LATVIJAS BANKA
EIROSISTĒMA

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Q1 2025 assessment of the cyclical systemic risk and applicable countercyclical capital buffer rate

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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.[5] 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[1] to implement a positive neutral CCyB approach[2]. 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[3].

Considering the Q1 2025 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 assessed as low taking into account the slow growth of the economy, moderate activity in the real estate and lending markets. The ratio of domestic private non-financial sector credit to GDP remains at a low level.

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[1] 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.
[2] For more information please see Latvijas Banka's approach to applying the countercyclical capital buffer.
[3] 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.

The **credit-to-GDP gap** of the private non-financial sector continues to 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**[4]

Variable	**Standardised (broad) credit definition**	**Additional (narrow) credit definition**
	Q3 2024	Q4 2024
Credit-to-GDP ratio (%)	69.0	27.9
Credit-to-GDP gap (pp)	–13.1	–4.3
Benchmark buffer rate (% of risk weighted assets)	0	0[5]

Domestic lending has moderately increased (see Chart 3 and 4). At the end of 2024 and in February 2025, the outstanding amount of loans issued[6] to households and non-financial corporations (hereinafter – NFC) annually grew by 6.2% and 7.0% respectively (including households – by 6.2% and 6.8%, and NFC – by 6.2% and 7.2%). The rise in lending has been largely driven by the reduction in interest rates and correspondingly the realisation of the deferred demand for loans. At the same time, the more active growth of loans continues to be constrained by high uncertainty, slow domestic economic growth, and several structural factors[7].

The level of **private non-financial sector debt** is low. Along with the gradual decrease in interest rates, the ratio of credit interest payments to GDP in the private non-financial sector has slightly decreased (see Chart 5). The overall financial resilience of borrowers remains good. The resilience of bank's balance sheets – bank capitalization, profitability, and asset quality (see Chart 7 and 8) – also remain very good.

There is moderate activity in the **real estate** market. In the fourth quarter of 2024, the total number of real estate transactions increased by 7.1% compared to the same period previous year. The activity was driven by the rise in disposable household income and the decrease in interest rates. The Central Statistical Bureau of Latvia (hereinafter – CSB) data on house price index increased by 8.1% in the fourth quarter of 2024 year-on-year (see Chart 6), but compared to the previous quarter it decreased by 0.2%. The slight decrease is explained by the drop in prices in the new housing segment (by 2.8% compared to the previous quarter). Over the last year new housing prices still increased (by 4.1%). At the same time in the existing housing segment prices rose by 9.2% year-on-year, but in the fourth quarter of 2024 they grew by 0.6%. The prices of standard apartments remained stable – the price changes were negligible.

Weak **macroeconomic development** in Latvia also suggests that the cyclical risk is low. In the fourth quarter of 2024 and in 2024 overall Latvia's GDP decreased by 0.4% compared to the corresponding period in the previous year. GDP growth was significantly affected by a decline in investments that were hampered by high uncertainty, interest rate levels, and delays in adopting EU funds. Private consumption developed slowly, despite the increase in purchasing power – uncertainty could have somewhat contributed to this

[4] 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.

[5] 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.

6 Excluding one-off effects regarding structural changes in the banking sector as well as the overclassification of sectors.

7 For example, shortcomings in the business environment, weak construction sector, insufficient capital market, demographic factors.

aspect. In 2024 the export of goods and services decreased as it was negatively affected by external factors – weak economic development in trading partner countries. The current account balance improved in the second half of the past year, and in the fourth quarter it was positive – 0.8% of GDP (see Chart 9).

