

Pursuant to a decision of the Board of Directors of the Banco de Portugal of 16 June 2020, the updated list of third countries to which the Portuguese banking system is exposed for the purposes of recognising and setting the countercyclical capital buffer (CCyB) rates for third countries, valid until the second quarter of 2021, includes the Federative Republic of Brazil, 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), the Banco de Portugal should identify, on an annual basis, the third countries to which the Portuguese banking system is materially and directly exposed for the purposes of recognising and setting the CCyB rates for exposures to those countries and monitor the risks stemming from excessive credit growth in those countries (Recommendation B).¹ The CCyB is a macroprudential instrument that was designed with the aim of increasing resilience of the banking sector against system-wide cyclical risks from excessive credit growth. This note summarises the main results of the 2020 identification exercise, based on supervisory data with reference date of 31 December 2019, and presents the updated list of material third countries.²

In line with Decision ESRB/2015/3, the identification methodology adopted by the Banco de Portugal focuses on: (i) the evolution of three indicators – risk-weighted exposures, original exposures and defaulted exposures as a percentage of the respective total exposure amount; and (ii) the criteria that guide the revision of the list of material third countries. Indicators include only direct (risk-weighted, original and defaulted) exposures of the Portuguese banking system to the private non-financial sector in third countries, such as exposures to corporates and retail or exposures secured by mortgages on immovable property. This means that they do not comprise direct exposures to public sector entities or financial institutions. Moreover, exposures of the Portuguese banking system via credit granted to Portuguese non-financial corporations whose activity is, to some extent, dependent on third countries were also excluded from this analysis.

As for the criteria on the identification of material third countries, 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. Exit criteria were designed to be more conservative than entry criteria. A third country can only be removed from the list if the average of exposures to that country is less than 1% in the previous 12 quarters preceding the reference date for the three indicators at the same time. This means that designated authorities should observe a sustained decrease in exposures' materiality (less than 1% of total exposures) for a long period of time (three years) for all metrics considered.

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.

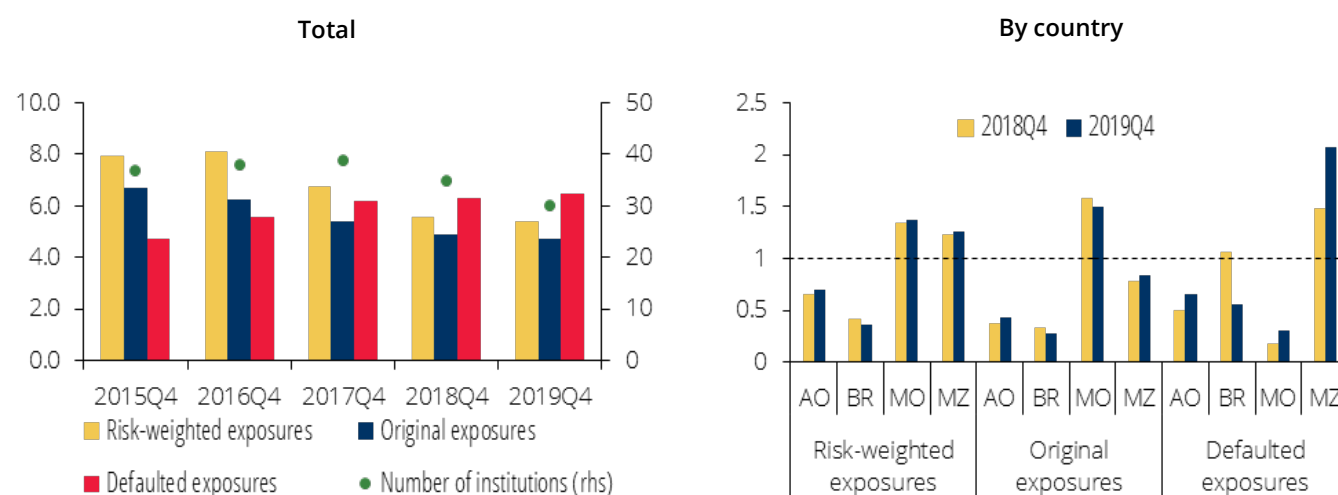
² The identification of material third countries follows the methodology described in https://www.bportugal.pt/sites/default/files/anexos/documentos-relacionados/institution_specific_countercyclical_capital_buffer.pdf.

Following the assessment, the list of material third countries for the Portuguese banking system has been altered in 2020, vis-à-vis 2019, now comprising Brazil, Macao and Mozambique. This decision of the Banco de Portugal is in force until the second quarter of 2021. Angola, a borderline case in the 2019 exercise, is no longer considered a material third country in 2020 for the purpose of recognising and setting CCyB rates for exposures to third countries. Nonetheless, the Banco de Portugal will continue monitoring developments associated to this country in what other sources of risk are concerned, since there are other types of exposures that renders this country relevant for the Portuguese banking system. Brazil, on the other hand, has been included in the list for the first time.

