

ACTIVITY REPORT 1997



Banco Comercial Português

ACTIVITY REPORT

ECONOMIC AND FINANCIAL SITUATION

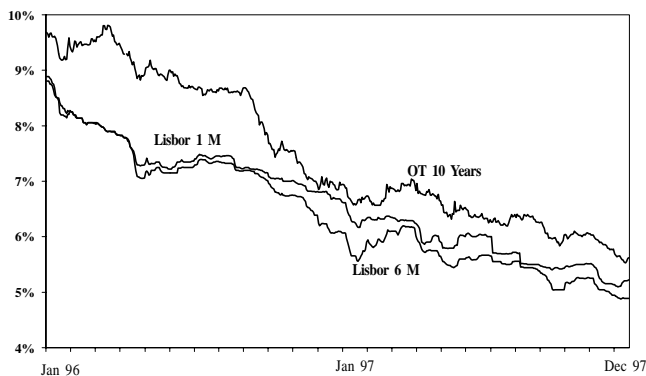
Inspired by the countdown to the 3rd phase of European Monetary Union, most European countries chose in 1997, as their main objective of macro-economic policy, to comply with the Maastricht criteria and adopt restrictive budgetary policies. The convergence process also led to inflation decreasing to historically low levels and the narrowing of the spreads between the Central Banks' intervention rates and long term yields down to levels compatible with the high likelihood of the adoption of the Euro by 11 countries on 1 January 1999.

The reduction of the Harmonised Consumer Price Index from 2.9% to 2% between December 1996 and 1997, lowering the gap vis-à-vis the three countries with lower inflation rates from 1.9 p.p. to 1.1 p.p., as well as the narrowing of the spread between Treasury Bonds yields and the Bunds (10 years) from 110 b.p. to 35 b.p., and the decrease in the budget deficit to 2.9% of GDP (3.2% in 1996) together with the decline in the Public Debt ratio to 62.5% in 1997 (65.6% in 1996), confirmed the eligibility of the country to participate in the EMU in 1999 according to the Maastricht Treaty convergence criteria.

Alongside complying with the nominal convergence and budgetary consolidation goals, economic activity grew at a strong pace in the first half of 1997, induced by investment in infrastructure and the recovery in equipment goods and in residential buildings investment, while private consumption and exports gained momentum in the second half. Accordingly, the GDP growth rate in Portugal (estimated at 3.8% in 1997) stood above the European Union average for the second consecutive year (1.2% in 1997 and 1.5% in 1996).

Corporate and individual loans were expected to have grown by 20% between the end of 1996 and the end of 1997, as a result of the strong impact of mortgage credit growth – and to a lesser extent, of consumer credit – as well as the increase in loans granted to the service and construction sectors. These trends reflect the favourable impact of the increase in the volume of real estate transactions, of investment growth in construction, of the improvement of retail sales and of service sector confidence levels as well as the downward trend in interest rates. Liquidity aggregates held by residents (including investment in financial instruments) are believed to have grown by 10% in 1997, while the channelling of savings from traditional deposits to capital market instruments was reinforced, due to the decrease of time deposit rates and the positive expectations for the prices of shares and fixed income bonds, which have led to the sustained growth of investment funds and the increasing attractiveness of investing in privatisations and IPOs.

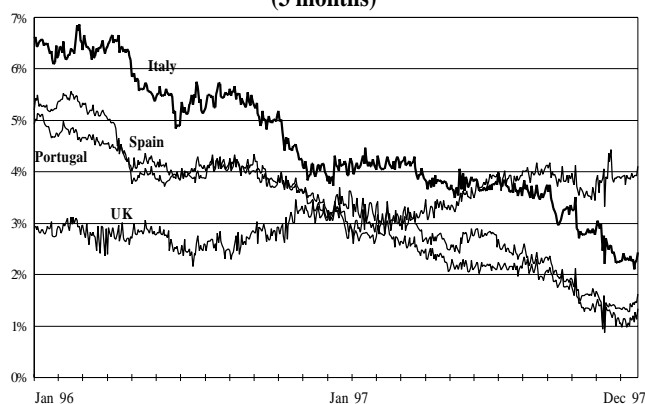
Interest Rates



During 1997, the Bank of Portugal cut its intervention rate on six occasions (from 6.7% in January to 5.3% in November), to conform with the convergence process of EMU Central Banks intervention rates. Those reductions were also prompted by exchange rate stability, by the downward trend in inflation, by wage moderation and by budget deficit consolidation. Banks' lending and deposits rates followed the downward trend of money market rates, displaying a decrease of 1-1.5 p.p. between the end of 1996 and 1997.

