Indicators for determining the 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 still records negative values and far from the threshold level that would, as a rule, be associated with an increase in the countercyclical capital buffer. The values of the primary indicator have narrowed in the last four quarters.

Table 1: The primary indicator

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Historical average</th>
<th>2020 Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Credit to economy / GDP gap”</td>
<td>1.3 pp</td>
<td>-8.1 pp</td>
</tr>
</tbody>
</table>

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

Such developments reflect simultaneously the contraction of the economic activity the sustained annual growth rate of credit to the economy, fueled mostly credit to resident businesses. The evolution in the values of the primary indicator over time are shown in the following chart.
Table 2 of the Complementary Indicator values, shows a continuous upward trend of real estate loans in annual terms, albeit at a lower rate compared to the previous period. At the same time, the house price index maintains its upward trend compared to the previous period, marking still an increase in annual terms. 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

<table>
<thead>
<tr>
<th>Other Indicators vi (in %)</th>
<th>Historical average (2002 Q4 – 2020 Q1)</th>
<th>2020 Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intensity of credit to economy viii</td>
<td>3.1%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Real estate bank credit, annual change</td>
<td>22.3%</td>
<td>5.3%</td>
</tr>
<tr>
<td>“House price to rent index”, annual change vii</td>
<td>7.6%</td>
<td>11.8%</td>
</tr>
<tr>
<td>“House price index”, annual change ix</td>
<td>4.7%</td>
<td>13.5%</td>
</tr>
<tr>
<td>Bank credit iv, annual growth</td>
<td>15.5%</td>
<td>5.1%</td>
</tr>
</tbody>
</table>

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 narrowing of the negative value of the primary indicator.

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

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.


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.

iv GDP is estimated as the sum of the values for the last four quarters. For Q2-2020 the GDP growth rate was -10.23%. The actual GDP growth rate for Q2-2020 might be subject to revision in the short-term by INSTAT.

v The value of primary indicator of [-7.1] pp in Q2-2020, records an improvement (a lower negative value) of the credit gap compared to the value of Q1-2020. This change was affected by both higher rate of growth of the credit to economy and the domestic activity deep narrowing during the period.

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 to both public sector and to the private nonfinancial sector.