

COUNTERCYCLICAL CAPITAL BUFFER



31 MAR. 2021

Pursuant to the decision of the Board of Directors of 23 March 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 April 2021

After the economic recovery that has started in the third quarter of 2020, there are signals that this recovery process has ground to a halt. In the third quarter of 2020, the Portuguese economy was clearly recovering from the negative effects of the COVID-19 pandemic, against the support measures taken by European and national authorities and the gradual relaxation of the lockdown measures. In the last quarter of 2020, notwithstanding the reintroduction of containment measures, GDP increased by 0.2% quarter-on-quarter. Nevertheless those containment measures became more restrictive in the beginning of 2021 due to the rising risks from the COVID-19 pandemic for the public health. As a result, the recovery path may be interrupted and the short-term economic outlook became more uncertain. Taking these circumstances into consideration, it is important to guarantee that financial institutions are capable to continue to provide credit to the economy and to absorb unexpected losses, as a way to promote financial stability.

This decision was taken based on the above information and on the assessment of a set of financial and macroeconomic indicators.¹

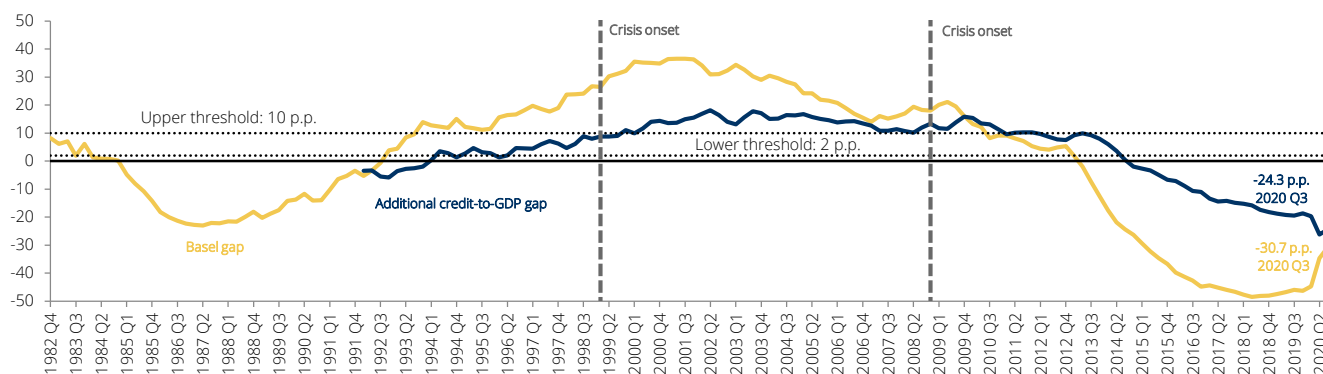
Credit-to-GDP ratio has increased, despite staying below long-term trends

The Basel gap reached -30.7 percentage points (p.p.) in the third quarter of 2020, maintaining the increasing path observed since the end of 2019 (Chart 1). Nevertheless, the drivers of this evolution have not always been the same over that period. Since the outbreak of the pandemic in March 2020, the gap has been narrowing more due to an increase in the credit-to-GDP ratio motivated by the drop in GDP. The additional credit-to-GDP gap increased, reaching -24.3 p.p., in contrast with the evolution observed since the beginning of 2020. Both measures show that the credit-to-GDP ratio still remains well below long-term trends and, therefore, the threshold that would trigger a positive benchmark buffer rate (2 p.p.) was not reached.

The credit-to-GDP ratio increased from 167.4% to 169.7%, from the second to the third quarter of 2020. This change is a result of (i) an increase in both credit granted to non-financial corporations (NFCs) (0.2%, quarter-on-quarter) and credit granted to households (0.7%, quarter-on-quarter), leading to a 0.4% (quarter-on-quarter) increase in the total credit granted to the private non-financial sector, and (ii) a 3.8% (year-on-year) drop in nominal GDP.

¹ The assessment is based on data available up to 17 March 2021. Any differences in figures from previous assessments are due to revisions in underlying data.

