

COUNTERCYCLICAL CAPITAL BUFFER



BANCO DE
PORTUGAL
EUROSYSTEM

30 JUNE 2022

Pursuant to the decision of the Board of Directors of 28 June 2022, 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 July 2022

The medium to long-term outlook remains highly conditioned by the uncertainty associated with the impact of the invasion of Ukraine by Russia and the lockdown measures still being implemented due to the pandemic, in particular in China. The increase in energy and commodity prices, initially associated with temporary mismatches between supply and demand due to the pandemic, was significantly amplified by the war in Ukraine, which contributed to an increase in inflationary pressures and weakened the recovery of economic activity in the post-pandemic context. Notwithstanding the downward revision of growth expectations, both worldwide and in the euro area, economic activity in Portugal is expected to continue its recovery trajectory.

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

Both credit-to-GDP gaps remain well below their long-term trends

In the fourth quarter of 2021, the Basel gap reached -23.0 percentage points (p.p.) (Chart 1), 0.5 p.p. lower than in the previous quarter (-22.5 p.p.), mostly driven by the credit-to-GDP ratio decrease, since its trend takes more time to adjust. The additional credit-to-GDP gap also became more negative, reaching -11.5 p.p. (1.2 p.p. lower than in the third quarter) (Chart 1). Both measures show that the credit-to-GDP ratio 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 decreased from 173.9% to 172.1%, from the third to the fourth quarter of 2021. Since the second quarter of 2021, against a background of economic recovery, GDP has increased at a higher rate than total credit outstanding to the private non-financial sector (quarter-on-quarter), leading to a downward trajectory of the credit-to-GDP ratio.

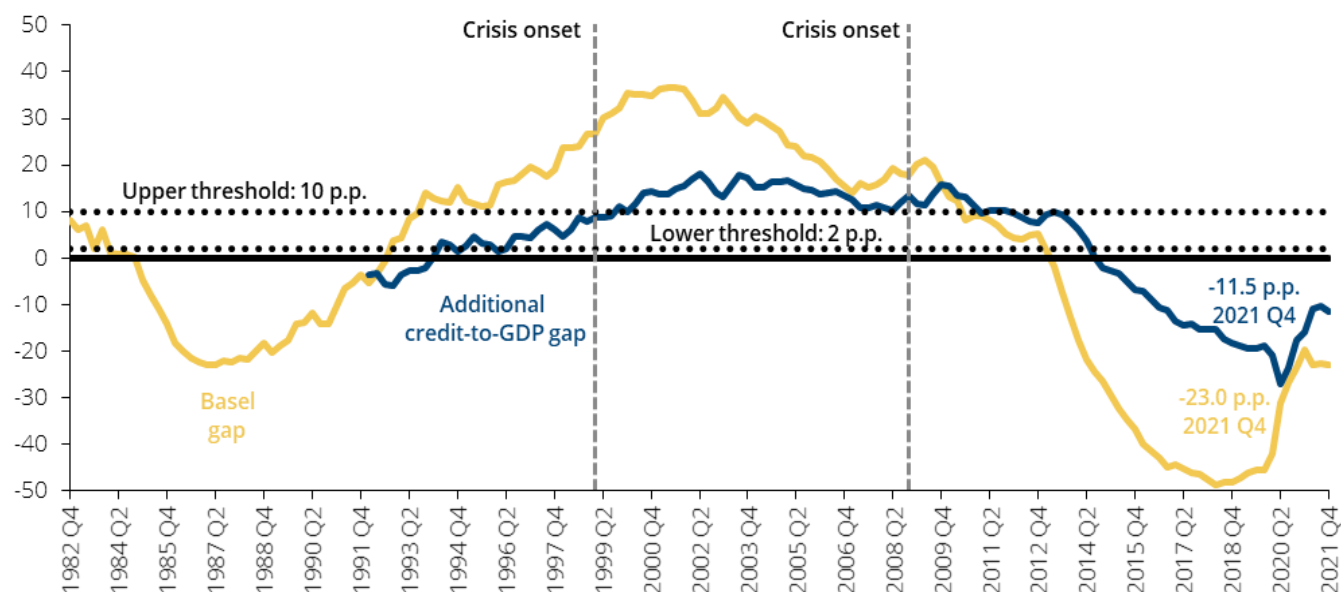
In the last quarter of 2021, total credit granted² to the private non-financial sector increased 3% (year-on-year), driven by an increase in both credit granted to non-financial corporations (NFCs) (2.7%, year-on-year) and to households (3.5%, year-on-year). As such, and as mentioned above, the decrease in the credit-to-GDP ratio was driven by the more significant increase in nominal GDP (5.6%, year-on-year), which outweighed the increase in credit. More recently (February 2022) the annual rate of change of the credit granted to the non-financial private sector adjusted for securitisation operations, reclassifications, write-offs, price and exchange rate revaluations, and sales was 4.0% (year-on-year), driven by an increase in both credit granted to NFCs and to households (4.1% and 3.7%, respectively).

