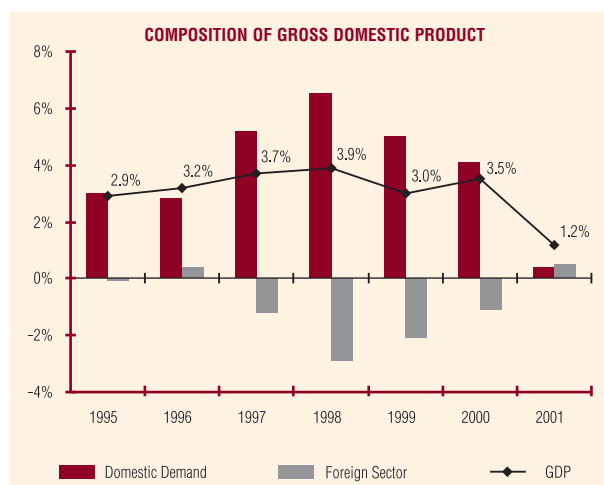


THE PORTUGUESE ECONOMY

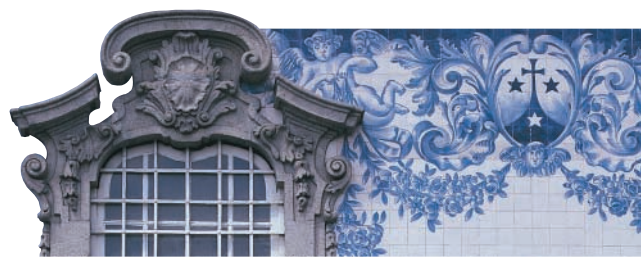
During 2001 the Portuguese economy grew at a rate lower than the average for the euro area, making it the second consecutive year with no particular progress towards real convergence. The slowdown of activity helped to attenuate some of the imbalances that have affected the Portuguese economy in recent years: the acceleration of consumer prices between 2000 and the first half of 2001, the worsening of the Current Account and Capital Account deficits and the increase of household and company indebtedness. The end to exceptional factors that led to the increase of food and energy prices, the slowdown of private consumption, the prospect of worsening conditions on the labour market and moderation of international inflation helped to reduce the inflation rates as from the summer of 2001, despite the risks arising from wage growth at a rate higher than both the benchmark of the wage negotiations in other euro area countries and the productivity gains. Household savings improved during 2001, driven by poorer expectations as to the future performance of the economy, by the need to service existing debt and by the reduction of financing requirements as a result of the slowdown of investment in housing. The reduction of the private sector borrowing requirements made up for the imbalance of the public accounts – the budget deficit stood at around 2.2% of the GDP, compared to the initial commitment to 1.1% within the scope of Stability and Growth Pact for 2001 – and the lower transfers from the European Union, leading to a slight reduction of the foreign deficit, reversing the trend of the worsening imbalance of the foreign accounts seen since 1996.

The GDP growth rate fell from 3.5% in 2000 to around 1% in 2001, since in net terms, as in the two previous years, the reduction of domestic demand was only partially offset by the increase of foreign demand. The smaller contribution of domestic demand mirrored the slowdown of its main components, with particular



emphasis on the slowdown of private consumption and a downturn in investment. The greater contribution of the foreign sector largely reflected the impact of the moderation of imports, while exports also advanced at a much less dynamic rate. The slowdown of private consumption was mainly the result of the poor performance of consumer durables purchases stemming from the slowdown of real disposable household income, by the fall-off in financing capacity linked to the increase of indebtedness in recent years and by lower consumer confidence. The latter mirrored the widespread less favourable opinions on the future performance of the domestic economy, concern as to higher unemployment and cautious prospect for household finances.

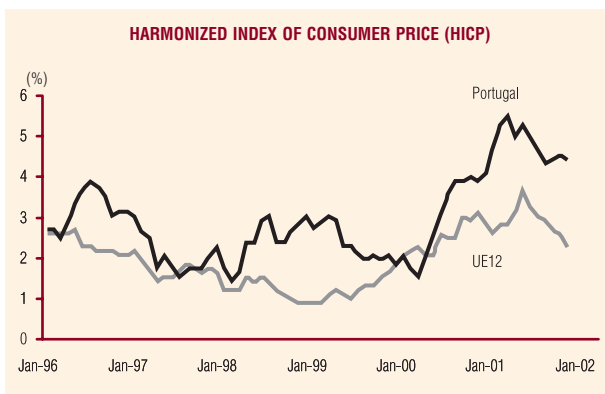
Fixed investment fell slightly during 2001, mainly as a result of the sharp downturn in investment in capital goods. Despite less dynamic growth than in 2000, due to the downturn in housing construction – the result of the high level of family debt, the sharp increase of home purchases seen in recent years, the alterations to the subsidised mortgage loan regime and the impact of rising interest rates up to the middle of 2001 – investment in construction was driven by the increase seen in public works. Exports of goods and services were up by about 4% in 2001, reflecting the slowdown of foreign demand for Portuguese products. The real growth of imports of goods