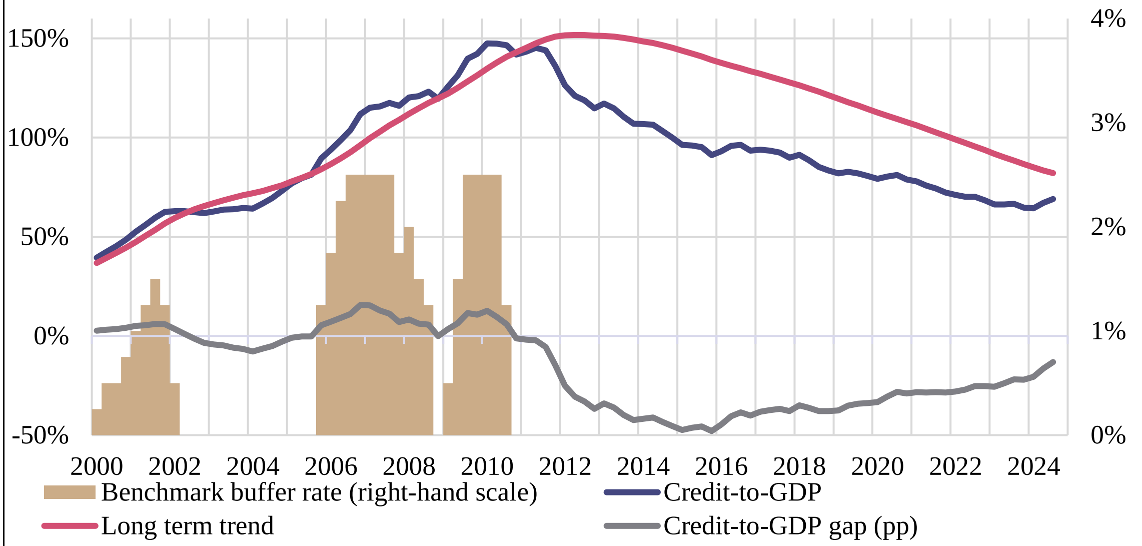
According to the latest forecasts of the Bank of Latvia, GDP growth could peak at 2.1% in 2025. Macroeconomic development will be significantly affected by by external factors, consumer and investor sentiment as well as government spending related to investment projects and national defence. The inflation rate in 2025 will remain at a low level (around 1.4%). The labour market will be resilient – in 2025 the unemployment rate could slightly decrease (to 6.8%), while wage growth might become more moderate.

Latvijas Banka's composite systemic cyclical risk indicator (hereinafter – the CCRI)[8] has declined from 5.0 points in the third quarter of 2023 to 4.7 points in the third quarter of 2024. It is close to the lower bound of the medium-risk interval (see Chart 11).

[8] 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).

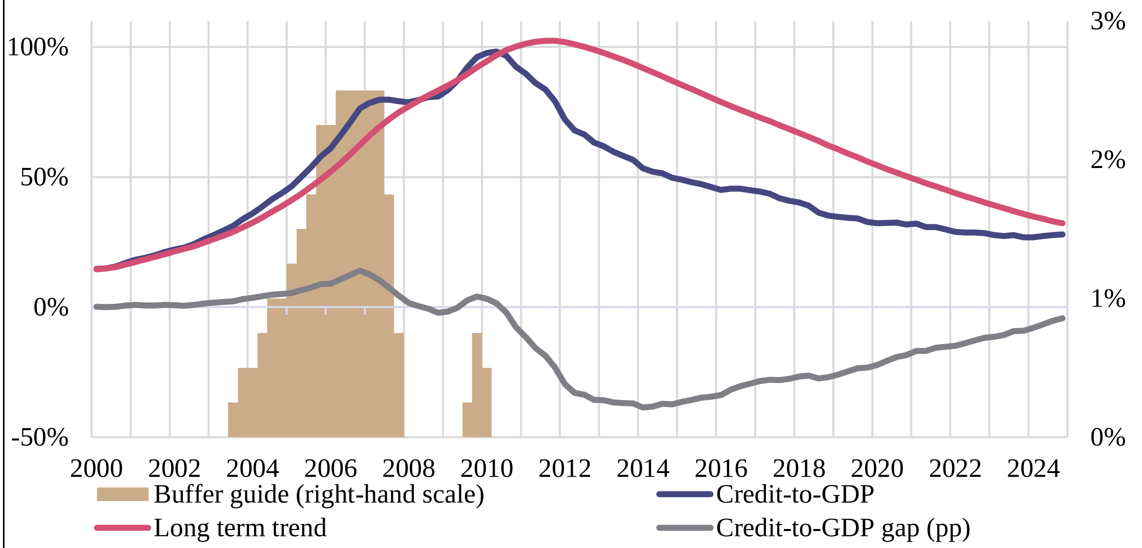
Annex 1. **Key variables of the Financial Cycle**

