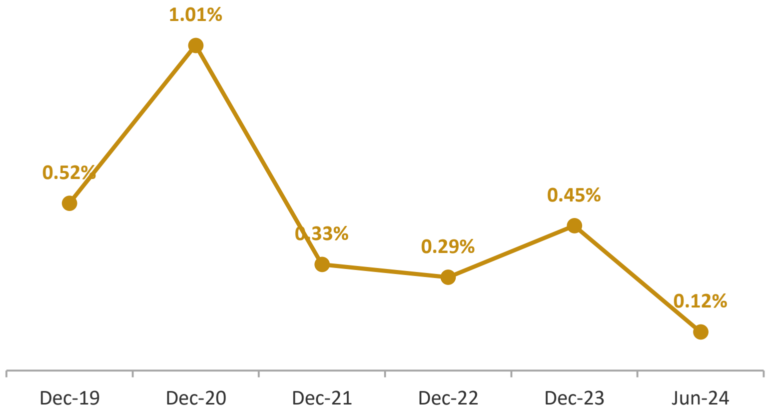
Loan-to-deposit ratio



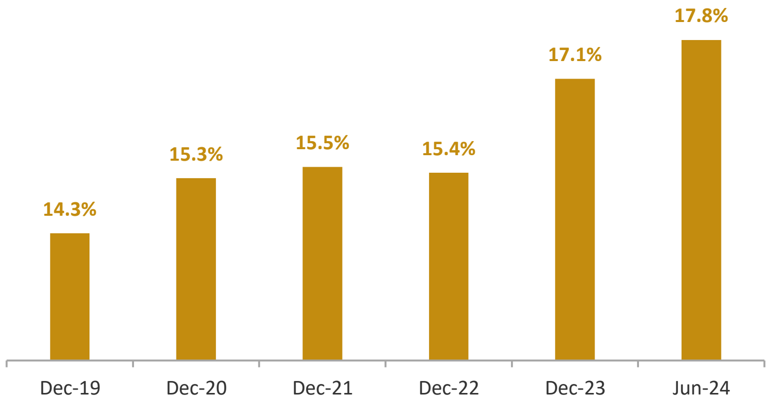
NPL ratio



Cost of credit risk



Common Equity Tier 1 ratio

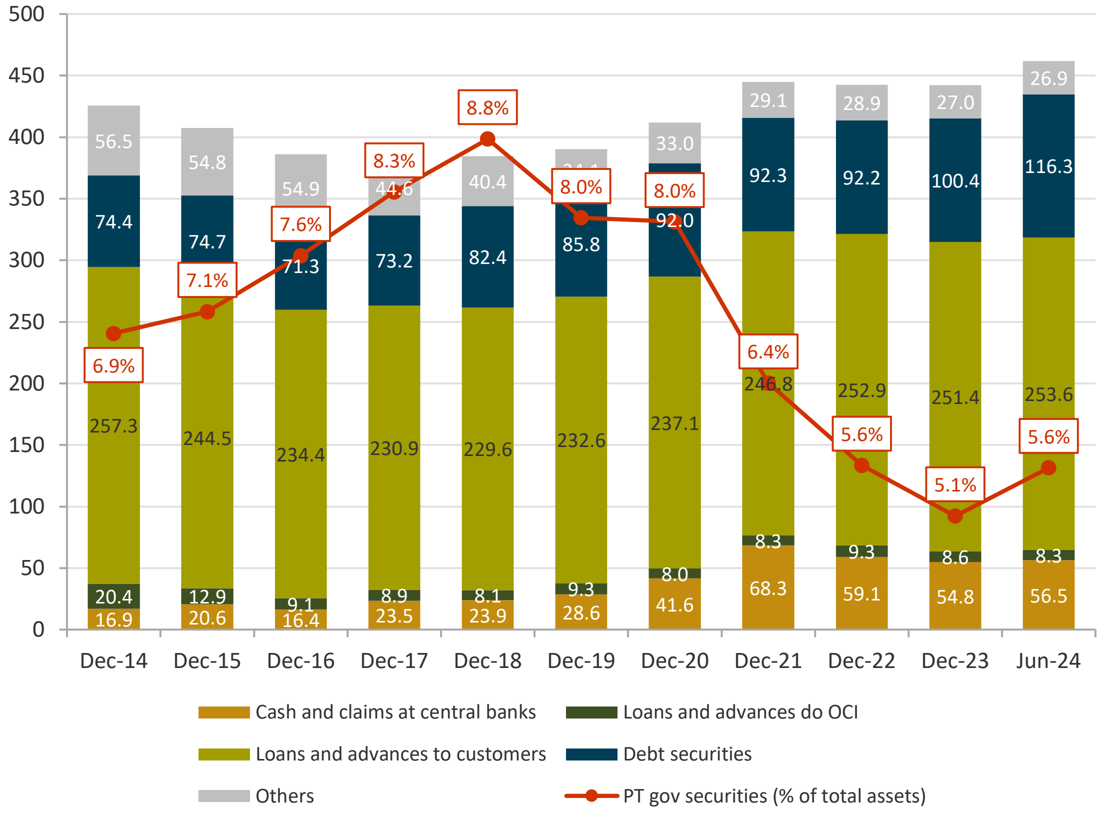


Source: Banco de Portugal (consolidated data). Return on Equity is calculated based on net income after tax and before minority interests and average equity.

II. FINANCIAL POSITION

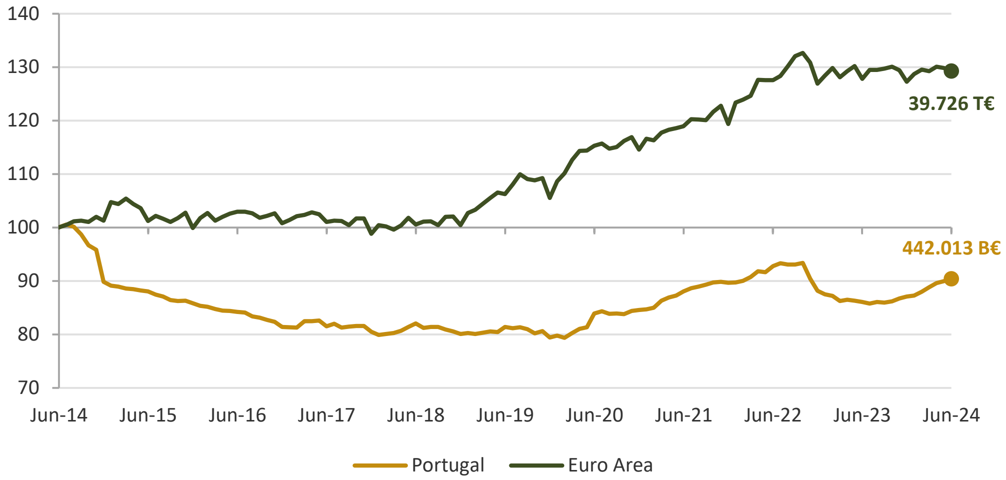
In the first half of 2024, the Portuguese banking sector's total assets increased by 4.4% compared to December, mainly due to the increased exposure of the debt securities portfolio, mostly made up of public debt securities (68%), which rose by around 16% (+15.9 billion euros), and reflecting the sector's robust liquidity situation. Cash and claims on central banks rose 4.2% (+2.2 billion euros) and loans and advances to customers increased 0.9% (+2.2 billion euros).

Total assets breakdown (EUR billion)

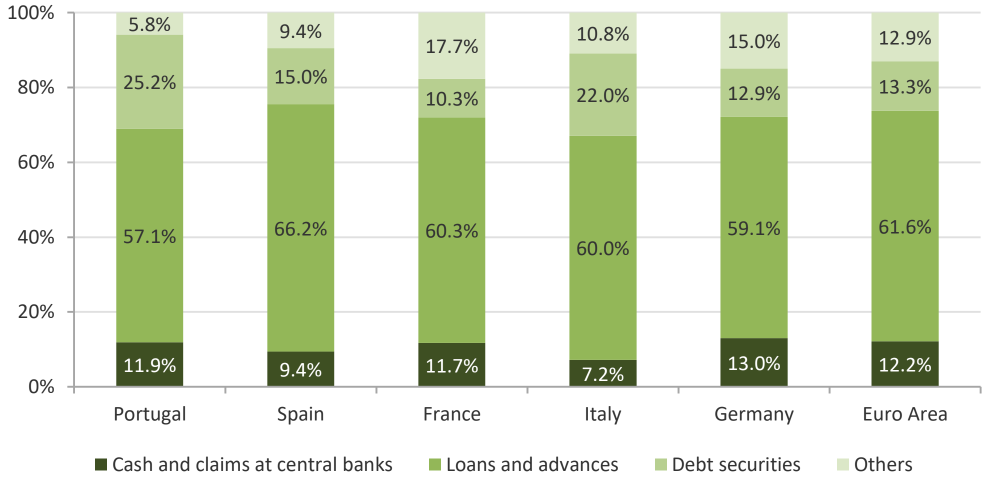


Source: Banco de Portugal (consolidated data) and ECB – MFI Balance Sheet Items (Monetary and Financial Statistics).

Total assets evolution - domestic activity (Jun-14 = 100)



Total assets breakdown: Portugal vs. Euro Area (Jun-24)

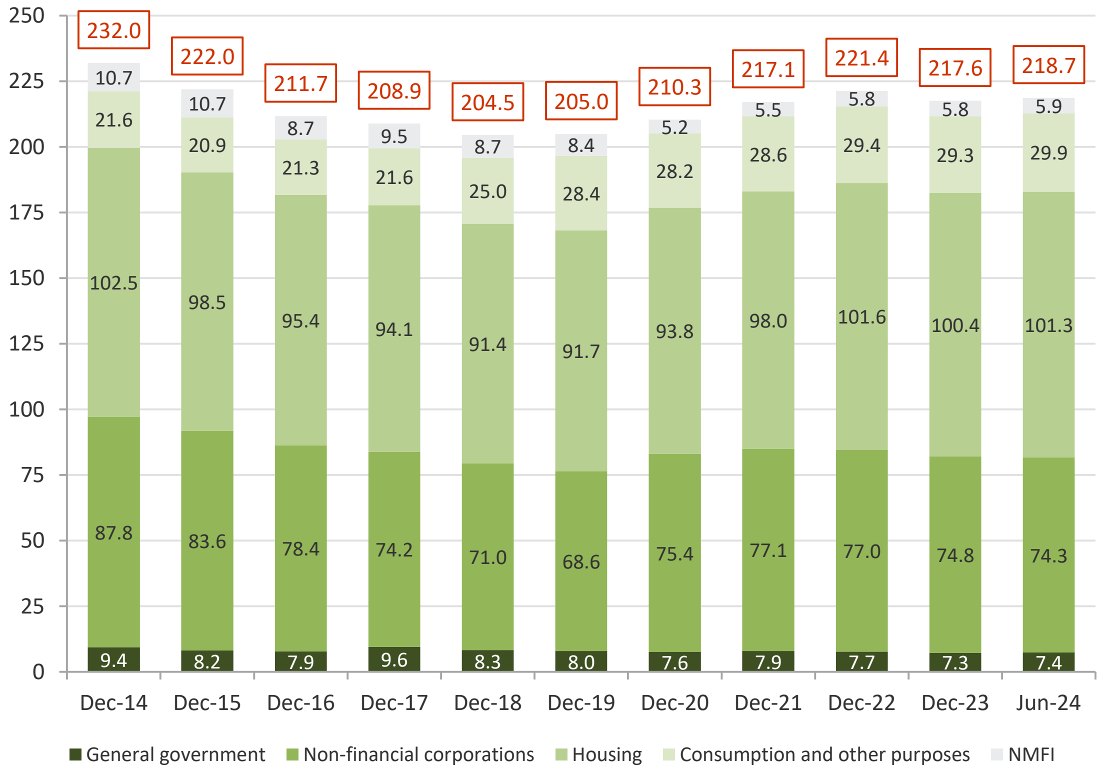


Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Consolidated Banking Data and Eurostat.

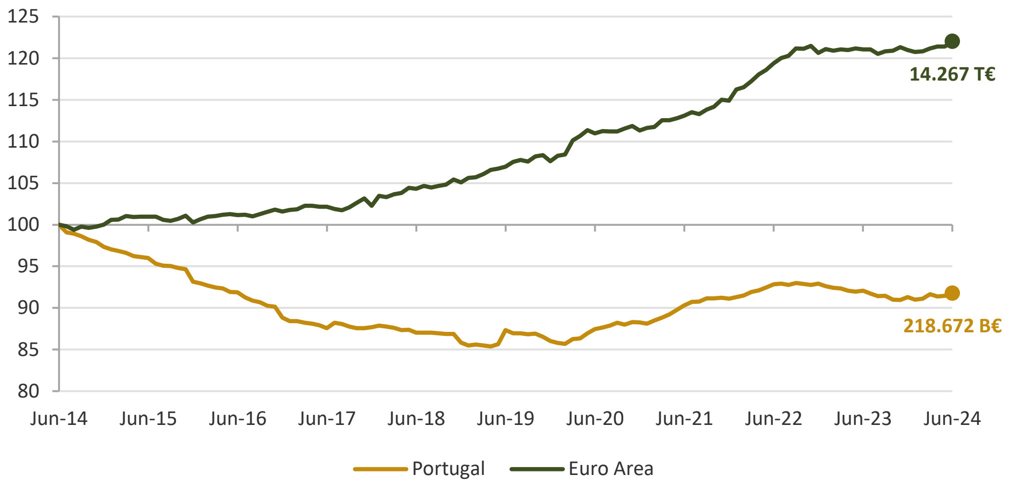
II. LENDING

In June 2024, the evolution of the stock of loans to households was positive (+1.3%), showing an upward trend since the start of the year, on the back of the continued growth of the stock of consumer loans (+6.6%) and the recovery of the stock of loans for house purchase (+0.1%), reflecting the increase of new loans and the reduction in the volume of early repayments. Loans to non-financial corporations (NFCs) recorded an annual rate of change that was still negative (-0.5%) but showed an improvement compared to the end of 2023 (-1.1%). The general level of interest rates and, to a lesser extent, the lower financing needs for investment contributed to the decrease in demand for credit from companies observed from Q3 2022 onwards.

