

# COUNTERCYCLICAL CAPITAL BUFFER



BANCO DE PORTUGAL  
EUROSYSTEM

29 December 2017

Pursuant to a decision of the Board of Directors of 21 December 2017, the countercyclical buffer rate for credit exposures to the domestic private non-financial sector will remain at zero per cent of the total risk exposure amount, with effect from 1 January 2018.

This decision is based on the overall assessment of a set of financial and macroeconomic indicators:<sup>1</sup>

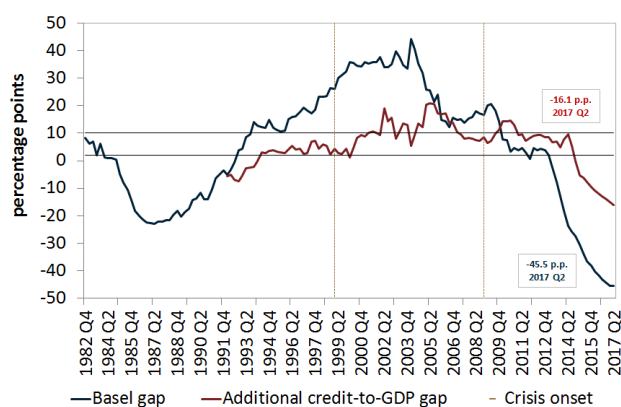
In the second quarter of 2017, credit-to-GDP gap measures have further reduced

Diverging paths in the evolution of GDP, which increased, and credit, which decreased over the period under analysis, led both measures of credit-to-GDP gap to decrease further, remaining at negative levels at the second quarter of 2017. Hence, both measures continue to be below the threshold that would translate into a positive benchmark buffer rate.

In fact, in the second quarter of 2017, the Basel gap was -45.5 p.p., which compares with -45.4 p.p. in the previous quarter. In turn, the additional credit-to-GDP gap, which includes estimates for the forthcoming values of the credit-to-GDP ratio, was -16.1 p.p. in the second quarter of 2017, *vis-à-vis* -15.1 p.p. in the first quarter (Chart 1).

Taking into account the estimate for the GDP growth rate of 2.5 per cent in 2017, displayed in the Economic Bulletin of October 2017, in tandem with the expected negative growth rate for credit granted to the private non-financial sector, no change to the countercyclical buffer rate is expected in the forthcoming quarters.

Chart 1 – Basel gap and additional credit-to-GDP gap<sup>2</sup>



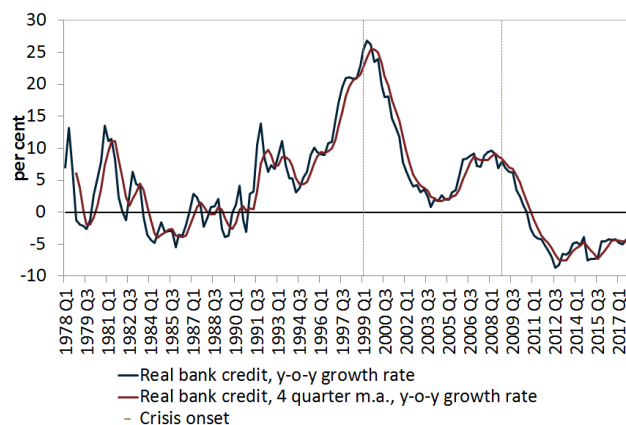
Sources: BdP, INE; and BdP's calculations. Last observation: 2017 Q2.

The stock of total credit to the private non-financial sector continued to decrease, despite positive net flows

The stock of total credit granted to the private non-financial sector continued to gradually decline in the second quarter of 2017, although at a slower pace (from a year-on-year growth rate of -2.5 per cent, in the first quarter of 2017, to -1.6 per cent, in the second quarter). The outstanding amount of bank

credit granted by resident institutions presented a real year-on-year growth rate of -4.3 per cent in the third quarter of 2017, which compares with -5 per cent in the second quarter (Chart 2).

Chart 2 – Real bank credit growth<sup>3</sup>



Sources: BdP and BdP's calculations. Last observation: 2017 Q3.

However, the change in the outstanding amount of credit is being influenced by other changes (besides transactions), in particular write-offs and credit portfolio sales, which amounted to *circa* 1.5 per cent of GDP in the first semester of 2017. In fact, in the same period, net flows of credit to the non-financial sector were positive.

Focusing only on transactions also allow us to highlight the following differences between credit segments. Even though net flows of credit granted to households recorded negative values in the first semester of 2017, the reduction observed was smaller than in the same period of 2016 (-362 million euros in the first semester of 2017, which compares with -1690 million euros in the first semester of 2016). Net flows of credit to non-financial corporations, on the other hand, have become positive in the first semester of 2017, interrupting the declining trend that started in 2014: in the first six months of 2017, the net flow of debt securities issued by non-financial corporations (1965 million euros) more than offset the negative net flow of loans granted to non-financial corporations (-1058 million euros).

