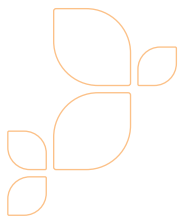




MACROECONOMIC FRAMEWORK





The IMF forecast for world economic growth in 2006 (5.1%) seems to have come in as expected and they are holding to their estimate for 2007 (4.9%). This is in spite of lower than expected recent growth in some economies, especially the U.S., and the risks that still exist in 2007 (oil prices, the twin deficit of the U.S., and the inflated housing market in the U.S. and elsewhere). The rates of growth reflect a dynamic world economy, which is going through its biggest expansion of all time.

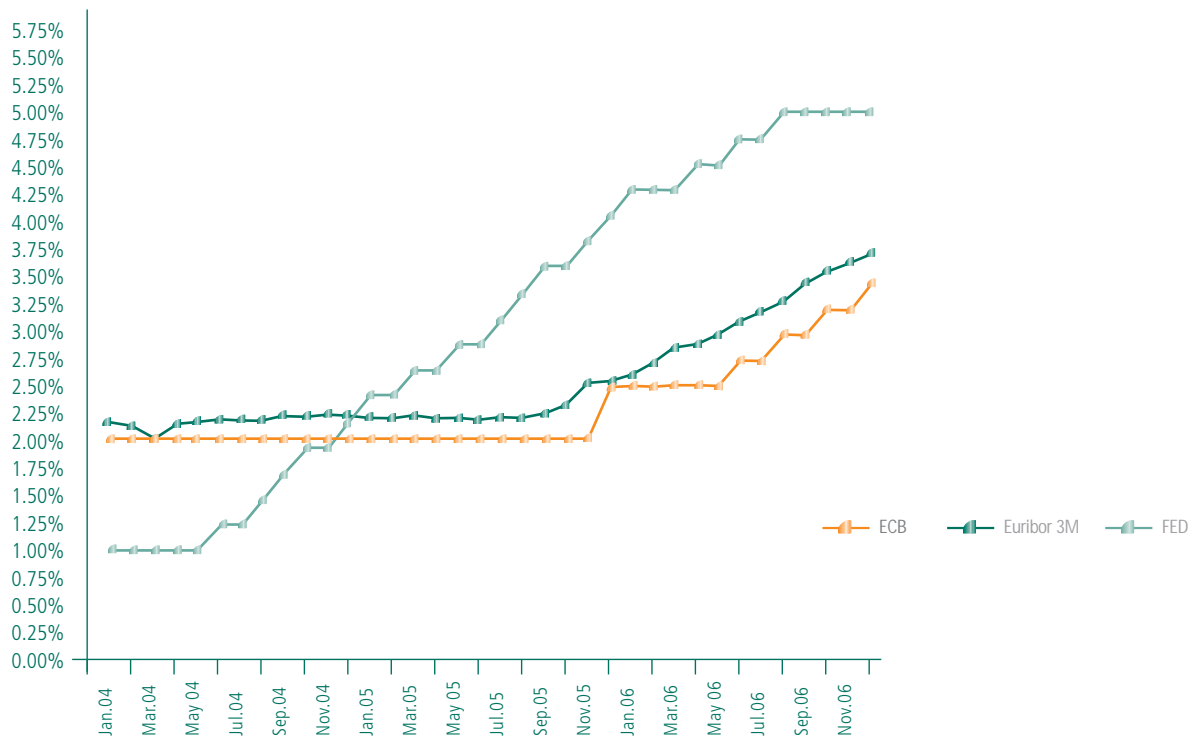
The cycle of growth is prevalent in practically all the major areas of the world economy. It covers developed countries, including Japan and the euro area (which both moved ahead at a slower rate) and also the so-called emerging countries (China, India, Russia, Brazil and others), and even Africa.

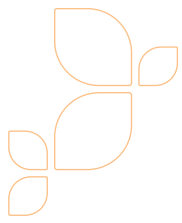
GDP growth in most developed countries (the US, the euro area, Japan) is likely to slow in 2007 (from 2.4% to 2% in the euro area) but emerging countries look as if they will stay buoyant.

