COUNTERCYCLICAL CAPITAL BUFFER

> Pursuant to the decision of the Board of Directors of 12 September 2023, the countercyclical buffer rate for credit exposures to the domestic private non-financial sector will remain at 0% during the fourth quarter of 2023.

The short to medium-term outlook for the Portuguese economy remains constrained by geopolitical tensions and the economic slowdown in the euro area. As a result, developments in the Portuguese economy over the coming months will continue to be characterised by some uncertainty, particularly in view of the inflation environment and the lagged effect of rising interest rates.

This decision was made on the basis of the abovementioned information and the assessment of a set of financial and macroeconomic indicators.[1]

Both credit-to-GDP ratio measures remained well below their long-term trends

In the first quarter of 2023, the Basel gap and the additional credit-to-GDP ratio measure remained well below their long-term trends (Chart 1). The Basel gap reached -36.0 p.p. (-33.2 p.p. in the previous quarter), mainly driven by the narrowing of the credit-to-GDP ratio, exceeding the reduction's long-term trend. The additional measure of the credit-to-GDP gap reached -13.0 p.p. at the end of the first quarter of 2023 (-13.3 p.p. in the previous quarter).

The credit-to-GDP ratio stood at 148.9% in the first quarter of 2023 (154.0% in the fourth quarter of 2022), remaining on the downward path observed since the first quarter of 2021. These developments reflect GDP growth, amid a rapid recovery from the pandemic crisis, and a deceleration in credit granted to the private non-financial sector.

In the first quarter of 2023, the stock of credit granted[2] to the private non-financial sector declined by around 0.5% compared with the same quarter of the previous year. These developments reflect, on the one hand, the reduction in credit granted to non-financial corporations (NFCs) and, on the other hand, the deceleration in credit to households (-2.0% and 1.9% year on year, respectively). More recently, in June 2023, the annual rate of change in credit granted to the private non-financial sector, adjusted for securitisation operations, reclassifications, sales, write-offs and price and exchange rate revaluations, was 0.6% (year on year), reflecting changes in credit granted to NFCs and households of 0.5% and 0.9% respectively.

In the first half of 2023, the Portuguese economy saw solid growth, underpinned by buoyant exports and, to a lesser extent, an increase in private consumption. For the second half of the year, external risks mainly relate to a potential worsening of the geopolitical environment and slowing economic growth in some of Portugal's main trading partners. An environment of more persistent inflation may also imply a further tightening of monetary policy, and in this environment there is a risk of heightened financial tensions at global level, affecting the real economy. Given the projected GDP growth, the maintenance of tight

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[1] The assessment is based on available data up to 5 September 2023. 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.

monetary policy, adding to the expected lagged impact of the rate changes that have occurred so far, it is unlikely that the sign of both credit-to-GDP gaps will shift in the near future.

Chart 1 • Basel gap and additional credit-to-GDP gap[3] | In percentage points
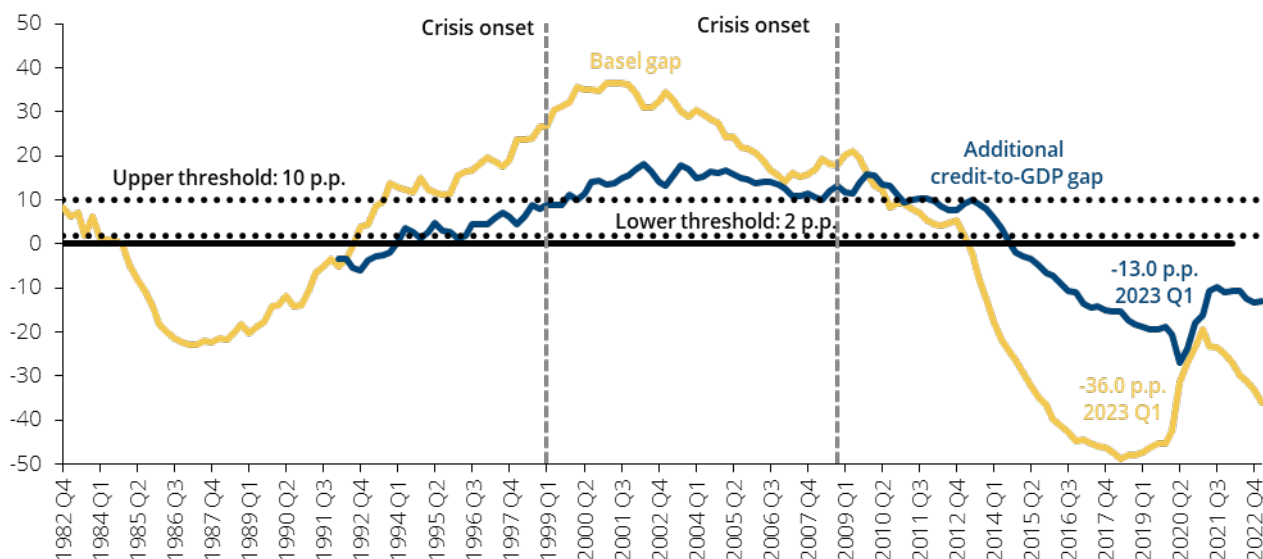
Bank credit[4] to NFCs exacerbated the downward trend, while loans to households decelerated further