Detail of "Janela da Igreja do Carmo"

and services stood at some 2%, compared to 5.5% in 2000, in line with the reduction of the consumption of consumer durables, investment in equipment and the decline of the flow of Portuguese tourists abroad.

The average inflation rate at the end of 2001 was 4.4% (2.9% in December 2000). Following a sharp increase during the first quarter, consumer prices tended to slow as from the second quarter of 2001. This reflected moderation of the price of goods, while non-tradable services accelerated slightly. The fading of the factors that had led to sharp price increases during 2000, the prospects of increasing precarious employment and moderation of international inflation all contributed to reduce the inflation rate during the second half of the year. The unemployment rate for 2001 was about 4%, roughly the same as the figure for the previous year, though correcting for the seasonal effect, unemployment rose gradually over the year. Total employment was up by about 1.5% in 2001 (1.7% in 2000), largely through the greater number of employees, particular on term contracts.



As a result of the reduction of the trade deficit, partially offset by a slight increase of the deficit of the income account related to the increased funding of Portuguese banks by non-resident entities, and with the reduction of the surplus of public transfers, the Current Account deficit fell during 2001. The Current and Capital Accounts aggregate deficit decreased in 2001, despite the fact that the Capital Account surplus fell slightly by virtue

of the reduction of the public transfers received by Portugal as a result of the delay to payments received in connection with the 3rd Community Support Framework.

The public sector deficit amounted to 2.2% of the GDP – compared to the initial commitment to 1.1% within the scope of the 2001-04 Stability and Growth Pact – with particular emphasis on the sharp reduction of tax revenue when compared to the budget. In addition to the effect of the slowdown of activity on tax revenue, the increase of the public deficit was also caused by the lesser efficiency of the tax collection systems and of the lower taxation levied within the scope of the reform of income tax. The State's primary spending continued to grow sharply in 2001, and emphasis is given to the increase of the civil service wage bill at a rate far higher than the increase established in the collective bargaining agreements.

THE PORTUGUESE FINANCIAL SYSTEM

The Portuguese financial institutions carried on their business against a background that continued to be conditioned by a number of structural trends: economic globalisation, leading to growing integration and harmonisation of the working of the markets and uniformity of financial products and services; industry deregulation; technological innovation, which has led to increased competition and narrowing intermediation margins; the introduction of innovative financial products and services; and the growing focus on strategic consolidation, involving several concentration operations within domestic markets and restructuring designed to take full advantage of operating synergies.

Credit extended to the non-monetary sector rose by about 10% in 2001, continuing to reflect both the trend of slowing loans to individuals seen since mid 1999 and the slight moderation of corporate loans since the end of 2000. The combined effect of the earlier increases of interest rates, the more restrictive credit conditions imposed by the

banking institutions, the falling household confidence, the greater difficulty in the access to subsidised mortgage loans, the increase household savings as a result of the higher level of indebtedness, and the postponement of corporate investment decisions were offset by the recent reversal of the trend of falling interest rates. Household debt accounted for some 93% of disposable income at the end of 2001. The slowdown of loans and advances during 2001 suggests that the adaptation to a new financial situation, marked by flexibility in extending credit and by significantly lower interest rates, may be near completion.

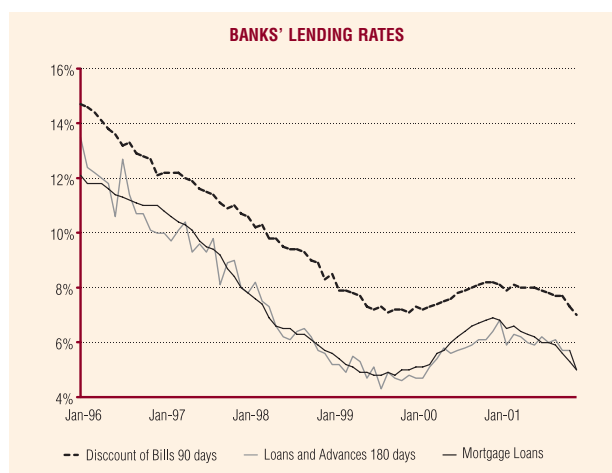
The banking industry's interest rates tended to fall as a whole, in line with the main money market indices, down by about 0.5 p.p. during the fourth quarter of 2001. The reduction of the rate of growth of customer funds, allied to the continued sharp growth of credit extended, meant that the banks increasingly fell back on financing via the capital markets, particularly through the issue of securities and subordinated loans, taking advantage of the ease of access to the international markets as a result of Portugal's membership of the euro.

