

Portugal

By Banco Montepio

IN A NUTSHELL

- The House Price Index (HPI) increased 9.4% by end 2021, above the growth in 2020 (+8.4%), while index reached a new historical maximum, with continued signs of overvaluation in the residential real estate prices observed since 2018.
- The residential real estate market has seen increased prices and transactions, whilst the commercial real estate market, had an unclear trend, with price and transaction volume drops in some segments.
- The shortage of housing supply resulted from reduced construction activity in the years before the pandemic. External demand and the growth of housing credit in 2021 also contributed to the rise in residential property prices.
- In recent months there has been an increase in construction costs, associated with a shortage of labour and materials, exacerbated by the conflict in Ukraine, and constitutes an additional upward pressure on prices of residential real estate.
- New loans to households for house purchase reached the highest value since 2007, EUR 15.3bn with an average interest rate of 0.82%, while the NPL ratio of this segment decreased from 2% to 1.6% by the end of the year. Portuguese banks increased their balance sheet by 8%, mainly reflecting the inflows from customer deposits and central bank funding.

MACROECONOMIC OVERVIEW

Gross domestic product (GDP) grew by 4.9% in 2021, above the majority of estimates and higher than that expected in the last quarter of the year, but especially an upward revision of the historical GDP data since the beginning of the year. This was the highest growth rate since 1990, but it took place after the contraction of 8.4% in 2020 (worse than the accumulated recession during the height of the euro area crisis of 2009-2014), following the adverse effects of the pandemic on economic activity.

This return to economic growth was accompanied by a reduction of the unemployment rate (from 6.9% in 2020 to 6.6% in 2021), an increase in inflation (measured by the harmonised consumer prices index (HCPI), from -0.1% in 2020 to 0.9% in 2021) -albeit much less than in most of the euro area countries- reduction of the budget deficit, from 5.8% in 2020 to 2.8% of GDP in 2021, and of the public debt ratio, from 135.2% in 2020 to 127.4% of GDP in 2021 and a maintenance of the current balance deficit (1.1% of GDP), with the saving rate of households falling (from 12.6% in 2020 to 10.9% in 2021), after the marked rise observed in 2020 (from 7.2% in 2019), at that time strongly influenced by the decline of consumption arising from the pandemic context.

LOOKING AHEAD

The Portuguese economy should remain on its path of recovery during 2022, with real GDP growth projected at 4.9% (4.9% in 2021), according to the most

recent estimates published by Banco de Portugal in March 2022, a forecast that is in line with the estimates assumed by the Portuguese Government in April 2022 and as with Montepio's previous forecasts (however, the strong and unexpected growth of 2.6% in the 1st quarter of 2022 caused an upward revision of Montepio's 2022 growth forecast to a centre of the forecast range of 5.4%). This growth projection takes place in against the backdrop of the conflict in Ukraine, which brings in high uncertainty, and strong risks concerning the evolution of oil prices, the effects on inflation and indirect impacts (e.g., on wages) of the rise of commodity prices and the duration of the war. Economic growth in 2022 will continue to benefit from the implementation of the Recovery and Resilience Plan ("PRR") and the maintenance of the still favourable financial conditions. The growth of private consumption will continue to be sustained by the increase of disposable income, while exports should continue to benefit from the international flows associated with tourism, assuming limited effects of the conflict in Ukraine, with exports of services surpassing the pre-pandemic value during the first half of 2022.

Note that, in the case of the Portuguese economy, the ongoing conflict in Eastern Europe has led to a downward revision of GDP growth in 2022. The impact of the conflict on economic activity should be experienced via net exports, reflecting the slowdown of Portugal's main economic partners, which are primarily European, as well as via investment and private consumption, with enhanced uncertainty and the increased price of energy and other commodities affecting investment and consumption decisions. The effects on private consumption may, however, be dampened by the savings accumulated in 2020 and 2021 (when the use of this surplus saving was not previously considered).

The impact of the war on commodity prices, especially of oil and natural gas, led to an upward revision of the Banco Montepio forecast of the inflation rate (measured by the HCPI) for 2022, from 2.4% to a range from 5.2% to 6.2%, with the centre of the forecast range (+5.7%) being well above the 4.0% forecast by Banco de Portugal and the Portuguese Government.

HOUSING MARKETS

According to the analysis by Banco de Portugal carried out in the Financial Stability Report (REF) of December 2021, the residential real estate market has been characterised by an increase in prices and transactions, unlike the commercial real estate market, where the trend was unclear, with price and transaction volume drops in some segments. Signs of overvaluation have continued in the residential real estate prices observed since 2018, with some indicators stabilising against recent highs. Similarly to what was observed in Europe, prices in the residential real estate market continued to increase during the period of the pandemic, although showing some slowdown.

