

## Q4 2024 assessment of the cyclical systemic risk and applicable countercyclical capital buffer rate

9 December 2024

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.<sup>5</sup> 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<sup>1</sup> to implement a positive neutral CCyB approach<sup>2</sup>. According to this 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.

To ensure gradual implementation of the positive neutral CCyB approach, the Council of Latvijas Banka determined that the 0.5% CCyB rate requirement takes effect on 18 December 2024 and the 1% CCyB rate requirement – on 18 June 2025. Credit institutions apply the respective CCyB rate to the risk exposures to residents of the Republic of Latvia when calculating the institution-specific CCyB rate<sup>3</sup>.

**Considering the Q4 2024 cyclical systemic risk assessment, Latvijas Banka has decided not to increase the cyclical component of the CCyB rate. Therefore the decision on the applicable CCyB rate taken on 18 December 2023 remains in force. The cyclical systemic risk is still assessed as low taking into account the weak growth of the economy, subdued lending rates, continuously high interest rates as well as**

<sup>1</sup> An administrative act No 444/10 of the Council of Latvijas Banka of 18 December 2023 (available only in Latvian) [Par pretcikliskās kapitāla rezerves normas riska darījumiem, kuri noslēgti ar Latvijas Republikas rezidentiem, noteikšanu 1 procenta apmērā.](#)

<sup>2</sup> For more information please see [Latvijas Banka's approach to applying the countercyclical capital buffer.](#)

<sup>3</sup> Pursuant to Regulation No 137 of the Financial and Capital Market Commission of 25 August 2020 on [calculating the institution-specific countercyclical capital buffer rate.](#)

moderate activity in the real estate market. The ratio of domestic private non-financial sector credit to GDP remains at a low level.

The **credit-to-GDP gap** of the private non-financial sector continues to gradually narrow but remains negative both according to the standardised (broad) credit definition and additional (narrow) credit definition (see Table 1 and Charts 1 and 2). Consequently, the CCyB buffer guide is 0%.

Table 1 **Key variables of the CCyB rate assessment**<sup>4</sup>

Variable	Standardised (broad) credit definition	Additional (narrow) credit definition
	Q2 2024	Q3 2024
Credit-to-GDP ratio (%)	64.3	28.0
Credit-to-GDP gap (pp)	-16.6	-5.1
Benchmark buffer rate (% of risk weighted assets)	0	0 <sup>5</sup>

The growth rate of **domestic lending** in the third quarter of 2024 (see Chart 3 and 4) and in October have improved slightly from a low base level, but overall lending remains subdued. In October 2024, the annual growth rate of domestic loans to both non-financial corporations (hereinafter – NFCs) and households increased up to 5.0% (inter alia, the annual growth rate of the household loan portfolio increased by 5.5%, while that of the NFC loan portfolio - by 4.4%). The reduction in interest rates could have stimulated deferred demand for loans, however, weak economic growth continues to dampen the private non-financial sector's willingness and ability to borrow. Moreover, lending is still affected by several structural factors such as shortcomings in the business environment, weak construction sector, insufficient capital market, demographic factors.

The level of **private non-financial sector debt** is low. As interest rates gradually decrease, the **debt service burden** level of the private non-financial sector has stabilized (see Chart 5). The ability for households to service their mortgage loans continues to be supported by the wage growth and by the interest rate compensation that is paid-out from the mortgage borrower protection fee<sup>6</sup>. The share of Stage 2 loans is at historically low levels and overall the financial resilience of borrowers remains strong.

The **real estate** market is experiencing a moderate increase in activity, driven by declining interest rates and improving household purchasing power. In the third quarter of 2024 the total number of real estate purchases increased by 4.8% year on year. The Central Statistical Bureau of Latvia (hereinafter – CSB) data on house price index shows that in the second quarter of 2024 the annual growth rate of house prices increased by mere 1.1% compared to the same period in 2023 (see Chart 6), while the quarterly change was 2.3%. Inter alia the growth rate of prices for the new housing sustained high also in the second quarter of 2024 – they grew by 11.1% year on year and by 8.6% compared to the previous quarter of 2024. The prices for standard apartments in the third quarter of 2024 were stable and their monthly changes were close to zero.