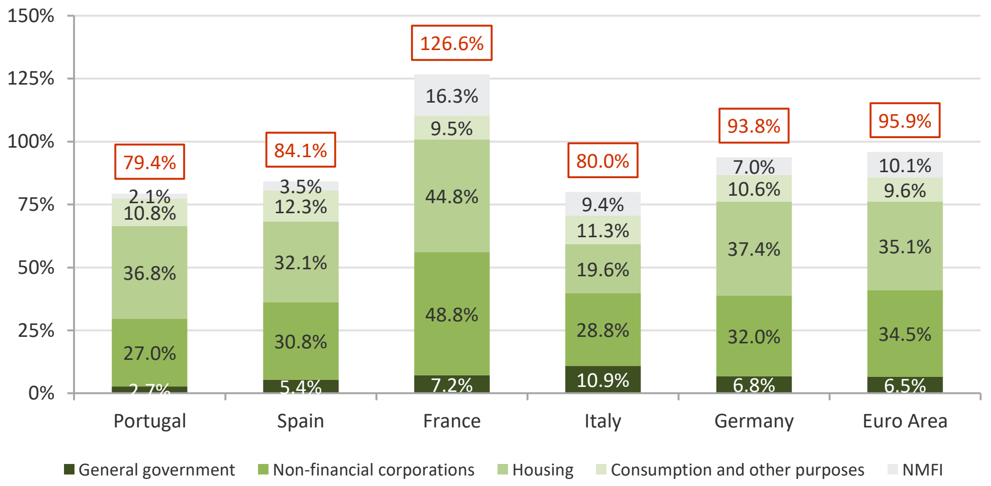
Loans to customers by institutional sector (EUR billion)



Loans to customers evolution (Jun-14 = 100)



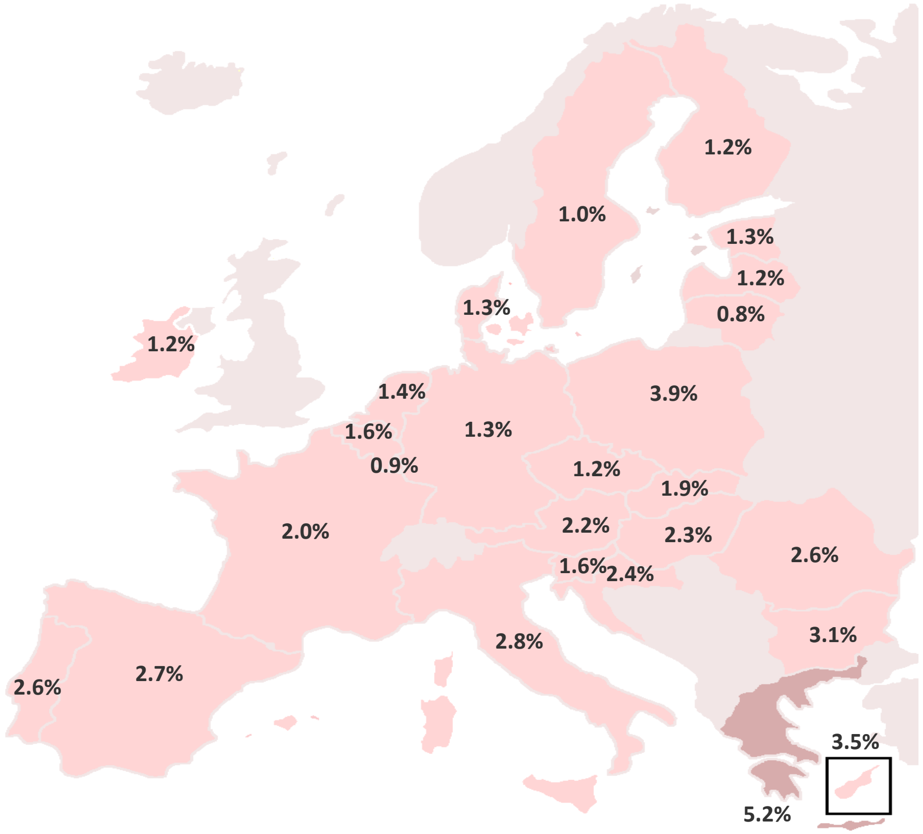
Loans to customers by institutional sector as a % of GDP (Jun-24)



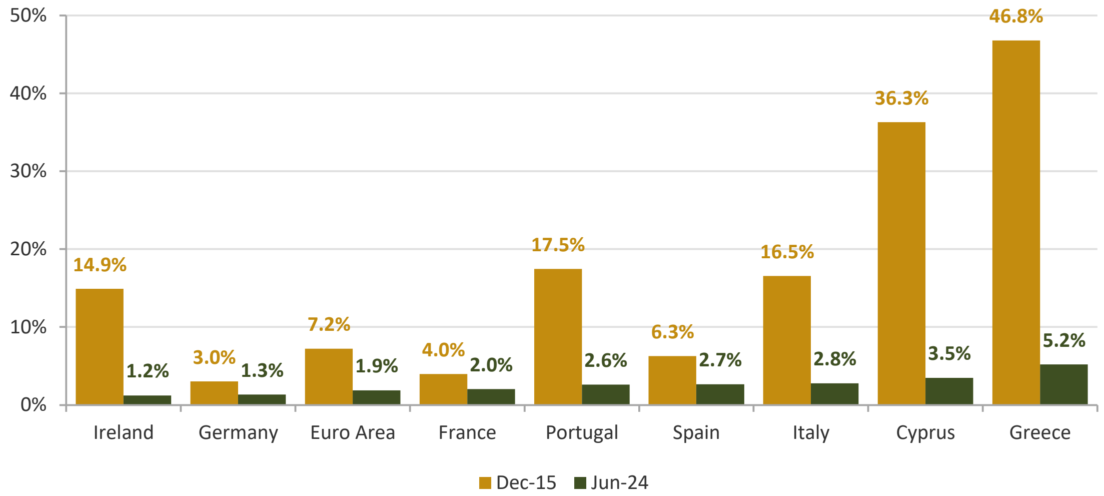
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) e Eurostat. Loans and advances to customers in the domestic activity; counterpart: residents in the Euro Area. NMFI = Non-Monetary Financial Institutions, which include Other Financial Intermediaries, Financial Auxiliaries, Insurance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

The NPL ratio fell, albeit marginally, to 2.6% in June 2024 (2.7% in December), 0.8 pp above the Euro Area average. This evolution was explained by the reduction in the stock of NPLs, which occurred in the NFC segment and more than offset the increase in the household segments, both for house purchase and for consumption and other purposes, and by the growth in performing loans. The ratio of NPL coverage by impairments fell to 55.1% (55.4% in December), having risen in the NFC segment and fallen in households. The net NPL ratio remained broadly stable at 1.2%.

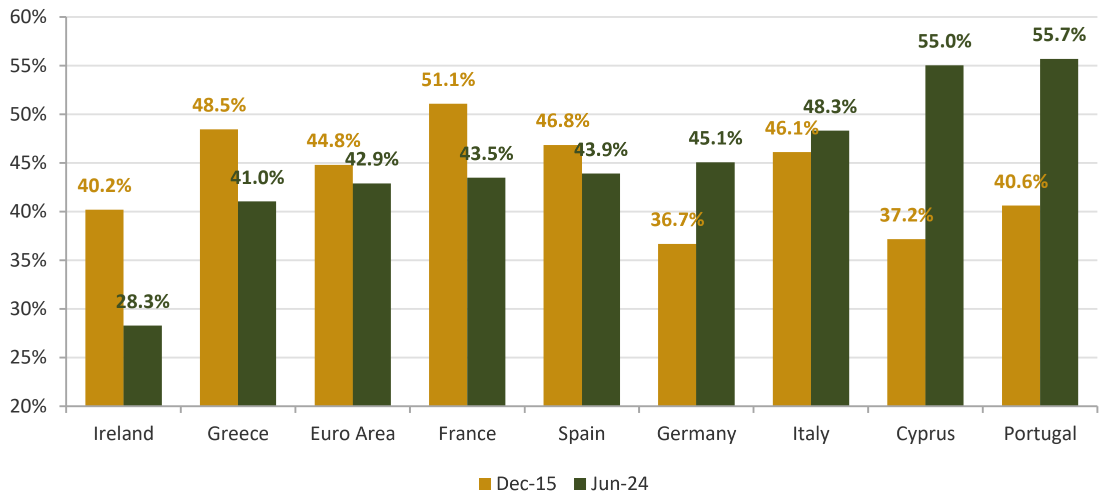
NPL ratio



NPL ratio evolution



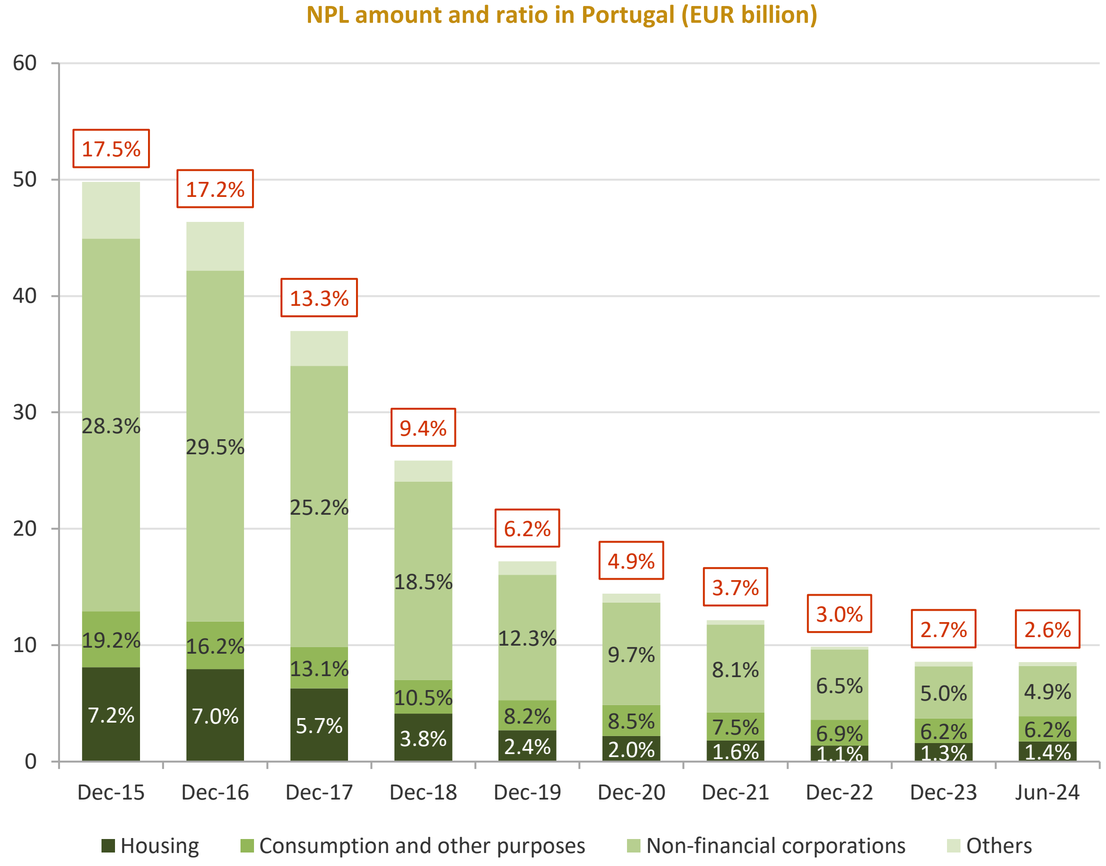
Impairment coverage ratio

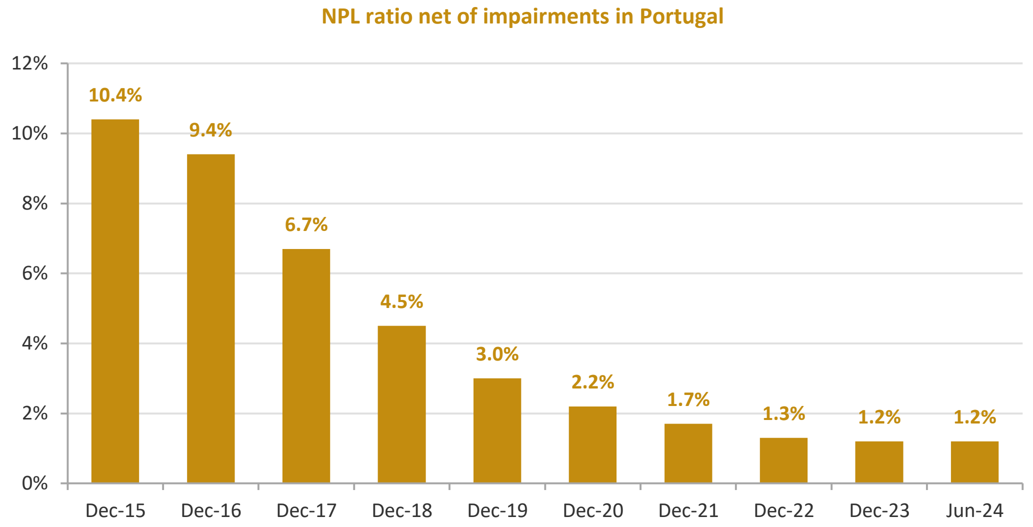


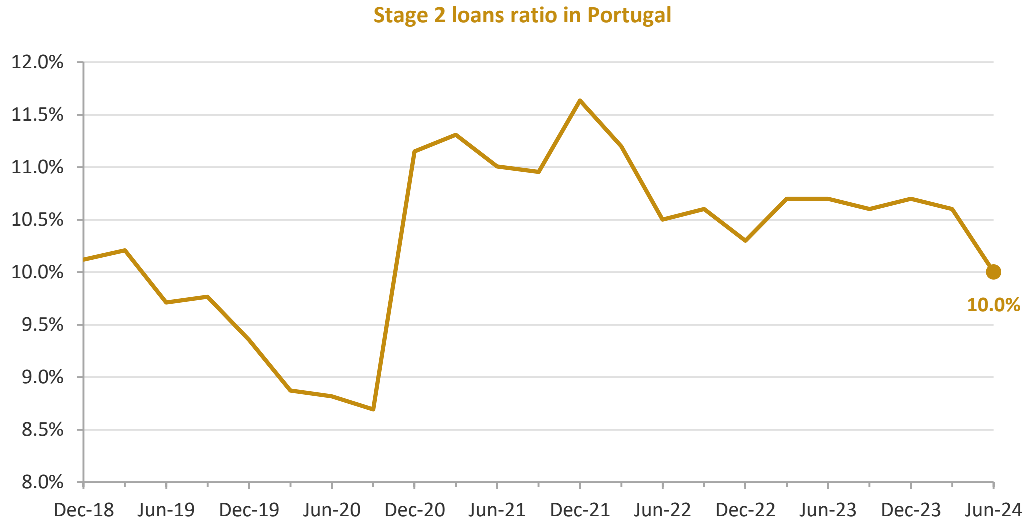
Source: ECB – Consolidated Banking Data. The impairment coverage ratio refers to non-performing loans and debt securities.

The rise in benchmark interest rates and the predominance of variable interest rate loans have put pressure on the financing costs of companies and families. However, the resilience of the labour market, the recovery of real household income, the reduced weight of borrowers with lower income levels and the specific measures taken by banks and the government have made it possible to mitigate the level of defaults. In housing loans, the NPL ratio is at a low level, having risen slightly (+0.1 pp) compared to December due to the higher flow of new NPLs than cures. In the consumer segment, the NPL ratio remained stable and in the NFC segment, the ratio fell again.

The ratio of Stage 2 loans fell by 0.7 pp to 10.0%, following a worsening in 2023.