However, Banco de Portugal estimates (regarding the overvaluation of residential property prices) do not include determining factors, such as demand by non-residents and demand for tourist activities, which contributed to the price increases in the period preceding the pandemic crisis that should be taken into account when evaluating market overvaluation. In 2019, non-residents accounted for 13% of the total value of property acquisitions in Portugal and the growth

of the tourism sector in recent years has intensified the demand for residential real estate, with the increase in new registrations of “Local Accommodation” contributing to the market dynamics and the appreciation of residential real estate assets (albeit to a limited extent, according to Banco de Portugal's analysis).

Foreign direct real estate investment grew by 8.2% in 2020 (+10% in 2019), but, according to Banco de Portugal data, in the first half of 2021 it fell by 12% compared to the same period in 2019. Investment in real estate, through the golden visa programme, continued to be significant in 2020 and 2021, possibly anticipating the end of the scheme in the regions of Lisbon, Porto and Algarve, scheduled for the beginning of 2022. Since the implementation of the scheme in 2012, it has represented 40% of foreign direct investment in the real estate sector.

According to the latest data from Statistics Portugal, in 2021, the House Price Index (HPI) increased 9.4% reaching historical maximum levels. This rate of change was 0.6 pps higher than in 2020. The price increase was more intense in existing dwellings (+9.6%) than in new dwellings (+8.7%). In 2021, 165,682 houses were sold, 20.5% more than in 2020. In this period, the value of transactions totalled EUR 28.1 bn, corresponding to a growth of 31.1% compared to the previous year. Existing dwellings sales increased by 22.1% and 34.2%, respectively, in the number and value of transactions. There was a 12.9% increase in the number of new dwellings sales and a 21.7% increase in value. In 2021, purchases of dwellings by households represented 85.6% and 85.7%, respectively, of the total number and value of registered transactions. In the period from 2019 to 2021, the value of dwelling sales to tax residents reached EUR 64.8 bn (89.8% of the total).

The shortage of housing supply – as a result of reduced construction activity in the years before the pandemic –, external demand and the growth of housing credit in 2021, have contributed to the rise in residential property prices. In recent months, there has also been an increase in construction costs, associated with a shortage of labour and materials, which was exacerbated by the conflict in Ukraine and creates additional pressure on prices of residential real estate.

The median value of bank appraisals was EUR 1,231 per square meter, up by 9.0%. Appraisal value growth was observed in all NUTS II (Nomenclature of Territorial Units for Statistical Purposes) regions – there are seven NUTS II regions (North, Centre, Lisbon Metropolitan Area, Alentejo, Algarve and the two autonomous regions of Madeira and Azores) –, with the Lisbon Metropolitan Area showing the greatest increase (+8.7%), followed by the Algarve (+7.6%), the North (+7.6%) and the Autonomous Region of Madeira (+6.8%). The Autonomous Region of the Azores showed the smallest increase (+3.9%), followed by the regions of Alentejo (+4.4%) and of the Center (+5.3%).

According to Statistics Portugal for the Commercial Property Price Index (IPPCoM), in 2021 commercial property prices increased 5.1%, 2.3 pps more than the rate observed in 2020. This was the highest price increase since 2010. Similarly to what has been happening since 2016, the growth in commercial property prices was less intense than that observed in residential property prices (+9.4%). However, commercial property price evolution is underpinned by sectoral heterogeneity (for example, retail properties devalued in 2020 due to Covid-19 restrictions). Despite the pandemic, investment in commercial real estate continued to be significant, totalling EUR 2.7 bn in 2020 and EUR 1.2 bn until September 2021 (according to Banco de Portugal data), which compares with EUR 3.3 bn in 2019. In 2021, international investors represented 70% of this segment.

Finally, 25,100 buildings were licensed, and 15,200 buildings completed, annual increases of 8.9% and 4.1%, respectively (-4.3% and +3.8%, in 2020).

In comparison with 2019 (pre-pandemic period), the increases were 4.2% for building permits and 8.0% for completed buildings.

MORTGAGE MARKETS

New loans to households for house purchase reached the highest value since 2007, at EUR 15.3 bn, a 34% increase from 2020, according to Banco de Portugal. The monthly average interest rate in these new loans reached a minimum of 0.76% in February 2021 and rose thereafter finishing the year at 0.83%. The average interest rate for the loans to households for house purchase was 0.82%, a 0.17pp decrease compared to 2020. The stock of outstanding residential mortgage loans increased 2%.

