

## THE COUNTERCYCLICAL CAPITAL BUFFER RATE

### Eesti Pank's assessment of the countercyclical capital buffer rate (Q1 2019)<sup>1</sup>

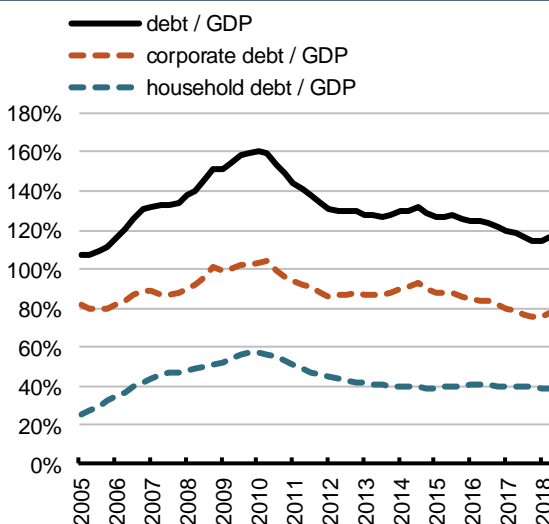
The Executive Board of Eesti Pank decided on 25 March 2019 to keep the countercyclical capital buffer rate at 0%.

- The applicable countercyclical capital buffer rate: **0%**
- The standardised credit-to-GDP ratio: **114%**; its deviation from the long-term trend: **–15 percentage points**
- The buffer rate: **0%**
- **Reasoning for the buffer rate:** the rate of growth in debt in the non-financial sector has increased, but it remains below nominal economic growth for the current year and the long-term average nominal growth. Gross debt has grown faster because companies have borrowed more, which was partly because of some increase in investment. The growth in new loans to households slowed in the second half of 2018 and the residential real estate market continued to develop at a gentle pace. The growth in bank loans and leases has been supported in recent years by demand-side factors. The banks have not eased their lending standards and loan margins rose slightly in 2018. This development does not indicate any major imbalance in the credit market, though the relatively good state of the economy and low interest rates mean the risk remains of excessive borrowing that could increase the risks from the credit cycle. For this reason Eesti Pank monitors the growth in debt and indicators that affect it, and can if necessary raise the countercyclical capital buffer rate above 0%.

**The level of non-financial sector indebtedness has not substantially changed.** The credit-to-GDP ratio fell back to 114% by the end of the third quarter, having risen slightly in the previous quarter (see Figure 1). The Eesti Pank December forecast 2018 does not expect any significant rise in the debt burden in the next two years (see Figure 2).

**The debt of the non-financial sector grew a little more slowly in the third quarter of 2018 than in the second quarter.** The yearly growth in debt was 6.2% by the end of the third quarter of 2018. Growth slowed in the debt of both companies and households to a rate that was lower than nominal GDP growth in both cases. The danger of rapid growth in debt may be underestimated when the economy is growing fast though, and so the growth in debt is compared to the long-term average

**Figure 1. Non-financial sector indebtedness**

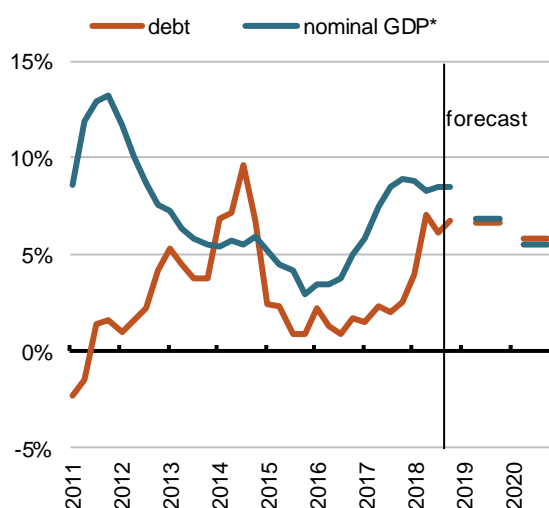


Sources: Statistics Estonia, Eesti Pank

<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.  
[http://www.eestipank.ee/sites/eestipank.ee/files/files/Finantsstabiilsus/ccb\\_est.pdf](http://www.eestipank.ee/sites/eestipank.ee/files/files/Finantsstabiilsus/ccb_est.pdf)