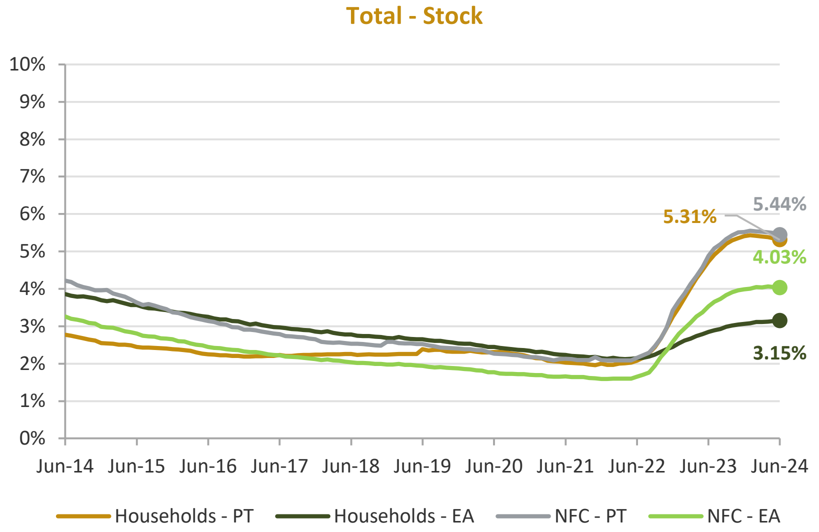


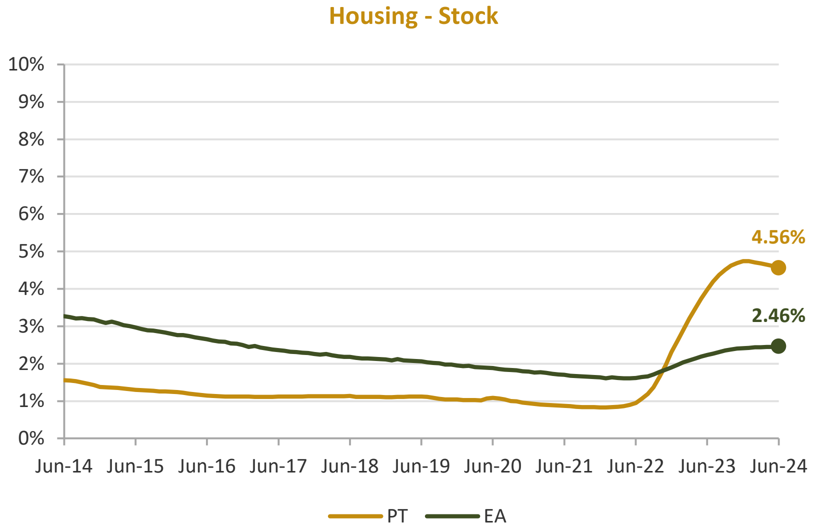


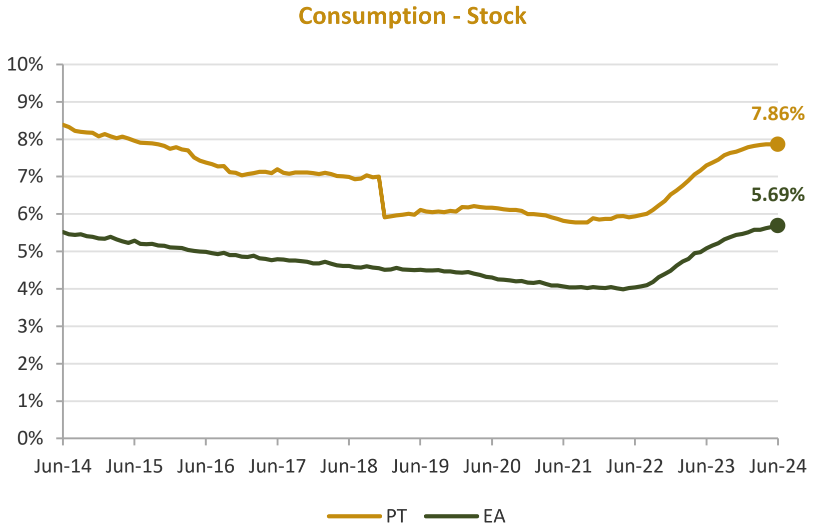
Source: Banco de Portugal (consolidated data).

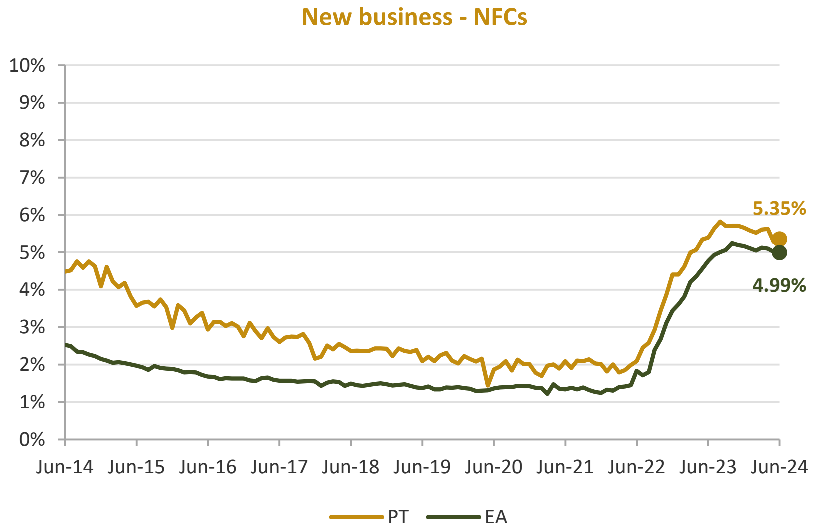
II. LENDING | LOAN CONDITIONS | INTEREST RATES

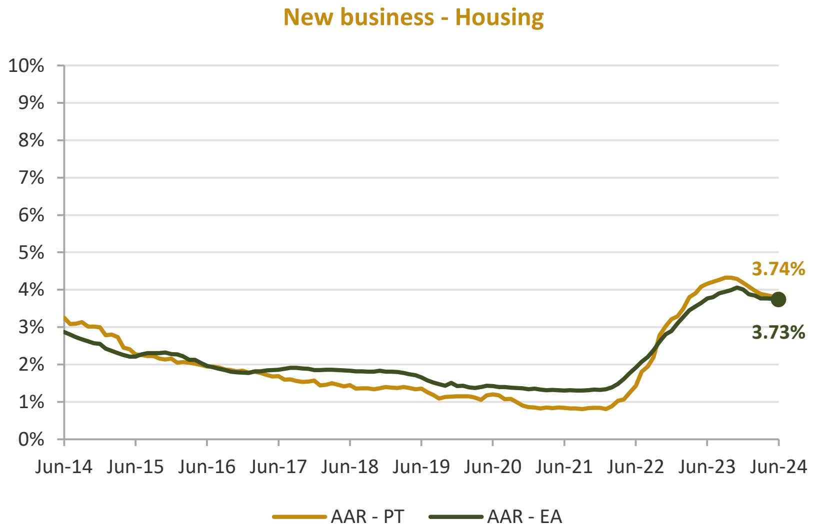
In June 2024, the interest rate on new home loans fell by 0.4 pp year-on-year to 3.7%, the same as the Euro Area average. In turn, the average interest rate on new loans to companies fell to 5.4%, reflecting the reduction in Euribor rates and a slight compression of spreads.

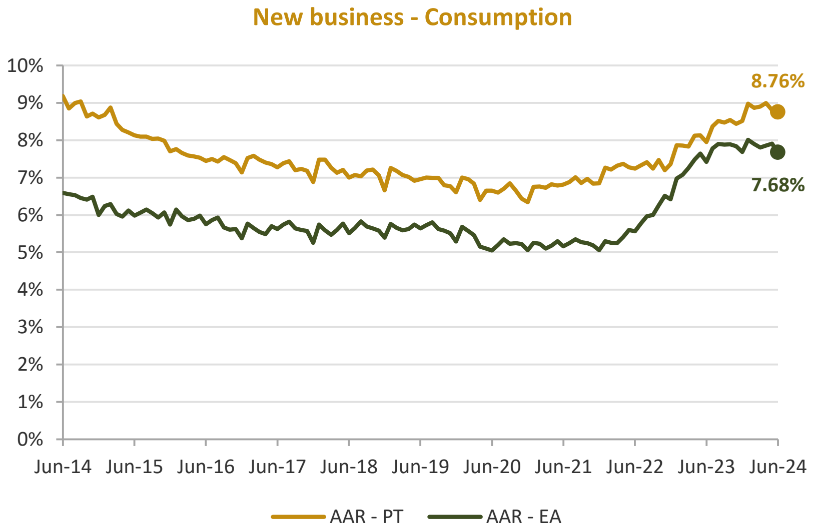










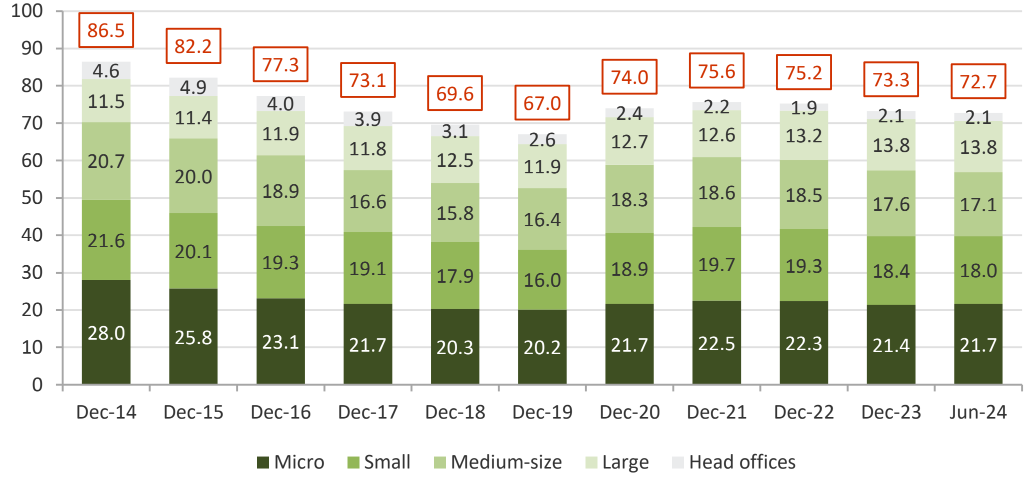


Source: ECB – MFI Interest Rate Statistics.

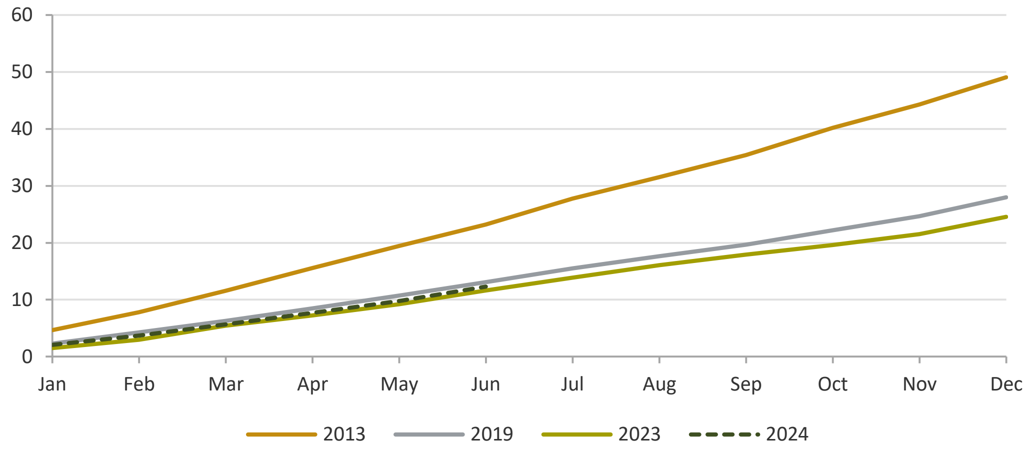
II. LENDING | NON-FINANCIAL CORPORATIONS

In June 2024, the annual rate of change in the stock of loans to NFCs remained negative (-0.5%), although it improved compared to the end of 2023 (-1.1%). By size, loans to small and medium-sized enterprises continued to fall, while loans to micro-enterprises grew again (5.4%). Loans to large companies recovered slightly (0.6%). By sector of activity, the manufacturing and hotels and similar sectors still recorded negative rates but more moderately (-7.3% and -2.6%, respectively) and the construction, real estate and professional and administrative activities sectors continued to see growth (1.9%, 3.8% and 5.4%, respectively).

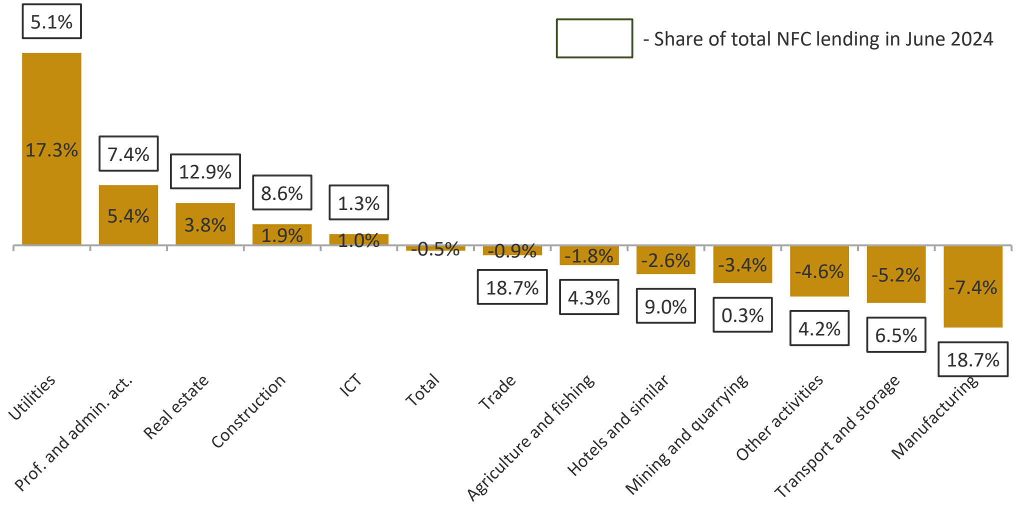
Stock of loans to NFCs (EUR billion)



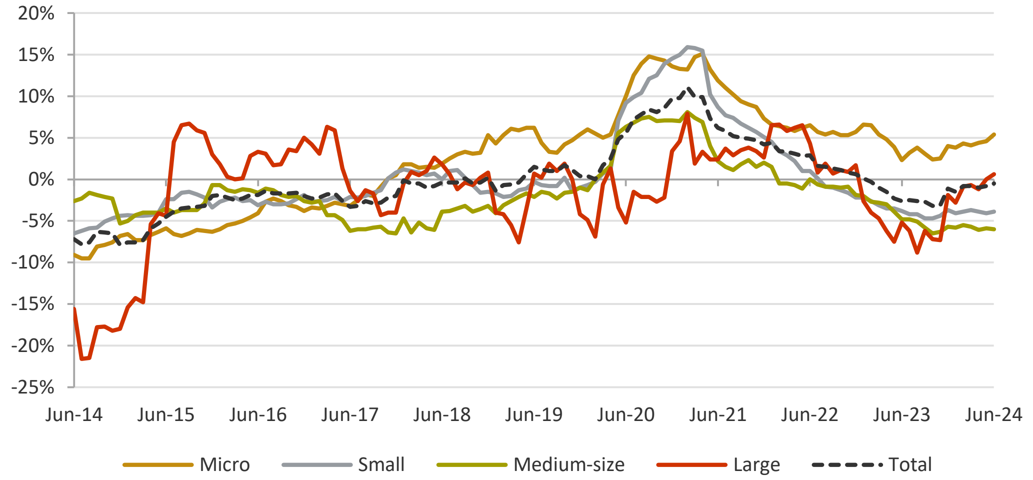
New business lending to NFCs (cumulated amounts, EUR billion)



