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SUERF: KEY TAKEAWAYS FROM THE ECB'S NEW FINANCIAL STABILITY REVIEW

Discussion and Q&A

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Disclaimer: The views expressed are those of the presenter and not necessarily those of Banco de Portugal, the Eurosystem, or any of its policy committees.

AGENDA

01

KEY TAKEAWAYS

02

HOW EFFECTIVE HAS MACROPRUDENTIAL POLICY BEEN? WHAT MORE CAN WE DO?

01

Key takeaways

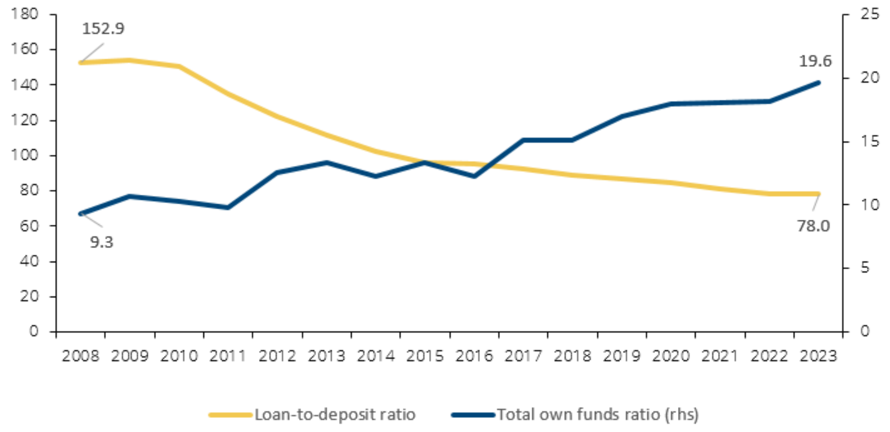
FINANCIAL STABILITY VULNERABILITIES IN THE EURO AREA EASED … … BUT THE OUTLOOK REMAINS FRAGILE

- Balanced analysis!
- The report highlights the positive evolution in inflation towards its medium-term objective together with an improvement in the economic outlook.
- **The pass-through of higher interest rates to the private sector is still incomplete**, leaving it vulnerable to adverse shocks. **Public debt** is above pre-pandemic levels. The downturn in the housing and commercial real estate markets is challenging real estate companies.
- Banks have remained resilient, but **their profits are likely to decline.**
- **The likelihood of the materialization of tail events** (geopolitical risk, policy uncertainty, shift in the financial market risk aversion, deviation of inflation from the expected path, economic and financial fragmentation) appears to have **increased**.
- Going forward the challenges are to preserve the resilience of the banking sector and to implement a comprehensive set of policy measures to enhance the resilience of non-bank sectors.

PORTUGUESE BANKING SECTOR: RESILIENCE, UNDERPINNED BY STRONG CAPITAL AND LIQUIDITY POSITIONS

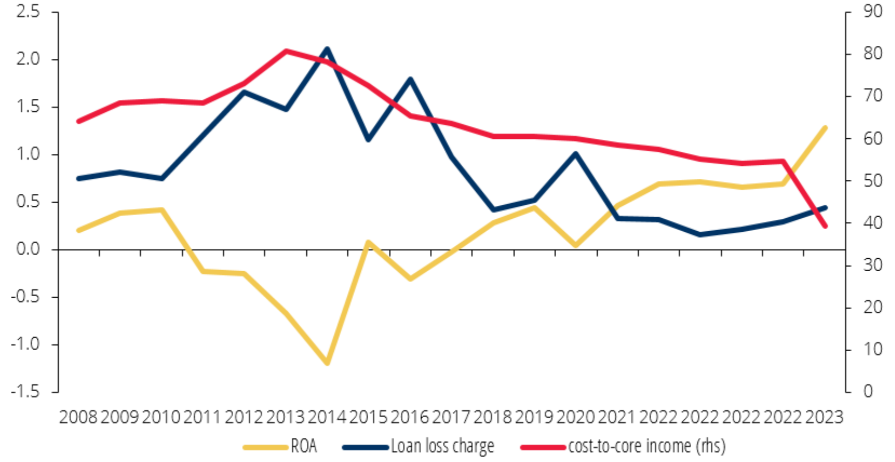
- CAPITAL RATIOS allowed banks to continue financing the economy, while keeping room for manoeuvre to absorb unexpected losses.
- PROFITABILITY at historically high levels: ROA was significantly higher than that of the euro area, while cost to income continued its downward trend.
- Banks' NPL ratio net of impairments stabilized around 1.2% and loan loss charge slightly increased.