Demand for loans for house purchase increased through the year, as a result of an increase in consumer confidence and low interest rates. From a supply-side standpoint, credit standards reported by the credit institutions did not change during 2021, although the terms and conditions eased slightly in loans to households for house purchase, during the second quarter of 2021, due to higher competition and decreased risk perception.

The ratio of non-performing loans (NPL) continued to decrease, from 4.9% at year-end 2020 to 3.6% at the end of 2021. The NPL ratio for house purchase loans also decreased, from 2% at year-end 2020 to 1.6% at the end of 2021, due to the reduction of the stock of those loans by 16%. The coverage ratio of the non-performing mortgage loans increased 200 basis points, since the end of 2020, to 32.6% at the end of 2021.

In 2018, Banco de Portugal, as the national macroprudential authority, issued a recommendation introducing limits on new loans to consumers, namely for house purchase. This recommendation, slightly updated in 2020, is based on the “comply or explain” principle and includes four different limits to some of the criteria that institutions should comply with in the assessment of the borrower's creditworthiness when granting credit.

The first is a limit on the Loan-to-Value ratio (LTV), where new credits for house purchase, or construction of own residence, are capped at 90% or 80% if the loan relates to residential immovable property or is secured by a mortgage or equivalent guarantee but with other purposes. In the case of foreclosures, the limit increases to 100%.

The second is a limit on the debt-service-to-income ratio (DSTI) of 50%, although up to 10% of the contracts may extend this limit to 60%. Just 5% of the total contracts may not comply with these limits. The calculation of the DSTI must consider constant monthly instalments for the entire maturity of the contracts, while for mixed and variable rate contracts, the impact of a rise in interest rates shall be considered. Also a decrease in income must be assumed if the borrower is older than 70 years at the maturity of the contract.

The third sets the maximum maturity on new credits at 40 years and states that the average maturity in new credit agreements should gradually converge to 30 years by the end of 2022.

Finally, new loans should be granted with regular payments of interest and capital. These measures have contributed to the prevention of pockets of high credit risk in the mortgage market and data suggests that institutions are generally complying with the macroprudential recommendation, except for the converging

maturity to 30 years at the end of 2022. For this reason, at the beginning of 2022, Banco de Portugal imposed new restrictions on the maturity of the new loans for house purchase according to the borrower's age.

MORTGAGE FUNDING

According to Banco de Portugal, there were favourable financing conditions for Portuguese banks in 2021, with the overall balance sheet increasing by 8% at the end of the year compared to the end of 2020, a faster pace than in the previous year, mainly reflecting the inflows from customer deposits and central bank funding, which grew by 9% and 29%, respectively. The increase in deposits from customers was the biggest in the previous decade with contributions from both Households and Non-financial companies. The banking system liquidity position remained at comfortable levels, with a loan to deposit ratio of 81.2% at the end of 2021, decreasing (84.7% at the end of 2020 and 87.1% at the end of 2019) due to the growth in the deposits. The liquidity coverage ratio was 259.9%, increasing from 245.9% at the end of 2020 and from 218.5% in 2019, due to the increase in highly liquid assets. Funding from central banks rose to 9.4% of total assets in 2021 (7.8% at the end of 2020 and 4.4% at the end of 2019) partially compensated by the decrease in wholesale funding from 7.2% of total assets at the end of 2020 to 6.1% at year-end of 2021.

GREEN FUNDING

In 2021, for the first time ever, the Portuguese banking sector issued EUR 1bn of sustainable bonds. Half of this value was issued in a sustainable finance bond whose proceeds will be channelled to loan operations in environmental and socio-economic areas while the other half corresponds to an ESG bond, focusing on the social component (social bond), the net proceeds will be applied to the financing and/or refinancing of loans granted under the COVID-19 lines.

	PORTUGAL 2020	PORTUGAL 2021	EU 27 2021
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	-8.4	4.9	5.4
Unemployment Rate (LSF), annual average (%) (1)	6.9	6.6	7.0
HICP inflation (%) (1)	-0.1	0.9	3.0
HOUSING MARKET			
Owner occupation rate (%) (1)	77.3	77.3	70.0
Gross Fixed Investment in Housing (annual change)(1)	-6.6	8.9	6.6
Building Permits (2015=100) (2)	303.5	343.5	134.0
House Price Index – country (2015=100) (2)	154.8	172.8	145.2*
House Price Index – capital (2015=100) (2)	144.7	n/a	146.1*
Nominal house price growth (%) (2)	8.0	11.6	10.3*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	96,176	98,149	6,508,621
Outstanding Residential Loans per capita over 18 (EUR) (2)	11,211	11,417	17,782
Outstanding Residential Loans to disposable income ratio (%) (2)	65.6	73.1	62.8*
Gross residential lending, annual growth (%) (2)	7.3	34.1	12.2
Typical mortgage rate, annual average (%) (2)	0.8	0.8	2.0

* Please note that this value is the simple average of the available values in 2021.

