

# THE COUNTERCYCLICAL CAPITAL BUFFER RATE

## EESTI PANK'S ASSESSMENT OF THE COUNTERCYCLICAL CAPITAL BUFFER RATE (Q1 2021)<sup>1</sup>

**Eesti Pank decided on 29 March 2021 to keep the countercyclical capital buffer rate at 0%.**

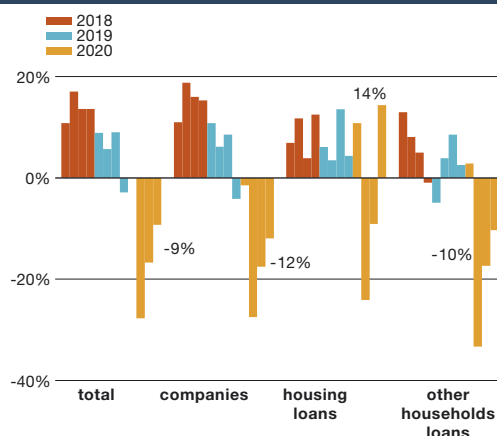
- The applicable countercyclical capital buffer rate: **0%**
- The standardised credit-to-GDP ratio: **112%**; its deviation from the long-term trend: **-8 percentage points**
- The buffer guide: **0%**
- **Reasoning for the buffer rate:** the economic damage caused by the spread of the Covid-19 pandemic and the efforts to prevent it mean that uncertainty remains about the future development of the economy. This has resulted in reduced borrowing by the non-financial sector. As the risk of rapid growth in borrowing is low at present, Eesti Pank currently considers it appropriate to keep the countercyclical capital buffer rate for the banks at 0%.

The restrictions introduced around the world to counter the spread of the Covid-19 pandemic reduced economic activity and, with that, borrowing activity in Estonia. Although the restrictions started to be eased in Estonia in May and so borrowing activity started to improve, the volume of new loans taken by the non-financial sector had not by the start of 2021 yet recovered to its level of before the pandemic. Businesses borrowed 12% less from banks operating in Estonia in the fourth quarter than a year earlier (see Figure 1). The amount of new loans taken by households was a little higher than a year earlier, and the yearly growth in loans to households was 3% in the fourth quarter.

The fall in borrowing by **businesses** was not as deep in the fourth quarter as it was in the third. Stronger borrowing with new long-term loans contributed to this, and yearly growth in it became positive again in the fourth quarter and reached almost 26%. The amount taken in new short-term loans, which is almost triple that of long-term loans, remained lower than it was a year earlier. The volume of new short-term loans was 21% smaller in the fourth quarter than it was a year earlier.

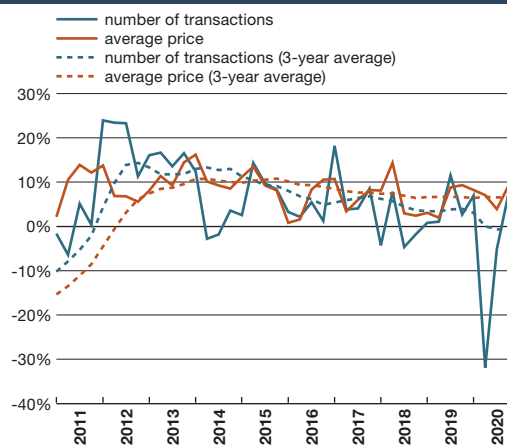
Increased activity by **households** could be seen in the real estate market, where 14% more was taken in new loans in the fourth quarter than a year earlier. However, amounts taken in other loans and leases remained smaller in the fourth quarter than they were a year earlier. Around 13% less was taken out in new car leases in the fourth quarter than a year earlier, and 10% less in other loans. Active borrowing with housing loans reflects the revival in the real estate market. The number of sales transactions for apartments was 7% higher in the fourth quarter than a year earlier (see Figure 2). Like in previous months, the Covid-19 pandemic has not yet had a negative impact on housing prices. Data from the Land Board show that the average price of transactions for apartments was 9% higher

**Figure 1. Annual growth rate by quarter of new corporate and household borrowing**

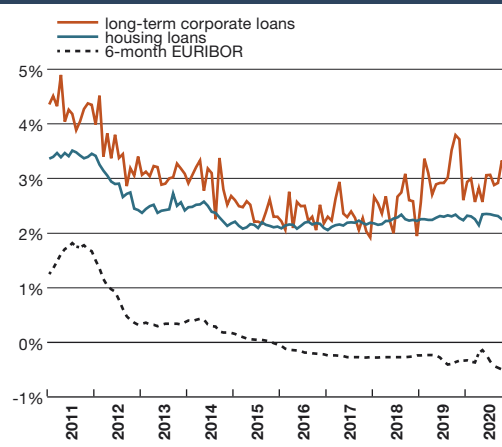


Source: Eesti Pank

<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.

**Figure 2. Annual growth of housing prices and number of transactions**

Sources: Estonian Land Board

**Figure 3. Weighted average interest rates on housing loans and long-term corporate loans**

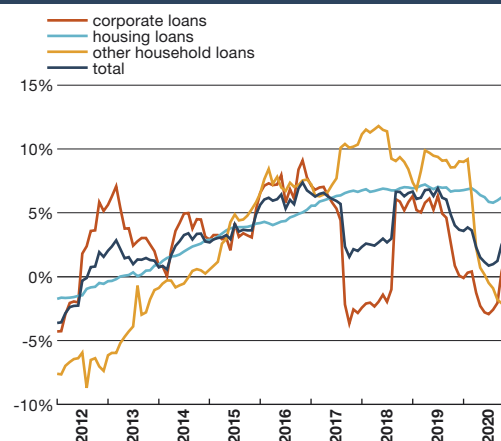
Sources: European Central Bank, Eesti Pank

in the fourth quarter than a year earlier, which is partly because the share of transactions that were with new apartments increased from 44% a year earlier to 46% in the fourth quarter.

