2025 Q4 assessment of the systemic cyclical risk and applicable countercyclical capital buffer rate

2025 | December

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 Q4, **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.

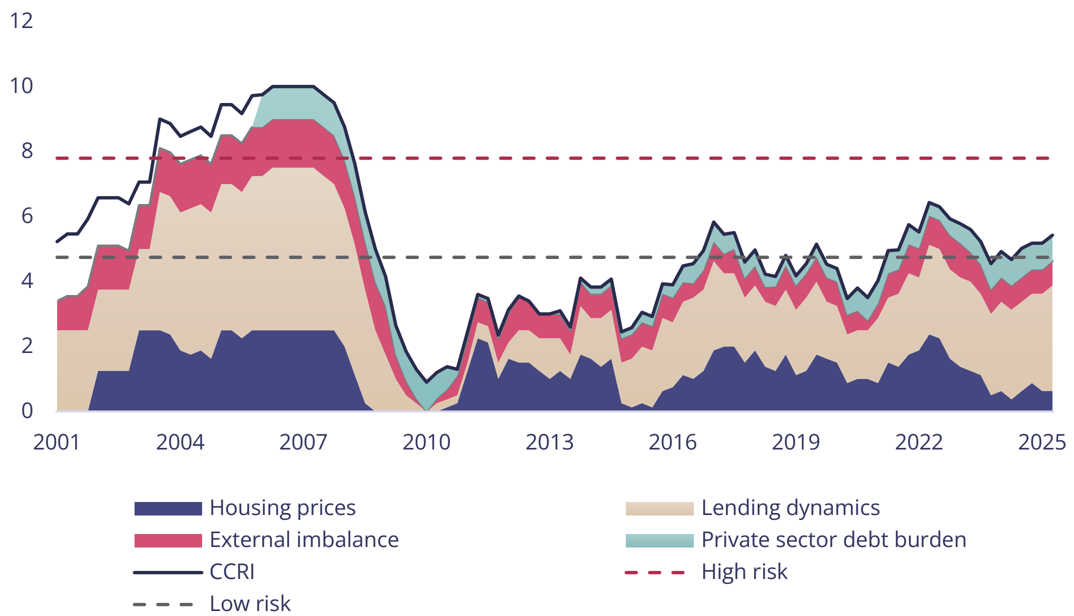
Overall, the cyclical risk level in Latvia remains low, though it is gradually approaching a medium level as lending activity increases.

Lending activity has grown significantly; however, it is developing from a persistently low base, and private sector debt remains low.

The real estate market is in a phase of moderate growth, with uneven activity across different segments. As wage growth continues to outpace the rise in housing prices, housing affordability keeps improving, albeit at a slower pace than before.

Economic growth is strengthening, though it remains rather moderate. The easing of global trade policy uncertainties, increased government spending, more favourable lending conditions, and rising household incomes are supporting economic sentiment and growth.

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%.

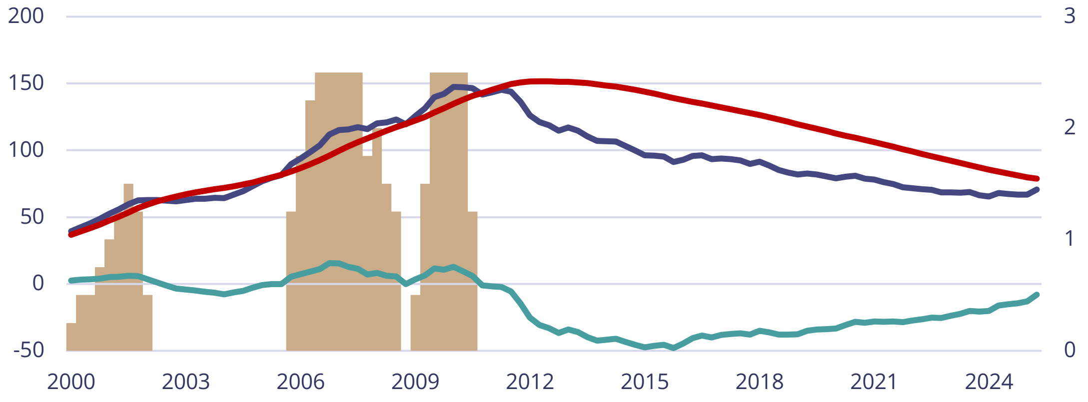
	Standardised credit definition 2025 Q2	**Additional** credit definition 2025 Q3
Credit-to-GDP ratio (%)	70.7	33.1
Credit-to-GDP gap (pp)	-8.1	-1.4
Benchmark buffer rate (% from TREA)	0	0

