

COUNTERCYCLICAL CAPITAL BUFFER



30 SEP. 2022

Pursuant to the decision of the Board of Directors of 27 September 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 October 2022

The medium to long-term outlook remains highly conditioned by uncertainty. The worldwide downward revision of growth expectations and higher-than-expected inflation, the spillovers from the war in Ukraine and lockdowns in China, and the tightening of financial conditions entail risks to financial stability. Despite the deteriorating international environment, economic activity in Portugal is expected to continue its recovery path over the next quarters, although at a slower pace, conditional on a gradual dissipation of these shocks from mid-2022 onwards.

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

The credit-to-GDP gap remains far from the benchmark buffer rate threshold

The Basel gap reached -24.1 percentage points (p.p.) in the first quarter of 2022 (Chart 1), 1.1 p.p. lower than in the previous quarter (-22.9 p.p.), mostly driven by the credit-to-GDP ratio decrease. The additional credit-to-GDP gap remained broadly unchanged during the same period, reaching -11.1 p.p. (0.4 p.p. less negative than in the last quarter of 2021) (Chart 1). Both credit-to-GDP measures remain below their long-term trends and, therefore, of the threshold that would trigger a positive benchmark buffer rate (2 p.p.).

The credit-to-GDP ratio maintained the downward trend observed in previous quarters, reaching 169.5% in the first quarter of 2022 (a 2.6 p.p. decrease when compared with the last quarter of 2021). The total credit granted² to the private non-financial sector increased 3.9% (year-on-year), driven by an increase in both total credit granted to non-financial corporations (NFCs) (4.0%, year-on-year) and to households (3.8%, year-on-year). As such, the decrease in the credit-to-GDP ratio was prompted by the significant increase in nominal GDP (9.8%, year-on-year), which more than outweighed the increase in total credit. More recently (June 2022), the annual rate of change of the total credit granted to the private non-financial sector adjusted for securitisation operations, reclassifications, sales, write-offs and price and exchange rate revaluations was 4.1% (year-on-year), driven by an increase in both total credit granted to NFCs and to households (3.9% and 4.4%, respectively).

As released in the June 2022 Banco de Portugal's *Economic Bulletin*, the projected GDP growth for 2022 was revised upwards (to 6.3%)³, reflecting buoyant economic activity at the beginning of the year. Figures recently released by Statistics Portugal

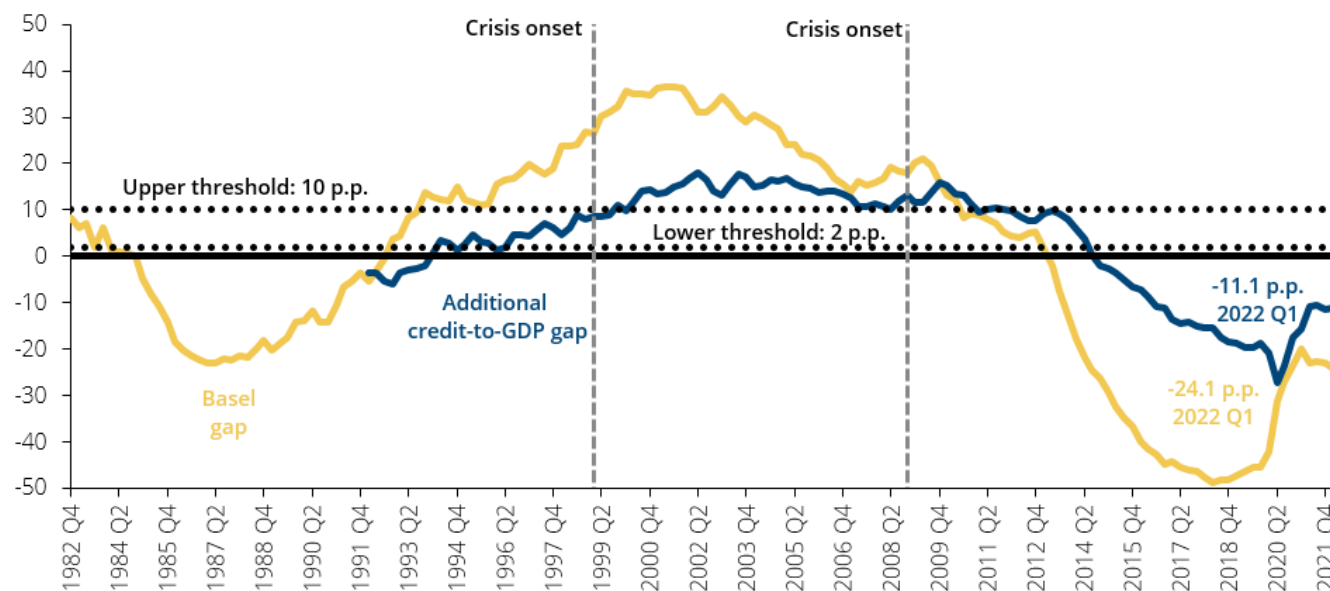
¹ The assessment is based on data available up to 2 September 2022. Any differences in figures from previous assessments are due to revisions in underlying data.