The short term interest rate spread of Portuguese money markets vis-à-vis German rates, which had declined from 5.5 pp in December, 1995, to 3.3 pp by the end of 1996, decreased to 1.4 pp in December, 1997, while the differential between the Portuguese and Spanish short term interest rates has been stable at 40 b.p. since August 1997. The exchange rate of the escudo against the DEM depreciated during 1997, rising from slightly below 100 to almost 102.2, in accordance with the expected bilateral conversion rate of 102.5 against the DEM in a Monetary Union scenario. This trend, along with dollar and sterling appreciation, brought about an average depreciation of the effective exchange rate of the escudo of 1.9% in 1997.

Interest Spreads vis-à-vis Germany
(3 months)



Banking sector profitability improved significantly in 1997, as a result of the favourable macroeconomic environment and the dynamism of capital markets. The high pace of credit growth, quality improvement in the loan portfolio, the recovery of previously written-off loans, the higher level of commission income, the rationalisation of operating costs and trading activity profits all contributed to the improvement in banking sector operating income.

Aside from the positive impact of the macroeconomic environment and the trend towards concentration of the financial conglomerates, the Portuguese financial market remained highly competitive: net interest margins resumed a downward trend, cross subsidisation increased and commissions have been reduced. These trends were concurrent with the emphasis given to market segmentation, value enhancement, marketing and promotion strategies, and with the emergence of new foreign and domestic competitors focusing in niche markets and the development of new distribution channels.

FINANCIAL PERFORMANCE

In priority order, BCP/Atlântico Group established its main financial objectives for 1997 as follows: to increase profitability indicators in the medium term; to take advantage of business growth opportunities with attractive levels of profitability; to protect net interest margins; to increase commissions and cross-selling; to improve efficiency and productivity gains through cost rationalization; to improve credit portfolio quality indicators and to improve risk provisioning policy.

Banco Comercial Português' consolidated net income amounted to PTE 36.135 billion in 1997, a 55.3% increase over the figure of PTE 23.268 billion for the previous year. This increase was mainly due to the combined impact of the following factors: substantial growth in lending; protection of net interest margin; insurance, asset management and leasing growth; increasing market share in those businesses; strong growth in capital markets commission fees; increase in the contribution of subsidiary companies to consolidated net income and increase in the shareholding in Banco Português do Atlântico and AF Investimentos; staff costs savings due to the reduction of the number of employees; reduction in administrative costs due to contracts renegotiation and implementation of cost reduction measures; and the sale of investments on non-strategic subsidiaries and real-estate assets.

Between 1996 and 1997, the net interest margin stabilised at 3.2%. Consequently, the 7.2% growth in the net interest income was mainly caused by the increase of the average balance in the loan portfolio – mortgage loans, consumer credit and service companies financing – partly offset by the effects of securities portfolio reduction. The interest margin preservation was helped by focused commercial activity, by the reduction of the relative weight of non-interest-earning assets due to the sale of non strategic assets, by the shift to fee based off balance sheet savings instruments, and by appropriate interest rate risk management in an interest rate reduction scenario.

In spite of net interest income growth and considerable changes in other income mix, the ratio of other income to total income remained almost unchanged (58.5% in 1997 against 58.7% in 1996). The good performance of financial services fees – arising from commissions from securities trading and credit cards, as well from cross-selling sales of insurance and asset management products – the good performance of trading profits, the increase of insurance premiums and the sale of 20% of Mundial Confiança's share capital, led to other operating income growth.

Operating costs stabilized in nominal terms, accounting for 49.7% of total income in 1997, compared with 53.0% in 1996; it is worth mentioning the small reduction of staff costs, the considerable decrease in advertising costs and equipment maintenance costs, as well as in expenses related to specialized services – in response to the centralisation of advertising space purchases and price negotiations with suppliers – and rents, benefitting from the savings of freed rented buildings. The improvement in efficiency indicators reflected the impact of the on-going rationalisation, centralisation and harmonisation processes in operational areas, based on ServiBanca.

