Portugal

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IN A NUTSHELL

- → Portuguese GDP grew by 2.7% in 2017, 0.1 pps above the Euro area growth, and was accompanied by a sustained downward trend of unemployment, a significant reduction in public debt and a sharp reduction in the budget balance.
- → After registering a cumulative decline of 13% in nominal terms between 2008 and 2013 (20% in real terms), residential real estate prices have recovered an average of 5.3% per year since 2014 and are currently returning to levels close to those prior to the financial crisis. Real estate sales have increased by double digit since the beginning of 2015.
- → The demand by non-residents has also stimulated the real estate market, as a result of the introduction in 2009 of a more favourable tax treatment for "non-habitual" European foreigners and the approval in 2012 of the Visa Gold regime, implemented with the aim of attracting investors and non-European professionals.
- → The recovery of the real estate market is also a consequence of the good performance of the tourism sector, stimulating the demand of real estate by investors to cope with the growing demand for accommodation (Local Accommodation).
- → Despite the strength of mortgage credit for residential real estate, household debt was at 75.4% of GDP in mid 2017 and continues to decline from its peak level (reached in 2013), although it remains above the euro area average (58.4%).

MACROECONOMIC OVERVIEW

In 2017, GDP recorded a growth in volume of 2.7% compared to 1.6% in 2016, representing an acceleration of 1.1 pps. Portuguese GDP growth in 2017 was 0.1 pps above the Euro area growth, but Portuguese GDP level still is 1.3% lower than that recorded in 2008, the year in which the last international economic and financial crisis began. Portuguese economic growth was accompanied by a sustained downward trend of unemployment, a significant reduction in public debt and a sharp reduction in the budget balance.

Economic activity was supported solely by domestic demand, with a strong positive contribution of 2.9 pps, with the acceleration of this contribution (+1.6 pps in 2016) mainly reflecting the behaviour of the investment, in a context of a slight acceleration of the already strong growth rate of private consumption and a slight fall of public consumption. Investment was critical to the growth of the economy in 2017. Gross fixed capital formation increased 9.2%, in strong acceleration compared to the growth of 1.5% observed in 2016.

The Government debt ratio in 2016 reached 129.9% of GDP, but in 2017 it fell to 125.7% of GDP. In December 2017, the balance of the International Investment position stood at EUR -204.1bn, corresponding to -106.2% of GDP (-106.3% of GDP by December 2016).

A decrease in the unemployment rate of 2.2 pps was registered, from 11.2% in 2016 to 9.0% in 2017, therefore continuing the trend of reduction from the historic peak reached in early 2013 (17.5%).

Inflation, measured by the annual average change in the Harmonised Index of Consumer Prices (HICP), was 1.6% in 2017 (+0.6% in 2016 and +0.5% in 2015). A slight rise in the savings rate to 5.9% was registered in 2016 (5.3% in 2015), but the rate went back down to 5.4% in 2017. In 2017, the non-performing loans ratios of households and enterprises declined, although they remain at high levels (4.2% and 13.5%, respectively).

HOUSING AND MORTGAGE MARKETS

OVERVIEW

Since the period of crisis and financial assistance program, the real estate market has been recovering. This recovery is reflected in the evolution of residential real estate prices, which, after registering a cumulative decline of 13% in nominal terms between 2008 and 2013 (20% in real terms), have recovered an average of 5.3% per year since 2014 and are currently returning to levels close to those prior to the crisis.

The dynamism of this sector is also reflected in the evolution of real estate sales, which have increased by double digit since the beginning of 2015. This behaviour has contributed to a more positive internal economic environment, reflected in the good performance of the labour market, increased income and very positive evolution of confidence indicators. The demand by non-residents has also stimulated the market, as a result of the introduction in 2009 of a more favourable tax treatment for "non-habitual" European foreigners and the approval in 2012 of the Visa Gold regime, implemented with the aim of attracting investors and non-European professionals.

The recovery of the real estate market is also a consequence of the good performance of the tourism sector, stimulating the demand of real estate by investors to cope with the growing demand for accommodation (Local Accommodation). As a result, there are deep differences in property prices between premium areas, such as historic city centres (Lisbon and Porto) or in areas with more tourist tradition (Algarve) and the rest of the country. The revival of the longer rental market (domestic and foreign students, younger people who advocate greater mobility) has also supported the demand for residential real estate.

