Quarterly decision of the National Bank of Belgium on the countercyclical buffer rate (1 January 2016): 0 %

Pursuant to Art. 5 §2 Annex IV to the Banking Law, the National Bank of Belgium has decided in its regulation of 24 November 2015[1], to set the countercyclical buffer rate for exposures in Belgium at 0 %. This countercyclical buffer rate is immediately effective.

Justification

1. The countercyclical capital buffer is a macroprudential instrument designed to mitigate cyclical systemic risks and to counter pro-cyclicality in lending. Its objective is to support the sustainable provision of credit through the cycle by strengthening the resilience of banks. In particular, capital buffers are imposed whenever there is an increase in cyclical systemic risks (i.e. with excessive growth in lending), so that these additional requirements can be relaxed when the cycle turns and the risks start to decline. If risks emerge – in a situation of financial stress for instance – a decision can be taken to release the buffer instantly in order to give the banks some extra breathing space and thus put them in a better position to absorb losses and keep up their level of lending when the economic and financial environment is vulnerable. The countercyclical buffer rate, expressed as a percentage of banks' risk-weighted assets, is generally between 0 and 2.5 %, but can be set higher when justified by the underlying risk. It should be noted that the countercyclical capital buffer is only one of the macroprudential instruments available to the National Bank of Belgium for achieving its mission of contributing to the stability of the financial system.
2. Pursuant to Article 5 of Annex IV to the Law of 25 April 2014 on the legal status and supervision of credit institutions, the National Bank of Belgium sets each quarter the countercyclical buffer rate applicable to credit exposures to counterparties located on Belgian territory on the basis of one or more reference indicators that reflect the credit cycle and the risks stemming from excessive credit growth in Belgium, and that account for the specific elements of the national economy. These indicators shall include the deviation of the credit-to-GDP ratio from its long-term trend (the credit-to-GDP gap), accounting for the change in volumes of credit granted on Belgian territory and the evolution of Belgian GDP, the recommendations issued by the ESRB, and any other variable that the National Bank of Belgium deems relevant to capture cyclical systemic risk.
3. The National Bank of Belgium sets the countercyclical buffer rate pursuant to its policy strategy regarding the countercyclical capital buffer published on 1 January 2016.[2] In line with the Basel III framework and the ESRB Recommendation of 18 June 2014 on guidance for setting countercyclical buffer rates, the quarterly decision on the countercyclical buffer rate is partially based on a 'buffer guide' derived from the credit-to-GDP gap.[3] Given the specific features of the domestic financial system and statistical properties of the credit series monitored, the National Bank of Belgium sets the credit-to-GDP variable on the basis of resident bank loans. The quarterly decision on the countercyclical buffer rate also takes into account additional macrofinancial indicators, including broader credit measures. More generally, the analysis for the countercyclical capital buffer forms an integral part of the National Bank of Belgium's overall risk assessment framework, which covers a broad range of threats to the stability of the financial system.

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[1] NBB Regulation of 24 November 2015 on determining the rate of the countercyclical tier 1 capital conservation buffer, as approved by Royal Decree of 25 November 2015, *M.B.* of 4 December 2015.

[2] 'Setting the countercyclical buffer rate in Belgium: a policy strategy'.

[3] The buffer guide is the result of the credit-to-GDP gap being mapped into a benchmark buffer rate, as specified in the ESRB Recommendation of 18 June 2014 on guidance for setting countercyclical buffer rates. The benchmark buffer rate equals 0 % for credit-to-GDP gap levels up to 2 percentage points. When the credit-to-GDP gap exceeds 2 percentage points, the benchmark buffer rate increases linearly, reaching its maximum level of 2.5 % for credit-to-GDP gap levels of 10 percentage points and higher.

4. Credit cycle

The credit-to-GDP gap and other credit cycle variables do not currently indicate a build-up of excessive imbalances in credit. The credit-to-GDP gap of the non-financial private sector for 2015Q3 remained slightly negative, i.e. -0.9 % GDP, compared to -1.0 % GDP in the previous quarter.

