2025 Q2 assessment of the systemic cyclical risk and applicable countercyclical capital buffer rate

2025 I June

The countercyclical capital buffer (hereinafter – the CCyB) is a macroprudential tool that aims at strengthening the capitalisation of credit institutions so that they are adequately equipped to absorb losses in times of crisis. When risks materialise, the CCyB rate is partially or fully released to help credit institutions continue to offer funding to the economy, thereby reducing the length of crises and their impact on the economy.

Latvijas Banka, in its capacity as the designated authority for the application of the CCyB requirement, evaluates the cyclical systemic risk on a quarterly basis pursuant to Section 35.5 of the Credit Institution Law and, if necessary, sets or adjusts the CCyB rate applicable to credit institution exposures to residents of the Republic of Latvia. Latvijas Banka publishes quarterly assessments of the cyclical systemic risk and the applicable CCyB rate. If the CCyB rate remains unchanged, the previous decision regarding the applicable CCyB rate remains in force.

On 18 December 2023, the Council of Latvijas Banka decided to implement a positive neutral CCyB approach and increase the CCyB rate to 0.5% from 18 December 2024 and to 1% from 18 June 2025.

According to the positive neutral CCyB approach the CCyB rate is set at positive basis level (above zero) already in a standard risk environment or at the neutral stage of the financial cycle when cyclical systemic risk is neither elevated nor subdued. Latvijas Banka has estimated 1% to be an appropriate base level of the CCyB rate. In the event of an increase in the cyclical systemic risk, the CCyB rate is raised proportionately to its intensity, starting from an already positive base rate, rather than from zero. Thereby the total CCyB requirement will comprise both the base rate and the cyclical rate components for which the level is determined every quarter. The CCyB rate may be partially or fully released in times of crisis as risks materialise and in the post-crisis recovery period.

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Starting from 2025 Q2, the Latvijas Banka conducts a cyclical risk assessment in accordance with the revised analytical framework. For more details on the revised framework, see Latvijas Banka's 2025 Financial Stability Report.

Main changes in the analytical framework:

- the definition of the additional credit measure has been revised – leasing loans issued by banks and their subsidiaries have been added to the existing scope of the additioanal credit definition (loans issued by credit institutions to non-financial corporations and households and purchased securities);
- composite cyclical risk indicator (CCRI) has been reviewed ;
- additional indicators have been revised:

  crisis signalling properties of more than 50 indicators have been tested;

  several additional indicators have been amended;

  a new category of additional indicators – the macroeconomic environment – has been established;

  in five categories additional indicators have been unified into one signalling index;

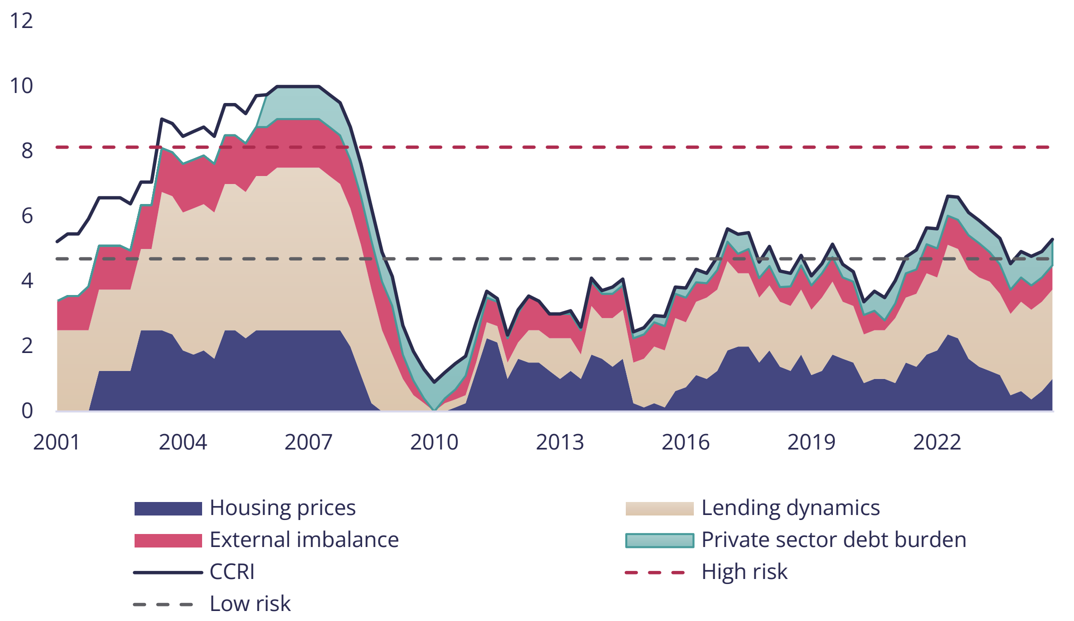
  risk thresholds have been established for these indices.

