



LIETUVOS BANKAS  
EUROSISTEMA

# Countercyclical Capital Buffer

Background material for decision

March

2020

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## DECISION BASIS FOR SETTING THE COUNTERCYCLICAL CAPITAL BUFFER RATE

On 31 March 2020, the Board of the Bank of Lithuania took a decision<sup>1</sup> to set a 0% countercyclical capital buffer (CCyB) rate, with effect from 1 April 2020. It is envisaged that the CCyB rate will not be increased for at least 12 months, i.e. the higher CCyB rate would come into force on 1 April 2022 at the earliest as normally the change takes effect after a transitional 12 month-period. This indicative period will also depend on the further economic and financial developments.

The above-mentioned decision was taken in light of the expected significant negative impact on the Lithuanian economy brought about by (i) weaker external and internal demand amid the COVID-19 outbreak, and (ii) operational restrictions that some companies have been facing as a result of the temporary nationwide quarantine which began on 16 March 2020. Businesses operating in Lithuania are closely interdependent, both due to the increase in trade credits that gained traction in recent years and corporate loans to other firms. Therefore, financial difficulties faced by companies in one sector might quickly spill over to another sector. In addition, available data shows that entities engaged in accommodation, construction, arts, manufacturing, transport and trade activities are more vulnerable in the short term than others, as their abilities to raise financial resources have been more limited due to low profitability. It should be noted that loans granted to some of these companies (transport, trade, manufacturing, accommodation) account for around 20% of the total bank loan portfolio and as much as 50% of the total value of corporate loans.

The shock caused by COVID-19 will undeniably lead to economic contraction, which may turn out to be quite substantial if the current disruption drags on both on a national and international level. Nevertheless, Lithuania's banking sector has adequate buffers to absorb potential losses. Under the U-shaped recession scenario, which is similar to the 2009 global financial crisis, Lithuania's GDP would contract by 11.4% in 2020, while banks' capital adequacy ratio would drop by 8.5 percentage points, remaining in line with the minimum capital requirement. Should the scenario of a V-shaped recession materialise, Lithuania's GDP would decline by 3.4% in 2020, yet banks' capital adequacy ratio would drop by a meagre 1.2 percentage points. A protracted recession and recovery scenario – when the country's GDP would decrease by 20.8% in 2020 – is also possible, albeit highly unlikely.<sup>2</sup>

The CCyB requirement is intended to ensure that the banking sector accumulates sufficient capital to be able to cover potential losses in case of cyclical systemic risk or during periods of economic downturn or stress. At the end of 2017, the Bank of Lithuania took a decision that, given the then-current economic upturn, with no financial imbalances, relatively high credit and RE market activity and profitable banking activities, banks needed to gradually accumulate a 1% CCyB. From 31 December 2018, national banks became subject to a 0.5% CCyB requirement. Since 30 June 2019 the CCyB rate has been set at 1%. When the positive CCyB rate was set, it was emphasised that the CCyB rate would be further increased if any financial imbalances were to be observed, and, conversely, reduced in view of economic shocks or a shift in the financial cycle to the recession phase.

At the end of 2019, credit institutions managed to accumulate a €86 million CCyB buffer. It is expected to not only help them absorb potential losses, but also give a stronger footing to plan further lending. The release of the buffer should allow banks to provide up to €1 billion in loans to businesses and residents, which could enhance the real economy.

According to available data (until the end of 2019), there were no significant imbalances in Lithuania's financial system. The gap between the credit-to-GDP ratio and its long-term trend continued to narrow yet remained negative. Corporate liabilities increased significantly, although bank lending to firms was contracting. Growth in the housing loan portfolio remained strong, even though the growth rate of the household loan portfolio has slightly decelerated. RE prices were close to their fundamental value. Other indicators did not show increasing imbalances either: the loan-to-deposit ratio decreased further to 92%, the current account balance was positive (2.5% of GDP), whereas the house price-to-income ratio declined.<sup>3</sup>

<sup>1</sup> Resolution No 03-40 of the Board of the Bank of Lithuania of 31 March 2020 on the application of the countercyclical capital buffer.