Weak **macroeconomic development** in Latvia also suggests that the cyclical risk is low. In the third quarter of 2024 the GDP declined for the fourth consecutive quarter – by 0.2% compared to the previous quarter. The GDP decreased by 1.0% also year on year. This

<sup>4</sup> The narrow credit definition includes credit institution loans to NFCs and households and debt securities purchased by credit institutions, but the broad definition comprises liabilities of NFCs and households to credit institutions, as well as their loans from non-bank financial institutions or other NFCs.

<sup>5</sup> In Latvia, the narrow measure of credit provides better signalling properties; therefore, the benchmark buffer rate calculated according to the narrow credit definition serves as the buffer guide.

<sup>6</sup> [The amendments to the Consumer Rights Protection Law of 06 December 2023](#) (available only in Latvian).

decline was mostly affected by weak investments and cautious private consumption (regardless of improved purchasing power). The current account deficit decreased to 4.6% of GDP in the third quarter of 2024 (see Chart 9).

According to the latest forecasts of Latvijas Banka, economic activity will be slower than previously predicted, taking into account the caution of consumers and investors as well as weak external demand. The inflation rate is one of the lowest in the euro area, although the growth in service prices and wage levels remains persistent. Inflation is forecasted to remain around 1.5% in 2024 and 2025.

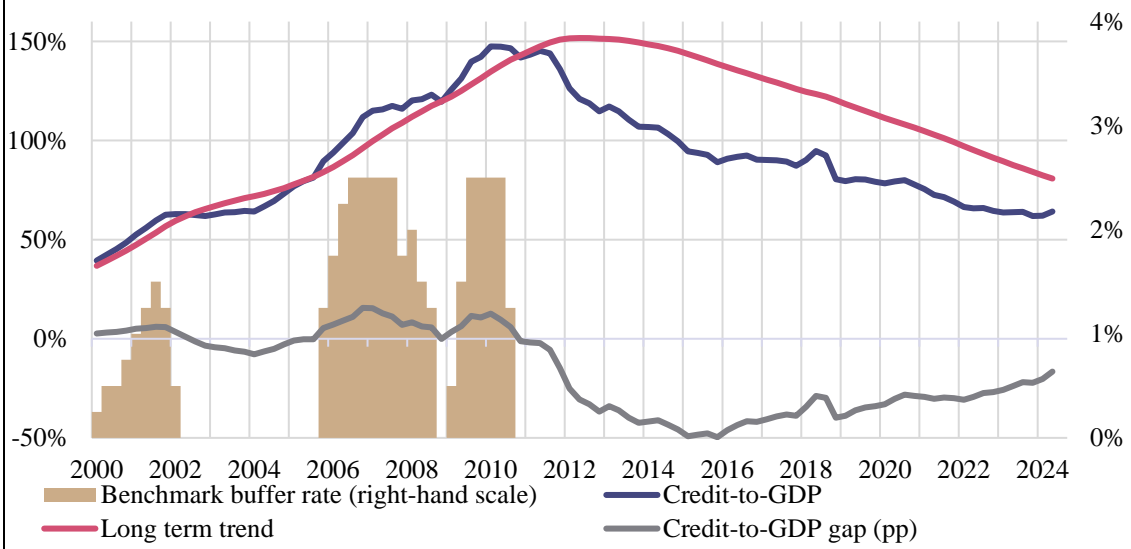
**Latvijas Banka's composite systemic cyclical risk indicator** (hereinafter – the CCRI)<sup>7</sup> has declined from 5.3 points in the second quarter of 2023 to 4.6 points in the second quarter of 2024. It is still below the risk level that is considered to be above average (see Chart 11).

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<sup>7</sup> For further information on the CCRI methodology, see Appendix 1 to Latvijas Banka's Financial Stability Report 2020 ([https://datnes.latvijasbanka.lv/fsp/FSP\\_2020\\_en.pdf](https://datnes.latvijasbanka.lv/fsp/FSP_2020_en.pdf)).