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.

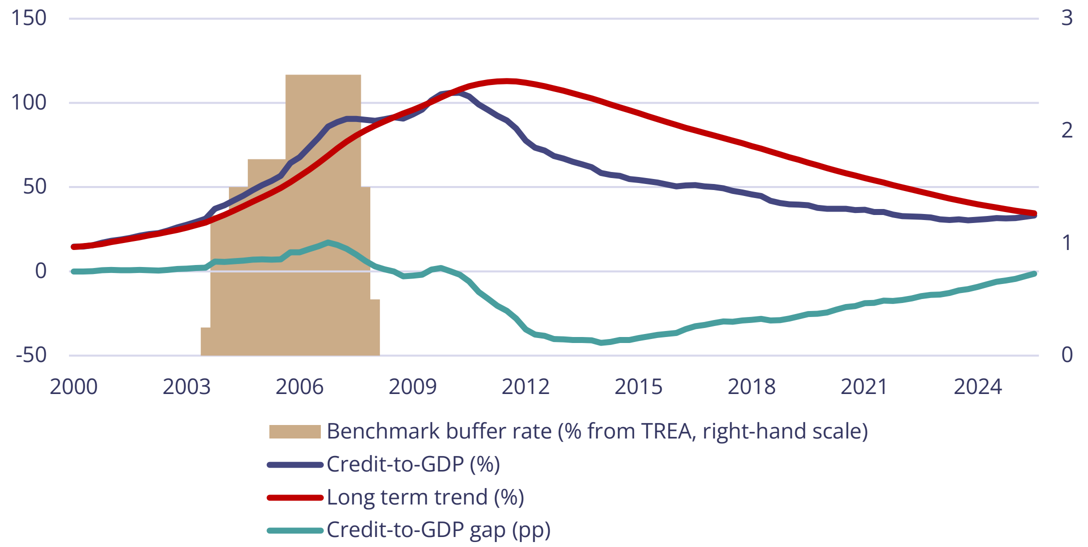
Additional credit definition – bank loans to NFCs and households, and holdings of NFCs debt securities, and loans granted by banks' leasing subsidiaries.

The benchmark buffer rate calculated from the additional credit definition has been chosen as the buffer guide. The data is available sooner, and the benchmark buffer rate calculated from the additional credit measure aligns better with the historically required CCyB rate.

