

COUNTERCYCLICAL CAPITAL BUFFER



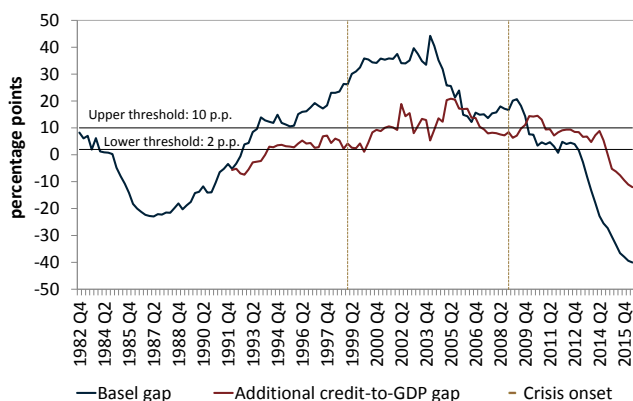
BANCO DE PORTUGAL
EUROSYSTEM

30 December 2016

Pursuant to a decision of the Board of Directors, the countercyclical buffer rate for credit exposures to the domestic private non-financial sector will remain at 0 per cent of the total risk exposure amount, with effect from 1 January 2017.

This decision is based on the overall assessment of a set of financial and macroeconomic indicators¹:

Chart 1 – Basel gap and additional credit-to-GDP gap²

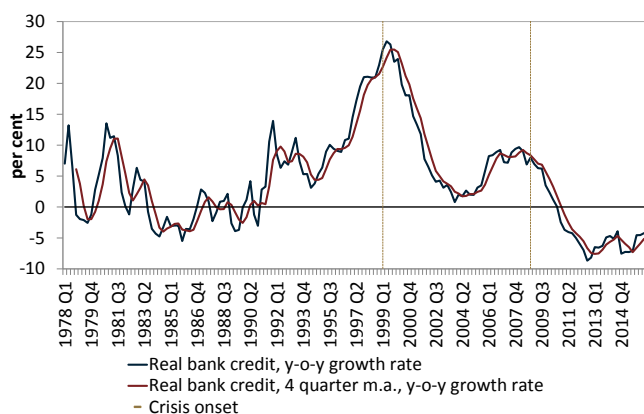


Sources: BdP, INE and BdP's calculations. Last observation: 2016 Q2.

Gap measures remain negative

At the end of the second quarter of 2016, the Basel gap was -40.1 p.p., while the gap measure developed by Banco de Portugal was -12.1 p.p., both widening in comparison with the previous quarter (see Chart 1). As such, the two measures of the credit cycle are below the 2 p.p. threshold which would trigger a positive benchmark buffer rate as implied by the BCBS methodology. The quarterly change in the two gaps reflected both the reduction in the outstanding amount of total credit to the private non-financial sector and the increase in nominal GDP. Hence, there is no evidence of a sustained reversion of the credit cycle justifying a change in the current macroprudential policy stance.

Chart 2 – Real bank credit growth³



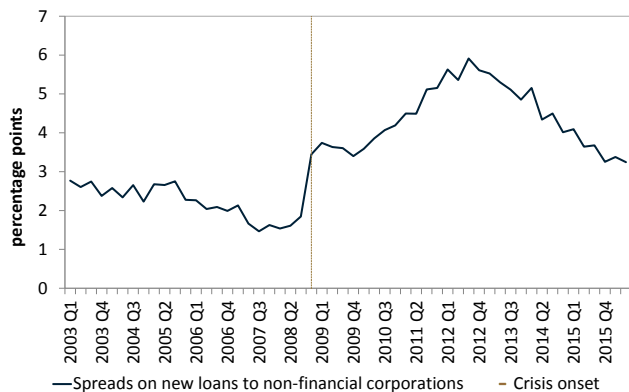
Sources: BdP, INE and BdP's calculations. Last observation: 2016 Q2.

Credit is recovering, but slowly

Other indicators³ of credit to the private non-financial sector also support the maintenance of the current policy stance. Although both the year-on-year growth rate of real bank credit and the ratio between the one year difference in bank credit and the five year moving average of GDP have been increasing in recent quarters, they remained negative, providing no signals of excessive credit. In particular, the year-on-year growth rate of real bank credit stood at -4.2 per cent in the second quarter of 2016, which represents an increase of 0.4 p.p. from the previous quarter (see Chart 2).

According to the Banco de Portugal's October 2016 Economic Bulletin, although new lending for house purchase has increased during the first half of 2016, early repayments of mortgages have also been substantial, possibly driven by the low level of interest rates, implying that the stock of credit

Chart 3 – Spreads on new loans granted to non-financial corporations⁴



Sources: BdP, Reuters and BdP's calculations. Last observation: 2016 Q2.

for house purchase is still declining. Moreover, the rise in housing prices observed over the last two years seems to be broadly in line with fundamentals and not to have been fuelled by the recovery in new lending for house purchase. In fact, house prices seem to have evolved in tandem with an increase in households' real disposable income, against the background of a significant reduction in unemployment. However, in some specific regions, it cannot be excluded the existence of pressures for real estate price appreciation above fundamentals. There is some anecdotal evidence supporting the view that this appreciation is triggered, at least in part, by demand from abroad and, consequently, that it is not directly related with developments in the domestic mortgage market. The stock of loans for consumption purposes, as detailed in the Banco de Portugal's November 2016 Financial Stability Report, has maintained an increasing trend during the first half of 2016, but it accounts for only a minor share of banks' loan portfolios and there is evidence that new credit is mainly flowing to less indebted individuals.