Chart 1 • Basel gap and additional credit-to-GDP gap² | In percentage points

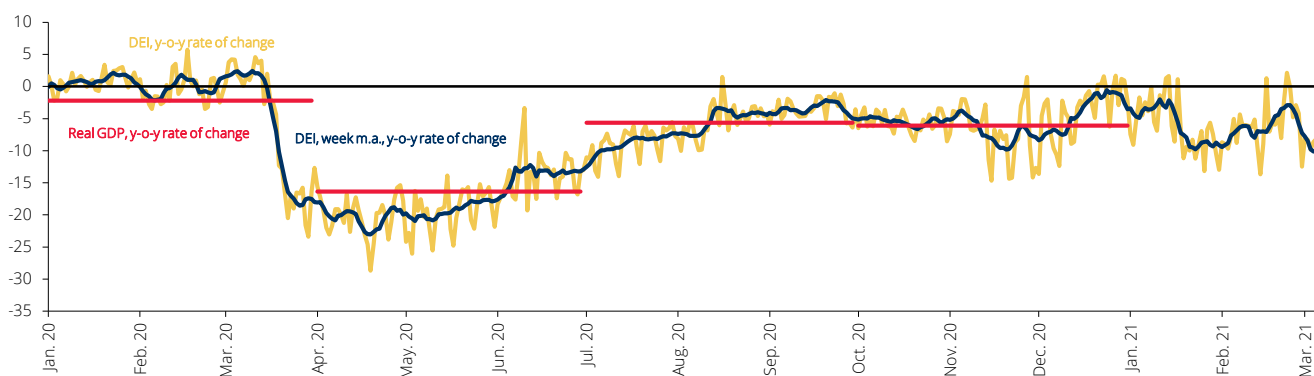


Sources: Banco de Portugal, Statistics Portugal and Banco de Portugal calculations.

Notes: The last observation refers to 2020Q3. p.p. stands for percentage points. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

On the back of the most recent developments related to the pandemic crisis, including lockdown measures, the short-term economic outlook for 2021 became more uncertain, and so did the projections for the evolution of the credit-to-GDP ratio. Due to the extension of the public loan moratorium until September 2021 and the implementation of other new support measures, as the reinforcement of credit lines with State guarantee, the outstanding amount of credit is expected to keep increasing in 2021. According to Statistics Portugal, real GDP fell 6.1% (year-on-year) in the last quarter of 2020 and of 7.8% in 2020. Going forward, the latest projection published in the March 2021 *Economic Bulletin* of the Banco de Portugal points to an increase in GDP of 3.9% in 2021. The daily economic indicator (DEI)³ points to a sharp fall in the daily economic activity since mid-January, when the second lockdown was announced (Chart 2). As such, GDP will most likely be negatively affected during the first quarter of 2021, even though there was a reinforcement of the measures targeted at minimising the negative impact of the second lockdown, such as the reinforcement and creation of new credit lines with State guarantee, extraordinary support to small and medium-sized enterprises, simplified layoff and deferral of taxes and social contributions. Against this background, the credit-to-GDP ratio may continue to increase during the first half of 2021.

Chart 2 • Year-on-year rate of change of the daily economic indicator | Per cent



Sources: Banco de Portugal.

Notes: The last observation refers to 07/03/2021. m.a. stands for moving average.

² 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 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% 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 http://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.

³ The DEI was developed by the Banco de Portugal with the goal of tracking sudden changes in the economic activity in a timely manner. More information regarding the indicator is available on https://www.bportugal.pt/sites/default/files/anexos/pdf-boletim/be_out2020_e.pdf (Box 1), on <https://www.bportugal.pt/en/publications/banco-de-portugal/all/9085> and Lourenço and Rua (2020), “The DEI: tracking economic activity during the lockdown”, *Working paper* No. 13, Banco de Portugal.

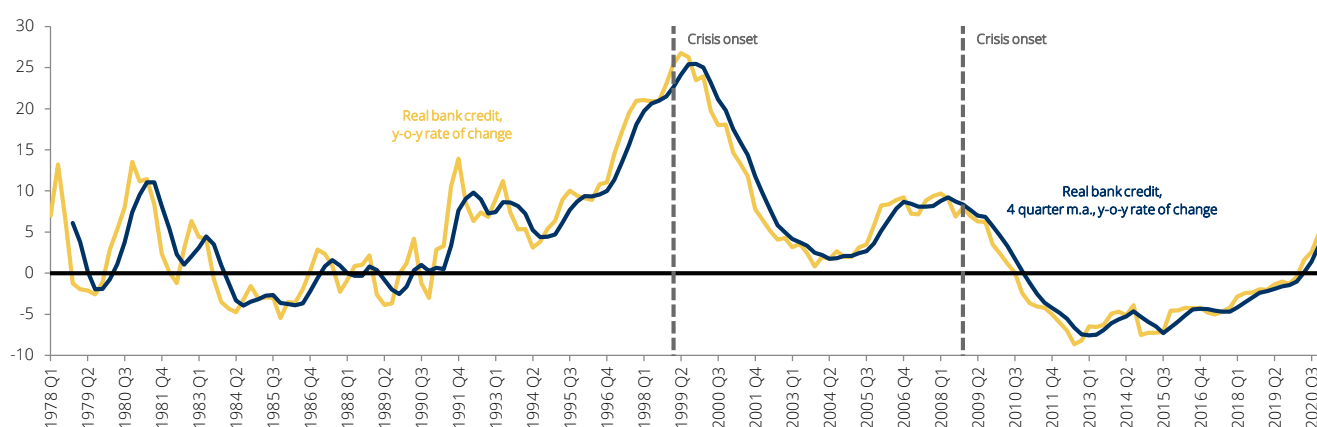
The rate of change of real bank credit granted to the non-financial private sector continued to rise

