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 with the guidelines of the European Systemic Risk Board, reference indicators are used to determine the countercyclical capital buffer rate (*Alb.* 'KUNC'). Such indicators aim to fairly capture 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 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, a complementary indicator is used, built as a compound index. The Complementary Early Warning Indicator (CEWI), in addition to the primary indicator, includes five other sub-indicators capturing the 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 records negative values and far from the threshold level that would, as a rule, be associated with an increase in the countercyclical capital buffer rate[i]. The values of the primary indicator have widened versus the same period last year and less so versus the last quarter[ii].

Table 1. The primary indicator

Indicator[iii]	Historical average		2022-Q1
	2002 Q4 : 2008 Q4	2009 Q1 : 2021 Q4	
"Credit to economy / GDP[iv]" gap	1.9 pp	-7.9 pp	-7.16 pp[v]

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

Such development reflects the lower growth rate of credit to economy versus the higher growth rate of the annualized GDP. However, the performance of this indicator is different for the "business" segment versus that of "individuals". During the last period the widening of the negative value of the indicator has been mostly impacted by the change in the "individual" segment.

However, taking a long-term view, it can be seen from the chart below that the value of the primary indicator for individuals is slightly approaching the "zero" level, signaling the need for an increased attention.

Chart 1. Performance of "Credit to economy/GDP" gap, in percentage points
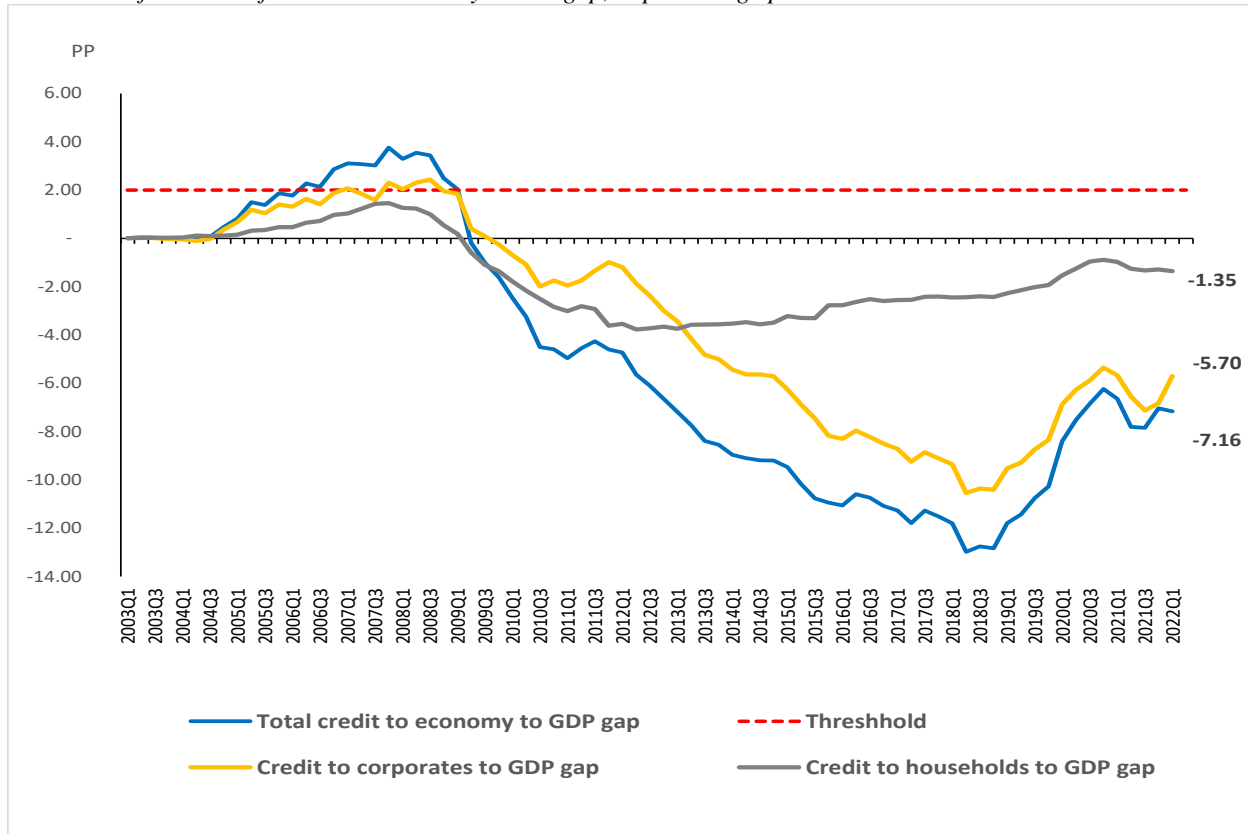
Source: Bank of Albania calculations.