The improvement in risk evaluation systems, granting and monitoring, the centralisation and rationalisation of mechanisms of credit control, collection and litigation, the change in loan portfolio mix – through increased weight of mortgage loans and large corporate loans – the favourable performance of the Portuguese economy, the recovery of some non-performing loans and the risk provision effort, led to an improvement of loan loss indicators of the BCP/Atlântico Group in 1997. Between 1996 and 1997 the proportion of non-performing loans more than 90 days overdue to total loans dropped from 3.7% to 2.3%, while the coverage of non-performing loans more than 90 days overdue by provisions went up from 103.6% to 129.7%.

The development of the main financial indicators shows that the BCP/Atlântico Group is still growing at a rate slightly above the sector average, increasing its market share in the most dynamic business areas. Between the end of 1996 and 1997, Loans and Advances to Customers and Customers' Funds (including Investment Funds and Unit Linked insurance) increased, respectively, by 22.6%

and 24.4%, totalling PTE 2,682 billion and PTE 5,670 billion. Notwithstanding the reinforcement of the stake in Banco Português do Atlântico's share capital and the increase in total assets and in off-balance sheet items weighted according to their risk resulting from business expansion, the estimated solvency ratio, on a consolidated basis according to Bank of Portugal rules stood at 9.3% in 1997 (9.7% in December 1996).

BCP shares secured their relevant status in the Lisbon Stock Exchange, with total share turnover increasing from PTE 70.6 billion to PTE 312.9 billion (corresponding to 95.3 million shares) between 1996 and 1997. In the foreign stock exchange markets where BCP is listed, the aggregate turnover amounted to 52.3 million shares. Between the end of 1996 and 1997, BCP's share price increased by 84.1%, which, added to a dividend yield of 3.4%, provided a total yield of 87.5%, out-performing the BVL index increase (65.2% in 1997) for the eighth year since 1987. As a result of the share price increase and the issuance of 19.320 million shares due to the conversion of subordinated loans and preference shares, the market capitalisation of BCP more than doubled, amounting to PTE 587 billion at the end of December 1997.

MOST SIGNIFICANT DEVELOPMENTS IN 1997

In light of the opportunities and challenges resulting from the restructuring of the Portuguese financial system and the financial objectives stated by the Group, the main activities of BCP/Atlântico Group in 1997 were developed according to the following guidelines: the restructuring and conversion of the traditional distribution networks; creation and promotion of innovative and efficient commercial platforms; integration of resource management, service providers and management and control units in ServiBanca; rationalisation and standardisation of operating and information systems; staff reduction; the concentration of strategic financial areas; divestment of real estate assets and non strategic financial holdings; consolidation of the leadership in financial and technological innovation and total capital strengthening.

Restructuring and expansion of the traditional distribution networks and promotion of innovative distribution platforms

- Completion of the restructuring programme of the Atlântico commercial platform, with 215 traditional branches being transformed into "Lojas Atlântico" in 1997.
- Opening of 56 "Lojas Expresso Atlântico".
- Selective expansion of the other commercial networks, particularly: opening of 9 branches of NovaRede and 6 BII branches, supported by the development of the new concept of "Loja BII".
- Design and launch of the "HomeBanco 7", the first internet homebanking service in Portugal, provided by Banco 7.
- Reshaping of the Internet sites of several networks and subsidiaries of the BCP/Atlântico Group.
- Restructuring of the Corporate Retail, Individual and Small Business networks of BCP, and of the Group's Private Banking operations.

Integration of resource management and service provider units and rationalisation of human and operative resources

- Increased intervention scope of ServiBanca, with the integration of several areas.
- Completion of the Group's common systems platform.
- Integration of the international business areas of BCP and Atlântico.
- Reduction of staff, mainly in Atlântico and through early retirements, totalling 651 employees in 1997.
- Signature of a new labour agreement with one of the Portuguese banking unions.

Concentration on strategic financial areas

- Reinforcement of the shareholding in Banco Português do Atlântico from 50,12% to 75,42%, through the acquisition of 27.5 million shares from Império, at PTE 2,800 per share.
- Acquisition by Leasefactor of 2 million shares of Macaulease, corresponding to 100% of its share capital.
- Acquisition of a 49.8% stake of AF Investimentos, from Eureka by the BCP/Atlântico Group, which now holds the total share capital of AF Investimentos.
- Acquisition of 27.5% of the share capital of BPA Vida from Mutuelle du Mans, with Seguros e Pensões now holding the total share capital of BPA Vida and Praemium.
- Launch of the Companhia de Seguros de Macau - Vida, an insurance company held by BCM and Seguros e Pensões.
- Sale of a 50% stake in Colombo (the largest shopping centre in Portugal) and of the financial holdings in SLAT (hotel developer) and Espaço Atlântico (the training and education institute), together with 440 other real estate assets.
- Sale of 9.7 million shares of Mundial Confiança, corresponding to 19.96% of its share capital.

