Chapter 16
The Short-Term Effects of the Pandemic (COVID-19) on Banks With Activity in Portugal:
Particularly With Regard to Capital Buffer

Maria Clara Pereira Pires
Polytechnic Institute of Beja, Portugal

Milene Horta
Caixa Geral de Depósitos, Portugal

Rute Fradinho
Caixa Geral de Depósitos, Portugal

ABSTRACT

In this chapter, the authors assess the short-term effects of the pandemic (COVID-19) on banks with activity in Portugal. Namely, with regard capital buffer, it is intended to describe, in a succinct way, the measures taken by Portugal government to minimize the crisis effects. On the other hand, researchers divided the factors that can influence bank capital buffer in several groups, namely management efficiency, credit quality, and profitability. The panel dataset is composed of report annual data of 18 banks operating in Portugal, representing about 98% of the Portuguese banking product. The dependent variable is the capital buffer (BUF). The results show that credit quality (ICV), management efficiency (CTIN), and profitability (ROA and ROE) have a significant impact on bank capital buffer. Banks that have good credit quality indicators (ICV), management efficiency (CTIN), capital adequacy, and capital buffer (BUFF) will be better prepared to face the pandemic that is just taking its first steps.

DOI: 10.4018/978-1-7998-6643-5.ch016

INTRODUCTION

From the eighties onwards, there was a progressive opening of economies and markets internationalization, that represented the first steps of the phenomenon that today we call globalization. Globalization has had repercussions on every country's financial system. The lack of harmonization in regulatory and supervisory activities between countries led to the recognition that their convergence was important. Only in this way would be possible to optimize the functioning and confidence between banks based in different states.

Thus, the effort of some countries[1] to improve and harmonize the activities of regulation and supervision of banking activity culminated, in 1988, in the First Basel Accord (Basel I). Although concluded only by a limited number of countries, this Agreement had the merit of introducing transformations with international effects.

In practical terms, Basel I aimed at increasing supervisory activities. Its goal was to safeguard the solvency of financial institutions, their survival and confidence in the entire system. In this sense, a minimum indicator of 8% was established to cover credit risk, which was the most important in the financial intermediary activity.

In the following years, the growth of markets and financial operations forced the need to rethink the initial Agreement, to continue to ensure transparency and security throughout the system. In 1996, the First Accord was reformulated, also considering market risk (and not just credit risk). However, these new requirements were not enough for the increasingly complex reality of the global banking sector.

As a result of the progressive inadequacy of the first Accord, the Second (Basel II) emerges while continuing to maintain the value of 8% for the minimum solvency indicator and introducing changes in its calculation formula. In this context, in addition to credit and market risk, the new Accord also considers operational risk. Basel II was implemented in the European Union in 2006 and 2007 through Directives 2006/48/EC and 2006/49/EC, structures banking regulation in three pillars[2].

Basel III introduced a more rigorous definition of regulatory capital (minimum capital requirements) and, for the first-time, requirements of liquidity risk were defined. On the other hand, they introduced capital buffer requirements to reinforce the solvency of institutions and more effectively promote the internationalization of the financial system.

Portugal followed the evolution of the III Basel Accords. But are our banks prepared to face the pandemic that is affecting the entire world? That is the main purpose of this chapter. How are we facing this pandemic and what will be the consequences in the coming years?

Even if the bank is meeting all the requirements of the Basel Accords, the recent pandemic will have an impact that cannot yet be confirmed. One of the implicit factors is the duration and intensity of the restrictions imposed in Portugal. As it is common knowledge, both companies and families are exposed to the crisis. In many cases most employment contracts are temporary. On the other hand, companies are small and medium-sized. The measures imposed by the government may have positive impacts on the present and negative impacts quite soon in the future. The level of uncertainty is very clear. There are several aspects, still unknown, that may cause more adverse epidemiological situations in the near future, which may imply more persistent collapses in banking activity. With this chapter, it is essential to contribute to a small clarification of most of these constraints.