

# THE COUNTERCYCLICAL CAPITAL BUFFER RATE

## EESTI PANK'S ASSESSMENT OF THE COUNTERCYCLICAL CAPITAL BUFFER RATE (Q3 2021)<sup>1</sup>

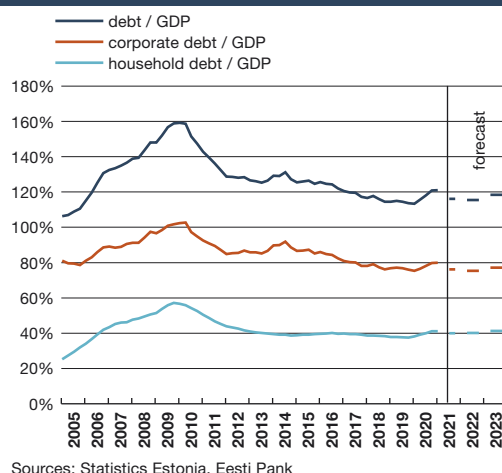
**Eesti Pank's assessment in September 2021 is that the systemic risks coming from the credit cycle are not currently large, and so it is justified to keep the countercyclical capital buffer rate at 0%.**

- The applicable countercyclical capital buffer rate: **0%**
- The standardised credit-to-GDP ratio: **121%**; its deviation from the long-term trend: **-1 percentage point**
- The buffer guide: **0%**
- **The reasoning behind the buffer rate.** Growth in the debt of the non-financial sector remains slower than long-term average nominal growth in the economy, and the risk of a rapid increase in indebtedness is currently small. In consequence Eesti Pank currently considers it appropriate to keep the countercyclical capital buffer rate for the banks at 0%. The danger remains that growth in debt may continue to accelerate as economic activity increases, and it may start to exceed long-term nominal economic growth consistently. In this case the risks from the credit cycle would increase and it may become necessary to raise the countercyclical capital buffer rate above 0%.

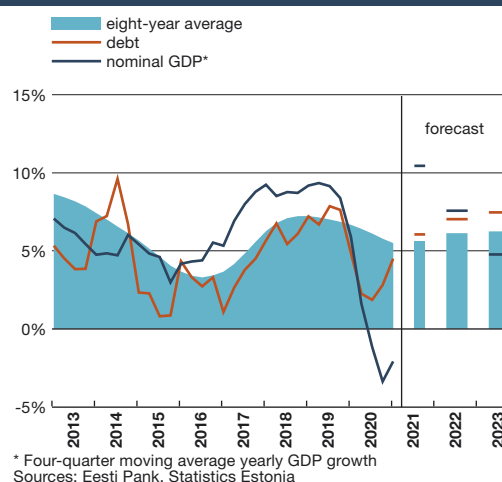
**The indebtedness of the non-financial sector in the first quarter of 2021 was essentially unchanged from the previous quarter.** The debt-to-GDP ratio in the first quarter of this year was 121% (see Figure 1). Indebtedness increased in the preceding quarters because nominal GDP shrank and the debt of the non-financial sector grew, but this trend has ceased as growth has recovered in the economy, and continuing economic growth will in future reduce indebtedness. The danger remains though that growth in debt could accelerate in the years ahead and indebtedness could start to increase.

**The yearly growth in the debt of the non-financial sector accelerated to 4.5% in the first quarter of 2021** (see Figure 2). However, the growth in the debt of the non-financial sector remains slower

**Figure 1. Real sector indebtedness**



**Figure 2. Forecast for the yearly growth of non-financial sector debt and nominal GDP**



<sup>1</sup> The assessment methodology is described in more detail in the Eesti Pank document "Countercyclical Capital Buffer. The principles and indicators for setting the buffer rate in Estonia". October 2015.