While this negative gap is partly caused by a methodological revision of the outstanding loan volumes (related to the reclassification of entities across institutional sectors in the national accounts), loan growth series confirm that lending to the non-financial private sector remains below average, in particular for NFCs. Credit growth for households has picked up recently, but the sector-specific credit-to-GDP gap still points to an approximately neutral stance of the credit cycle.

On the basis of the current stance of the credit-to-GDP gap, the ‘buffer guide’ suggests a benchmark buffer rate of 0 %.

In addition to the credit-to-GDP gap statistics, the National Bank of Belgium also closely monitors and factors additional credit indicators into its decision. These indicators confirm the credit-to-GDP gap analysis and corroborate the decision to set the initial countercyclical buffer rate at 0 %.

5. Non-financial private sector resilience

Notwithstanding the further increase and the high level of the gross debt ratio of the non-financial private sector (113.1 % GDP in 2015Q2), concerns on imminent and broad-based debt sustainability problems remain largely absent in the Belgian market.

Mainly driven by mortgage loans, the household debt ratio has been increasing further over the recent period. It reached its highest level (58.8 % of GDP) in the first quarter of 2015, and stabilised in the second quarter. The overall financial position of the Belgian households, as measured by their net financial assets in relation to GDP, is still strong even though, following the recent financial market turmoil, it has deteriorated slightly, from 240.1 % – its historical peak – in the first quarter of 2015 to 237.1 % in the second quarter. It must, however, also be underlined that these aggregated data mask an uneven distribution of assets and liabilities at the level of the households. Consequently, some pockets of risk exist as vulnerable households, in particular the youngest and low-income ones, may lack the financial reserves to service their mortgage loans in the event of large negative income shocks.

Risks have nonetheless been mitigated by the tightening of banks’ credit standards on new mortgages that followed the macroprudential measures taken by the NBB in the last quarter of 2013 – in particular the decision to impose a 5-percentage-point increase in the risk-weights assigned to mortgage credits calculated using internal ratings-based models – as well as by the fall in long-term interest rates, which was particularly marked in 2014 and in the first half of 2015, and allowed people to refinance existing loans at lower interest rates. At the current juncture the default rate on mortgage credit remains low.

The debt[4] of Belgian non-financial corporations remains high in historical terms, at 54.3 % of GDP. The recent increase in that ratio is attributable to the issuance of debt securities by larger companies for which financing costs on financial markets are favourable. Bank lending growth picked up recently, but remains below nominal GDP growth, resulting in a slight decrease of bank loans relative to GDP. On the whole, the financial situation of Belgian firms remains sound, with net liabilities expressed as a percentage of GDP at a lower level than their euro area counterparts. The outstanding amount of cash reserves, in particular, was still large at the end of the second quarter or 2015, supported by an expanding gross operating surplus.

[4] Debt securities and loans, excluding loans of non-financial corporations granted by other resident non-financial corporations, ’captive financial institutions and non-institutional money lenders’ and the non-banking foreign sector.

6. Financial and asset markets

   Notwithstanding increased volatility, imminent risks stemming from financial and asset markets remain relatively contained. The recent world-wide correction of financial markets also affected equity prices (BEL 20) and led, in terms of P/E ratios, to less stretched valuations. Notwithstanding this correction, higher market volatility on international markets may trigger increased stress and generate substantial downside risks for the equity markets. So far, however, the impact on the real economy remains small. Housing market developments (data up to 2014Q4) have slowed down somewhat, with nominal and real price increases decelerating on a yearly basis and volatility remaining low.

