

# COUNTERCYCLICAL CAPITAL BUFFER



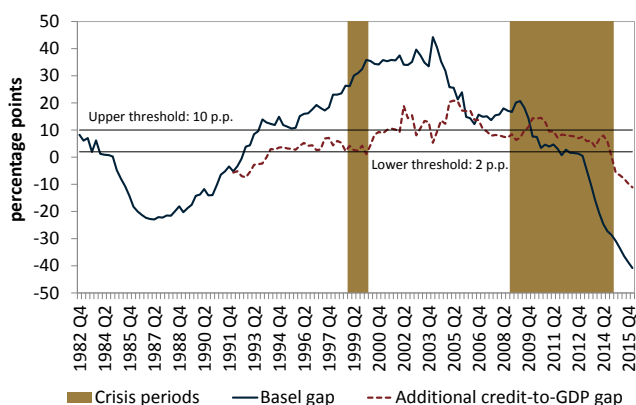
BANCO DE PORTUGAL  
EUROSYSTEM

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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 October 2016.

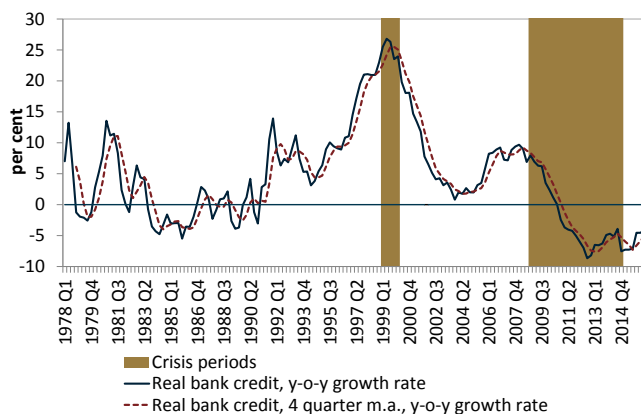
This decision is based on the overall assessment of recent developments in a set of financial and macroeconomic indicators, as follows<sup>1</sup>:

**Chart 1 – Basel gap and additional credit-to-GDP gap<sup>3</sup>**



Sources: BdP, INE and BdP's calculations. Last observation: 2016 Q1.

**Chart 2 – Real bank credit growth<sup>4</sup>**



Sources: BdP, INE and BdP's calculations. Last observation: 2016 Q2.

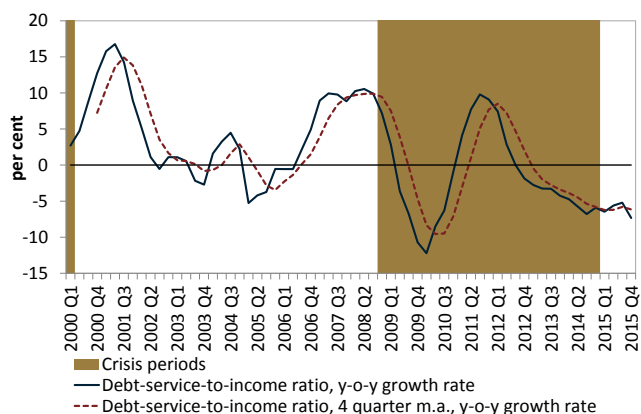
## Credit-to-GDP gap measures have further declined

Both measures of the credit-to-GDP gap continued to decline in the first quarter of 2016, indicating that the credit-to-GDP ratio remains below its long-term trend. Accordingly, the Basel gap decreased to -40.8 p.p. and the additional credit-to-GDP gap to -11.1 p.p., which compares to -38.7 p.p. and -9.7 p.p. in the last quarter of 2015, respectively. For these values of the gap, the BCBS methodology suggests that **the benchmark buffer rate should be kept at 0 per cent of the total risk exposure amount** (see Chart 1)<sup>2</sup>.