Chart 1. Standardised credit-to-GDP gap



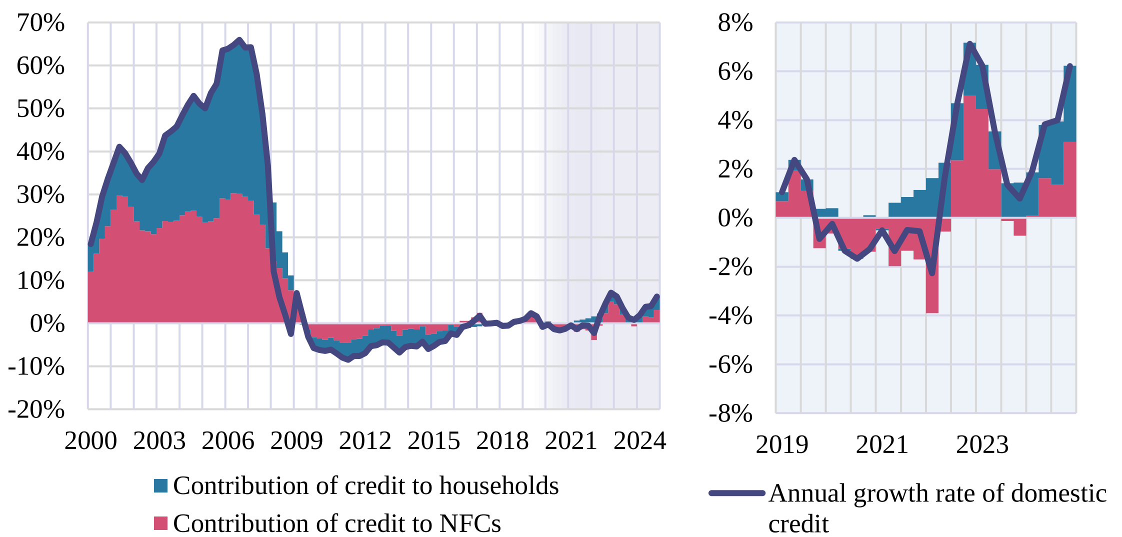
Source: Latvijas Banka, CSB.

Chart 2. Additional credit-to-GDP gap



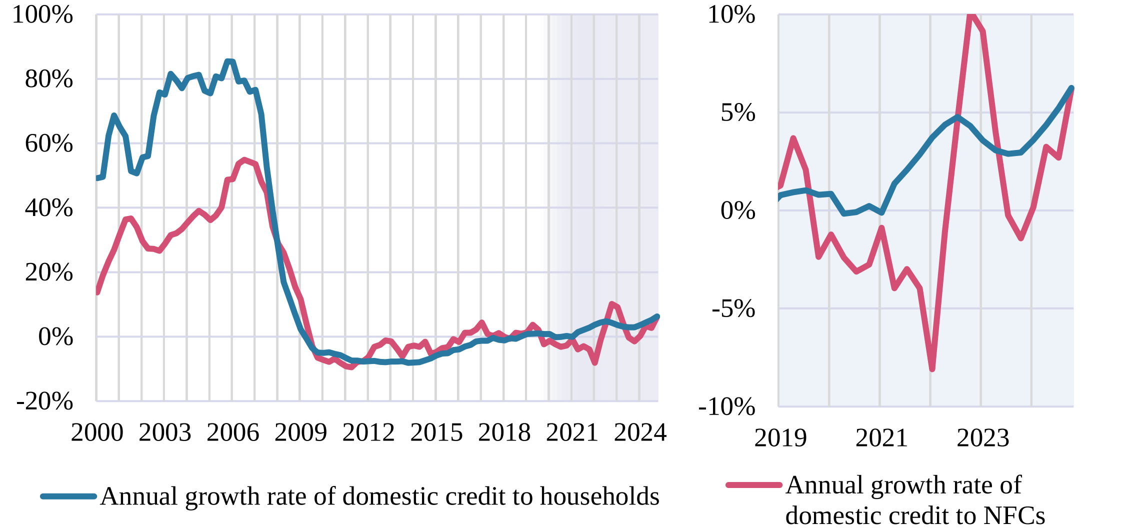
Source: Latvijas Banka, CSB.

