

Material Third Countries for the Portuguese Banking System

28 June 2019



Pursuant to a decision of the Board of Directors of Banco de Portugal of 25 June 2019, the updated list of material third countries for the Portuguese banking system, valid until the second quarter of 2020, includes the Republic of Angola, the Republic of Mozambique and Macao Special Administrative Region of the People's Republic of China.

According to Recommendation ESRB/2015/1 of the European Systemic Risk Board (ESRB), Banco de Portugal should identify, on an annual basis, the third countries to which the Portuguese banking system is materially exposed and monitor the risks stemming from excessive credit growth in those countries.¹ This note summarises the main results of the 2019 identification exercise, based on supervisory data with reference date of 31 December 2018, and presents the updated list of material third countries for the Portuguese banking system.²

In line with Decision ESRB/2015/3, the identification methodology adopted by Banco de Portugal focuses on the evolution of three indicators – risk-weighted exposures, original exposures and defaulted exposures as a percentage of the respective total exposure amount –, and on the criteria that guide the revision of the list of material third countries. On one hand, a third country is identified as material if at least one of the three indicators is equal to or higher than 1% in each of the last two quarters and on average in the eight quarters preceding the reference date. On the other hand, a third country is dropped from the list if all the three indicators are lower than 1% in each of the last two quarters and on average in the twelve quarters preceding the reference date.

The list of material third countries for the Portuguese banking system remains unchanged in 2019, vis-à-vis 2018, comprising Angola, Macao and Mozambique. This decision of Banco de Portugal is in force until the second quarter of 2020, and results simultaneously from the fact that (i) no other third country meets the entry criteria and (ii) the above-mentioned three countries do not comply with the exit thresholds.³

In the fourth quarter of 2018, the developments observed in the three metrics for exposures in third countries were in line with what was observed in the identification exercise conducted in 2018. The relative total exposure of the Portuguese banking system to third countries decreased (year-on-year) in terms of risk-weighted exposures and original exposures, respectively by -1.23 percentage points (p.p.) to 5.55% and -0.50 p.p. to 4.90%, whereas relative total defaulted exposures slightly increased by 0.10 p.p. to 6.28%, over the same period (Chart 1, Panel (a)).

Considering the relative exposures to each material third country, in the fourth quarter of 2018, risk-weighted exposures contracted (year-on-year) more significantly in Angola (-0.50 p.p.) than in Macao and Mozambique (around -0.20 p.p. for each country), whereas the fall in original exposures was relatively balanced across the identified countries, ranging from -0.15 p.p., for Angola, to -0.05 p.p., for Macao (Chart 1, Panels (b), (c), (d)). In contrast, developments in relative defaulted exposures were not homogeneous across these countries, remaining virtually unchanged in Angola and Macao, and increasing by 0.39 p.p. in Mozambique, over the same period. Furthermore, exposures in default of Portuguese resident

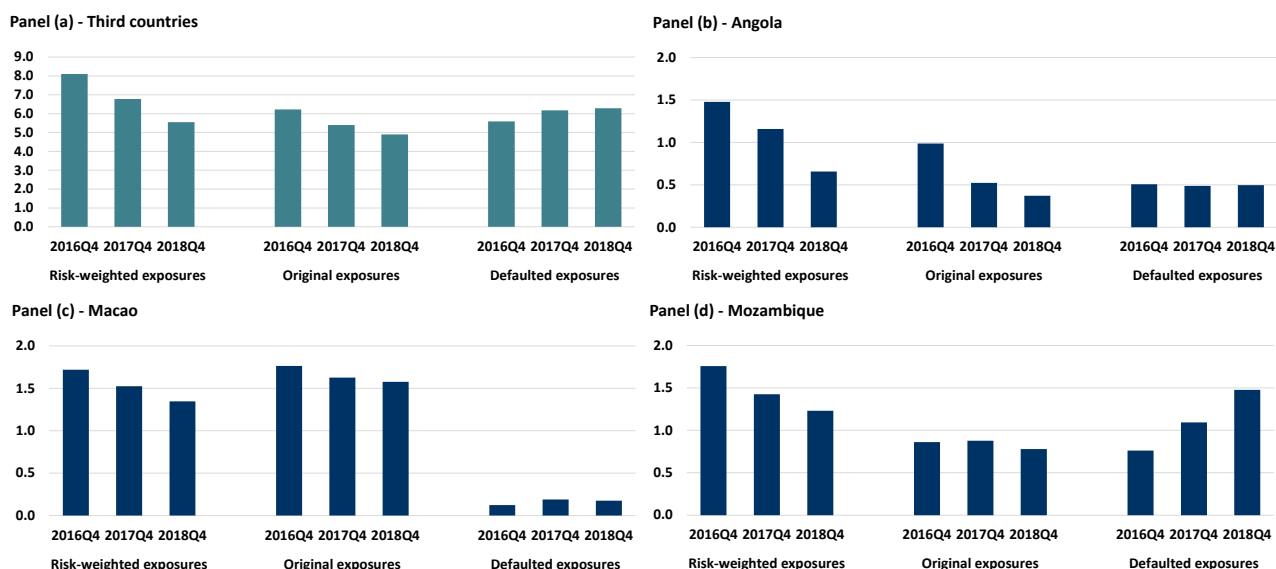
1 A third country is any jurisdiction outside the European Economic Area. The European Economic Area includes the European Union Member States, Iceland, Liechtenstein and Norway.

