

# Portugal

## One Lender Causes Widespread Market Turbulence

- Concerns about the financial stability of the parent company of the second-largest Portuguese bank have triggered in recent days an across-the-board fall in Portuguese asset prices, including a widening of the sovereign spread (to 260bp against Germany, against 190bp one month ago). The Portuguese government and the central bank both have assured that the lender under scrutiny is ring-fenced against losses in the rest of the controlling group. However, concerns about the lack of transparency in the corporate structure and about potentially larger-than-expected losses for a major lender have spurred quite a severe market reaction, spilling over to the rest of the euro area periphery.
- [Our equity analysts](#) last week estimated that the maximum losses for the bank stemming from its exposure to the rest of the group could amount to €4.3bn (while its current CET1 stands at a fairly high level of 10.7%). We make two considerations at the macro level. First, non-financial corporate debt in Portugal remains extremely high, at 131% of GDP in Q4 13, only starting to stabilise since mid-2013. [We have highlighted in the past](#) how this still represents a major risk for the sustainability of the Portuguese recovery, as private deleveraging could always bring about unexpected macro turbulence mainly due to the negative effects on the banks' balance sheets. We view the recent events in Portugal as an example of how the ongoing deleveraging could quickly generate widespread concerns. However, we believe that the economy is now on a stronger foot than it was a few years ago and it is better able to withstand these shocks. Private savings are at historically high levels (the financial surplus of households plus non-financial corporations stood at 4.4% of GDP in Q1 14, down marginally from a record-high of 6% of GDP in Q3 13), corporate profitability is strengthening, bank deleveraging has made significant progress (the loan-to-deposit ratio has fallen to around 120% from 167% in 2010) and real GDP is growing again boosted by improved export competitiveness.
- Second, even in the extreme case where the troubled bank is not able to raise the potential capital shortfall from private sources, we note that the cash reserves still available with the Portuguese government for bank recaps, as part of the bailout programme, amount to €6.4bn (or 4.2% of GDP). Total cash reserves of the central government (including the €6.4bn) amounted to an even larger €15bn (or 9% of GDP) at the end of 2013, as the government has been building buffers to smooth the transition from official bailout funding to market funding. We reckon these cash reserves represent quite a large buffer in case one or more Portuguese banks fail to raise the necessary capital from private sources and the government has to step in to fill the gap. Therefore, as long as the shock remains idiosyncratic and repercussions to the rest of the banking system fairly contained, we think the implications of the recent developments for the sovereign should be relatively limited.

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