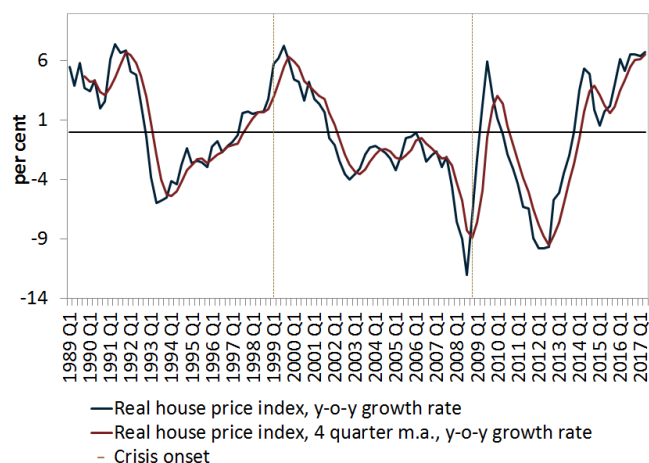
The ratio between the one year absolute difference in bank credit and the five year moving average of nominal GDP - another early indicator of credit imbalances - continued to be negative, in the second quarter of 2017 (-17.4 per cent), and slightly below the previous quarter (-16.6 per cent).

## Residential real estate cycle continues to expand

Price misalignments in real estate sector, when related to credit expansions, may pose cyclical systemic risks to financial stability.

In the second quarter of 2017, the real house price index maintained its upward trajectory, as reflected in its year-on-year growth rate and its four quarter moving average, of 6.7 per cent and 6.6 per cent, respectively (Chart 3). Further, a recent study by Banco de Portugal concludes that, given the current projections for the Portuguese economy, the elevated consumers' confidence index and persistently low interest rates, it is very likely that house prices will continue to increase in the future<sup>4</sup>. However, it should also be highlighted, as detailed in the December 2017 *Financial Stability Report*, that house prices in Portugal are, in fact, getting closer to their fundamentals, but there is still no evidence of overvaluation. Moreover, in the third quarter of 2017, the outstanding amount of bank loans for house purchase continued to decrease, although at a slower pace. As such, there is no indication that house prices and credit cycles are synchronized. Still, new lending for house purchase continued to increase, calling for close monitoring of developments in the residential real estate market.

Chart 3 – Real House Prices<sup>5</sup>



Sources: OECD. Last observation: 2017 Q2.

## Maintenance of the lending conditions to the non-financial private sector

The average interest rate on new loans to households for house purchase reached a new minimum in September. Overall the credit demand in the households segment remained stable in the third quarter of 2017 *vis-à-vis* the second quarter, according to the October 2017 Bank Lending Survey. Nonetheless, some banks reported a slight increase in the demand for loans for house purchase, due to the higher consumer confidence and to the low level of interest rates.

Moreover, in what concerns credit to households, banks reported that credit conditions remained stable in the third quarter of the current year, although, regarding loans for consumption and other purposes, some institutions referred that spreads decreased slightly, due to competition pressures. For the last quarter of 2017, no changes in credit standards are expected by inquired banks.

According to the October 2017 Bank Lending Survey, credit demand by non-financial corporations remained virtually unchanged in the third quarter of 2017, and inquired banks reported no perspectives of change in the fourth quarter. In August 2017, the average interest rate on new loans to non-financial corporations was 2.75 per cent, with no significant change *vis-à-vis* December 2016, while banks' spreads on new lending to non-financial corporations remained at around 3 per cent in the second quarter of 2017, a value still above the pre-crisis levels.

Given the reduction of outstanding lending amounts, coupled with decreasing interest rates, economic growth and an increase in disposable income, the debt-service-to-income ratio evolution continued to indicate both households and non-financial corporations' improvement of debt servicing capacity. In effect, the debt-service-to-income ratio year-on-year growth rate was -7.2 per cent in the first quarter of 2017, a rate similar to that observed in the previous quarter.

Reflecting the deleveraging process and a more stable funding structure of Portuguese banks, the ratio of credit-to-deposits continued its downward trend in the second quarter of the current year, reaching 93.5 per cent (which represents a decrease of one percentage point compared to the previous quarter).

## The Portuguese economy continues to present overall financing capacity

The seasonally adjusted current account has continued to depict a surplus in the second quarter of 2017, although smaller than in the first quarter of 2017 (from 0.7 per cent of GDP, in the first quarter of 2017, to 0.2 per cent, in the second quarter). During the latter period, the four quarter moving average of the seasonally adjusted current account remained at 0.7 cent of GDP. Consequently, there is no evidence of accumulation of external imbalances at the aggregate level.

### General assessment

The total outstanding amount of credit to the private non-financial sector continued to decline in the second quarter of 2017, albeit at a slower rate than in the previous quarters. Moreover, loan write-offs and the sale of loan portfolios contributed significantly to this evolution, in particular for non-financial corporations, for which net flows of credit were positive.

Positive GDP growth rates coupled with the decrease in the stock of credit led to a further reduction of both credit-to-GDP gap measures.

House prices in Portugal are getting closer to their fundamentals, but there is still no evidence of overvaluation in this market, as detailed in the December 2017 Financial Stability Report.

Taking into account all available information in this regard, Banco de Portugal has decided to keep the countercyclical capital buffer rate at zero per cent of the total exposure amount.

## Notes

- 1 The assessment is based on available data up to 31 October 2017. 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 zero 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](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 Lourenço and Rodrigues (2017), "House prices in Portugal - what happened since the crisis?", *Banco de Portugal Economic Studies*, Volume III.
- 5 Real house price index (2010=100) produced by the OECD. The house price index is adjusted for inflation using the private consumption deflator (2010=100) taken from the National Accounts. The OECD has identified one main nominal index for each country that covers the prices for the sale of newly-built and existing dwellings.

## Abbreviations

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