In accordance with the cyclical risk assessment for 2025 Q2, **Latvijas Banka has decided not to increase the cyclical component of the CCyB.**

The decision of Latvijas Banka regarding the applicable CCyB rate, adopted on December 18, 2023, remains in force.

The cyclical risk in Latvia is generally assessed as low. Although activity in the domestic lending market and the housing market has moderately increased, it should be noted that it is still recovering from a low level. The level of credit debt in the domestic private non-financial sector remains small. Domestic demand is low, sentiment indicators suggest caution, and economic development is slow.

Composite cyclical risk indicator (CCRI), points



Composite cyclical risk indicator (CCRI) reached 5.3 points in 2024 Q4, which is a slight increase compared to 4.9 points in 2024 Q3. The CCRI is at the lower boundary of the medium risk range.

For more details on the CCRI, see Latvijas Bankas 2025 Financial Stability Report.

Sources: Latvijas Banka, Central Statistical Bureau of Latvia (CSB), Latvijas Banka's calculations

The credit-to-GDP gap of the private non-financial sector continues to decrease; however, it remains negative according to both – standardized and additional credit definitions.

The buffer guide is 0%.

	Standardised credit definition 2024 Q4	**Additional** credit definition 2025 Q1
Credit-to-GDP ratio (%)	68.3	36.1
Credit-to-GDP gap (pp)	-12.4	-4.3
Benchmark buffer rate (% from TREA)	0	0

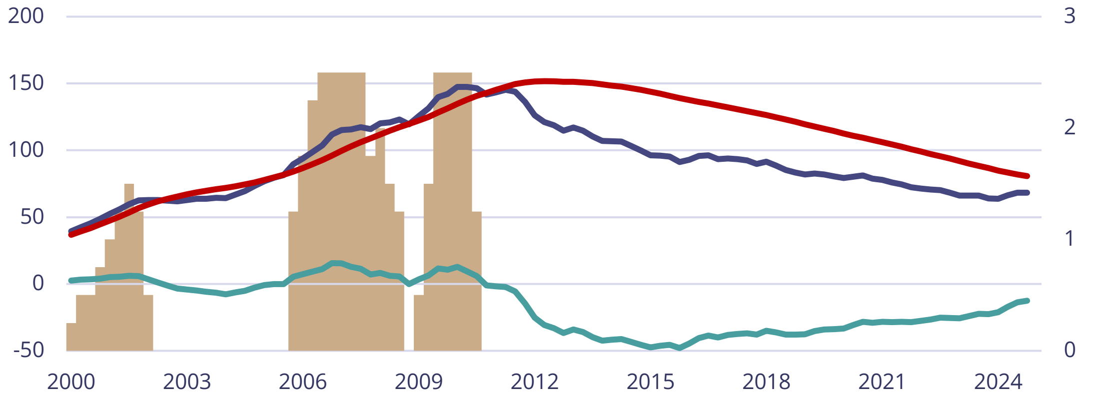
Standardized credit definition – liabilities of non-financial corporations (hereinafter – NFCs) and households to credit institutions, as well as their loans from non-bank financial institutions or other NFCs.

