



Quarterly announcement of the Bank of Slovenia  
9 February 2021

**Macprudential instrument:**  
**COUNTERCYCLICAL CAPITAL BUFFER: 4<sup>th</sup> quarter of 2020**

Pursuant to a resolution adopted by the Governing Board of the Banka Slovenija at its 546<sup>th</sup> meeting of 8 December 2015, the Bank of Slovenia introduced the macroprudential measure of a countercyclical capital buffer (hereinafter: the buffer). The measure has been effective as of 1 January 2016.

The purpose of the buffer is to protect the banking system against potential losses insofar as these are related to an increase in risks in the system as a result of excessive credit growth. This directly increases the resilience of the banking system, and prevents excessive credit growth.

The Bank of Slovenia calculates a buffer guide<sup>1</sup> on a quarterly basis in accordance with Article 210 of the ZBan-2. The buffer guide is a meaningful reflection of the credit cycle and risks due to excess credit growth in Slovenia, and takes into account the specificities of the Slovenian economy. In setting the buffer rate the Bank of Slovenia takes account of the methodology of the BCBS (2010)<sup>2</sup> and the ESRB (2014).<sup>3</sup> The buffer is activated when excessive credit growth is linked to an increase in risks in the system.

The Bank of Slovenia sets the countercyclical buffer rate for Slovenia between 0% and 2.5% of the total risk exposure amount (or higher in exceptional cases), in steps of 0.5 percentage points. When the defined buffer rate is higher than zero, or when an established rate is being raised, the new buffer rate begins to be applied 12 months after the announcement. In extraordinary circumstances, a new buffer rate may also be applied less than 12 months after the announcement.

In the event of the reversal of the credit cycle or a decline in risks, the buffer rate is either reduced, or fully relaxed (a zero rate). In the wake of relaxation (or reduction), the lower buffer rate allows banks to absorb potential losses. The risk of the supply of credit being restricted by regulatory capital requirements is reduced at the same time.

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<sup>1</sup> In accordance with the Recommendation of the ESRB of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1), the buffer guide is not intended to give rise to an automatic buffer setting or to bind the designated authority.

<sup>2</sup> Basel Committee on Banking Supervision (2010). Guidance for national authorities operating the countercyclical capital buffer.

<sup>3</sup> ESRB (2014). Operationalising the countercyclical capital buffer: indicator selection, threshold identification and calibration options.

In accordance with the ESRB guidelines, six indicators of risk in the system have been selected as guidance for setting the buffer rate. The following criteria are taken into account in selecting the indicators:

- i) the indicators should cover various risk factors,
- ii) each indicator should have sufficient predictive power in forecasting a crisis,
- iii) the time series of the indicator should be long enough to allow for static analysis<sup>4</sup> of the suitability of the indicator (points iv and v),
- iv) the indicator should activate the buffer in periods of excessive lending to the real economy,
- v) the indicator should not activate the buffer (too frequently) in periods of moderate credit growth,
- vi) the indicator should cover a wide area of the banking system and the wider system, i.e. it should not be partial.

Because the calculations of indicators are based on past developments, it is necessary to subject the buffer rate signalled by the indicators to expert assessment, and to take account of any new findings.

The key indicator for setting the buffer rate is the private-sector credit-to-GDP gap, i.e. the deviation in the private-sector credit-to-GDP ratio from its long-term trend. This indicator signals potential excessive credit growth in relation to economic growth. Five indicators have been selected alongside the credit-to-GDP gap:

- i) annual growth in real estate prices (a measure of the potential overvaluation of property prices),
- ii) annual growth in credit to the domestic private non-financial sector (a measure of credit developments),
- iii) the LTD ratio for the private non-banking sector (a measure of the robustness of bank balance sheets),
- iv) return on equity (a measure of the robustness of bank balance sheets), and
- v) the ratio of credit to gross operating surplus (a measure of private sector indebtedness).

