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).

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 definition 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 T2-2024, but the size of the negative value has decreased[i]. The value of the indicator has narrowed almost 1 p.p. against the previous quarter.
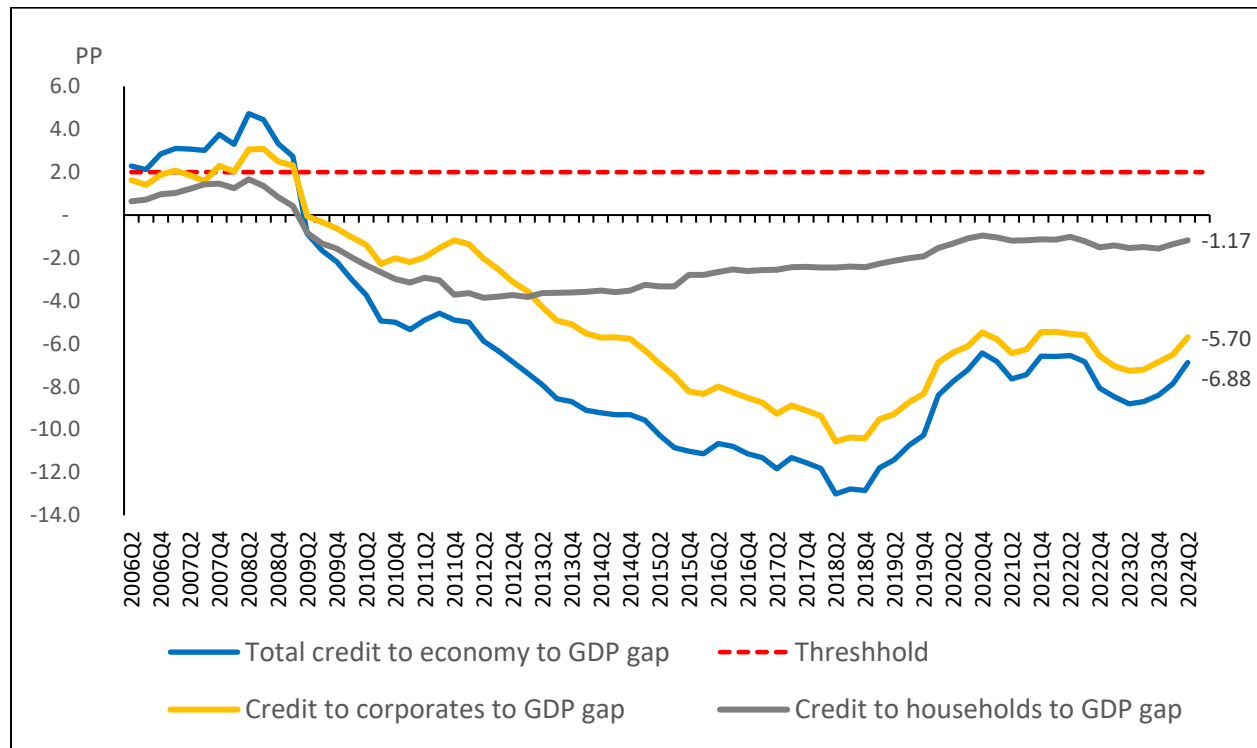
Table 1. The primary indicator

Indicator[ii]	Historical average		2024 Q2
	2003 Q4 : 2008 Q4	**2009 Q1 : 2024 Q1**	
"Credit to economy / GDP[iii]" gap	1.90 pp	-7.97 pp	-6.88 pp

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

The above performance reflects the accelerating growth rate of credit to the economy in Q2-2024, compared to the growth of gross domestic product for the same period. The primary indicator recorded a narrowing of the values of the negative gap for the "individual" and for the "business" segment. 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.

Although the primary indicator shows negative values, the performance of CEWI signals the transition to a situation with a marked acceleration of lending, which may be accompanied by the accumulation of risks for credit quality in the future. Hence, Bank of Albania decided to raise for the first time the countercyclical capital buffer rate to 0.25 percent
.
The performance of CEWI subcomponents is shown in Table 2. The developments of the period reflect a significant acceleration of the growth rate of the real estate loan portfolio, both in annual and quarterly terms. The growth rate of this credit remains faster than the growth rate of the outstanding bank credit and of the nominal growth of GDP. Consequently, the actual value of the sub-indicator in question significantly exceeds the historical average. Same holds true also for the developments in the housing price index, which has accelerated its growth rate for the fourth consecutive quarter, registering values above the historical average. The ratio of the housing price index to rent has increased, with overall contribution coming from the performance of the housing price.

