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). The decision-making on the level of the countercyclical supplement is mainly based on the performance of the values of the indicator of the gap of the ratio of credit to GDP. Although the "gap of the credit ratio to GDP" is the main indicator for the activation of KUNC, the practice of its implementation in other countries and in Albania has evidenced the slowness of the response of this indicator in general, and its insufficiency to capture and evidenced rapid developments in certain loan segments. Therefore, the regulatory and methodological framework of the Bank of Albania foresees that the decision-making for the level of KUNC is also based on the Supplementary Early Warning Indicator (CEWI).

Justification for setting the CCyB rate

The following tables show the most recent available values of selected indicators and their historical averages. From table 1, it can be observed that the values of the primary indicator have continued to be negative until T4-2024, but the size of the negative value has still decreased[i]. The value of the indicator has narrowed almost 0.74 p.p. against the previous quarter and almost 3.1 p.p. against the previous year., to [-5.5pp].
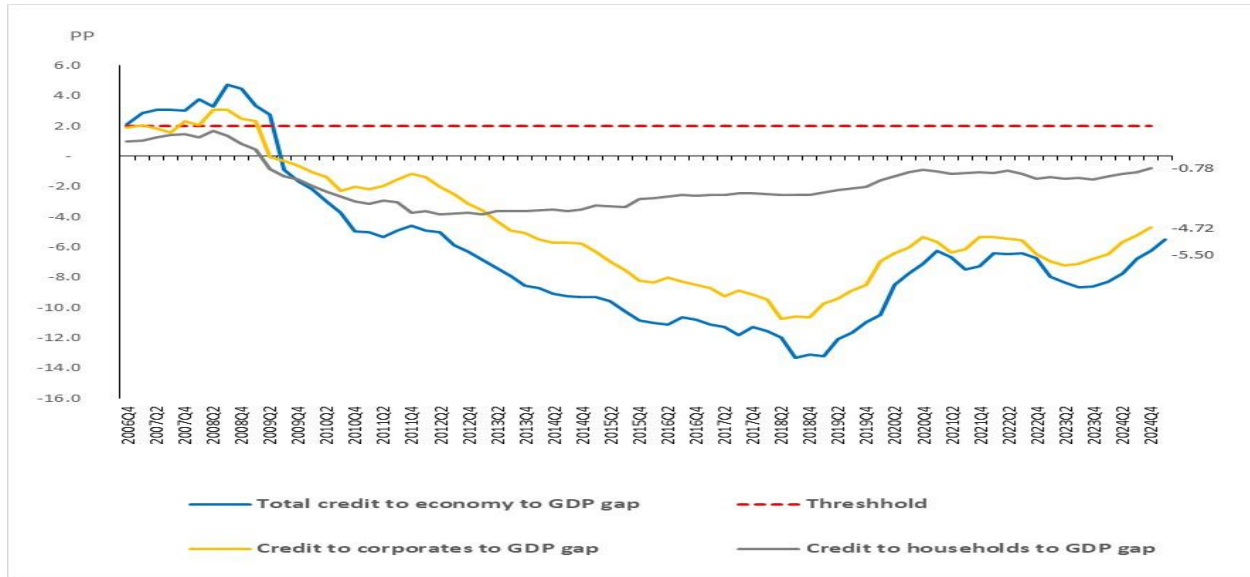
Table 1. The primary indicator

Indicator[ii]	Historical average		2024 Q4
	2003 Q4 : 2008 Q4	2009 Q1 : 2024 Q3	
"Credit to economy / GDP[iii]" gap	1.90 pp	-7.9 pp	-5.5 pp

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

The above performance reflects the higher growth rate of the credit to economy (about 12%) in Q4-2024, compared to the growth rate of gross domestic product for the same period (about 7%). The primary indicator recorded a narrowing of the values of the negative gap both for the "individual" and for the "business" segment.

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

Source: Bank of Albania calculations.

The decision-making of the Bank of Albania on the determination of the countercyclical capital addition rate, in addition to the primary indicator, is also based on the performance of the TPHP[iv]. The values of its constituent sub-indices are presented in Table 2.

The developments of the period reflect a positive growth rate of the real estate loan portfolio, but with a downward trend both in annual and quarterly terms. The growth rate of this loan segment remains comparable to that of the total bank credit, but higher than the nominal growth of GDP. The value of the period for this sub-indicator does not exceed its historical average.

The housing price index, has accelerated its growth rate for the fourth quarter in a row, registering values significantly above its historical average. The performance of the house price index to the rent index has also increased, with a full contribution from the performance of house prices. For this reason, the annual change in the values of this sub-indicator registers a value higher than the historical average for the third quarter in a row[i].