Chart 3. Credit developments



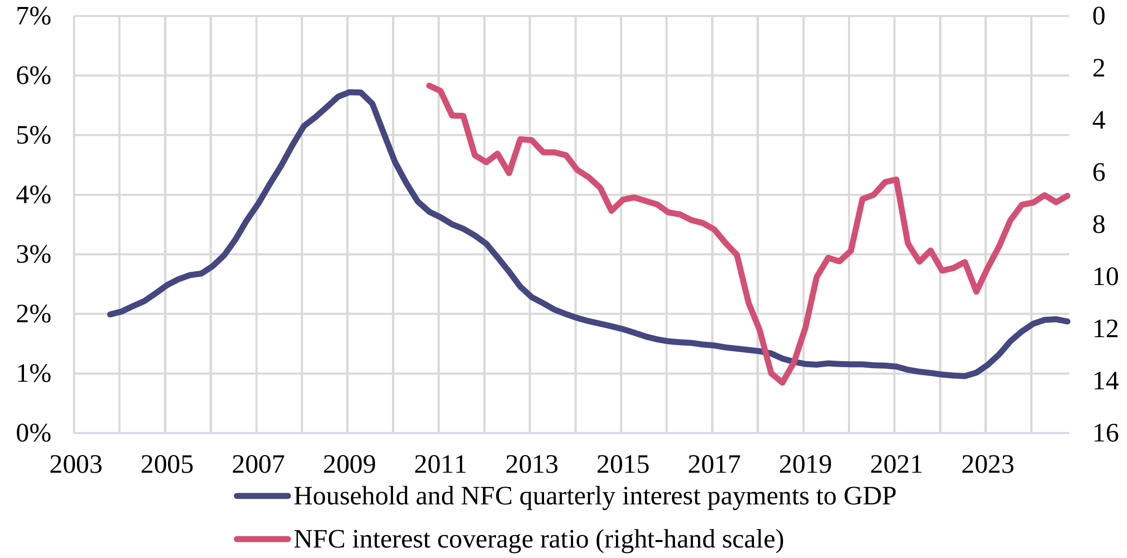
Source: Latvijas Banka, CSB. Note. The credit growth rate excludes overclassification and other one-time effects but includes loan write-offs.

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



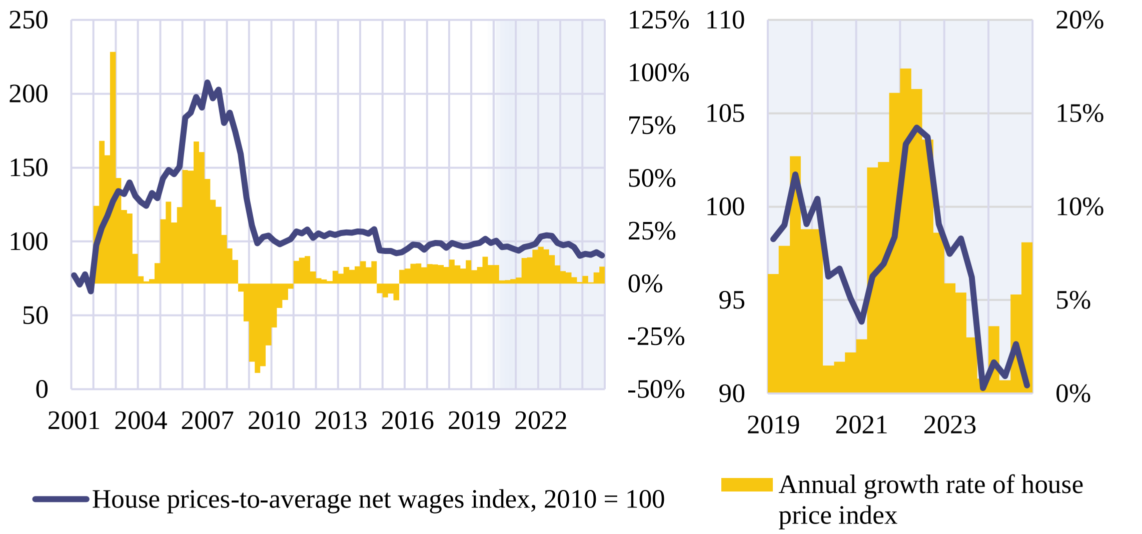
Source: Latvijas Banka, CSB. Note. The credit growth rate excludes overclassification and other one-time effects but includes loan write-offs.