The annual rate of change in bank loans to households, adjusted for securitisation operations, reclassifications, sales, write-offs and price and exchange rate price revaluations, decelerated further during the second quarter of 2023, to stand at 0.4% in nominal terms in June 2023 (Chart 2). In the housing segment, the adjusted annual rate of change was 0.1% and became negative the following month (-0.3%). Turning to bank loans for consumption and other purposes, the adjusted annual rate of change was 1.6%. In both segments, these rates reflect a deceleration from those observed in the recent past. In the NFC sector, the downward trend that started in the previous quarter intensified, with the adjusted annual rate of change reaching -2.5% in June (-1% in March).

Amid a tightening of monetary policy, financing conditions continued to worsen during the second quarter of 2023. The average interest rate on new loans to NFCs reached 5.5% in June 2023, up by 0.4 p.p. from March (and 3.6 p.p. from March 2022). In the household segment, the average interest rate on new loans for house purchase reached 4.3% in June 2023, 0.4 p.p. higher than in March 2023 (and up by 3.2 p.p. from March 2022). The average interest rate on new loans for consumption and other purposes was 7.6% in June 2023, in line with the figures observed in this segment since the beginning of the year.

Looking ahead, and according to the July 2023 Bank Lending Survey,[5] during the third quarter of 2023 credit standards are expected to tighten somewhat for small and medium-sized enterprises (SMEs) across all loan maturities. Regarding households, a slight tightening in consumer credit and a stabilisation in lending for house purchase are expected. In addition, demand for credit by NFCs, particularly SMEs, and for long-term loans is projected to decrease. Conversely, a slight increase in demand by NFCs for short-term loans is expected. Demand for loans by households is expected to decline somewhat. The

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[3] 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 by 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. Should the gap exceed 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, associated with a gap of 10 p.p. See Recommendation ESRB/2014/1, Annex, Part II, available on the ESRB's website. The Basel Committee on Banking Supervision's 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.

[4] Annual rates of change were adjusted for securitisation operations, reclassifications, sales, write-offs, and price and exchange rate revaluations. Bank credit comprises loans to the resident non-financial sector, excluding general government.

[5] For additional information, see the Banco de Portugal's website.

drop in consumer confidence, together with unfavourable prospects for the housing market and the general level of interest rates, has been considered as having contributed to the decline in demand for credit by households, in particular for house purchase. These factors should persist over the coming months.