The proportion of households that allocate more than 40% of their disposable income to housing costs stood at 7.5% at the end of 2016 according to Eurostat, well below the euro area average (11.0%). Similarly, the ratio of property transaction prices to average gross disposable income is about 7.5, a level that is similar to the average in the last eight years (7.0). An alternative indicator to assess the demand for residential real estate is the level of domestic debt. Despite the strength of mortgage credit for residential real estate, household debt was at 75.4% of GDP in mid 2017 and continues to decline from its peak level (reached in 2013), although it remains above the euro area average (58.4%).

At the same time, the current momentum in the domestic real estate market is not being fuelled by an increase in household leverage. In fact, the volume of new home loans remains well below the levels prior to the international financial crisis, although there is a clear trend towards acceleration. It is also important to note that although most mortgages have been granted at a variable rate, the impact of higher interest rates on households' financial burdens should be contained as the ECB should normalize its monetary policy very much gradually.

DETERMINANTS OF HOUSING PRICES IN PORTUGAL

Interest rates, activity growth and the degree of restriction of the criteria for granting housing loans are the variables with the greatest impact on the growth of housing prices. Housing prices in Portugal have increased in the recent past, and only surpassed the pre-crisis level in the third quarter of 2017, accordingly the INE index with a retropolation using ECB/BIS/Confidencial Imobiliário data before 2009 (but we have to keep in mind that the last available data for ECB/ BIS/Confidencial Imobiliário, October 2017, is still 3.2% below the peak of this index in September 2007). Between 2007 and 2011, the fact that residential investment contraction may have prevented further price during this period, thus reducing the demand for housing. The growth of investment by foreigners in over that period may also have contributed to this same effect, i.e. to avoid a further fall in housing prices. Between 2011 and mid-2017, low interest rates (or even negative) may be affecting housing prices via options savings alternatives. It should also be noted that investment in housing by non-residents slowed down after the years of the sovereign debt crisis.

MORTGAGE MARKETS

During the year 2017, Banco de Portugal reported that 89,249 new housing loan agreements were signed, 33% above that of 2016, almost double that of 2015 and three times more than that of 2013. By looking at the number of houses sold in Portugal in 2017 (153,292 according to INE data), one concludes that only 58% of the homes sold are bought using housing loans. This figure is far below the 92% registered in 2009. At that time, almost all housing transactions were financed, while in 2017 only slightly more than half. This is a very relevant fact. Additionally, if by comparing the credit granted with realised sales, but in value, one concludes that the leverage of the sector is even lower. In 2017, a total of EUR 8.26 bn was granted, compared to approximately EUR 19 bn traded, i.e. only 43% of the volume of transactions in housing in Portugal was leveraged, which is also well below the 66% registered in 2009. The leverage in value is much lower than the number of transactions, mainly due to the weight of sales made to foreigners, typically of a higher value and not leveraged. If, on the one hand, foreign demand for housing in Portugal has contributed to strong price growth, it is also fair to say that it contributes to lower leverage in the sector. Despite the tightening rules on the part of the Bank and the restrictions imposed by Banco de Portugal, namely at the level of the effort rate, credit continues to rise. The average LTV of the market is at 70%, very close to the 73% registered in 2009, which greatly contributes to the growth of the average value of banks assessment.

As regards credit granted for construction and for promotion of real estate activities, there is an increase in bank loans, which is offset by the reduction in securities in the portfolio. However, there is evidence of different dynamics in these two branches of activity. With regard to construction credit, in 2017, the downward trend continued started in 2010, albeit at a slower pace. There has, however, been a recovery in the credit granted to promote real estate activities in the last quarter of 2017.

FURTHER IMPORTANT EVOLUTION

The Financial Stability Report, published by Banco de Portugal (Banco de Portugal), pointed to the high real estate prices in the market and financial sector risks and mentions that "price growth in the residential real estate segment has been particularly strong" and that "in the second half of 2017 some signs began to appear, although very limited, price overvaluation in this segment".