¹ The assessment is based on data available up to 5 May 2022. 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.

In the first quarter of 2022, economic activity in Portugal reached a level slightly above the one observed before the pandemic. Going forward, and according to the projections published in the June 2022 Banco de Portugal's *Economic Bulletin*, Portuguese GDP is expected to continue recovering in 2022 (6.3%), recording a more moderate pace of expansion in 2023 and 2024 (2.6% and 2.0%, respectively). In the short to medium term, the downside risk remains associated with the indirect economic repercussions of the conflict in Ukraine in the Portuguese economy, in terms of increased uncertainty and higher inflation rates, particularly in the energy and food components. Additional factors of uncertainty are those related to the less favourable financial conditions, underlying the normalisation of monetary policy, and a further negative impact on global supply chains, conditioned by the pandemic situation in China. Albeit subject to heightened uncertainty, a change in the sign of both credit-to-GDP gaps is unlikely to occur in the 2022-2024 period.³

Chart 1 • Basel gap and additional credit-to-GDP gap⁴ | In percentage points



Sources: Banco de Portugal and Statistics Portugal. | Notes: The last observation refers to 2021 Q4. p.p. stands for percentage points. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

During the first quarter of 2022, bank credit, in real terms, to the non-financial private sector resumed the downward path observed before the pandemic, but driven, this time, by increased inflation

The outstanding real bank credit to the non-financial private sector turned negative during the first quarter of 2022 (-1.0% year-on-year) (Chart 2), due to a decrease in real bank credit outstanding to NFCs (-2.4% year-on-year), which more than offset the slight increase in real bank credit outstanding to households (0.1% year-on-year). These developments mainly reflect the significant increase in inflation during the first quarter of 2022 (4.3%, year-on-year), as bank credit to households and NFCs continued to increase in nominal terms (4.3% and 1.8%, respectively). The annual rate of change of the outstanding real bank credit to the non-financial private sector adjusted for securitisation operations, reclassifications, write-offs, price and exchange

³ The June 2022 Economic Bulletin of the Banco de Portugal is available at the Banco de Portugal website (for the moment, only the Portuguese version is available).

⁴ 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 the ESRB website. 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.

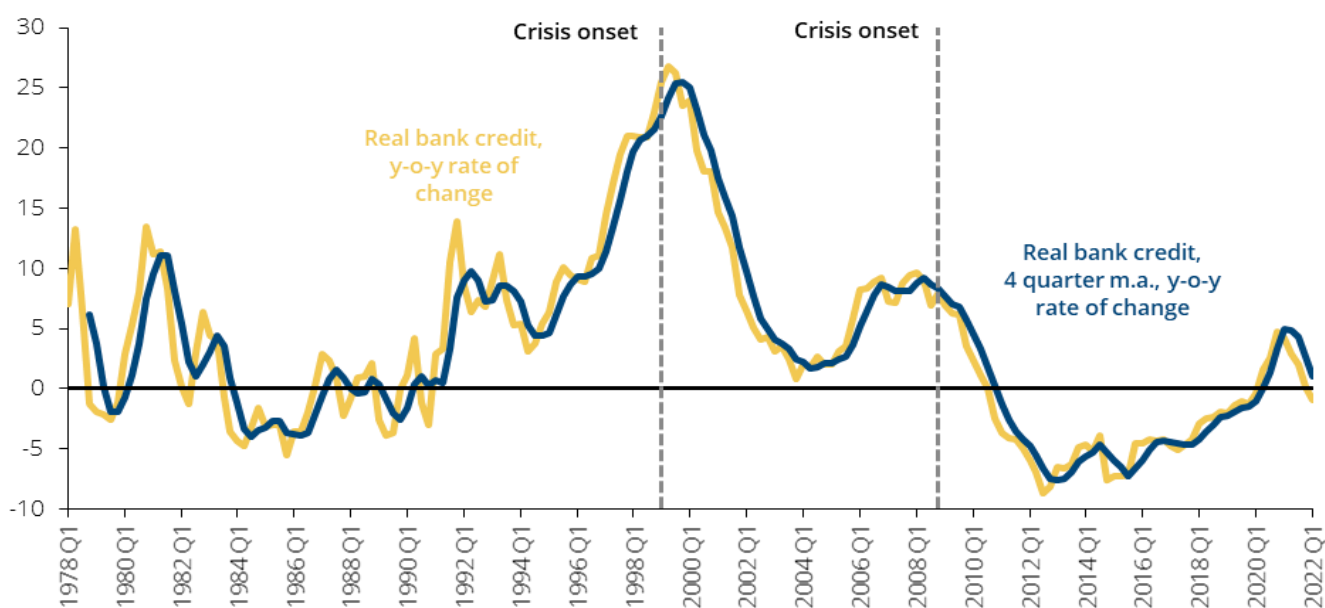
rate revaluations, and sales was also negative in February 2022 (-1.3%, year-on-year), decreasing by 1.6 p.p. when compared to December 2021. This evolution, strongly influenced by inflation, was mainly driven by the decrease in real bank credit outstanding to NFCs (from -0.6%, in December 2021, to -2.9%, in February 2022) and, to a lesser extent, by the decline of real bank credit outstanding to households (from 0.9%, in December 2021, to -0.1%, in February 2022).⁵

