COUNTERCYCLICAL CAPITAL BUFFER

BANCO DE PORTUGAL
EUROSYSTEM

31 DEC. 2021

Pursuant to the decision of the Board of Directors of 21 December 2021, the countercyclical buffer rate for credit exposures to the domestic private non-financial sector will remain at 0% of the total risk exposure amount, with effect from 1 January 2022

The significant progress of the vaccination process and the consequent progressive reduction of the restrictive lockdown measures in the third quarter of 2021 contributed to the consolidation of the economic activity recovery and to an increase in the confidence of economic agents, which is expected to continue. However, supply disruptions, rising energy prices and the reintroduction of the restrictive measures to contain the new wave may pose risks to the speed of this recovery.

This decision was taken given the abovementioned information and the assessment of a set of financial and macroeconomic indicators.[1]

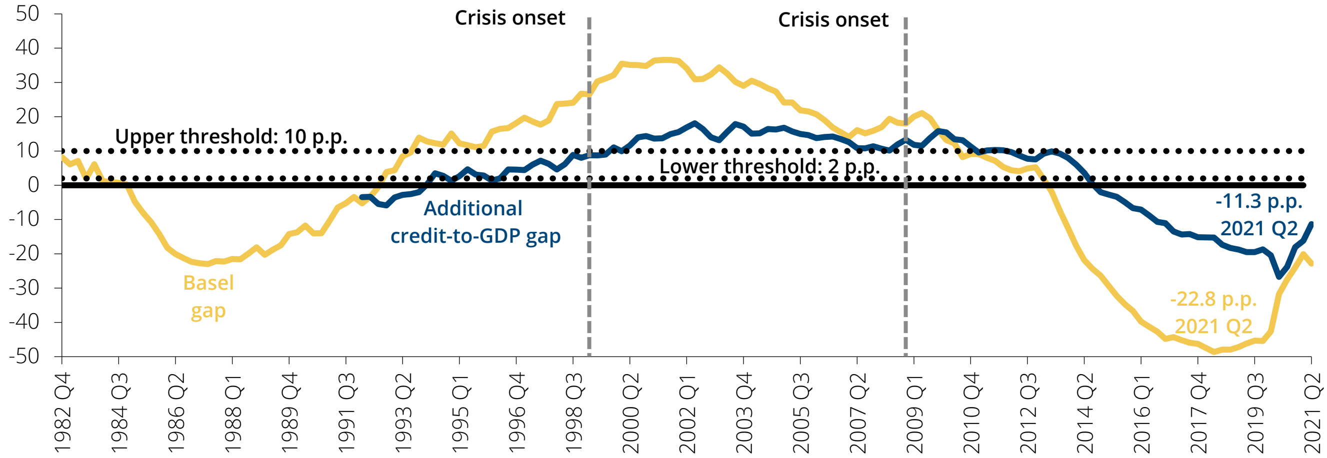
Credit-to-GDP gap measures remain at negative levels

In the second quarter of 2021, the Basel gap reached -22.8 percentage points (p.p.) (Chart 1), 2.7 p.p. lower than in the previous quarter, mostly driven by the credit-to-GDP ratio, since its trend takes more time to adjust. The additional credit-to-GDP gap increased from -16.2 p.p., in the first quarter of 2021, to -11.3 p.p., in the second quarter of 2021. Both measures remain well below the threshold (2 p.p.) that would trigger a positive benchmark buffer rate.

The credit-to-GDP ratio reached 174.2%, in the second quarter of 2021, decreasing 4.1 p.p. when compared with the previous quarter. The large increase in nominal GDP observed in the last quarters has been the driver of the reduction in the credit-to-GDP ratio. Nominal GDP increased 15% in the second quarter of 2021, when compared with the same period of the previous year (4.2% in the third quarter of 2021 according to INE's flash estimate). In the second quarter of 2021, credit granted[2] to the private non-financial sector increased 1.5% (year-on-year), driven by an increase in both credit granted to NFC (0.4%) and to households (3.1%).

[1] The assessment is based on data available up to 1 November 2021. Any differences in figures from previous assessments are due to revisions in underlying data.
[2] Credit includes loans granted to the domestic private non-financial sector and debt securities issued by the domestic private non-financial sector.

