Moratoria, guarantees and banks

- **The Portuguese banking system is in a reasonably resilient financial position to face the crisis and contribute to the recovery.**
- **Credit quality will be a major challenge for the sector in the future, especially if moratoria and credit guarantees expire before a strong recovery.**

As shown in the first table, the Portuguese financial system faces the COVID-19 crisis in a relatively more resilient position and with more room for manoeuvre in periods of stress. We highlight several positive elements: (i) Solvency and liquidity indicators are higher than those of the European Union. (ii) Profitability ratios have evolved favourably and the financial margin is stable, despite the fact that interest rates are at exceedingly low levels. In Portugal, negative interest rates are not applied to deposits. (iii) Default ratios remain far above the European average, but had evolved very favourably in the years prior to the pandemic. (iv) Coverage levels of non-performing loans due to impairments are above European levels.

However, in the context of the severe economic contraction unleashed by COVID-19, credit quality will be a major challenge for the sector in the future, especially if moratoria and credit guarantees mature before a strong recovery.

The role of loan moratoria...

The main purpose of loan moratoria[1] is to temporarily mitigate liquidity problems caused by the suspension or

Banking system indicators (%)

	2011	2014	2016	2Q 2020	European Union
Efficiency					
Cost-to-income	61,7	65,2	59,4	61,0	66,7
Profitability					
ROE	–0,2	–1,2	–0,3	0,1	0,0
Financial margin	1,5	1,3	1,5	1,5	1,3
Asset quality					
Non-performing loans1					
Private sector	7,5	11,9	17,5	6,6	2,9
Housing	5,0	5,9	7,0	2,2	2,7
Consumption	13,3	17,0	16,2	8,6	
NFC	9,7	19,0	29,5	11,1	5,1
NPL coverage ratio[1]	56,8	64,0	45,3	53,1	45,3
Credit risk cost	1,2	2,4	1,8	0,9	0,9
Solvency					
CET 1	8,7	10,5	11,4	14,6	14,7
Total leverage ratio	–	–	6,6	7,6	5,1
Liquidity					
Loan-deposit ratio	135,0	102,0	95,5	84,6	116,1
Liquidity coverage ratio	–	–	150,8	256,6	165,7

Notes: *1. Series break in 2015.*
Comparisons between ratios in Portugal and EU are purely indicative, as there are some technical differences in the calculations.
Sources: *Banco de Portugal and EBA.*

1. Public moratoria remain in effect until 30 September 2021; The sign up period ends on 31 March 2021 and is only available to families and companies with a regularised tax status. Companies must meet certain financial requirements and the extension or suspension of payment of capital, interest and guarantees can be requested up to 27 March 2020. In the case of families affected by the pandemic, moratoria cover mortgage loans and loans to finance educational services. Private moratoria adopted by banks cover credit agreements that do not benefit from public moratoria, such as personal loans, car loans and credit cards. Briefly, the conditions for accessing moratoria for families are: Not having bad credit or being in the process of insolvency, and having a regularised tax status and a financial situation negatively affected by the pandemic. For companies, the conditions include: No loans in arrears as of 18/3/2020; No irregularities before the tax authorities in excess of 5,000 euros, with these regularised or undergoing regularisation by 09/2020.

reduction of income received by companies and families and to provide protection to creditors in potential default situations. The moratoria in Portugal establish that – until September 2021 – families and companies that do not pay loan instalments avoid their credit being classified as bad debt, postponing the maturity of the loan by the number of months in which the debtor benefits from the moratorium and helping to stabilise or even decrease default ratios.

As can be seen in the second table, in September, 17.3% of household loans and 32.0% of business loans were covered by moratoria. The total amount of credit under moratorium was 45 billion euros, approximately 23% of the credit stock granted to the private sector and of GDP. Banco de Portugal estimates that the instalments accumulated up to September 2021 amount to 13 billion euros: 2 billion for families and 11 billion for companies.

Up to June, Portugal has the third highest default rate in the euro area (22.2% of total credit, according to the EBA,[2] considerably above the European average of 7.5%), which is explained by the combination of various factors: i) A high rate of indebtedness (66% of GDP for families in Portugal vs 60% in the euro zone, and 101.4% for companies vs 115% in the EMU, according to Eurostat); ii) Low savings rate; And, especially, iii) the fact that the tourism sector, representing a large portion of GDP, has been severely affected by the pandemic.