Following a period of some stability of the spreads between the Portuguese long-term interest rates and those of its Community partners, the end of 2001 saw a narrowing trend, the result of risk and liquidity considerations. This could have been caused by a possible increase of investor appetite for risk and by a reversal of the flight to safety effect. During the second half of 2001 the

yield curve flattened, largely the result of the fall of short- and medium-term yields. In the shorter maturities the curve tended to fall, driven by the ECB's cuts of its prime rates. The curve steepened as from the second year of maturity as a result of expectations of economic recovery within the euro area as from the second half of 2002 and of worsening budget deficits for the euro area economies.

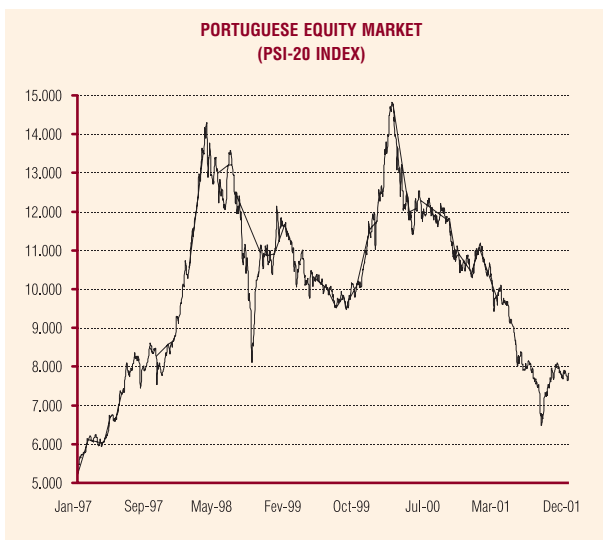
The State's financing activity during 2001 was centred on fixed-rate Treasury Bond issues. TBs totalling 8.6 billion euros were issued, covering about 72% of the State's gross borrowing requirements. The public debt management policy was adjusted in 2001, giving rise to TB issues maturing in 2004 and 2005. This led to an increase to five TB issues with the status of benchmarks for the public debt of the euro area (admitted to trading on the EuroMTS platform). Short-term instruments were used for 2001 financing, with particular emphasis on the issue of Euro Commercial Paper. The year saw the implementation for the first time of a debt swap programme that involved a number of repurchase/amortisation of old securities transactions and their refinancing through net TB issues. During 2001 the Special Public Debt Market (MEDIP/MTS Portugal) consolidated its position as a very liquid, transparent and efficient wholesale Treasury Bond trading platform.

Generally speaking, the profitability of the Portuguese financial institutions stabilised when compared to the figures for 2000, mainly reflecting the impact of the slowdown seen in loans and advances, the reduction of other income (securities brokerage revenues, commissions and profits on financial transactions in particular) and exceptional items. Net interest income performed well during the year, in step with the increased spreads on loan transactions and the changes to the balance sheet structure that provided a larger proportion of assets with greater spreads. Other current profits were sharply lower as a result of the reduction of income on securities, commissions and profits on financial operations, showing the negative impact of lower equity prices and smaller turnover on the equity market. The Portuguese banking system continued to show comfortable solvency ratios and the overall own-funds



adequacy ratio at the end of 2001 is estimated at 10.5% on a consolidated basis.

The PSI 20 index fell 24.7% in 2001, in line with the performance of the major European equity markets. Share prices were sharply lower during the first nine months of the year as a result of the global economic slowdown, the downward revision of corporate profits and the severe penalisation of the riskier financial assets. At the end of 2001 the PSI 20 index turned round, to rise in step with the recovery of the leading global equity indices, which came to incorporate the prospects of economic recovery during the second half of 2002 and the restructuring programme announced by various companies with a view to increasing their profitability.



Window of "Igreja do Carmo"