Standardised credit-to-GDP gap

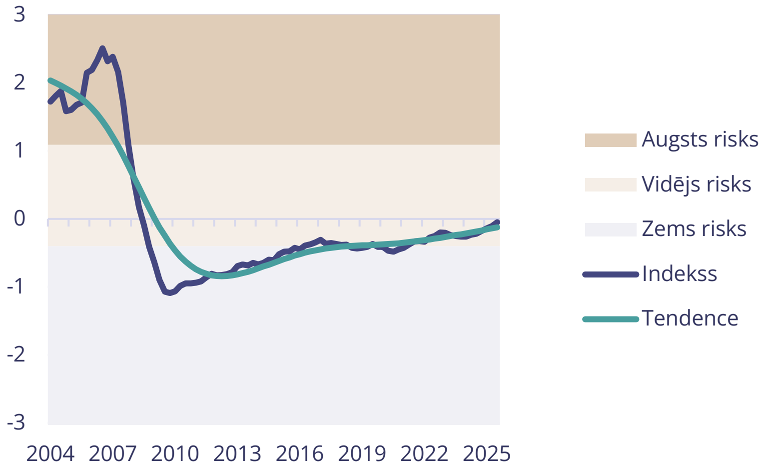


Additional credit-to-GDP gap

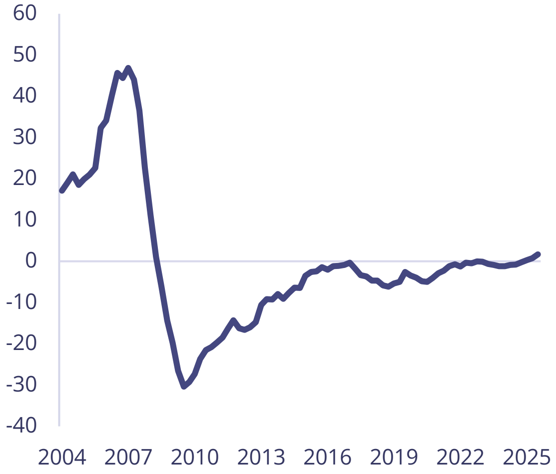


Sources: Latvijas Banka, CSB, Latvijas Banka's calculations

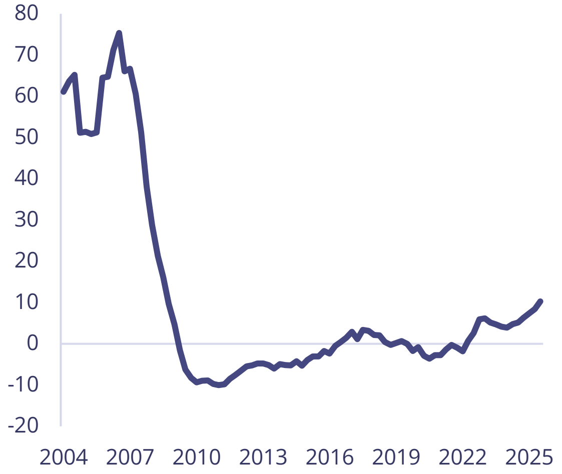
Credit developments index



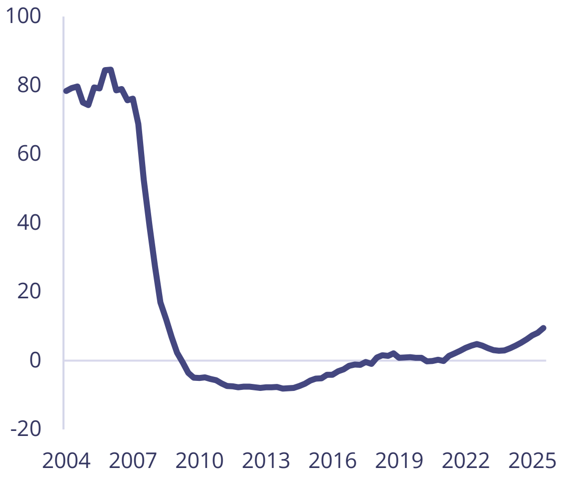
Additional credit measure to 7-year GDP annual difference, percentage points



Additional credit measure annual growth rate*, %



Household credit annual growth rate*, %



Domestic lending continues to grow at a strong pace, which is regarded as a favorable development considering the prolonged period of weak credit activity. In the third quarter of 2025 and in October, the outstanding loans issued to households and NFCs increased year-on-year by 12.0% and 11.8%, respectively (including 9.5% and 9.8% for households, and 14.8% and 14.0% for NFCs).