Starting 2025 Q2, Latvijas Banka uses new additional credit definition – to the previously used scope – credit institution loans to NFCs and households and purchased debt securities – leasing loans from banks and their subsidiaries have been added. The benchmark buffer rate, calculated based on this credit definition, is used by Latvijas Banka as the buffer guide for the CCyB rate.

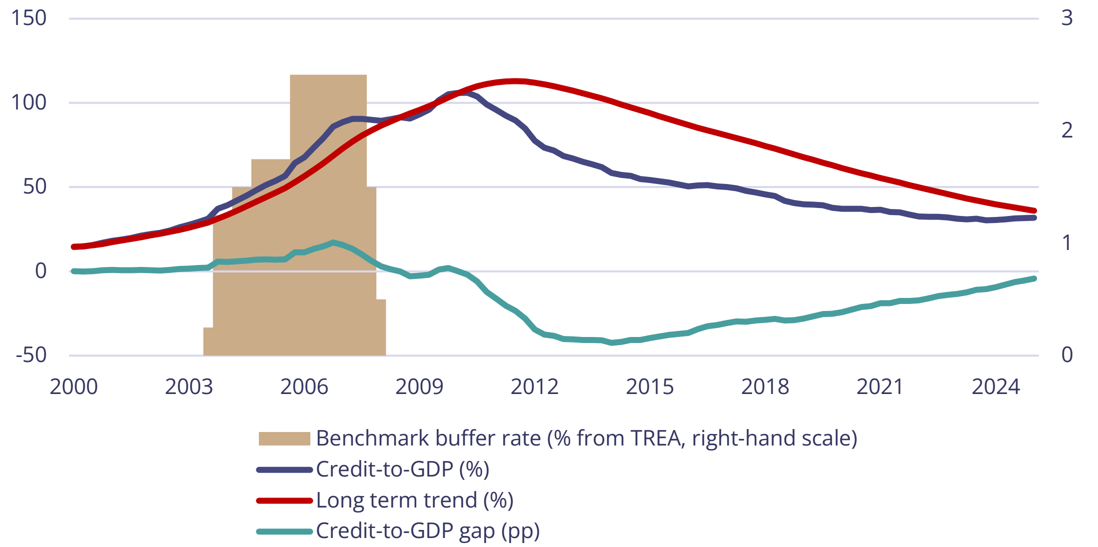
* For more details on the revised cyclical risk framework, see Latvijas Banka's 2025 Financial Stability Report