When compared with the same period of the previous year, the real bank credit outstanding to the private non-financial sector increased 3.5% (year-on-year) in the fourth quarter of 2020 (Chart 3). This is a result of a 6.6% and 1.4% (year-on-year) increase in the real bank credit outstanding to NFCs and to households respectively. Concerning real bank credit outstanding to households, there was a decrease in credit for consumption and other purposes of 1.3% (year-on-year) and an increase in credit for house purchase of 2.2% (year-on-year). The increase in real bank credit outstanding to the private non-financial sector is partially related to the loan moratoria that are in place which contribute to slowdown the pace of redemptions. Credit lines with State guarantee are also supporting NFCs access to credit in order to tackle liquidity issues. Going forward, the outstanding real bank credit to the private non-financial sector is expected to keep increasing due to the public loan moratorium and the credit lines with State guarantee.

Overall, financial conditions have remained stable during the last quarter of 2020 due to an accommodative monetary policy stance, expected to be maintained throughout 2021, and to the conditions entailed in the credit lines with State guarantee. Interest rates spreads on new lending were broadly stable during 2020. Concerning the NFCs sector, spreads applied on new lending remained at 2.5 p.p. in December 2020. As for the households sector, spreads decreased to 2.7 p.p. (0.4 p.p. less than in September 2020). More specifically, the spreads applied on new lending for house purchase and for consumption and other purposes decreased 0.1 p.p. and 0.6 p.p., reaching 1.3 p.p. and 5.5 p.p. respectively.

According to the January 2021 *Bank Lending Survey*,⁴ banks anticipate the demand for credit to remain basically unchanged in the first quarter of 2021. Regarding the supply of credit, banks expect tighter credit standards for NFCs, while households should benefit from basically unchanged conditions.

Chart 3 • Year-on-year rate of change of real bank credit⁵ | Per cent



Sources: Banco de Portugal, Statistics Portugal and Banco de Portugal calculations.

Notes: The last observation refers to 2020 Q4. m.a. stands for moving average. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

Real house prices continued to increase in the third quarter of 2020, albeit at a slightly slower pace

In the third quarter of 2020, real house prices continued to increase at a slower pace year-on-year (6.2%) compared to the second quarter of 2020 (6.7%) (Chart 4). Dwelling transactions increased 4.4% (year-on-year), which compares to a decrease of 15.2% in the second quarter of 2020 (year-on-year).

As detailed in the December 2020 *Financial Stability Report* of the Banco de Portugal, the resilience of real house prices is related to the ECB's accommodative policy, which translates into very low interest rates, favouring the demand for housing

⁴ More information is available on https://www.bportugal.pt/sites/default/files/anexos/pdf-boletim/results_jan2021_en.pdf

⁵ 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.

