

Quarterly announcement of the Bank of Slovenia  
28 June 2016

**Macprudential instrument:**  
**COUNTERCYCLICAL CAPITAL BUFFER: 2<sup>nd</sup> quarter of 2016**

Pursuant to a resolution adopted by the Governing Board of the Bank of Slovenia 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 is effective as of 1 January 2016.

The Bank of Slovenia has set out the buffer in accordance with Article 210 of the ZBan-2. The ZBan-2 stipulates that the buffer may be imposed on banks as of 1 January 2016. The current buffer rate has been applied as of 1 January 2016. When the defined buffer rate is higher than 0%, or when an established rate is being raised, the new buffer rate begins to be applied 12 months after the announcement (except in extraordinary cases).

**The buffer rate has been kept at 0% of the total risk exposure amount.** In the definition of the buffer rate and the length of the transition period, the Bank of Slovenia took account of the methodology of the BCBS (2010)<sup>1</sup> and the ESRB (2014),<sup>2</sup> and an assessment of the state of the credit cycle in Slovenia.

The purpose of the instrument 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 growth in lending. This directly increases the resilience of the banking system, and prevents excessive growth in lending. The buffer is activated when excessive growth in lending is linked to an increase in risks in the system. The capital buffer rate may range from 0% to 2.5% of the total risk exposure amount (only exceptionally higher). It depends on the level of risks in the system. In the event of the reversal of the credit cycle or a decline in risks, the buffer rate is either reduced, or fully relaxed (to the rate of 0%). During relaxation (or reduction), the lower buffer rate allows banks to absorb potential losses. The risk of the supply of loans being restricted by regulatory capital requirements is reduced at the same time.

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 were 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>3</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,

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<sup>1</sup> Basel Committee on Banking Supervision (2010). Guidance for national authorities operating the countercyclical capital buffer.

<sup>2</sup> ESRB (2014). Operationalising the countercyclical capital buffer: indicator selection, threshold identification and calibration options.

<sup>3</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 2004-2008). The analysis neglects that the banks' behaviour would most likely have altered had the buffer been active at that time.

- 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 growth in lending in relation to economic growth. Five indicators have been selected alongside the credit-to-GDP gap:

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

Table 1 gives the current values of the risk indicators and the corresponding historical averages. The current 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 -40.0%). The 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 same conclusion can be made by observing the negative rate of annual growth in lending to the domestic private non-financial sector (-5.4%). Annual growth in real estate prices has turned positive in 2015 after a long period of decline in prices (it reached 5.0% in 2015Q4), which is lower than in 2015Q3 (5.4%). However, no overheating of the real estate market that could be driven by excess credit growth is observed at the moment. The LTD ratio for the private non-banking sector is also below its past values (at 0.9). This indicates that lending is primarily being financed by customer deposits, a stable source of bank funding. ROE exceeded zero in 2015Q4 for the first time after 2010Q3, however its level in 2016Q1 remains modest (at 0.05). In periods of excessive lending ROE reaches higher values. And finally, the ratio of credit to gross operating surplus is low. The ratio of credit to gross operating surplus is a measure of private-sector indebtedness, which reflects the corporate sector's capacity to finance debts.

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

Table 1: Indicators for setting the buffer rate

<b>Indicator\Value</b>	<b>Average value (2000Q1-2016Q1)*</b>	<b>Value of indicators taken into account in the decision on the buffer made in 2016Q2**</b>
credit-to-GDP gap	<b>-1.7 %</b>	<b>-40.0 %</b>
annual growth in real estate prices (available since 2001)	4.5 %	5.0 %
annual growth in lending to domestic private non-financial sector	10.8 %	-5.4 %
LTD ratio for private non-banking sector	1.2	0.9

return on equity	-0.01	0.05
ratio of credit to gross operating surplus	4.3	2.6

Sources: SORS and own calculations

\*Value serves merely for orientation purposes. Due to data availability the average annual growth in real estate prices is calculated over the period 2001Q1-2015Q4.

\*\*Latest available indicator value is used (2016Q1). The latest available value for annual growth in real estate prices is for 2015Q4.

The full relaxation of the buffer (from a rate of 2.5% to a rate of 0%) is envisaged solely when profound imbalances that could threaten the functioning of the banking system have emerged. 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.

A bank calculates an institution-specific countercyclical buffer rate as the weighted average of countercyclical buffer rates that apply in the countries in which its credit exposures are located.

A rate of 0% is applied to exposures located in Slovenia. The rates applied to exposures in other EEA countries are given on the [ESRB website](#). A rate of 0% is applied to credit exposures located in countries that are not listed on the ESRB website.