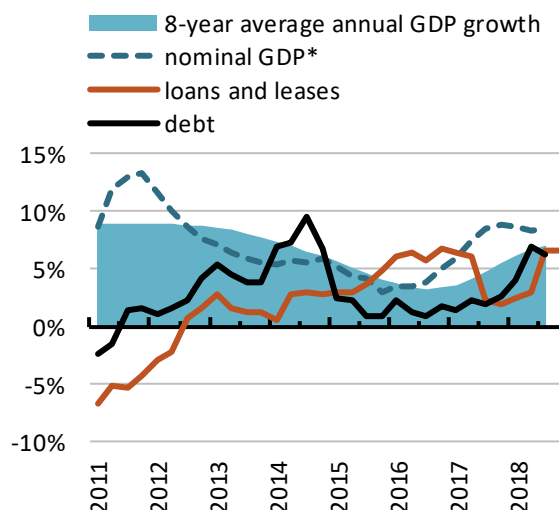
growth in the economy (see Figure 3). The debt of the Estonian non-financial sector has grown more slowly in the past four years than the eight-year average for nominal GDP, though by the end of the third quarter of 2018 its rate of growth had approached that of GDP. The growth in bank loans and leases was 6.6% in the fourth quarter.

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



\*Four-quarter moving average yearly GDP growth  
Sources: Eesti Pank, Statistics Estonia

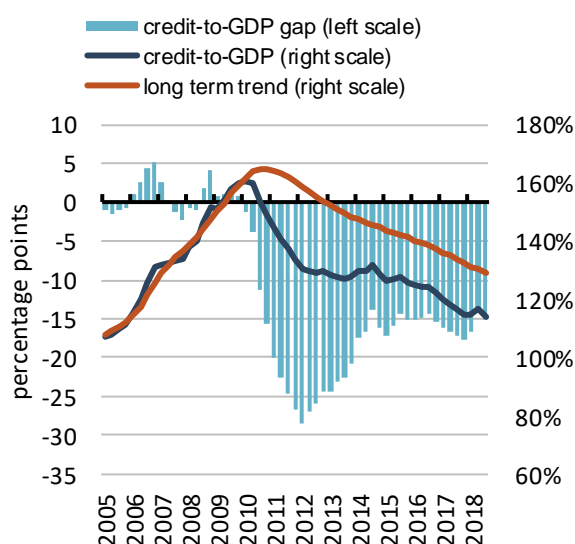
**Figure 3. Annual growth of loans and leases, debt and nominal GDP**



\*Four-quarter moving average yearly GDP growth  
Sources: Statistics Estonia, Eesti Pank

The standardised credit-to-GDP<sup>2</sup> gap calculated using the methodology of the Basel Committee on Banking Supervision was -15 percentage points at the end of the third quarter of 2018 (see Figure 4). The additional gap, which is also used by Eesti Pank, was -23 percentage points.<sup>3</sup> This means that the credit-to-GDP ratio is lower than the long-term trend, and so the countercyclical buffer guide remains at 0%. As the time series for Estonia are short, the Basel methodology does not give a reliable estimate of the credit cycle. This means that other indicators showing the development of indebtedness need to be analysed in depth to reach an estimate of the need for the countercyclical buffer.

