



BANK ĊENTRALI TA' MALTA  
EUROSISTEMA  
CENTRAL BANK OF MALTA

## The Countercyclical Capital Buffer Rate

*June 2016*  
*Financial Stability Department*

## **The Countercyclical Capital Buffer (CCyB)**

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 third quarter of 2016.

### **Notification**

- The applicable countercyclical capital buffer rate: 0%
- The relevant credit-to-GDP ratio: 93.3% and its deviation from the long-term trend: -23.3 percentage points.
- The buffer guide: 0%

### **Analysis**

The aim of the countercyclical capital buffer is to protect the banking sector from losses that could stem from 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 a 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 for activating the countercyclical capital buffer (CCyB). This note provides the rationale for the proposed buffer rate to be set at 0%.<sup>1</sup> The main indicator is the deviation of credit-to-GDP ratio from its long-term trend. The analysis is also supplemented by a sub-set of additional quantitative indicators and also expert judgement.<sup>2</sup>

### **Indicators used in the assessment of the countercyclical capital buffer rate**

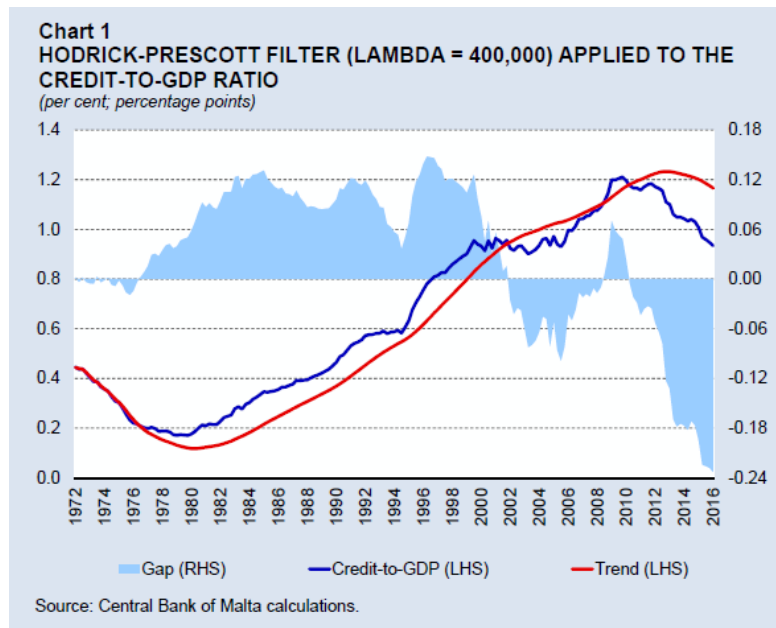
Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCyB, Chart 1 illustrates the results of a one-sided Hodrick-Prescott (HP) filter of the

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<sup>1</sup> 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.

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

credit-to-GDP ratio for Malta.<sup>3</sup> The trend represents the smoothed version of the actual series of the ratio of credit-to-GDP, both plotted on the left hand axis. The gap between the two is reflected in the light blue histogram which is plotted on the right hand axis.