Capital market operations

- Participation of Banco Cif in the following privatisation operations: joint leader in the Public Offer and National Direct Sale syndicates and co-manager in the Continental Europe and Rest of the World offering of the first phase of the EDP privatisation and third phase of the Portugal Telecom privatisation; global co-ordinator and joint leader of the first phase of the Brisa-Autoestradas de Portugal, SA privatisation.
- Participation of Banco Cif in the following capital markets operations (among many others): organisation and leadership of the euro-fungible bond issue of the European Investment Bank (PTE 20 billion); leadership of the first Portuguese Treasury bond-stripping programme (PTE 12.5 billion); joint leadership in the offer of Central Hispano Eurocapital preferred shares and participation in the offer of Repsol preferred shares.

Total capital increase

- Share capital increase from PTE 136.686 billion to PTE 150 billion through the issue of 13,314,000 new shares, resulting from the full exercise of the conversion rights associated with the convertible loan issued by BCP Bank & Trust Company (Cayman), in April 1992.
- Share capital increase from PTE 150 billion to PTE 156.006 billion, corresponding to the issue of 6,006,351 new shares, resulting from the conversion of part of the convertible preferred shares issued by BCP International Bank in July 1996.

FINANCIAL HIGHLIGHTS

	1997	1997	1996	Change
	(ECU million)	(PTE million)		
Total Assets	29,225	5,907,248	5,467,861	8.0%
Loans and Advances to Customers	13,269	2,682,008	2,186,867	22.6%
Customers' Funds	28,049	5,669,503	4,556,039	24.4%
Own Funds	2,188	442,309	450,496	-1.8%
Interest Income	1,882	380,369	424,275	-10.3%
Interest Expense	1,168	236,108	289,758	-18.5%
Net Interest Income	714	144,261	134,517	7.2%
Other Income ⁽¹⁾	1,479	298,895	263,455	13.5%
Other Costs ⁽²⁾	1,681	339,728	318,352	6.7%
Net Income Attributable to the Bank	179	36,135	23,268	55.3%
Solvency Ratio ⁽³⁾		9.3%	9.7%	
Return on Total Assets (ROA)		0.6%	0.4%	
ROA before Minority Interests		1.1%	0.9%	
Return on Shareholders' Equity (ROE)		17.7%	12.0%	
Non-Performing Loans (NPL) more than 90 days overdue / Total Loans		2.3%	3.7%	
Provisions for Loan Losses / Total NPL		116.1%	95.6%	
Provisions for Loan Losses / Total NPL more than 90 days overdue		129.7%	103.6%	
Market Capitalisation (Year-end)	2,905	587,208	279,523	110.1%
Earning per share (EPS)	1.2	248.5	184.9	34.4%
Market Price per share				
Maximum	19.9	4,015	2,412	
Minimum	10.1	2,033	1,700	
Year-end	18.6	3,764	2,045	
Price/Earnings Ratio (PER)		15.1	11.1	
Price/Cash-Flow Ratio (PCF)		2.5	1.4	
Number of Branches in Portugal				
BCP		404	394	3%
BCP/Atlântico Group		742	692	7%
Number of Employees				
BCP		4,386	4,260	3%
BCP/Atlântico Group		10,913	11,163	-2%

(ECU exchange rate: 202.128 Escudos as at December 31, 1997)