² Total credit includes loans granted to the domestic private non-financial sector and debt securities issued by the domestic private non-financial sector.

³ The June 2022 Economic Bulletin of the Banco de Portugal is available at the Banco de Portugal [website](#).

point to a 7.1% increase in real GDP, year-on-year, in the second quarter of 2022 (2.5% and 0% quarter-on-quarter, in the first and second quarters of 2022, respectively).⁴ Looking forward, the downside risks remain associated with the negative spillovers of the war in Ukraine in the Portuguese economy, through an increase of uncertainty and higher inflation rates, particularly due to energy and food components. Tighter financial conditions, against a background of normalisation of monetary policy, renewed COVID-19 outbreaks and lockdowns in China, with a further negative impact on global supply chains, and a worse-than-anticipated slowdown in the activity of Portugal's major economic partners are additional factors of risk. Notwithstanding, taking into account the projections for GDP growth and the potential impact of the normalisation of the monetary policy on credit demand, the sign of both credit-to-GDP gaps is unlikely to change in the near future.

Chart 1 • Basel gap and additional credit-to-GDP gap⁵ | In percentage points



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

The adjusted annual growth rate⁶ of bank credit to the non-financial private sector, in nominal terms, has remained relatively stable at around 3%

In the second quarter of 2022, outstanding real bank credit to the non-financial private sector decreased 4.3% (year-on-year) (Chart 2), due to a decrease in real bank credit outstanding to NFCs (-5.5%, year-on-year) and to households (-3.4%, year-on-year). These developments reflect the surge of inflation during the second quarter of 2022 (8.0%, year-on-year), as bank credit to households and NFCs continued to increase in nominal terms (4.3% and 2.1%, respectively). The annual rate of change of the outstanding real bank credit to the non-financial private sector adjusted for securitisation operations, reclassifications, sales, write-offs and price and exchange rate revaluations was also negative in June 2022 (-5.8%), decreasing by 3.4 p.p. when compared to March 2022. This evolution was driven by both the decrease in real bank credit outstanding to NFCs (from -4.1% in March 2022, to -7.7%, in June 2022) and by the decline of real bank credit outstanding to households (from -1.1%, in March 2022, to -4.4%, in June 2022).⁷

⁴ The press release for the Quarterly Nacional Accounts for the second quarter of 2022 is available at the Statistics Portugal [website](#).

⁵ 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.

⁶ Adjusted for securitisation operations, reclassifications, sales, write-offs, price and exchange rate revaluations.