Bank credit in real terms to NFCs increased significantly in the beginning of the pandemic crisis due to the public support measures, notably state-guaranteed loans and the moratorium, against a background of an increase in firms' liquidity needs. Over the last few quarters, in a context of recovering economic activity, the end of the moratorium and the reduction of support measures, credit to NFCs has been decelerating. In real terms, bank loans to NFCs interrupted the growth path in the fourth quarter of 2021, reflecting in particular the significant increase in inflation. As to financing conditions, spreads on new lending to NFCs reached 2.3 p.p., in March 2022, decreasing by 0.3 p.p. when compared to December 2021.

Regarding households, the year-on-year slight increase in outstanding bank credit, in real terms, reflects an increase in credit for consumption and other purposes of 8.4%, as credit for house purchase decreased by 2.1%. However, when adjusted for securitisation operations, reclassifications, write-offs, price and exchange rate revaluations, and sales, the annual rate of change of the outstanding real bank credit for consumption and other purposes, in February 2022, was -0.6% (year-on-year), whilst increasing for house purchase (0.1%).⁶ Interest rate spreads on new lending continued to reflect stable financing conditions, as spreads for mortgages reached 1.4 % in March 2022, broadly in line with the values reported in December 2021. Spreads on new lending for consumption and other purposes reached 6.5%, in March 2022, increasing by 0.6 p.p. when compared to December 2021.

Looking forward, and according to the April 2022 *Bank Lending Survey*⁷, on the supply side, and over the second quarter of 2022, credit standards are expected to become slightly tighter for NFCs and unchanged for households. The demand for loans by NFCs is expected to increase, in particular the demand for short-term loans by SMEs. Banks also expect a slight increase in the demand for housing and consumer credit by households.

Chart 2 • Year-on-year rate of change of real bank credit⁸ | Per cent



Sources: Banco de Portugal and Statistics Portugal. | Notes: The last observation refers to 2022 Q1. m.a. stands for moving average. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

⁵ In nominal terms, the annual rate of change of the outstanding bank credit to the non-financial private sector adjusted for securitisation operations, reclassifications, write-offs, price and exchange rate revaluations, and sales, in February 2022, was 2.9% (year-on-year), driven by an increase in both credit granted to NFCs and to households (1.3% and 4.1%, respectively).

⁶ In nominal terms, both the outstanding bank credit for consumption and other purposes and for house purchase increased by 13.0% and 2% (year-on-year), respectively, in the first quarter of 2022. In nominal terms, the annual rate of change of the outstanding bank credit for consumption and other purposes and for house purchase adjusted for securitisation operations, reclassifications, write-offs, price and exchange rate revaluations, and sales, in February 2022, was 3.6% and 4.3% (year-on-year), respectively.

⁷ More information is available at the Banco de Portugal [website](#).

⁸ 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.

