



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

The Countercyclical Capital Buffer Rate

January 2016
Financial Stability Department

The Countercyclical Capital Buffer (CCB)

In accordance with Article 136(7) of EU Directive 2013/36/EU, transposed in the Central Bank of Malta Directive 11 “Macro-prudential Policy”, the Central Bank of Malta is hereby notifying its decision on the buffer rate for the first quarter of 2016.

Notification

- The applicable countercyclical capital buffer rate: 0%
- The relevant credit-to-GDP ratio: 97% and its deviation from the long-term trend: -21.4 percentage points.
- The buffer guide: 0%

Analysis

The aim of the countercyclical capital buffer is to protect the banking sector against losses that could be caused by the build-up of excessive credit growth. The countercyclical capital buffer is built during the upswing of the financial cycle to absorb losses that may arise in the downturn of the financial cycle, and to continue supplying credit to the real economy.

The Central Bank of Malta (CBM) assesses private credit variables and other banking sector indicators with the aim to decide on the need to activate the countercyclical capital buffer (CCB). This note provides the rationale for the proposed buffer rate being set at 0%.¹ The main indicator underlying this proposal is the deviation of the credit-to-GDP ratio from its long-term trend. The analysis is also supplemented by a sub-set of additional quantitative indicators and by expert judgement.²

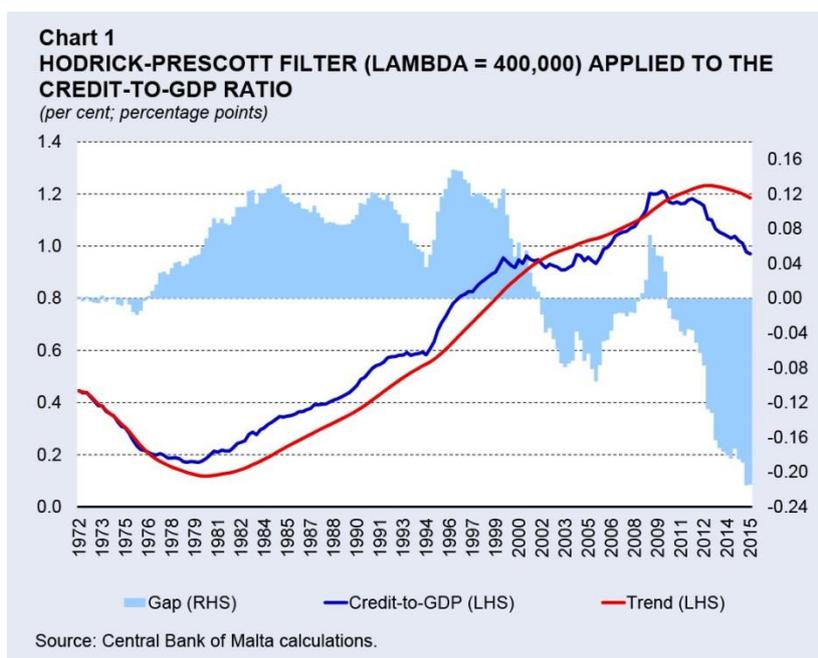
Indicators used in the assessment of the countercyclical capital buffer rate

Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCB, Chart 1 illustrates the results of a one-sided Hodrick-Prescott (HP) filter of the

¹ The analysis is based on the guidelines issued by the European Systemic Risk Board (ESRB) and Bank of International Settlements (BIS) as well as the experience of relevant international and European authorities.

² ESRB/2014/1 - Recommendation on the Guidance for Setting Countercyclical Buffer Rates.

credit-to-GDP ratio for Malta.³ The red line represents the smoothed version of the actual series (dark blue line), with both plotted on the left hand axis. The difference between the two (the gap) is reflected in the light blue histogram which is plotted on the right hand axis.