ARC of loans to NFCs by economic sector (Jun-24)



ARC of loans to NFCs

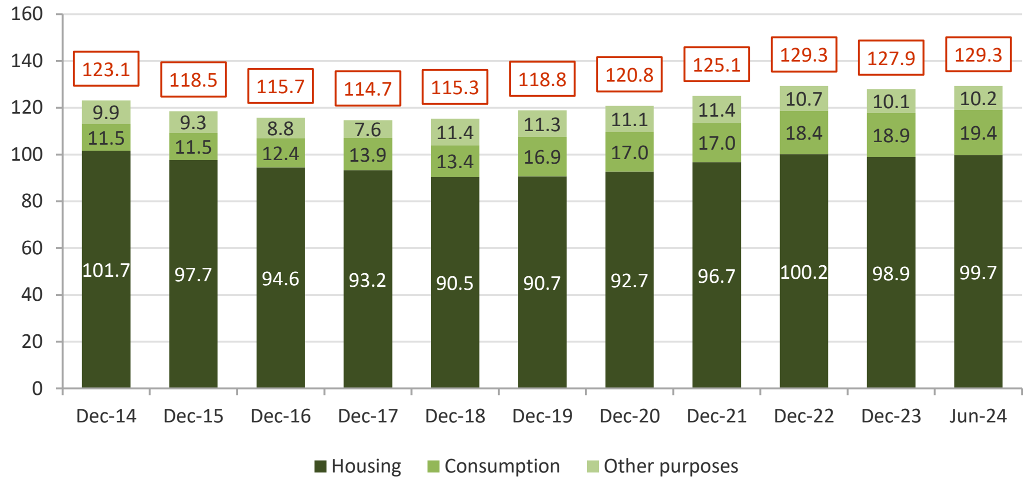


Source: Banco de Portugal (Monetary and Financial Statistics). Loans to NFCs in the domestic activity; counterpart: residents in Portugal. ARC = Annual rate of change. New business loans include both pure new loans and renegotiations without default. Pure new loans include new credits, credit consolidations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

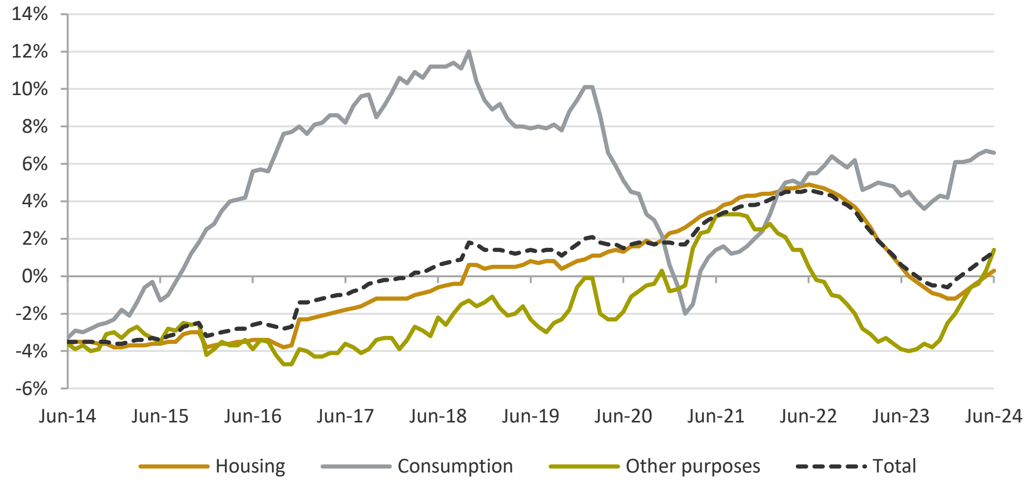
II. LENDING | HOUSEHOLDS

In June 2024, the stocks of loans for consumption and for house purchase grew by 6.6% and 0.3%, respectively. Housing loan transfers between institutions totalled 2.1 billion euros (+54% year-on-year) in the first half of the year and accounted for 23% of new housing loans (excluding renegotiations) and 37% of total early repayments in June 2024. Excluding these operations, new loans for house purchase increased by 20%. Also in the first half of the year, early repayments of housing loans totalled 6.1 billion euros (+8.8% year-on-year) and represented 0.9% of the stock of loans for house purchase in June 2024.

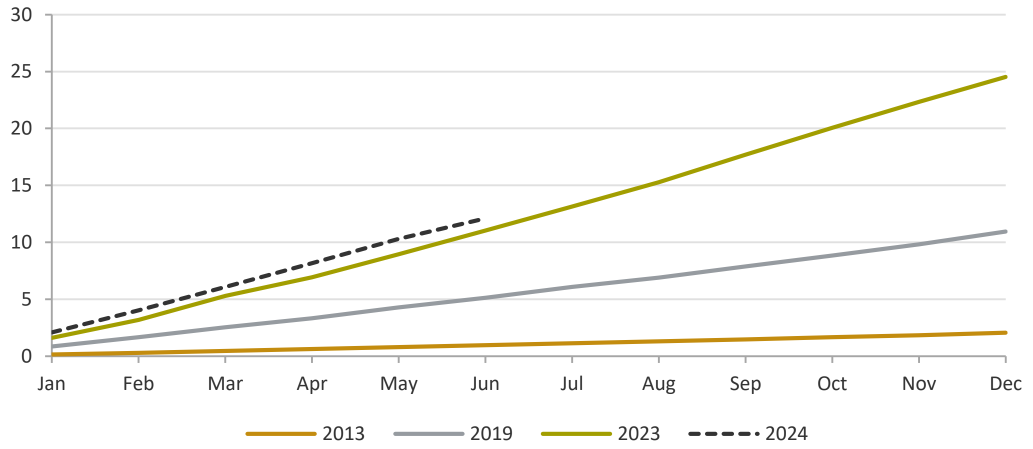
Stock of loans to Households (EUR billion)



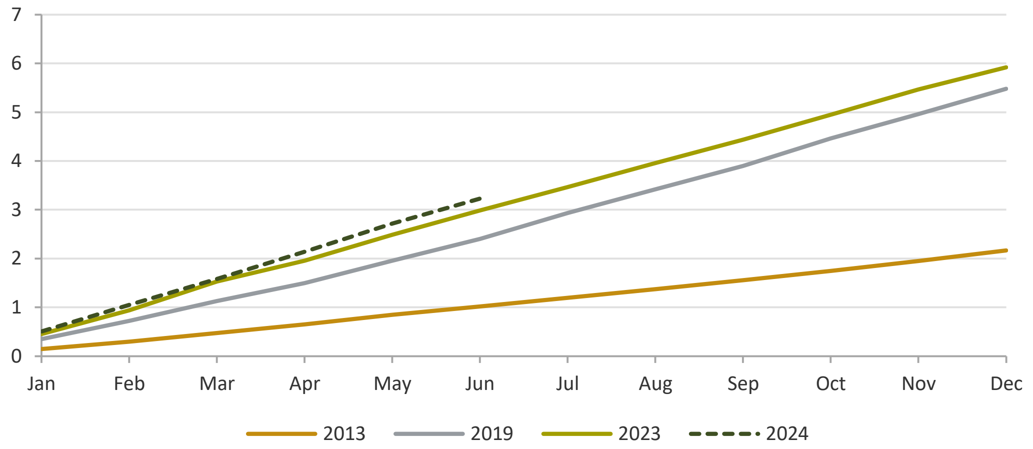
ARC of loans to Households



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



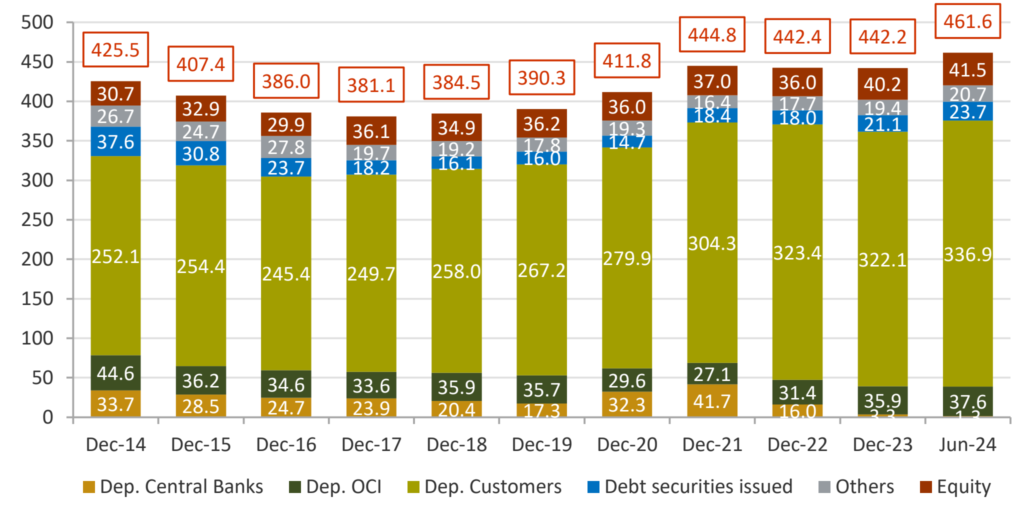
New business to Households - Consumption (cumulated amounts, EUR billion)



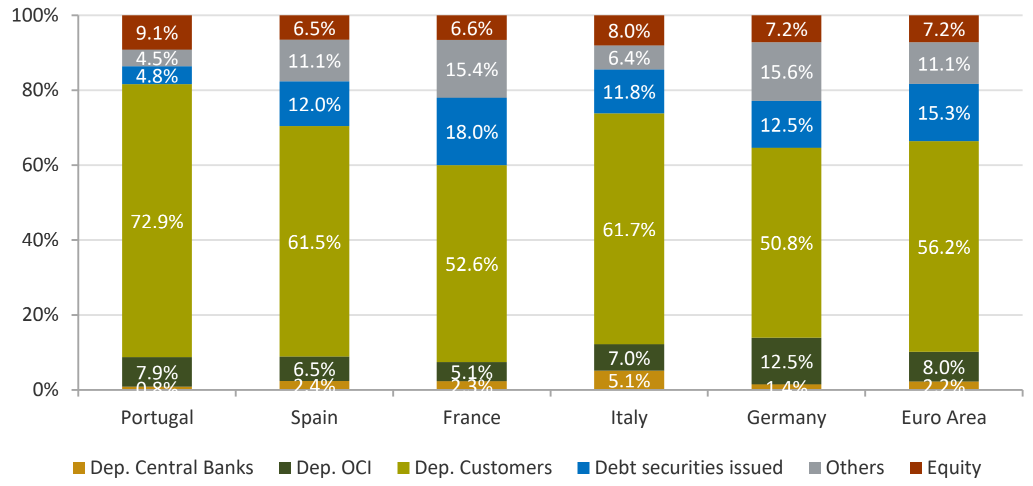
Source: Banco de Portugal (Monetary and Financial Statistics). Loans to Households in the domestic activity; counterpart: residents in Portugal. ARC = Annual rate of change. New business loans include both pure new loans and renegotiations without default. Pure new loans include new credits, credit consolidations and credit transfers between institutions.

In the first half of 2024, customer deposits rose by 4.6%, with a growth in term deposits, especially in the household segment, in the context of an increase in the average remuneration offered on these products.

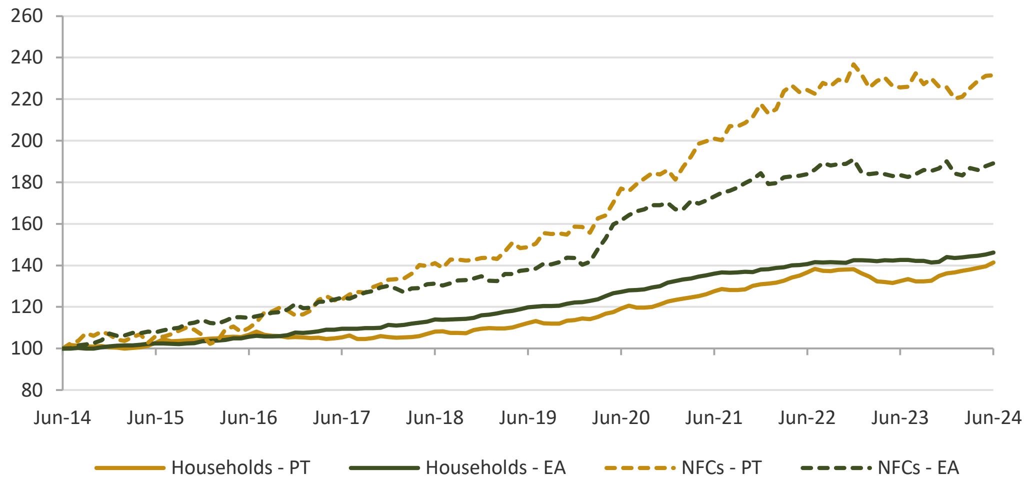
Origin of the funds (EUR billion)



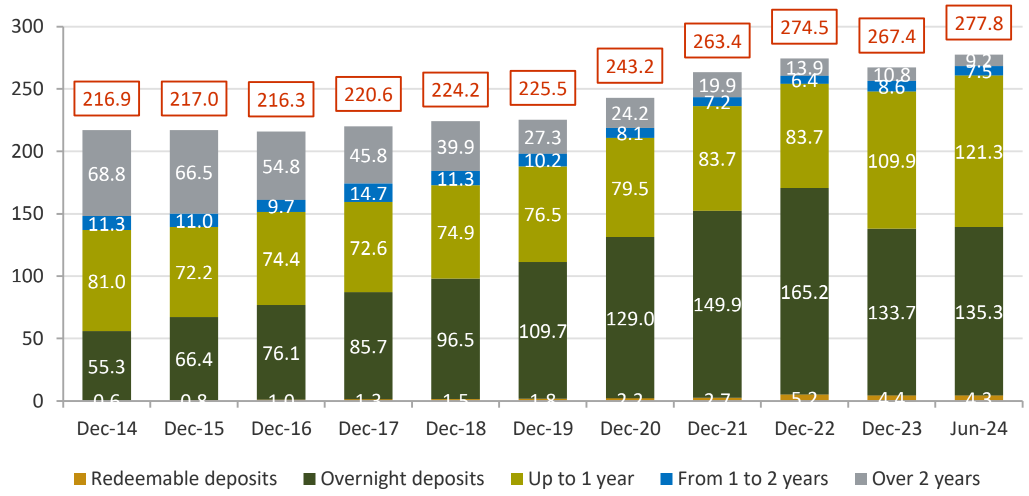
Origin of the funds: Portugal vs. Euro Area (Dec-23)



Evolution of deposits - Domestic activity (Jun-14 = 100)



Evolution of deposits - Domestic activity (EUR billion)

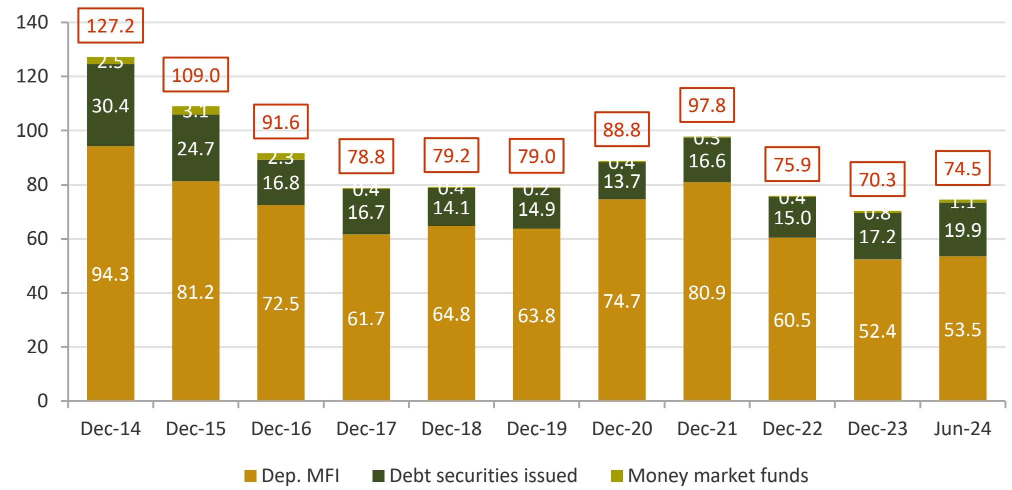


Source: Banco de Portugal (consolidated data and Monetary and Financial Statistics) and ECB – Consolidated Banking Data (consolidated data reported in FINREP format) and MFI Balance Sheet Items (Monetary and Financial Statistics). OCI = Other Credit Institutions.