Total own funds ratio and loan-to-deposit ratio | %



Source: Banco de Portugal

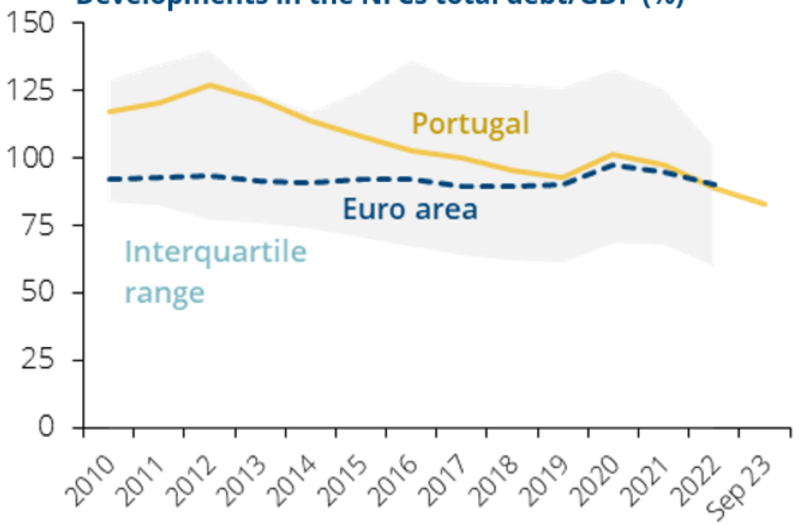
ROA, LLC and cost-to-core income| %



Source: Banco de Portugal

NFCs AND HOUSEHOLDS SHOW RESILIENCE AMID SOME SIGNS OF DETERIORATION

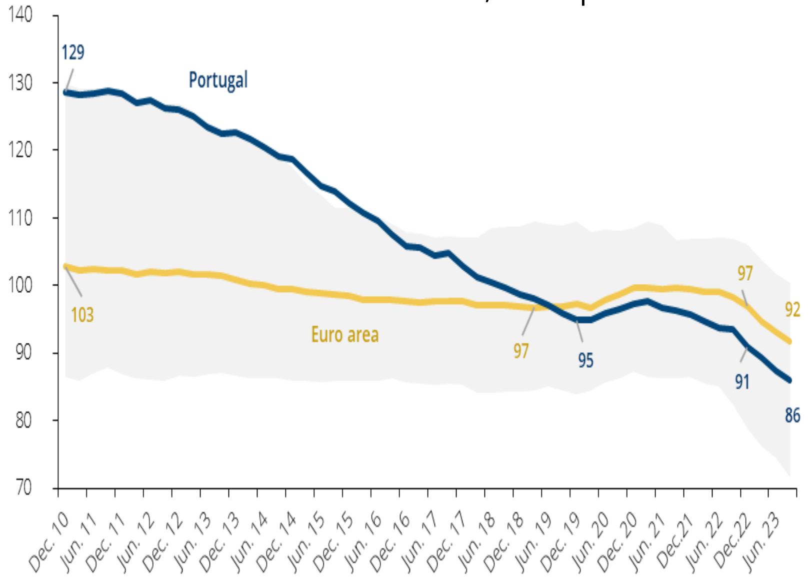
- NFCs' debt and leverage ratios have decreased persistently and have recently converged to the euro area levels.
- Overall, firms' financial position remains sound, but the most vulnerable firms need to be monitored (its share has increased in 2023).