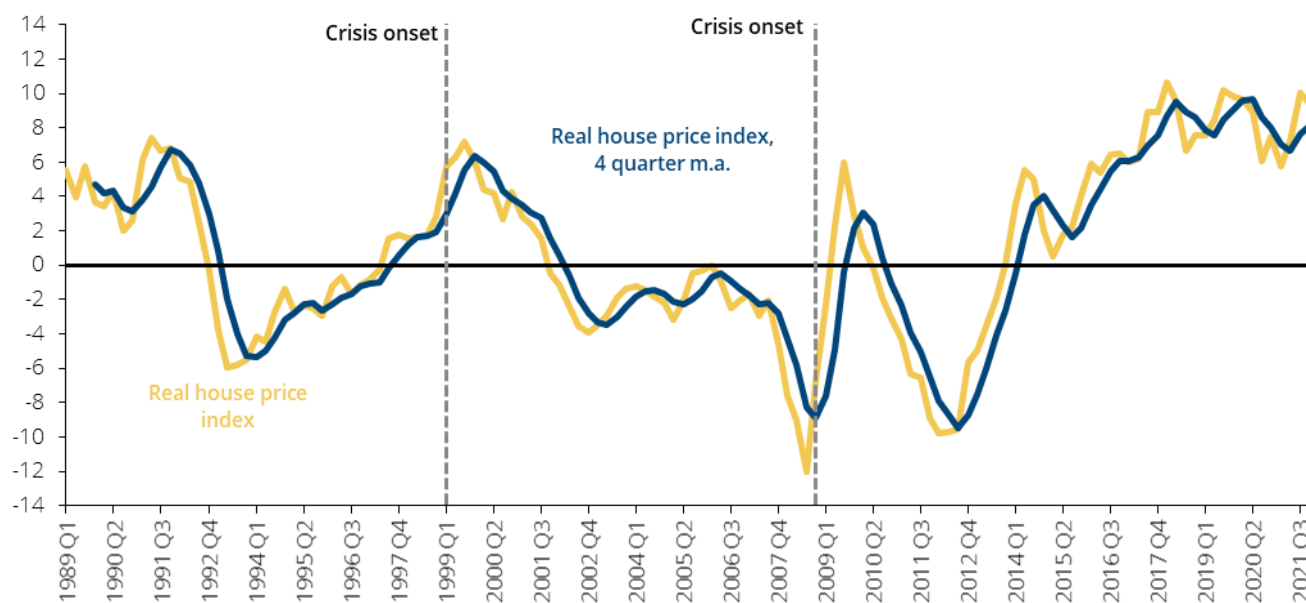
The growth rate of real house prices decelerated in the last quarter of 2021

In the last quarter of 2021, the real house price index continued to increase, reaching a growth rate of 9.4% (year-on-year), somewhat lower than the growth rate observed in the previous quarter (Chart 3).

In this period, the increase in the number of house transactions also continued to be observed, although at a slower pace, with a year-on-year rate of change of 17.2%, which compares with a rate of change of 22.1% and 58.2%, respectively, in the third and second quarters of 2021. On the supply side, in the fourth quarter of 2021, building permits for new constructions and completed buildings decreased by 0.5% and 4.7% (year-on-year), respectively.⁹ The average value *per* house transaction maintained the upward trajectory observed since the end of 2020, reaching a growth rate of 15% (year-on-year) in the last quarter of 2021.

Overall, the February 2022 *Portuguese Housing Market Survey*¹⁰ signals a momentum stalling, with measures of market activity turning flat. The majority of survey respondents expect near-term sales to exhibit a slowdown whilst prices should continue rising across all areas, even though at a lower rate, at both three- and twelve-month time horizons. Participants' expectations anticipate positive developments in rental growth over the coming months. In addition, the results from the March 2022 *Survey on bank evaluation on housing*¹¹ indicate that the median value of bank appraisals continued to increase, with a year-on-year growth rate of 12.1% in March 2022, which compares to 11.9% in the previous month. The number of bank appraisals rose 23.5% in March 2022 (year-on-year), compared to a rate of change of 24.2% in the previous month.

Chart 3 • Year-on-year rate of change of house prices, in real terms¹² | Per cent



Source: Organization for Economic Co-operation and Development. | Notes: The last observation refers to 2021 Q4 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 increased moderately, albeit remaining at low values, and the economic sentiment indicator remained close to the pre-pandemic values

⁹ More information is available at the [INE website](#).

