BANKA SLOVENIJE

EVROSISTEM

Macroprudential instrument:
COUNTERCYCLICAL CAPITAL BUFFER: 2nd quarter of 2023

The countercyclical capital buffer rate for Slovenia stands at 0.5% of the total risk exposure amount.

Based on the quarterly data from the first quarter of 2023, we conducted a regular quarterly assessment of cyclical systemic risks in Slovenia in the second quarter of 2023. We estimate that cycical systemic risk remains broadly unchanged compared to the prevous quarter, as uncertainties in the macroeconomic and financial environment reamin considerable in both Slovenia and Europe. A turn in the financial cycle can be detected both in Slovenia (Figure 1) and in Europe (ECB Financial Stability Report, May 2023, p. 88), which consequently increases the probability of the materialization of various macro-financial risks. The turnaround in the financial cycle is particularly evidend in the area of the residential real estate market, where the growth of residential real estate prices and the growth of housing loans have moderated recently. The overall growth of loans to the private non-financial sector also moderated. Higher interest rates, however, increase debt servicing costs, which affects the ability of households and businessess to repay loans. It is important to maintain the resilience of the banking system in the current environment in order to be prepared for problems that may arise in the future. Therefore, we maintain the countercyclical buffer rate at 0.5 % of the total risk exposure amount. Banks must comply with the countercyclical buffer requirement from December 31, 2023 onwards.

Banka Slovenije calculates a buffer guide[1] on a quarterly basis in accordance with Article 233 of the Banking Act (Official Gazette of the Republic of Slovenia, Nos. 92/21 and 123/21 [ZBNIP]; hereinafter: the ZBan-3). 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 Banka Slovenije takes appropriate account of the methodology of the BCBS (2010)[2] and the ESRB (2014).[3] In accordance with the ESRB guidelines, six individual indicators of risk in the system and a composite indicator have been selected as guidance for setting the buffer rate.

The following criteria were taken into account in selecting the individual indicators:

i)   the indicators should cover various risk factors,
ii)   the indicators should have sufficient predictive power in forecasting a crisis,
iii)   the time series of the indicators should be long enough to allow for static analysis[4] of the suitability of the indicator (points iv and v),
iv)   the indicators should activate the buffer in periods of excessive lending to the real economy,
v)   the indicators should not activate the buffer (too frequently) in periods of moderate credit growth,
vi)   the indicators should cover a wide area of the banking system and the wider system, i.e. they 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 individual 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.[5] Five indicators have been selected alongside the credit-to-GDP gap:

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

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[1] 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.
[2] Basel Committee on Banking Supervision (2010). Guidance for national authorities operating the countercyclical capital buffer.
[3] ESRB (2014). Operationalising the countercyclical capital buffer: indicator selection, threshold identification and calibration options.
[4] Static analysis on the basis of historical data (roughly 2004 to 2008) 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. The analysis neglects that the banks' behaviour would most likely have altered had the buffer been active at that time.
[5] Analysis by the BCBS shows that the credit-to-GDP gap is a useful starting point for guiding decisions on countercyclical capital buffer rates, but its performance varies over time and across countries. Given the diversity and the dynamic nature of financial systems, the specificities of national economies, and the significant differences in the availability of data in the EU, the designated authorities must take account of a range of information when assessing the risk level in the system as a whole, and must set the buffer rate accordingly. This information includes additional indicators that warn of an increase in risk at the level of the system as a whole. The quantitative and qualitative information used in this assessment, including the buffer guide and the additional indicators, lay the foundation for explaining and substantiating decisions on the buffer rate.

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Table 1: Indicators for setting the countercyclical capital buffer rate

Indicator	Average value (Q1 2000 to Q1 2023)	Snapshot value Q1 2023
credit-to-GDP gap	-9.8%	-18.7%
annual growth in used residential real estate prices (available since 2001)	6.1%	6.4%
annual growth in lending to domestic private non-financial sector	8.3%	4.6%
LTD ratio for private non-banking sector	1.1	0.7
return on equity	2.1%	11.8%
ratio of credit to gross operating surplus	4.1	1.7

Notes: The average is cited solely for orientation purposes. Owing to data availability, the average value of the indicator of annual growth in used residential real estate prices is calculated for the period of Q1 2001 to Q1 2023.
Sources: SORS, own calculations

The table shows that the credit-to-GDP gap is negative (in the amount of 18.7%), whereby the credit-to-GDP ratio stands at 55.7% (see Figure 1). The gap between the credit-to-GDP ratio and the long-term trend is still profoundly negative, on account of the extremely high growth in lending to the private non-banking sector in the period before the global financial crisis.[6]

