NPL
Outlook Portugal 2021

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2021 NPL Outlook: Portugal

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When the outbreak of the coronavirus disease (Covid-19) was first reported at the end of 2019 (December), in Wuhan, China, few could imagine the impacts the disease would have globally. For most, it was a disease that would likely have an impact in China's growth, but would not spread across the globe. Fewer could imagine that in a 2 month period we would move from lockdown to lockdown, hospital's intensive care units would be full of patients fighting for their lives, and that the economy would be hugely impacted. However, that was exactly what happened. The world changed drastically, people were sent home, factories closed, retail stores were empty, and governments barely knew how to act. Some still don't.

We now wait in anticipation of every word from the government, which now guides everything from Church to school, from funerals to weddings, from businesses to limited exercise outdoors.

All this has a huge impact on the global economy, banks' balance sheets, and on the levels of non-performing loans (NPLs).

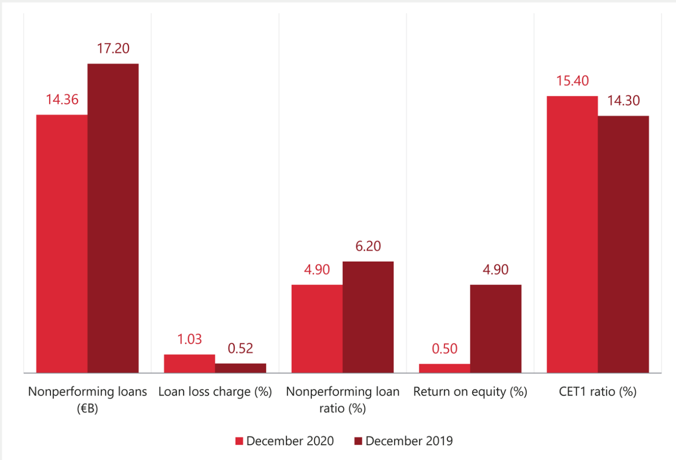
The current pandemic challenges the banking system through unknown tracks. Typically, the increase of non-performing loans on banks' balance sheets results from wide macroeconomic crises, but not in this case, where the main impact arises from the abrupt freeze in economic activity, even if moratoria on loan repayments and public loan guarantees have attenuated the immediate impact.

Portugal is among the countries in Europe with one of the highest shares of loans subject to moratoria (along with Cyprus and Hungary), and is one of the countries where public loan guarantees are higher (although with longer maturities when compared to the loans subject to moratoria).

These policies, along with new lending, provided the necessary breathing space to borrowers, but have also disguised the weak corporate trading, and delayed credit losses and, ultimately, NPLs.

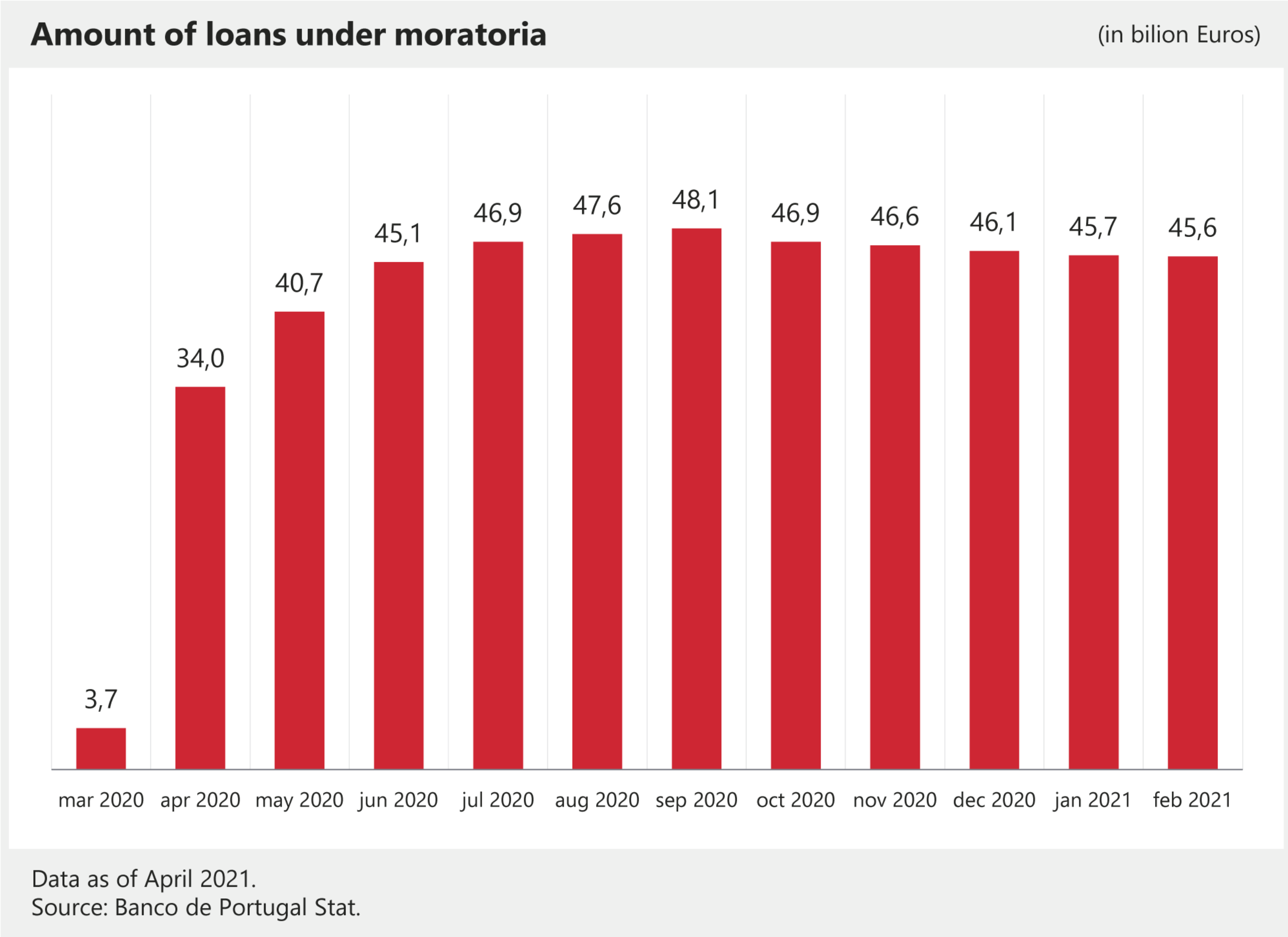
Nonetheless, banks have been cautious and even though the significative loan loss provisions made in 2020 (total credit impairments as a percentage of average gross customer loans — almost doubling to 1.03% from 0.52% in 2019), Banco de Portugal data shows that the stock of non-performing loans for the whole banking system has decreased last year to €14 billion in 2020 from €17 billion a year ago (Debt sales and write-offs have helped reduce the NPL stock in 2020).