And "even though Portuguese banks are not the main drivers of the real estate market, a marked decrease in prices in this market would have a negative effect on the banking sector, affecting the sale of properties owned by credit institutions and, on the other hand, the decrease of non-performing loans (NPL) associated with secured credit for real estate".

Banco de Portugal highlights the fact that "there has also been a strong growth in consumer credit and new housing lending operations, which shows less restrictiveness in the lending criteria".

The flexibilisation of some credit granting criteria, such as the rate of effort (relation between yield and cost of the loan) led Banco de Portugal to adopt a macroprudential measure (recommendation that introduces limits on some of the criteria which the institutions must observe when assessing the creditworthiness of the borrower when granting this type of credit), which will come into force in July 2018.

MORTGAGE FUNDING

In 2017, a deleveraging trend of the banking sector balance sheet was still seen, with total assets decreasing by c.1% from 2016. The banks' financing structure showed, overall, a decrease in liabilities (around -3.1%, contribution of -2.9 pps for the change in total assets) and an increase in equity (+20.8%, contribution of 1.2 pps to the change in total assets), thus reflecting an improvement in the capital position in the banking system. The evolution of liabilities translated into an increase in customer deposits, more than offset by the decrease in financing through securities and in the interbank market and central bank. The ratio of loans to customer deposits decreased in 2017 from the previous year (-3 pps to 92.6%), reflecting the increase in deposits and the decrease in net loans to customers. In 2017, there was also a marked decrease in financing through securities, whose decrease in contribution to total assets was around 1.5 pps. Financing obtained from central banks declined in the whole of 2017 (around -3.1%, reaching 6.3% of total assets), maintaining the downward trend, and the interbank financing net of investments and deposits of other institutions remained virtually unchanged from 2016 (-0.8%, to around EUR 20.5 bn).

	PORTUGAL 2016	PORTUGAL 2017	EU 28 2017
Real GDP growth (%) (1)	1.6	2.7	2.4
Unemployment Rate (LSF), annual average (%) (1)	11.2	9.0	7.6
HICP inflation (%) (1)	0.6	1.6	1.7
Outstanding Residential Loans (mn EUR) (2)	95,377	94,093	7,013,738
Outstanding Residential Loans per capita over 18 (EUR) (2)	11,169	11,032	16,872
Outstanding Residential Loans to disposable income ratio (%) (2)	74.1	71.0	73.8*
Gross residential lending, annual growth (%) (2)	44.3	42.6	3.5
Typical mortgage rate, annual average (%) (2)	1.9	1.6	2.4**
Owner occupation rate (%) (1)	75.2	n/a	66.4*
Nominal house price growth (%) (2)	7.1	13.2	6.0

* The aggregate EU figure is from 2016.
** Please note that this value is the simple average of the typical interest rate of the EU 28 countries.

Sources:
(1) Eurostat
(2) European Mortgage Federation - Hypostat 2018, Statistical Tables.