Chart 1 • Basel gap and additional credit-to-GDP gap[3] | In percentage points



Sources: Banco de Portugal and Statistics Portugal. | Notes: The last observation refers to 2021 Q2. p.p. stands for percentage points. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

According to the December 2021 *Economic Bulletin* of the Banco de Portugal, GDP is expected to increase 4.8% in 2021 and 5.6% in 2022, with positive effects on the confidence of the economic agents, supported by the maintenance of favorable financing conditions and greater transfer of funds from the European Union.[4]

The rate of change of outstanding real bank credit to the non-financial private sector continued to slow down

In the third quarter of 2021, outstanding real bank credit to the non-financial private sector continued to increase but at a slower pace (2% year-on-year) (Chart 2), and interest rates spreads on new lending continued to reflect stable financing conditions.

Regarding NFCs, in the third quarter of 2021, outstanding real bank credit to NFCs increased 2% (year-on-year) and spreads on new lending to NFCs remained at 2.5 p.p., in comparison with the previous quarter.

In the third quarter of 2021, outstanding real bank credit to households increased 2% (year-on-year), driven by the increase of: (i) credit for consumption and other purposes (7.9% year-on-year) and (ii) credit for house purchase (0.5% year-on-year). Spreads for mortgages remained constant at 1.3 p.p., and those for loans for consumption and other purposes decreased 0.1 p.p., in comparison with the second quarter of 2021, reaching 6 p.p., in the third quarter of 2021.

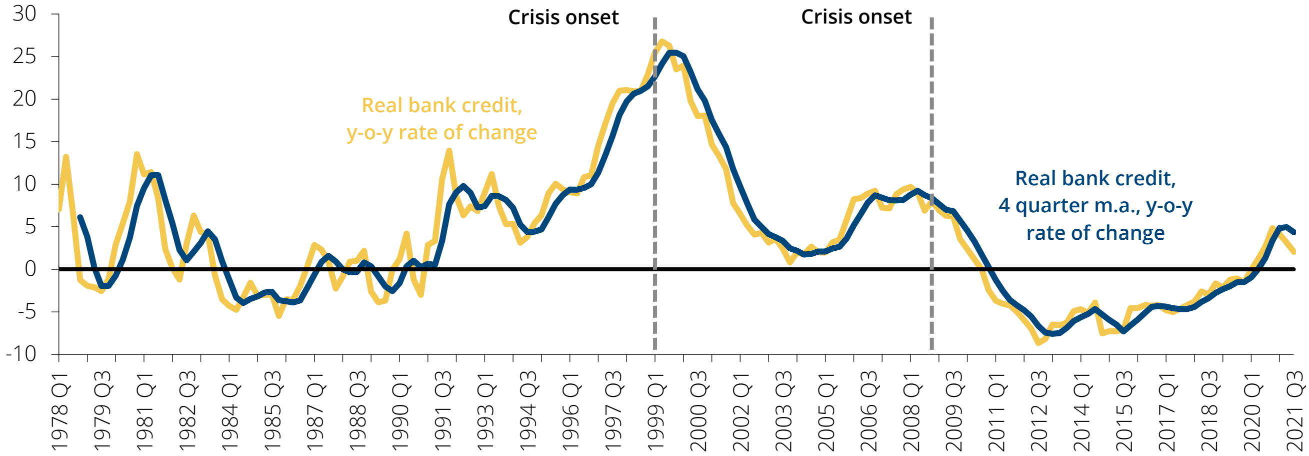
Looking forward, and according to the October 2021 *Bank Lending Survey*[5], credit standards for loans to NFCs and households are expected to remain broadly unchanged over the fourth quarter of 2021. On the demand side, an increase in the demand for loans by NFCs (more significant in short-term loans and by SME) and by households (more significant in consumer loans and other lending) is expected.

[3] 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 Hodrick–Prescott filter with a smoothing parameter set to 400,000. Until the first quarter of 2015, the optimal lag order (p) of the forecasti ng 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 ca se the gap exceeds 2 p.p., the benchmark buffer rate will increase linearly from 0% to the upper threshold of 2.5% 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 https://www.esrb.europa.eu/pub/pdf/recommendations/2014/140630_ESRB_Recommendation.en.pdf. Basel Committee on Banking Supervision 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.

[4] The December 2021 *Economic Bulletin* of the Banco de Portugal is available at https://www.bportugal.pt/sites/default/files/anexos/pdf-boletim/be_dez2021_p.pdf.

[5] More information is available at https://www.bportugal.pt/sites/default/files/anexos/pdf-boletim/results_oct2021_en.pdf.