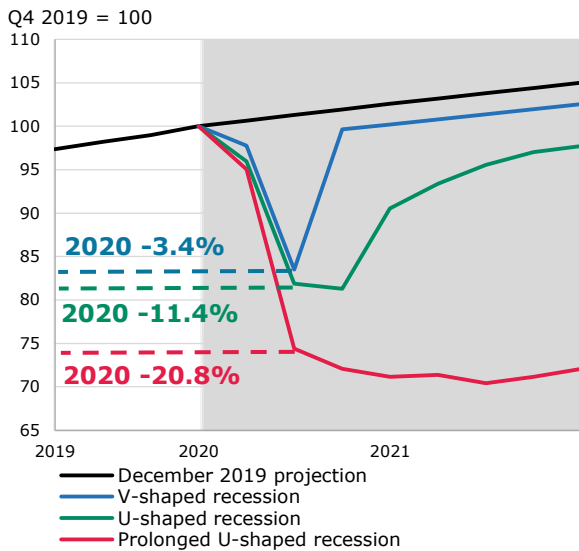
<sup>2</sup> For more information, see the [Bank of Lithuania's press release \(26 March 2020\)](#).

<sup>3</sup> More detailed information on trends and imbalances in the credit and housing market until end-2019 is provided in Annex 1 and 2.

## ANNEX 1. CREDIT AND HOUSING MARKET TRENDS

Chart 1. Lithuania's GDP dynamics, projection and potential scenarios

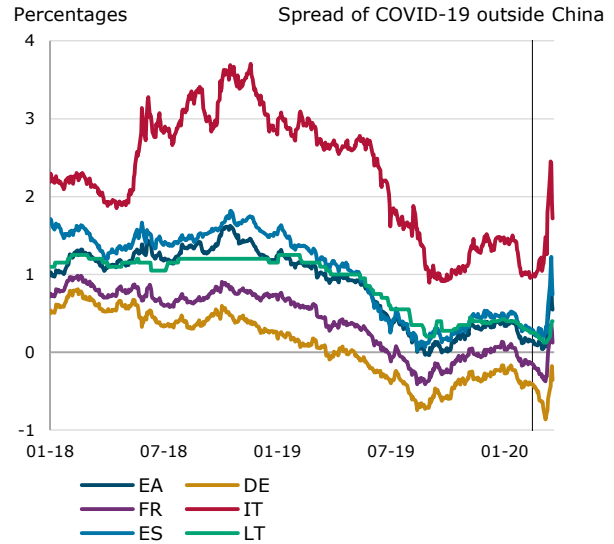
(Q1 2019–Q4 2019 – data;  
Q1 2020 –Q4 2021 – projection)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Chart 2. Euro area government bond yields

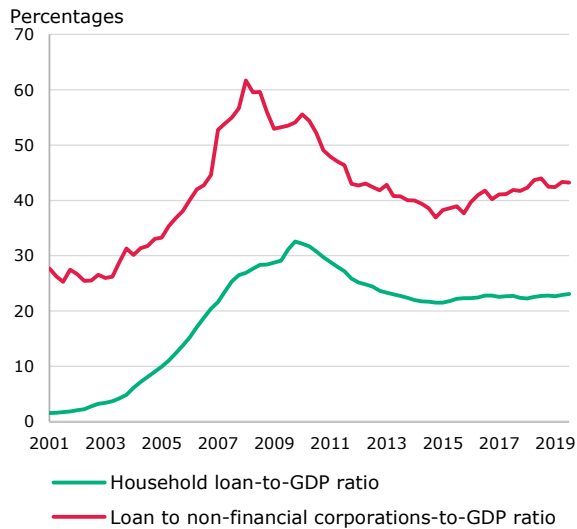
(1 January 2018–25 March 2020)



Sources: Thomson Reuters and ECB.

