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 versus the last quarter[ii].

Table 1. The primary indicator

Indicator[iii]	Historical average		2023 Q1
	2002 Q4 : 2008 Q4	2009 Q1 : 2022 Q4	
"Credit to economy / GDP[iv]" gap	1.9 pp	-7.79 pp	-8.43 pp[v]

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

The quarterly developments reflect the slight decrease of the credit to economy against the positive growth of the annualized gross domestic product. The developments in the primary indicator has been in different directions for the "business" and "individual" segments. During the quarter, the deepening of the value of the primary indicator has been determined by the performance of the

corresponding indicator of the "businesses" segment. However, in the long run, it seems that the value of the primary indicator for "individuals" fluctuates closer to the "zero" level, signaling the need for increased attention.

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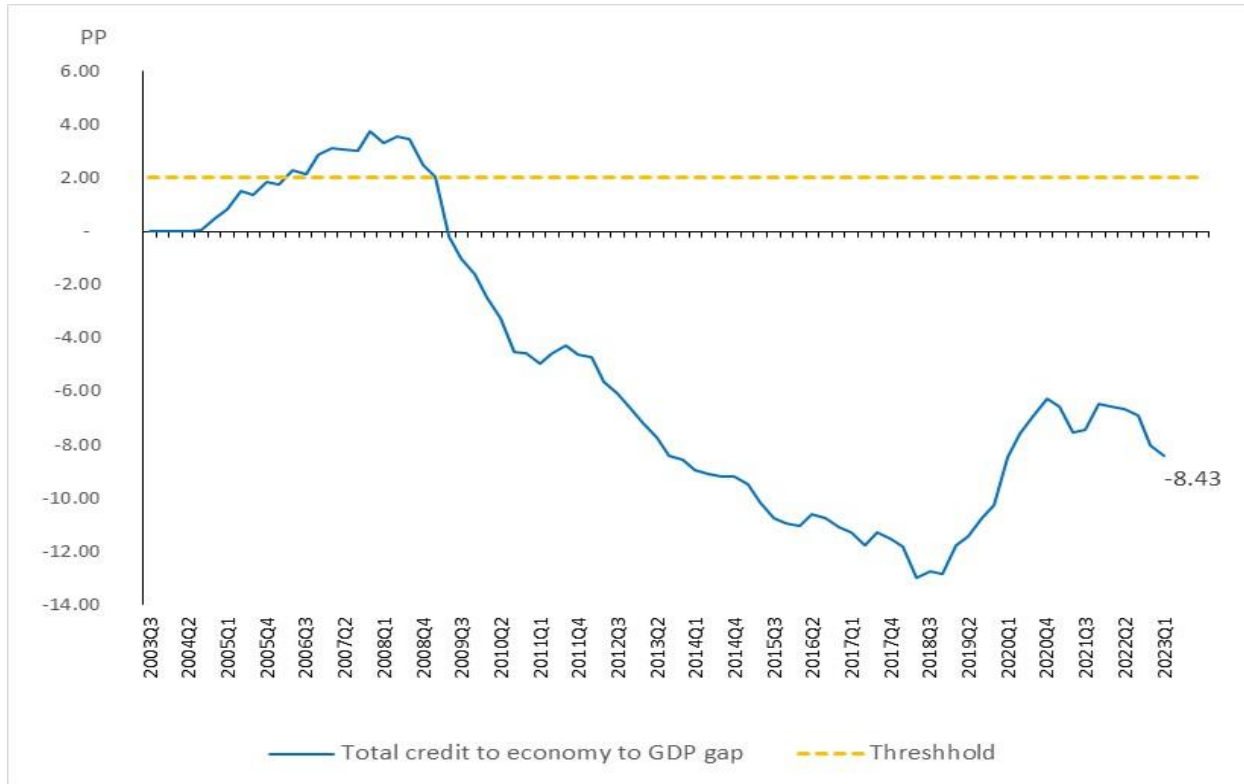
Source: Bank of Albania calculations.

The decision making process of the Bank of Albania on the countercyclical capital buffer rate, takes also into account the performance of CEWI overt time. The performance of its subcomponents is presented in the following table. The developments of the period reflect a narrowing – both in annual and quarterly terms – in the growth rate of the real estate loan portfolio. This narrowing continues since the first quarter of 2022 and the values of the sub-indicator remain below the historical average. On the other hand, the housing price index registers higher values in annual terms but has slowed down the pace of growth in quarterly terms. The same trend is observed in the performance of the ratio of this sub-indicator against that of rent. Despite this development, the value of this sub-indicator continues to remain significantly above the historical average. The developments in these two sub-indicators, which tend to reinforce each other's performance, are 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. In addition, the sub-indicator of credit intensity to the economy records a decrease for the second quarter in a row, both in annual and quarterly terms.

Table 2. Complementary Indicator

Other Indicators and the CEWI index	Historical average (2002 Q4 : 2022 Q4)	2023 Q1
Intensity of credit to economy[vi]	3.0%	1.2%
Real estate bank credit, annual change	20.7%	12.9%
"House price to rent index", annual change[vii]	8.3%	14.9%
"House price index", annual change[viii]	6.0%	16.7%
Bank credit[ix], annual growth	14.3%	3.3%
CEWI index[x]	**0.50**	**0.52**

Source: BOA and INSTAT

Consequently, at the end of the Q1-2023, the value of the CEWI index recorded a lower value of 0.52 versus the previous quarter level of 0.55, but still remains above the comparative threshold of 0.50. Regardless of the performance of the primary indicator, if the value of CEWI index continues to exceed the threshold value in a steady manner, the possibility of an increase in the rate of countercyclical capital buffer will be considered.

Chart 2. Time performance of CEWI index
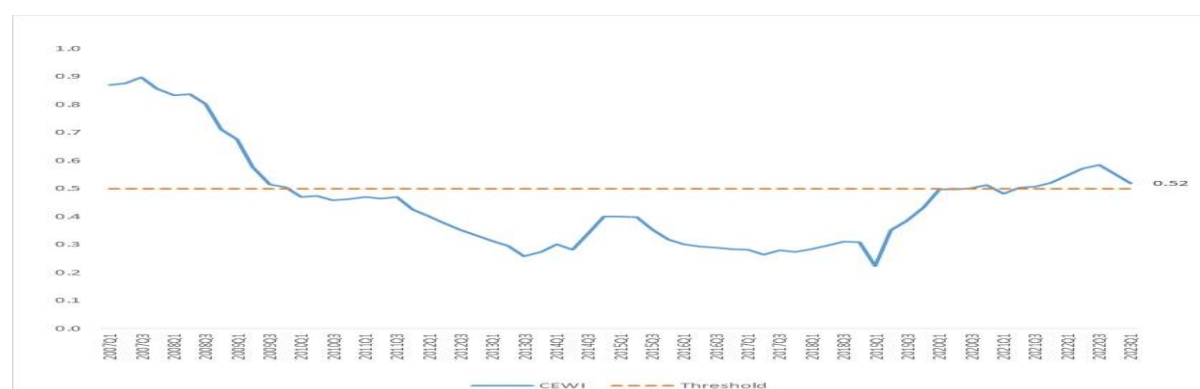
Source: BOA

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 controlled.

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: [-6.66] pp in Q2-2022, [-6.90] pp in Q3-2022, [-8.00] pp in Q4-2022 and [-8.43] pp in Q1-2023.

[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 Q1-2023 the real GDP growth rate is 2.72%. 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 in Q1-2023, records a widening (a higher negative value) of the credit gap compared to the value of Q1-2022 [-6.58].

[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/