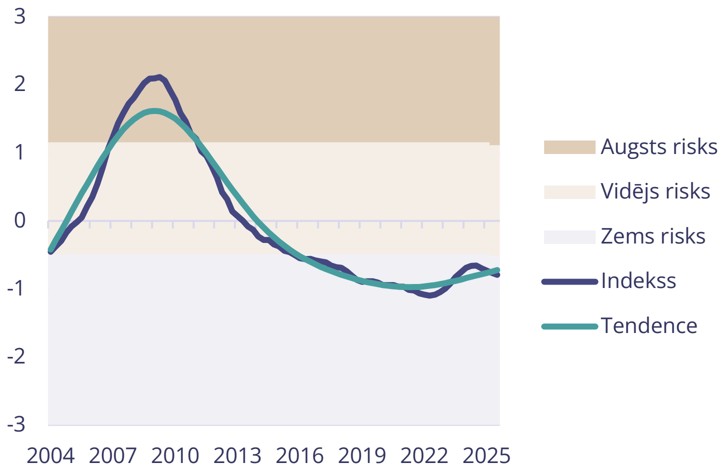
This growth is supported by lower interest rates, the realization of deferred demand, and the gradual improvement in economic activity. Additional momentum comes from the Solidarity Contribution Law, which allows credit institutions to receive a discount if they meet specific credit portfolio growth targets.

However, geopolitical developments and uncertainty may still significantly constrain lending. It is also possible that the pace of credit supply will slow once the Solidarity Contribution application period ends, as the incentive to expand lending will no longer apply.

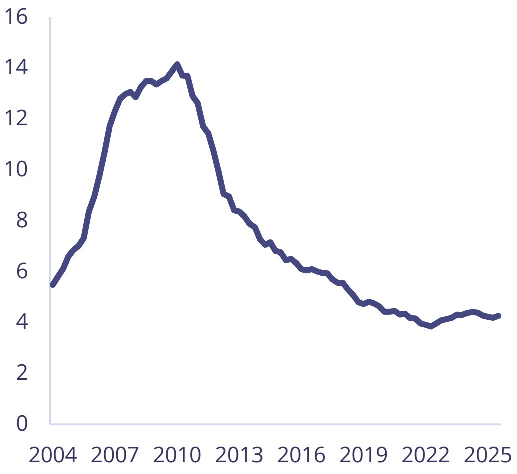
* Reclassifications and other one-time effects are excluded from the loan growth rate, but the effect of written-off loans is not excluded.

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

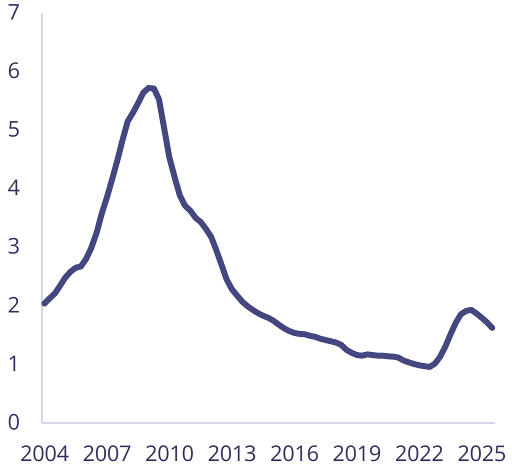
Private sector debt burden index



Household and NFC debt service ratio*, %



Household and NFC annual interest payments to GDP, %

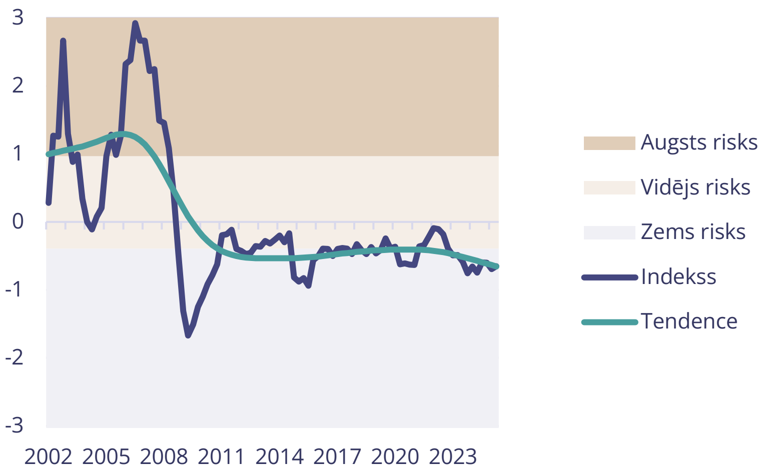


The debt of the private non-financial sector is low. Along with the gradual decrease in interest rates, the ratio of interest payments on private non-financial sector loans to GDP has also slightly decreased. The financial resilience of borrowers remains good.