Sources: Latvijas Banka, CSB, Latvijas Banka's calculations

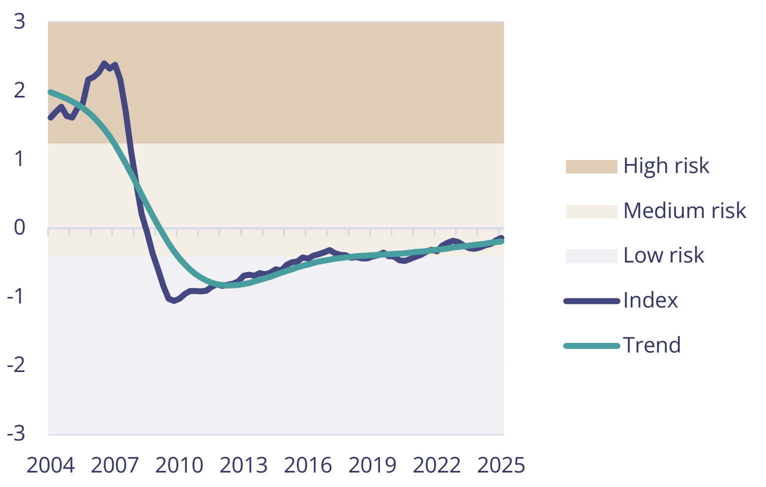
Standardised credit-to-GDP gap



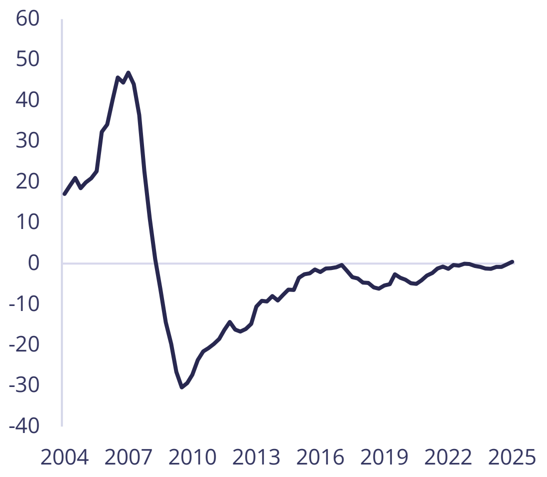
Additional credit-to-GDP gap



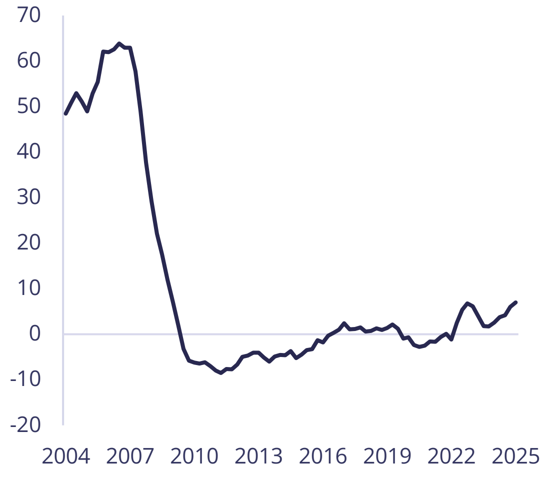
Credit developments index



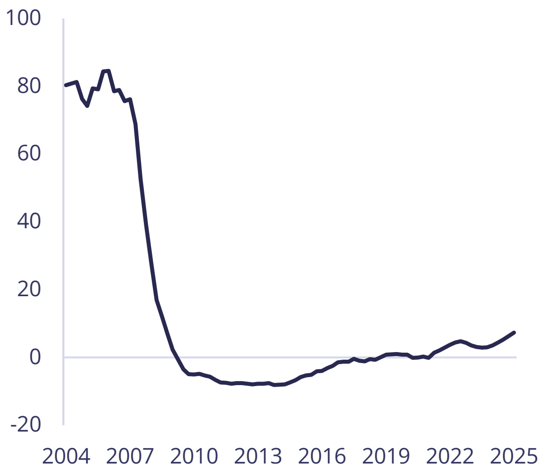
Credit to 7-year GDP annual difference, percentage points 2)



Household and NFC credit annual growth rate, % 1), 2)



Household credit annual growth rate, % 1)



Domestic lending has increased. In 2025 Q1 and in April, the outstanding loans issued to households and NFCs increased respectively by 7.8% and 8.0% year-on-year (including 7.3% and 7.7% for households, and 8.4% for NFCs in both periods).