7. Banking sector resilience

   Bank balance sheet indicators do not point to any immediate sustainability concerns. Banks are well-capitalised and the other indicators largely comply with the minimum regulatory requirements too. Moreover, banks can rely on a wide deposit base, which has continued to expand. Credit risk on lending to the domestic private sector continues to be low, as indicated by the low level of loan losses, confirming the sound asset quality and sustained debt servicing capacity of the private sector. Other exposures, mainly on the foreign sectors, increased somewhat, but remain low compared to pre-crisis levels, illustrating that, in case of external shocks, banks would be less affected than they were before crisis.

   In spite of these developments, the prospects for future bank profitability as well as that of other financial sub-sectors, continue to be weak within a low interest, low growth environment. These developments might induce greater risk-taking and search for yield. Targeted measures (extension of the add-on to the risk-weight for banks using internal ratings-based models in 2016) have been taken in view of some initial signs of relaxation of certain credit standards for households in recent months.

Overall, taking the buffer guide and the other relevant indicators into account, the National Bank of Belgium has decided to set the countercyclical buffer rate for exposures in Belgium at 0 %. This countercyclical buffer rate is immediately effective.

Key indicators[1]

Variable	Unit	Latest period	Value
Non-financial private sector credit cycle (resident bank loans)			
Credit-to-GDP gap	% GDP	2015 Q3	-0.9
Households	% GDP	2015 Q3	-0.1
Non-financial corporations	% GDP	2015 Q3	-0.8
Bank loan growth	y-o-y %	2015 Q3	3.7
Households	y-o-y %	2015 Q3	5.1
Non-financial corporations	y-o-y %	2015 Q3	1.3
p.m. Credit-to-GDP ratio[2]	*% GDP*	*2015 Q3*	*76.5*
Non-financial private sector resilience			
Debt-to-GDP ratio	% GDP	2015 Q2	113.1
Households	% GDP	2015 Q2	58.8
Non-financial corporations	% GDP	2015 Q2	54.3
Net financial assets	% GDP	2015 Q2	145.2
Financial and assets markets			
Equity prices, nominal (BEL 20)	y-o-y %	2015 M10	12.5
Price-earnings ratio (BEL 20)[3]	–	2015 M10	21.1
House prices, nominal	y-o-y %	2014 Q4	0.6
House prices, real	y-o-y %	2014 Q4	0.5
10-year government bond yield	% points/y	2015 Q3	1.0
Bank lending rate on mortgage loans to households	% points/y	2015 Q3	2.5
Bank lending rate on loans to non-financial corporations	% points/y	2015 Q3	2.2
Banking sector resilience			
CET 1 capital ratio	%	2015 Q2	15.1
Equity-to-total assets ratio	%	2015 Q2	6.5
Loan-to-deposit ratio	%	2015 Q2	94.1

Source: NBB.

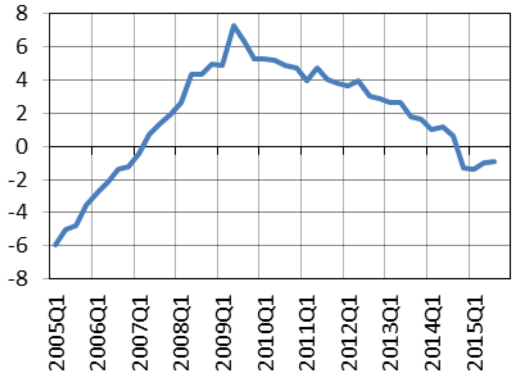
1 Monthly averages for daily data. Data are shown end of quarter (March, June, September, December) or for the latest month available.

2 Outstanding amounts of loans granted by resident monetary financial institutions to households and non-financial corporations, including those securitised and otherwise transferred, in percentage of GDP.

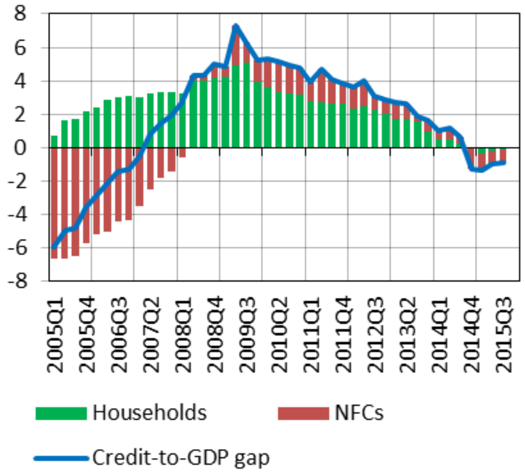
3 Price earnings (P/E) ratio is a trailing (12 months) P/E ratio.