Figure 1: Credit-to-GDP gap
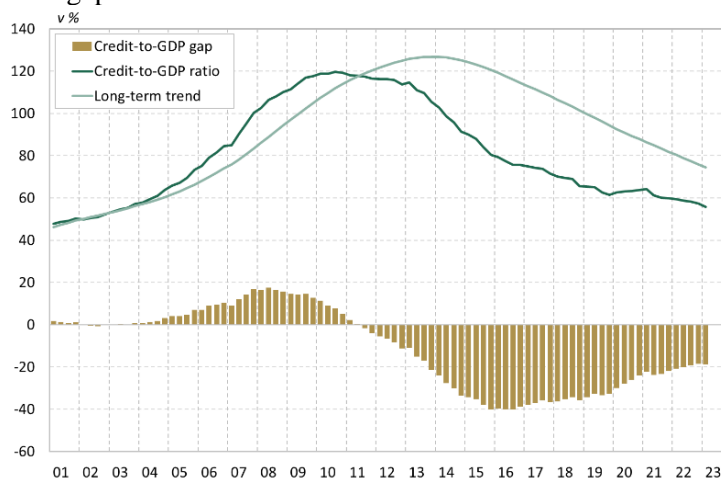
Note: The calculation of the credit-to-GDP gap includes all bank loans (by domestic and foreign banks) to the private non-banking sector (the non-banking sector excluding the government sector) before impairments. GDP is annualised as the sum

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[6] Growth in credit to the non-banking sector exceeded 35% in 2007. The private-sector credit-to-GDP ratio stood at 65.8% at the beginning of 2005. By the end of 2008 the ratio had risen by 44.4 percentage points to 110.2%, before peaking at almost 120% in the third quarter of 2010. The high credit growth, which outpaced GDP growth for a lengthy period, drove a sharp rise in the estimate of the long-term trend. As a result of the pronounced slowdown in credit growth after the global financial crisis and the sharp decline in the credit-to-GDP ratio, the credit-to-GDP gap fell sharply, reaching its lowest level (of -41%) in mid-2016. Since 2016 the credit-to-GDP gap has undergone a sustained narrowing.

of nominal GDP over the last four quarters. The trend in the credit-to-GDP series is estimated by means of a recursive Hodrick-Prescott (HP) filter with a lambda parameter of 400,000. The credit-to-GDP gap is the gap between the actual credit-to-GDP ratio and its trend.
Source: Banka Slovenije

Annual growth in prices of used residential real estate stood at 6.4 % in the first quarter of 2023, slightly above the average over the period between Q1 2001 and Q1 2023 (see Figure 2).[7] The high price growth meant that residential real estate in Slovenia had become overvalued relative to fundamentals by 2021, but the relative overvaluation of residential real estate declined slightly in the first quarter of 2023 (see Figure 3).[8]

Figure 2: Residential real estate prices

Figure 3: Overvaluation of residential real estate
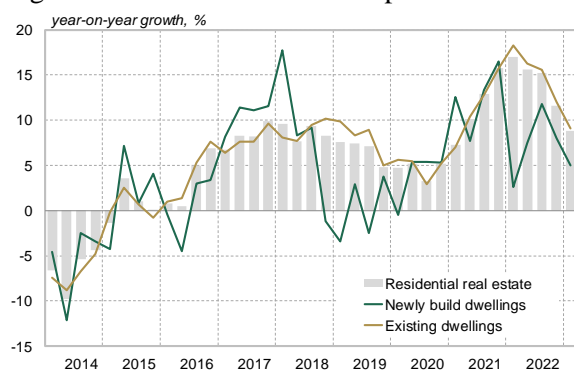
Note: In the right figure the indicators of housing price alignment with fundamentals are normalised around their own long-term averages, which are assigned a value of zero. Each indicator's deviation from the long-term average illustrates the overvaluation or undervaluation of residential real estate.
Sources: SORS, SMARS
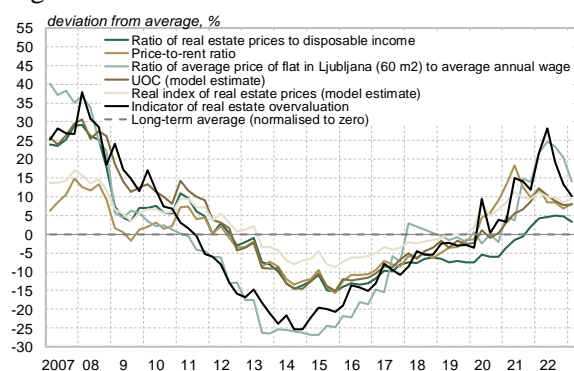
Growth in credit to the private non-financial sector slowed in the first quarter of 2023. Growth in credit to the private non-financial sector slowed by 3.4 percentage points in the first quarter of 2023 to reach 4.6%. Growth in housing loans remains above the euro area median, while growth in loans to non-financial corporations fell below the euro area median (see Figures 4 and 5).