Source: Banco de Portugal and Eurostat. | Notes: Consolidated figures. Latest observation: Portugal - September 2023, Euro Area – December 2022.

- Household indebtedness ratio (as % disposable income) has decreased significantly through the last decade.
- The share of housing loans with LSTI > 50% has increased, linked with an increase in interest rates and with a very high share of variable interest rates.

Indebtedness ratio of households, % Disposable Income



Sources: Banco de Portugal and Eurostat. Notes: Non-consolidated figures. The grey area corresponds to the interval between the 3rd and the 1st quartiles of the distribution for a set of euro area countries (Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Slovenia and Spain). Last observation: 2023Q3.

02

How effective has macroprudential policy been? What more can we do?

PRESERVING THE RESILIENCE OF THE BANKING SECTOR

Preserving the resilience of the banking sector

Further enhance macroprudential space in the medium term

Maintain/Increase releasable macroprudential capital buffers

- Policy: sectoral Systemic Risk Buffer (sSyRB) of 4.0%

- Motivation: to increase the resilience of institutions to the materialization of potential systemic risk in the residential real estate market (e.g. potential downturn in the financial cycle or an unexpected significant correction of in RRE prices).

- Impact on credit for house purchase: could further slow down credit for house purchase, by making sector-specific banking loans more costly.

- BUT: the impact is likely to be small, given the buffer level that was implemented, the level of banks' capital headroom and the improvements in profitability.

PRESERVING THE RESILIENCE OF THE BANKING SECTOR

Maintaining macroprudential capital buffers, complemented by BBMs, acting as structural backstops to ensure sound lending standards

BBMs should continue to fulfil their role as structural measures

BBMs acting as structural backstops, to ensure sound lending standards

- Policy: BBMs: LTV, DSTI, maturity limits and regular payments requirement.
- Motivation: to increase the resilience of the financial system and of the households.
- Has acted as a backstop to safeguard lending standards and has improved the risk profile of borrowers.
- BUT: adjustable according to the nature of the shocks and to the monetary policy stance. The design and the calibration of BBMs, in general, should take into account the structural features of mortgage markets, allowing for some flexibility via exemption clauses or other features.
- 2023: PT reduced the interest rate shock included in the stressed DSTI ratio.

WHAT MORE CAN WE DO IN THE BANKING SECTOR?

Enhancing the macroprudential framework for banks

Banks’ Framework

- Support for the continued implementation of the Basel Capital and Liquidity Standards.
- Increased flexibility in the activation of the countercyclical capital buffer (CCyB) to allow macroprudential policy to be pre-emptive and implemented early in the financial cycle.
- Promote consistency in the use of different capital buffers.
- Support the development of guidelines while preserving flexibility at the national level.
- Strengthen cooperation between macroprudential authorities and other supervisors with different mandates (microprudential, resolution), in particular during systemic shocks.

WHAT MORE CAN WE DO IN THE NON-BANKS?

Enhance the macroprudential framework

- Holistic perspective;
- Building resilience ex ante rather than relying on ex post measures;
- Adopting an entity and activity basis;
- Developing flexible measures that can be adapted over time as risks evolve;
- Align with international principles.

Net benefit analysis

- Consider trade-offs in the design of policy measures in terms of their effectiveness, feasibility and potential costs;
- Promote the objectives of Capital Markets Union through the diversification of funding sources and risk sharing;
- Be profitable in the medium term (investment returns).

Cooperation

- Cooperation between different supervisory and macroprudential authorities;

Potential topics for the next FSR

Soft landing versus hard landing: could we avoid a severe recession? What are the major threats to financial stability out there?

What are the risks to financial stability from diverging monetary policy stances across economies going forward?

How could banks and other financial intermediaries maintain the adequate profitability and resilience levels going forward?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