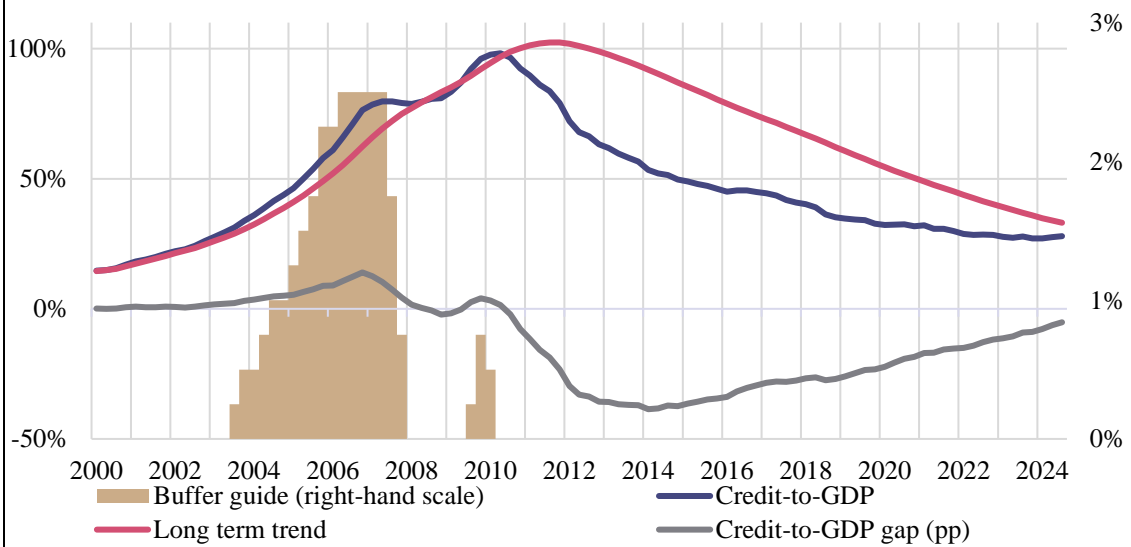
Annex 1. Key variables of the Financial Cycle

Chart 1. Standardised credit-to-GDP gap



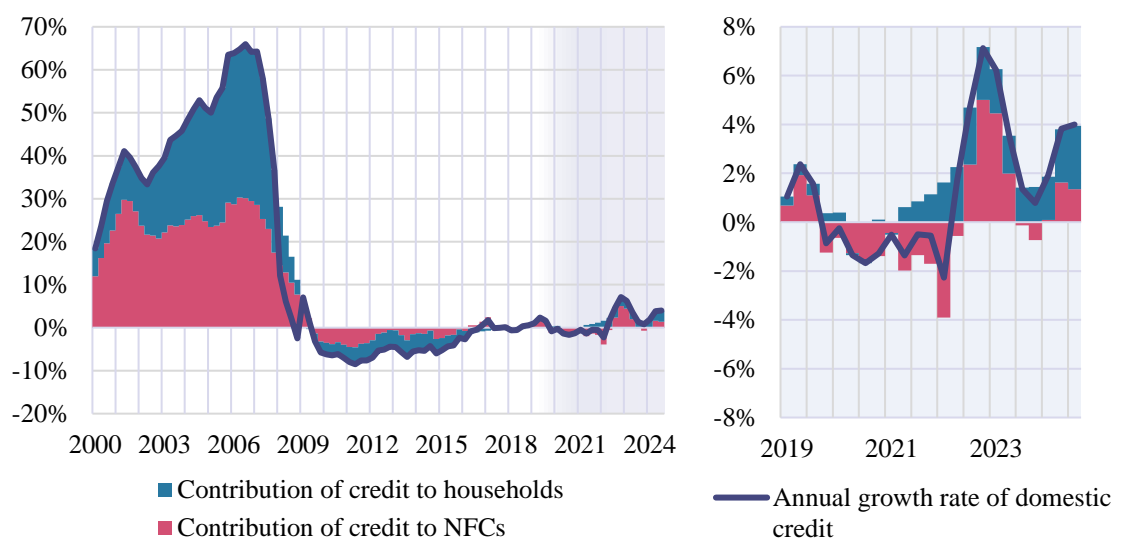
Source: Latvijas Banka, CSB.

