LATVIJAS BANKA
EIROSISTĒMA

2025 Q3 assessment of the systemic cyclical risk and applicable countercyclical capital buffer rate

2025 | September

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 to implement a positive neutral CCyB approach. 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 accordance with the Council's decision of 18 December 2023, a 1% CCyB rate will take effect from 18 June 2025.

As cyclical risk increases, the CCyB rate should be raised proportionally to the intensity of the risk, starting already from the base rate. Thus, the total CCyB requirement consists of the base rate and the cyclical component, which is assessed on a quarterly basis. In times of crisis, as well as during the recovery period following a crisis, the CCyB rate may be reduced or released.

In accordance with the cyclical risk assessment for 2025 Q2, **Latvijas Banka has decided not to increase the cyclical component of the CCyB.**

The decision of Latvijas Banka regarding the applicable CCyB rate, adopted on December 18, 2023, remains in force.

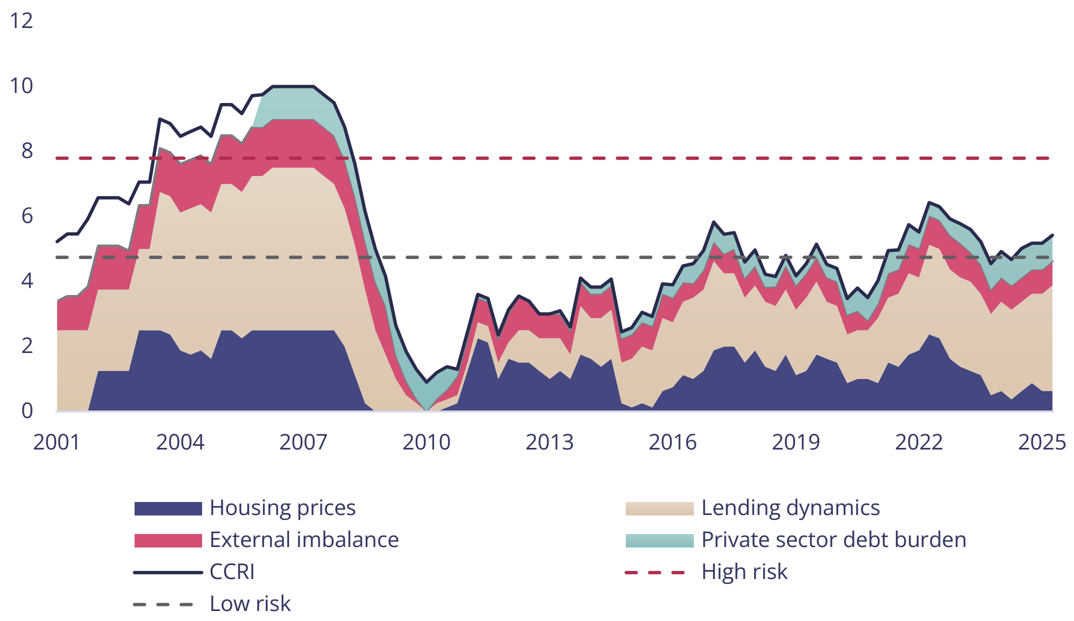
Overall, the cyclical risk level in Latvia remains low, with early signs of increase.

Domestic lending activity has increased significantly; however, the level of private non-financial sector debt remains low.

Activity in the real estate market is generally in a phase of moderate growth and varies across different market segments. As wage growth continues to outpace the average increase in housing prices, housing affordability is improving.

Domestic economic growth is picking up, though it remains modest. Private consumption is weak, while the rise in investment is largely driven by government spending. Economic development is significantly influenced by external uncertainties, consumer and investor sentiment, as well as government expenditure policy.

Composite cyclical risk indicator (CCRI)



Composite cyclical risk indicator (CCRI) reached 5.4 points in 2025 Q2, which is a slight increase compared to 5.2 points in 2024 Q4. The CCRI slightly above the lower bound of the medium risk range.

For more details on the CCRI, see Latvijas Bankas 2025 Financial Stability Report.