PORTUGAL FACT TABLE

Entities which can issue mortgage loans:	In Portugal, credit institutions have the competence to grant financing according to Decree-Law No. 349/98 of November 11 and within the limits established in articles 3 and 4 of Decree-Law No. 34/86, of March 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).
The market share of the mortgage issuances:	According to Banco de Portugal retail banking report, in 2016 57,912 new mortgage loans were celebrated (+34.2% comparing to 2015) in a total amount of €5.5 bn (+39.6% comparing to 2015) with an average term of 32.8 years per contract (+9 months comparing to 2015). The six largest institutions concluded 84.9% of new mortgage contracts, which represent 86.7% of the contracted amount, comparing with 84.2% and 83.1%, respectively, in 2015. At December 31, 2016, the ten largest credit institutions had 96.8% of mortgage contracts and 95.5% of outstanding mortgage amount.
Proportion of outstanding mortgage loans of the mortgage issuances:	The seven largest institutions in Portugal are Millennium BCP, CGD, BPI, Santander Totta, Novo Banco, Montepio and Crédito Agricola, and hold: CGD (28.6%); Millennium BCP (18.5%); Santander Totta (20.3%); BPI (11.8%); Novo Banco (10.4%); Montepio (7.0%); Crédito Agricola (3.0%).
Typical LTV ratio on residential mortgage loans:	The national macroprudential authority considers that, on the one hand, in the current economic environment, household indebtedness is still high by international standards, and the financial system is highly exposed to credit relating to residential immovable property. On the other hand, this credit's new business has increased strongly and the stock of consumer credit has grown significantly. In addition, the recent economic recovery, amid very low interest rates and a rebound in house prices, has been accompanied by an easing of credit standards, in an environment of increased competition among institutions. The national macroprudential authority has issued a recommendation on new credit agreements for consumers, in particular credit relating to residential immovable property, credit secured by a mortgage or equivalent guarantee. The macroprudential measure includes a set of recommendations on limits to the ratio of the loan amount to the value of the property pledged as collateral (LTV – loan to-value ratio) that, for the purpose of this measure, should be calculated based on the minimum of the property's purchase price and appraisal value. In accordance with the recommendation on the LTV ratio, new credit agreements relating to residential immovable property and credit secured by a mortgage or equivalent guarantee should observe the following limits: • Limit to the LTV of 90% for credit for own and permanent residence; • Limit to the LTV of 80% for credit for purposes other than own and permanent residence; • Limit to the LTV of 100% for credit for purchasing immovable property held by the credit institutions themselves and for property financial leasing agreements. This recommendation enters into force on July 1, 2018.
Any distinction made between residential and non-residential loans:	Loans for residential purpose comprise (i) mortgage loans and (ii) other related-mortgage loans. (i) Mortgage loans cover credit agreements for the acquisition or construction of permanent, secondary or for-rental housing. They also include credit agreements for the acquisition or maintenance of property rights over existing or projected land or buildings and credit for the payment of the signal due under the future acquisition of property for permanent, secondary or for-rental housing. This is typically a credit with a long term, in which, in general, the mortgage of the house is given as a guarantee of repayment. (ii) Other mortgage-related loans are loans celebrated with individuals that are subject to the mortgage loans rules. Thus, they are covered by the following rules: • Credit agreements that, while not corresponding to a mortgage loan, are secured by a mortgage or other equivalent guarantee usually used on real estate; • The leasing of immovable property for permanent, secondary or rental purposes.
Most common mortgage product(s):	The most common mortgage products are written with variable interest rate indexed to Euribor rate.
Typical maturity of a mortgage:	Mortgage loans granted in 2016 had an average maturity of 32.8 years (+9 months per contract when compared to 2015), 10 months higher comparing to the contracts portfolio. The maximum term contracted in 2016 was 50 years, equal to the verified during the previous three years. Although, In accordance with recommendation of the regulatory entity that enters into force on July 1, 2018, new credit agreements should observe the following limits: • Limit of 40 years to the original maturity and gradual convergence towards an average maturity of 30 years by the end of 2022 for new agreements for credit relating to residential immovable property or credit secured by a mortgage or equivalent guarantee; • Limit of 10 years to the original maturity for new consumer credit agreements. In line with international guidelines, and in recognition of the importance of ensuring that the original maturity of loans allows some flexibility in case of default or difficulties in the payment of credit agreements, limits should be applied to the original maturity, depending on the type of credit.
Most common way to fund mortgage lending:	On the banks perspective, retail and wholesale funding are the main sources of funding of the national banking system, with deposits becoming the main source of funding (LTD ratio of 94% as of September 2017). On the customer perspective, commercial banks are the most common providers of mortgage.
Level of costs associated with a house purchase:	The banks usually charge commissions related to study and to open the process. Often these commissions include the costs of evaluation, because the bank always requires a report with the evaluation of the property, carried out by a technician. There are also other bureaucratic charges related with the necessary procedure with the registration, at the Land Registry, with Municipality Council and Notarial Office. Also there are specific taxes related with house transaction, as the payment of municipal tax on real estate (IMI) and municipal tax on onerous transfer of property (IMT).
The level (if any) of government subsidies for house purchases:	Since September 30, 2012 it is not any more possible to hire mortgages loans with a subsidised system scheme. Currently there are special conditions for disable people with a disability grade greater than 60% and for family households in very difficult economic situation (Law 58/2012 of November 9).