Spain is a growing market for Portuguese exports, but it too seems set to lose momentum (with GDP growth slowing from 3.4% to 3%).

The robust growth brought inflationary pressures in its train, above all in the first half of the year. Oil and industrial metal prices rose steadily to reach their highest ever, though pressure eased around the mid-year period. In the euro area, inflation is near the 2% target defined by the European Central Bank, benefiting from a fall in oil prices around mid-year, followed by further dips. Core inflation (without energy and fresh foodstuff) stayed below target.

INTEREST RATES

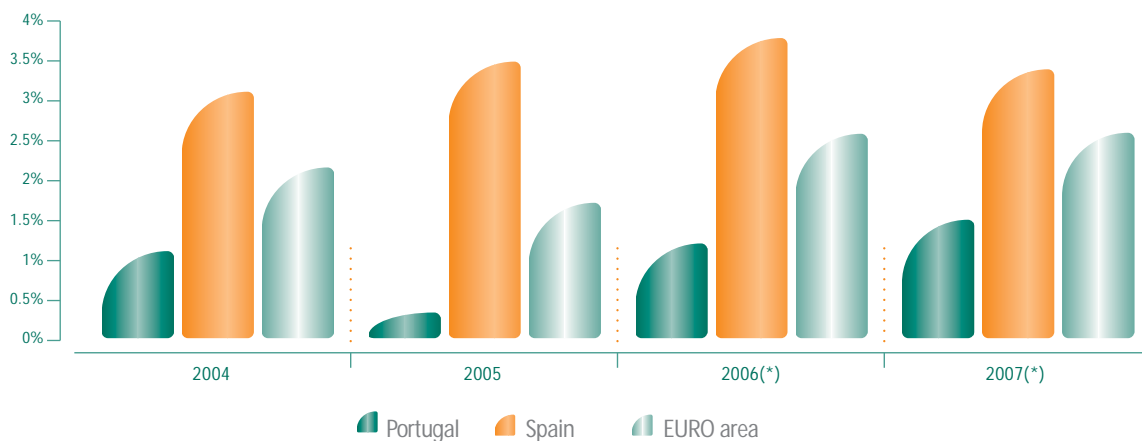




The ECB, however, raised its main rate – the repo rate – over the period, moving it from 2.25% in December 2005 to 3.5% a year later. Market consensus points to new rises until end-2007, since the ECB still sees a looming threat of higher inflation. The recovery in euro area economies gives the ECB some leeway to continue on this track. The bank will, however, have to keep a weather eye on the euro exchange rate, especially against the dollar and the yen: a really big rise in the euro will damage recovery prospects for Europe's economies by hitting competitiveness.

In terms of the Portuguese economy, the *Banco de Portugal* held to its forecast of a 1.2% growth in GDP for the year, though the estimate for 2007 was revised upwards. Prospects now look to be around 1.8%, as against the earlier figure of 1.5%.

GDP GROWTH



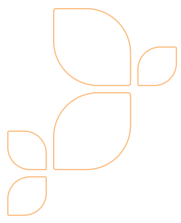
(*) European Commission forecasts, as quoted in the November 2006 *Banco de Portugal* economic framework

Exports provided a boost to the Portuguese economy, growing by 9.3% more than the previous year. The picture was therefore brighter than the recent past, where GDP expansion hinged solely on private consumption as investment withered. There was, however, no sign that investment would pick up in any clear and sustained fashion: indeed, it actually fell again.

Economic recovery in the country is still heavily weighed down by an array of structural imbalances. These must perforce be resolved, but the process is slow and the competitiveness of our economy on the international field is still hobbled. The recent surge in exports is encouraging, but it should not blind us to reality. And that reality, especially in respect of the country's traditional exports, has meant that growth was only achieved through a cut in company margins.