Chart 5. Private non-financial sector debt servicing burden



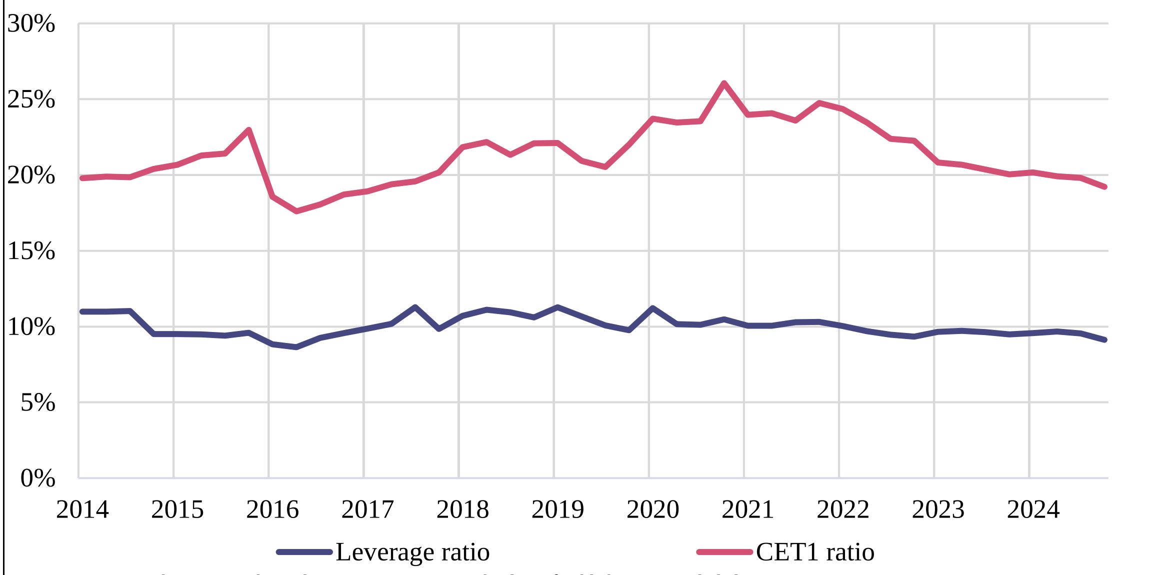
Source: Latvijas Banka, CSB. Note. The NFC interest coverage ratio includes the ratio of earnings before taxes and interest payments to interest payments.

Chart 6. Potential overvaluation of property prices



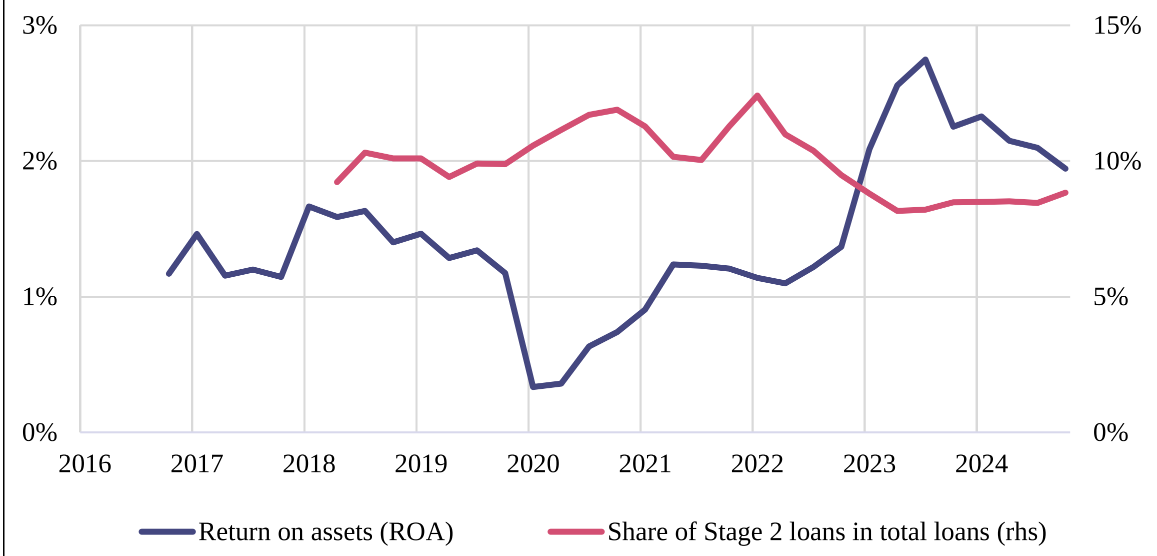
Source: CSB.