Sources:

(1) Eurostat

(2) European Mortgage Federation - Hypostat 2022, Statistical Tables.

PORTUGAL FACT TABLE

Which entities can issue mortgage loans in your country?

Credit institutions (according to Decree-Law No. 349/98 of Nov/11 and within the limits established in articles 3 and 4 of DL No. 34/86, of Mar/3 for commercial and investment banks). The types of credit institutions and respective activities are defined by the Legal Framework of Credit Institutions and Financial Companies (articles 3 and 4).

What is the market share of new mortgage issuances between these entities?

The mortgage market returned to double-digit growth in 2021. New credit operations increased 34% y-o-y (7% y-o-y in 2020). The latest available data about market concentration (as of 2017) shows that the six largest institutions concluded 82% of new mortgage contracts, which represent 80.6% of the contracted amount, comparing with 84.5% and 83.6%, respectively, in 2016. On 31 December 2017, the ten largest credit institutions had 96.7% of mortgage contracts and 95.4% of outstanding mortgage amount. In 2021, the largest institutions are expected to have continued representing the bulk of new mortgage production, with market shares generally reflecting the current market structure (as per question #3).

Source: Banco de Portugal (Retail Banking Markets Monitoring Report 2018; Monetary and Financial Statistics).

Which entities hold what proportion of outstanding mortgage loans in your country?

The seven largest institutions in Portugal are CGD, Santander Totta, Millennium BCP, BPI, Novo Banco, Banco Montepio and Crédito Agrícola, which hold market shares of c. 25%, 23%, 19%, 13%, 10%, 6% and 4% respectively as of December 2021.

Source: Annual Reports; Banco de Portugal (Monetary and Financial Statistics).

What is the typical LTV ratio on residential mortgage loans in your country?

Since 1 July 2018, new residential credit agreements should observe the following LTV limits: 90% for credit for own and permanent residence; 80% for other purposes than the latter; 100% for purchasing immovable property held by the credit institutions themselves and for property financial leasing agreements. In 2021, the bulk of new credit operations (99.4%) had an LTV ratio equal or below 90% (49% with LTV ≤80% and 50% with 80% < LTV ≤90%).

Source: Banco de Portugal (Macroprudential measure within the legal framework of credit for consumers).

How is the distinction made between loans for residential and non-residential purposes in your country?

Loans for residential purpose comprise (i) mortgage loans, which include credit agreements for the acquisition or construction of permanent, secondary or for-rental housing, and (ii) other related-mortgage loans, which comprise loans celebrated with individuals that are subject to the mortgage loans rules.

Source: Banco de Portugal (Bank Customer Website).

What is/are the most common mortgage product(s) in your country?

The most common mortgage products are written with variable interest rate indexed to Euribor rate.

What is the typical/average maturity for a mortgage in your country?

Mortgage loans granted in 2020 had an average maturity of 33.1 years (33.2 years in 2019), 1.2 months lower comparing to the contracts portfolio.

Source: Banco de Portugal (Retail Banking Markets Monitoring Report 2020).

What is/are the most common ways to fund mortgage lending in your country?

From the perspective of banks, retail and wholesale funding are the main sources of funding of the national banking system, with deposits becoming the main source (LTD ratio of 81.2% as of December 2021). From the point of view of costumers, commercial banks are the most common providers of mortgage.

Source: Banco de Portugal, Portuguese Banking System: latest developments, 4th quarter 2021

What is the level of costs associated with house purchase in your country (taxes and other transaction costs)?

There are bureaucratic charges related with the necessary procedures (at the Land Registry, Municipality Council and Notarial Office), and specific taxes related with house transaction, as the municipal taxes on real estate (IMI) and on onerous transfer of property (IMT). In purchases through loans, banks usually charge commissions related to the credit process (study and opening), which often include asset-evaluation costs.

What is the level (if any) of government subsidies for house purchases in your country?

Since September 2012 it is not possible to hire mortgages loans with a subsidised system scheme. Currently there are special conditions for disabled people with a disability grade greater than 60% and for family households in very difficult economic situation (Law 58/2012 of Nov/9).