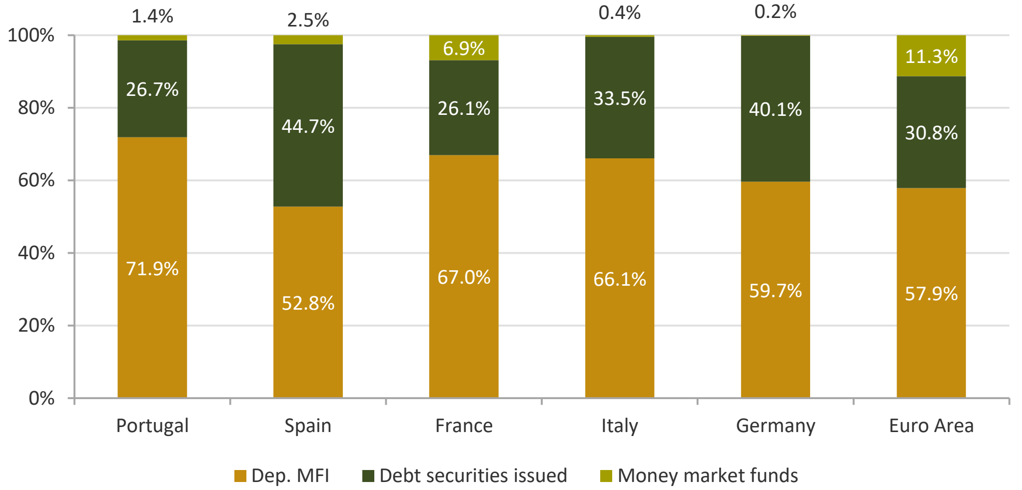
III. ORIGIN OF THE FUNDS AND LIQUIDITY

Recourse to market sources of financing continued to be insignificant in the banking sector's financing structure. Since 2021, the share of funding obtained from the Eurosystem has been decreasing with the repayment of TLTRO III loan operations by banks. At the end of the first half of 2024, the share of Eurosystem funding represented 0.3% of the sector's total assets. The ratio of encumbered assets fell to historically low levels.

Origin of wholesale funds (EUR billion)

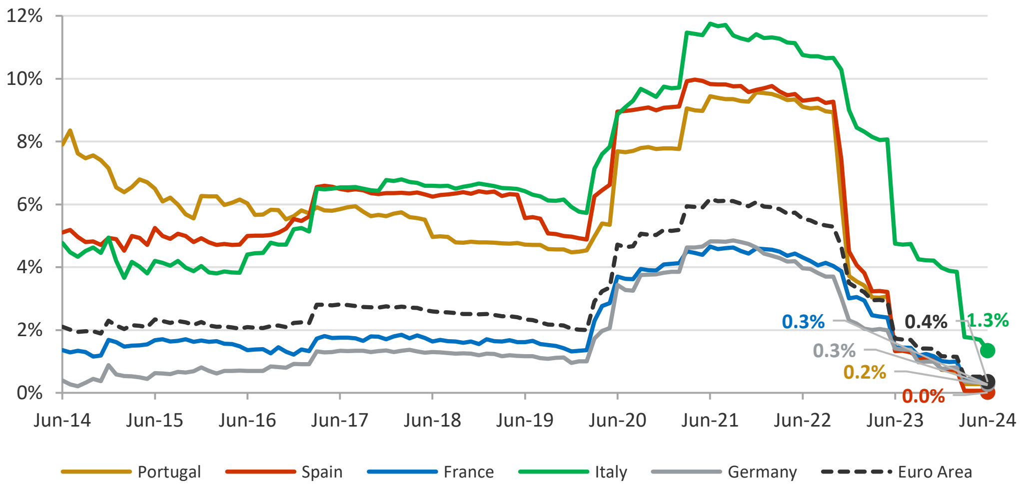


Origin of wholesale funds: Portugal vs. Euro Area (Jun-24)



Borrowing from the ECB (EUR billion)

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



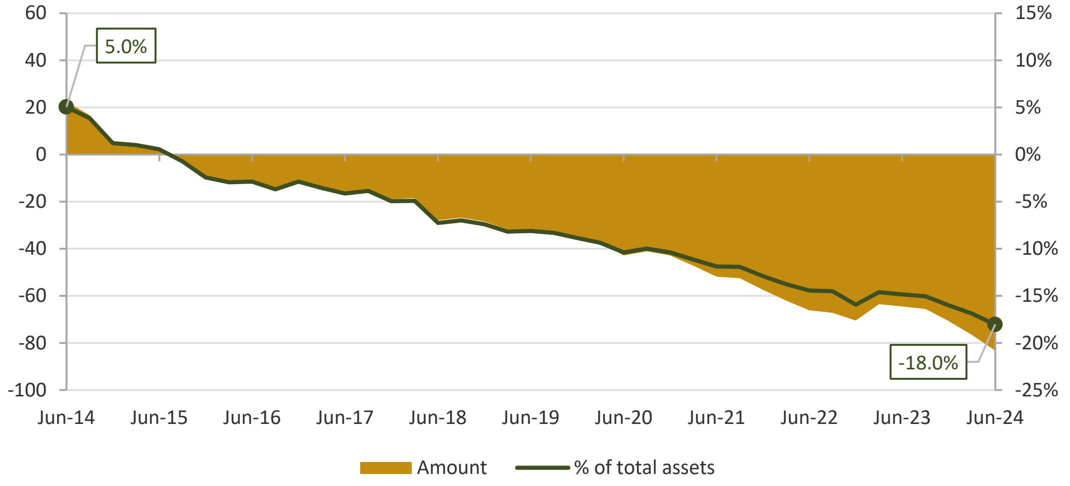
Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics). Origin of wholesale funds from domestic activity. Monetary and Financial Institutions (MFI) include Central Banks and Other Monetary and Financial Institutions (OMFI).

III. ORIGIN OF THE FUNDS AND LIQUIDITY

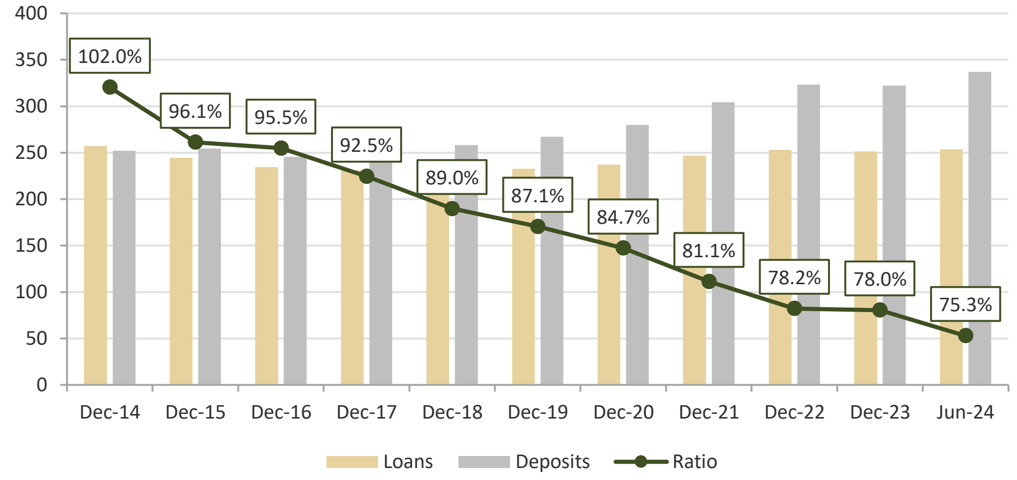
In the first half of 2024, the Portuguese banking system maintained high liquidity levels. The loan-to-deposit ratio fell to 75.3%, reflecting the increase in customer deposits. In turn, the liquidity coverage ratio increased to 272.7% due to the rise in highly liquid assets, especially public debt instruments. At the same time, central bank reserves remained high.

The issuance of instruments eligible for compliance with MREL totalled 2.4 billion euros.

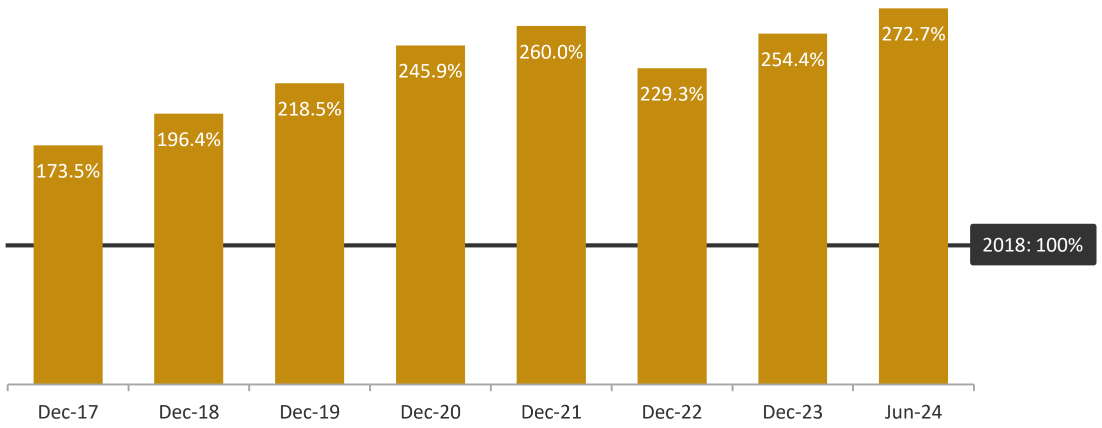
Funding gap (EUR billion and % of total assets)



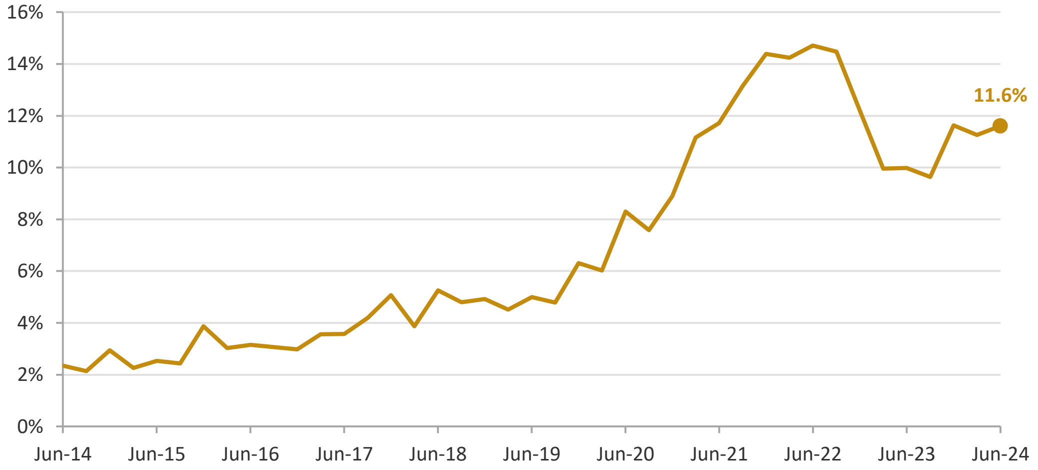
Loan-to-deposit ratio (EUR billion)



Liquidity Coverage Ratio



Cash and claims at Central Banks (% of total assets)

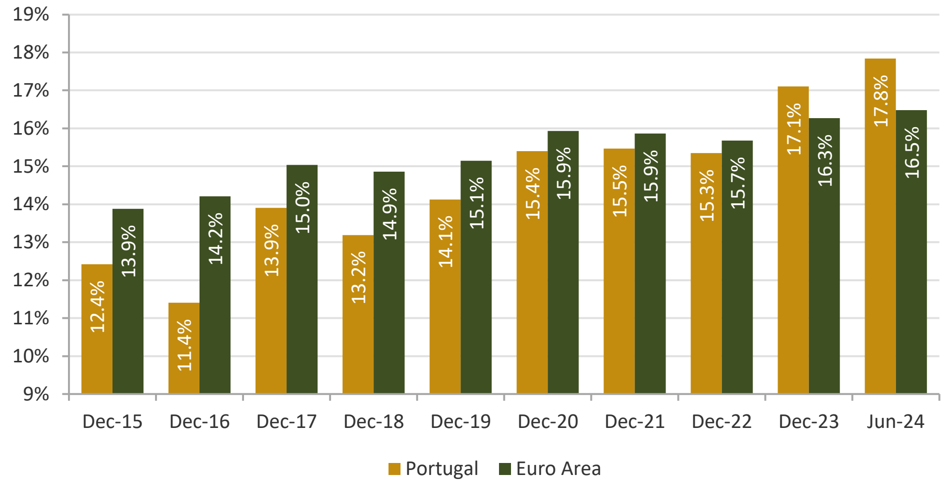


Source: Banco de Portugal (consolidated data).

