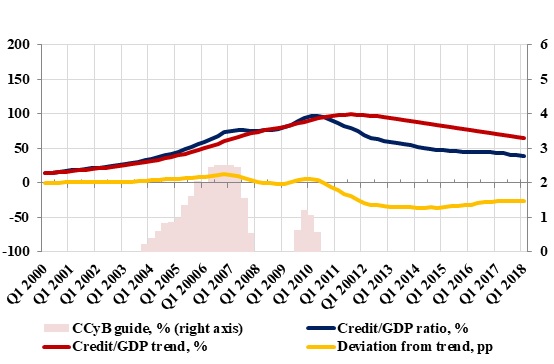
**The 24.07.2018 decision on setting the countercyclical capital buffer rate**

The countercyclical capital buffer (CCyB) rate for the exposures to Latvian residents has been set at 0%. The established CCyB rate will be used to calculate a credit institution-specific CCyB rate from 1 August 2019. The Financial and Capital Market Commission (FCMC) will decide about the necessity to set the CCyB rate above 0%, as soon as a significant rise in cyclical systemic risks is recorded in Latvia's financial sector.

FCMC, as an institution responsible for the application of the CCyB according to Article 35.5 of the Credit Institution Law, analyses the credit-to-GDP ratio every quarter, as well as its deviation from the trend and the additional indicators to justify the decision on the CCyB rate.

Using the broad credit definition, the credit-to-GDP ratio was 94% at the end of Q1 2018 while its standardized gap was -34%, implying the benchmark buffer rate of 0%. Using the narrow credit definition, the credit-to-GDP ratio at the end of Q1 2018 was 39% and the respective gap was -26%, as a result the benchmark buffer rate calculated under the narrow credit-to-GDP gap also was 0% (see the graph).

*Credit-to-GDP, its deviation from the trend and the respective benchmark buffer rate according to the narrow credit definition*

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In 2018, a positive economic growth is continuing with the GDP increase by 4.2% in Q1 (compared to Q1 of previous year). The economic growth in Q1 was attained notwithstanding a decline in certain segments, including a considerable decrease (-27% against Q1 2017) faced by the financial and insurance sectors largely related to the ongoing decline in the non-resident business segment. Under sectoral breakdown, the most rapid GDP growth was noted in construction activities (36%) related to the implementation of the European Union structural funds' related  projects, as well as private investments, including building of office and commercial buildings.  In  2018, the economic growth will be supported by available EU funds' investments, as well as by the economic growth of Latvia's export partner countries. Along with export and investments, private consumption will remain as substantial stimulus for the development, supported by the strong salary increase and further decline in the unemployment rate.

In Q1 2018, credit demand from non-financial corporations and households slightly grew. A minor weakening of credit standards for housing purchase was observed; however, the current credit standard level compared with their level over an extended period (from Q1 2003 up to now) is still either slightly or considerably stricter than a midpoint of range. There is still no sustainable increase in lending observed. A moderate increase in non-financial corporations' credit portfolio, observed in H2 2016 and at the beginning of 2017, has now come to a halt, even showing a 3.9% decrease at the end of Q1 2018. Besides, according to the lending index by the Association of Latvian Commercial Banks , households are cautious – the ability to borrow in the private sector in general is higher than the desire to borrow.

Winding up of ABLV bank AS and change of business models of banks primarily serving foreign clients is not expected to have a substantial impact on the dynamics of financial cycle, because of insignificant involvement of those banks in transactions with domestic clients – their share in total domestic deposits makes up 7.3% and the share of loans granted is 11.7 % of total domestic loans (at the end of May this year).

The housing price dynamics continue to be affected by improvements in the household confidence indicators and financial situation, with a declining debt burden and increasing wages and salaries, as well as in the context of the state support programme for mortgage loan guarantees for families with children and, from 2018, also to young professionals with regular income. The housing market shows no signs of overheating despite of rising prices – the level of household debt is low, mortgage lending dynamics are sluggish, and the ratio of housing price index to the average salary index remains below a long-term trend.

In the near future and medium-term, risks to the Latvian financial sector stability will be mainly related to the openness of the Latvian economy, geopolitical risks, as well as possible adjustments to the property prices on the Scandinavian countries' housing markets. Overall, domestic loan portfolio dynamics, increase in housing prices and other indicators demonstrate the early upswing phase of financial cycle in Latvia. The economic growth observed takes place without any vigorous involvement of credit institutions, and indicators do not show accumulation of excessive financial imbalances and necessity for the setting CCyB rate above 0%. FCMC will continue assessment of relevant ratios and tendencies when deciding on the setting of CCyB rate for subsequent quarters. FCMC will decide on the necessity to set the CCyB above 0% if any material increase in the cyclical systemic risks is observed in the Latvian financial sector.