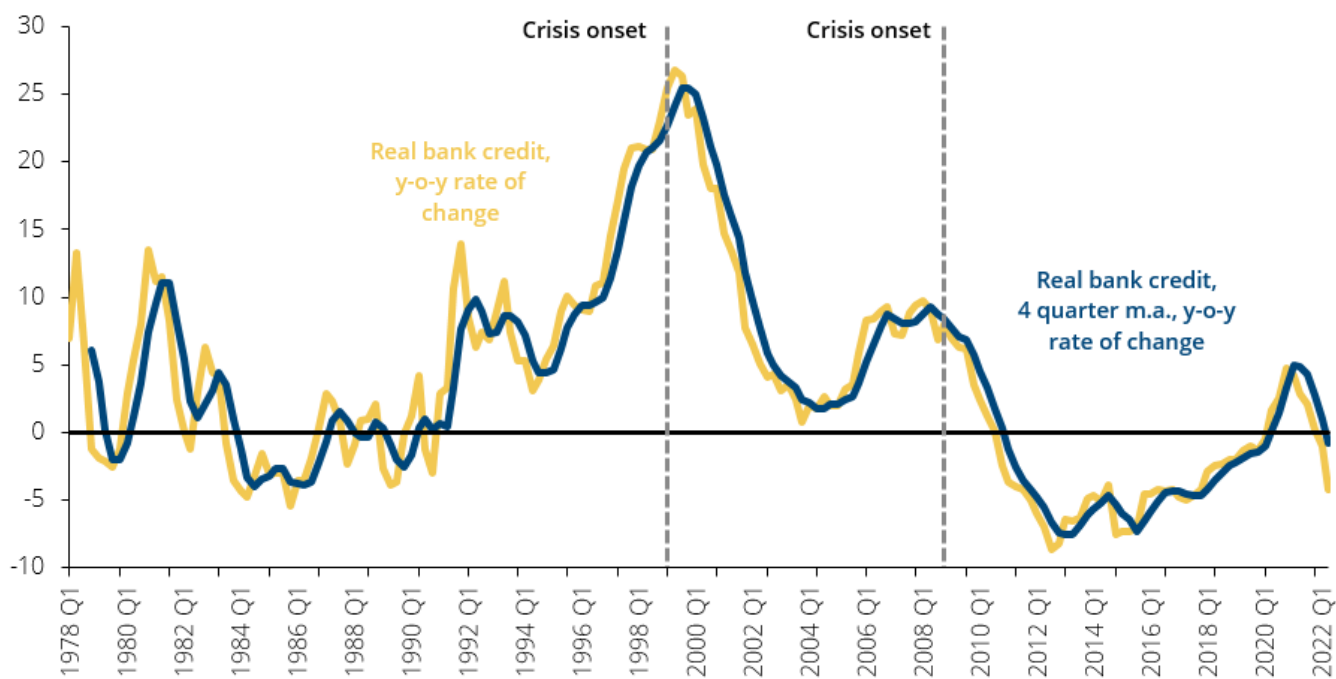
⁷ In nominal terms, the annual rate of change of the outstanding bank credit to the non-financial private sector adjusted for securitisation operations, reclassifications, write-offs, price and exchange rate revaluations, and sales, in June 2022, was 2.9 (1.1% and 4.3%, for NFCs and households, respectively).

After a significant increase during the pandemic crisis, broadly supported by public sector measures, bank credit to NFCs, in nominal terms, decelerated, with its annual growth rate, adjusted for securitisation operations, reclassifications, write-offs, price and exchange rate revaluations, reaching 1.1% in June 2022. In real terms, the year-on-year growth rate of bank credit to NFCs turned negative, in the fourth quarter of 2021, and has been progressively declining ever since, also reflecting the increase in inflation. As to financing conditions, the average interest rate on new lending to NFCs reached 2.2%, in June 2022, increasing by 0.3 p.p. when compared to March 2022.

Regarding households, the year-on-year decrease in outstanding bank credit, in real terms, reflects a decrease of both credit for consumption and other purposes (-4.2%) and credit for house purchase (-3.2%). The annual rate of change of the outstanding real bank credit adjusted for securitisation operations, reclassifications, sales, write-offs, price and exchange rate revaluations, in June 2022, was even more pronounced, reaching -5.2% and -4.2% for consumption and other purposes and for house purchase, respectively (in nominal terms, the adjusted annual rates of change were 3.5% and 4.5%, respectively). The average interest rate on new lending for house purchase reached 1.5% in June 2022, increasing by 0.4 p.p. when compared to March 2022. The average interest rate on new lending for consumption and other purposes reached 6.2%, in June 2022, slightly above the values reported in March 2022 (6.1%).

Looking forward, and according to the July 2022 *Bank Lending Survey*⁸, on the supply side, and over the third quarter of 2022, credit standards are expected to become tighter for NFCs, in particular for long-term loans to SME, and for households as well. The demand for loans by NFCs is expected to increase slightly, in particular the demand for short-term loans by SME. Banks also expect a slight decrease in the demand for loans by households, mainly for house purchase.

Chart 2 • Year-on-year rate of change of real bank credit⁹ | Per cent



Sources: Banco de Portugal and Statistics Portugal. | Notes: The last observation refers to 2022 Q2, m.a. stands for moving average. Dates for crises onset as defined in the ESCB Heads of Research Group's banking crises database.

Despite the existing signals of deceleration in demand, nominal house prices continued to increase at a significant pace, also reflecting supply-side constraints

⁸ More information is available at the Banco de Portugal website .