Chart 2 • Adjusted annual rate of change[6] in bank credit to the private non-financial sector | Per cent
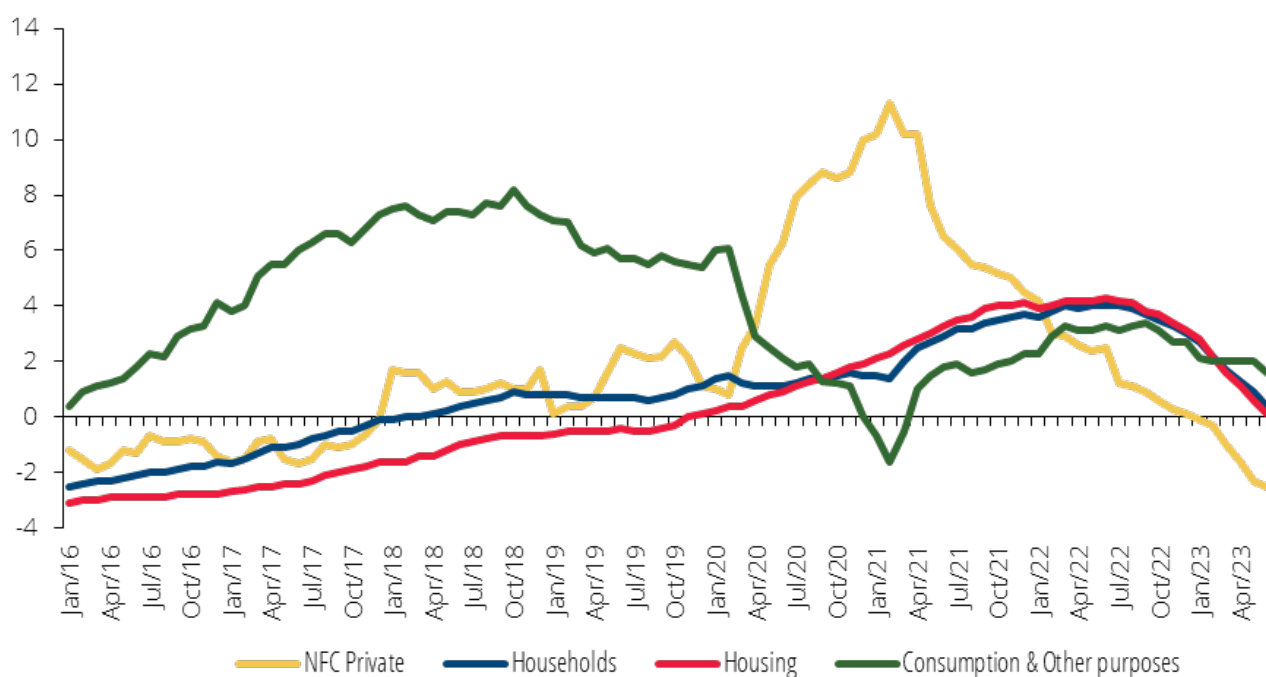
Source: Banco de Portugal.

Residential real estate prices decelerated further in early 2023

In the first quarter of 2023, the nominal housing price index increased by 8.7% (compared with the same period one year earlier), down by 2.6 p.p. from the fourth quarter (11.3%), while the quarterly rate of change rose slightly to 1.3% (from 1.1% in the last quarter of 2022). In real terms, developments in the house price index also remained positive (+1.3% year on year), albeit growing at its slowest pace since the first quarter of 2015 (Chart 3).

The first quarter of 2023 also saw a reduction in the number of housing transactions. The annual rate of change in this period was -20.8%, compared with a rate of change of -16.0% in the last quarter of 2022. Similarly, the value of housing transactions fell by 15.2% year on year, with the effect of the lower volume of transactions more than offsetting the effect of positive price changes. The average value per housing transaction increased further, reaching an annual growth rate of 7.1%, slightly higher than in the last quarter. On the supply side, the number of building permits for new constructions and completed buildings in Portugal decreased respectively by 10.9% and 2.9% (year on year).[7]

Constraints on new housing supply, rising construction costs (despite the ongoing slowdown), the fact that residential real estate continues to be an attractive asset for portfolio diversification (in particular in the context of international financial market turmoil and Portugal's geographical location), and the security and stability conditions that have made it a desirable destination and which support demand from non-residents have been the main factors contributing to higher residential real estate prices. It should be noted that the significant increase in residential real estate prices in recent years has been accompanied by muted growth in the stock of loans for house purchase, unlike other euro area countries. In 2022 the share of transactions financed with recourse to credit (excluding renegotiations) decreased from 2021 (-4 p.p.), averaging 46%, an amount equal to the average over 2018-22. Existing literature has documented that, in situations of substantial house price growth, the impact of any significant correction thereof on the economy and on the banking system tends to be more limited when such growth does not occur in tandem with a substantial increase in the stock of loans for house purchase.

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[6] Annual rates of change were adjusted for securitisation operations, reclassifications, sales, write-offs, and price and exchange rate revaluations. Bank credit comprises loans to the resident non-financial sector, excluding general government.

[7] For additional information, see the Statistics Portugal's website.