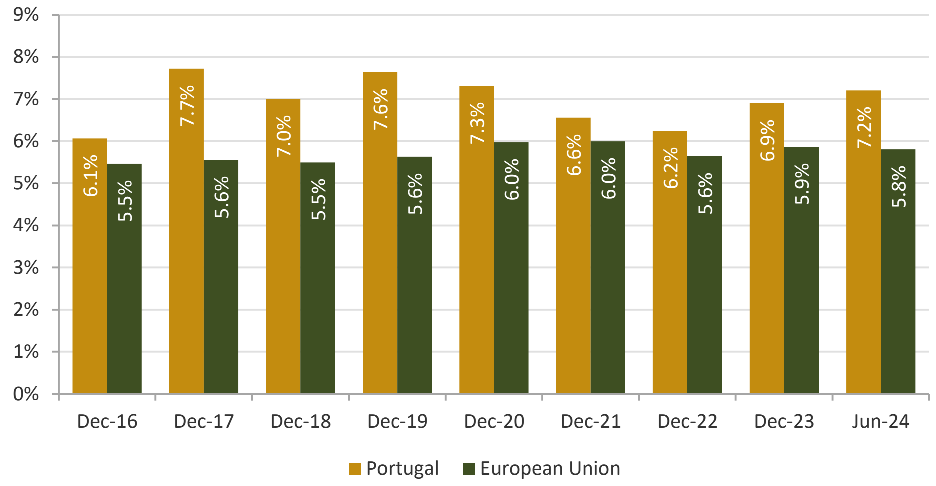
IV. SOLVENCY

The solvency of the Portuguese banking sector strengthened further in the first half of 2024 and reached historically high levels. The total capital ratio and Common Equity Tier 1 (CET1) ratio stood at 20.5% and 17.8%, respectively, above the Euro Area average. According to Banco de Portugal, the impact of implementing the Basel III reforms is expected to be contained in Portugal, in absolute terms and compared to the European Union. In turn, the leverage ratio rose to 7.5%, remaining at a considerably higher level than the European Union average and the regulatory reference minimum (3%).

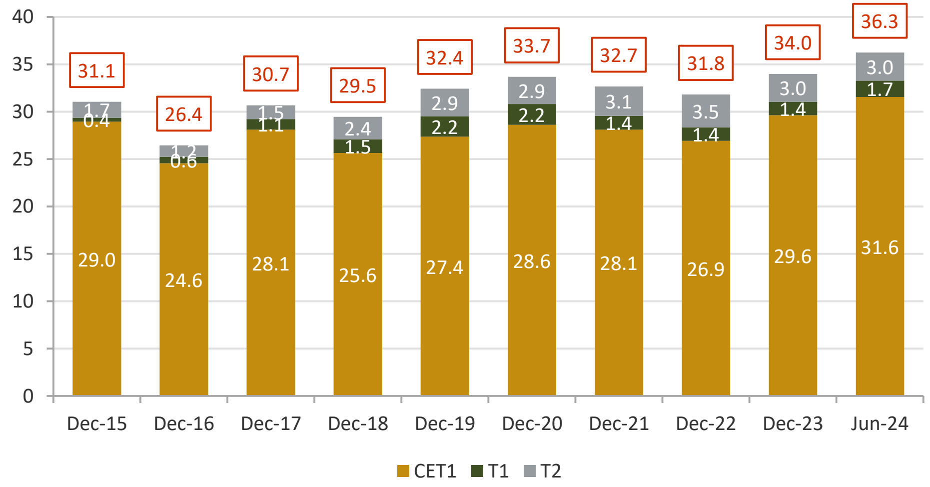
Common Equity Tier 1 ratio



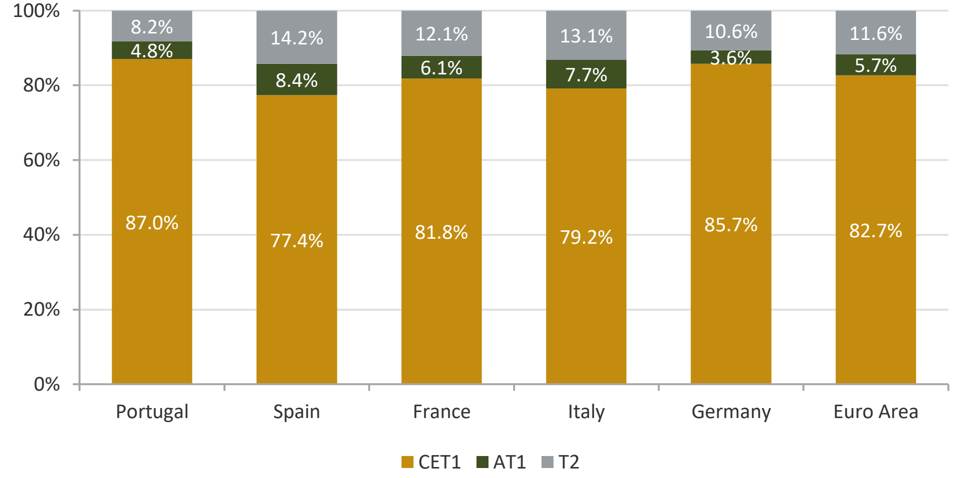
Leverage ratio



Evolution of the structure of own funds (EUR billion)



Structure of own funds: Portugal vs. Euro Area (Jun-24)



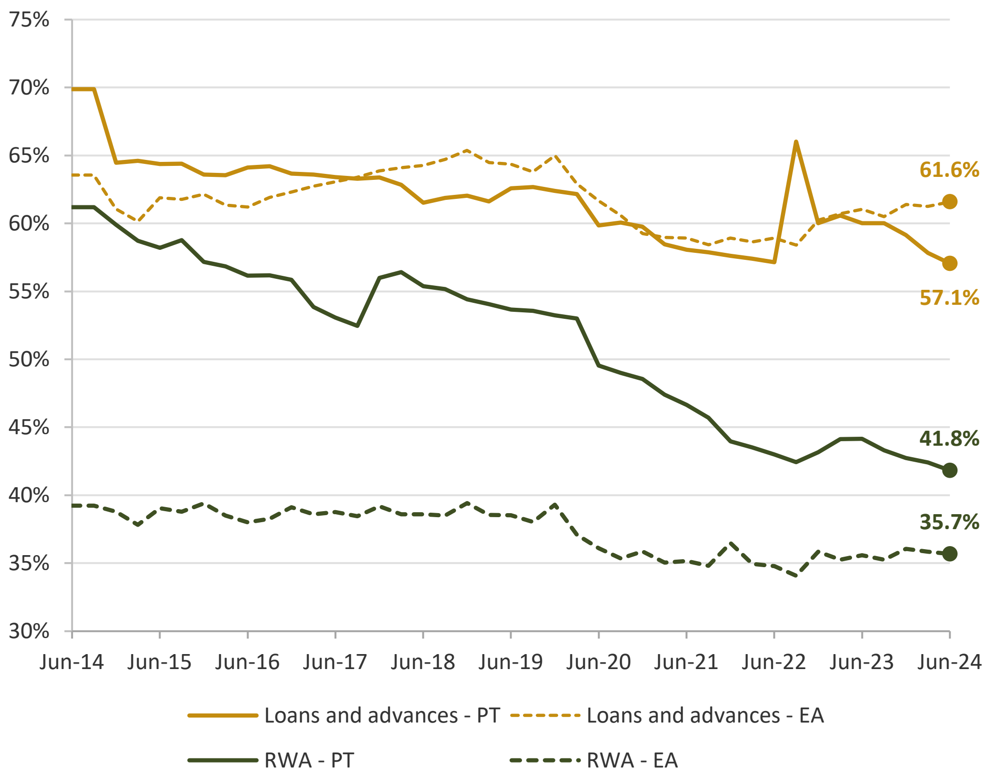
Source: ECB – Consolidated Banking Data (consolidated data) and EBA – Risk Dashboard (leverage ratio – fully phased-in definition of Tier 1). In June 2024, the EBA sample included 162 European banks, covering more than 80% of the EU/EEA banking sector (sample for Portugal: BCP, CGD, LSF Nani Investments e Santander Totta).

IV. SOLVENCY

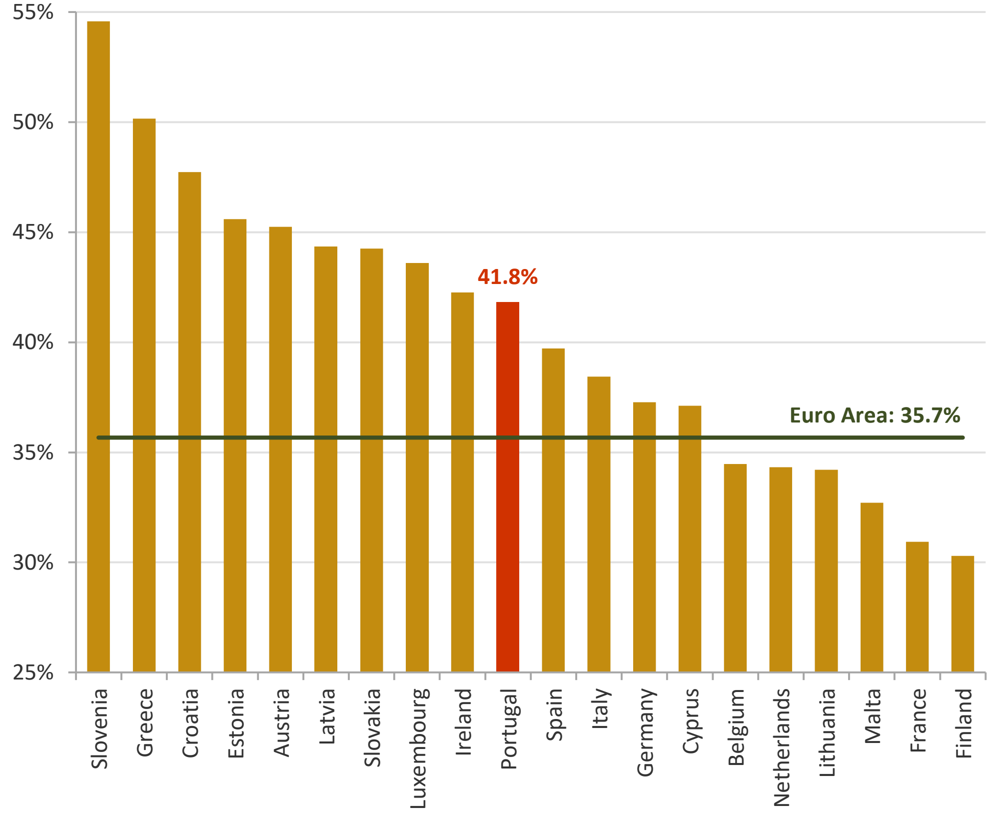
In June 2024, the ratio of risk-weighted assets (RWA) as a percentage of total assets fell 0.9 pp compared to December, to 41.8%, due to an increase in total assets greater than that of RWA. In the change in total assets, there was an increase in lower risk components (-1.4 pp contribution), particularly exposure to public debt, and an increase in exposures at risk (+0.5 pp contribution) mainly due to a rise in credit exposures to companies.

This ratio still compares unfavourably with the Euro Area (35.7% in June 2024). That is due to the lower prevalence of internal models in assessing financial risks for prudential purposes in Portuguese banks and a past still influenced by high levels of defaults and losses, implying higher capital requirements than most banks in the EA.

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-24)



Source: ECB – Consolidated Banking Data.

V. PROFITABILITY

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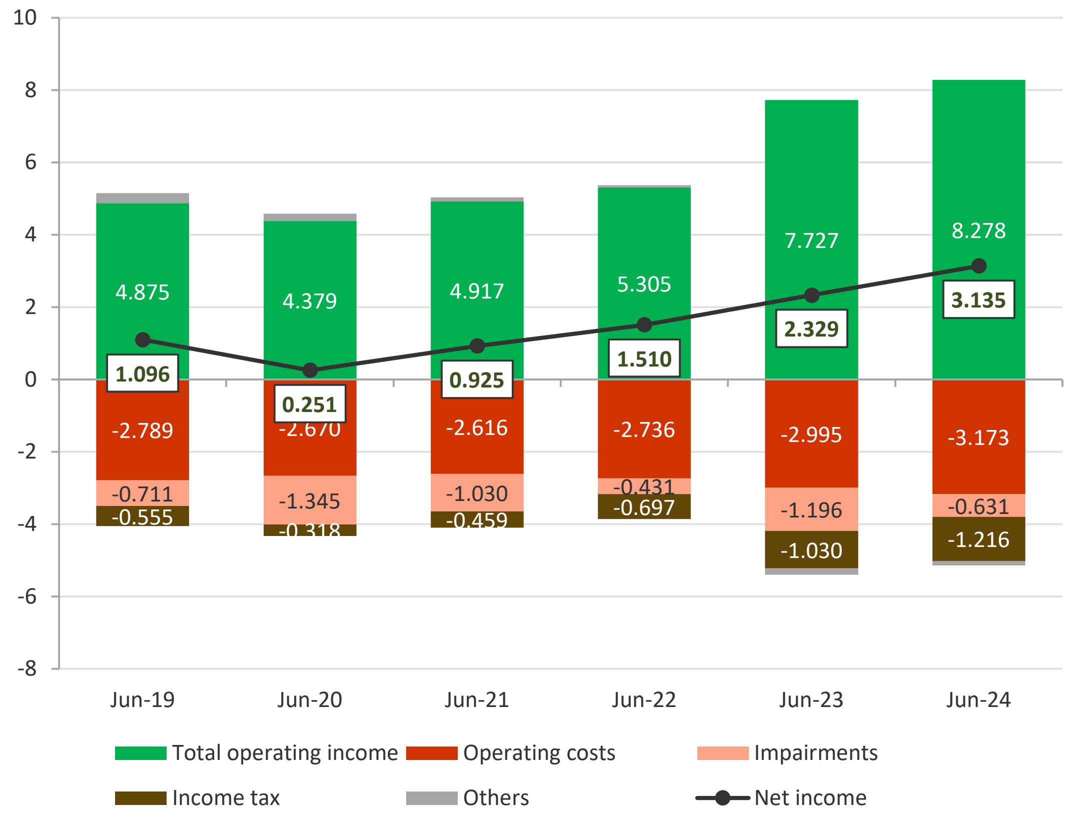
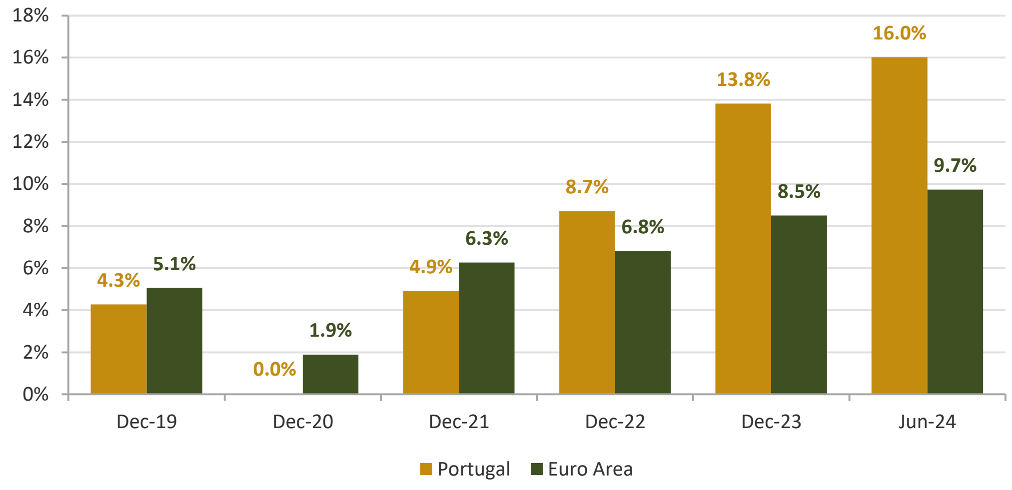
In the first half of 2024, the profitability of the banking sector improved further, reflecting the positive contribution of total operating income and net provisions and impairments, which more than offset the negative contribution of operating costs.

