PORTUGUESE INSIGHTS

IS A NEW PORTUGUESE BANKING CRISIS LOOMING ON THE HORIZON?

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In March 2020, the Portuguese government required banks to extend loan payments on households and businesses to mitigate the effect of the economic downturn caused by the Covid19 pandemic. The loan moratoria did not negatively impact the banks' accounts in 2020, but markets are concerned that with the lifting of the loan moratoria, many companies and individuals may default and precipitate a new banking crisis in Portugal.

Portugal was one of the countries that most resorted to the exceptional moratoria on loans during the pandemic, which indicates a greater debt vulnerability in the post-pandemic period.

In September 2020, loans under moratoria reached their peak with €48,100 million. By the end of August 2021, Portuguese banks had suspended principal and interest payments on €36,339 million of corporate and household debt, of which €21,503 million were corporate loans, close to 29% of the total credit granted to companies.

Leisure and catering companies, the businesses most affected by the pandemic, had 55.3% of the amount of their bank debt covered by the moratoria. By sector of activity, the increase in indebtedness in manufacturing and leisure sectors stood out at 8.6% and 7.4%, respectively. Of the total credits to households, 11.1% were in the moratorium, €14,102 million, 91% of which were house mortgages.

At the end of September 2021, non-financial sector indebtedness stood at €746,000 million, of which €347,300 million referred to the public sector; €269,500 million referred to companies, and €144,500 million referred to households.

Corporate debt increased by 8.8 percentage points between the second quarter and fourth quarter of 2020 reflecting the impact of the pandemic and ending its downward trend that started in 2012 when Portuguese corporate debt represented 180% of GDP. Between the third and fourth quarter of 2020 corporate increased from 125.6% of GDP to 134.4% and increased the gap to the Eurozone average of 116.8%.

At the time of the first lockdown, in March 2020, the expectation was that there would be a rapid recovery. However, the economic crisis is lasting longer than anticipated, as a result of the successive waves of the pandemic and strict lockdowns, which is eroding the financial defenses of households and businesses.

By the end of September 2021, when the moratoria on loans was lifted, a large number of debtors had not yet recovered, which may lead to the increase in non-performing loans (**NPLs**).

Until now, the exceptional moratorium scheme and the state-guaranteed lines protected banks' asset quality, but NPLs will increase with the lifting of these exceptional measures. The loans protected by State guarantees should not pose an immediate problem for banks but may lead to an increase of public debt, which is already at historically high levels.

Between mid-2016 and mid-2020, Portugal reduced its NPL ratio to 4.9%, (which remained double the European average). One of the main measures that led to this decline was the sale of NPLs to international investors, which reached its peak in 2019, with the sale of approximately €8,000 million.

By the end of September 2021, Portugal's NPLs ratio was 4.3%. Moody's estimates that Portugal's NPLs ratio will increase in 2022 to a percentage higher than 9%. The worsening of NPLs will force banks to increase provisions to cover possible losses, which will further reduce their net income (already squeezed by the impact of the pandemic on financial margins) of financial institutions.

The uncertainties posed by the international energy crisis, a possible increase of inflation, and a possible lifting of the ECB's monetary support, against a backdrop of Portugal's high public debt, may put Portugal a step away from a new financial crisis.

The end of the loan moratorium scheme may be a significant setback on Portuguese banks' deleveraging efforts unless banks act preemptively. Still, Portuguese banks are now in much better conditions than in 2011 to face an increase in NPLs. The time to act is now and banks need to prepare to support viable businesses that are not yet generating sufficient liquidity to repay loans while setting aside problematic loans.

With about 22% of financial institutions' portfolios under moratoria, we expect that NPLs will increase in 2022 and NPL sales will surge.

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Since the incorporation of the firm in 1996 we have been involved in several high profile transactions in all of the firm's fields of practice, including banking and finance, capital markets, corporate and M&A, energy, real estate, project finance, complex disputes and restructurings.

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