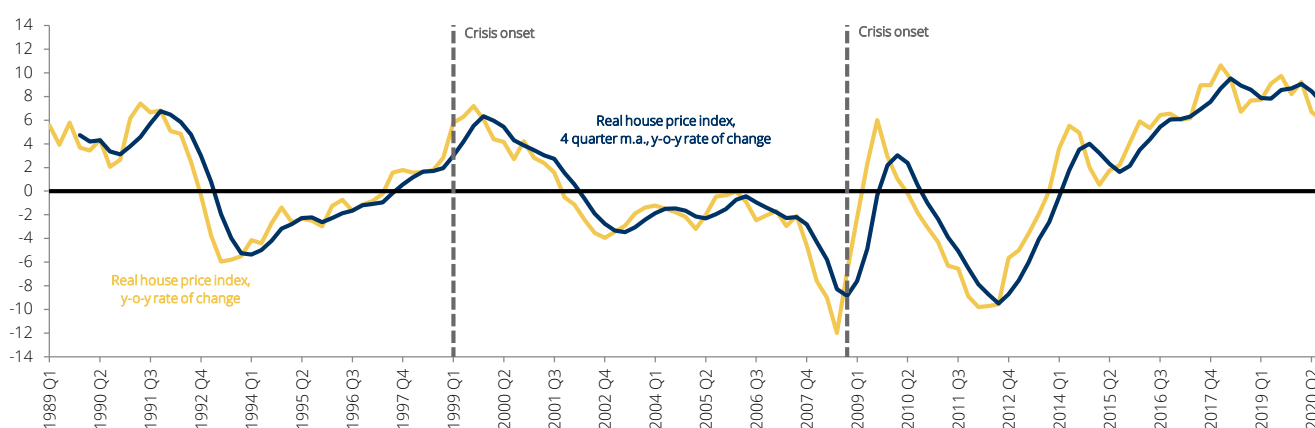
loans. Moreover, the real estate sector continues to present high return rates. The pressure on the real estate market is also mitigated by the existing credit moratoria which mitigate borrowers' liquidity constraints and risk of default.

The Portuguese real estate market has been characterised, in the recent past, by a significant demand of housing for tourism activities and by non-residents, both contributing to the increase in prices in the period before the pandemic crisis. Going forward, a correction in real estate prices might occur. The materialisation of the risk depends on the pace and magnitude of the adjustment that might take place.

According to the December 2020 *Portuguese Housing Market Survey*,⁶ participants in this survey report a decline in new buyers demand for houses for the fifth consecutive month. At the same time, on the supply side, new offers on the sales market have deteriorated further. Looking ahead, the participants expect that sales volume continues to drop until, at least, March 2021. As far as house prices are concerned, those participants continue to signal a marginal decline in house prices and going forward they expect a 1.5% fall over the next year. Consequently, the national confidence index (a combined measure capturing near term price and sales expectations) also published in this survey was -25 in December, exhibiting a decreasing trend since October, and comparing to 11 in January 2020.

The December 2020 *Survey on bank evaluation on housing*⁷ indicates that the year-on-year rate of change of the median value of bank appraisals started to increase (6%) after decreasing 2.9% between February and November 2020. The number of bank appraisals reported in the current period rose to around 26 thousand, a value close to pre-pandemic levels. This value is 4.4% higher than reported in the same period of the previous year. In the three months after the outbreak of the COVID-19 pandemic the number of bank appraisals drop significantly, starting to recover in July 2020.

Chart 4 • Year-on-year rate of change of house prices, in real terms⁸ | Per cent



Source: Organization for Economic Co-operation and Development.

Notes: The last observation refers to 2020 Q3 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 for Portugal remains close to pre COVID-19 crisis levels

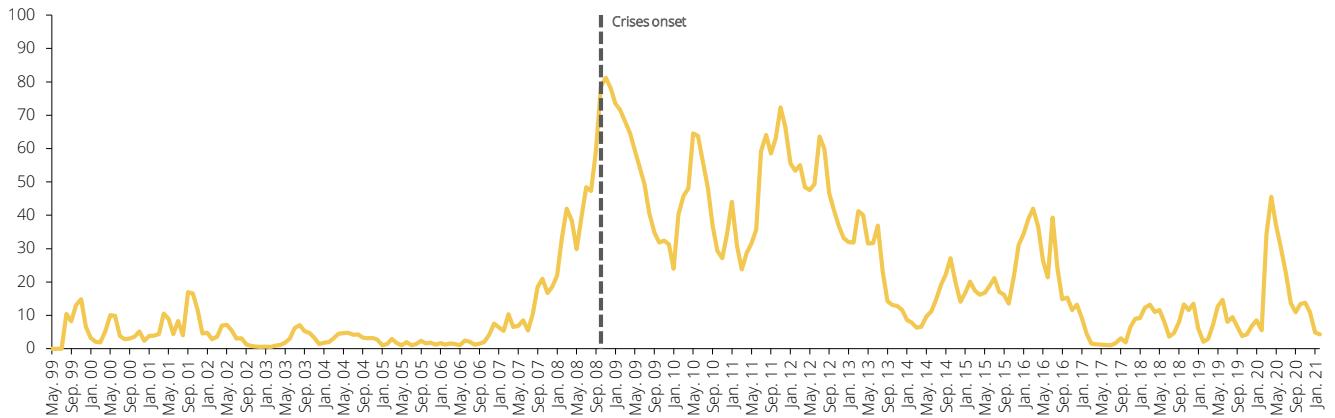
After a sharp increase around March 2020 following the negative shock caused by the COVID-19 pandemic, the composite indicator of financial stress for Portugal shows until December 2020 some signs of stabilisation around pre COVID-19 crisis levels (Chart 5). The mild volatility in the figures for the period between August and December 2020 possibly reflects the uncertainty related to a second wave of the COVID-19 pandemic and its economic impact. However, in January 2021, this indicator decreased significantly.

