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 is observed that the figure of the primary indicator results in high negative values, far from the benchmark values that would, as a rule, be associated with an increase in the countercyclical capital buffer[i].

Table 1: The primary indicator

Primary indicator[ii]	Historical average		2019 Q2
	2002 Q4 – 2008 Q4	2009 Q1 – 2019 Q1	
Gap of "Credit to economy / GDP[iii]"	1.9 pp	-7.3 pp	-11.2 pp[iv]

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

However, during Q2-2019, the annual growth rate of credit to the economy accelerated due to the increase in both lending to households and resident enterprises. This development narrowed the negative values of the primary indicator over the last year, as shown in the following chart.

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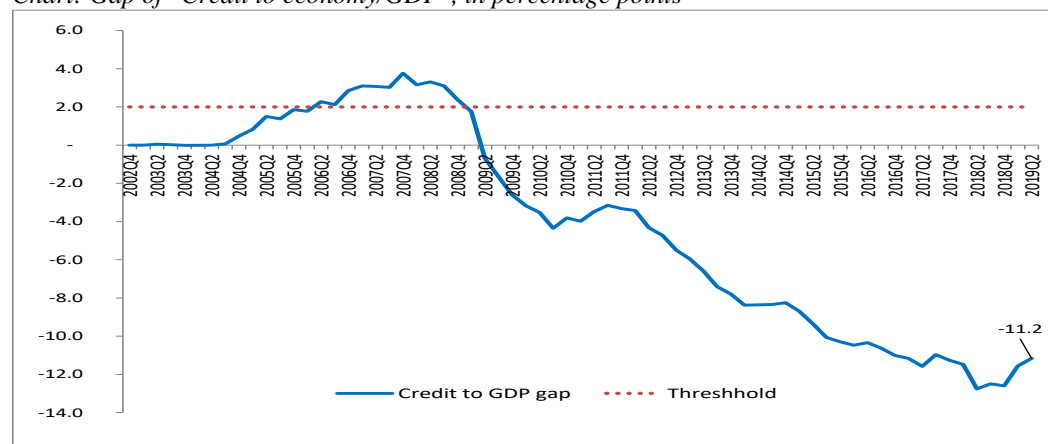
Source: Bank of Albania calculations.

Table 2 of the complementary indicators, shows an annual increase in the bank lending to real estate and, simultaneously, an annual increase in the residential house price index. It is important for the performance of these two indicators, which tend to reinforce each other's movements, to be monitored on a regular basis. The purpose is, considering also developments in the debt burden of households, to identify and prevent developments where prices in the real estate market are considered as unsustainable.

Table 2: Complementary indicators

Complementary Indicators[v]	Historical average (2002 Q4 – 2019 Q1)	2019 Q2
Intensity of credit to economy[vi]	3.1%	-0.3%
Real estate bank credit, annual change	23.3%	3.3%
"House price to rent index", annual change[vii]	7.7%	2.4%
"House price index", annual change	3.7%	4.6% [viii]
Bank credit[ix], annual growth	17.7%	-3.5%

Source: Bank of Albania and INSTAT

Based on the data and analysis of the above indicators, it is estimated that the risks associated with excessive lending are not currently significant. As a result, the countercyclical capital buffer rate (KUNC) for Albania is proposed to remain at 0%.

CLARIFICATIONS:

[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] 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) GDP value reviews performed regularly by the Institute of Statistics (INSTAT). These two sets of factors can influence the value of the primary indicator, in the same direction or in a different one. More specifically, the estimated value of the primary indicator in Q1-2019, published on 28.06.2019 as part of this analysis, was -11.1%. 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 in -11.6%.

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

[iv] The value of primary indicator in Q2-2019: -11.2%, records a narrowing (improvement) of the credit gap compared to the revised value of Q1-2019. This change was affected by the higher rate of growth of credit to economy during Q2 compared to GDP growth.

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

[vi] Annual growth of credit to economy as a ratio of annualized GDP (sum of GDP values of the last four quarters). "Credit to economy" refers to credit granted from banks and non-banks, to the resident private sector.

[vii] The index values are smoothened for the last 8 quarters.

[viii] The index values are smoothened for the last 8 quarters. In Q2-2019, the methodology of the index construction has changed, thus affecting also the value of its historical average.

[ix] It refers to credit provided from the banking sector both to public sector and to the private sector "households" and "businesses".