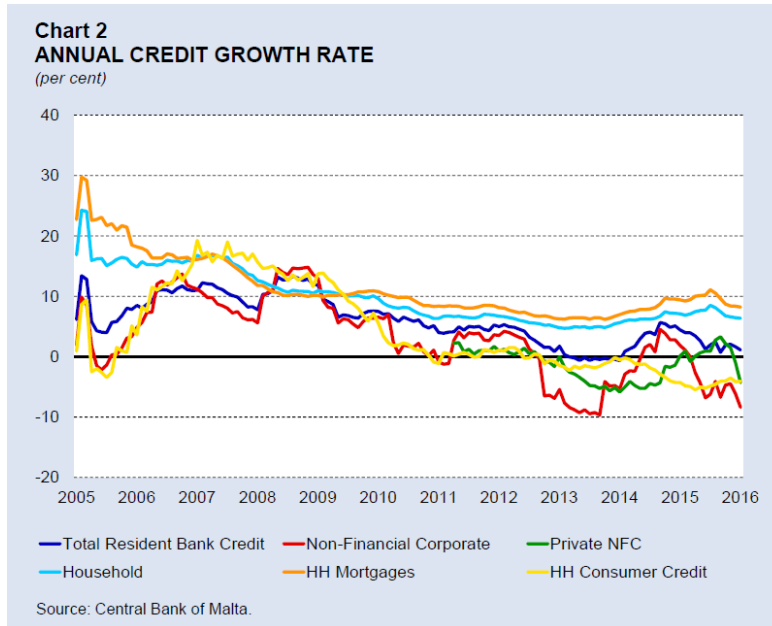


It is observed that the current credit-to-GDP-ratio based on March 2016 data is 23.3pp below the trend and the cyclical component has been negative since 2010. In this regard, the negative gap means that a CCyB rate of zero is appropriate. Furthermore, previous cycles show that the most pronounced former downswing of almost 10pp took several quarters to return to positive territory. Therefore, it is unlikely that the credit-to-GDP ratio will exceed its long-term trend in the near future.

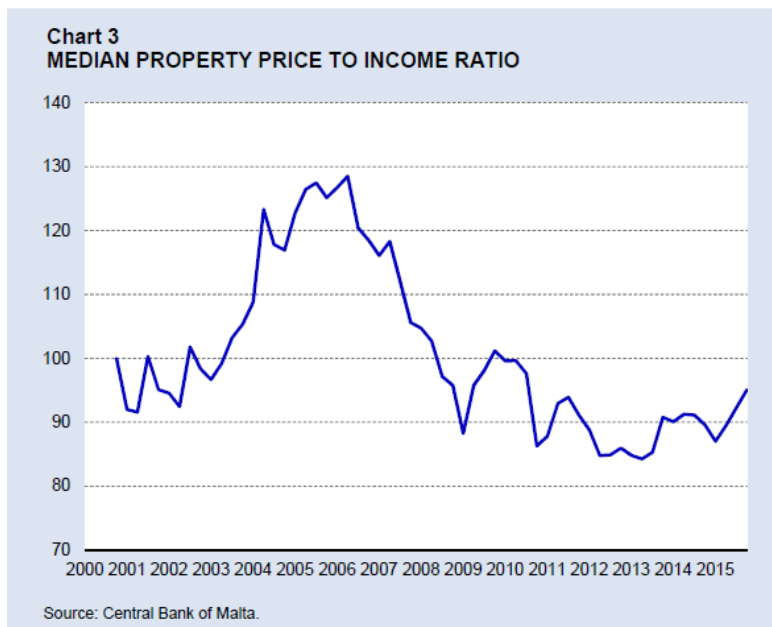
## Credit Growth

Following a pick-up in early 2014, resident credit growth decelerated somewhat in 2015 and in the first quarter of 2016. This reflects the weak developments in credit to NFCs, as otherwise lending to households remained positive. The latter was driven entirely by mortgages, although a slight slowdown was reported since the last quarter of 2015. Consumer credit continued to contract, though the rate of decline decelerated somewhat since the second half of 2015 (see Chart 2).

<sup>3</sup> 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 remains buoyant, on the back of strong economic performance with very low unemployment and high home ownership rates, mortgage growth remained less pronounced than in 2005/2006 when housing affordability was lower. While the median property price-to-income ratio resumed its upward trend, particularly since 2015, it nevertheless still remains well below its peak in 2006 (see Chart 3).