¹⁰ 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.

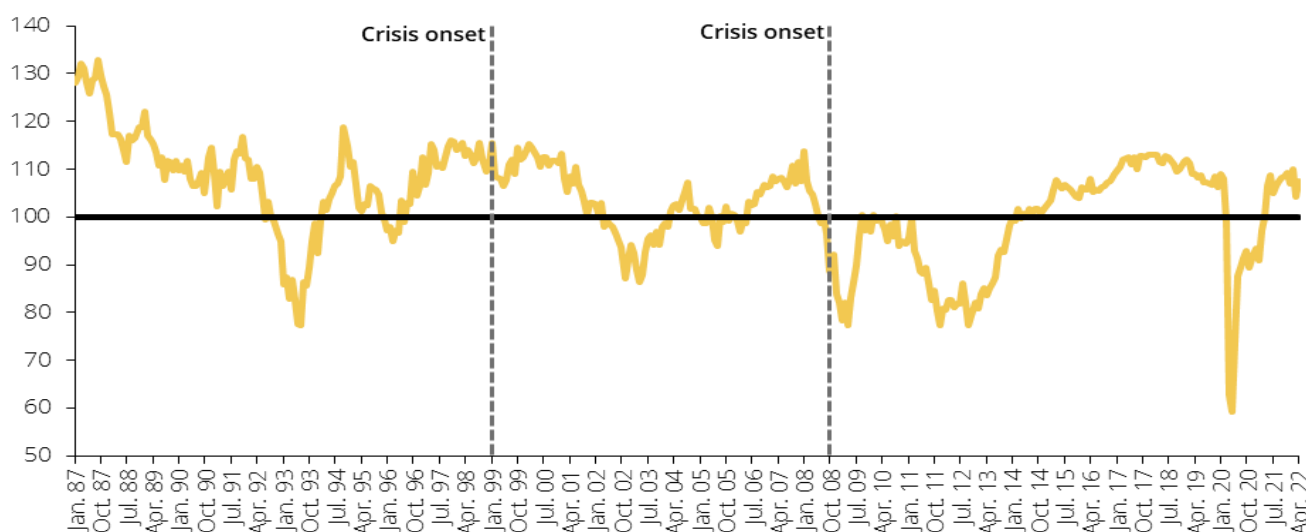
¹¹ More information is available at the [INE website](#).

¹² 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.

In November 2021, the composite indicator of financial stress for Portugal reverted the downward trajectory observed since the end of 2020. Albeit remaining at low values, it increased moderately in April 2022, recording its highest value since mid-2020, due to the uncertainty related to the disruptions in global value chains and future energy price developments, compounded by the Russia-Ukraine conflict. Looking forward, the level of financial stress will largely depend on the second-round effects of the war in Ukraine on Portugal's economic activity and financial sector.

In April 2022, the economic sentiment indicator for Portugal, albeit amid some volatility, decreased slightly in comparison to December 2021 (Chart 4), reflecting the abovementioned risks. Nevertheless, it remains close to the pre-pandemic values. This more recent negative evolution reflects a deterioration in all sub-indicators except for the services sector (which includes tourism, restaurants and entertainment) vis-à-vis December 2021. The sub-indicator related to consumers, which collects information on households' spending and savings intentions, was the one that displayed the highest decrease.

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



Source: European Commission. | Notes: The last observation refers to April 2022. 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 decided to maintain at 0% the countercyclical capital buffer rate over the third quarter of 2022. Despite the recovery in economic activity, there is still a high level of uncertainty over the duration and impact of the current Russia-Ukraine conflict. The conflict has contributed to heightened inflationary pressures due to the rise in the prices of energy commodities and a number of primary goods, thus limiting the economic momentum. The negative impact on activity could also stem from the expected decline in the confidence of households and entrepreneurs, potential turbulence in financial markets, as well as the impacts of the sanctions imposed on Russia.

This decision avoids unintended procyclical effects and constraints on banks' ability to lend to the economy. Notwithstanding, the Banco de Portugal will continue to closely monitor the developments in cyclical systemic risk, taking into consideration the current environment, the projected impact of the pandemic and the situation in Ukraine, and the normalization of monetary policy, and may take macroprudential measures, including those more targeted toward specific pockets of vulnerability, aimed at mitigating the potential build-up of systemic risk in the economy.