Mortgage default rates are particularly significant (mortgages make up around 40% of loans extended to the private sector with moratoria, and 84% of loans extended to individuals with moratoria). There are factors that mitigate this concern, however, such as the fact that the level of mortgage defaults is historically very low, showing the strong commitment of families to honour debts related to the home. In addition, unemployment is forecast to deteriorate by a little more than 1% in 2021, a scenario that would be compatible with a contained deterioration of default levels of around 0.08% (according to historical data), a relatively small value compared to the great improvement observed in recent years.

Portugal also has a relatively low rate of loans under moratoria whose risk has worsened (figure 3), suggesting that any potential future increase in defaults will be limited.

...and of credit guarantees

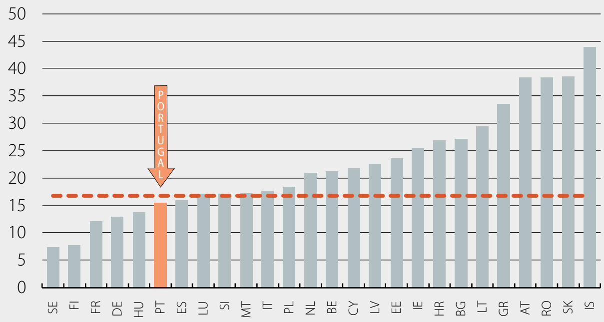
Another important instrument to cushion the impact of COVID-19 is government-backed lines of credit.[3] The objective of these is to maintain the flow of loans into the real economy at a time when the quality of credit demand has deteriorated due to the economic impact of the pandemic. In general, they target small and medium-sized enterprises, micro-enterprises and self-employed workers without access to any other source of financing besides bank loans. Between March and September 2020 in Portugal, these government-backed lines of credit represented around 40% of loans granted

Moratoria and government-backed lines of credit

	Millions of euros	% of respective credit stock
Moratoria		
Individuals - Total	**21.272**	**17,3**
Housing	17.952	18,5
Consumption	3.320	17,2
NFC - Total	**23.237**	**32,0**
Accommodation and catering	2.972	50,0
Consulting and Industry	6.133	30,0
Construction	1.581	25,0
Trade	2.866	24,0
Transportation	1.075	22,0
Guaranteed loans granted to NFC between March and September		
Total new credits	7.029	40,0
of which:		
to the sectors most affected[1]	4.147	59,0
SMEs	3.093	44,0
Large companies	1.195	17,0

Note: *1. Accommodation; catering and restaurants; commerce; transportation; storage; artistic, entertainment and recreational activities; and industry.*
Source: *BPI Research based on Banco de Portugal.*

Loans classified as stage 2 *
(% of loans under current moratorium)



Note: ** Loans that have seen significant deterioration in their level of credit risk since their commencement.*
Source: *EBA.*

2. EBA, thematic note, First evidence on the use of moratoria and public guarantees in the EU banking sector, November 2020.

3. The government-backed credit guarantee extends up to 90% in the case of micro and small businesses and up to 80% in the case of medium-size companies, Small Mid Cap and Mid Cap2. They are granted to companies that were financially viable in the pre-covid period, with positive equity, a regularised tax and financial situation, and more than 2 years of existence. The term of these loans be extended to up to 6 years and benefit from an 18-month grace period.

to companies (worth some 7 billion euros), concentrated in small and medium-sized companies in the sectors most affected by the pandemic.[4]

Despite the risks related to granting credit to companies facing difficulties, it is important to bear in mind that Banco de Portugal claims that the requirements underlying its granting of credit lines are based on slightly better risk assessments than those of other loans. The fact that these companies benefit from an 18-month grace period suggests that repayment of the loans obtained will not begin until the end of September 2021, when it is anticipated that companies will have resumed their activity on a regular basis. Additionally, the fact that these loans mostly have a term of more than 5 years also limits potential situations of financial stress for companies.[5]

4. Accommodation, catering and restaurants; commerce; transportation and storage; artistic, entertainment and recreational activities; and, to a lesser extent, the manufacturing industry.
5. According to the EBA, 47.2% of loans have a maturity of more than 5 years, and 50.9% have a maturity of between 2 and 5 years.