Chart 2. Additional credit-to-GDP gap



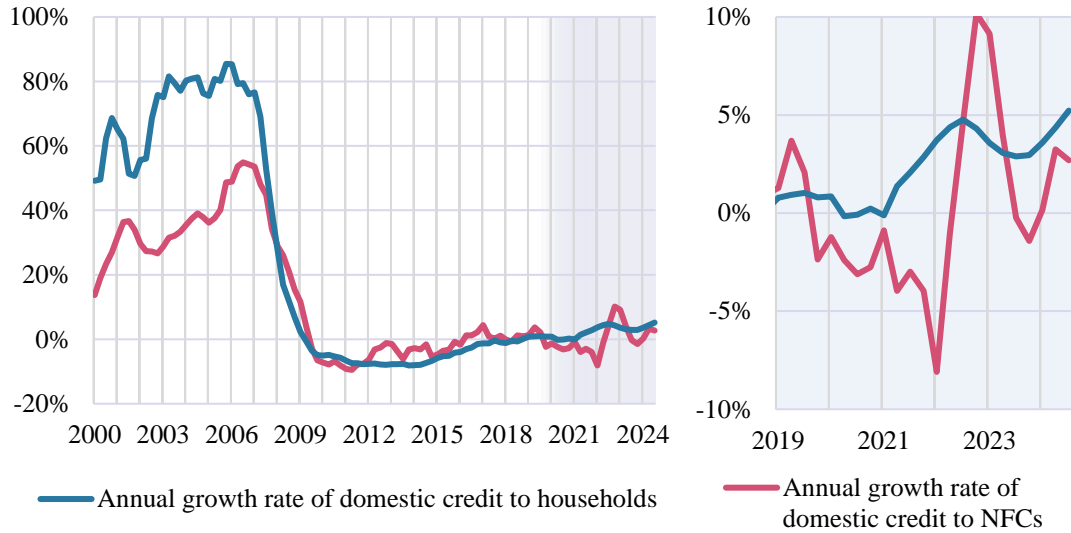
Source: Latvijas Banka, CSB.

Chart 3. Credit developments



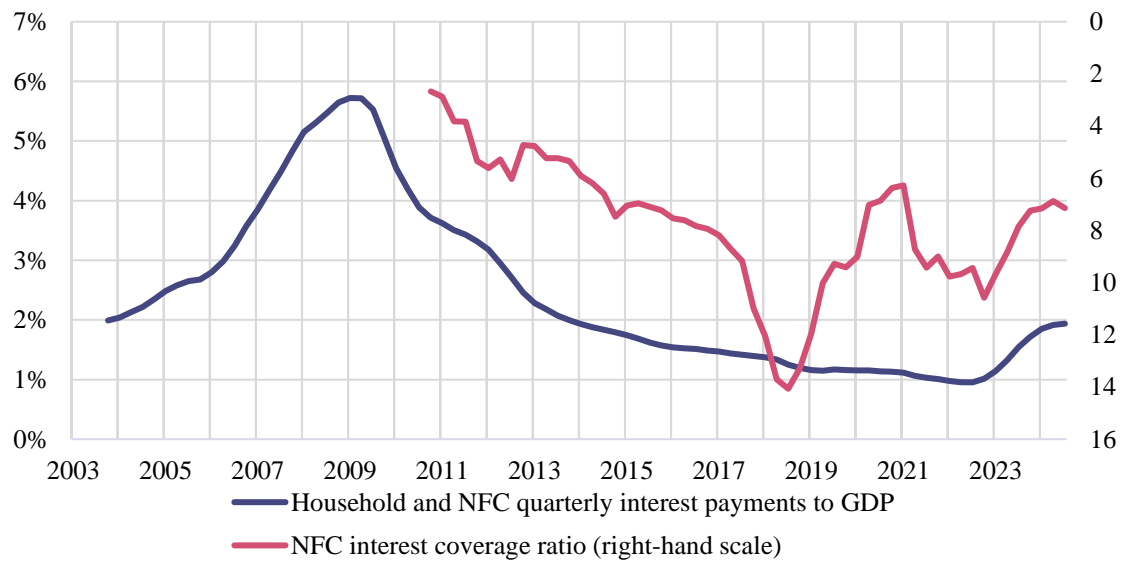
Source: Latvijas Banka, CSB. Note. The credit growth rate excludes overclassification and other one-time effects but includes loan write-offs.