*The calculation of the Debt Service Ratio (DSR) is based on an equal-payment (annuity) approach, which accounts for both interest payments and principal amortization burden: $DSR=\frac{i_t * D_t}{(1-(1+i_t)^{-s_t}) * Y_t}$, where *D* represents the measure of additional credit measure or the total private non-financial sector debt volume, *i* is the sector's average interest rate, income *Y* is replaced by GDP, and the average loan term *s* is assumed to be 10 years. This methodology allows for assessing the debt servicing burden at the macro level.

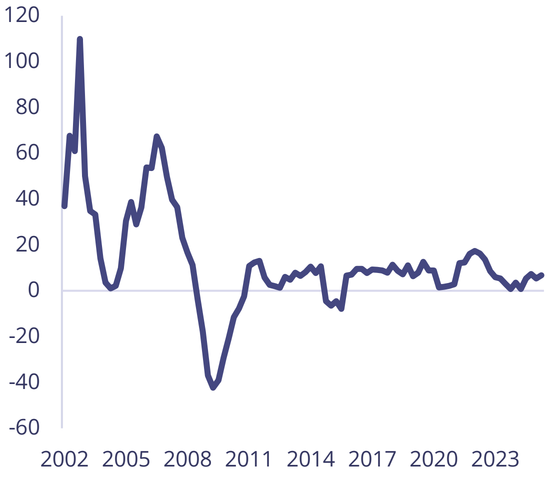
Sources: Latvijas Banka, CSB, Latvijas Banka's calculations

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, while the number of transactions involving land continues to decline, although the pace of decrease has slowed. In the third quarter of 2025, compared to the corresponding period of the previous year, the total number of real estate purchase transactions fell by 1.6%. This included a 10.9% drop in land transactions and a 3.7% increase in housing transactions.

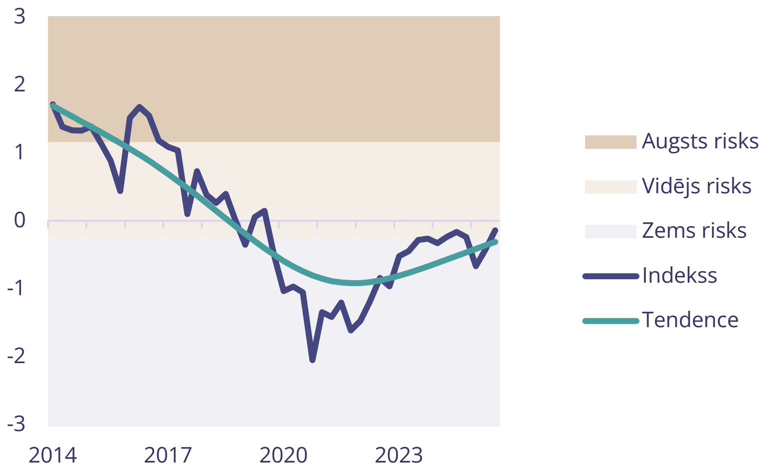
In the apartment market, standard-type apartments dominate, accounting for around 70% of all purchases. In this segment, the number of transactions increased by only 0.8% year-on-year in the third quarter. Meanwhile, transactions involving new projects continue to grow rapidly, with a year-on-year increase of 38.9% in the third quarter, although growth in the primary market slowed to 19.3%.

Average wage growth still outpaces the rise in housing prices, thus **housing affordability continues to improve, albeit at a slower pace**.

