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 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 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, in principle, be associated with an increase in the countercyclical capital buffer. In Q2-2021 the negative value of the primary indicator has widened compared to the last three previous quarters but remains narrower compared to the same period last year.

Table 1: The primary indicator

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Historical average</th>
<th>2021 Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Credit to economy / GDP” gap</td>
<td>1.9 pp</td>
<td>-7.4 pp</td>
</tr>
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</table>

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

Such development reflects the lower positive growth rate of credit to economy versus the much higher growth rate of GDP observed during Q2-2021, both in annual and quarterly terms. 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 doubling of the growth rate for real estate loans, both in annual and quarterly terms. Meanwhile, the house price index, maintains the same upward trend compared to a year ago and to the previous period. It is important that trends in these two indicators, which tend to amplify each other's performance, should be monitored in an ongoing basis. 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.

Table 2: Complementary Indicator

<table>
<thead>
<tr>
<th>Other Indicators(^{vi}) (in %)</th>
<th>Historical average (2002 Q4 – 2021 Q1)</th>
<th>2021 Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intensity of credit to economy(^{vii})</td>
<td>3.0%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Real estate bank credit, annual change</td>
<td>21.4%</td>
<td>11.4%</td>
</tr>
<tr>
<td>“House price to rent index”, annual change(^{viii})</td>
<td>7.9%</td>
<td>11.8%</td>
</tr>
<tr>
<td>“House price index”, annual change(^{ix})</td>
<td>5.2%</td>
<td>13.3%</td>
</tr>
</tbody>
</table>
A sustained credit growth rate, especially of relevant credit subcategories, and a return to more normal long-term GDP growth rates, could cause faster closure of credit gap in the near future and change perspective on the necessary countercyclical capital buffer (KUNC) value. However, based on the current values and analysis of the above indicators, it is assessed that the risks associated with excessive lending remain currently under control.

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 Q2-2021 the GDP growth rate is 17.89%. 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 [-6.44] pp in Q2-2021, records an improvement (a lower negative value) of the credit gap compared to the value of Q2-2020, [-6.92] pp. This change was affected by the higher growth rate of the credit to economy versus the growth of the GDP.

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. In Q4-2020, the change in the rent index calculation methodology has impacted its historical average value as well.

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.