STATISTICAL ANNEX

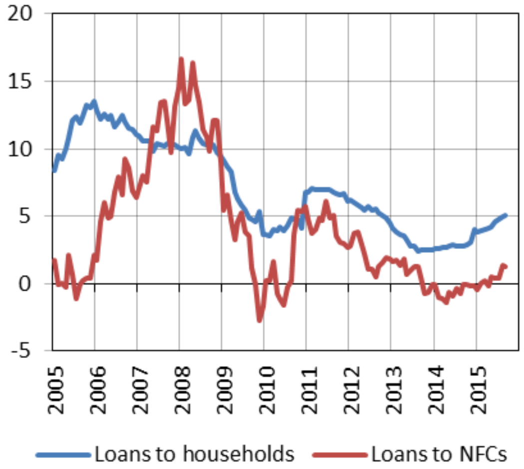
Credit-to-GDP gap
(quarterly data, % of GDP)



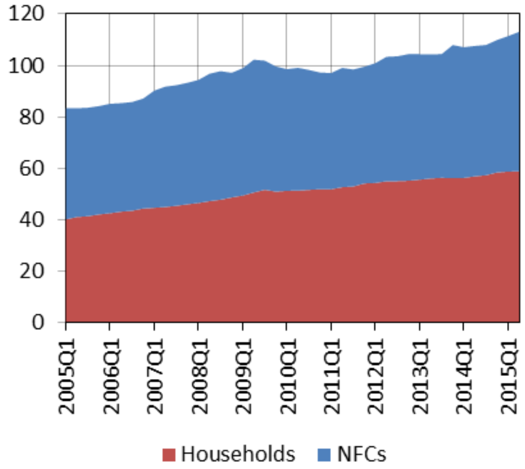
Credit-to-GDP gap: sectoral breakdown
(quarterly data, contributions in % of GDP)



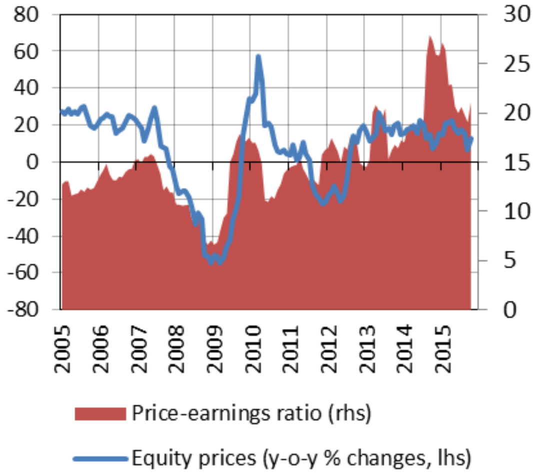
Bank loan growth
(monthly data, y-o-y % changes)



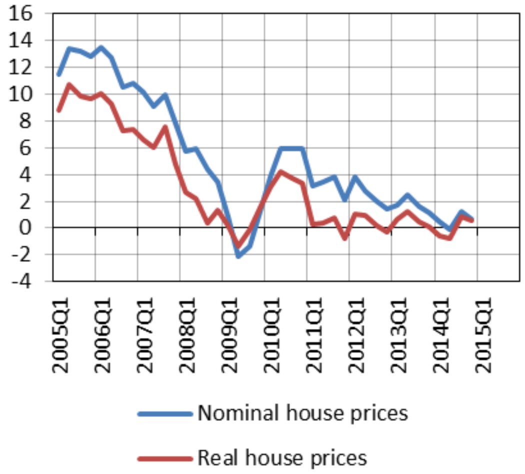
Non-financial private sector debt
(quarterly data, % of GDP)