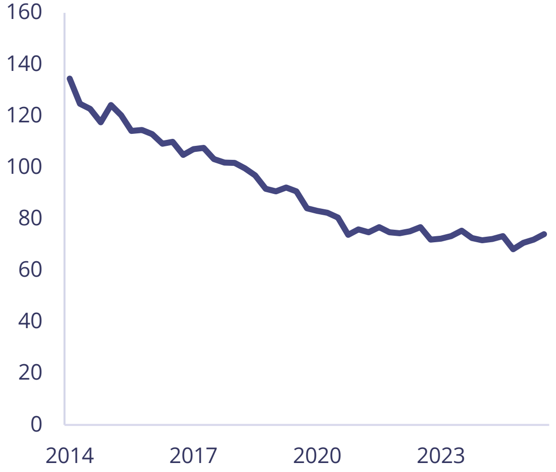
The increase in housing prices remains moderate. In the third quarter, the year-on-year price change for standard-type apartments in Riga was 1.8%. In the new project segment, despite minor price fluctuations in previous quarters, overall price dynamics indicate moderate growth.

Sources: CSB, Latvijas Banka's calculations

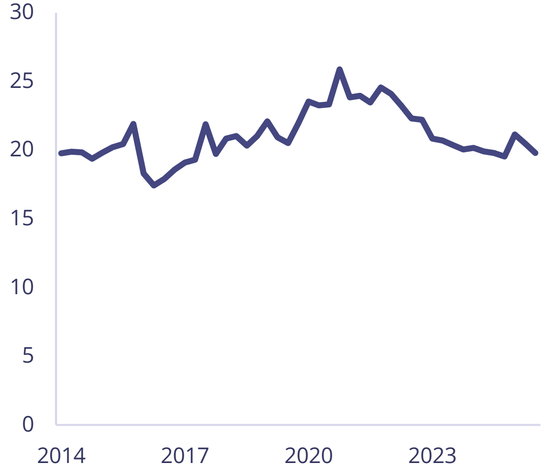
Strength of bank balance sheets index



The ratio of domestic credit to deposits, %



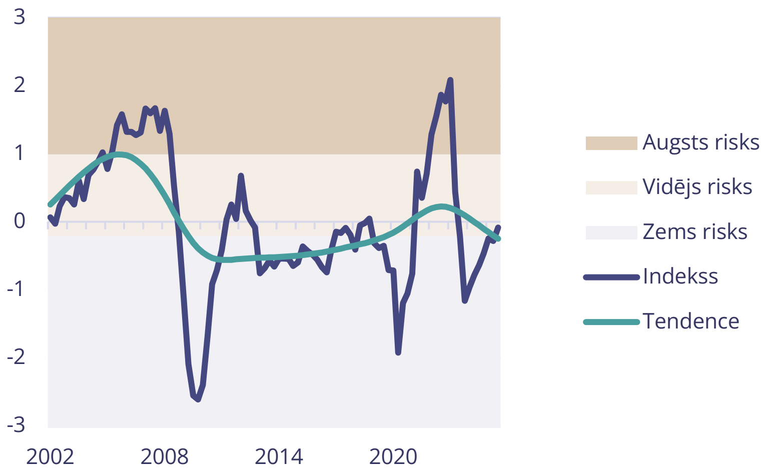
CET1 ratio, %



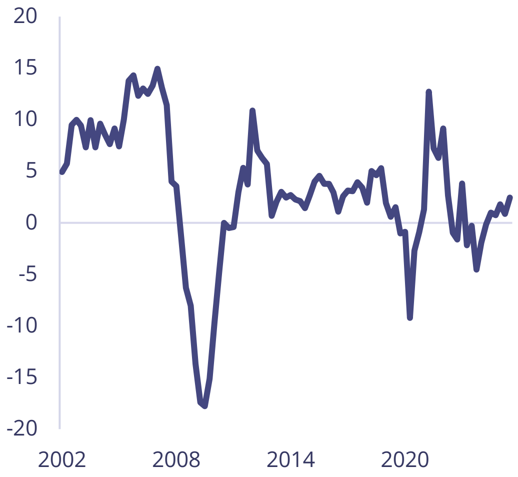
Bank balance sheet resilience indicators – bank capitalization, as well as profitability and asset quality – are very strong. The ratio of bank loans to deposits remains consistently low.