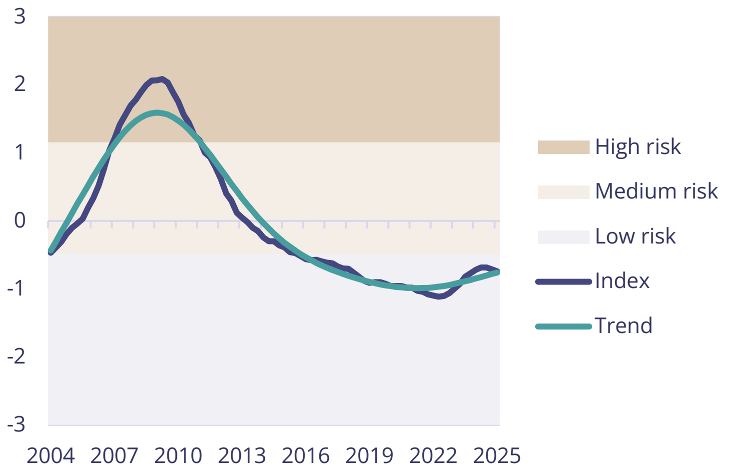
The increase in lending is driven by the reduction in interest rates and the realization of deferred demand for loans. The Solidarity Contribution Law, adopted in 2024, which provides credit institutions with the opportunity to receive a discount on the contribution if their outstanding loan balance increases more than the thresholds set by law, motivates credit institutions to increase lending.

The more active growth of loans continues to be limited by the high uncertainty and a caution due to external trade and geopolitical risks, slow domestic economic growth, and several structural factors.

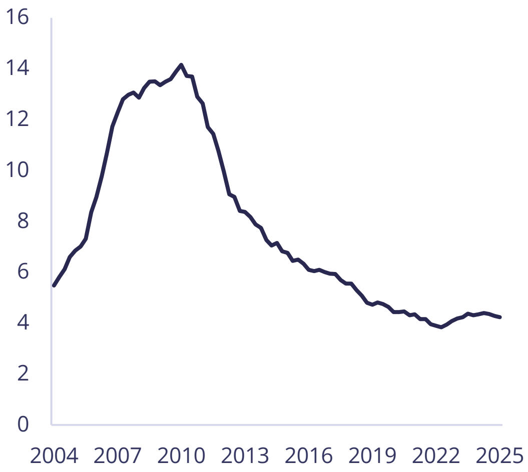
1) Reclassifications and other one-time effects are excluded from the loan growth rate, but the effect of written-off loans is not excluded.
2) Including loans issued by bank subsidiaries.

Sources: Latvijas Banka, CSB, Latvijas Banka's calculations

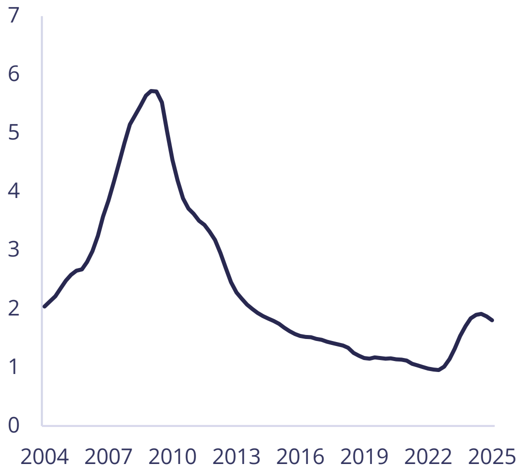
Private sector debt burden index



Household and NFC debt service ratio, %



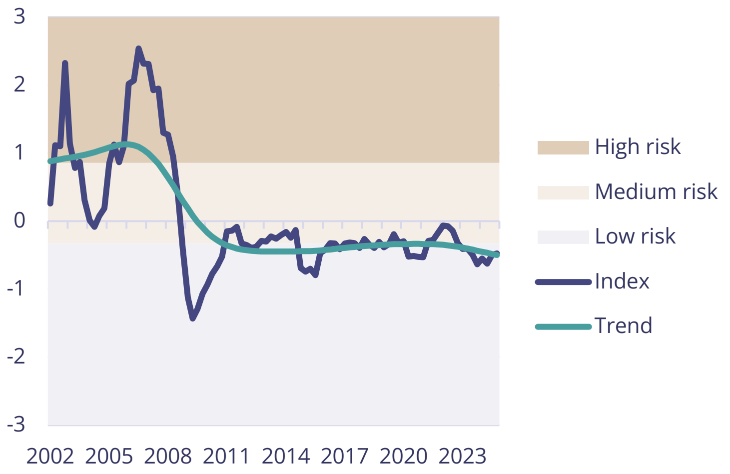
Household and NFC annual interest payments to GDP, %