The decision making process of the Bank of Albania on the countercyclical capital buffer rate, takes into account the timely performance of CEWI as well. The performance of its subcomponents is presented in Table 2. The developments of the period for the complementary indicator show a further expansion in the growth rate of real estate loans, both in quarterly and annual terms. Meanwhile, the house price index although is recording a decline compared to a year ago and to the previous period, remains above average historical value. The developments in these two sub-indicators, which tend to reinforce each other's performance, are being closely monitored. The purpose is, while considering also developments in the debt burden of households, to identify and prevent developments where price developments in the real estate market are considered as not sustainable. The same upward trend, both in annual and quarterly bases, holds true also for the intensity of credit to economy subcomponent.

Table 2. Complementary Indicator

Other Indicators and the CEWI index	Historical average (2002 Q4 : 2021 Q4)	2022-Q1
Intensity of credit to economy[vi]	3.0%	3.7%
Real estate bank credit, annual change	21.1%	15.6%
"House price to rent index", annual change[vii]	8.0%	9.5%
"House price index", annual change[viii]	5.5%	10.9%
Bank credit[ix], annual growth	14.5%	12.8%
CEWI index[x] (threshold)	0.49	0.53

Source: BOA and INSTAT

Following the above, the values of the CEWI index, record values above the threshold level. This development, despite the performance of primary indicator, may support the need to increase the countercyclical capital buffer rate if it remains and consolidates above the threshold level.

Chart 2. Time performance of CEWI index
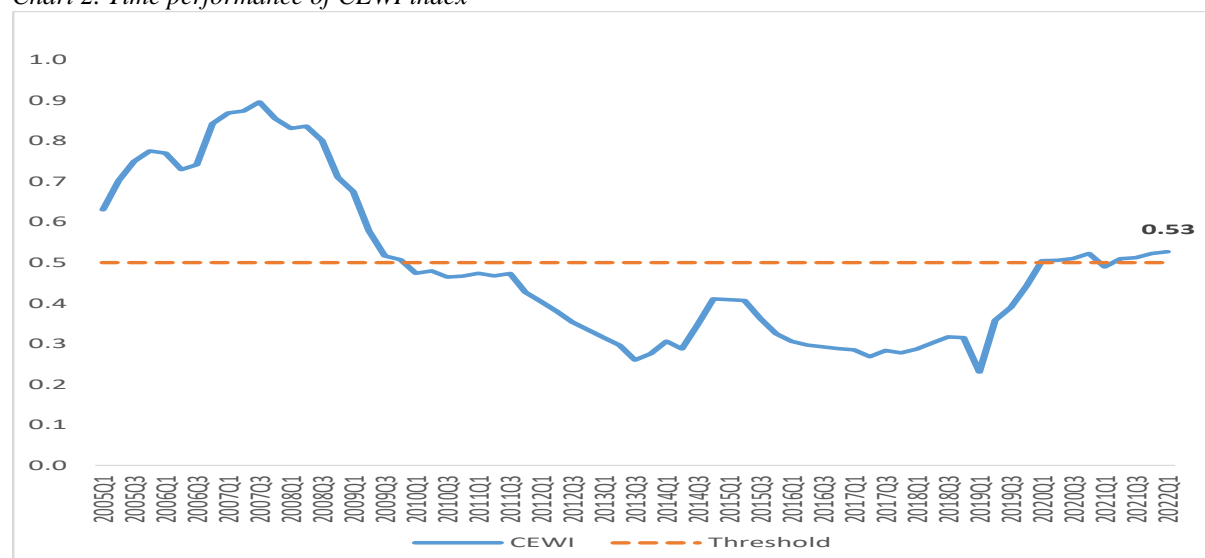
Source: BOA

Based on the data and analysis of the above indicators, results show that developments in specific indicators need an increased attention. However, the risks associated with excessive lending still remain at controlled levels.

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.

[ii] The value of the primary indicator was: [-6.64] pp in Q1-2021, [-7.08] pp in Q2-2021, [-7.84] pp in Q3-2021 and [-7.04] pp in Q4-2021.

[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 Q1-2022 the real GDP growth rate is 5.97%. The actual GDP growth rate for the referring period might be subject to revision in the short-term by INSTAT.

[v] The value of primary indicator of [-7.16] pp in Q1-2022, records a widening (a higher negative value) of the credit gap compared to the value of Q1-2021 [-6.64]. This change was affected by the lower growth rate of the credit to economy versus the growth of the annualized GDP.

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

[vii] Data series is smoothed for 8 quarters. In Q4-2020, the change in the rent index calculation methodology has impacted its historical average value as well.

[viii] 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.

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

[x] The individual sub-indicators, along with the primary one, make up the "Complementary Early Warning Indicator", alias CEWI. The indicator is built as an index, where each of the sub-indicators is equally weighted. The comparative threshold for the CEWI index is set at 0.5. For more information, please refer to the methodology "For countercyclical capital buffer":
https://www.bankofalbania.org/Financial_Stability/Macroprudential_policies/Instruments_of_Macroprudential_Policy/test/