**Chart 4. Credit developments – annual growth rates of credit to households and NFCs**



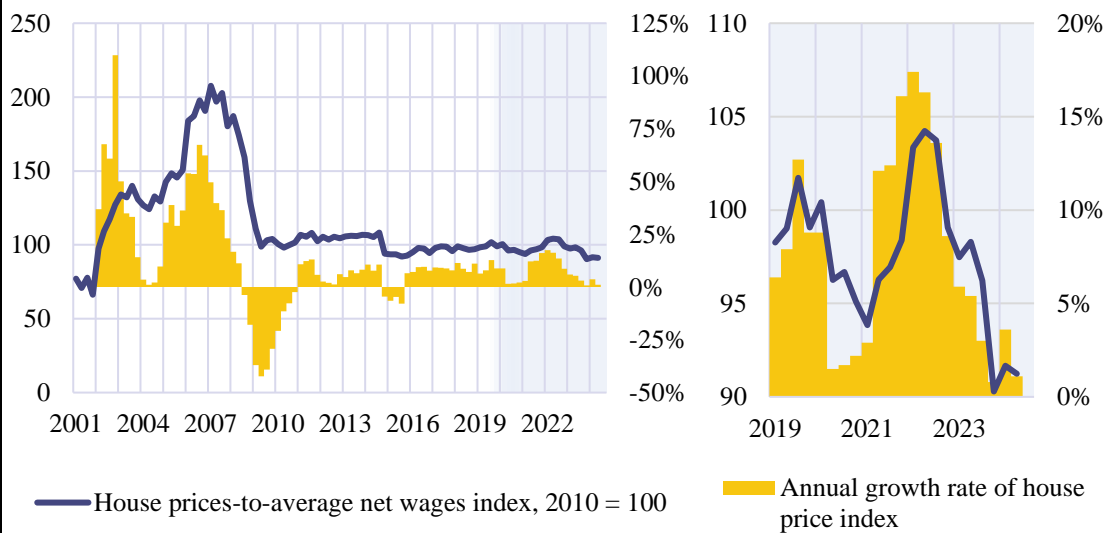
Source: Latvijas Banka, CSB. Note. The credit growth rate excludes overclassification and other one-time effects but includes loan write-offs.