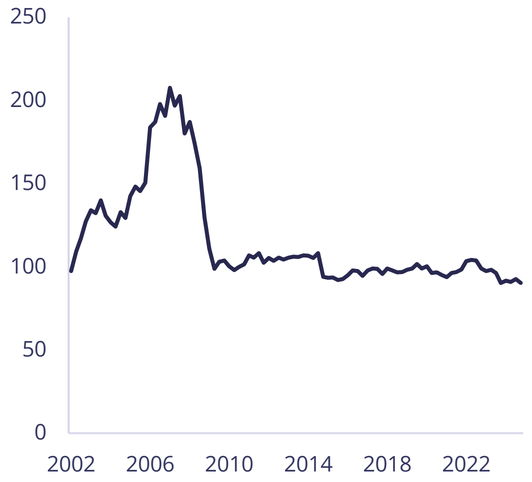
The debt of the private non-financial sector is low. Along with the gradual decrease in interest rates, the ratio of interest payments on private non-financial sector loans to GDP has also slightly decreased. The financial resilience of borrowers remains good.

Sources: Latvijas Banka, CSB, Latvijas Banka's calculations

Potential overvaluation of property prices index



House prices-to-average net wages index, 2010 = 100



CSB's house price annual growth rate, %

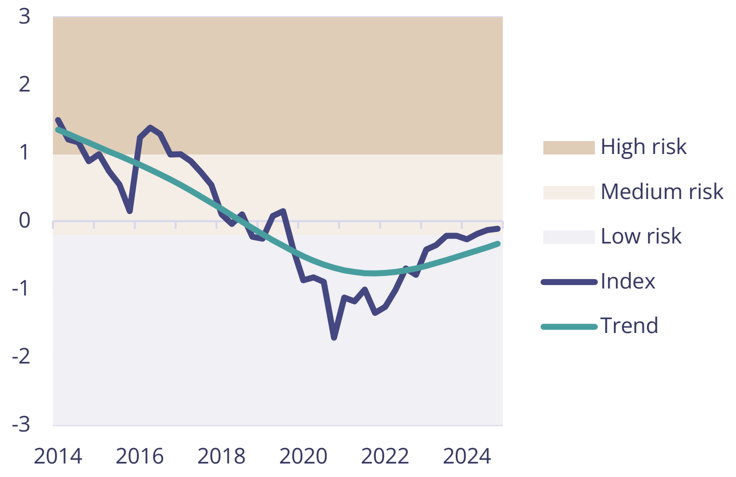
In the real estate market activity is increasing in the housing segment, particularly for new housing, but it is decreasing in the land property segment. In 2025 Q1, the total number of real estate purchase transactions increased by 1.4% compared to the same period last year; among these, the number of land purchase transactions decreased by 15.0%, while the number of housing purchase transactions increased by 16.2%.

The fastest growth (72.9%) was observed in the transactions with new apartments. In 2025 Q1, their share of total housing transactions reached 14.7% (compared to 9.9% a year earlier). This dynamic in the new housing segment was driven by rising wages and falling interest rates.