Sources: Latvijas Banka, Central Statistical Bureau of Latvia (CSB), Latvijas Banka's calculations

The credit-to-GDP gap of the private non-financial sector continues to decrease; however, it remains negative according to both – standardized and additional credit definitions.

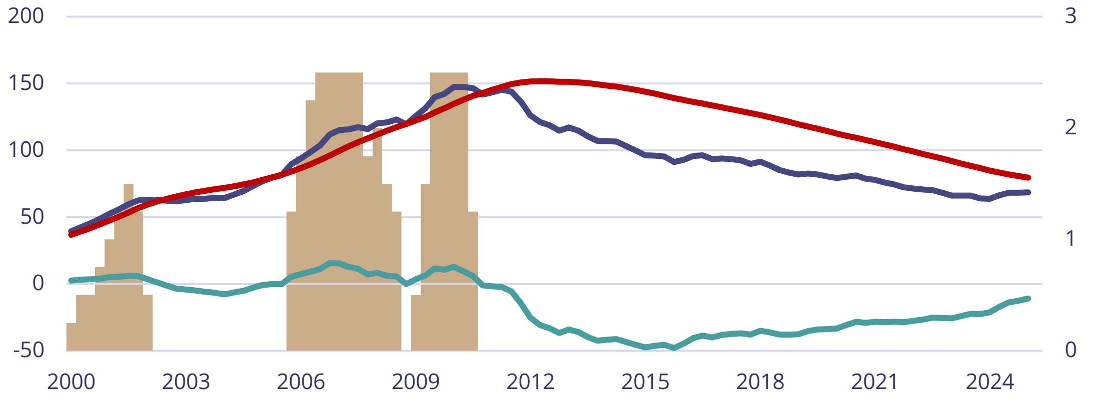
The buffer guide is 0%.

	Standardised credit definition 2025 Q1	**Additional** credit definition 2025 Q2
Credit-to-GDP ratio (%)	68.5	32.4
Credit-to-GDP gap (pp)	-11.0	-2.9
Benchmark buffer rate (% from TREA)	0	0

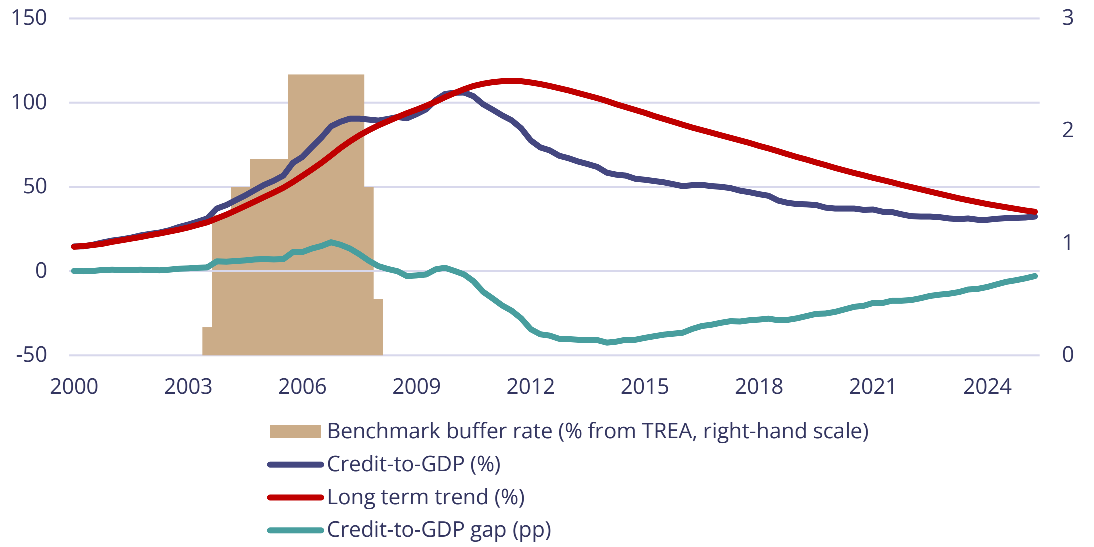
Standardized credit definition – liabilities of non-financial corporations (hereinafter – NFCs) and households to credit institutions, as well as their loans from non-bank financial institutions or other NFCs.

