THE COUNTERCYCLICAL CAPITAL BUFFER RATE

EESTI PANK'S ASSESSMENT OF THE COUNTERCYCLICAL CAPITAL BUFFER RATE (Q2 2025)

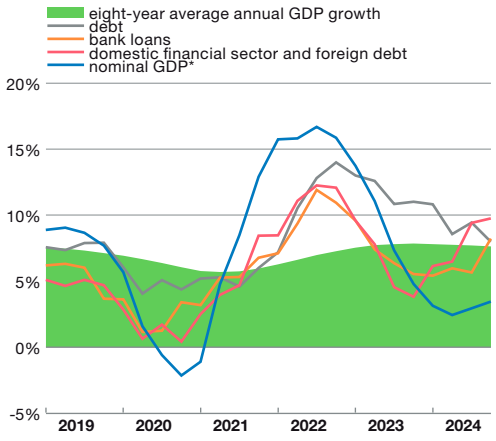
Eesti Pank is maintaining the countercyclical capital buffer for the banks at the level of 1.5%.

The reasoning for the buffer rate. Corporate and household debt has grown faster than the rate of long-term growth in the economy. The danger of geopolitical risks escalating also needs to be considered, as this makes it necessary for the banks to maintain their current large capital buffers to ensure their resilience.

- The applicable countercyclical capital buffer rate: **1.5%**
- The gap between the growth in debt and the growth in long-term nominal GDP: **0.3 pp**
- The debt-to-GDP ratio: 123% (change in the quarter **+0.5 pp**, change over the year **+5.1 pp)**
- The buffer benchmark rate: **1%** (not including statistical revision, **1.5%**)

The growth in debt exceeded long-term growth in the economy at the end of 2024. Yearly growth in debt reached 8% at the end of 2024, which was a little faster than the average GDP growth of 7.6% in the past eight years (see Figure 1). The indebtedness of the non-financial sector, or the debt-to-GDP ratio, increased by five percentage points over the year to 123%. The figure for the rate of growth does not however properly reflect the dynamics in 2023-2024, as an extensive revision of the statistics caused a large structural increase in debt in 2023[1]. It is consequently more accurate to use data on bank loans or more broadly on borrowing from the Estonian financial sector and abroad when estimating the growth trend in cyclical risks.

Figure 1. Annual growth of credit aggregates and nominal GDP

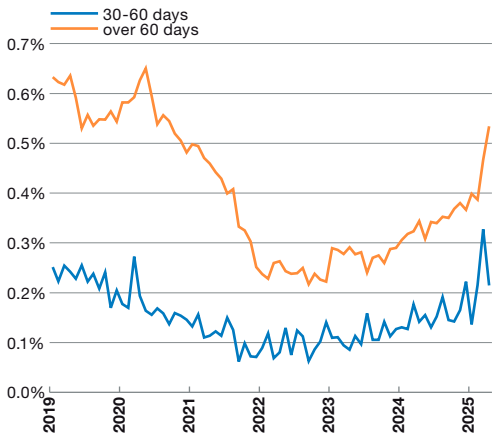


* Four-quarter moving average yearly GDP growth
Sources: Eesti Pank, Statistics Estonia

Growth in the debt liabilities from the domestic financial sector and abroad became faster in the second half of 2024 and was around 10% at the end of the year. The growth in aggregate credit consequently exceeded that in long-term nominal GDP by more than two percentage points, which is a clear indication that cyclical risks are increasing. The methodology used by Eesti Pank shows that debt at this level justifies maintaining the countercyclical capital buffer at 1.5% at least.

The quality of the loan portfolio has continued to deteriorate. The share of loans in the portfolios of the banks that were overdue by more than 60 days at the end of April 2025 reached 0.5%. This is not a high level in historical terms, but the increase in the volume of loans overdue still indicates that there are more borrowers facing difficulties with servicing their loans (see Figure 2).

Figure 2. Share of overdue loans in the loan portfolio of banks



Source: Eesti Pank

1 See *The revision of statistics raised the debt level of 2022-2023 substantially from its earlier estimate* in Financial Stability Review 1/2025 pp25-26.

The standardised credit-to-GDP gap calculated using the methodology of the Basel Committee on Banking Supervision increased substantially because of the large statistical revision. The gap was 1 percentage point in the third quarter of 2024, but by the end of the fourth quarter it had widened to 7 percentage points. The buffer guide for the countercyclical capital buffer calculated using the Basel methodology was consequently 1.75% at the end of 2024. It should be noted with this indicator though that its short time series and the statistical revision mean that it does not adequately show the changes to the risks coming from the financial cycle in Estonia.

In summary, Eesti Pank currently considers it necessary to maintain the countercyclical buffer rate at 1.5%. This is because the growth in the debt of companies and households has been faster than the long-term growth in the economy. It will be possible to lower the buffer requirement to the 1% base requirement once the pace of growth in credit has calmed. The danger of geopolitical risks escalating equally needs to be considered though, as that could push the economy back into recession. Maintaining the current high level of the capital buffer is consequently a necessary way of supporting the resilience of the banks.