**Chart 5. Private non-financial sector debt servicing burden**

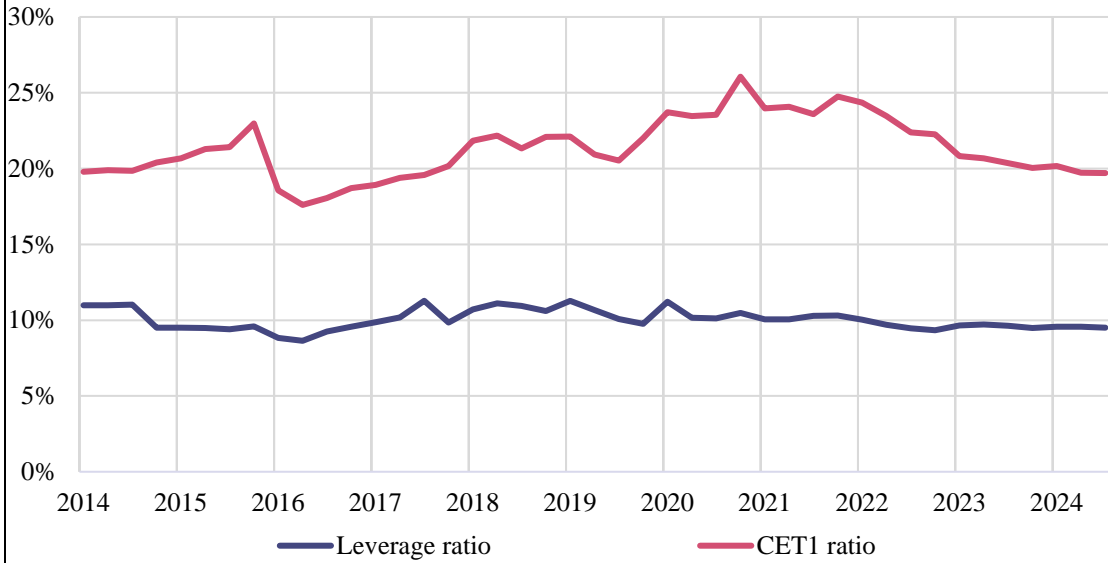


Source: Latvijas Banka, CSB. Note. The NFC interest coverage ratio includes the ratio of earnings before taxes and interest payments to interest payments.

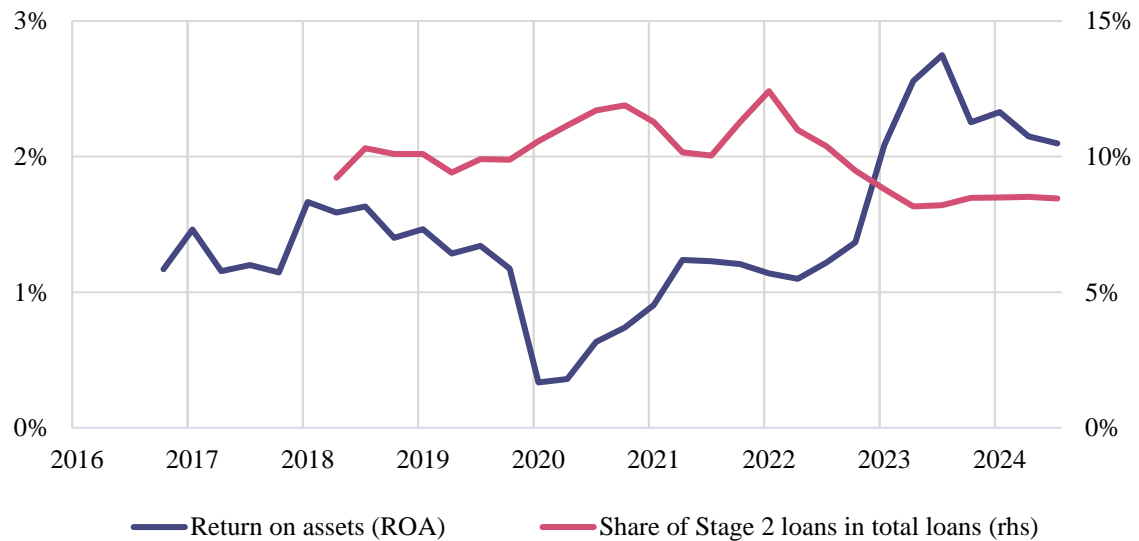
**Chart 6. Potential overvaluation of property prices**