Additional credit definition – bank loans to NFCs and households, and holdings of NFCs debt securities, and loans granted by banks' leasing subsidiaries.

Standardised credit-to-GDP gap

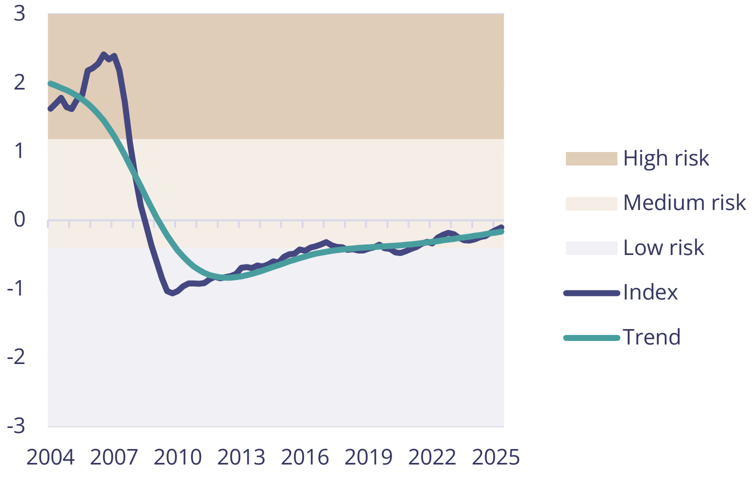


Additional credit-to-GDP gap

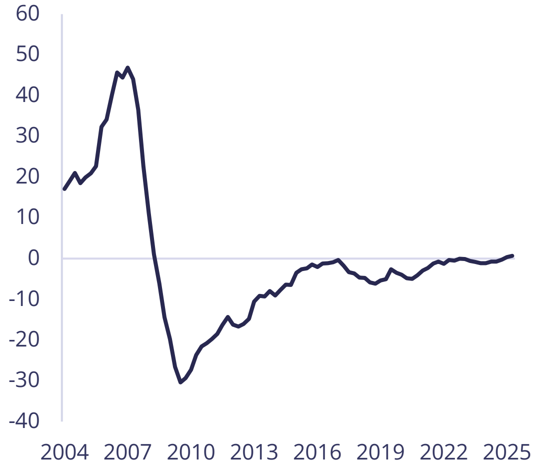


Sources: Latvijas Banka, CSB, Latvijas Banka's calculations

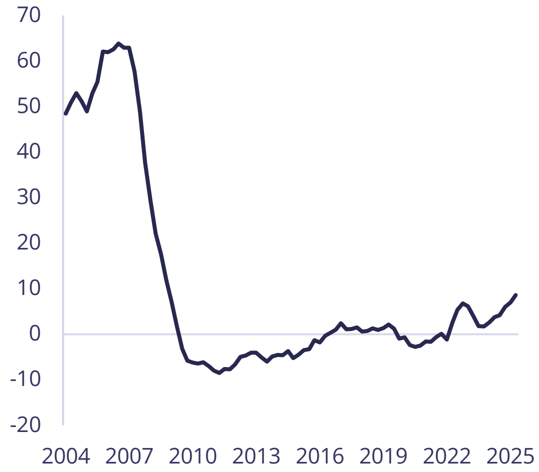
Credit developments index



Credit to 7-year GDP annual difference, percentage points 2)



Household and NFC credit annual growth rate, % 1), 2)

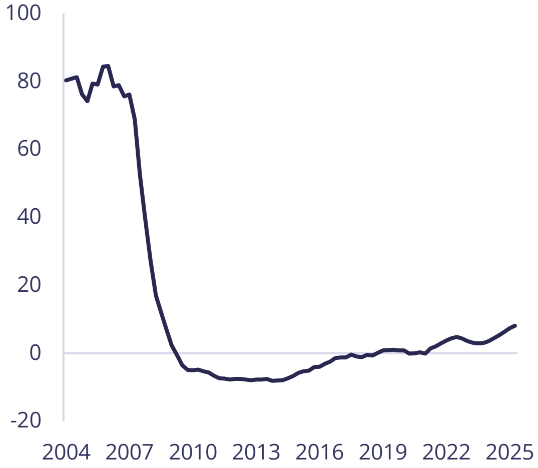


Domestic lending continues to increase. In the second quarter of 2025 and in July, the outstanding loans issued to households and NFCs increased year-on-year by 9.4% and 11.8%, respectively (including 8.1% and 8.6% for households, and 10.9% and 15.3% for NFCs).

