
Indicators for determining the Countercyclical Capital Buffer (Alb. 'KUNC')

The countercyclical capital buffer (hereinafter, CCyB) is an important macroprudential instrument, which alone or combined with other macroprudential instruments, helps maintain the stability of the banking sector and mitigates volatility in the financial cycle by addressing the cyclical nature of risk systemic related to excessive lending.

The application of CCyB for local banks is based on regulation no. 41, dated 05.06.2019 "On macroprudential capital additions", and on the methodology "On countercyclical capital additions in Albania" (November 2021). The first decision of the Governor on the level of the KUNC supplement is that of no. 3368, dated 28.06.2019, where the value of KUNC was set at the level of 0%. The value of KUNC has remained unchanged at the level of 0% in all subsequent quarterly decisions until June 2024, when KUNC was raised for the first time to 0.25%.

The decision-making on the level of the countercyclical addition is mainly based on the performance of the values of the indicator of the gap of credit to economy to GDP ratio, otherwise considered as the primary indicator. Although "the gap of credit to economy to GDP ratio" is the main indicator for the activation of CCyB, the practice of its implementation in other countries and in Albania has evidenced the slowness of the reaction of this indicator in general, and its insufficiency to capture and evidence rapid developments in certain loan segments. Therefore, the regulatory and methodological framework of the Bank of Albania foresees that the decision-making for the definition of CCyB is also based on the Complimentary Early Warning Indicator (CEWI), where, in addition to the primary indicator, other indicators that monitor the intensity of lending as a whole and in certain segments of it are included.

Justification for setting the CCyB rate

The values of the primary indicator have continued to be negative until Q3-2024, but the size of the negative value has narrowed. Although the primary indicator is at a level that still does not suggest, as a rule, the adoption of macroprudential measures, the performance of CEWI suggests that this attitude needs to be reviewed under circumstances where credit growth has continued steadily and is more accelerated in certain segments of it. These developments signal the transition to a situation with a pronounced acceleration of lending, which may be accompanied by the accumulation of risks for credit quality in the future. In this case, the need to react counter-cyclically in order to control risks, directly reflects the concept and purpose of using CCyB.

Performance indicators

At the end of the third quarter of 2024, the primary indicator records a narrowing of the negative gap (improvement in its values) for the fifth consecutive quarter. The value of the indicator has narrowed both versus same period a year ago and the previous quarter¹.

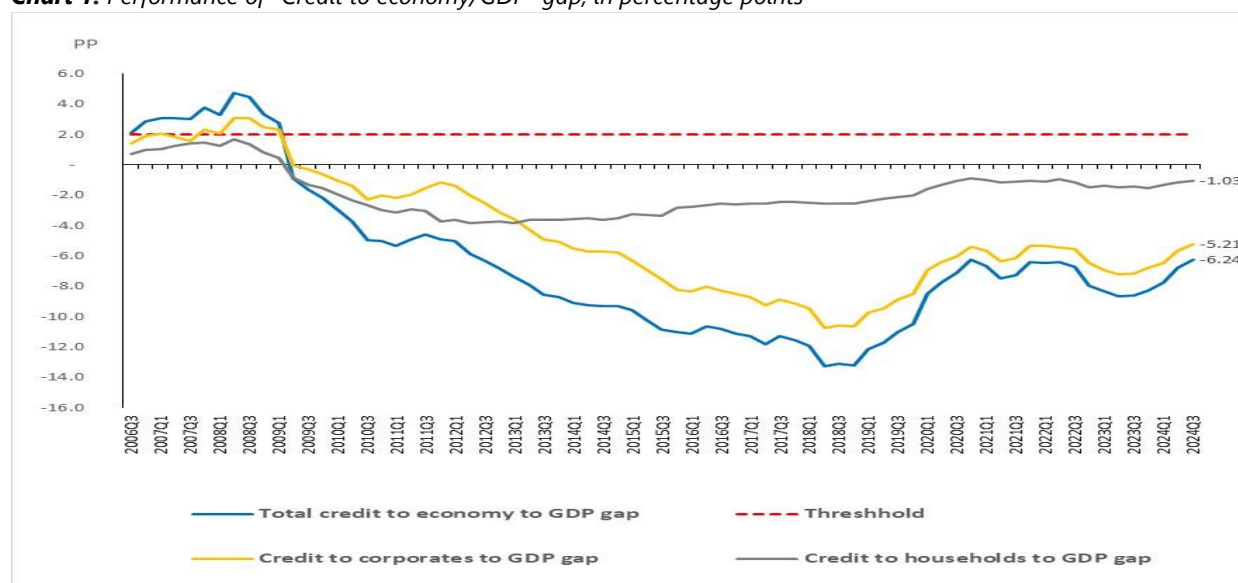
Table 1. The primary indicator

Indicator ⁱⁱ	Historical average		2024 Q3
	2003 Q4 : 2008 Q4	2009 Q1 : 2024 Q2	
"Credit to economy / GDP ⁱⁱⁱ " gap	2.1 pp	-7.96 pp	-6.24 pp ^{iv}

