

COUNTERCYCLICAL CAPITAL BUFFER



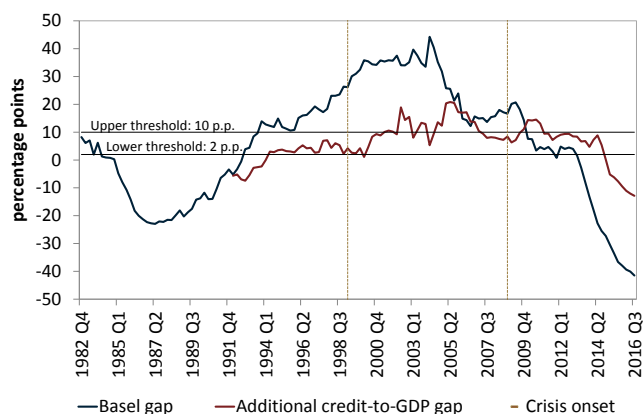
BANCO DE PORTUGAL
EUROSYSTEM

31st March 2017

Pursuant to a decision of the Board of Directors of 21 March 2017, 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 April 2017.

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

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

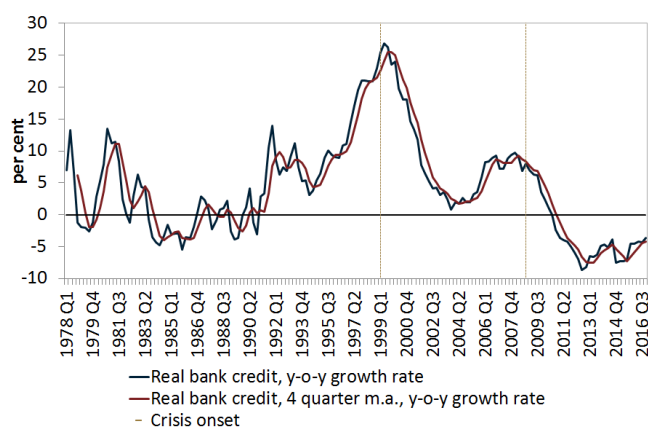


Sources: BdP, INE and BdP's calculations. Last observation: 2016 Q3.

Gap measures remain negative

At the end of the third quarter of 2016, the Basel gap was -41.5 p.p., while the gap measure developed by Banco de Portugal was -12.8 p.p., both widening in comparison with the previous quarter (see Chart 1). The two measures of the credit cycle remain negative, reflecting both the quarterly reduction in the outstanding amount of total credit to the private non-financial sector and the increase in nominal GDP. As such, they remain below the 2 p.p. threshold which would trigger a positive benchmark buffer rate as implied by the BCBS methodology.³ Therefore, 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 growth⁴



Sources: BdP, INE and BdP's calculations. Last observation: 2016 Q4.

Credit is recovering, but at a slow pace

Other indicators of credit granted to the private non-financial sector also support the maintenance of the current policy stance. Despite the increase in the year-on-year growth rates of both bank credit (real) and the four-quarter moving average of real bank credit, these indicators remained negative, providing no signals of excessive credit growth. In particular, the year-on-year growth rate of bank credit (real) stood at minus 3.6 per cent in the fourth quarter of 2016, which represents an increase of 0.7 p.p. from the previous quarter (see Chart 2).

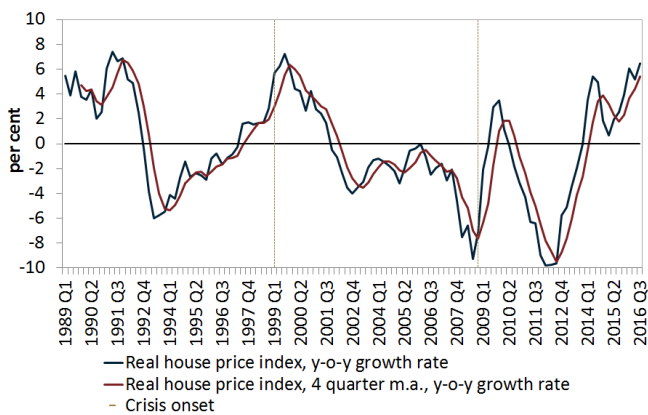
A breakdown of the credit granted by institutional sector and purpose provides further insight in this regard. On the one hand, the growth rate of total credit granted to the non-financial corporations has already signaled some recovery, becoming less negative in the third quarter of 2016. This trend

reflects a decrease in credit granted by resident banking groups being partially compensated by a positive net flow of credit granted by non-residents.

On the other hand, total credit granted to households has further decreased, which reflects different developments across segments. In fact, the stock of housing credit continues to decrease, while the outstanding amount of consumer credit has increased during 2016.

House prices continue to increase

Chart 3 – Real House Price Growth⁵



Sources: OECD. Last observation: 2016 Q3.

House prices have steadily increased in the last two years, as depicted in Chart 3. In fact, the House Price Index has reached 100.9 in the third quarter of 2016, approximately the same value as in its base year, 2010. However, as highlighted in the October 2016 Economic Bulletin, developments in house prices appear to be in line with the economic fundamentals and there is no evidence of overvaluation in overall house prices, even though there might be pressures in real estate price appreciation in specific regions, namely in the Lisbon metropolitan area.

Additionally, there is no evidence that the increase in house prices has been fuelled by credit granted by resident banks, given that the real and nominal growth rates of total housing credit remain negative. Moreover, the increase in the demand for residential real estate has been driven, to a large extent, by non-residents (see, in this regard, the May 2016 Economic Bulletin).

Some signals of loosening of credit standards

According to the January 2017 Bank Lending Survey, lending conditions to the non-financial sector remained globally stable in the last three months of 2016, although some of the major banks have reported a loosening in lending standards, due to increased competition. In particular, a reduction in spreads on lending to house purchase and to medium risk non-financial corporations was reported. Surveyed institutions' expectations are of maintenance of credit standards for the next six months. Although spreads on new loans to non-financial corporations remained stable, spreads on new lending for house purchase have indeed been consistently declining over 2016, although these spreads are still above their historical average and minimum.

In addition, the interest rates on new lending for house purchase have converged to the euro area levels in 2016, following a period of several years during which they were constantly higher in Portugal.

General assessment

Despite of the improvements in macro-financial conditions in Portugal over the recent quarters, cyclical systemic risk remains contained. The majority of the indicators does not provide evidence of emerging imbalances in the financial system driven by credit growth and, as a result, the countercyclical buffer rate will be maintained at 0 per cent during the second quarter of 2017.

Notes

- 1 The assessment is based on available data up to 25 January 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.
Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.
- 3 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.
- 4 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.
- 5 Residential Property Prices Index are index numbers that measure the prices of residential properties over time (Index: 2010=100; seasonally adjusted figures), as available in the OECD dataset "Analytical House Prices Indicators". 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

ARIMA	Autoregressive Integrated Moving Average
BCBS	Basel Committee on Banking Supervision
BdP	Banco de Portugal
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)
OECD	Organisation for Economic Cooperation and Development
p.p.	Percentage points