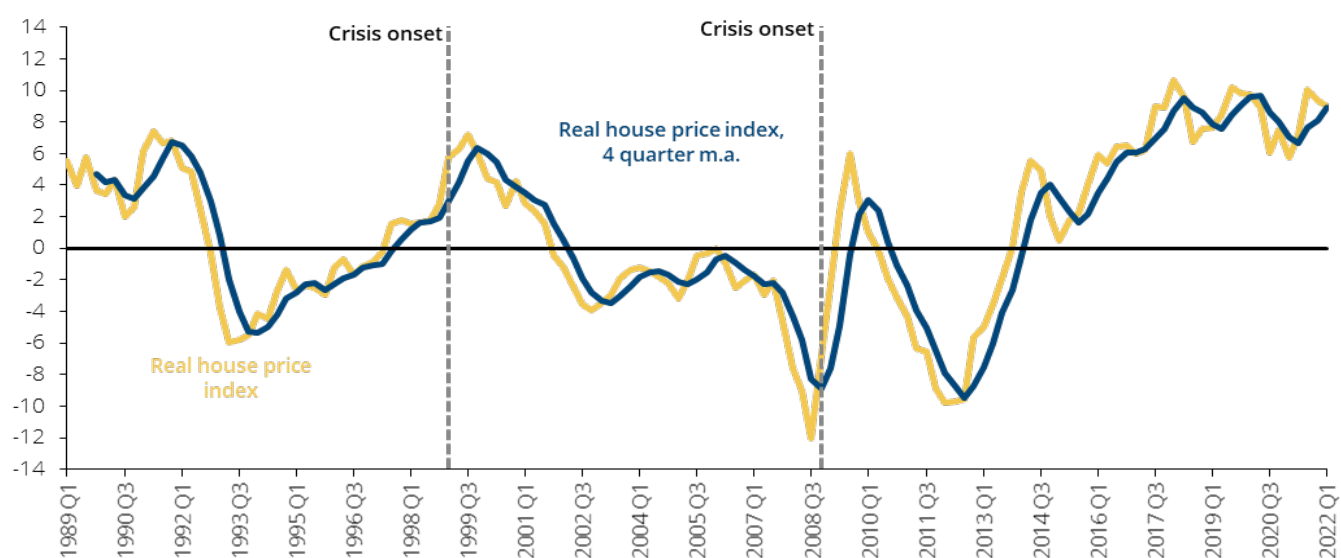
⁹ Bank credit includes loans granted to the domestic private non-financial sector and debt securities issued by the domestic private non-financial sector and held by banks. Bank credit granted by resident monetary financial institutions as available in Monetary and Financial Statistics published by the Banco de Portugal. The credit variable is adjusted for inflation using the consumer price index (2012=100) published by Statistics Portugal.

In the first quarter of 2022, the nominal house price index increased by 12.9% (year-on-year), which compares with year-on-year growth rates of 11.5% and 11.6%, in the third and fourth quarter of 2021, respectively. In real terms, the house price index continued to increase, reaching a growth rate of 9.0% (year-on-year), although at a slower pace relative to the peak observed in third quarter of 2021 (Chart 3).

The number of house transactions also continued to increase, with a year-on-year rate of change of 25.8% in the first quarter of 2022, which compares with a rate of change of 17.2% in the last quarter of 2021. On the supply side, in the first quarter of 2022, the number of building permits for new constructions and completed buildings in Portugal increased by 4.1% and 1.8% (year-on-year), respectively.¹⁰ The average value *per* house transaction increased by 15% (year-on-year), in line with the preceding quarter.

The June 2022 *Portuguese Housing Market Survey*¹¹ signals a stalling in housing market activity along with a continued firmly rise in nominal prices. The majority of survey respondents expect near-term sales to stagnate but prices to remain on an upward trajectory at a twelve-month time horizon. In the rental market, participants' expectations anticipate a rise in rents over the near-term, reflecting a robust tenant demand growth along with a tight supply. In addition, the results from the June 2022 *Survey on bank evaluation on housing*¹² indicate that the median value of bank appraisals on housing continued to increase, with a year-on-year nominal growth rate of 15.8% in June 2022, which compares to 13.9% in the previous month. Meanwhile, the number of bank appraisals decreased by 2.7% (year-on-year) in June 2022, compared to a year-on-year growth rate of 8.0% in the previous month.

Chart 3 • Year-on-year rate of change of house prices, in real terms¹³ | Per cent



Source: Organization for Economic Co-operation and Development. | 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.

The composite indicator of financial stress for Portugal increased, albeit remaining at low values, and the economic sentiment indicator is slightly below the pre-pandemic values

In July 2022, the composite indicator of financial stress for Portugal maintained the upward trajectory observed since November 2021. Albeit remaining at low values, this evolution reflects the uncertainty related to the length of constraints on

¹⁰ More information is available at the Statistics Portugal [website](#).

¹¹ 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.