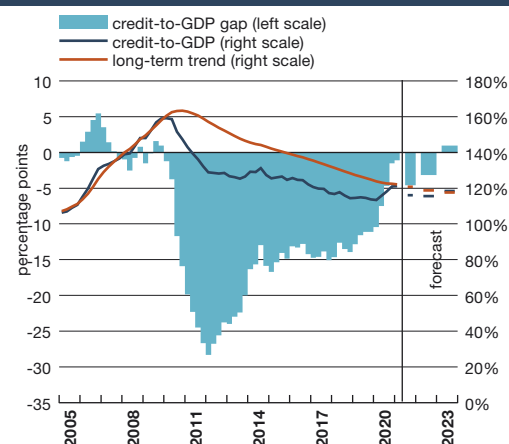
than the long-term average nominal growth in the economy of 5%. Growth in debt was earlier led by housing loans to households, but in the first quarter of 2021 the yearly growth in corporate debt accelerated for the second consecutive quarter. Corporate debt increased by 4% over the year in the first quarter and household debt by 6%. The Eesti Pank June forecast predicts that growth in debt will accelerate in the coming years together with growth in the economy, and that it will start to exceed long-term average nominal GDP growth. Growth in debt remaining faster than that in long-term nominal GDP would indicate an increase in the risks coming from the credit cycle. For this reason it may prove necessary in future to raise the countercyclical capital buffer requirement above its current level of 0% to cover those risks.

**The standardised credit-to-GDP<sup>2</sup> gap calculated using the methodology of the Basel Committee on Banking Supervision was -1 percentage point at the end of the first quarter of 2021** (see Figure 3). The additional gap<sup>3</sup>, which is also used by Eesti Pank, was -13 percentage points. This means that the credit-to-GDP ratio is lower than the long-term trend, and so the buffer guide remains at 0%. The Eesti Pank June forecast expects that the credit-to-GDP gap will remain negative for the next two years and will only turn positive at the end of 2023.

**The lending margins of the banks did not notably change over the quarter in the second quarter of 2021** (see Figure 4). There were no notable changes in the credit supply in the second quarter either. The bank lending survey shows that there was no change in lending conditions for companies or households in the second quarter.

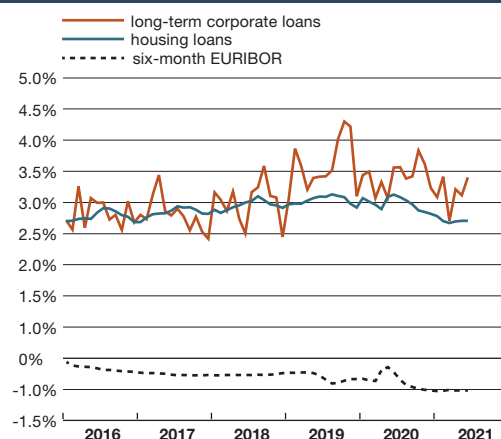
**In summary, Eesti Pank does not currently consider it necessary to change the countercyclical buffer rate.** This is because the growth in the debt of the non-financial sector remains slower than the long-term average nominal growth in the economy. Although developments so far do not indicate imbalance in the credit market, the risk remains that faster growth in the economy could be accompanied by faster growth in debt and that the growth in debt could in that case consistently exceed the long-term nominal growth in GDP. The increasing risks from the credit cycle could then make it necessary to raise the countercyclical capital buffer rate above 0%.

**Figure 3. Standardised credit-to-GDP gap**



Sources: Statistics Estonia, Eesti Pank

**Figure 4. Weighted average interest rates on housing loans and long-term corporate loans**



Sources: European Central Bank, Eesti Pank

2 In calculating the standardised credit-to-GDP ratio, Eesti Pank uses the quarterly statistics of the financial account from the system of national accounts for finding the debt level. This covers loans to the non-financial sector and bonds issued both within Estonia and abroad. This is an unconsolidated indicator.

3 The additional credit-to-GDP ratio is calculated using a narrow aggregate of credit that covers domestic loans and leases issued by banks operating in Estonia.