However, the current environment, characterised by an increase in financial costs due to monetary policy tightening and the resulting lower demand for credit for house purchase by residents, may contribute to a moderation in growth of residential real estate prices, or even some price correction in this market. According to the Banco de Portugal's May 2023 issue of the *Financial Stability Report*, this adjustment may occur chiefly in geographical areas where demand from non-residents is less relevant and demographic pressure is lower.

Chart 3 •   Real year-on-year rate of change in house prices[8] | Per cent
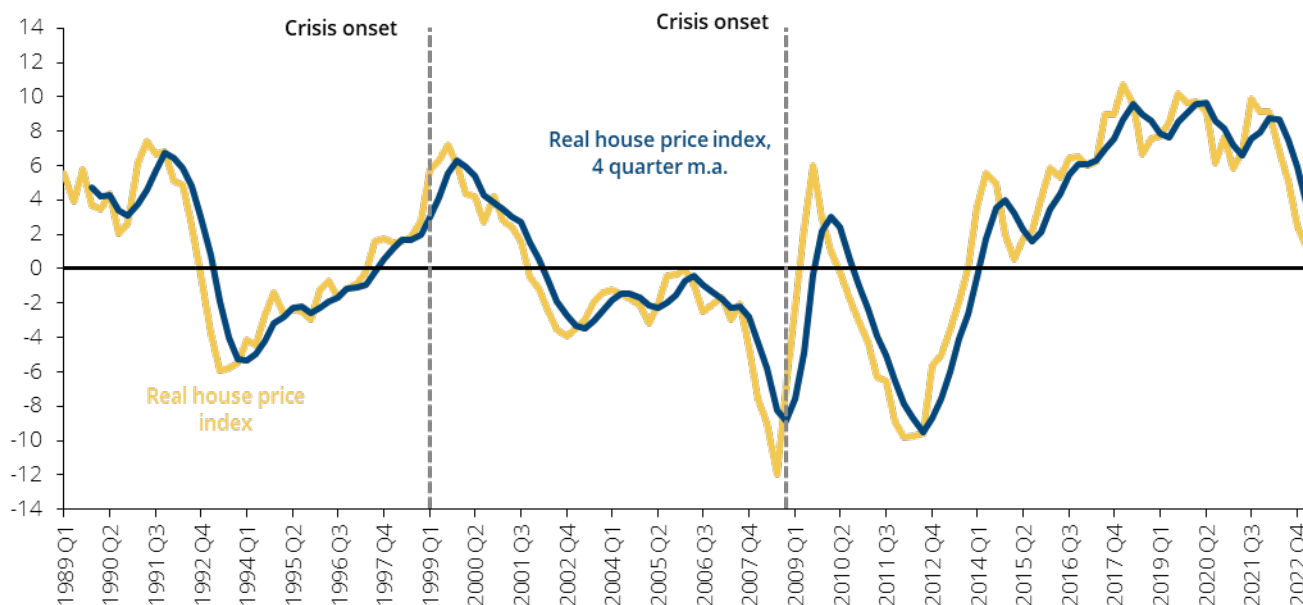
Source: Organisation for Economic Co-operation and Development. | Notes: The latest observation is for 2023 Q1. Onset of crises as identified in the ESCB Heads of Research Group's banking crises database.

The Economic Sentiment Indicator declined, but remains slightly above the 2000-22 average

In July 2023 the Economic Sentiment Indicator for Portugal declined compared with April, yet remained slightly above the 2000-22 average. These negative developments were to a large extent driven by the deterioration in the services confidence indicator. Conversely, developments in the construction and public works confidence indicator were positive, but insufficient to prevent a deterioration in the overall index.

General assessment

Taking into account the available information and in line with previous risk assessments, the Banco de Portugal decided to maintain the countercyclical buffer rate at 0% of the total risk exposure amount, with effect from 1 October 2023.

The Banco de Portugal will continue to monitor cyclical systemic risk developments and, where appropriate, may adopt or adjust macroprudential measures with a view to promoting the resilience of the Portuguese banking system.

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[8] Real house price index (2015=100) published by the Organisation for Economic Co-operation and Development (OECD). The house price index is adjusted for inflation using the private consumption deflator (2016=100) taken from the National Accounts (ESA 2010, 2016 benchmark), published by Statistics Portugal.