Chart 2 • Year-on-year rate of change of real bank credit[6] | Per cent



Sources: Banco de Portugal and Statistics Portugal. | Notes: The last observation refers to 2021 Q3. m.a. stands for moving average. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

After some slowdown, real house prices rose at a higher pace in the second quarter of 2021

In the second quarter of 2021, real house prices increased by 6% year-on-year (8.2% and 4.5% in the last quarter of 2020 and in the first quarter of 2021, respectively) (Chart 3). The number of house transactions increased 58.3% in the second quarter of 2021 (year-on-year), after falling 22% (year-on-year) in the second quarter of 2020. This should be justified by the postponement of acquisitions as a consequence of the restrictions in house intermediation activity and mobility associated with the lockdown measures.

As highlighted in the June 2021 *Financial Stability Report* of the Banco de Portugal[7], in the last few years, domestic bank credit has not been the main driver behind the rise in house prices. The share of residential real estate transactions financed by domestic credit is over 25 p.p. lower than in the period prior to the sovereign debt crisis, about 40% since 2016, compared to 66% in 2009.

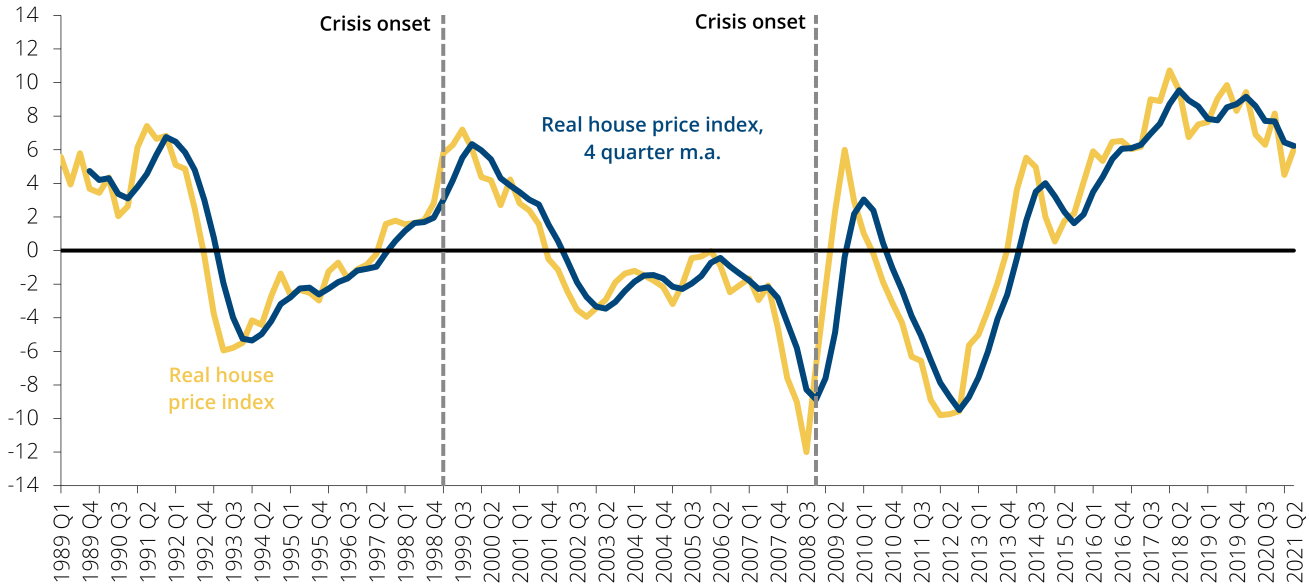
The August 2021 *Portuguese Housing Market Survey*[8] suggests that the participants' expectations continued to improve. Most of the participants in this survey expect a near term sales increase, as well as price increases in a year's time.

[6] Credit includes loans granted to the domestic private non-financial sector and debt securities issued by the domestic private non-financial sector. Bank credit granted by resident monetary financial institutions as available in Monetary and Financial Statistics published by the Banco de Portugal. The credit variable is adjusted for inflation using the consumer price index (2012=100) published by Statistics Portugal.

[7] More information is available at https://www.bportugal.pt/sites/default/files/anexos/pdf-boletim/ref_06_2021_en.pdf.

[8] The Portuguese Housing Market Survey (PHMS), a joint initiative by Confidencial Imobiliário and the Royal Institution of Chartered Surveyors, provides a qualitative assessment of the sales and lettings markets, based on a monthly survey to a panel of real estate agents and developers.