Chart 7. Resilience of credit institutions - capitalization



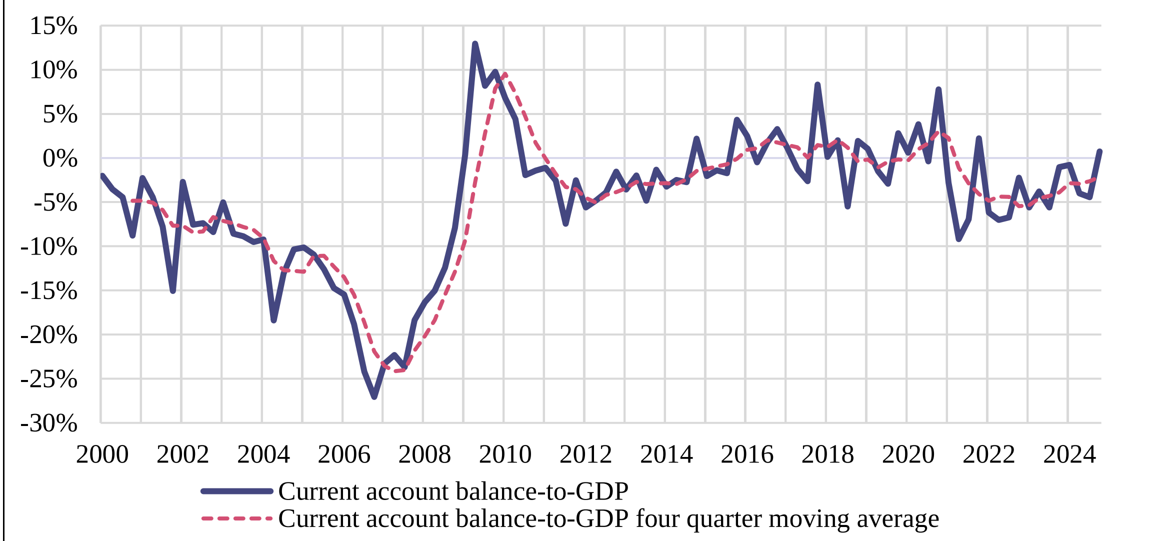
Source: Latvijas Banka. Note. Only credit institutions active at the date of publishing are included.

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



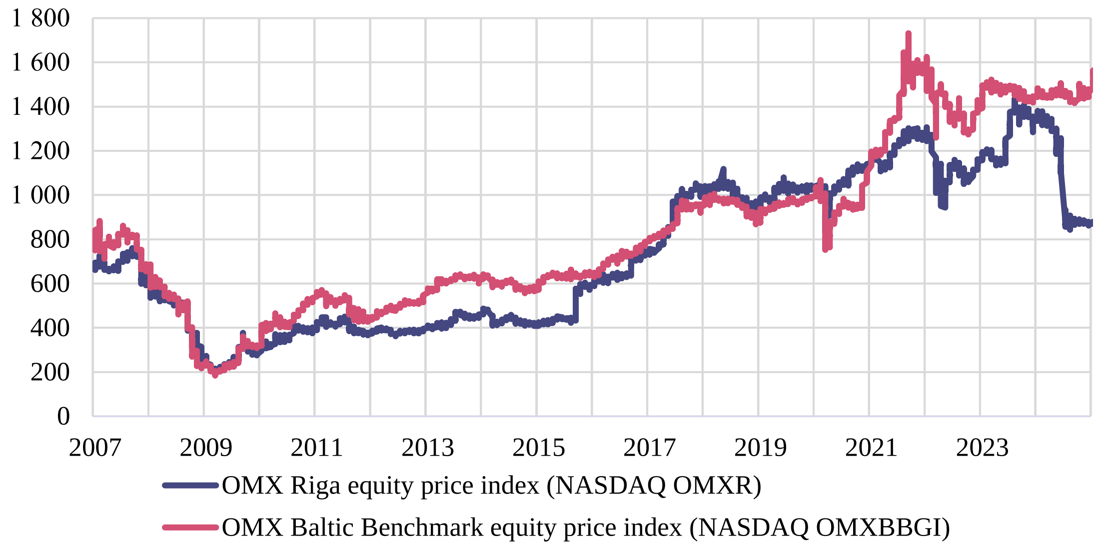
Source: Latvijas Banka. Note. Only credit institutions active at the date of publishing are included.