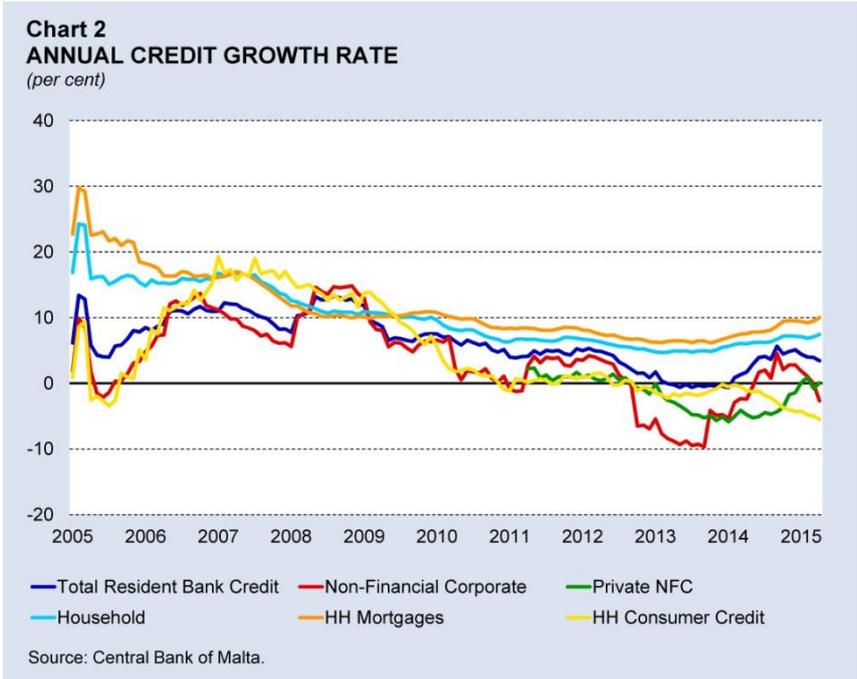


It can be observed that the current credit-to-GDP-ratio based on the latest available data is 21.4 pp below the trend and the cyclical component has been negative since 2010. The most pronounced former downswing had almost reached 10pp and it took several quarters to return to positive territory. Therefore, it appears rather unlikely that the credit-to-GDP ratio will exceed its long-term trend in the near future. The negative gap would thus suggest that a CCB rate of zero is appropriate.

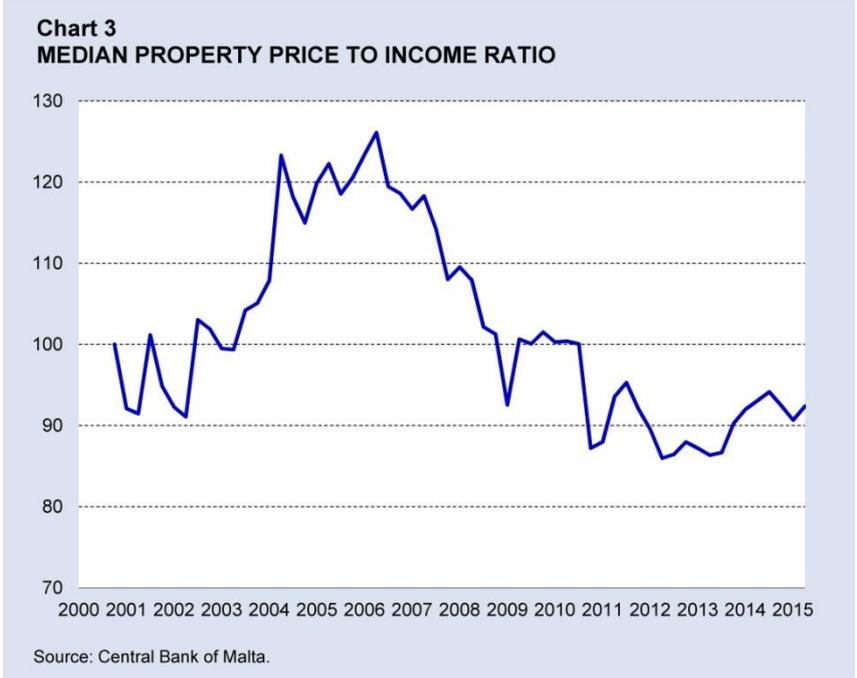
Credit Growth

Resident credit growth has been decelerating since 2007. It recovered in early 2014, only to decelerate somewhat in the second half of 2015. This reflects the weak developments in credit to NFCs, as otherwise lending to households is increasing, driven entirely by mortgages. Consumer credit continued to contract at a sharper rate (see Chart 2).

³ Credit represents total bank credit. CRD IV Article 136 (2a) states that “an indicator of growth of levels of credit within that jurisdiction” shall be used by the authority. Even though Drehmann (2013) showed that the credit gaps based on total credit outperform the credit gaps based on bank credit as early warning indicators for banking crises this might be not so relevant for Malta because the domestic economy is strongly reliant on bank credit and therefore the use of total bank credit is highly appropriate for this purpose. Besides, total credit data revealed breaks in the series over time which could lead to reliability issues in the estimations that were undertaken.



Although lending for house purchases is increasing, on the back of a strong economy with low unemployment and high home ownership rates, mortgage growth remained less pronounced than in 2005/2006 when housing affordability was lower. Although the median property price-to-income ratio resumed its upward trend, it remains well below its peak (see Chart 3).