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

The above performance reflects the higher annual growth rate of credit to the economy in Q3-2024 (12%), compared to the growth of annualized gross domestic product for the same period (8%). The primary indicator recorded a narrowing of the values of the negative gap both for the "individual" and "business" segments. The latter continues to make the main contribution to the performance of the value of the primary indicator.

Chart 1. Performance of "Credit to economy/GDP" gap, in percentage points



Source: Bank of Albania calculations.

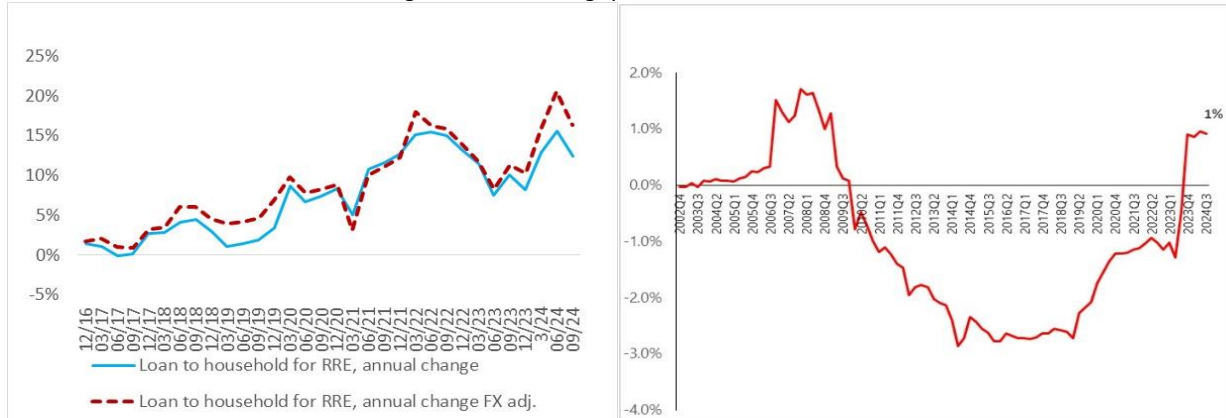
As can be seen from the graph no.1, after Q2-2008, where the highest positive value was recorded (4.7 pp), the values of the primary indicator have mainly followed a downward trend. Both for businesses and individuals, a period of continuous decline (widening of the negative gap) was observed, mainly in the periods 2008-2012 (for individuals) and 2012-2018 (for businesses). Afterwards, their values have shown an upward trend, so the negative gap has narrowed. This trend has been more stable over time for individuals.

In general, the development of the nominal value of loans to individuals (as reported by banks) is determined by the development of loans for the purchase of real estate (residential real estate). The growth of this credit has been faster than the growth rate of the overall credit balance, faster than the nominal growth of GDP, and as a result its weight in relation to GDP has increased since 2019.

The growth of credit as a whole, and that of credit for the purchase of residential real estate, is even stronger when corrected for the diminishing effect of (appreciation) the exchange rate. As can be seen from Chart 2 (left), at the end of September 2024 annual credit growth, when corrected for the effect

of the exchange rate, was 17% (compared to the reported 12%). The same indicator for the mortgage loans was 16% (compared to the reported 12.4%).

Chart 2. Household real estate loans granted and the gap to the ratio to GDP



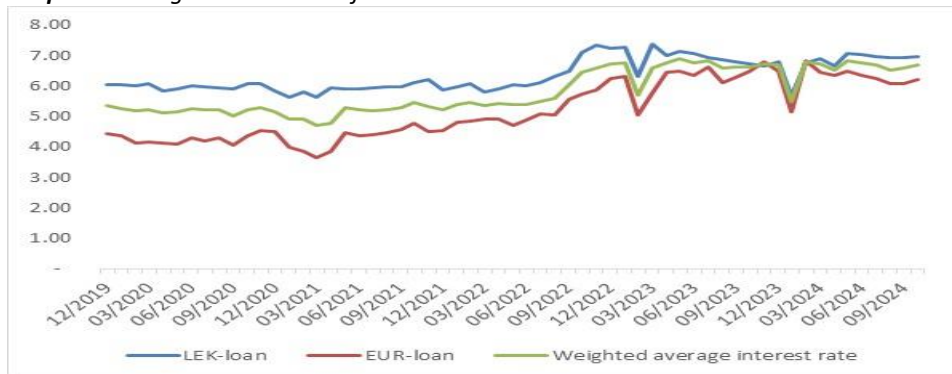
Source: Bank of Albania calculations.