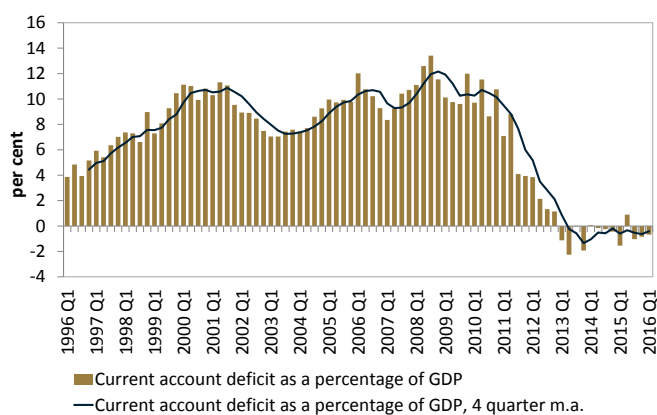
## Bank credit is still sluggish

Other indicators of credit to the private non-financial sector are in line with the information provided by the two measures of the credit-to-GDP gap. Despite the recent increase in consumer credit, the year-on-year growth rate of total bank credit to the private non-financial sector remained negative in the second quarter of 2016, standing at -4.2 per cent, almost unchanged when compared to the previous quarter (see Chart 2). Furthermore, bank spreads on new loans to non-financial corporations have remained stable in the first quarter of 2016, standing at 3.4 p.p. (more 0.1 p.p. than in the previous quarter), which is still above the pre-crisis minimums.

Overall, there are only minor indications that this trend in bank credit might revert in the near future. According to the July 2016 Bank Lending Survey, conditions in the credit market should remain broadly stable, although there could be an easing of the credit standards and an increase in loan demand

Chart 3 – Debt-service-to-income ratio<sup>5</sup>

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

Chart 4 – Current account deficit as a % of GDP<sup>6</sup>

Sources: BdP, INE and BdP's calculations. Last observation: 2016 Q1.

by households. Among the factors influencing these developments in the supply and demand for credit are the low level of interest rates, the better prospects for the housing market and the improved economic outlook.

## Private non-financial sector continues to deleverage

The debt-service-to-income ratio of the private non-financial sector has been declining since the beginning of the Economic and Financial Assistance Programme, which is consistent with the adjustment of non-financial corporations and households' balance sheets observed since then. In particular, the year-on-year growth rate of this indicator has declined from around 9.8 per cent in the third quarter of 2011 to -7.3 per cent in the last quarter of 2015 (see Chart 3).

Going forward, it is expected that the debt servicing capacity of the private non-financial sector continues to improve. The projections underlying the Banco de Portugal's June 2016

Economic Bulletin indicate that households' debt-service-to-income ratio, in particular, should benefit from a reduction in indebtedness levels. Against this background, recent developments in the debt-service-to-income ratio provide no signals of excessive credit growth.

## Current account should remain positive

The current account balance continues in positive territory, registering a surplus of 0.7 per cent of GDP in the first quarter of 2016 (see Chart 4). According to the June 2016 Economic Bulletin's projections, the Portuguese economy is expected to maintain its external net lending capacity over the medium-term due to an increase in both saving and investment rates, in the context of the still ongoing adjustment process. These prospects are consistent with a gradual reduction in external indebtedness levels of the Portuguese economy and provide no evidence of an acceleration in the credit market fuelled by external resources over the medium-term.

## General assessment

In line with the previous risk assessment, the current outlook does not point to the build-up of imbalances due to excessive credit growth. This is consistent with the adjustment that is still taking place in the Portuguese economy. Consequently, the countercyclical buffer rate is expected to remain unchanged during 2016.

## Notes

- 1 The assessment is based on available data up to 25 July 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 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 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>.
- 6 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
GDP	Gross Domestic Product
HP	Hodrick and Prescott
INE	<i>Instituto Nacional de Estatística</i> (Statistics Portugal)
m.a.	moving average
p.p.	percentage points
y-o-y	year-on-year rate of change