Chart 3. Ratio of non-financial corporation and household credit to GDP

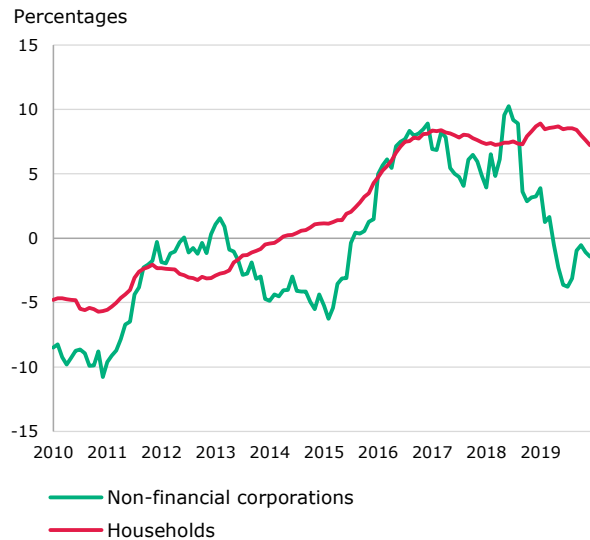
(Q1 2001–Q3 2019)



Source: Bank of Lithuania.

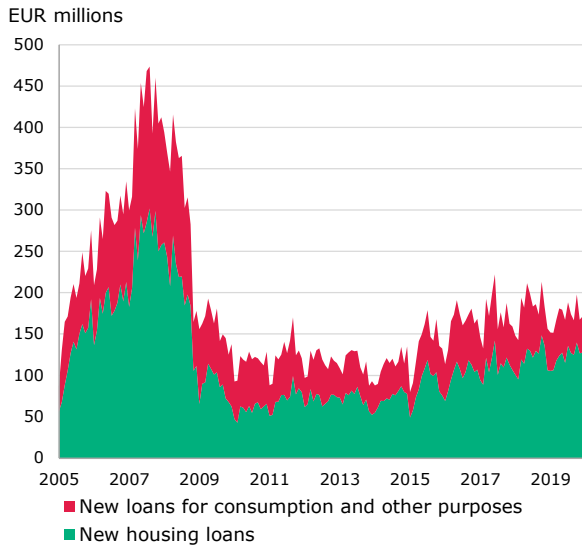
Chart 4. Annual growth of the portfolio of MFI loans to non-financial corporations and households

(January 2010–December 2019)



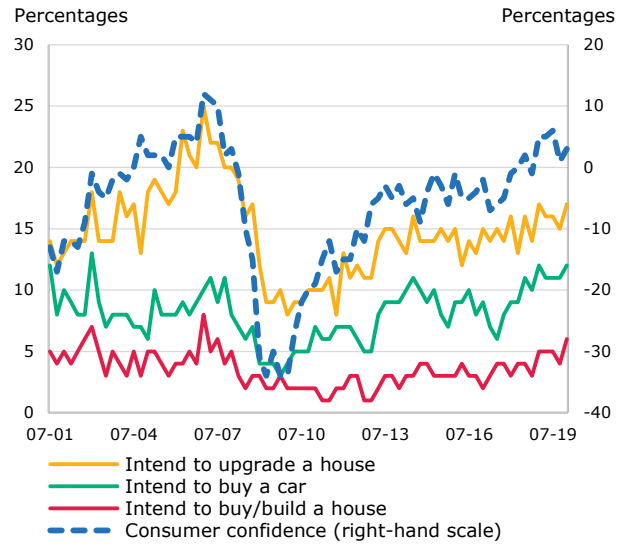
Source: Bank of Lithuania.

Chart 5. Flow of new MFI loans to households  
(January 2005–December 2019)



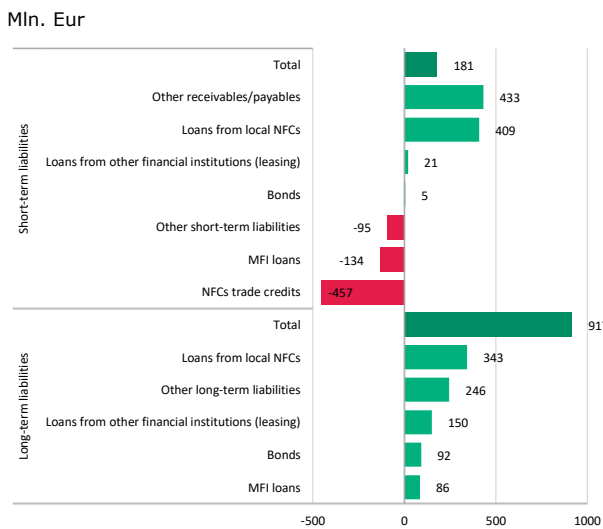
Source: Bank of Lithuania.