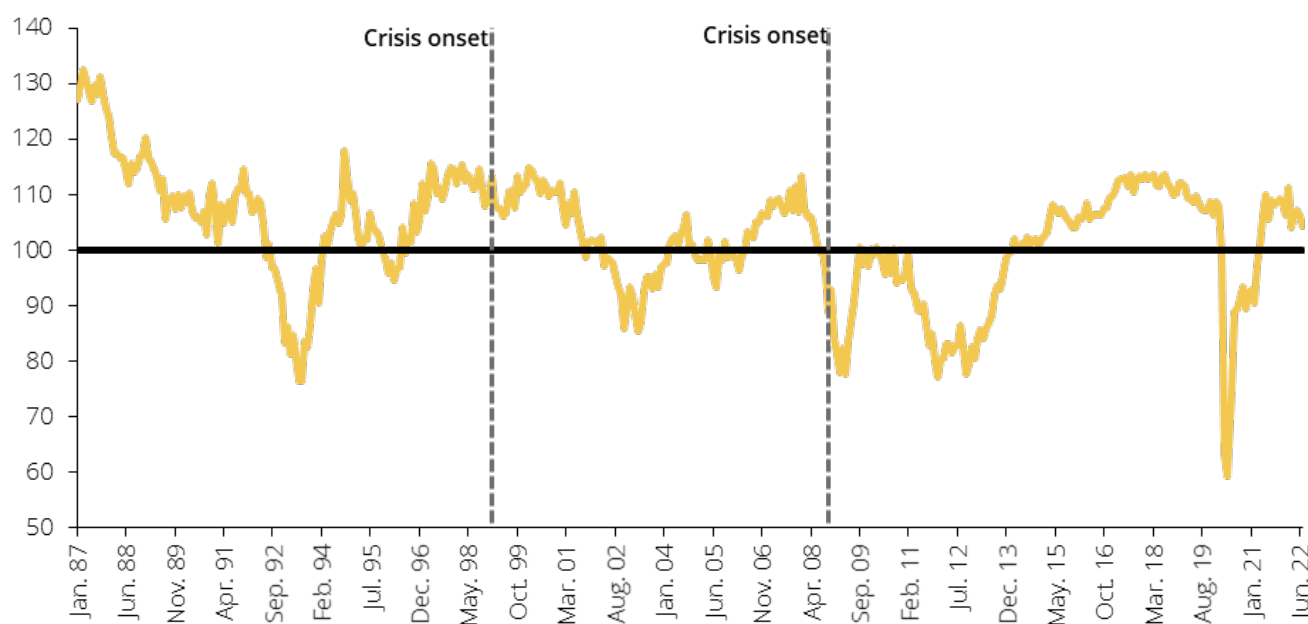
¹² More information is available at the Statistics Portugal [website](#).

¹³ 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.

global value chains and to future energy and other commodities' price developments. In the short-term, a slowdown in growth, increasing cost pressures, less accommodative monetary policies and potential turbulence in financial markets could lead to a further deterioration in financing conditions. Over the medium term, at least part of these conditions may actually support financial stability, mitigating some of the imbalances being built-up due to historically low borrowing costs and search-for-yield behaviour, but the overall effect depends on how the adjustment proceeds.

When compared to April 2022, the economic sentiment indicator for Portugal in July 2022 decreased and is now slightly below the pre-pandemic values (Chart 4). This decrease was driven by a deterioration in the confidence indicators for the services, industry, and retail trade sectors.

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



Source: European Commission. | Notes: The last observation refers to July 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 fourth quarter of 2022. Despite the recovery in economic activity following the pandemic crisis, the medium to long-term outlook remains highly conditioned by uncertainty. The war in Ukraine has contributed to the downward revision of growth expectations and to heightened inflationary pressures, due to the rise in the prices of energy and other commodities. The macro-financial outlook is also dependent on the potential negative impact from renewed COVID-19 outbreaks and lockdowns in China, with further negative impacts on global supply chains, and from the tightening of financing conditions underlying the normalisation of monetary policy or the turbulence in financial markets.

In recent years, domestic bank credit has not been the main factor behind the rise in house prices in Portugal, which has been chiefly driven by housing demand by non-residents and a tight supply. However, in the context of the recent higher growth in credit for house purchase, it is crucial to ensure that mortgages do not become a key determinant of price developments in the residential real estate market. The adoption of the macroprudential recommendation on new credit agreements led to an improvement in the risk profile of borrowers and of the housing loan portfolio on banks' balance sheets. The loan-to-value (LTV) ratio of Portuguese banks' loan portfolio for house purchase indicates resilience to a potential correction in house prices, resulting from tighter financing conditions.

The Banco de Portugal will continue to closely monitor the developments in cyclical systemic risk, taking into consideration the current environment described above, and may adopt macroprudential measures, including those more targeted toward specific pockets of vulnerability, aimed at mitigating the potential build-up of systemic risk in the economy.