COUNTERCYCLICAL CAPITAL BUFFER

BANCO DE PORTUGAL
EUROSYSTEM

30 SEP 2021

Pursuant to the decision of the Board of Directors of 21 September 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 October 2021

The rapid rollout of the vaccination program as of the second quarter of 2021 seems to be contributing to the control of the pandemic. Consequently, some of the most restrictive lockdown measures implemented in the beginning of the year have been gradually unwound, leading to an improvement in the outlook for the economic activity and in the confidence of economic agents. Nevertheless, support measures still play an important role in the economic recovery, guaranteeing an adequate financing to the economy and support to both non-financial corporations (NFC) and households. The economy is expected to continue its recovery path over the next quarters, but a non-negligible degree of uncertainty still lingers given the unknown full impact of the Delta variant of the virus and the constraints that still exist in supply chains that are likely to persist for some time.

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

Credit-to-GDP gap measures remain negative

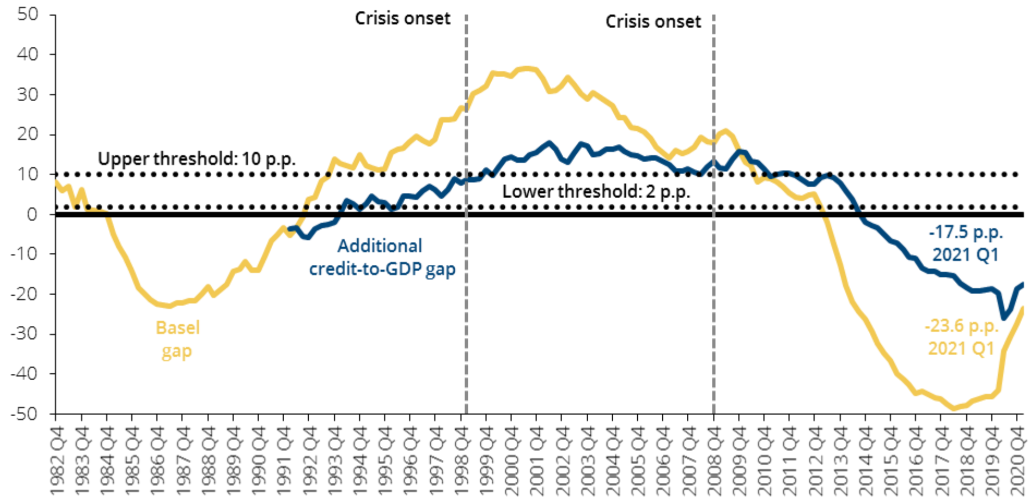
The Basel gap reached -23.6 percentage points (p.p.) in the first quarter of 2021 (Chart 1), becoming 4 p.p. less negative when compared with the value of the last quarter of 2020. The additional credit-to-GDP gap also became less negative increasing from -18.7 p.p., in the last quarter of 2020, to -17.5 p.p., in the first quarter of 2021. Despite the recent upward trend, both measures remain below the threshold (2 p.p.) that would trigger a positive benchmark buffer rate.

The credit-to-GDP ratio also continued to increase in the first quarter of 2021, reaching 174.3%. This represents an increase of 3 p.p. when compared with the last quarter of 2020. Over the first quarter of 2021, credit granted to the private non-financial sector increased 0.6%, driven by an increase in both credit granted to NFC (+0.6%) and to households (+0.5%). Nominal GDP decreased 3.6% in the first quarter of 2021, when compared with the same period of the previous year. Therefore, both the behavior of credit and of GDP contributed positively to the evolution of credit-to-GDP ratio.

The credit-to-GDP gap has continued to increase, mostly driven by the evolution of the credit-to-GDP ratio, since its trend takes more time to adjust. The large drop in nominal GDP observed in the last quarters has been the main driver of the behavior observed in both measures of the credit-to-GDP gap.

[1] The assessment is based on data available up to 9 September 2021. Any differences in figures from previous assessments are due to revisions in underlying data.