Sources: Latvijas Banka, Latvijas Banka's calculations

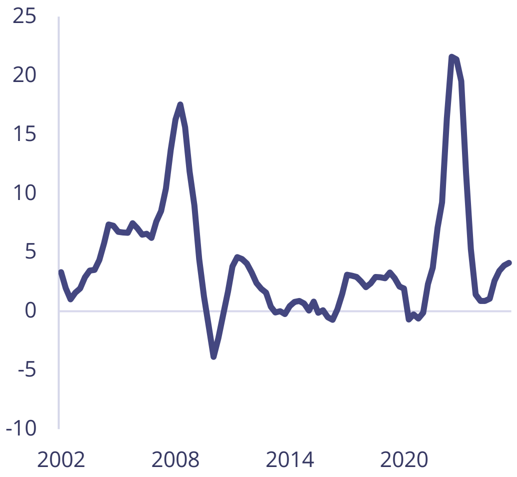
Macroeconomic environment index



Real GDP annual growth rate, %



HICP annual growth rate, %



Economic growth has resumed and is strengthening; short-term data suggest that it may remain resilient, though moderate. In the third quarter of 2025, Latvia’s GDP increased by 0.6% compared to the previous quarter and by 1.8% compared to the corresponding period of the previous year (seasonally adjusted data).

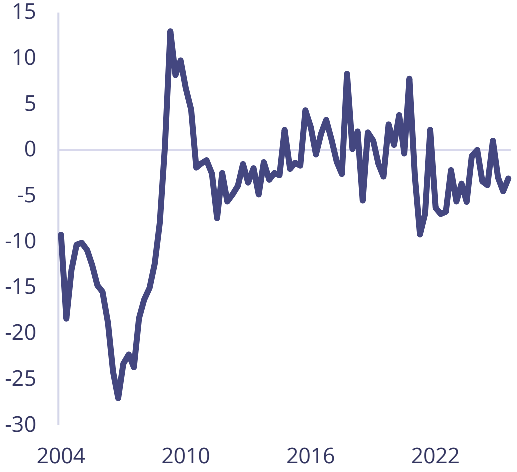
Following strong growth at the beginning of 2025, investment activity slowed in mid-year. Nevertheless, public investment plans remain ambitious, and announcements of private sector projects in manufacturing, energy, and residential construction point to further increases in investment levels.

The easing of global trade policy uncertainty, the government’s commitment to raise defence spending, more favourable lending conditions, and rising household incomes are strengthening economic sentiment. This is already reflected in monthly data on lending and retail trade and will continue to support consumption and investment.

Inflation remains persistent, driven by significant income growth. In October 2025, compared to October 2024, consumer prices in Latvia increased by 4.3%. The impact of stronger demand is most visible in the continued increase in service prices.

Sources: CSB, Latvijas Banka's calculations

Current account balance-to-GDP, %



In the third quarter of 2025, the current account deficit reached 3.1% of GDP.

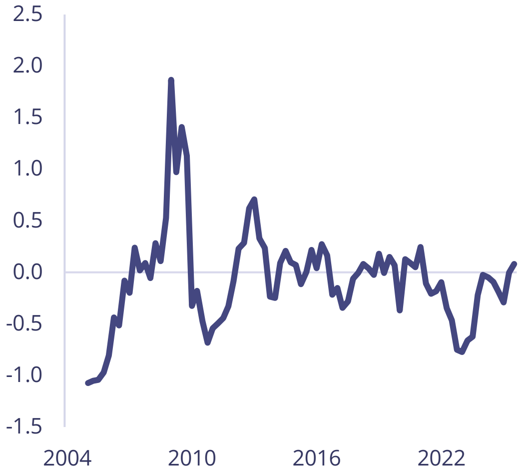
This was mainly driven by seasonal factors in external trade and uncertainty in export markets. At the same time, service exports continued to grow, supported by an increase in tourism and transport services.

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

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



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