

COUNTERCYCLICAL CAPITAL BUFFER



BANCO DE PORTUGAL
EUROSYSTEM

30 June 2016

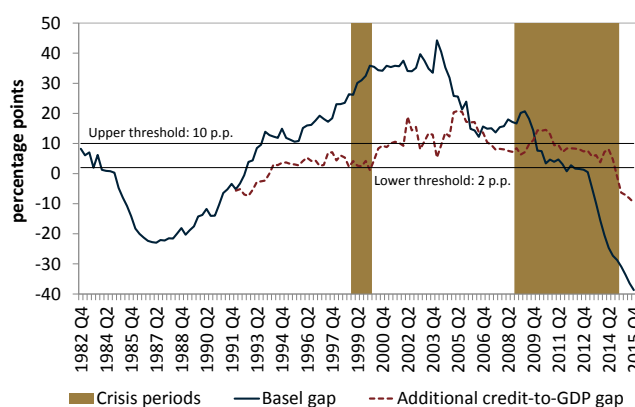
Banco de Portugal decided that the countercyclical buffer rate for credit exposures to the domestic private non-financial sector remains at 0 per cent of the total risk exposure amount, with effect from 1 July 2016.

This decision is based on the overall assessment of recent developments in a set of financial and macroeconomic indicators, as follows¹:

Credit cycle is still in a contractionary phase

In the last quarter of 2015, the credit-to-GDP ratio remained below its long-term trend and, accordingly, the two measures of the gap recorded negative values (-38.7 p.p. for the Basel gap and -9.7 p.p. for the additional credit-to-GDP gap). As a result, the benchmark buffer rate should be set at 0 per cent of the total risk exposure amount (see Chart 1)². In addition, aggregate indicators of bank credit to the private non-financial sector remain negative, mirroring the mild improvements in macroeconomic and financial conditions at end-2015 (see Table 1). Against this background, **there is no evidence that credit has picked-up or even returned to normal levels warranting a deviation from the benchmark buffer rate.**

Chart 1 – Basel gap and additional credit-to-GDP gap³



Sources: BdP, INE and BdP's calculations. Last observation: 2015 Q4.

No evidence of cyclical systemic risk build-up

Developments in other early warning indicators are in line with the previous two risk assessments and the May 2016 Financial Stability Report, providing no evidence of cyclical systemic risk build-up (see Table 1).

Real house prices are recovering, with a year-on-year growth rate of 4.3 per cent in the fourth quarter of 2015 (which compares to 2.5 per cent in the previous quarter and to 1.4 per cent in the same quarter of the previous year). However, the revival in house prices seems to be mainly driven by increasing investment in real estate by non-residents, which is in line with the continued deleveraging of the private non-financial sector. Accordingly, the year-on-year growth rate of the debt-service-to-income ratio for the private non-financial sector remains negative, standing at -5.2 per cent in the third quarter of 2015.

Banks' spreads on new loans to non-financial corporations in the last quarter of 2015 were slightly lower than in the previous quarter but remained at a conservative level above the pre-crisis minimum (1.5 p.p. in the third quarter of 2007). Additionally, the April 2016 Bank Lending Survey results show that spreads are not decreasing for high risk loans and the narrowing in spreads for medium risk loans is due to pressure from competition, a more favorable assessment of the general economic situation and the costs related to the banks' capital position. Notwithstanding, credit standards remained overall stable in the first quarter of 2016. Going forward, banks

participating in this survey do not foresee significant changes in lending standards, but anticipate an increase in loan demand from non-financial corporations and households, which is consistent with Banco de Portugal's March economic projections for 2016-2018, that point to a moderate pick-up in economic activity.

The loan-to-deposit ratio continues to decrease standing at 102.6 per cent in the fourth quarter of 2015, in contrast to the historical maximum achieved during the financial and sovereign crises (166.6 per cent in the second quarter of 2010).

Finally, the current account balance continues to improve, standing at 1.0 per cent of GDP in the fourth quarter of 2015. According to Banco de Portugal's March economic projections for 2016-2018, there should be a gradual decrease in the levels of external indebtedness over the medium-term,

reflecting mostly an increase in the savings rate of the economy. In particular, net lending in 2016 is expected to be higher than in 2015, largely due to significant gains in terms-of-trade, associated with the decline in oil prices. Accordingly, there is no indication of acceleration in the credit market during 2016 fuelled by external resources.

General assessment

The prevailing risk environment does not justify a tightening of the current macroprudential policy stance in what concerns the countercyclical buffer rate.