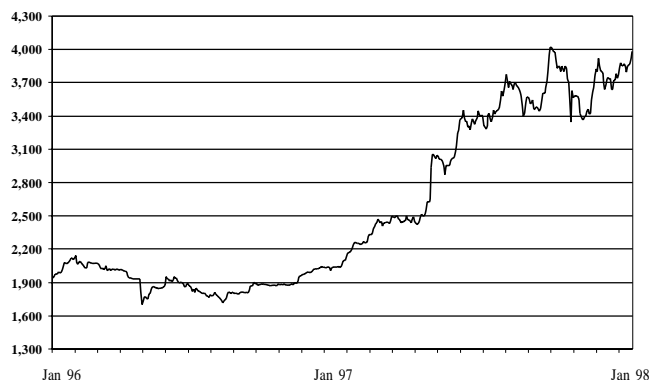
Per shares figures in PTE/ECU

⁽¹⁾ Net of trading losses

⁽²⁾ Excluding trading losses

⁽³⁾ Estimate for 1997

BCP Share Price



**CONSOLIDATED BALANCE SHEET
AS AT DECEMBER 31, 1997 AND 1996**

ASSETS	1997	1997	1996
	(ECU thousand)	(PTE thousand)	
Cash and deposits at the			
Bank of Portugal	436,711	88,271,466	70,462,514
Loans and advances to credit institutions			
Repayable on demand	511,723	103,433,588	60,482,432
Other loans and advances	5,371,984	1,085,828,344	1,214,817,710
Loans and advances to customers	13,268,859	2,682,007,891	2,186,866,927
Securities	5,758,483	1,163,950,566	1,257,584,302
Investments	491,101	99,265,199	107,630,461
Intangible assets	616,554	124,622,816	146,363,096
Tangible assets	949,732	191,967,419	177,630,622
Other debtors	593,829	120,029,540	96,267,200
Prepayments and accrued income	1,226,306	247,870,772	149,755,754
Total Assets	29,225,282	5,907,247,601	5,467,861,018
LIABILITIES			
Amounts owed to credit institutions			
Repayable on demand	380,578	76,925,501	67,484,702
With agreed maturity date	6,074,294	1,227,784,872	1,255,536,603
Amounts owed to customers			
Repayable on demand	5,709,066	1,153,962,003	908,184,315
With agreed maturity date	9,598,667	1,940,159,422	1,965,558,213
Debt securities	1,073,271	216,938,111	188,663,777
Other liabilities	722,824	146,102,949	92,950,307
Accruals and deferred income	1,085,820	219,474,598	117,978,718
Provision for liabilities and charges	1,967,172	397,620,442	317,711,451
Subordinated debt	795,697	160,832,734	137,664,297
Total Liabilities	27,407,389	5,539,800,632	5,051,732,383
SHAREHOLDERS' EQUITY			
Share capital	771,820	156,006,351	136,686,000
Share premium	197,444	39,909,041	23,281,261
Reserves and retained earnings	(180,138)	(36,410,843)	35,653,684
Treasury stock	(746)	(150,871)	-
Total Shareholders' Equity	788,380	159,353,678	195,620,945
Minority interests in subsidiaries	425,328	85,970,679	103,297,016
Minority interests in preference shares	604,185	122,122,612	117,210,674
	1,029,513	208,093,291	220,507,690
Total Liabilities, Shareholders' Equity and Minority Interests	29,225,282	5,907,247,601	5,467,861,018

**CONSOLIDATED STATEMENT OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 1997 AND 1996**

	1997	1997	1996
	(ECU thousand)	(PTE thousand)	
Interests income	1,881,822	380,368,838	424,275,108
Interests expense	1,168,112	236,108,203	289,758,380
Net interest income	713,710	144,260,635	134,516,728
Provision for loan losses	129,055	26,085,561	28,755,011
Net interest income after provision for loan losses	584,655	118,175,074	105,761,717
Other operating income			
Income from securities	60,809	12,291,249	6,777,104
Commissions	264,930	53,549,819	38,921,283
Profit arising from trading activity	755,421	152,691,782	107,271,613
Insurance premiums	733,558	148,272,542	127,842,897
Other income	139,823	28,262,068	33,427,187
Gains on sale of shares of subsidiaries and associated companies	71,941	14,541,384	1,316,634
	2,026,482	409,608,844	315,556,718
Other operating expenses			
Commissions	47,435	9,587,852	9,597,091
Losses arising from trading activity	547,740	110,713,666	52,102,150
Staff costs	435,502	88,027,076	88,318,309
Other administrative costs	284,383	57,481,780	56,290,663
Depreciation	135,544	27,397,295	28,042,450
Other provisions	426,640	86,235,794	74,499,575
Claims incurred in the insurance activity	283,770	57,357,891	48,924,786
Other expenses	67,484	13,640,214	12,679,425
	2,228,498	450,441,568	370,454,449
Income before income taxes	382,639	77,342,350	50,863,986
Income taxes	76,819	15,527,227	6,106,282
Net income	305,820	61,815,123	44,757,704
Minority interests	127,051	25,680,477	21,489,647
Net income for the year attributable to the Bank	178,769	36,134,646	23,268,057

(ECU exchange rate: 202.128 Escudos as at December 31, 1997)