Table 1 gives the values of the risk indicators in the third quarter of 2020 and the corresponding historical averages. The values of the indicators imply a buffer rate of 0% of the total risk exposure amount. The table shows that the credit-to-GDP gap is negative (at -25.5%), while the ratio of credit to GDP stands at 63.9%. The credit gap reflects the low level of lending to the private non-banking sector compared with past levels. The low level of lending implies no systemic risks originating from excessive credit growth. The annual rate of growth of real estate prices for existing apartments in the third quarter of 2020 was 4.4%, which is less than the average over the period of Q1 2001 to Q3 2020. Annual growth in lending to the domestic private non-financial sector stood at -0.36%, significantly below its average over the period of Q1 2000 to Q3 2020. The LTD ratio for the private non-banking sector is lower than it has been in the past (at 0.7). This indicates that lending is primarily being funded by customer deposits, which are a more stable source of funding. Return on equity stood at 9.9% in the third quarter of 2020. The ratio of credit to gross operating surplus, which is a measure of private-sector indebtedness and reflects the corporate sector's capacity to finance debts, remains low.

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<sup>4</sup> Static analysis is used to assess what the dynamic of the buffer would be during a period of increasing imbalances in the banking system and in the wider system, on the basis of historical data (approximately 2004 to 2008). The analysis neglects that the banks' behaviour would most likely have altered had the buffer been active at that time.

Table 1: Indicators for setting the buffer rate

Indicator	Average (Q1 2000 to Q3 2020)*	Value of indicator taken into account in the decision on the buffer**
credit-to-GDP gap	<b>-8.9%</b>	<b>-25.5%</b>
annual growth in real estate prices (available since 2001)	5.2%	4.4%
annual growth in lending to domestic private non-financial sector	8.8%	-0.36%
LTD ratio for private non-banking sector	1.1	0.70
return on equity	1.1%	9.9%
ratio of credit to gross operating surplus	4.4	2.2

Source: SORS and own calculations

Note: \*Value serves merely for orientation purposes. Owing to data availability, the average value of the indicator of annual growth in real estate prices is calculated for the period of Q1 2001 to Q3 2020.

\*\*Latest available indicator value is used (Q3 2020)

In accordance with a decision taken by the Governing Board of the Bank of Slovenia at its 645<sup>th</sup> meeting of 16 June 2020, the Bank of Slovenia additionally monitors a composite indicator that combines individual risk indicators that showed good predictive power in forecasting a crisis on the basis of data from euro area countries and from Denmark, Sweden and the UK.

The risk indicators combined into the composite indicator are:

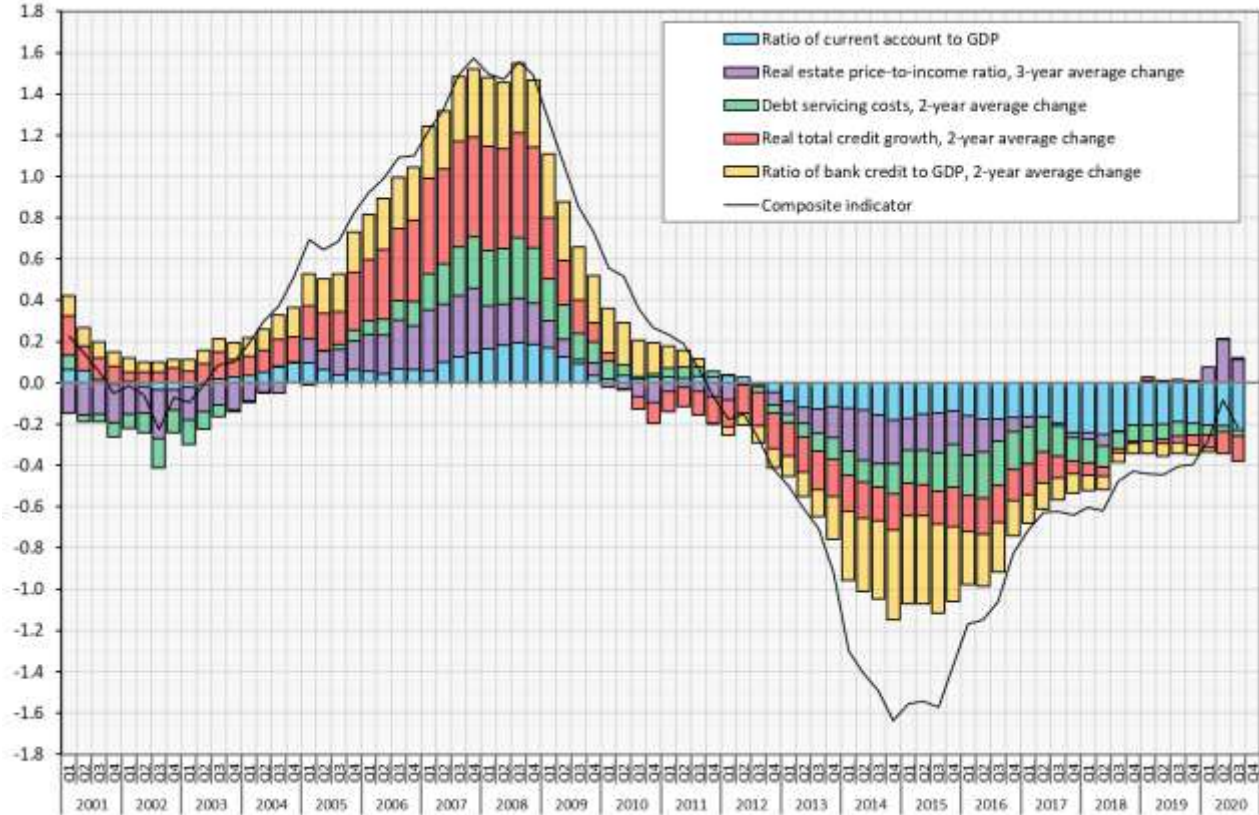
- i) bank credit to the domestic private non-financial sector to GDP (a measure of credit developments),
- ii) real total credit growth (a measure of credit developments),
- iii) the ratio of residential real estate prices to income (a measure of potential overvaluation of property prices),
- iv) the debt-service to income ratio (a measure of private sector debt burden),
- v) the ratio of the current account balance to GDP (a measure of external imbalances).

Various transformations (quarterly, one-year, two-year and three-year etc.) were tested for each of these indicators with the aim of identifying those with the best predictive power. The two-year or three-year changes in the indicators have the best predictive power in forecasting a crisis. When used, the individual indicators rise or fall for approximately five years before the outbreak of a systemic financial crisis, and usually hit their peak or trough one to two years before the crisis, which are desirable attributes for early warning indicators.

The individual risk indicators are combined into a composite indicator so as to optimise the predictive power of the early warning of the crisis five to twelve quarters before the outbreak of the crisis. Figure

1 illustrates the value of the composite indicator in the third quarter of 2020, and the individual indicators' contributions to the composite indicator. The composite indicator stood at -0.215 in the third quarter of 2020.

Figure 1: Composite indicator for Slovenia



Source: Bank of Slovenia

The full relaxation of the buffer (from a rate of 2.5% to a zero rate) is envisaged at the reversal of the credit cycle, or in the event of profound imbalances that could threaten the functioning of the banking system. Indicators that react rapidly to financial stress apply to relaxation. The relaxation of the buffer is subject to a higher level of uncertainty, and requires a very high level of discretionary judgement.

On the basis of the values of the indicators of imbalances in the banking system for the third quarter of 2020, and expert judgements, it is assessed that there are no risks in the banking system that derive from excessive lending, for which reason the buffer rate is set at 0% of the total risk exposure amount.

**Requirement to maintain an institution-specific countercyclical capital buffer**

In accordance with Article 209 of the ZBan-2, each bank is required to maintain an institution-specific capital buffer equal to its total risk exposure amount multiplied by the weighted average of the countercyclical buffer rates calculated in accordance with the Regulation on the calculation of the institution-specific countercyclical capital buffer rate for banks and savings banks (Official Gazette of the Republic of Slovenia, Nos. 55/15, 42/16 and 9/17) on an individual and consolidated basis, as applicable in accordance with Title II of Part One of Regulation (EU) No 575/2013.

A zero rate is applied to exposures located in Slovenia. The rates applied to exposures in other EEA countries are given on the [ESRB website](#). The buffer rate cited on the [BIS website](#) is applied to credit

exposures located in countries that are not listed on the ESRB website, while a zero rate is applied to any remaining unlisted countries.