Chart 9. External imbalances



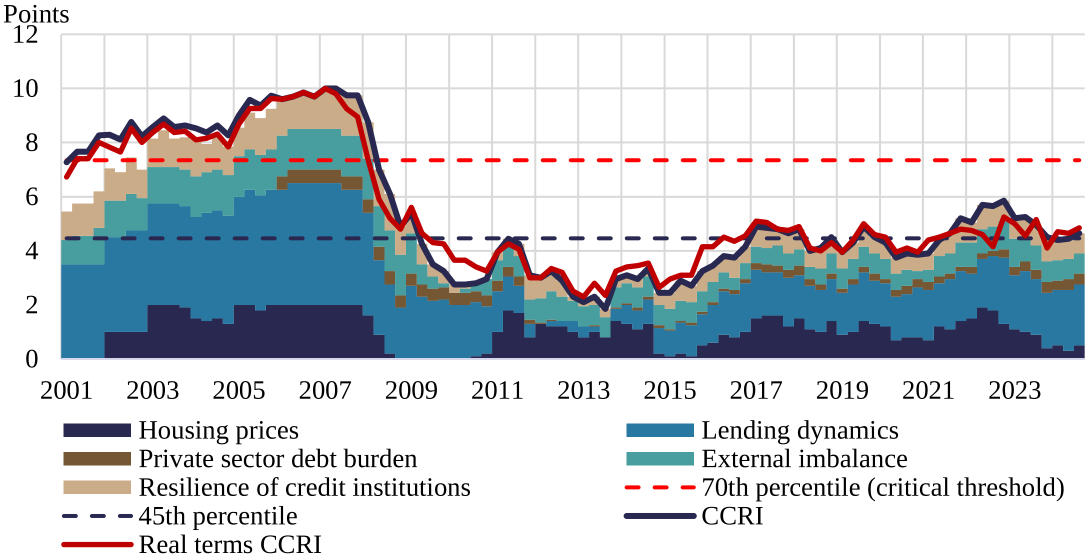
Source: Latvijas Banka, CSB.

Chart 10. Potential mispricing of risk



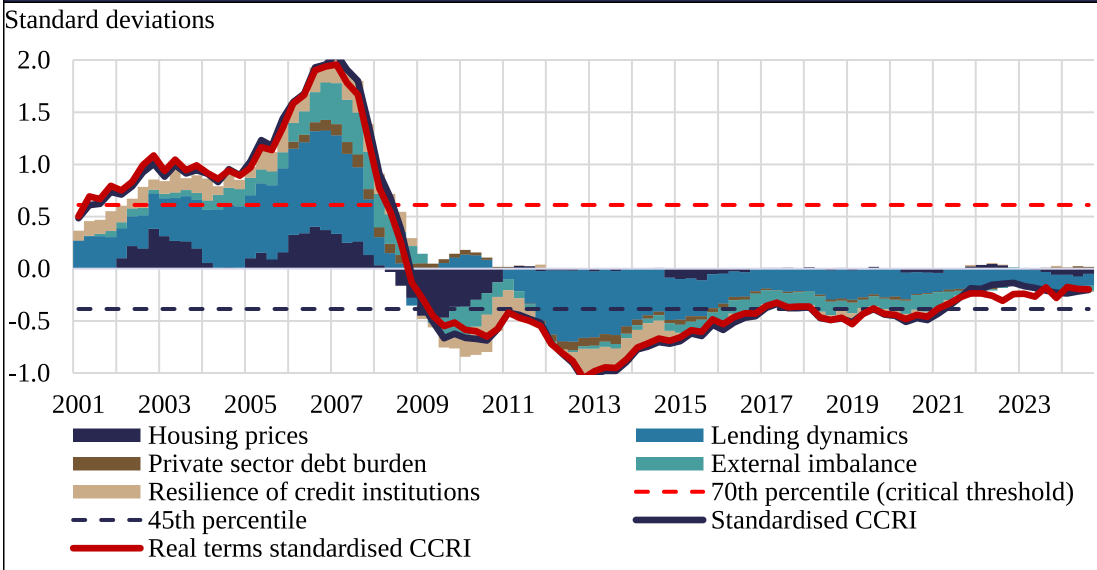
Source: Bloomberg.

Chart 11. CCRI – percentile method



Source: Latvijas Banka, CSB.

Chart 12. CCRI – standardised method



Source: Latvijas Banka, CSB.