On another level, the need to correct budget imbalance makes it impossible to put off the rigorous measures required to contain expenditure on public administration. As a result, public consumption would seem to have dropped by 0.2% in 2006, with a more marked fall in investment (down 9%). In terms of public finances, the government's policy was to bring the budget deficit down to 4.6% of GDP by the end of 2006 and, with the help of an increase in receipts, this seems to have been done.

Private consumption came in with an increase in the region of 1.2%, in spite of the high level of household debt and the current trend towards a rise in the interest rate.



With the economy recovering slightly, unemployment fell from its 2005 fourth-quarter rate of 8% to 7.4% at the end of the third quarter of 2006. In the last quarter, however, according to figures published by the National Statistical Office, the figure was once again on the rise, coming in at 8.2%.

Inflation stood at around 3% at year-end, mainly on the back of energy-based products and a rise in some indirect taxes. The figure should come down to 2.3% for 2007.

The slightly higher growth projected for the economy in 2007 is based on an anticipated recovery in private investment, which could offset the negative variation in public investment. There is likely also to be bigger growth in private consumption, with disposable income on the rise, and exports should move up again and give another welcome fillip to GDP growth, though less than in 2006.

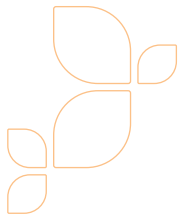
The estimate for economic growth in 2006 has been lifted, and the forecast for 2007 is higher, but this cannot mask the country's real divergence from the euro area, a process that set in and has continued since 2002.

With the marginally brighter picture, credit to non-financial companies grew more significantly, continuing the recovery that began in the second half of 2005. In the first eleven months of 2006, the year-on-year growth in aggregate credit came in at 6.5%, peaking at 8% in October, a figure somewhat higher than 2005, when most months came in at under 5% more, year-on-year. In fact, in mid-2005, the figure stood at a mere 2.6%.

These developments notwithstanding, credit to companies continued to fall in terms of total credit granted by domestic financial institutions. Credit to individuals recorded considerably higher year-on-year growth rates: for housing 9.9% and for consumption 10.4%, according to data supplied by the *Banco de Portugal* for November. The evolution shows a slight slowing in housing credit and a big push in consumer credit. This had been gathering momentum since July and places household indebtedness at around 120% of disposable income.

BANK CREDIT GROWTH RATES





The average level of interest rates was up significantly on previous years, above all the last three, which started with historically low ECB reference rates. Since the end of 2005 there has been an overall rise in most interest rates, above all in average rates for different kinds of credit.

Average interest rates for credit to companies rose 86 base points from December 2005 to November 2006 (from 4.45% to 5.27%), which does not completely reflect the interbank rates stemming from the ECB hike. This is for technical reasons, and also because competition between banks has led to a reduction in spreads. Housing credit has led to a fall over the last three years in the wake of cut-throat competition between institutions in a product seen as strategically important for most banks. The correction here was 98 base points (from 3.73% to 4.71%), rather less in personal credit (only up 73 base points, from 7.68% to 8.41%), though this also shows increasing competition in this area of the market.

Deposit rates for up to 2 years, on the other hand, only rose by 52 base points (from 2.06% to 2.58%).

Given this overall framework, Portuguese financial institutions moved positively during the year. Results and net worth were up, in both the financial and the complementary margin. To this can be added the gains in securities portfolios, with financial markets upbeat, especially shares (the Portuguese Stock Exchange was up 33% on the year and the Dow Jones Euro Stoxx up 20.3%). Some institutions are also reaping the rewards of operations abroad, in several cases by a significant amount.

Along with this growth in business, there has been a clear effort to rein in operating costs, especially in those banks where there has been a consolidation process after recent mergers and acquisitions. Also worth noting is the fact that banks have managed to keep their levels of overdue credit relatively under control, in spite of the unfavourable economic climate.

In the sector overall, the volume of credit granted outstrips customer deposits, with the country's banks taking on debt from abroad to an amount standing now at around 75 thousand million euros. The *Crédito Agrícola* is an exception to this panorama, with a net interbank credit balance (that is credit granted to other banks) coming in at over a thousand million euros.