Net interest income breakdown (EUR billion)

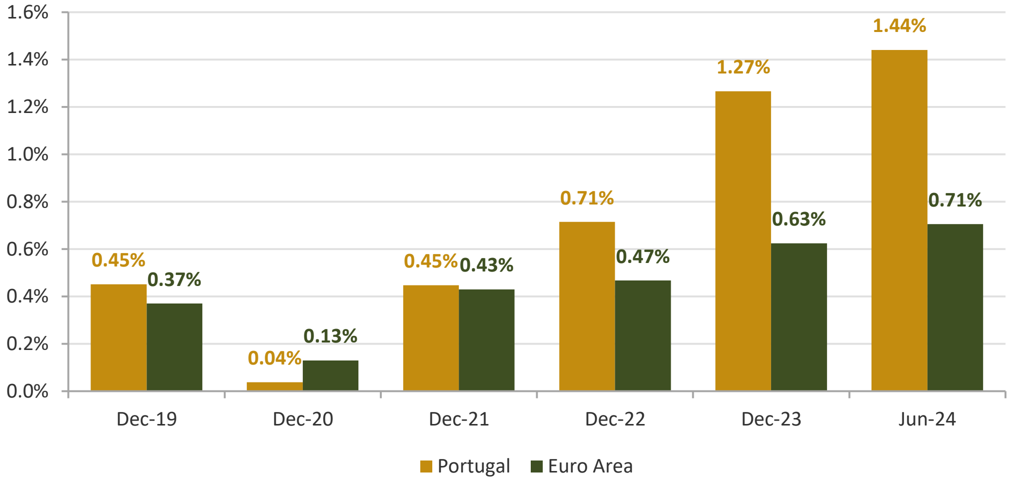


Source: Banco de Portugal (consolidated data).

Return on Equity (ROE)



Return on Assets (ROA)

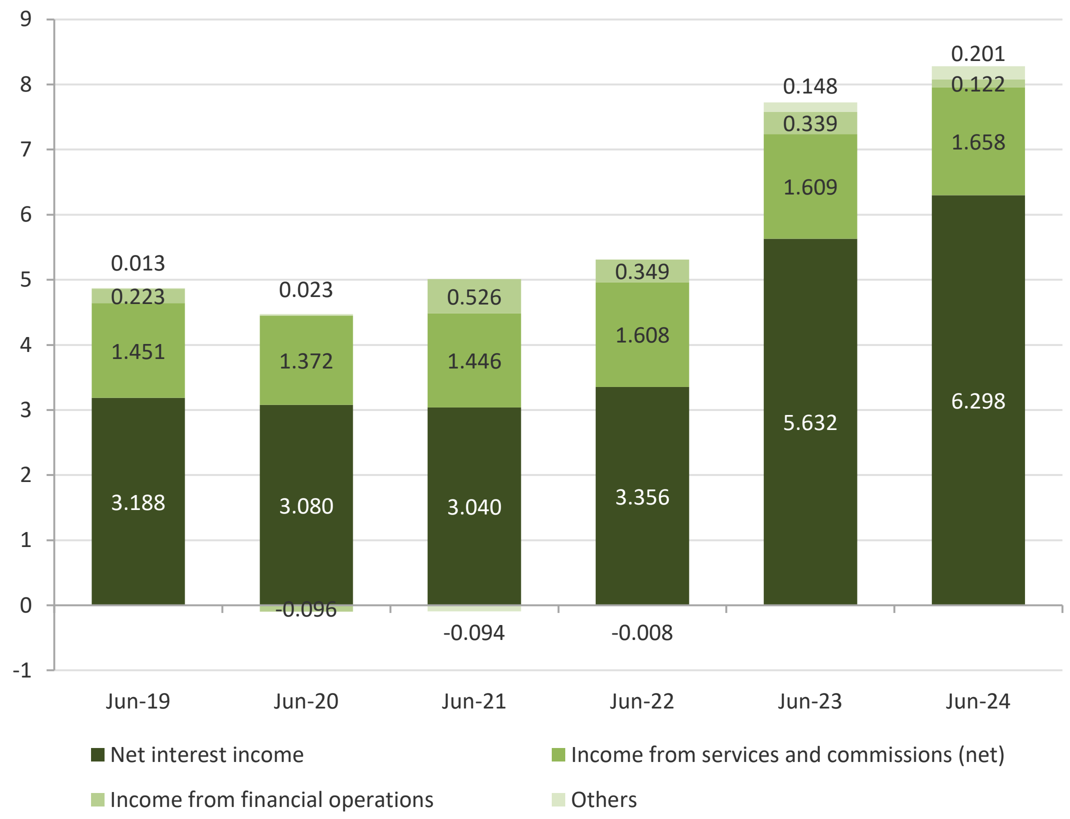


Source: ECB – Consolidated Banking Data. Calculated based on net interest income after tax and minority interests and on end-of-period equity and total assets. Return on equity excludes branches of foreign banks. Annualised values for Jun-24

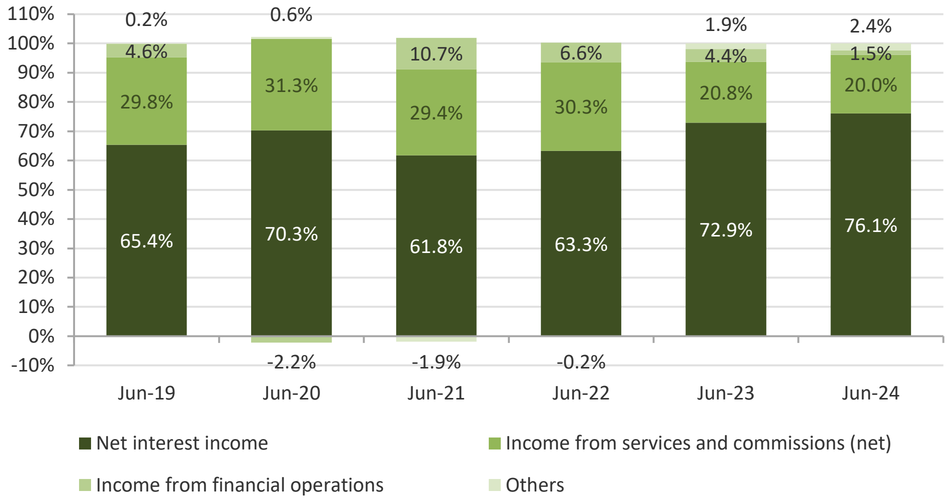
V. PROFITABILITY

The improvement in total operating income is fundamentally explained by the growth, albeit more moderate, in net interest income, while income from services and commissions rose slightly. On the other hand, income from financial operations had a negative contribution, largely explained by the base effect of an institution recognising the gains made on the sale of a subsidiary in the first half of 2023.

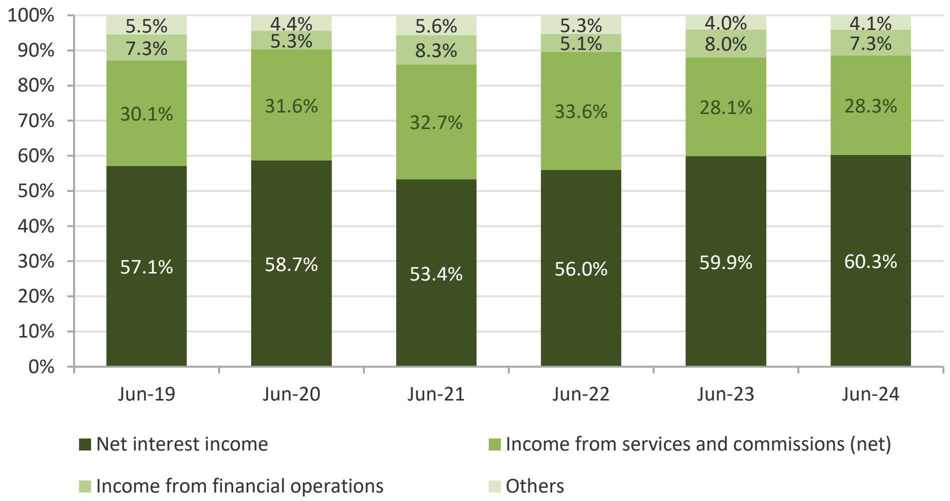
Total operating income breakdown (EUR billion)



Total operating income breakdown: Portugal



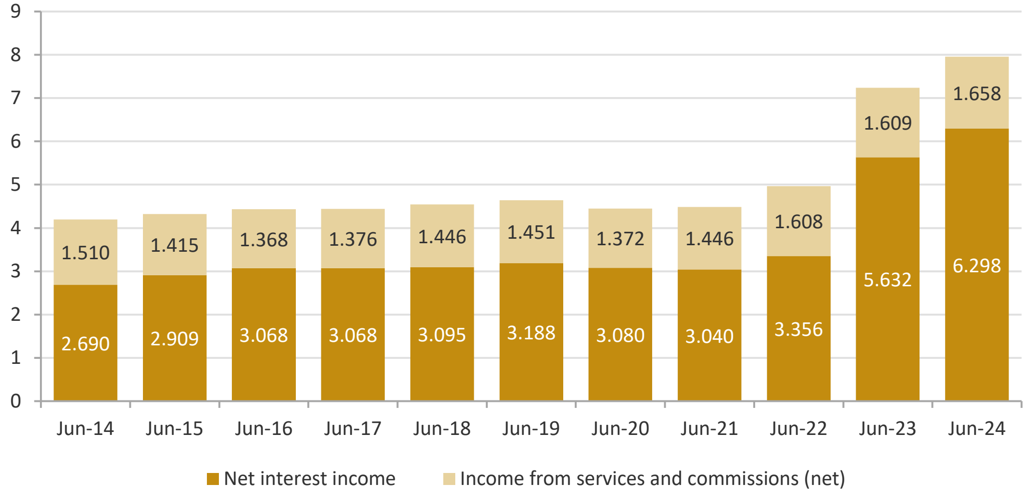
Total operating income breakdown: Euro Area



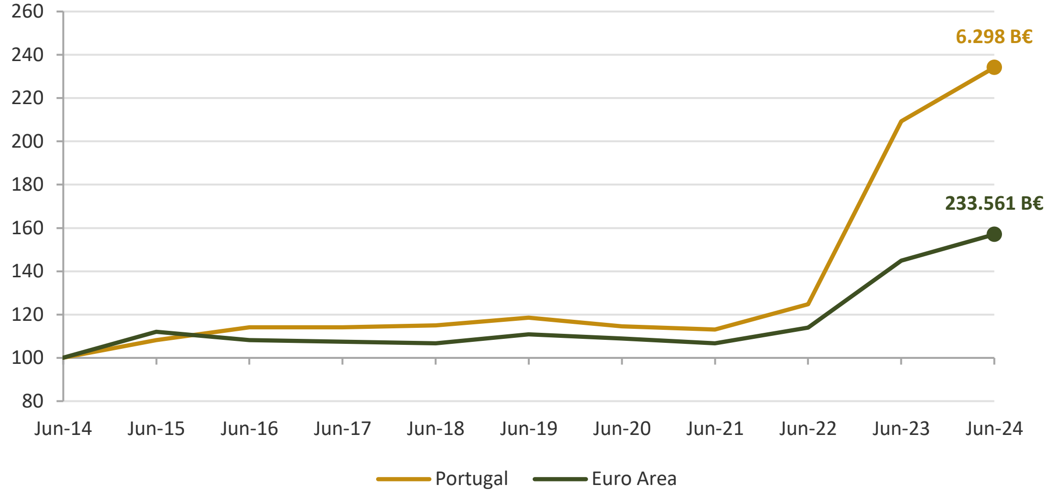
Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data (Euro Area).

The more moderate growth in net interest income resulted from the significant rise in interest expenses, mainly due to increasing interest rates on household deposits. The rise in interest income was due to the positive evolution of the customer loans portfolio, which benefited from the transmission of market interest rates observed in 2023, and the debt securities portfolio.

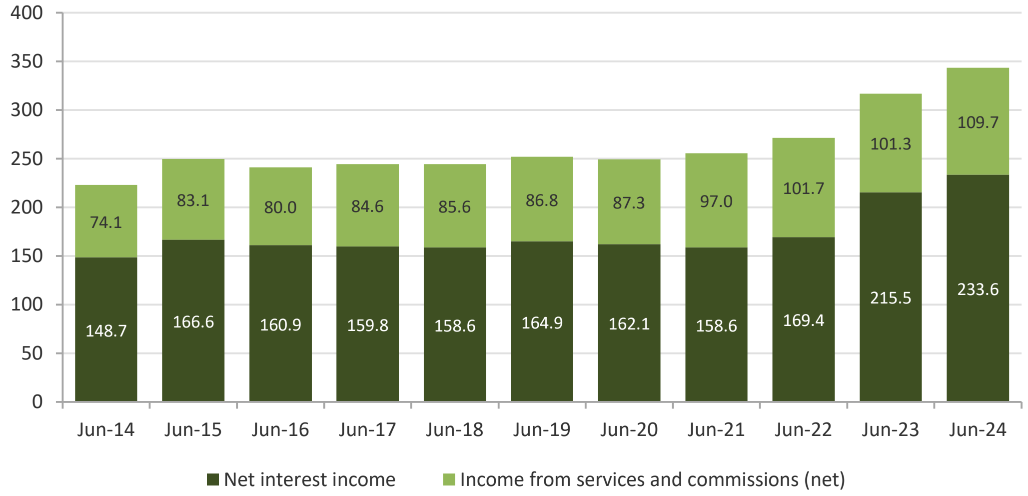
Net interest income and Commissions (EUR billion) – Portugal



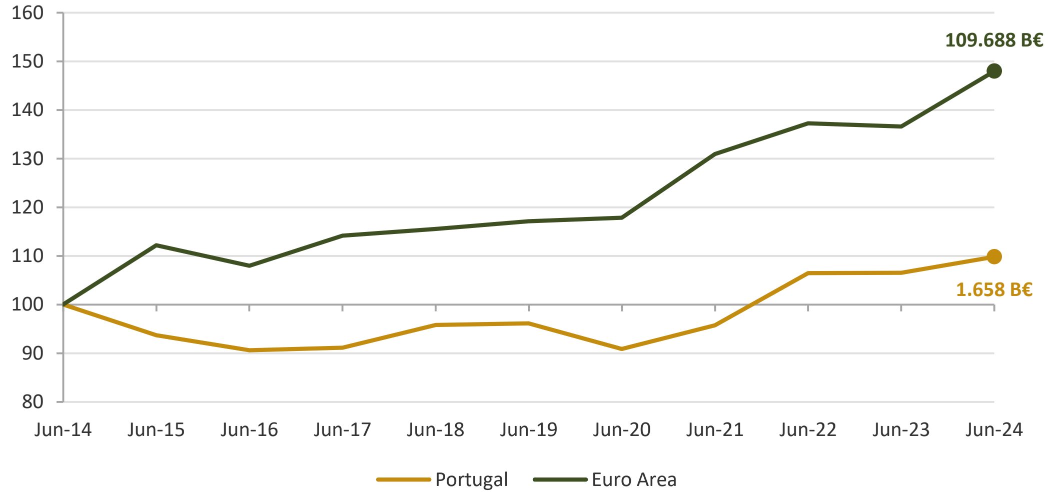
Net interest income (Jun-14 = 100)



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



Income from services and commissions (Jun-14 = 100)

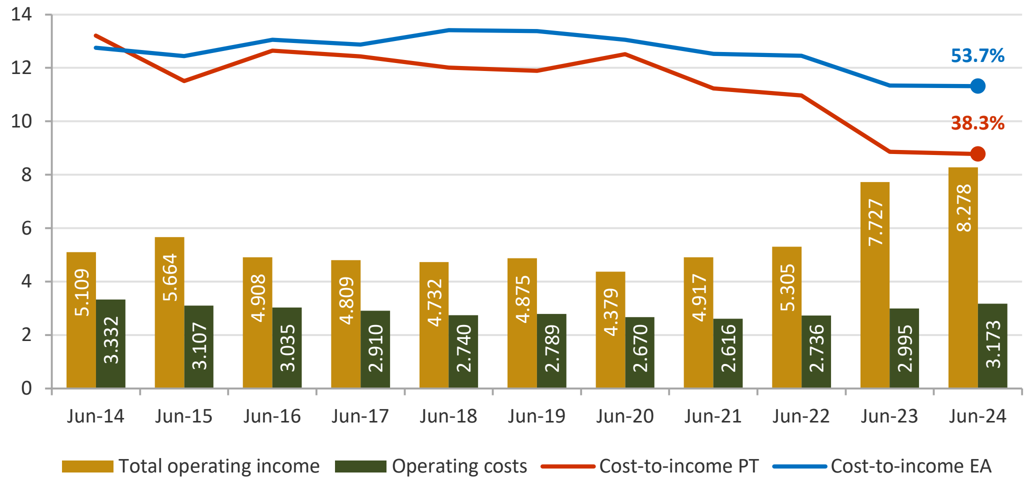


Source: Banco de Portugal (consolidated data) and ECB – Consolidated Banking Data (Euro Area).