Chart 6. Consumer survey results  
(July 2001–January 2020)



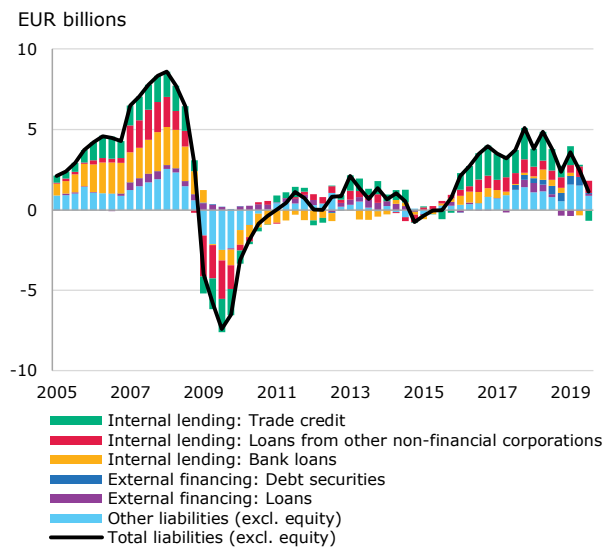
Sources: Statistics Lithuania and Bank of Lithuania

Chart 7. Annual change in non-financial corporation short-term and long-term obligations  
(Q3 2018–Q3 2019)



Source: Bank of Lithuania.

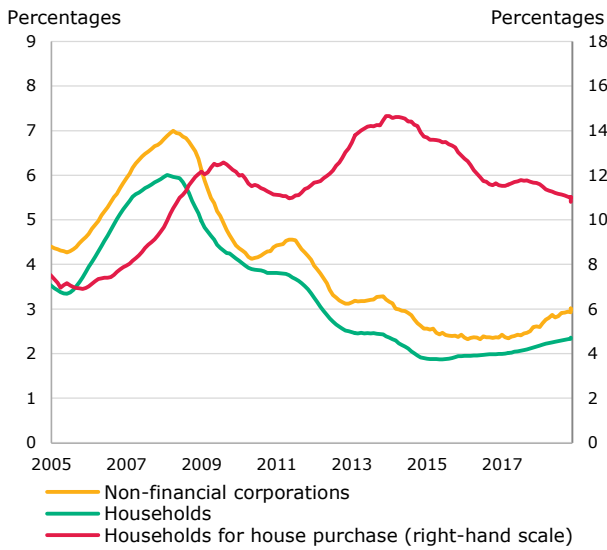
Chart 8. Annual change in credit granted to non-financial corporations  
(Q1 2005–Q3 2019)



Source: Bank of Lithuania.

Chart 9. Average weighted interest rates on new loans to non-financial corporations and households (12-month moving average)

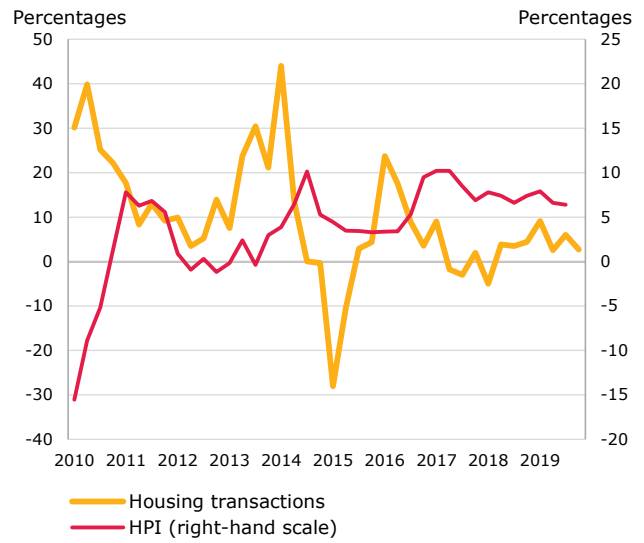
(October 2005–December 2019)



Source: Bank of Lithuania.