Portuguese banking system indicators, 2020



Data as of March 2021.
Numbers are rounded.
Source: Banco de Portugal.

These loan moratoria and public loan guarantees have so far protected the Portuguese banks asset quality, but this is likely to change and have an impact during 2021. In fact, we should expect that asset quality will deteriorate later this year considering that moratoria and other government measures implemented to support companies and families will end in September. And the impact may be significative. According to the data released in April by Banco de Portugal, loans under the moratoria scheme amounted in February to €45 billion.



Portugal is one of the most dependent countries on these pandemic programs with over 20% of total loans under moratoria and the pressure on bank's balance sheets will increase and NPLs rise. Adding to this, and according to the European Central Bank, Portuguese banks have the lowest capital ratios in Europe, even considering that the banks have strengthened their capital ratios since the last economic crisis, a decade ago.

So, what's next? What should we expect for the near future, in Portugal? Only Greek and Cyprus banks have higher levels of NPLs ratios and the impact of the COVID-19 crisis on the banking sector has yet to materialise in full. We experienced one of the severest recessions on record in the first half of 2020, which, after some rebound in the second half of the year, resulted in a GDP drop of 6.8% in 2020 for the euro area.

We can anticipate almost with certainty that we will see an increase in default rates, at a higher pace than until now, with estimates of about 10% of the loans currently under moratoria going bad. And even though there will be differences in the borrower type that will go into default (residential mortgages have lower default rates), we can expect a significant increase in SMEs, mainly in the Hospitality and tourism related sectors, with Portugal being one of the most dependent countries on the tourism sector in the eurozone, ranked in second position by the share of tourism sector contribution to GDP, and the third by the share of tourism employment to total employment. The longer the pandemic remains, the greater the impact from travel restrictions in the real economy, with a bigger effect in job losses and closure of businesses.

Moody's expects the NPL ratio in Portugal to rise to 9% this year from 5.5% in 2020, stating that the full extent of the impact on Portuguese banks will only become apparent after the end of the current measures to support companies and families.
Having said this, and as the crisis echoes through the real economy, banks should be better prepared to deal with the expected increase in NPLs.

The sooner NPLs are identified and provisioned for, the faster and smoother the NPL resolution and disposal process will be. This will allow the banks to avert the damaging effects of future debt hangovers. Focus on forbearance and timely debt restructuring can maximise value recovery. On the other side of the coin, skipping these measures is likely to lead to higher bank losses later.

We will see an increase in NPL and REOs sales in the second semester of 2021, not only because we should expect more loans to default in the near future, but because many of the transaction's banks were planning last year were postponed with the pandemic. Investors have been keen in the Portuguese market in these last few years, with new entrants in the market bidding and winning transactions. The servicing landscape is mature, with accumulated know how and experience to deal with the flow of new transactions we should expect.

It will be an interesting 2021. Let's see how we deal with these challenges.

Servdebt's Company Profile

Servdebt is an independent Iberian NPL and REO Asset Management company with €5,5 billion AuM. Lisbon-based, we also have offices in Porto and Madrid. Throughout our 13 years of history, we have been building a relevant presence in the Iberian market, by working with the leading financial institutions and major international investors. Our track record of successful projects results from the combination of a multidisciplinary and committed team, and the development of our technological solutions, which helps us to provide an end-to-end service to our clients.

With approximately 400 employees, Servdebt offers expertise in the provision of integrated services for the acquisition and management of distressed loan portfolios and real estate assets. From market analysis and advisory services to valuation and asset recovery, we are here for our clients.

About Bruno Carneiro

Bruno is the co-founder and CEO of Servdebt Group and is responsible for setting the overall direction and strategy of the company. Back in 2007, after accruing extensive experience in the Management of distressed loan portfolios for one of the leading asset managers in Portugal, Bruno decided to venture in a new project, co-founding Servdebt. From the get-go, Bruno was sure that there had to be a better way to go about it, and has been one of the driving forces behind Servdebt's success, leading the company to achieve extraordinary growth since its inception and becoming a benchmark in the Loan Servicing and Distressed Debt sector in Iberia.

Bruno is a graduate in Law as well as a graduate from Católica Lisbon School of Business & Economics and Kellogg School of Management - Northwestern University Advanced Management Program (AMP).