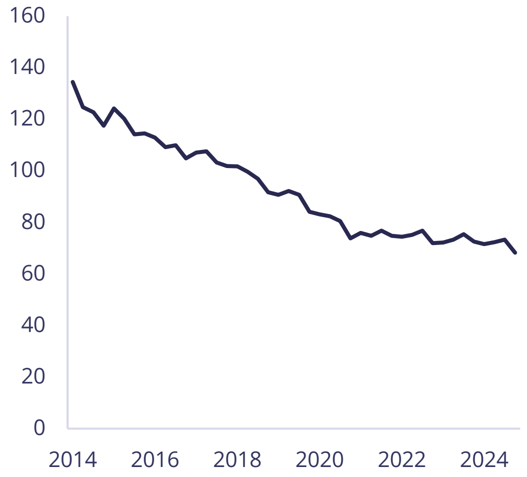
According to real estate industry experts, the overall dynamics of housing price growth is moderate. According to the latest available data from the CSB, housing prices increased by 8.1% year-on-year in 2024 Q4. After a prolonged period, slight increase was observed in the segment of standard series apartments, where prices rose on average by 0.8% in the first four months of 2025.

Sources: CSB, Latvijas Banka's calculations

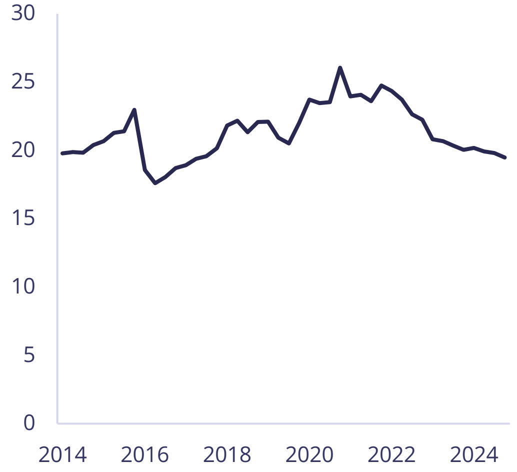
Strength of bank balance sheets index



The ratio of domestic credit to deposits, %



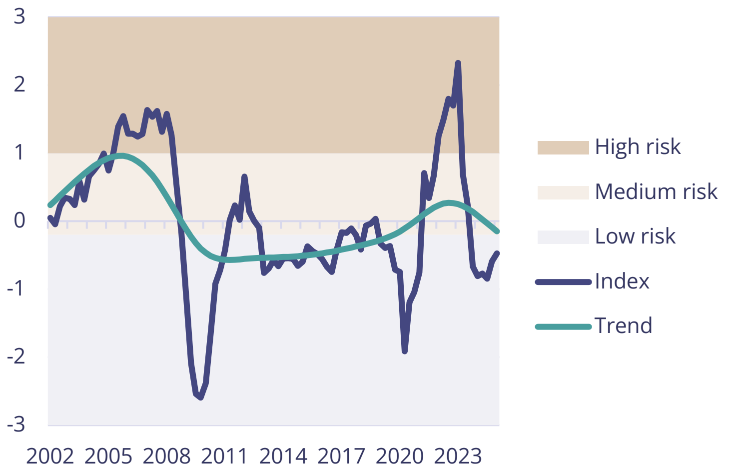
CET1 ratio, %



The indicators of the strength of bank balance sheets – bank capitalization, as well as profitability and asset quality – are very good. The ratio of bank loans to deposits remains consistently low.

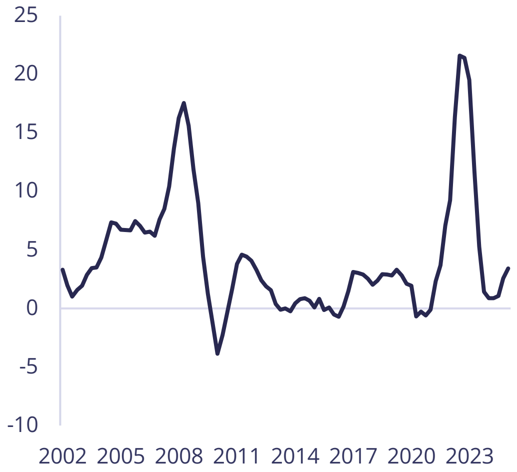
Sources: Latvijas Banka, Latvijas Banka's calculations