Chart 10. Annual change in the number of housing transactions and the house price index (HPI)

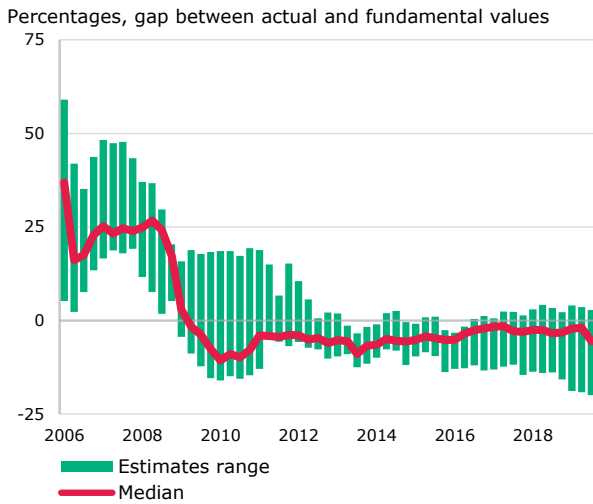
(Q1 2010–Q4 2019)



Sources: Centre of Registers and Statistics Lithuania.

Chart 11. Gap between actual house prices and their fundamental values

(Q1 2006–Q3 2019)

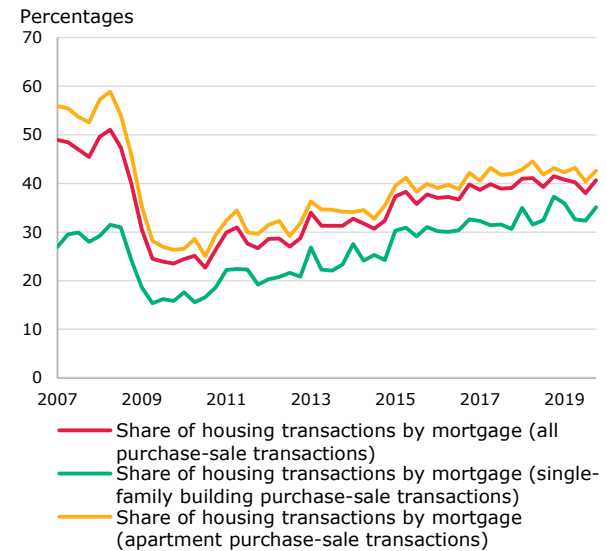


Source: Bank of Lithuania.

Note: Calculated based on the house price-to-rent ratio, house price-to-income ratio, an econometric model and the HP filter.

Chart 12. Share of housing transactions by mortgage

(Q1 2007–Q4 2019)

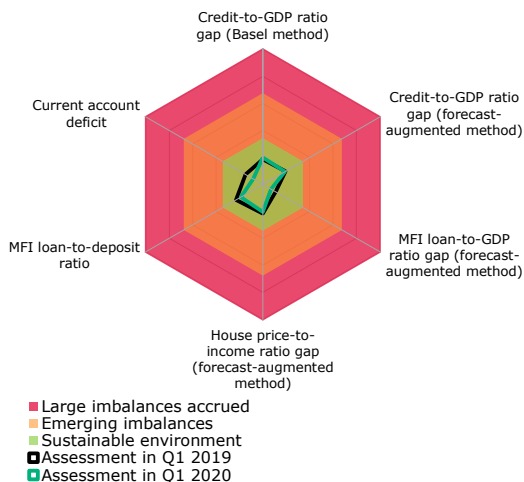


Source: Centre of Registers.

## ANNEX 2. CREDIT AND HOUSING MARKET IMBALANCES

Chart A. Evaluation of credit market imbalances based on core and additional indicators

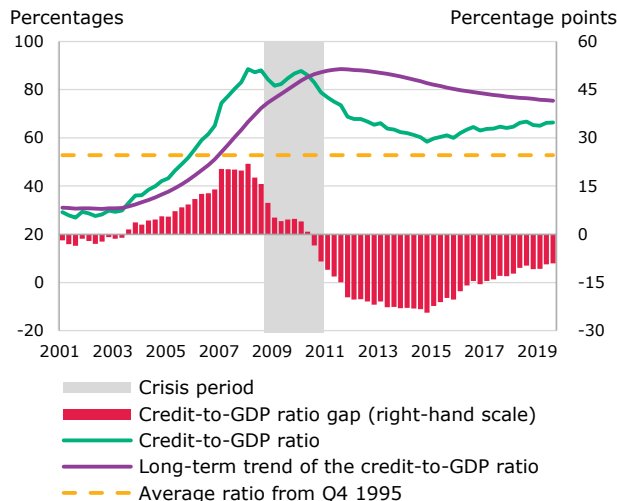
(Q1 2020)



Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Note: Axes are scaled according to the range of a particular indicator: from its minimal value up to the maximal value.