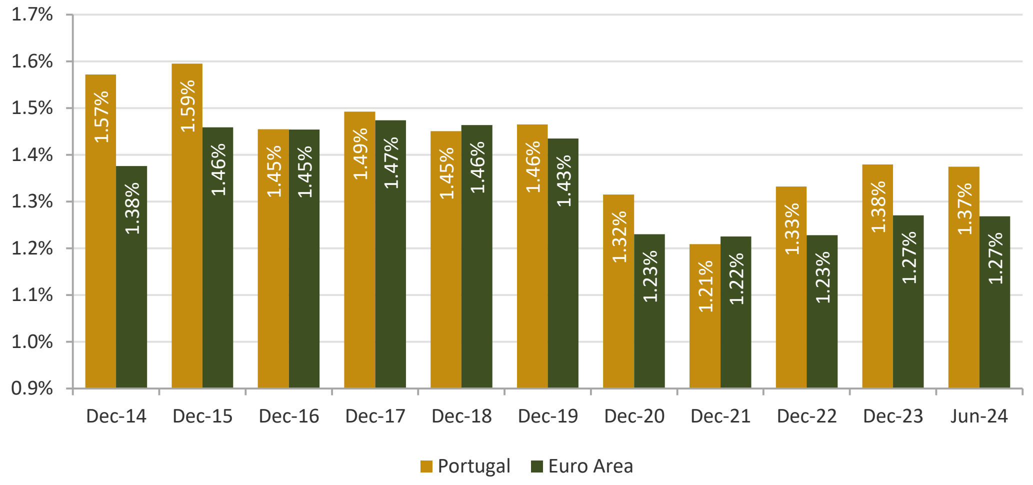
V. PROFITABILITY

In June 2024, the sector's efficiency improved, with the cost-to-income ratio decreasing slightly despite the increase in operating costs, namely staff costs and, to a lesser extent, other general administrative expenses. The evolution of the ratio is essentially explained by the increase in net interest income. The cost of risk fell, mainly reflecting the decrease in the flow of credit impairments.

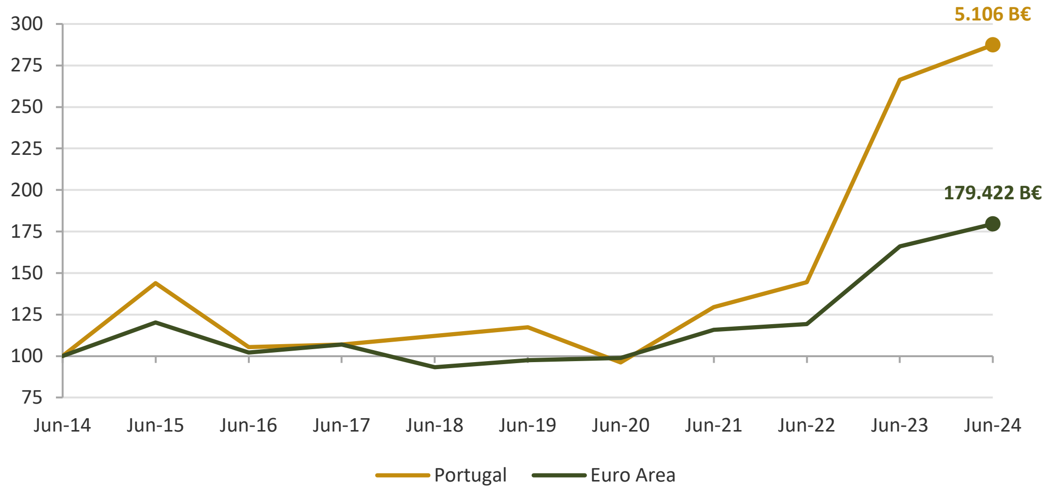
Cost-to-Income breakdown (EUR billion) – Portugal



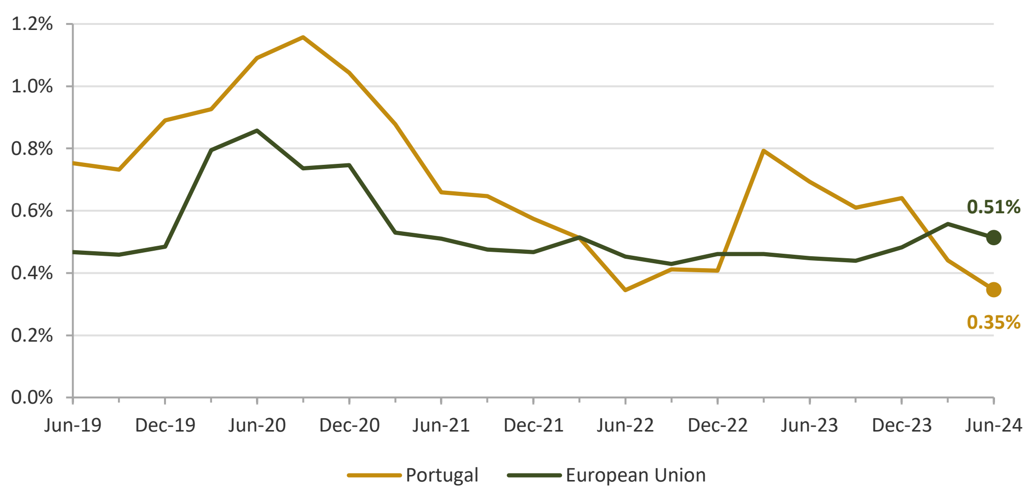
Operating costs as a % of total assets



Net operating income (Jun-14 = 100)



Cost of credit risk

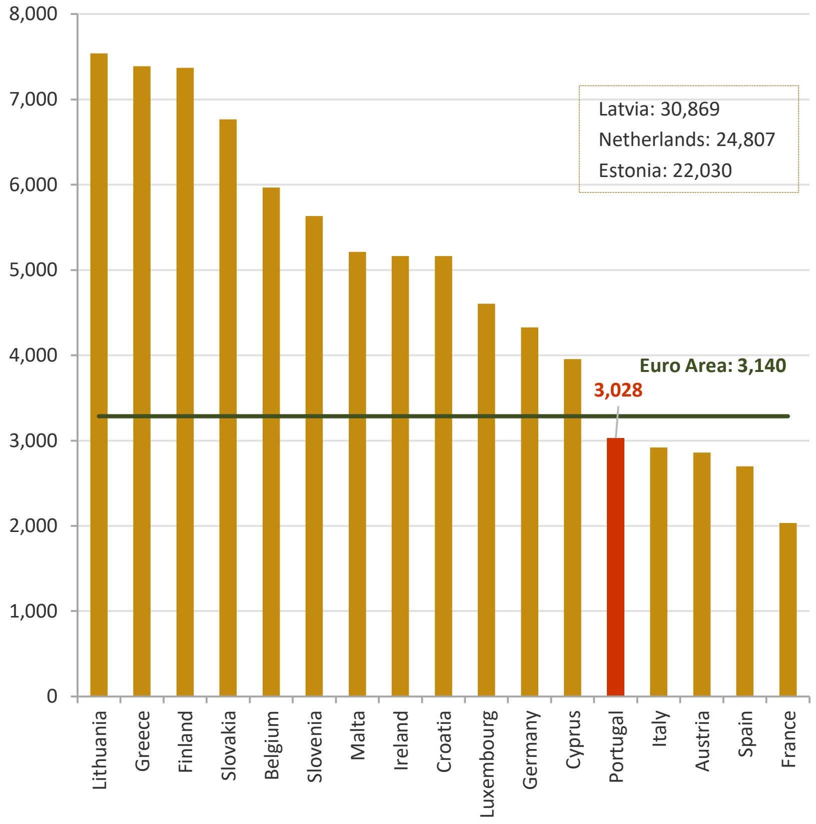


Source: Banco de Portugal (consolidated data), ECB – Consolidated Banking Data (Euro Area) and EBA – Risk Dashboard (cost of credit risk). In June 2024, the EBA sample included 162 European banks, covering more than 80% of the EU/EEA banking sector (sample for Portugal: BCP, CGD, LSF Nani Investments e Santander). The methodology to calculate the cost of credit risk of EBA is different from that of Banco de Portugal. Both can be found in the following reports: Sistema Bancário Português: Desenvolvimentos recentes (Banco de Portugal) and Risk Dashboard (EBA).

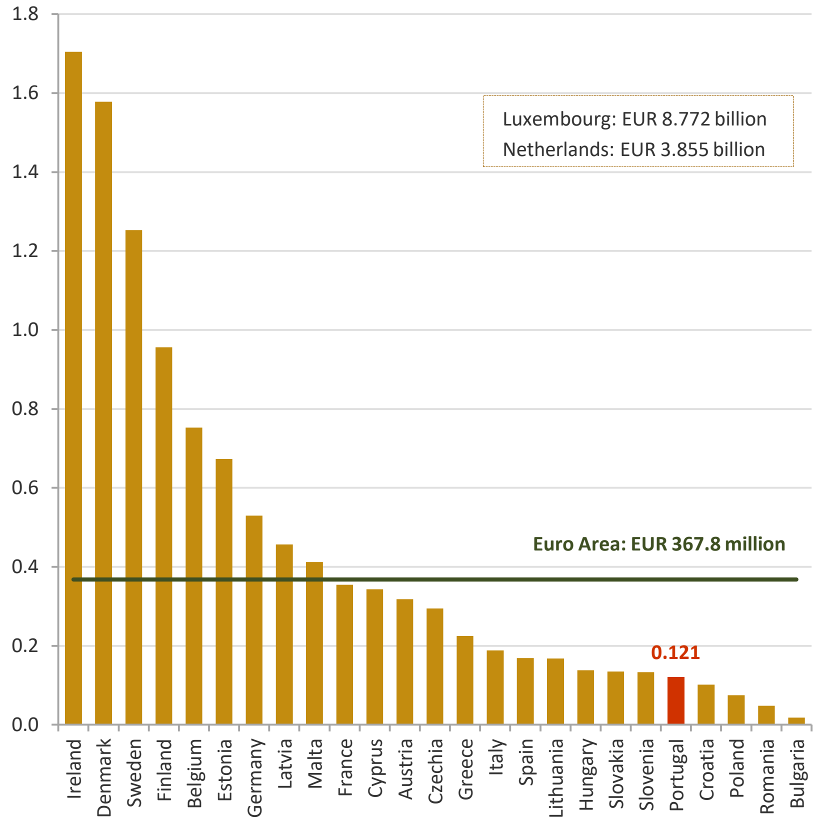
VI. PRODUCTIVITY

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.

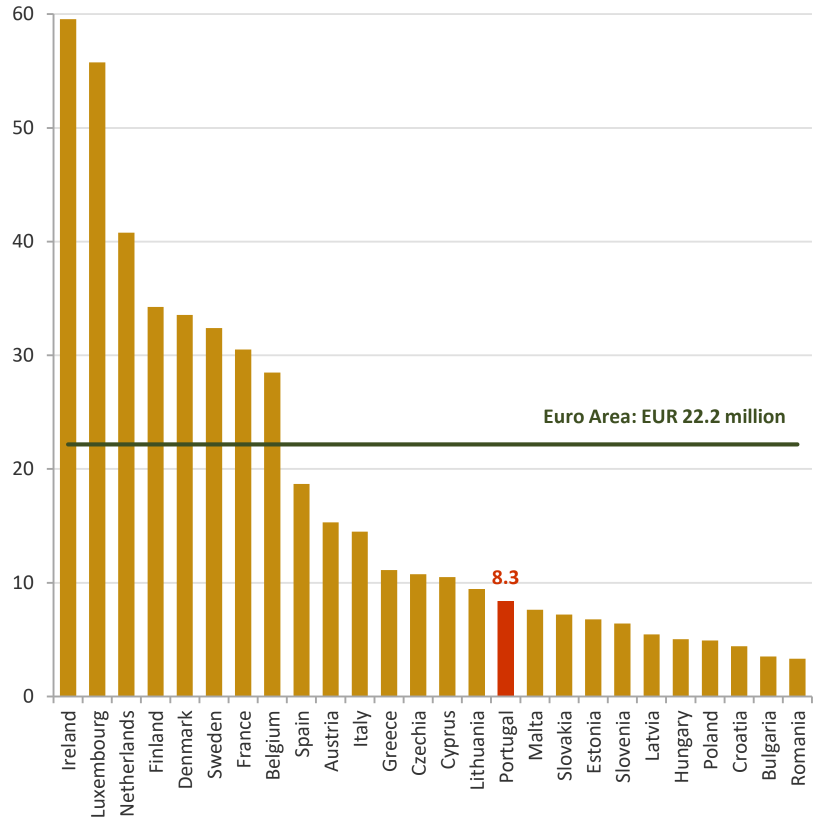
Residents per branch (Dec-23)



Total assets per branch (EUR billion, Dec-23)



Total assets per employee (EUR million, Dec-23)



Source: ECB – MFI Balance Sheet Items (Monetary and Financial Statistics) and Banking Structural Financial Indicators, INE – Statistics Portugal and Eurostat. Domestic activity data.

VII. METHODOLOGY

- The information provided by Banco de Portugal and the ECB regarding monetary statistics differ from that provided in the context of consolidated data of the banking system. The main differences derive fundamentally from non-coincidence in the universes surveyed and from different consolidation procedures. This information is available on the Banco de Portugal and the ECB websites. Among others, the following documents may be consulted: Suplemento ao Boletim Estatístico n.º1/2001, 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 4 December 2024.

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JUNE 2024

ASSOCIAÇÃO PORTUGUESA DE BANCOS

DECEMBER 2024