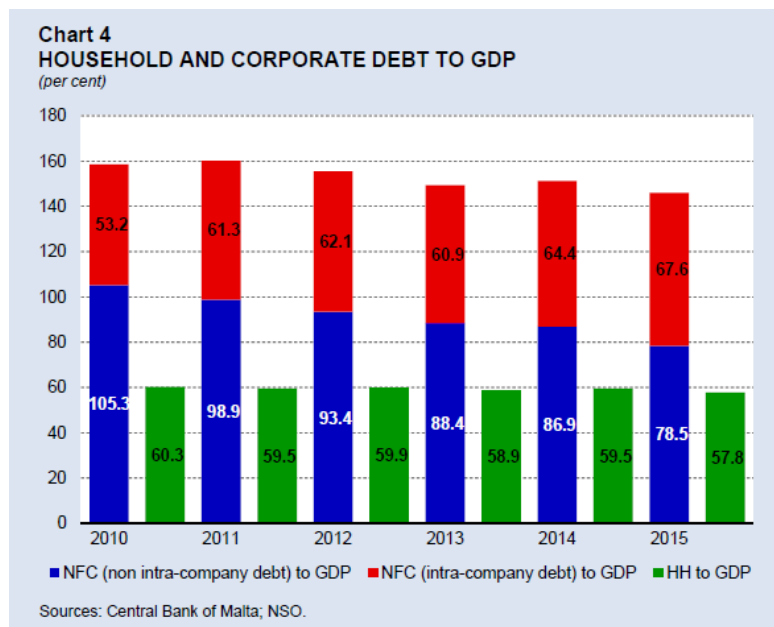


Property prices are recovering. However, the conservative haircuts and relatively low loan-to-value ratios applied by banks mitigate potential vulnerabilities. Moreover, delinquency rates on mortgages have traditionally been low, the exposure of banks to the construction and real estate sectors has been 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, growth in private NFCs remains weak.

### Household and Corporate Debt

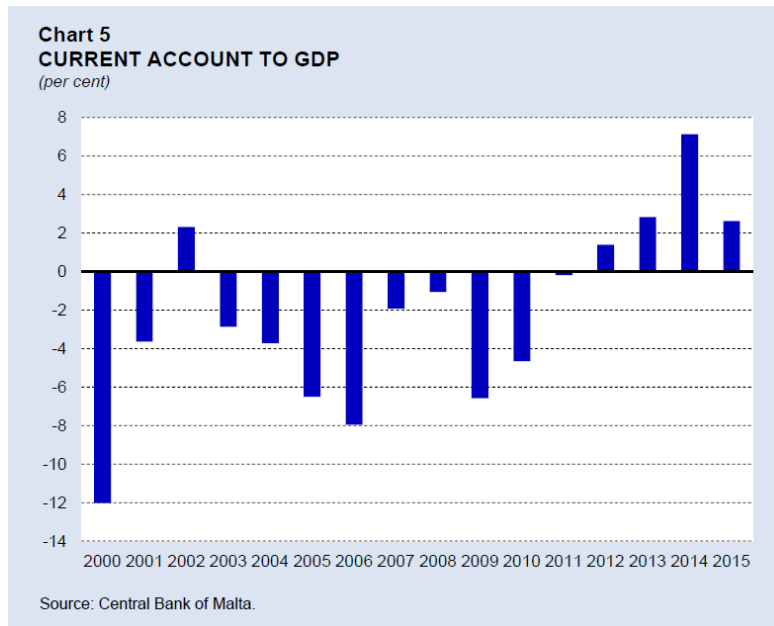
While both household and corporate indebtedness increased in absolute terms, these dropped when expressed as a percentage of GDP (see Chart 4). Household debt, as a percentage of GDP, stood at 57.8% in December 2015, lower than the euro area average despite the high home ownership rate which stands at around 80%. Furthermore, despite the increase in household debt in absolute terms, up by an annual 5.8%, households' net financial wealth increased further, up by 8.1% to 195.5% of GDP, mainly as a result of higher deposit holdings.

Corporate debt dropped to 146.1% of GDP in December 2015, as GDP grew at a faster pace. Furthermore, almost half of NFC debt is characterised by intra-company debt, so that on a consolidated basis, NFC indebtedness stood at 78.5% of GDP, in line with that for 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 2.6% of GDP in 2015 (see Chart 5). This shows that while the correction for past imbalances is still underway, Malta is not currently resorting to external debt financing.



The core domestic banks remained resilient and profitable, with robust capital ratios, backed by ample liquidity and stable funding. All the relevant quantitative and qualitative information assessed were judged to convey strong indications that the CCyB rate for Malta should continue to be set at zero at the current juncture. The standardised bank credit-to-GDP gap is currently negative at -23.3pp, which is well below the lower reference threshold of 2pp proposed in the BCBS guidance.