These two sub-indicators, which tend to reinforce each other's performance, are being closely monitored. The analysis of the values of these two sub-indicators, together with the indirect information that is obtained from the survey of the debt burden of households, serve to identify and prevent situations in which the progress of prices in the real estate market may constitute an increased systemic risk. Finally, the credit intensity sub-indicator for the economy has continued to maintain its upward pace both in annual and quarterly terms.

Table 2. Complementary Indicator

Other Indicators and the CEWI index	Historical average (2003 Q4 : 2024 Q1)	2024 Q2
Intensity of credit to economy[iv]	2.9%	3.1%
Real estate bank credit, annual change	20.9%	47.2%
"House price to rent index", annual change[v]	8.6%	5.7%
"House price index", annual change[vi]	6.6%	15.3%
Bank credit[vii], annual growth	13.7%	11.1%
CEWI index[viii]	0.50	0.53

Source: BOA and INSTAT

At the end of the second quarter of 2024, the value of the CEWI index remains above the maximum limit suggested by the methodology for determining the countercyclical buffer rate (historical average) and has been mostly above this limit since the end of 2021. This development signals a possible accumulation of risks stemming from an overheating in the credit market.

Chart 2. Time performance of CEWI index
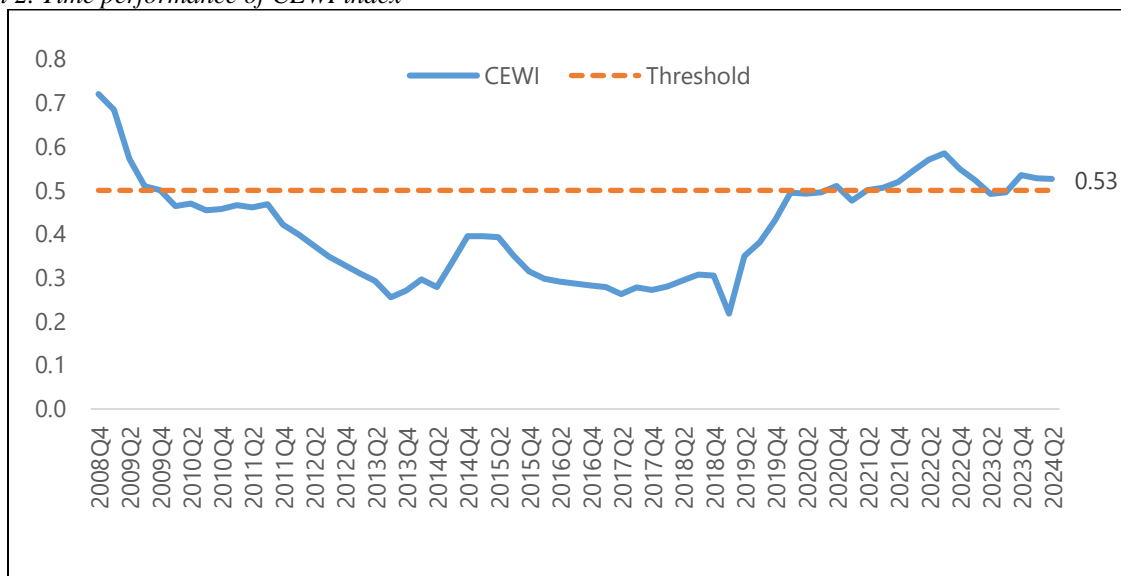
Source: BOA

In conclusion the monitored data confirm the ongoing fast growth of credit, supporting an additional rise of KUNC rate. However, considering that Bank of Albania already raised the KUNC rate in the previous quarter and in order to ensure better support for the decision-making on more stable data, *we propose that the KUNC rate for Albania remains currently at 0.25%.*

If the fast credit growth rates of credit will be confirmed in the coming months, a further increase of the KUNC rate by the end of the year is highly probable.

NOTES

[i] The value of the primary indicator was: [-8.8] pp in Q2-2023, [-8.7] pp in Q3-2023, [-8.4] pp in Q4-2023 and [-7.9] pp in Q1-2024.

[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 Q2-2024 the real GDP growth rate is 4.06%. The actual GDP growth rate for the referring period might be subject to revision in the short-term by INSTAT.

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

[v] 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.

[vi] 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.

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

[viii] 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/