In the last quarter of 2019, the relative total exposure of the Portuguese banking system to third countries followed the trend that has been observed in recent years (Chart 1, left panel). Relative risk-weighted and original exposures decreased, year-on-year, by 0.15 percentage points (p.p.) to 5.39% and 0.20 p.p. to 4.70%, respectively. Conversely, relative defaulted exposures increased by 0.18 p.p. to 6.47%, over the same period. The number of Portuguese resident institutions reporting exposures to third countries continued to decline, reaching the value of 30 in the fourth quarter of 2019, down from 35 in the same period of the previous year.

In terms of exposures to third countries currently and formerly recognized as material for the Portuguese banking system, in the last quarter of 2019, relative risk-weighted exposures have slightly increased (year-on-year) in Macao and Mozambique (around 0.03 p.p. each) to 1.38% and 1.26%, respectively, whereas in Brazil the same indicator contracted by 0.06 p.p. to 0.36% (Chart 1, right panel). Considering relative original exposures, Mozambique has recorded a yearly increase of 0.05 p.p. to 0.42%, while Brazil and Macao registered decreases of 0.05 p.p. to 0.28% and 0.07 to 1.50%, correspondingly. Regarding relative defaulted exposures, Macao witnessed a yearly increase of 0.60 p.p. to 2.08% while in Brazil this metric decreased by 0.50 p.p. to 0.56%. In Mozambique, relative defaulted exposures increased by 0.13 p.p. to 0.31%, over the same period. In Angola, relative risk-weighted exposures and relative original exposures have registered small yearly increases of 0.04 p.p. and 0.05 p.p., to 0.70% and 0.83% in the fourth quarter of 2019, while relative defaulted exposures increased by 0.16 p.p. to 0.65%, in the same period. All the metrics continued to report figures well below the threshold of 1% for this country.

Chart 1 • Amount of relevant credit exposures in third countries in relation to the total amount of relevant credit exposures: total and by relevant third countries | In percentage



Sources: COREP and Banco de Portugal calculations. | **Notes:** (a) Based on COREP data with reference date of 31 December 2019. The assessment is based on data available up to 7 May 2020. (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) "Number of institutions" refers to institutions that report exposures to third countries. (d) Country codes: AO – Angola; BR – Brazil; MO – Macao; MZ – Mozambique

In the previous identification exercise, Angola remained in the list of material third countries as it did not meet the exit requirements at the time, but was already flagged as a borderline case. In the current identification exercise, the sustained decrease of the Portuguese banking sector relative exposures to the Angolan private non-financial sector in recent years has been accounted for by the exit criteria. This is reflected in the relative exposures of resident institutions to the Angolan private non-financial sector that have recorded figures below the threshold of 1% for the 12-quarter average, as well as for the observations in each of the two quarters before the reference date, in the three metrics considered (Table 1). Therefore, Angola was dropped from the list of material third countries for the purposes of recognising and setting the CCyB rates for exposures to third countries by virtue of having met the exit criteria. Despite this decision, the Banco de Portugal will continue to closely follow developments in and related to this country with respect to other sources of risk, as the Portuguese banking system has other types of exposures to Angola that are not covered by this assessment exercise.

In reverse, Brazil, considered a borderline case in the 2019 exercise, now meets the entry requirements as each of the observations in the two quarters before the reference date and the 8-quarter average of the relative defaulted exposures registered figures only slightly above the threshold of 1% of total defaulted exposures. As such, Brazil is identified as a material third country for the Portuguese banking system, integrating the list of material third countries for the first time since the identification exercise was conducted.

Macao and Mozambique remain on the list of material third countries for the Portuguese banking system given that exit criteria are not met.

Table 1 • Entry and exit criteria for the list of relevant material third countries | In percentage of the total amount of relevant credit exposures

Third Countries	Risk-weighted exposures					Original exposures					Defaulted exposures				
	2019			Average over the last 8 quarters	Average over the last 12 quarters	2019			Average over the last 8 quarters	Average over the last 12 quarters	2019			Average over the last 8 quarters	Average over the last 12 quarters
	Q2	Q3	Q4			Q2	Q3	Q4			Q2	Q3	Q4		
Angola	0.83	0.71	0.70	-	0.93	0.44	0.42	0.42	-	0.49	0.68	0.60	0.65	-	0.49
Brazil	0.36	0.34	0.36	0.47	-	0.32	0.31	0.28	0.37	-	1.00	1.01	0.56	1.05	-
Macao	1.18	1.21	1.38	-	1.42	1.50	1.52	1.50	-	1.60	0.22	0.24	0.31	-	0.17
Mozambique	1.29	1.28	1.26	-	1.41	0.79	0.81	0.83	-	0.82	1.54	1.73	2.08	-	1.23

Source: COREP (Banco de Portugal calculations). | **Notes:** (a) Based on COREP data with reference date of 31 December 2019. The assessment is based on data available up to 7 May 2020. (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 grey represent relative exposures above 1% for individual third countries. (d) The number of institutions included in each identification exercise may change across quarters.

Of the three third countries identified as material for the Portuguese banking system, only Brazil is monitored by the ESRB, by having been identified as material for the banking system of the European Union as a whole.³ Nevertheless, the Banco de Portugal will monitor the cyclical systemic risk of all three identified material third countries, using the set of macroeconomic and financial indicators described in the methodology adopted by the Banco de Portugal. The 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.⁴

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 2021.

³ 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 25 June 2019, 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.

⁴ 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.