Chart 1 • Basel gap and additional credit-to-GDP gap[2] | In percentage points



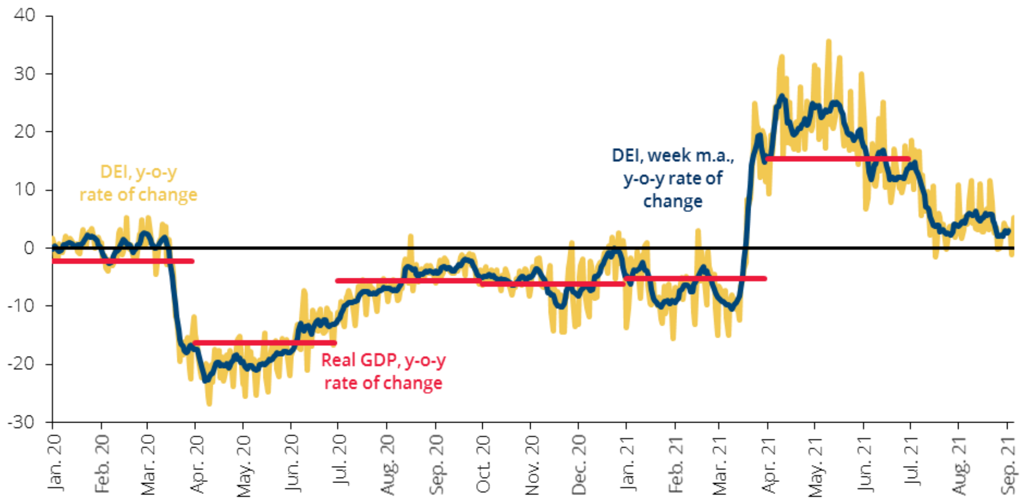
Sources: Banco de Portugal and Statistics Portugal. | Notes: The last observation refers to 2021 Q1. p.p. stands for percentage points. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

According to the June 2021 Banco de Portugal *Economic Bulletin*, the projected GDP growth for 2021 and 2022 was revised upwards. This revision is anchored on a more positive outlook for the economic activity in the short term. This is also in line with the figures published by Statistics Portugal, pointing to a 15.5% increase in real GDP, year-on-year, in the second quarter of 2021. Moreover, the daily economic indicator (DEI)[3] shows an improvement in economic activity as of middle of March, followed by a decrease in June (Chart 2). It should, however, be taken into account that the values reported in this chart are influenced by the volatility observed in this indicator in 2020. Regarding the evolution of credit, a moderate increase should be expected over the next quarters as a result of continued economic recovery, but below the GDP growth rate. Consequently, the credit-to-GDP ratio is likely to decrease.

[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 at https://www.bportugal.pt/sites/default/files/anexos/pdf-boletim/be_out2020_e.pdf (Box 1), at https://www.bportugal.pt/en/publications/banco-de-portugal/all/9085 and Lourenço and Rua (2020), "The DEI: tracking economic activity daily during the lockdown", *Working paper* No. 13, Banco de Portugal.

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



Source: Banco de Portugal. | Notes: The last observation refers to 5 September 2021. m.a. stands for moving average.

The rate of change of outstanding real bank credit to the non-financial private sector slowed decreased

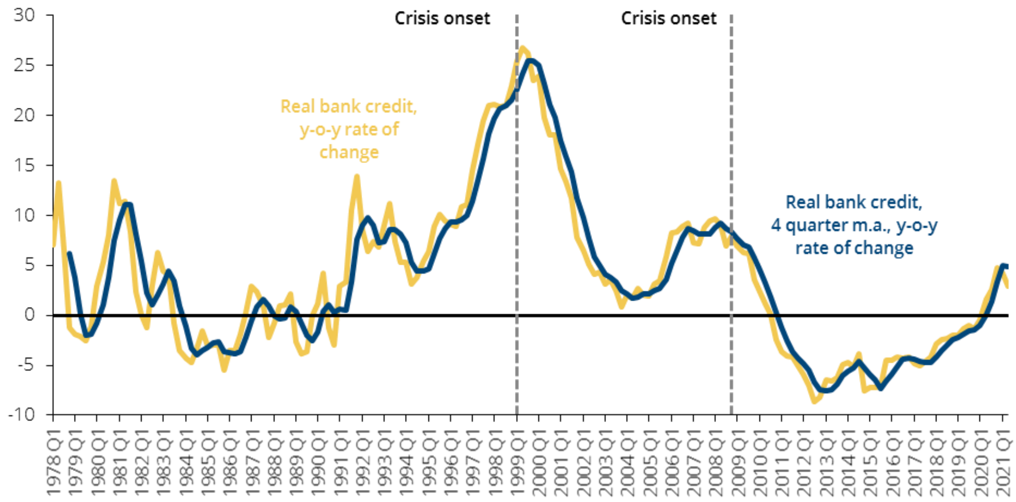
In the second quarter of 2021, outstanding real bank credit to the private non-financial sector increased 2.9% (year-on-year) (Chart 3), but to a lesser extent, when compared to the previous period (4.2% year-on-year). The increase in the second quarter of 2021 is driven by a 3.8% and a 2.2% increase in outstanding real bank credit to NFC and households, respectively. The outstanding real bank credit for house purchase increased by 0.5% (year-on-year), and the real bank credit for consumption and other purposes also increased by 8.7% (year-on-year).

Looking forward, and according to the July 2021 *Bank Lending Survey*[4], credit standards for loans to NFCs and households are expected to remain broadly unchanged. The assessment regarding loans to NFC is very heterogeneous across banks, with the overall demand remaining mostly unchanged. Banks also expect a slight increase in the demand for consumer credit and other lending.