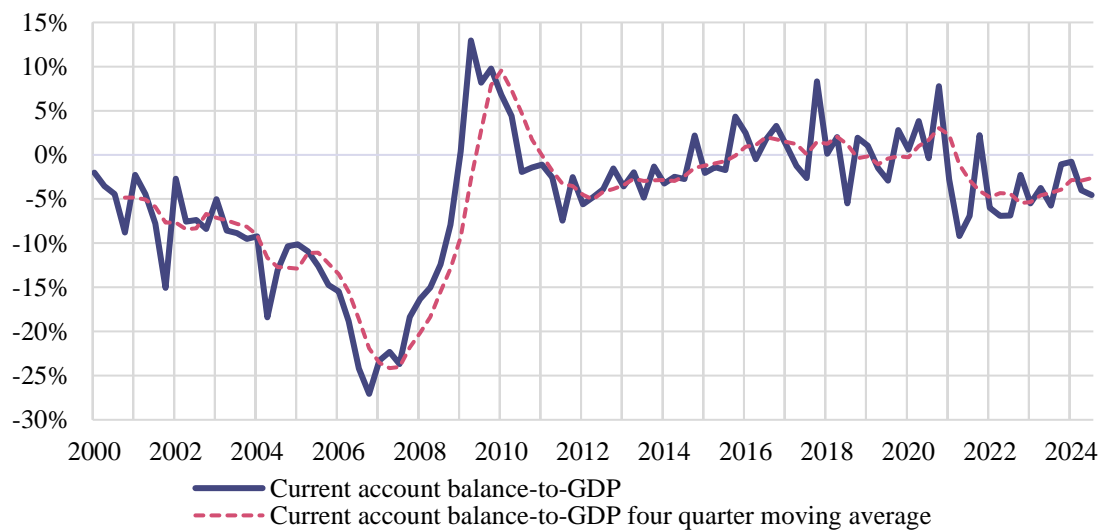
Source: CSB.

**Chart 7. Resilience of credit institutions - capitalization**

Source: Latvijas Banka. Note. Only credit institutions active at the date of publishing are included.

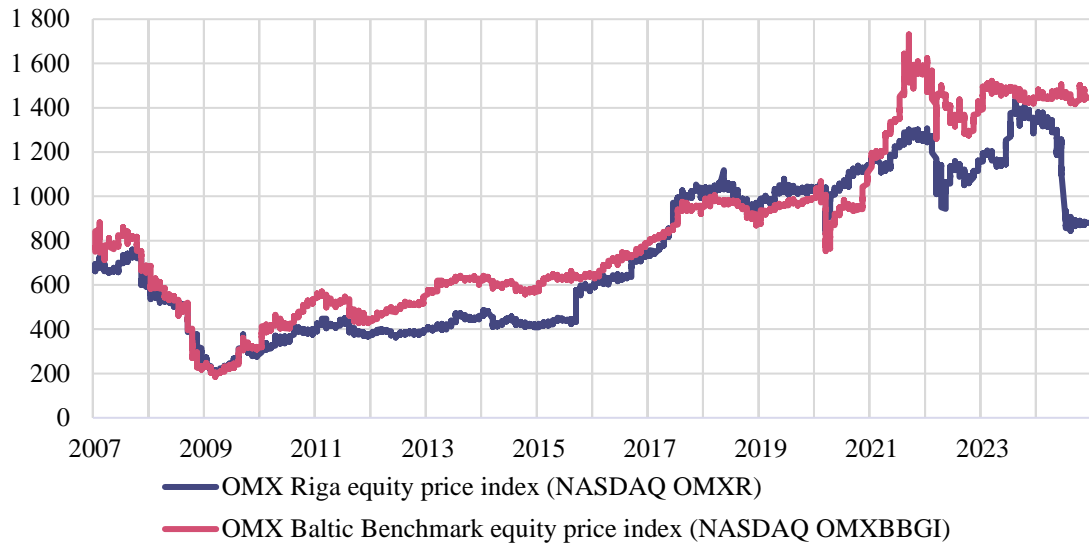
**Chart 8. Resilience of credit institutions - profitability and asset quality**

Source: Latvijas Banka. Note. Only credit institutions active at the date of publishing are included.