Lending growth is supported both by rising demand from households and NFCs – driven by lower interest rates and the realization of deferred demand – and by a more active supply of loans from credit institutions. The supply is further underpinned by the Solidarity Contribution Law adopted in 2024, which incentivizes credit institutions to increase lending volumes in order to qualify for a contribution discount.

Nevertheless, the further development of lending remains constrained by elevated uncertainty, borrower caution, and geopolitical risks. Despite the current growth, lending activity may subside following the expiry of the Solidarity Contribution application period.

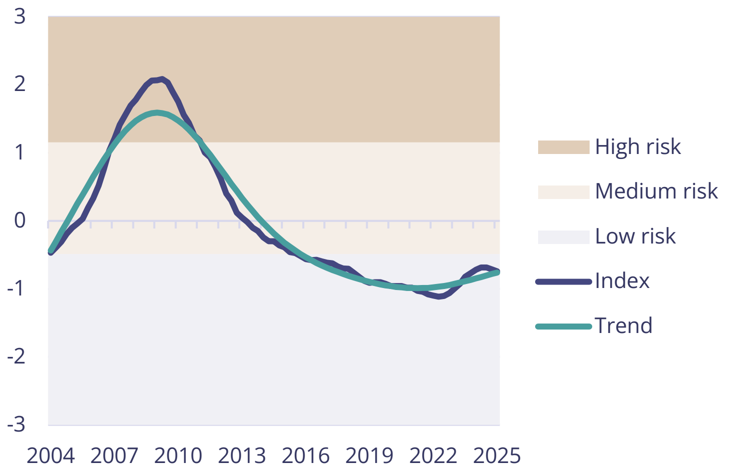
Household credit annual growth rate, % 1)



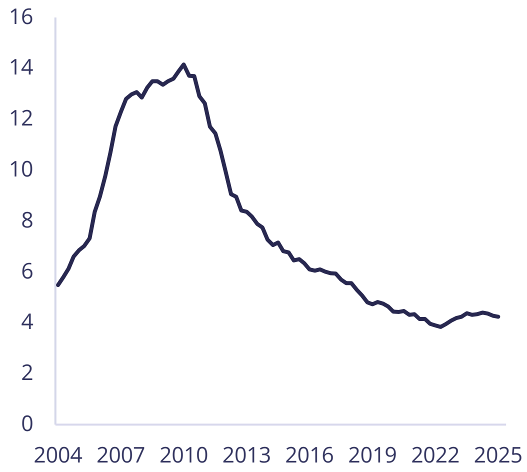
1) Reclassifications and other one-time effects are excluded from the loan growth rate, but the effect of written-off loans is not excluded.
2) Including loans issued by bank subsidiaries.