These two sub-indicators, which tend to reinforce each other's performance, have long been closely monitored. The analysis of the performance of the values of these two sub-indicators, together with the indirect information obtained from the household debt burden survey, serves to identify and prevent situations in which the exposure to the real estate market may constitute an increased

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[i] This indicator is higher in annual terms, but due to the methodology of its calculation, where its growth values are smoothed for eight quarters, resulting in a more contained growth rate.

systemic risk. Finally, the sub-indicator of credit intensity for the economy also maintains its upward trajectory in both annual and quarterly terms.

Table 2. Complementary Indicator

Other Indicators and the CEWI index	Historical average (2003 Q4 : 2024 Q3)	2024 Q4
Intensity of credit to economy[v]	2.9%	3.5%
Real estate bank credit, annual change	21.3%	11.5%
"House price to rent index", annual change[vi]	8.6%	9.2%
"House price index", annual change[vii]	6.6%	12.4%
Bank credit[viii], annual growth	14.4%	12.8%
CEWI index[ix]	0.50	0.53

Source: BOA and INSTAT

At the end of the fourth quarter of 2024, the TPHP index value remains above the maximum limit suggested by the countercyclical rate setting methodology (historical average) and has been largely above this limit since the end of 2021, signaling potential risks that may stem both from an overheating in the credit and non-financial asset market.

These developments were at the basis of the Bank of Albania's decision to further increase the CCyB rate by 0.25 percentage points in December 2024, to the level of 0.50%.

Chart 2. Time performance of CEWI index
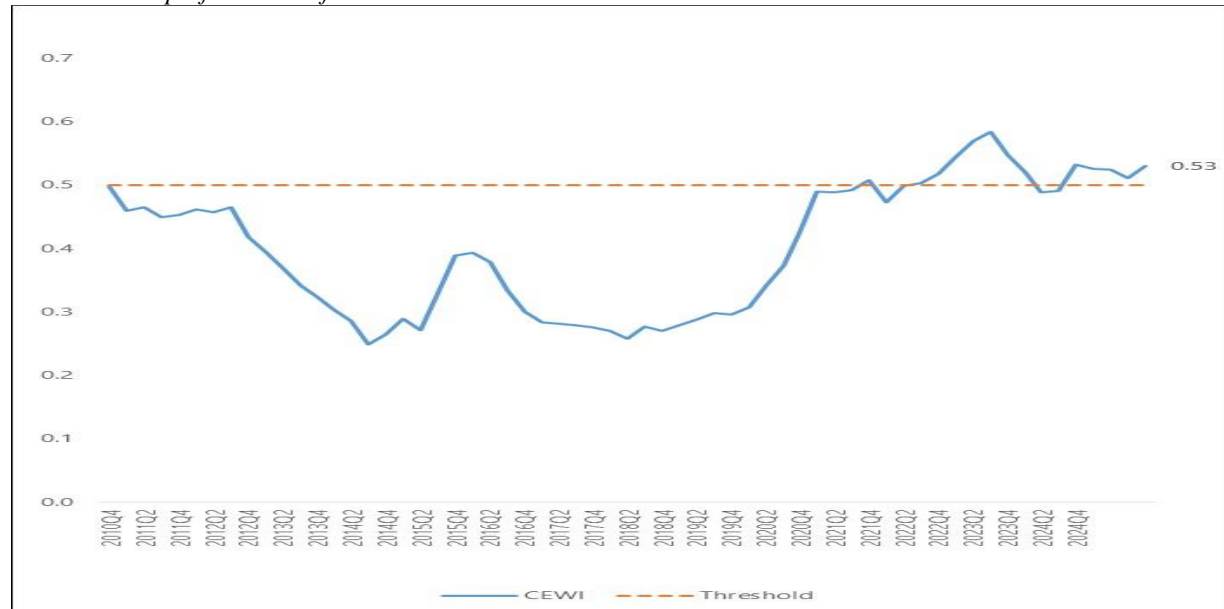
Source: BOA

As a result of the analysis of the above indicators, it is proposed that the rate of countercyclical capital addition (CCyB) for Albania remains at the level of 0.50%.

Further increases of CCyB rate are possible, depending on growth of total credit or of its segments.

NOTES

[i] The value of the primary indicator was: [-8.3] pp in Q4-2023, [-7.8] pp in Q1-2024, [-6.8] pp in Q2-2024 and [-6.2] pp in Q3-2024.

[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. For Q4-2024 the real GDP growth rate is 3.63%. The actual GDP growth rate for the referring period might be subject to revision in the short-term by INSTAT.

[iv] 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.

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

[vi] 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.

[vii] 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.

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

[ix] 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/