**Figure 4. Standardised credit-to-GDP gap**



Sources: Statistics Estonia, Eesti Pank

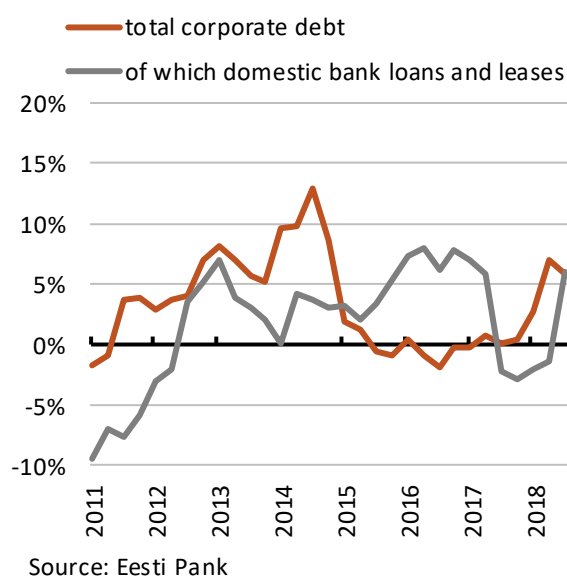
<sup>2</sup>In calculating the standardised credit-to-GDP ratio, Eesti Pank uses the quarterly statistics of the financial account from the system of national accounts for finding the debt level. This covers loans to the non-financial sector and bonds issued both within Estonia and abroad. This is an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

<sup>3</sup>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.

### Borrowing by companies has increased a little.

Having fallen for three quarters, investment by companies increased over the year in the third quarter of 2018. As the ability of companies to finance their activities and investments with own funds has improved, corporate borrowing has remained relatively modest. The yearly growth in total corporate debt had remained constant for three years but it accelerated a little to reach around 6% by the end of the third quarter of 2018 (see Figure 5). The Eesti Pank December forecast expects that companies will invest more in the years ahead, but as investment as a share of the economy is low by the levels of previous decades, this will not lead to any significant growth in corporate debt, and the yearly growth in debt will be around 6-7% over the next two years.

**Figure 5. Annual growth of corporate debt and corporate lending**



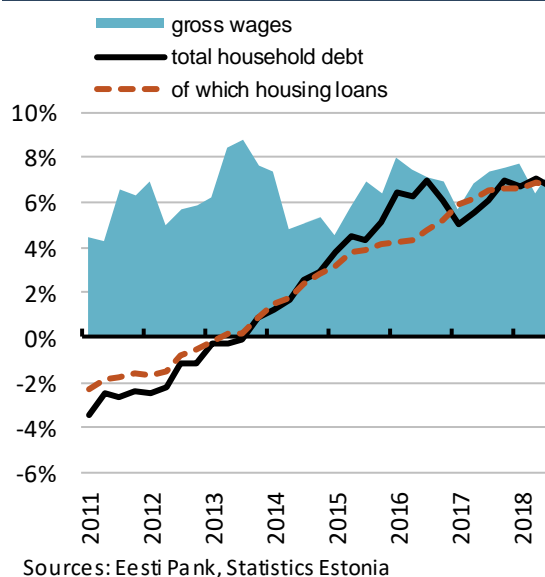
Growth in borrowing by companies from banks operating in Estonia reached 6% in the fourth quarter. Such loans have increased as a share of sources of financing for companies as access to loans in Estonia has been relatively good. The main borrowers have been companies that usually fund themselves primarily from banks operating in Estonia.

### Demand from households for loans remains strong.

It is supported by the continuing rapid growth in incomes and improved confidence, favourable interest rates, low unemployment, and an active housing market. Growth has been fast for housing loans, consumption loans and car leases. The growth in household debt has not accelerated in recent quarters but has remained at close to 7% (see Figure 6). The strong demand for labour means that wage pressures remain and the growth in borrowing could accelerate further in future.

