PORTUGAL: An Introduction to Banking & Finance

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In 2011, Portugal signed a EUR 78 billion bailout agreement with the European Union ("EU"), the European Central Bank ("ECB") and the International Monetary Fund ("IMF"), which led to the application of structural adjustments and the implementation of reform plans under the supervision of the so-called Troika. In conformity with this agreement, the Portuguese government and the international institutions concluded the negotiation of a Financial Assistance Programme with the aim of reducing the high levels of government debt registered at the time and the foreign dependency for gathering funding.

Since 2014, the economy has been gradually improving and financing conditions have shown signs of progress, leading to the conclusion of the Financial Assistance Programme in May 2015. The current socialist government, in power since 26 November 2015 backed by two far-left parties, has managed to retain the required majorities in parliament, providing some sense of stability during the past few years and making the control of public finances one of the top priorities. What many deemed to be a fragile coalition has proven to be a steady solution after the period of deep recession previously lived with in the country.

Two years later, Portugal managed to end 2017 with a budget deficit of 1.4%, substantially reduced from the 4% recorded in 2014 and the 2% in 2016. In addition, and confirming the prediction of most economic forecasts, the Portuguese economy is set to grow for the fifth year running. Figures released by the Bank of Portugal calculated an annual growth rate of the Portuguese GDP of approximately 2.6% for 2017 – the highest rate since the year 2000 – following a growth of 1.3% in 2016. The efforts undertaken by the Portuguese government to scale back public debt are showing some results; nevertheless, public debt still represents approximately 126% of the GDP, despite being forecast to drop for a second consecutive year to 123% in 2018.

2017 was also marked by the EU institutions' approval of a new waiver that allows Portugal to continue with its early reimbursement of the IMF loan granted in 2011 – a policy to be sustained during 2018.

The international markets registered a positive response to this evolution, reflected in Standard & Poor's decision, in September 2017, then followed suit by Fitch, Moody's and other rating agencies, to upgrade the country's rating back into investment grade status. Portugal has successfully restored market access and renewed optimism amongst international investors, as far as sovereign risk is concerned, which contributed to the fall in Portuguese 10-year bond yields to the lowest level registered since Portugal's entry into the single currency.

The 2018 State Budget Law was again approved with the votes of the left side of the political spectrum and came into force on 1 January 2018, comprising, among others, two changes that may be of particular interest to investors coming to Portugal.

The first, extends a deduction of 7% to taxable profits, up to a maximum amount of EUR 2 million, for share capital entries in kind related to the conversion into capital of any type of credits, whereas the similar provision in the 2017 State Budget was only applicable to cash conversions. This tax benefit applies only to credit conversions made in the fiscal year starting on or after 1 January 2018, but this is certainly an opportunity worth considering.

The second is a 25% deduction of the CIT granted to medium-sized companies for the reinvestment of retained earnings, up to the maximum amount of EUR 7.5 million in place for a period of three years. For micro and small companies, the deduction can reach 50%. Companies can benefit from this deduction in investments made in fiscal years starting on or after 1 January 2014.

The Banking Sector in 2017

During the last few years, the Portuguese government had to overcome a series of difficulties in the Portuguese banking sector, giving rise to many rescue programmes and also to two resolution cases that have marked significantly the landscape for Portuguese banking. In March 2017, Caixa Geral de Depósitos, a fully state-owned bank, completed a EUR 0.5 billion subordinated debt issuance, which allowed the authorities to move forward with the EUR 2.5 billion public capital injection foreseen in the EUR 5 billion recapitalisation plan agreed with the European Commission.

More recently, Lone Star, an American private investment fund, acquired 75% of Novo Banco's capital. In September 2017, Lone Star committed to inject EUR 1 billion into the bank, merely completing the process that had started back in August 2014 when this bridge bank was created in the context of the resolution of Banco Espírito Santo. More specifically, EUR 750 million on 18 October 2017, followed by an additional EUR 250 million by the end of 2017. From the sale process, it also resulted that the remaining 25% of the capital was retained by the Resolution Fund. To meet the required conditions established for this operation, Novo Banco had already redeemed all its state-guaranteed debt and repurchased senior bonds maturing between 2019 and 2052, ensuring a capital increase of EUR 500 million.

Meanwhile, the removal of the limitations on voting rights established by Decree-Law no. 20/2016 opened the door for the successful takeover bid over Banco BPI, S.A. ("BPI"), launched by CaixaBank, that was completed in February 2017. The Spanish bank completed the offer by paying EUR 645 million to raise its position in BPI from 45% to 84.5%. To comply with ECB requirements and to ensure the success of the operation, BPI then had to sell control of BFA, thus losing its dominant presence in the Angolan banking landscape.

Banco Comercial Português, S.A. ("BCP"), the largest Portuguese publicly traded bank, concluded a capital increase of EUR 1.33 billion in February 2017, allowing for the reimbursement of the remaining EUR 700 million of outstanding contingent convertible bonds that had been provided by the Portuguese Republic to this bank back in 2012. As a result, Fosun increased its share representation in the bank. The Chinese group had received an authorisation from the ECB to raise its stake to 30%, but it ended up not going above 25%. Sonangol, Angola's state oil company and BCP's second largest shareholder, had also received an authorisation to raise its stake to 30%, but decided not to strengthen its position in the bank, remaining with approximately 15% of the shares. At any rate, we would signal that the reimbursement of these contingent convertible bonds completes the reimbursement to the Portuguese Republic of all reserve monies that were provided to private banks in 2012.

Finally, one word to signal that Caixa Económica Montepio, S.A. ("Montepio") changed its legal status from a savings bank to a limited liability company, providing it with more flexibility to raise capital. The process that led to this change in Montepio's legal status began in 2016, following a requirement set by the Bank of Portugal. Associação Mutualista remains currently as the sole shareholder, holding 100% of the total voting shares, but this is a matter that may now evolve. Let's see how the future unfolds.