Equity prices
(monthly data, BEL 20 index)



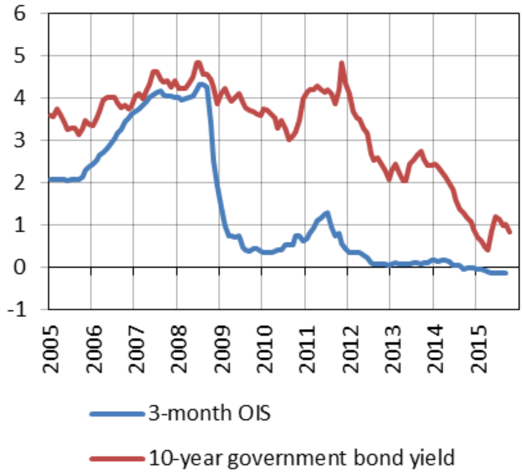
House prices
(quarterly data, y-o-y % changes)



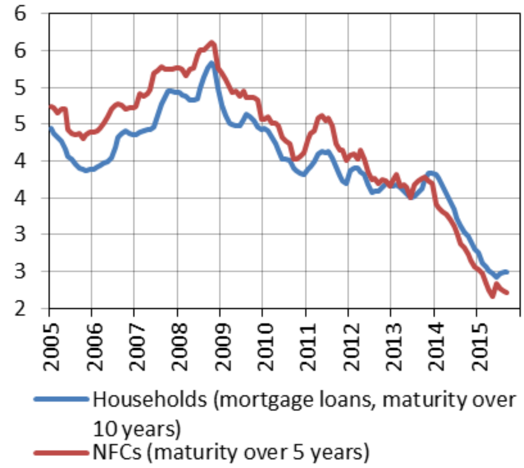
Sources: Thomson Reuters, NBB.

STATISTICAL ANNEX (cont.)

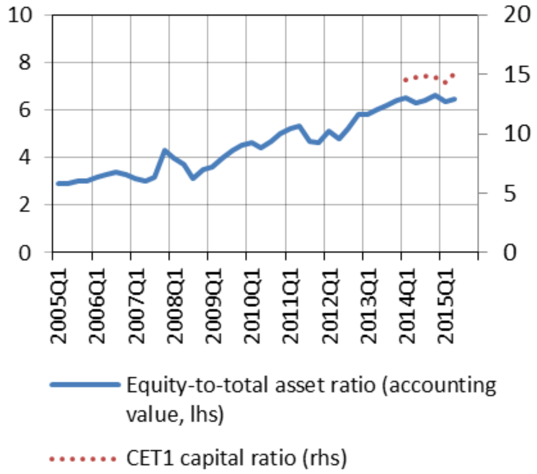
Short- and long-term interest rates
(monthly data, % points per year)



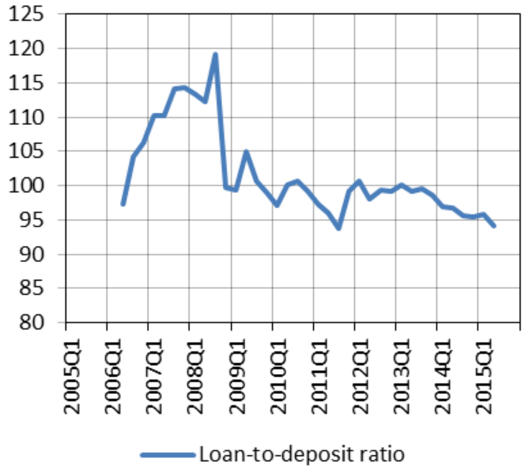
Bank lending rates
(monthly data, % points per year)



Bank solvency
(quarterly data, %)



Loan-to-deposit ratio
(quarterly data, %)



Source: NBB.