Table 1 – Other early warning indicators of systemic banking crises

	Units	Maximum	Minimum	t-4	t-1	t	Period	Vis-à-vis previous quarter		
Real bank credit to the private non-financial sector⁴	%, y-o-y	26.8	1999 Q2	-8.7	2012 Q3	-7.3	-4.5	-4.6	2016 Q1	↓
	%, 4q. m.a., y-o-y	25.5	1999 Q4	-7.6	2013 Q1	-6.0	-6.6	-5.9	2016 Q1	↑
1 year difference of bank credit as a % of 5 year m.a. of GDP⁵	%	92.9	1999 Q3	-42.3	2014 Q4	-42.3	-34.2	-20.5	2015 Q4	↑
	%, 4q. m.a.	91.7	2000 Q1	-38.1	2015 Q3	-31.5	-38.1	-32.7	2015 Q4	↑
Real house price index⁶	%, y-o-y	7.4	1991 Q2	-9.8	2012 Q1	1.4	2.5	4.3	2015 Q4	↑
	%, 4q. m.a., y-o-y	6.7	1991 Q4	-9.5	2012 Q3	3.6	1.6	2.4	2015 Q4	↑
Debt-service-to income ratio⁷	%, y-o-y	16.8	2001 Q2	-12.2	2010 Q1	-6.8	-5.6	-5.2	2015 Q3	↑
	%, 4q. m.a., y-o-y	14.9	2001 Q3	-9.6	2010 Q2	-5.4	-6.2	-5.8	2015 Q3	↑
Bank spreads on new lending to NFC⁸	p.p.	5.9	2012 Q3	1.5	2007 Q3	4.0	3.7	3.3	2015 Q4	↓
Loan-to-deposit ratio⁹	%	166.6	2010 Q2	102.6	2015 Q4	107.2	104.6	102.6	2015 Q4	↓
	%, 4q. m.a.	163.6	2010 Q2	105.0	2015 Q4	112.6	106.2	105.0	2015 Q4	↓
Current account deficit in % of GDP¹⁰	%	13.4	2008 Q3	-2.2	2013 Q4	-1.0	-1.5	-1.0	2015 Q4	↑
	%, 4q. m.a.	12.2	2008 Q4	-1.3	2013 Q4	-0.6	-0.9	-0.9	2015 Q4	↑

Notes

- 1 The assessment is based on available data up to 22 April 2016. This set of indicators covers the six categories set out in Recommendation ESRB/2014/1.
- 2 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. 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.
- 3 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 produced by BdP and nominal GDP from National Accounts (ESA2010, base 2011) produced 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. 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.
Crisis periods as identified for the ESCB Heads of Research Group's banking crises database.
- 4 Credit includes loans granted to the domestic private non-financial sector plus 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 Ratio between the one year absolute difference of bank credit and the five year moving average of nominal GDP, as proposed in Kalatie et al. (2015), "Indicators used in setting the countercyclical capital buffer", Bank of Finland Research, Discussion Papers, No. 8/2015. Bank credit extended by resident monetary financial institutions as available in Monetary and Financial Statistics published by BdP. Nominal GDP is obtained from National Accounts, ESA2010, base 2011, published by INE.
- 6 Real house price index (2010=100) published by the OECD. The house price index is adjusted for inflation using the private consumption deflator (2010=100) taken from the National Accounts, ESA2010, base 2011, published by INE.
- 7 Debt-service-to-income ratio estimates published by the BIS for the private non-financial sector, which uses gross disposable income as a proxy for income. Available at <http://www.bis.org/statistics/dsr.htm>.
- 8 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.
- 9 Both loans and deposits data are available at BdP and refer to values reported on a consolidated basis for supervisory purposes. Data for the fourth quarter of 2000 to the fourth quarter of 2004 correspond to aggregate banking system values according to local GAAP. Data for the first quarter of 2005 to the fourth quarter of 2006 correspond to values for the 6 largest banking groups according to IFRS. Data for the first quarter of 2007 onwards correspond to aggregate banking system values according to IFRS.
- 10 Current account deficit seasonally adjusted as available in Balance of Payments Statistics (ESA2010) 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
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
HP	Hodrick and Prescott
IFRS	International Financial Reporting Standards
INE	<i>Instituto Nacional de Estatística</i> (Statistics Portugal)
m.a.	moving average
NFC	Non-financial corporations
OECD	Organisation for Economic Co-operation and Development
p.p.	percentage points
y-o-y	year-on-year rate of change
4q.	4 quarters