**Chart 9. External imbalances**

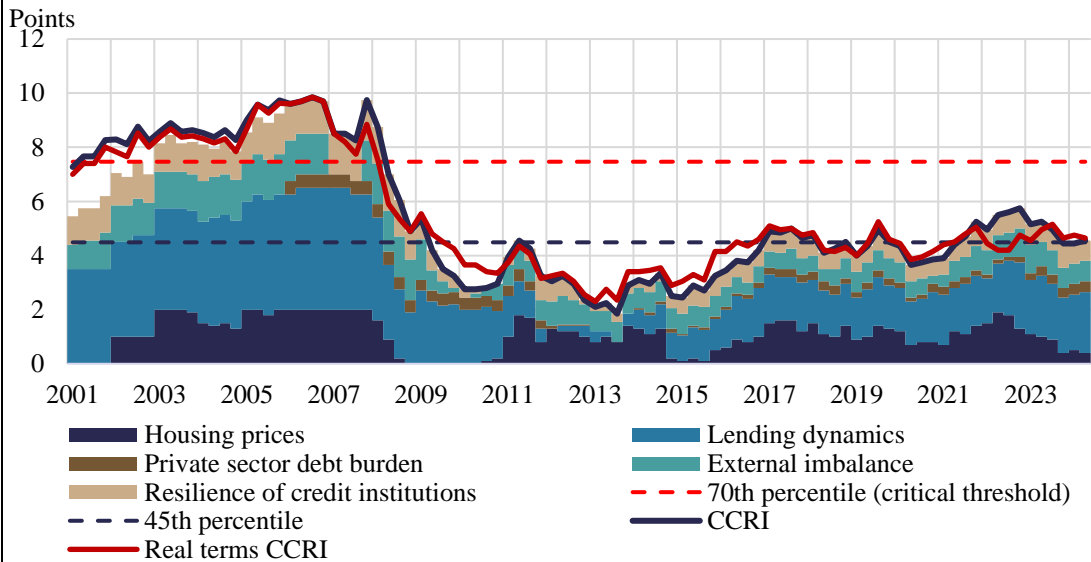
Source: Latvijas Banka, CSB.

**Chart 10. Potential mispricing of risk**



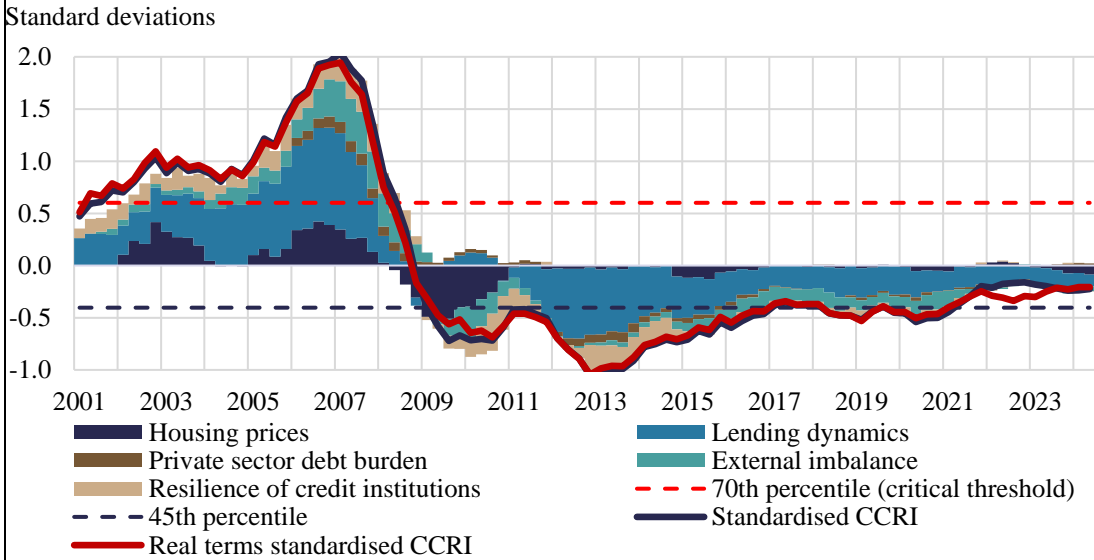
Source: Bloomberg.

**Chart 11. CCRI – percentile method**



Source: Latvijas Banka, CSB.

**Chart 12. CCRI – standardised method**



Source: Latvijas Banka, CSB.