2 The identification of material third countries for the Portuguese banking system follows the methodology described in https://www.bportugal.pt/sites/default/files/anexos/documentos-relacionados/institution_specific_countersyclical_capital_buffer.pdf.

3 See https://www.bportugal.pt/sites/default/files/anexos/documentos-relacionados/list_of_material_third_countries.pdf for details on the initial list of material third countries for the Portuguese banking system.

banks to Mozambique decreased less intensely than those to all countries, reflecting the deterioration of the economic conditions in this country initiated in 2016.

Chart 1 · Amount of relevant credit exposures in (identified material) third countries in relation to the total amount of relevant credit exposures | in percentage.



Sources: COREP and Banco de Portugal calculations. | **Notes:** (a) The assessment is based on data available up to 10 May 2019. (b) The relevant credit exposures comprise exposures to the private non-financial sector in the banking and trading books of credit institutions subject to own funds requirements associated with credit risk, counterparty risk and free deliveries.

According to the quantitative criteria defined to exclude a country from the list of material third countries, Angola has become a borderline case, as the relative risk-weighted exposures have gone below the 1% threshold throughout 2018. Nonetheless, and despite the fact that relative exposures, regardless of the metric used, are no longer above the established limit in each quarter of 2018 (Table 1), Angola remains in the list of material third countries because the twelve-quarter average of relative risk-weighted exposures is 1.21%.

Moreover, although relative exposures, in terms of risk-weighted and original exposures, have also been decreasing for Macao and Mozambique, these two countries are not considered a borderline case, for the time being, maintaining their position in the list of identified material countries. In fact, the relative exposures were above the 1% threshold over 2018 for two of the three metrics analysed.

Table 1 · Exit criteria for the list of identified material third countries | In percentage of the total amount of relevant credit exposures.

Third countries	Risk-weighted exposures					Original exposures					Defaulted exposures				
	2018				Average over the last 12 quarters	2018				Average over the last 12 quarters	2018				Average over the last 12 quarters
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
Angola	0.82	0.75	0.76	0.66	1.21	0.41	0.40	0.40	0.37	0.76	0.41	0.41	0.40	0.50	0.43
Macao	1.27	1.34	1.38	1.35	1.54	1.47	1.55	1.55	1.58	1.59	0.15	0.13	0.15	0.18	0.12
Mozambique	1.36	1.20	1.24	1.23	1.55	0.78	0.75	0.75	0.78	0.88	1.00	1.14	1.23	1.48	0.88

Sources: COREP and Banco de Portugal calculations. | **Notes:** (a) Based on COREP data with reference date of 31 December 2018. The assessment is based on data available up to 10 May 2019. (b) The relevant credit exposures comprise exposures to the private non-financial sector in the banking and trading books of credit institutions subject to own funds requirements associated with credit risk, counterparty risk and free deliveries. (c) Cells in light blue stand for relative exposures below 1%. (d) The number of institutions included in each identification exercise may change across quarters.

None of the third countries identified as material for the Portuguese banking system is monitored by the ESRB and, therefore, Banco de Portugal will monitor the cyclical systemic risk in all the third countries deemed as material using the set of macroeconomic and financial indicators described in the methodology.⁴ Banco de Portugal will only disclose its risk assessment if there is the need to take a decision on the countercyclical buffer rate applicable to exposures to a country included in the list of material third countries.⁵

This list shall be updated annually on the basis of the criteria established to guide the entry/exit of countries into/from the list. The tentative date for the next release of the list of material third countries for the Portuguese banking system is 30 June 2020.

⁴ According to Decision ESRB/2015/3, the current list of material third countries for the Union's banking system, as adopted by the ESRB on 8 June 2018, includes Brazil, China, Hong Kong, Russia, Singapore, Switzerland, Turkey, and United States of America. The cyclical systemic risk in these countries is, therefore, directly monitored by the ESRB.

⁵ Decisions cover the recognition of a countercyclical buffer measure implemented by a third country authority or the setting of the countercyclical buffer rate for exposures to a third country.