Figure 4: Growth in housing loans

Figure 5: Growth in loans to non-financial corporations

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[7] Growth in residential real estate prices rose sharply in 2021, surpassing the previous record rates seen in 2008, and strengthened further in 2022. In 2021 residential real estate prices passed their previous peak of 2008 in nominal and real terms.
[8] The indicators are showing relative overvaluation, where the dynamics in residential real estate prices are compared with developments in other fundamentals such as income (e.g. GDP, disposable income), prices (e.g. general inflation, rents) or costs (e.g. construction costs, interest rates on housing loans). The advantage in calculating relative overvaluation rather than absolute overvaluation is that relative overvaluation can be assigned a specific reference point (the fundamental in the numerator). With absolute overvaluation there is no reference point; instead it is the subjective perspective of the buyer or vendor that is important. Absolute overvaluation from the perspective of the buyer can differ considerably from that from the perspective of the vendor.
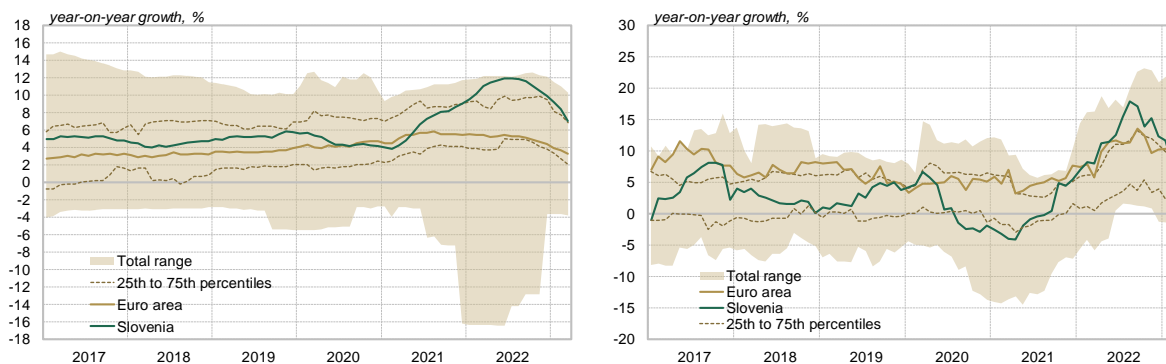
Source: ECB SDW

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 than wholesale funding. However, the high share of sight deposits (more than 80% of deposits by the non-banking sector) means that the risk of an outflow of deposits remains relatively high. The banks performed well in the first quarter of 2023: ROE stood at 11.8%. 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.

Since mid-2020 Banka Slovenije has additionally monitored 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 relative to GDP (a measure of credit developments),
ii) overall real growth in credit (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) 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 these are 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 6 illustrates the value of the composite indicator in the first quarter of 2023, and the individual indicators' contributions to the composite indicator. In 2022, the composite indicator maintained neutral value, but at the beginning of 2023, it turned downwards due to lower credit growth.

Figure 6: Composite indicator for Slovenia
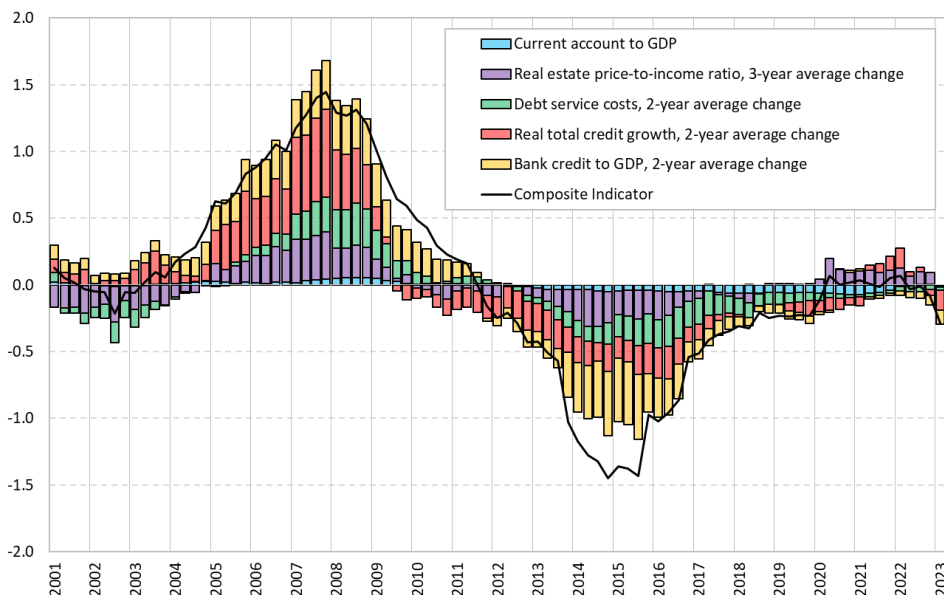
Source: Banka Slovenije

Requirement to maintain an institution-specific countercyclical capital buffer

In accordance with Article 232 of the ZBan-3, each bank is required to maintain an institution-specific capital buffer equal to its total risk exposure amount multiplied by the weighted verage 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, 9/17 and 92/21 [ZBan-3]) on an individual and consolidated basis, as applicable in accordance with Title II of Part One of Regulation (EU) No 575/2013.

A rate of 0.5% 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.