Chart B. Core indicator I: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the standardised Basel method)

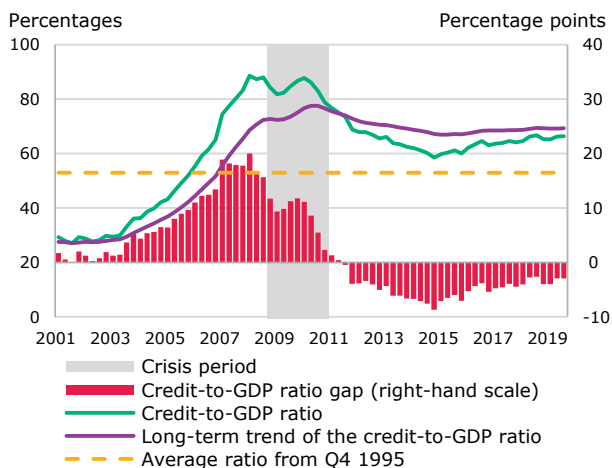
(Q1 2001–Q3 2019)



Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Note: The long-term trend is computed using a one-sided HP filter with a smoothing parameter of 400,000.

Chart C. Core indicator II: Credit to the private non-financial sector-to-GDP ratio gap (based on the forecast-augmented method)

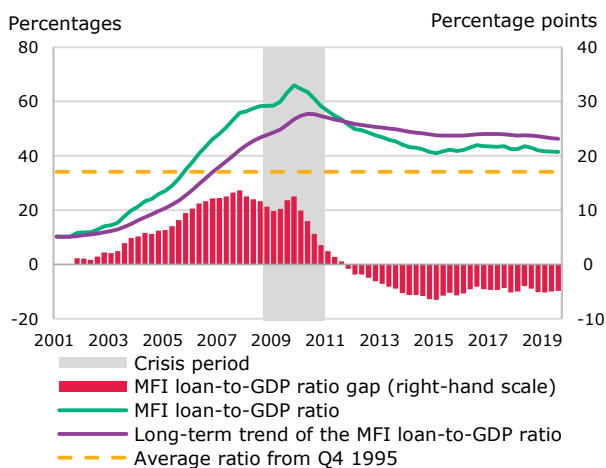
(Q1 2001–Q3 2019)



Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Note: The long-term trend is computed by applying a one-sided HP filter with a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next 5-year window using a 4-quarter weighted average.

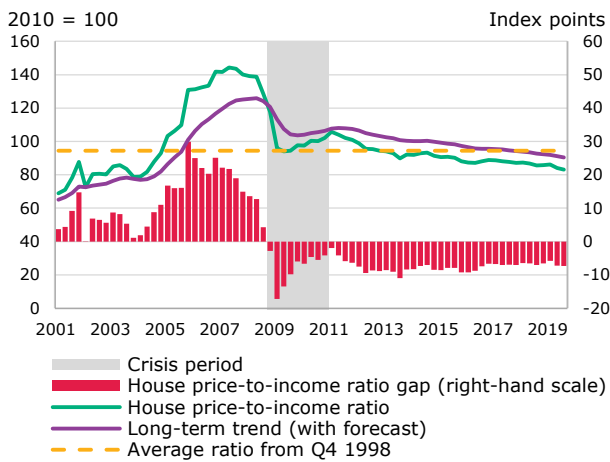
Chart D. Additional indicator I: MFI loan to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method)

(Q1 2001–Q4 2019)