⁶ *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.

⁷ More information is available on https://www.ine.pt/xportal/xmain?xpid=INE&xpgid=ine_destaque&DESTAQUESdest_boui=415145593&DESTAQUESmodo=2&lang=en

⁸ 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 5 • Composite indicator of financial stress for Portugal⁹ | Quantile rank



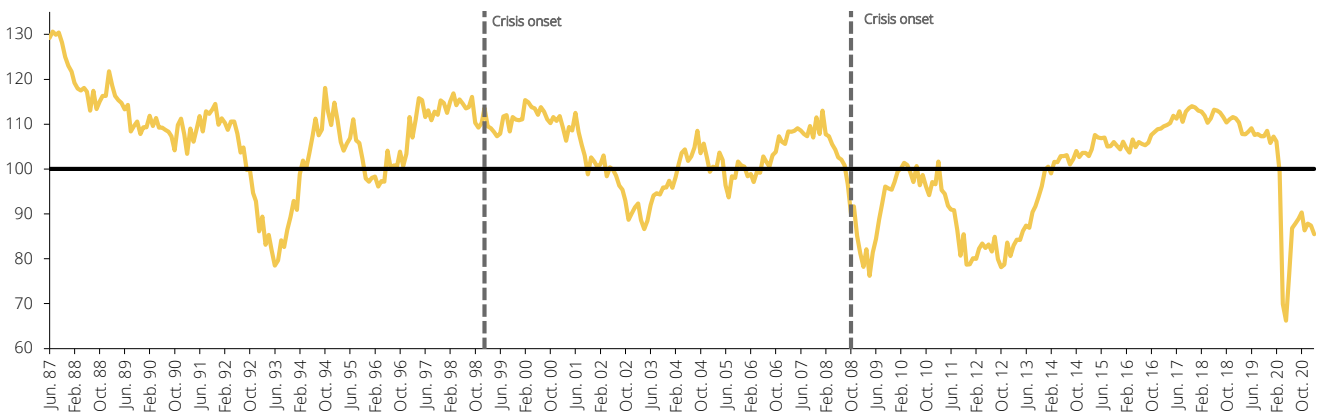
Source: Banco de Portugal

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

The economic sentiment indicator for Portugal seems to have stabilised

After reaching its lowest ever value in May 2020, the European Commission economic sentiment indicator for Portugal started to recover following the withdrawal of some of the lockdown measures (Chart 6). However, the most recent figures point to a stabilisation of this indicator most likely associated to the renewed concerns underlying the evolution of the health situation. The services sector, which includes tourism, restaurants and entertainment, and the consumer confidence continue to be the sub-indicators that contribute more negatively to the evolution of the composite indicator. The stabilisation of this indicator below its long-term average may point to an interruption in the recovery process of the economy and is in line with the DEI that provides evidence of a sharp fall in economic activity at the beginning of 2021.

Chart 6 • Economic sentiment indicator for Portugal | Index (2000-2020 average = 100)



Source: European Commission.

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

⁹ For more information on the composite indicator of financial stress see Braga, J. et.al (2014), "Composite Indicator of Financial Stress", *Financial Stability Papers*, Banco de Portugal, available on https://www.bportugal.pt/sites/default/files/anexos/papers/paper_1_en_0.pdf.

General assessment

In line with the previous risk assessment, the Banco de Portugal has decided to maintain at 0% the countercyclical capital buffer rate over the second quarter of 2021.

This decision takes into account the above analysis and the uncertainty induced by the new lockdown. At this point, it remains crucial to ensure that financial institutions are able to provide credit to the economy and to absorb potential losses that may arise from the materialisation of risks.

The Banco de Portugal will continue to closely monitor the developments in cyclical systemic risk, arising particularly from the current and the projected impact of the pandemic.