Indicators for determining Countercyclical Capital Buffer (Alb. 'KUNC')

In line with regulation "For macroprudential capital buffers" approved with the decision no.41, date 05.06.2019 of the Supervisory Council of the Bank of Albania and guidelines of the European Systemic Risk Board, reference indicators are used to determine the countercyclical capital buffer (*Alb.* 'KUNC'). Such indicators aim to capture fairly the credit cycle and risks associated with excessive credit growth in the country, as well as to appropriately consider features of the Albanian economy. Quantitative values of such indicators are subject to experts' interpretations and analysis, with other qualitative factors being included in such analysis.

Among reference indicators, "credit to GDP gap", is the primary one. It represents the deviation of the current value of "credit to the economy/GDP" from the ratio's long-term trend. It signals the excessive credit growth in relation to economic growth, and eventually the rise in cyclical systemic risk. To complement the primary indicator, other indicators are used. The Complementary Early Warning Indicator (CEWI), in addition to the primary indicator, includes five other sub-indicators capturing developments in bank credit and in non-financial assets (real estate).

Justification for setting the KUNC rate

The following tables show the most recent available values of selected indicators and their historical averages.

From Table 1, it can be seen that the figure of the primary indicator, although resulting in high negative values and far from the threshold level that would, as a rule, be associated with an increase in the countercyclical capital buffer[i], registers a narrowing by three quarters already[ii].

Table 1: The primary indicator

Indicator[iii]	Historical average		2019 Q3
	2002 Q4 – 2008 Q4	2009 Q1 – 2019 Q2	
"Credit to economy / GDP[iv]" gap	1.9 pp	-7.4 pp	-10.4 pp[v]

Source: Bank of Albania (BoA) and Institute of Statistics (INSTAT).

Such developments reflect the acceleration of the annual growth rate of credit to the economy, both from households and resident enterprises segments, in the latter case contributing more strongly. The evolution in the values of the primary indicator over time are shown in the following chart.

Chart: Performance of "Credit to economy/GDP" gap, in percentage points
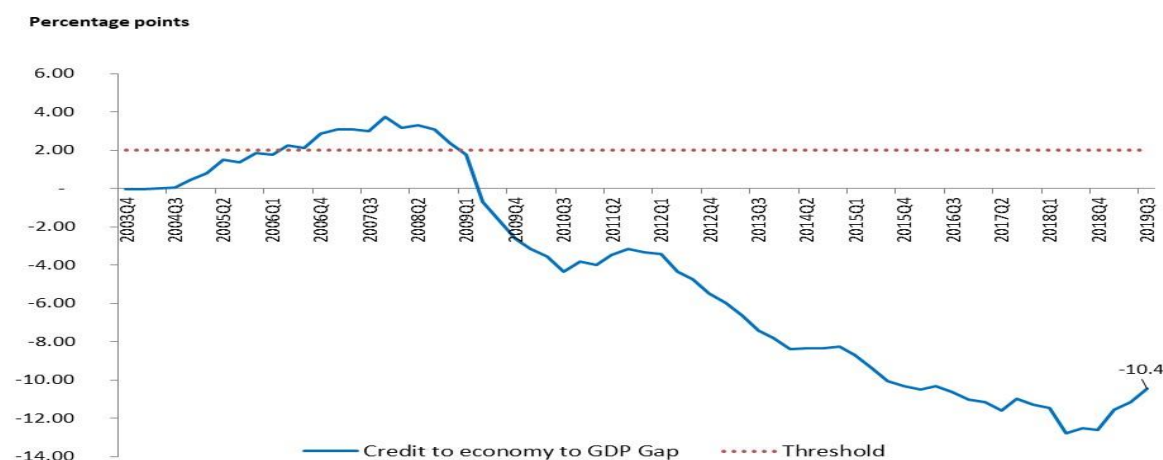
Source: Bank of Albania calculations.

Table 2 of the Complementary Indicator values, shows an upward trend, in annual terms, of bank real estate loans, along with an annual increase in the values of the house price index. It is important that trends in these two indicators, which tend to amplify each other's performance, be monitored in an on-going basis. The purpose is, when considering also developments in the debt burden of households, to identify and prevent developments where price developments in the real estate market are considered unsustainable.

Table 2: Complementary Indicator

Other Indicators[vi] (in %)	Historical average (2002 Q4 – 2019 Q2)	2019 Q3
Intensity of credit to economy[vii]	3.1%	1.7%
Real estate bank credit, annual change	23.0%	4.8%
"House price to rent index", annual change[viii]	7.6%	3.2%
"House price index", annual change[ix]	3.7%	5.4%
Bank credit[x], annual growth	17.7%	[-2.3]%

Source: BOA and INSTAT

Based on the data and analysis of the above indicators, it is estimated that the risks associated with excessive lending remain not significant, albeit a revival in the main indicators related to the lending itself.

As a result, Albania's countercyclical capital buffer rate (KUNC) is proposed to remain at 0%.

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[i] An increase in the countercyclical capital buffer might be necessary even if the values of the primary indicator are lower than the benchmark ones. This is the case when, despite the performance of credit in general, there are rapid developments in the lending activity in certain economic sectors, which are considered being unsustainable and a source of risk to the stability of the financial system and markets.

[ii] The value of the primary indicator was [-12.61]pp in Q4-2018, [-11.55]pp in T1-2019, [-11.15]pp in T2-2019.

[iii] In analyzing the values in the table, it should be considered that the calculated values of the primary indicator and its historical average differ due to two factors: a) developments in the values of credit to economy and GDP; and b) possible revisions of GDP value performed regularly by the Institute of Statistics (INSTAT). These two sets of factors can influence the value of the primary indicator, in the same or opposite directions. More specifically, the estimated value of the primary indicator in Q2-2019, published on 30.09.2019 as part of this analysis, was [-11.2]pp. Following the publication of the INSTAT of the GDP value and due to series revisions, the value of the primary indicator for that period results slightly lower, at [-11.15]pp.

[iv] GDP is estimated as the sum of the values for the last four quarters.

[v] The value of primary indicator of [-10.4]pp in Q3-2019, records an improvement (a lower negative value) of the credit gap compared to the value of Q2-2019. This change was affected by the higher rate of growth of credit to economy during the period, compared to GDP growth.

[vi] The indicators, along with the primary one, make up the "Complementary Early Warning Indicator", alias CEWI.

[vii] Annual growth of credit to economy as a ratio of annualized GDP (sum of GDP values of the last four quarters).

[viii] Data series is smoothed for 8 quarters.

[ix] Data series is smoothed for 8 quarters. In Q2-2019, the change in the index construction methodology has impacted its historical average value as well.

[x] It refers to credit provided from the banking sector both to public sector and to the private nonfinancial sector.