Macroeconomic environment index



Real GDP annual growth rate, %

HICP annual growth rate, %



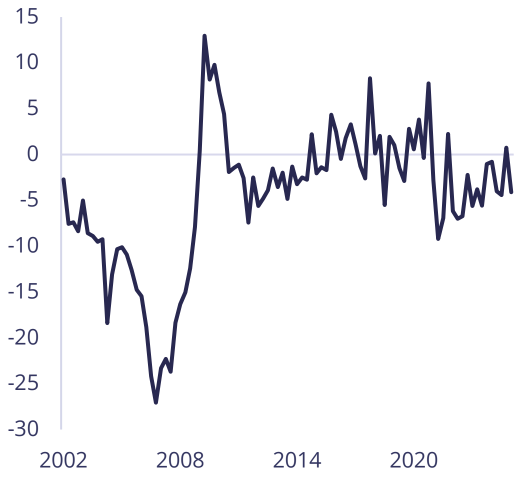
Economic development is weak. In 2025 Q1, Latvia's GDP decreased by 0.3% compared to the corresponding period of the previous year and remained unchanged compared to the previous quarter. The weak performance was driven by an unstable external environment, a weak consumption, and the adverse impact of weather conditions on energy production.

Although household income is rising, consumers remain cautious amid global shocks and domestic uncertainties. The caution is likely to persist, but the growth of real wages will support a recovery of consumption. Declining interest rates, an inflow of EU funds, and an increase in defense spending will strengthen investment activity.

According to Latvijas Banka's forecast, GDP growth could reach 1.2% in 2025. Economic development will be notably influenced by the external factors, consumer and investor sentiment, as well as the government spending related to investment projects and national defense. An inflation forecast for 2025 has been raised to 3.4%, driven by a faster than previously expected increase in food and service prices. A labour market will remain resilient in 2025, with an unemployment rate staying at the previous year's level (around 6.9%).

Sources: CSB, Latvijas Banka's calculations

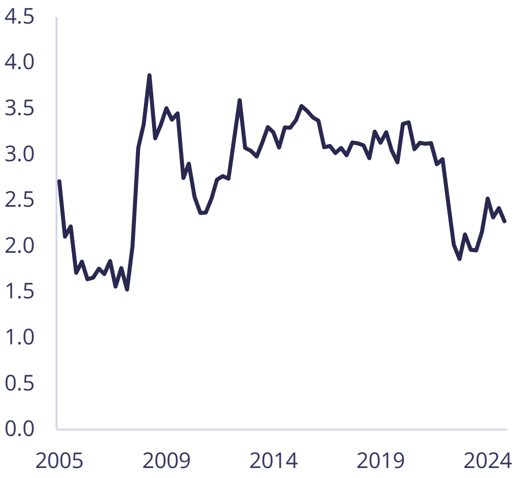
Current account balance-to-GDP, %



In 2025 Q1, **a current account deficit** increased to 4.1% of GDP. The deficit was driven by an increase in imports, significantly affected by Latvia's disconnection from the unified electricity grid with Russia. At the same time, both goods and services exports continued to grow.

The difference between the interest rates on newly issued housing loans for households and EURIBOR decreased with the rise of EURIBOR that began in 2022. As market interest rates increased, credit institutions more frequently offered discounts on the added loan rates at the initial phase of the loan term. In 2024 and 2025, this practice diminished, but the added rates offered by credit institutions also slightly decreased, thereby slightly reducing the payment burden for borrowers. The interpretation of this indicator, though, is not straightforward and the dynamics of market interest rates and structural factors should be considered.

Difference between interest rate on newly issued housing loans to households and 6-month EURIBOR, pp



In these two categories indices have not been created because each contains only one indicator. It is also hard to determine justified risk thresholds for these indicators based solely on their historical distribution – a qualitative expert assessment is required for risk evaluation.

Sources: Latvijas Banka, CSB, Latvijas Banka's calculations, The European Money Markets Institute.