Sources: Latvijas Banka, CSB, Latvijas Banka's calculations

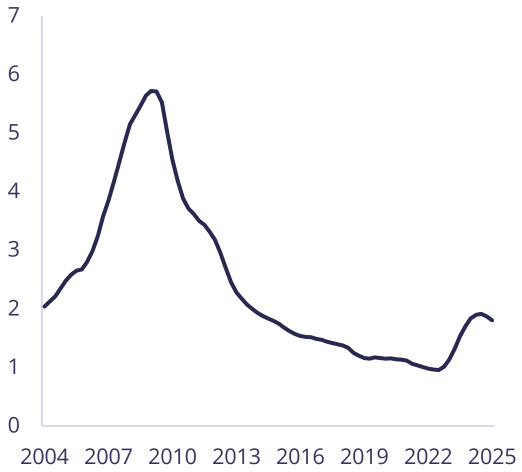
Private sector debt burden index



Household and NFC debt service ratio, %



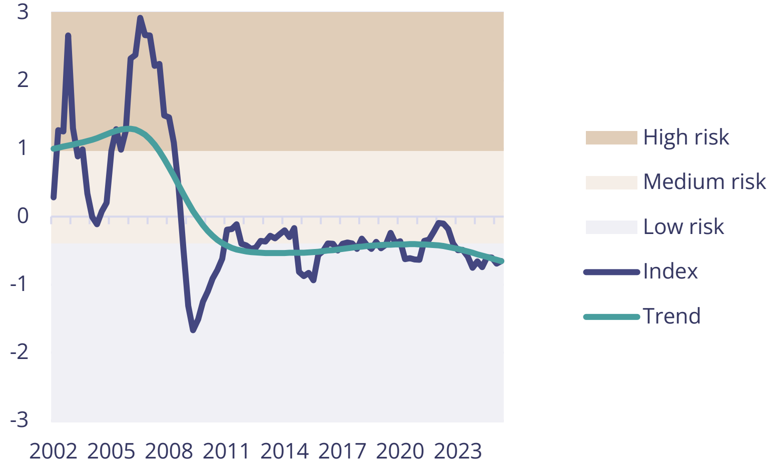
Household and NFC annual interest payments to GDP, %



The debt of the private non-financial sector is low. Along with the gradual decrease in interest rates, the ratio of interest payments on private non-financial sector loans to GDP has also slightly decreased. The financial resilience of borrowers remains good.

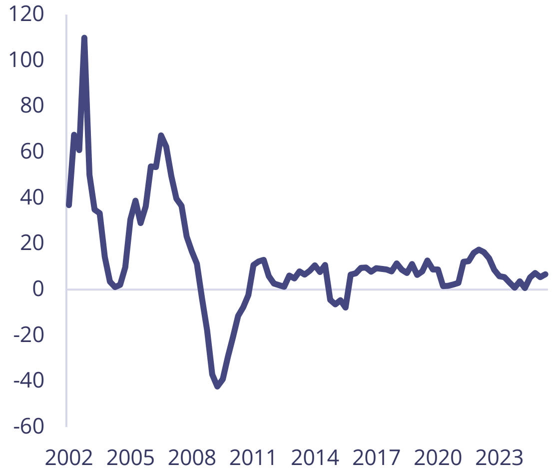
Sources: Latvijas Banka, CSB, Latvijas Banka's calculations

Potential overvaluation of property prices index



House prices-to-average net wages index, 2010 = 100

CSB's house price annual growth rate, %



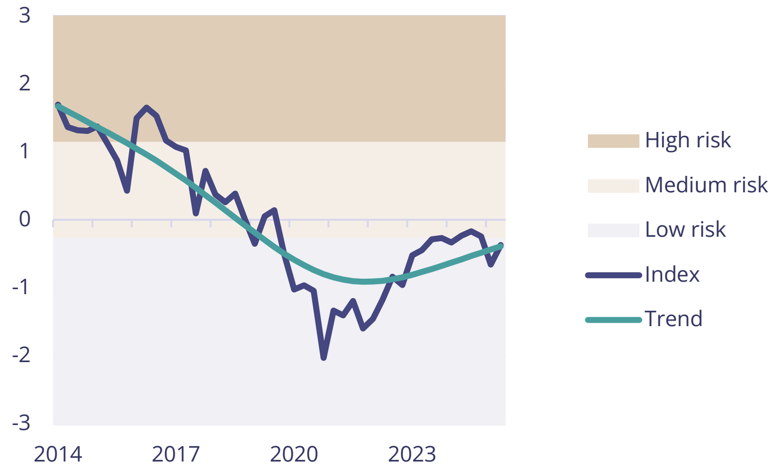
Overall, activity in the real estate market remains moderate. Growth is evident in the housing segment, particularly in transactions involving new apartments, while activity in the land segment is declining. In the second quarter of 2025, compared to the corresponding period of the previous year, the total number of real estate purchase transactions decreased by 3.1%. This included a 15.0% decline in land transactions and a 9.0% increase in housing transactions. Transactions involving new apartments rose markedly (by 40.8%), although in absolute terms, the number of such transactions remains relatively limited. At the same time, transactions with standard-type apartments – which continue to constitute the largest share of the housing market – increased by 3.9%.