Interest rates on new lending remained stable, continuing to reflect stable financial conditions. The interest rate on new lending to NFC reached 2.0% in June 2021, in line with the values observed since the beginning of 2021. The interest rate underlying new loans for house purchases remained constant at 0.8%, since the end of 2020, and those associated to bank loans for consumption and other purposes have slightly increased in the second quarter of 2021, reaching 5.4% in June 2021.

[4] More information is available at https://www.bportugal.pt/sites/default/files/anexos/pdf-boletim/results_jul2021_en.pdf

Chart 3 • Year-on-year rate of change of real bank credit[5] | Per cent



Sources: Banco de Portugal and Statistics Portugal. | Notes: The last observation refers to 2021 Q2. m.a. stands for moving average. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

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

In the first quarter of 2021, the real house price index increased by 4.2% year-on-year (Chart 4), compared to a 7.9% year-on-year growth rate in Q4 2020. The number of house transactions increased, but also at a slower pace, in the first quarter of 2021: 0.5% year-on-year rate of change vs 1% year-on-year increase in the last quarter of 2020. This deceleration in the rate of change should be partially explained by the mobility restrictions that were (re)introduced in the first quarter of 2021 and that were almost absent over the first quarter of 2020, in which the pandemic was just beginning to take effect.

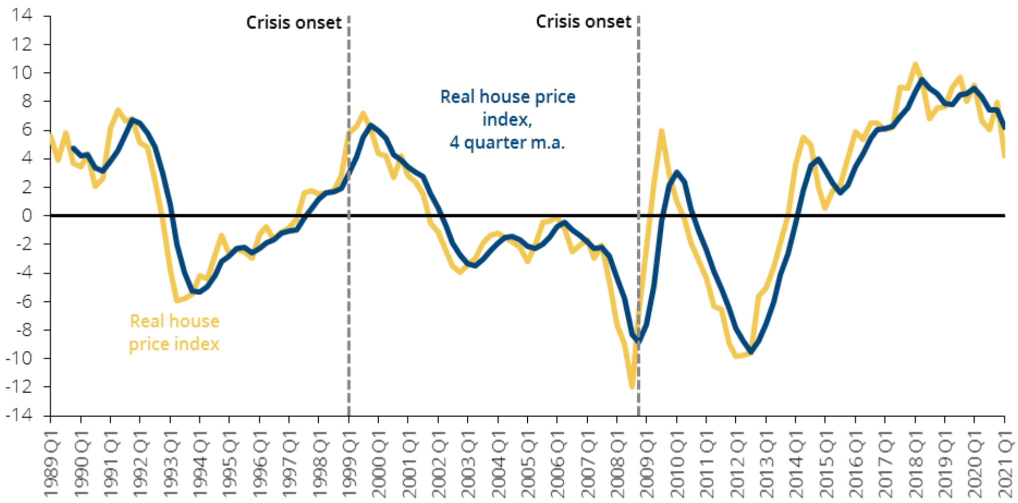
As highlighted in the June 2021 Banco de Portugal's *Financial Stability Report*, the residential real estate sector has showed signs of strong resilience during the COVID-19 pandemic. This behavior has essentially been driven by the low interest rate environment, which promotes housing demand, and the lack of housing supply, despite the resilience of the construction sector during the pandemic crisis. Looking forward, the June 2021 Banco de Portugal's *Economic Bulletin* suggests that, in a context of savings accumulation following the lockdown measures of the pandemic, real estate will remain as an attractive channel for investment.

The May 2021 *Portuguese Housing Market Survey*[6] suggests an increase in house sales and a gradual but steady improvement in participants' expectations in the housing market. Furthermore, most of the participants in this survey reported a positive outlook in the rental market over the past months.

[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.

[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.

Chart 4 • Year-on-year rate of change of house prices, in real terms[7] | Per cent



Source: Organization for Economic Co-operation and Development. | Notes: The last observation refers to 2021 Q1 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 has stabilized at low values

After a period of steady decline, the composite indicator of financial stress for Portugal stabilized at low levels (Chart 5). It reached 1.4 in August 2021, which compares to 45.6 observed at the onset of the COVID-19 pandemic crisis (April 2020). The support measures adopted to mitigate the economic and financial impact of the pandemic crisis, coupled with the economic recovery and the decrease in uncertainty, should have played a key role in this stabilization at low values.

