The Countercyclical Capital Buffer (CCyB)


Notification

• The applicable countercyclical capital buffer rate: 0%
• The relevant credit-to-GDP ratio: 84.1% and its deviation from the long-term trend: -26.7 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 subsequent downturn, without interrupting the supply of 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%.\(^1\) 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 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 CCyB, Chart 1 illustrates the results of a one-sided Hodrick-Prescott (HP) filter of the credit-to-GDP ratio for Malta.\(^3\) The trend represents the smoothed version of the actual

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\(^1\) 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.

\(^3\) 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.
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 in December 2016 stood at 26.7pp 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**

Resident credit growth remained contained, with the annual growth rate standing at 2.6% in December 2016. This continued to reflect subdued developments in credit to NFCs which remain in the negative growth territory, contracting further in the last quarter of 2016. Private NFC credit also fell, albeit at a lower rate. In the last quarter of 2016, the annual mortgage growth rate picked up some momentum following a period of slowdown since September 2015, growing annually by 7.7% in 2016. Consumer credit growth remained in negative territory since 2013 (see Chart 2).
Although lending for house purchases remained buoyant, the strong economic performance coupled with very low unemployment and high home ownership rates sustained the growth in mortgages. In 2015, the median advertised property price-to-income ratio resumed its upward trend, but in Q3 2016 stood well below its peak in 2006, and the average since 2000 (see Chart 3).
Property prices continued to recover. 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 and on a decreasing path, whereas household disposable income is growing at a healthy rate as economic activity remains strong. Overall risks stemming from the housing market remain contained.

**Household and Corporate Debt**

While both household and corporate indebtedness increased in absolute terms, these dropped somewhat when expressed as a percentage of GDP (see Chart 4). Household debt, as a percentage of GDP, stood at 54.4% in September 2016, below the euro area average notwithstanding the high home ownership rate which stands at around 80%. Furthermore, despite the increase in household debt in absolute terms, up by an annual rate of 3.7%, growth in households’ net financial wealth was stronger, up by 7.8% to 185.2% of GDP. Higher household wealth resulted mainly from higher deposit holdings, but also from equity, debt securities, and insurance, pension and standardised guarantees.

Corporate debt to GDP dropped marginally to 138.8% in September 2016. Furthermore, about 40% of NFC debt is characterised by intra-company debt, so that on a consolidated basis, NFC indebtedness stood at 81.5% of GDP, albeit still lower than the euro area average. Furthermore, NFCs have a strong financial position with financial assets significantly exceeding indebtedness.
Current Account

On the external front, following several years of current account deficits prior to 2011, the current account surplus reached 6.4% of GDP in the four quarters to Q3 2016 (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 -26.7pp, which is well below the lower reference threshold of 2pp proposed in the BCBS guidance.