Chart 3 • Year-on-year rate of change of house prices, in real terms[9] | Per cent



Source: Organization for Economic Co-operation and Development.
Notes: The last observation refers to 2021 Q2 m.a. stands for moving average. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

The composite indicator of financial stress is below pre-pandemic levels and the economic sentiment indicator continued to improve

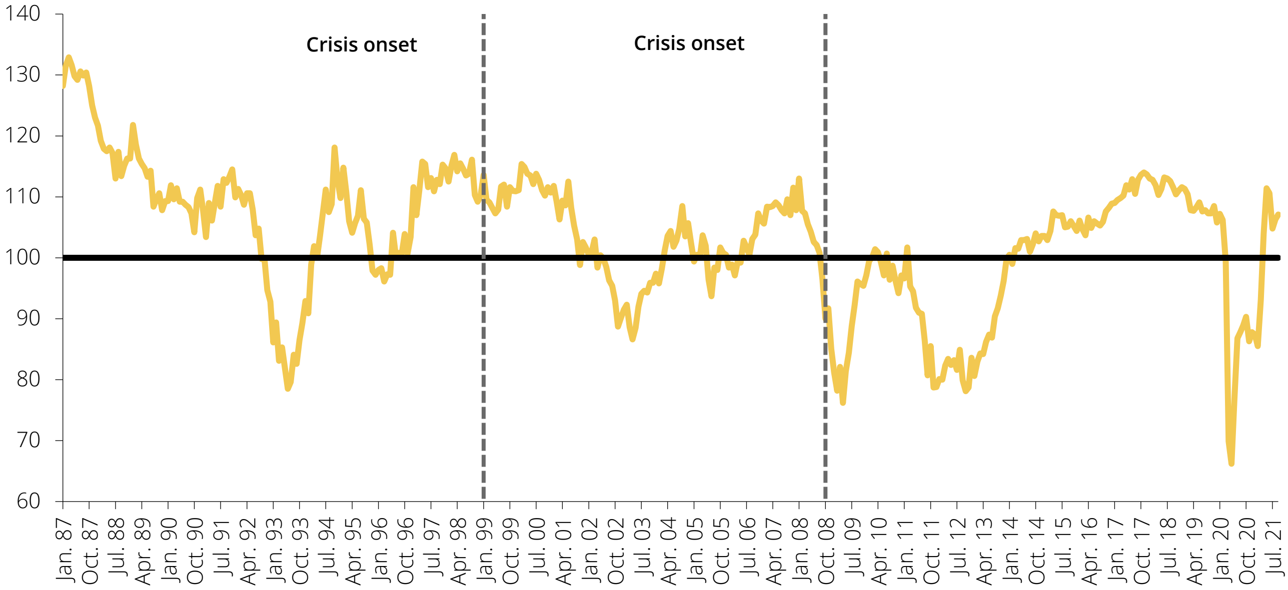
After the sharp increase observed in March 2020 due to the negative shock caused by the COVID-19 pandemic, the composite indicator of financial stress for Portugal has been decreasing since November 2020, reaching, in September 2021, a value below pre-pandemic levels.

The economic sentiment indicator for Portugal has been increasing since July 2021, most likely as a result of the control of the pandemic and the advances in the vaccination process (Chart 4).

Looking forward, and despite the more favorable international economic environment, the recovery in global demand was accompanied by disruptions in supply chains, as evidenced by the scarcity of goods, raw materials and intermediate goods with consequences on their prices, in longer delivery times and higher transport costs, conditioning the production of several goods.

[9] Real house price index (2015=100) published by the Organization for Economic Co-operation and Development. The house price index is adjusted for inflation using the private consumption deflator (2016=100) taken from the National Accounts (ESA2010, base 2016) published by Statistics Portugal.

Chart 4 • Economic Sentiment Indicator for Portugal | Index (2000-2020 average = 100)



Source: European Commission. | Notes: The last observation refers to September 2021. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

General assessment

In line with previous risk assessments and taking into account the above analysis, Banco de Portugal has decided to maintain at 0% the countercyclical capital buffer rate over the first quarter of 2022.

This decision intends to preserve banks' ability to provide credit to the economy and support the non-financial private sector throughout the foreseen recovery in a context still characterized by uncertainty of the impact of the pandemic on financial institutions.

Banco de Portugal will continue to closely monitor the developments in cyclical systemic risk, taking into consideration the current and the projected impact of the pandemic.