The largest share of household debt liabilities is made up of housing loans, and the yearly growth in the stock of such loans was 7% in the fourth quarter of 2018. This was driven until the second half of 2018 by a relatively active real estate market, where prices rose quickly (see Figure 7). However, real estate prices have risen at a slower rate since the second half of 2018 and the rate of rise has been below its three-year average. In consequence the upward pressure from housing loans has declined a little. As the rate of rise in real estate prices has slowed, so has the rate of growth in new housing loans. In 2017 the yearly growth in new housing loans was 16%, but by the end of 2018 this had slowed to 9%. To dampen the risks from housing loans, Eesti Pank has set three restrictions for new housing loans that limit their loan-to-value

**Figure 6. Annual growth of household debt and the average gross wage**

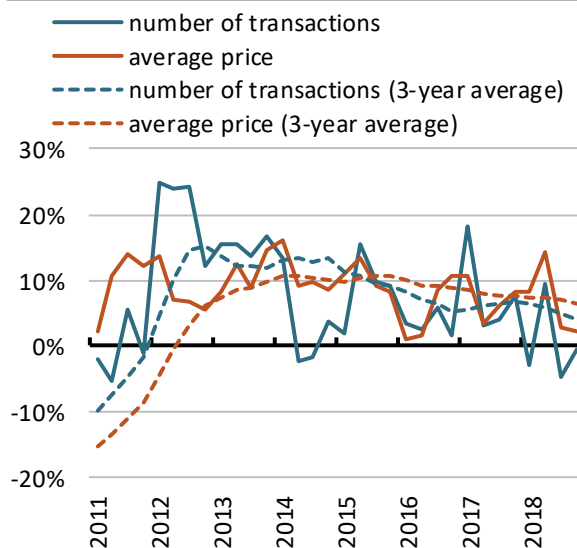


(LTV) ratio to 85%, the debt service-to-income (DSTI) ratio of borrowers to 50%, and the maximum maturity of the loans to 30 years.

**The lending standards of the banks and their lending conditions have not been loosened.** The bank lending survey shows that banks have tightened their lending conditions slightly in the past two years. Higher margins on both long-term corporate loans and residential loans to households have raised interest rates a little (see Figure 8), which suggests that the banks are not being aggressive about issuing loans.

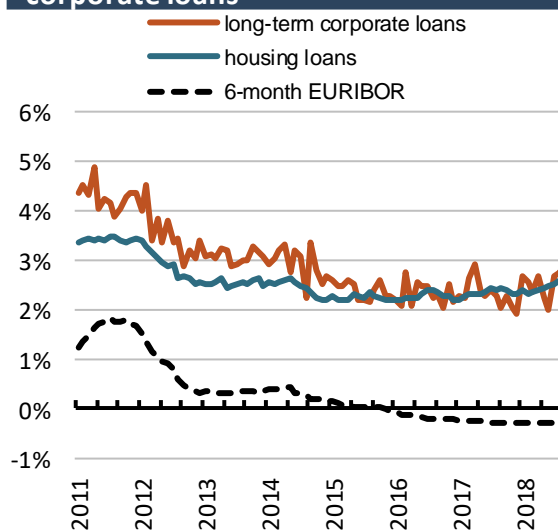
**In consequence, Eesti Pank does not currently consider it necessary to change the countercyclical buffer rate, though if debt grows faster in future it could consider raising the rate above 0%.** The reason for this is that although the rate of growth in debt in the non-financial sector has increased, it remains below nominal economic growth for the current year and the long-term average nominal growth. Gross debt has grown faster because companies have borrowed more, which was partly because of some increase in investment. The growth in new loans to households slowed in the second half of 2018 and the residential real estate market continued to develop at a gentle pace. The growth in bank loans and leases has been supported in recent years by demand-side factors. The banks have not eased their lending standards, and loan margins rose slightly in 2018. This development does not indicate any major imbalance in the credit market, though the relatively good state of the economy and low interest rates mean the risk remains of excessive borrowing that could increase the risks from the credit cycle. For this reason Eesti Pank monitors the growth in debt and indicators that affect it, and can if necessary raise the countercyclical capital buffer rate above 0%.

**Figure 7. Annual growth of housing prices and number of transactions**



Source: Estonian Land Board

**Figure 8. Weighted average interest rates on housing loans and long-term corporate loans**



Source: Eesti Pank