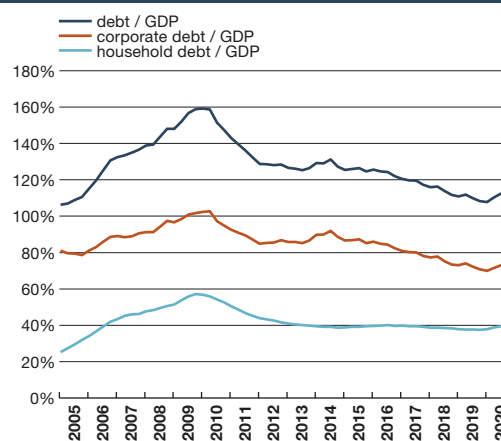
**The interest rates on new loans were not substantially different from what they were in 2019** (see Figure 3). The Bank Lending Survey found banks tightening both their lending standards and conditions in the first half of the year, but standards were not tightened any further in the second half. Lending standards for households even eased a little in the fourth quarter and the interest rates on housing loans have been pushed down a touch by competition in recent months.

**The improvement in borrowing with new loans meant the rate of yearly growth in the portfolio of bank loans to the non-financial sector stopped slowing in the second half of 2020, and even rose a little in the fourth quarter** (see Figure 4). Yearly growth in the loan portfolio to the non-financial sector was 3.4% in December. The portfolio of housing loans had grown by 6.7% over the year at the end of the fourth quarter. The growth in the loan portfolio to companies also turned positive in the fourth quarter because of stronger borrowing with long-term loans, and yearly growth reached almost 2%. The portfolio of other loans to households continued to shrink though, losing almost 3% over the year.

**A faster fall in nominal GDP than in borrowing as a consequence of the crisis has equally meant though that the indicator for indebtedness has risen.** The debt-to-GDP ratio was

**Figure 4. Annual growth of corporate and household loans**

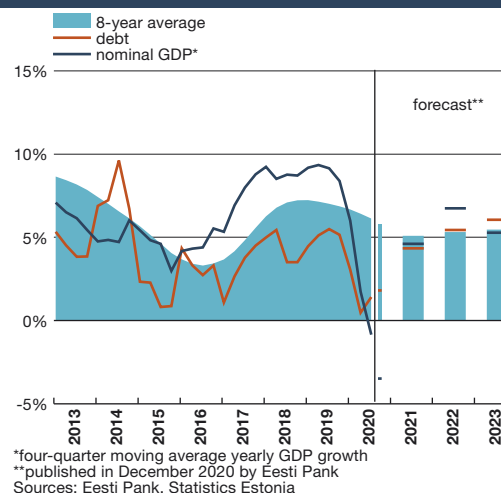
Source: Eesti Pank

**Figure 5. Non-financial sector indebtedness**

Sources: Statistics Estonia, Eesti Pank

112% in the third quarter of 2020 (see Figure 5), having risen by almost 2 percentage points over the quarter. It is quite usual for the indebtedness indicator to rise when there is a sharp drop in the economy<sup>2</sup>. Such a rise is only temporary though, and indebtedness will stop rising as growth in the economy recovers. This means the rise in the debt-to-GDP ratio is not the best indicator to use for assessing the credit cycle in the current environment. A more stable comparison base for estimating the speed of growth in debt is the eight-year average nominal growth in GDP of 5-6%. Over the next two years the growth in debt will be smaller than or about the same as the eight-year average nominal growth in GDP (see Figure 6).

**Figure 6. Forecast for annual growth of non-financial sector debt and nominal GDP**



**The pandemic affected the capacity of borrowers to service their loans, but the capitalisation of the banks remains strong.** The reduction in incomes caused by the efforts to stop the Covid-19 pandemic has been partially compensated for by state support measures for businesses and households. The banks also offered their clients payment holidays. Any reduction in the ability of clients to pay has not yet been reflected in the indicators for overdue loans. The share of loans overdue for more than 60 days in the loan portfolio was below 0.5% at the end of December, which is even lower than it was a year earlier. The resilience of the banks to future loan losses is supported by the current capital buffers that have been built up under the microprudential and macroprudential requirements of earlier years. At the end of December the average capital adequacy ratio of the banks was 26%, and the lowest indicator for any bank was 18%.

**In summary, Eesti Pank does not currently consider it necessary to change the countercyclical buffer rate.** The economic damage caused by the continuing spread of the Covid-19 pandemic and the efforts to prevent it mean that uncertainty remains about the future development of the economy. This has resulted in reduced borrowing by the non-financial sector. As the growth in debt is forecast to remain smaller than or about the same as the eight-year average growth in GDP over the next two years, and the risk of rapid growth in borrowing is low at present, Eesti Pank currently considers it appropriate to keep the countercyclical capital buffer rate for the banks at 0%.

<sup>2</sup> A similar dynamic was apparent in the economic crisis of 2008-2009 for example.