If the gap of this loan type to GDP is calculated, in a similar way as for the primary indicator, it can be observed (Chart 2, right) that this gap records steady positive values, starting from end 2023.

If we analyze the performance of loans granted to businesses, for development and investments in real estate (residential and commercial), when corrected for the exchange rate effect, the annual growth rates until September 2024 remain over 30% in each case. Further, when aggregating the loans granted to households and businesses for real estate (residential and commercial), the annual growth rate of this portfolio is 28% (from 24% according to reporting in nominal value). This growth rate is significantly higher than the annual growth rate for the entire loan portfolio of 17%, evidencing the acceleration of lending for this segment.

Credit growth in the last 3-4 years has continued to be strong, despite the increases in interest rates for the Albanian Lek and for foreign currencies. This increase in interest rates has been particularly significant during 2022, but has steadied afterwards.

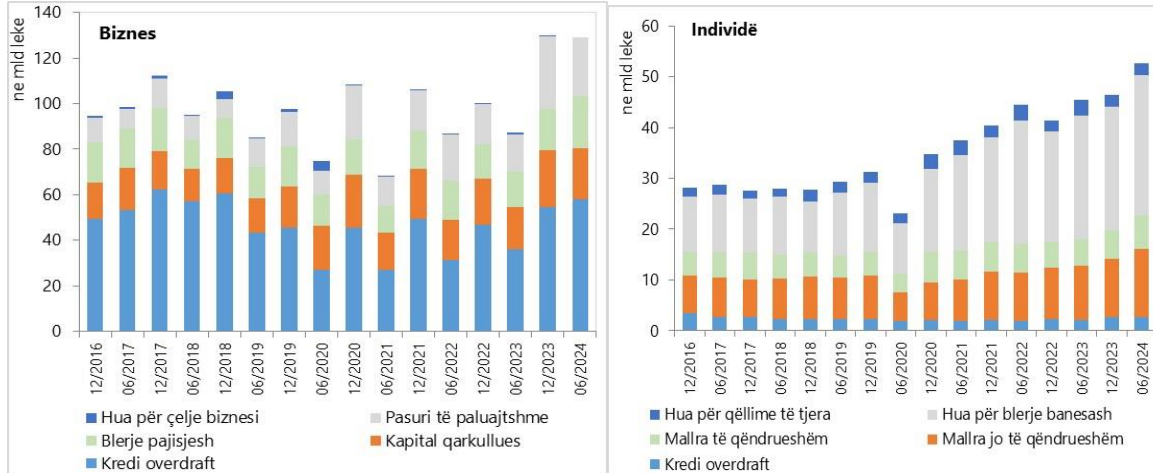
Graph 3. Average interest rates for new loans



Source: Bank of Albania calculations.

Contrary to expectations, the increase in interest rates has not had a significant restraining effect on loan volumes. In fact, it is observed that the volumes of new loans, sector-wise, have generally been stable or have increased (Graph 4).

Graph 4. New loan volumes (businesses, left – HH, right)

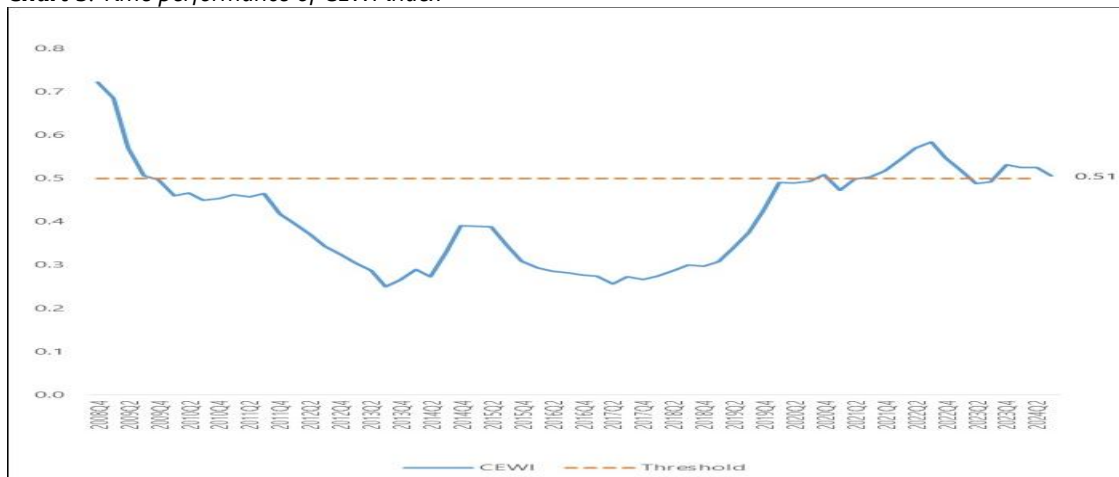


If interest rates will stop at these levels or start to decline, then the possibility of credit growth acceleration would be strengthened.