Spreads remain stable

In what regards bank lending conditions, spreads on new lending to non-financial corporations slightly decreased in the second quarter of 2016 as compared to the previous quarter, from 3.4 p.p. to 3.2 p.p., but are still above the pre-crisis minimum (see Chart 3). Furthermore, the major banks reported, in the October 2016 Bank Lending Survey, no narrowing of spreads for high risk loans to non-financial corporations and that they do not expect major changes in the credit standards applied to both non-financial corporations and households. As such, overall bank's credit conditions are

likely to remain conservative in line with the ongoing recovery of the financial system.

Debt-service-to-income ratio continues to improve

The ability of the private non-financial sector to service the debt continues to improve. The year-on-year growth rate of the debt-service-to-income ratio was -5.9 per cent in the first quarter of 2016, which compares with -6.3 per cent in the last quarter of 2015. According to the Banco de Portugal's October 2016 Economic Bulletin, this has been driven by the sustained low level of interest rates, the increase in disposable income and the decrease in the level of indebtedness of the private non-financial sector in the last two years. The decreasing path of the ratio is expected to continue in the coming quarters as the current accommodative monetary policy stance is not foreseen to change in the short-run and no major changes are expected in the demand for loans by non-financial corporations and households. Therefore, this indicator does not flag the reinforcement of macro-financial imbalances.

Current account is hovering at 0 per cent

The current account balance as a percentage of GDP is hovering at 0 per cent since the beginning of 2014 and in the second quarter of 2016 stood at -0.4 per cent. This indicates that the modest recovery in credit flows, particularly for consumption purposes and house purchase, which is accompanied by a still negative pace of growth in the stock of credit, is not being sustained by resources borrowed from abroad.

General assessment

Despite of the improvements in macro-financial conditions in Portugal over the last quarters, cyclical systemic risk remains contained. None of the indicators provides evidence of emerging imbalances in the financial system driven by credit growth. As a result, the countercyclical buffer rate is maintained at 0 per cent during the first quarter of 2017.

Notes

- 1 The assessment is based on available data up to 20 October 2016. Any differences in figures from previous assessments are due to revisions in underlying data. The set of indicators covers the six categories set out in Recommendation ESRB/2014/1.
- 2 Credit to the domestic private non-financial sector, comprising all lending (loans and debt securities) extended by domestic and foreign banks, non-banks and debt markets. The credit-to-GDP ratio is computed using a four-quarter moving sum of nominal GDP. Credit is obtained from National Financial Accounts Statistics published by BdP and nominal GDP from National Accounts (ESA2010, base 2011) published by INE.
The credit-to-GDP gap is calculated as the percentage point difference between the observed credit-to-GDP ratio and its long-term trend, where the trend is estimated employing a one-sided HP filter with a smoothing parameter set to 400,000.
The additional credit-to-GDP gap is computed as the percentage point difference between the observed credit-to-GDP ratio augmented with ARIMA(p,1,0) forecasts, using a maximum forecast horizon of 28 quarters, and its long-term trend, where the trend is estimated employing a one-sided HP filter with a smoothing parameter set to 400,000. Until the first quarter of 2015, the optimal lag order (p) of the forecasting model is recursively determined. From the second quarter of 2015 onwards, p is set to three quarters, which is the optimal lag length when data until the first quarter of 2015 is used.
In case the gap exceeds 2 p.p., the benchmark buffer rate will increase linearly from 0 per cent to the upper threshold of 2.5 per cent of the total risk exposure amount, which is associated with a gap of 10 p.p.. See Recommendation ESRB/2014/1 Annex Part II available at http://www.esrb.europa.eu/pub/pdf/recommendations/2014/140630_ESRB_Recommendation.en.pdf?03a7c5c908620b34673b6f290b54c13d.
BCBS thresholds of 2 p.p. and 10 p.p. were determined using the Basel gap. Nevertheless, they are used as an approximation to map the additional credit-to-GDP gap into a benchmark buffer rate.
Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.
- 3 Credit includes loans granted to the domestic private non-financial sector and debt securities issued by the domestic private non-financial sector. Bank credit extended by resident monetary financial institutions as available in Monetary and Financial Statistics published by BdP. The credit variable is adjusted for inflation using the consumer price index (2012=100) published by INE.
- 4 Average of spreads weighted by the corresponding outstanding loan amounts at the end of the quarter. Spread is calculated against the three month Euribor rate as available in Reuters. Only interest rates on new loans granted by other monetary financial institutions to residents with initial rate fixation up to one year are considered. Interest rates on new loans as available in Monetary and Financial Statistics published by BdP.

Abbreviations

ARIMA	Autoregressive Integrated Moving Average
BCBS	Basel Committee on Banking Supervision
BdP	Banco de Portugal
BIS	Bank for International Settlements
ESA	European System of Accounts
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
GDP	Gross domestic product
HP	Hodrick and Prescott
INE	<i>Instituto Nacional de Estatística</i> (Statistics Portugal)
m.a.	Moving average
p.p.	Percentage points