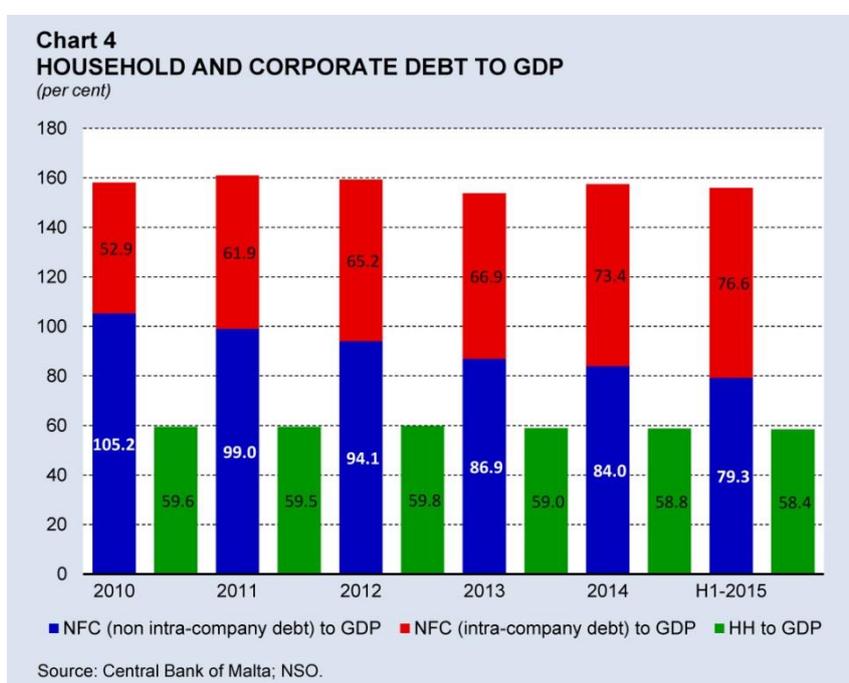


Although property prices are recovering, the conservative haircuts and relatively low loan-to-value ratios applied by banks mitigate potential vulnerabilities. Moreover, delinquency rates on mortgages have traditionally been low, the exposure of banks to the construction and real estate sectors has been declining, and household disposable income is growing at a healthy rate as economic activity remains strong. Overall risks stemming from the housing market remain contained. In addition, credit growth of private NFCs is weak.

Household and Corporate Debt

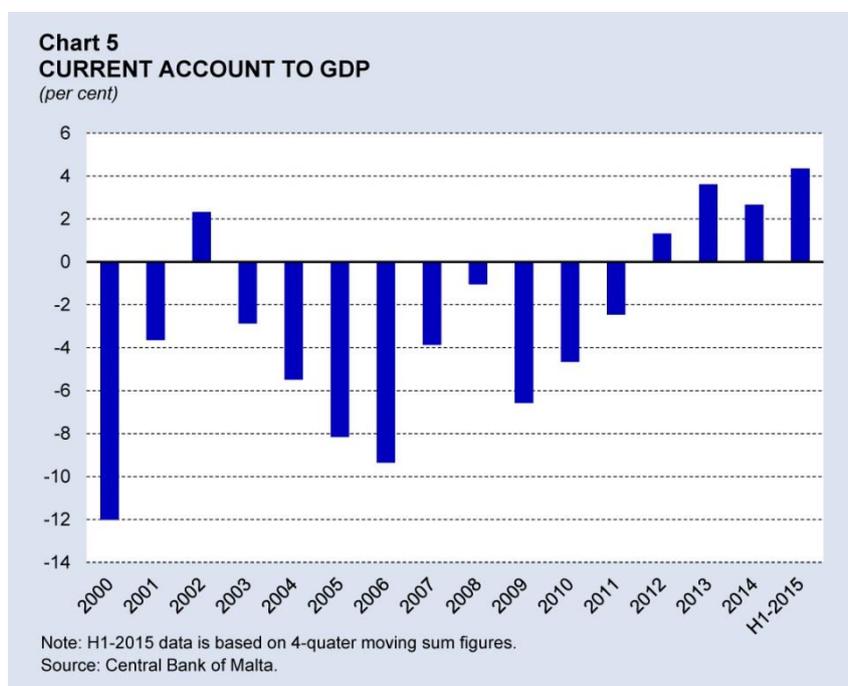
Both household and corporate indebtedness increased in absolute terms but remained relatively stable when expressed as a percentage of GDP (see Chart 4). Household debt, as a percentage of GDP, stood at 58.4% in June 2015, lower than the euro area average despite the high home ownership rate which stands at around 80%. Furthermore, given the low interest rate environment, the interest burden for households has been on a declining path.

Corporate debt reached 155.9% of GDP in June 2015. Around half of NFC debt consists of inter-company debt, so on a consolidated basis, NFC indebtedness stood at 79.3% of GDP, comparable with that in the euro area. Furthermore, NFCs have a strong financial position with financial assets exceeding indebtedness.



Current Account

On the external front, following several years of current account deficits, the current account surplus reached 4.4% of GDP (see Chart 5). This shows that while the correction for past imbalances is still underway, Malta is not currently financing its debt externally.



Banking sector indicators

The core domestic banks remained resilient and profitable, with robust capital ratios, backed by ample liquidity and stable funding.

All the quantitative and qualitative information assessed were judged to convey consistent and sufficiently homogenous indications in favour of not activating the CCB at the current juncture in Malta. The standardised bank credit-to-GDP gap is currently negative at -21.4pp, which is well below the lower reference threshold of 2% proposed in the BCBS guidance.