The accelerated credit growth over the last few years has not been sufficiently reflected in the values of the primary indicator. The index values, although narrowed, remain clearly in negative territory. This phenomenon has also been observed in other countries, and is mainly attributed to low rates of lending for a long period of time in the past (mainly after the global financial crisis of 2007-2009).

But the complementary early warning indicator (CEWI) has been signaling this rapid credit growth for several quarters. The values of the index (actually 0.51) are above the maximum threshold defined in the Methodology "For determining the countercyclical capital buffer" (0.5), a territory where this methodology envisages the application of a positive value of CCyB.

Chart 5. Time performance of CEWI index



Source: Bank of Albania.

In general, the positive developments in the financial cycle are also reflected in the performance indicators of the banking sector. As in 2023, also during 2024 the sector continued to expand its activity, ensured a good quality of assets as the ratio of non-performing loans fell to historically low levels (4.5% in November 2024), achieved a very good financial result (RoA 1.9% and RoE 18.3%, in September 2024) and maintained good levels of the capital adequacy ratio (20.2%, in September 2024).

In line with trends in the financial cycle, CCyB has been widely used in other countries of the region and of the European Union. Currently, in the Western Balkan region, according to information collected from central banks websites, CCyB has not started to be implemented in Kosovo and Bosnia and Herzegovina; has been kept at 0% in Serbia; was raised to 0.5% in **Montenegro**^v (to be met from April 1st, 2025); was raised to 1.75% in **North Macedonia** (to be met from September 1st, 2025). According to publications of European Systemic Risk Board, in EU member countries the level of KUNC varies from 0% in Italy, Greece, Spain, Portugal, Austria, Finland, Latvia and Poland; to 0.5% in Slovenia, Belgium and **Hungary**; to 0.75% in Germany; to 1% in France, Rumania, Cyprus and Lithuania; to 1.25% in Czechia^{vi}; to 1.5% in Ireland, Slovakia, Estonia and **Croatia**; to 2% in Netherlands, Bulgaria and Sweden; to 2.5% in Island, Norway and Denmark.

Conclusion and proposal for the CCyB rate

From several quarters, the Albanian economy is experiencing a positive financial cycle based on the accelerated growth of bank credit. Such periods are associated with good levels of financial performance for agents of the real economy and for the financial system. However, these periods are also associated with the beginning of certain risks, which may be related to a decrease in credit standards, the increase in the levels of its concentration in certain sectors or markets, the increase in debt levels for agents of the real economy beyond the healthy levels etc. These situations, if allowed to further develop, can make the economy and the financial system more sensitive to various shocks, thus undermining financial stability. For these reasons, in these cases it is suggested to use macroprudential instruments that soften the course of the financial cycle (act in a counter-cyclical way) and prevent the uncontrolled development of these risks. Among these instruments, CCyB holds an important place.

In our case, positive developments in the financial cycle are reflected in the narrowing of the negative values of the primary indicator (credit to GDP gap) and more so in the performance of the values of the Complementary Early Warning Indicator (CEWI). Based on the values of this index over several quarters, the use of CCyB is suggested by the methodology "For determining the countercyclical capital buffer".

In conclusion to the analysis of these developments, we propose:

- The increase of the CCyB rate for Albania from 0.25% currently, to 05%. Banks will have to meet this level of the buffer for the first time by the end of December 2025.

If lending growth rates will remain high, further increases in the KUNC rate can be expected in the coming periods.

NOTES

ⁱ The value of the primary indicator was: [-8.58] pp in Q3-2023, [-8.29] pp in Q4-2023, [-7.77] pp in Q1-2024 and [-6.79] pp in Q2-2024.

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) 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.

ⁱⁱⁱ GDP is estimated as the sum of the values for the last four quarters. The actual GDP growth rate for the referring period might be subject to revision in the short-term by INSTAT.

^{iv} The value of primary indicator in Q3-2024, records a narrowing (a lower negative value) of the credit gap compared to the value of Q3-2023.

^v In bold, are countries that have registered a growth of KUNC level since June 2024.

^{vi} Underlined, are countries that have registered a decline of KUNC level since June 2024