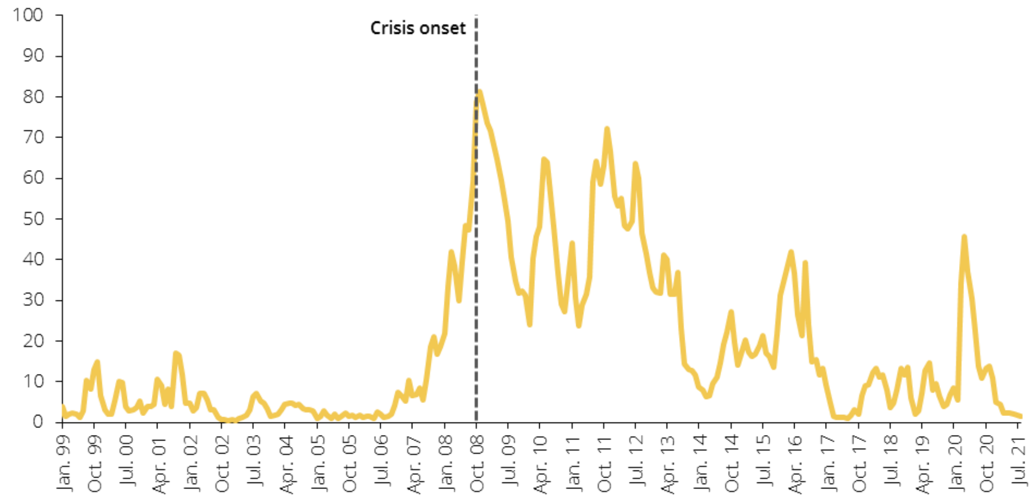
Looking forward, the continued economic recovery, the decrease of the levels of uncertainty regarding the impact of the crisis, together with a balanced unwinding of the support measures and the improvement of the epidemiological situation in Portugal, should keep the financial stress indicator at the current level.

The economic sentiment indicator is close to pre-pandemic values

The economic sentiment indicator for Portugal increased following the end of the second lockdown and the acceleration in the pace of the vaccination process. In April 2021, this indicator was above the threshold of 100 for the first time since February 2020, reaching a level of 104.0 (Chart 6). In August 2021, the indicator slightly increased, to 106.3, in comparison to the previous month. This increase follows from an improvement in the confidence indicators of almost all sectors, except in the industrial sector. This may reflect the uncertainty that still surrounds the pace of economic recovery associated, in particular, with difficulties in supply chains.

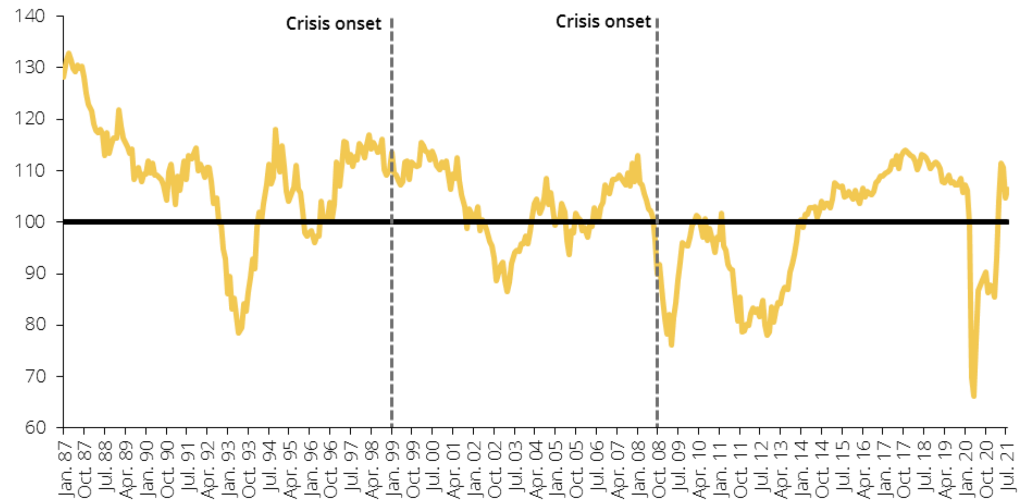
[7] Real house price index (2015=100) published by the Organization for Economic Co-operation and Development. The house price index is adjusted for inflation using the private consumption deflator (2016=100) taken from the National Accounts (ESA2010, base 2016) published by Statistics Portugal.

Chart 5 • Composite indicator of financial *stress* for Portugal[8] | Quantile Rank



Source: Banco de Portugal. | Notes: The last observation refers to August 2021. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

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



Source: European Commission. | Notes: The last observation refers to August 2021. 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, the Banco de Portugal has decided to maintain at 0% the countercyclical capital buffer rate over the fourth quarter of 2021. This decision is taken in a context still characterized by non-negligible degree of uncertainty and intends to preserve banks' ability to provide credit to the economy and support the private non-financial sector throughout the foreseen recovery. The Banco de Portugal will continue to closely monitor the developments in cyclical systemic risk, taking into consideration the current and the projected impact of the pandemic, including the measures adopted to mitigate such impact and those that have been, in the meantime, withdrawn.

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