Housing affordability continues to improve. Sustained wage growth, together with the recent decline in interest rates, has contributed to an improvement in household solvency. Meanwhile, **the increase in housing prices remains moderate.**

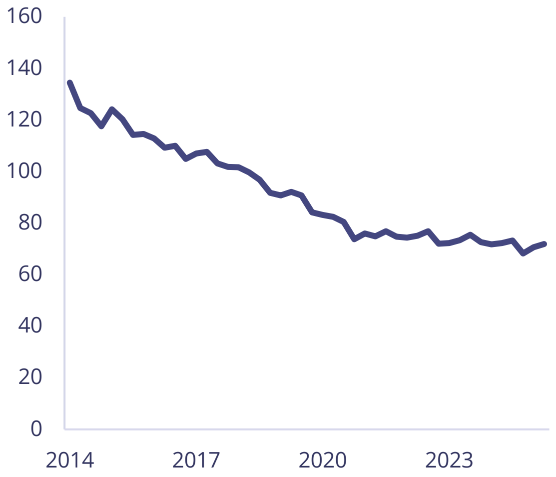
According to data from the CSB, in the second quarter of 2025, overall housing prices increased by 6.7% year-on-year. Within this, the prices of new housing were only 1.2% higher than a year earlier and 3.1% higher than in the previous quarter. The average price level for new housing is influenced by the relatively small number of transactions and the heterogeneous nature of supply in this segment. According to data from the real estate company "Latio", the prices of standard-type apartments increased by only 1.3% year-on-year in the second quarter of 2025.

Sources: CSB, Latvijas Banka's calculations

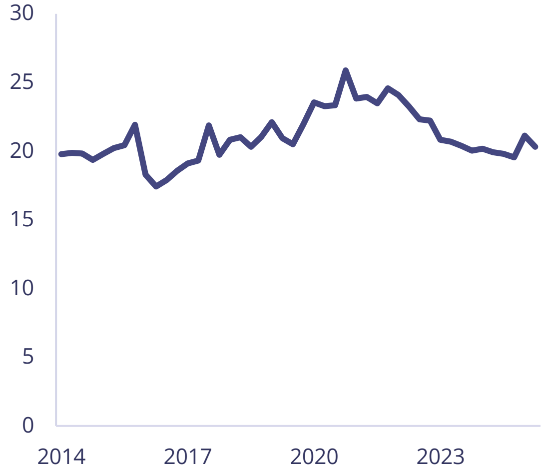
Strength of bank balance sheets index



The ratio of domestic credit to deposits, %



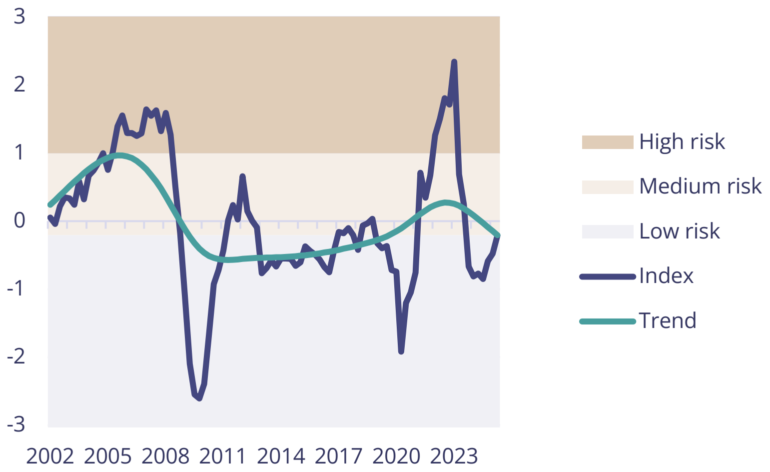
CET1 ratio, %



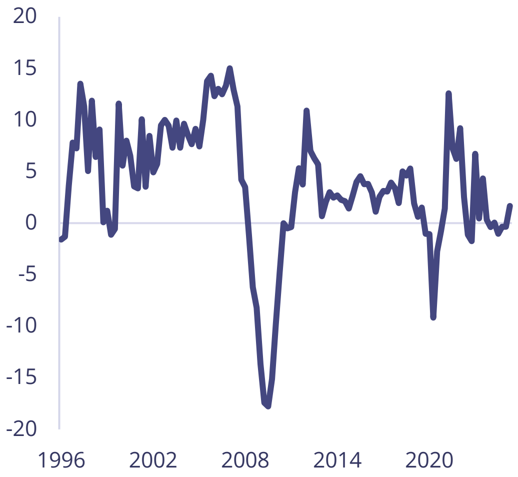
The indicators of the strength of bank balance sheets – bank capitalization, as well as profitability and asset quality – are very good. The ratio of bank loans to deposits remains consistently low.