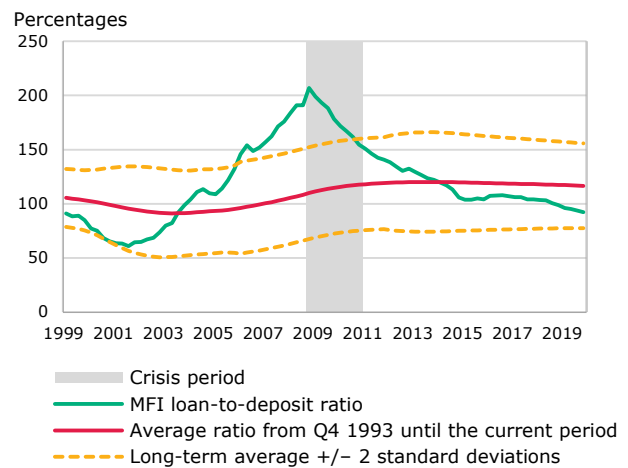
Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Note: The long-term trend is computed by applying a one-sided HP filter with a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next 5-year window using a 4-quarter weighted average.

Chart E. Additional indicator II: House price-to-income ratio gap (calculated using the forecast-augmented method) (Q1 2001–Q3 2019)



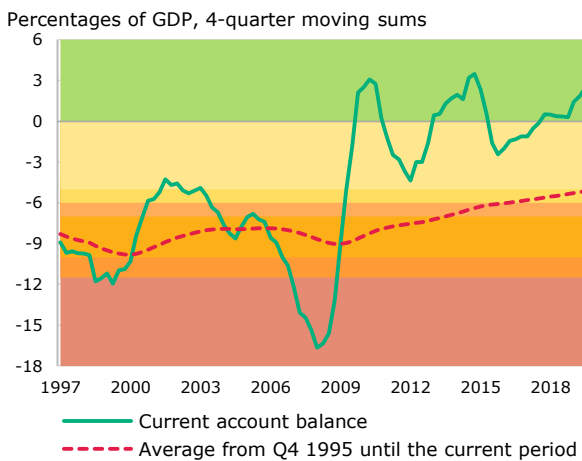
Sources: Statistics Lithuania and Bank of Lithuania calculations.  
Notes: 1) income – household wages and salaries; 2) the long-term trend is estimated by applying a one-sided HP filter with a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next 5-year window using a 4-quarter weighted average.

Chart F. Additional indicator III: Ratio of MFI loans to the private sector to private sector deposits (adjusted for seasonal effects) (Q1 1999–Q4 2019)



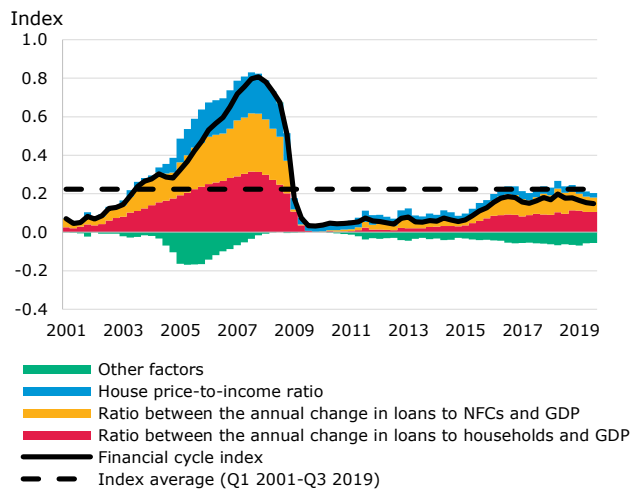
Source: Bank of Lithuania calculations.  
Note: The ratio develops in a balanced way if it does not deviate from its long-term average by more than two standard deviations. Standard deviation is computed on the basis of data covering the period of moderate changes in the ratio, excluding data for Q2 2006–Q4 2011.

Chart G. Additional indicator IV: Ratio between the current account balance (4-quarter moving sums) and GDP (Q1 1997–Q3 2019)



Sources: Statistics Lithuania and Bank of Lithuania calculations.  
Note: Different colours indicate different levels of risk which have been set based on Reinhart S. M. and V. R. Reinhart (2008): "Capital flow bonanzas: An encompassing of the past and present", NBER working paper, 14321.

Chart H. Contributions to Lithuania's financial cycle index (Q1 2001–Q3 2019)



Sources: Statistics Lithuania and Bank of Lithuania calculations.  
Note: Since 2020, the financial cycle index has been calculated following a broader definition of credit (covering all credits granted to non-financial corporations and households regardless of the credit provider).