Sources: Latvijas Banka, Latvijas Banka's calculations

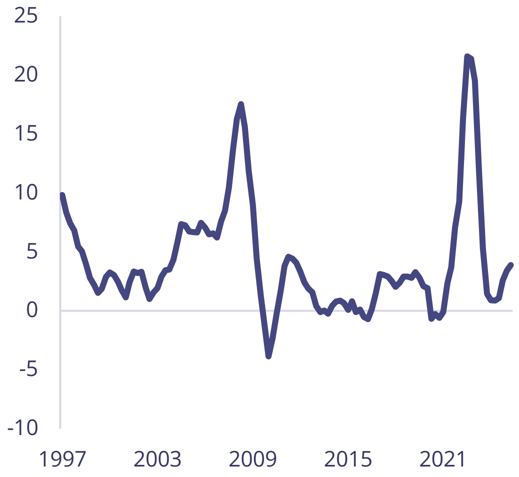
Macroeconomic environment index



Real GDP annual growth rate, %



HICP annual growth rate, %



Economic growth is improving, yet it remains weak. In the second quarter of 2025, Latvia's GDP increased by 0.4% compared to the previous quarter and by 0.6% compared to the corresponding period of the previous year (seasonally adjusted data).

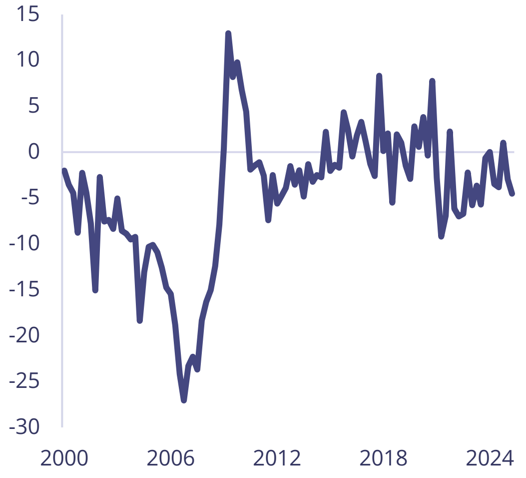
Investment activity is strong, supported by the implementation of EU-funded projects, including "Rail Baltica" and infrastructure development. Private consumption remains subdued. Despite an increase in household income, real expenditures show no growth, while savings continue to accumulate.

Economic development will continue to be influenced by external uncertainties, consumer and investor sentiment, as well as government expenditure policy, with a projected increase in defence spending.

Inflation remains persistent. As of August 2025, the average annual increase in consumer prices in Latvia was 4.1%. The inflation forecast for 2025 has been revised upwards to 3.4%, primarily owing to a stronger increase in food and service prices than was anticipated in earlier projections.

Sources: CSB, Latvijas Banka's calculations

Current account balance-to-GDP, %



In the second quarter of 2025, the current account deficit reached 4.5% of GDP.

The main factor contributing to the deficit was a decline in goods exports, which was adversely affected by weak external demand and exchange rate fluctuations in selected markets.

The increase in EURIBOR since 2022 has directly contributed to a reduction in margins, as the overall interest rate on loans rose less than EURIBOR, while the funding costs for banks did not increase as rapidly as EURIBOR.

Over the past two years, the decline in margins has also been influenced by policy measures aimed at promoting competition in the structurally weak banking sector, thereby improving household refinancing opportunities.

Difference between interest rate on newly issued housing loans to households and 6-month EURIBOR, pp

Sources: Latvijas Banka, CSB, Latvijas Banka's calculations, The European Money Markets Institute.