BANK ĊENTRALI TA' MALTA
EUROSISTEMA
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The Countercyclical Capital Buffer Rate

June 2019
Financial Stability Department

The Countercyclical Capital Buffer (CCyB)

In line 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 applicable buffer rate.

Notification

- The applicable countercyclical capital buffer rate: 0%
- The relevant credit-to-GDP ratio: 76.7% and its deviation from the long-term trend: -19.1 percentage points
- The buffer guide: 0%

Analysis

The aim of the countercyclical capital buffer (CCyB) is to strengthen banks’ capital buffers during periods when cyclical risks are thought to be on the increase, in a bid to enhance the resilience of the banking system against losses that could stem from excessive credit growth. In this regard, the CCyB is built during the upswing of the financial cycle and is released in a downturn to absorb any losses that may arise, without interrupting the supply of credit to the real economy.

The main indicator backing this proposal is the deviation of credit-to-GDP from its long-term trend. The analysis is further supplemented by a sub-set of additional quantitative indicators and expert judgement.[1] The Central Bank of Malta assesses variables related to private sector lending and other banking sector indicators with the aim to decide on the need to activate this buffer. This note provides the rationale for the proposed buffer rate to be maintained at 0%.[2]

Indicators used in the assessment of the countercyclical capital buffer rate

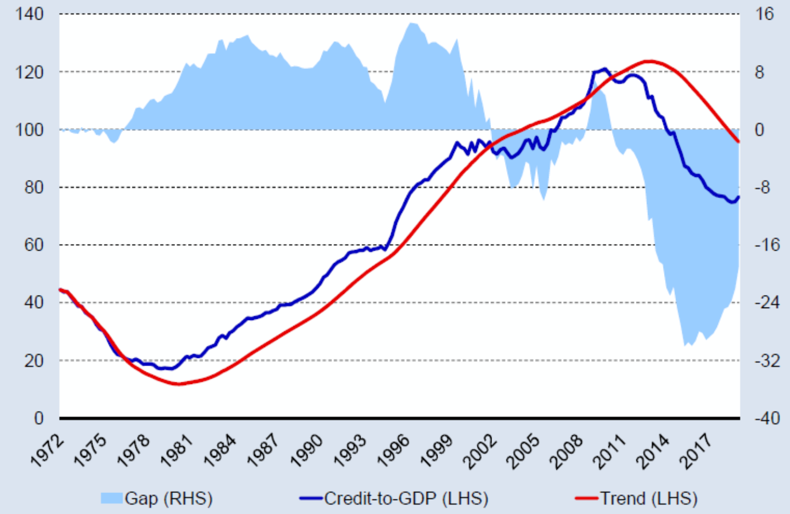
Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCyB, Chart 1 illustrates the results of the one-sided Hodrick-Prescott (HP) filter of the

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

[2] 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.

credit-to-GDP ratio for Malta.[3] The trend represents the smoothened credit-to-GDP plotted on the left-hand axis together with the actual series. The gap between the two is reflected in the light blue histogram which is plotted on the right-hand axis.

Chart 1
HODRICK-PRESCOTT FILTER (LAMBDA = 400,000) APPLIED TO THE CREDIT-TO-GDP RATIO
(per cent; percentage points)



Source: Central Bank of Malta calculations.

In the first quarter of 2019, the credit-to-GDP gap narrowed to -19.1 pp from a trough of -30 pp in the second quarter of 2015. Nevertheless, the gap remains in significant negative territory with the CCyB rate of zero still remaining appropriate. Estimates based on historical developments also indicate that the narrowing of the gap is expected to take several quarters before it returns in positive territory. Furthermore, such decision is supplemented by additional analysis.

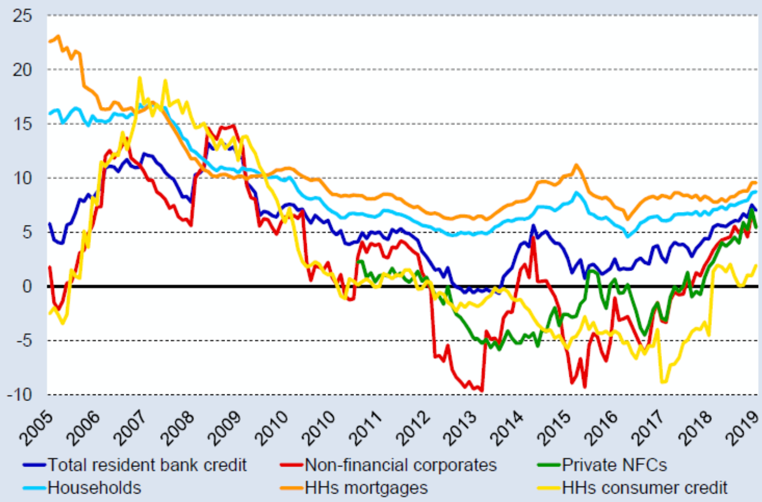
Credit Growth

Resident credit grew by 7.0% in March 2019 driven by increases in both household and NFC lending. Mortgage lending rose by 9.6%, up by 0.8 pp compared to the previous quarter, but still lower than the double-digit growth rates reported prior to 2008. Consumer credit also increased albeit by a more contained rate of 1.9% (see Chart 2). Meanwhile, growth in NFC credit picked up further momentum, up by 5.5% year-on-year in March 2019. Such growth

[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. Although Drehmann (2013) showed that credit gaps based on total credit outperform those based on bank credit as early warning indicators for banking crises, this might not be so relevant for Malta given that the domestic economy is strongly reliant on bank credit and therefore the use of total bank credit is highly appropriate for this purpose. Furthermore, the time series for total credit contains breaks in the data over time, which could lead to unreliable estimations.

rates reflect the pick-up in gross capital formation amid robust economic developments. This analysis does not indicate any signs of overheating within the market.

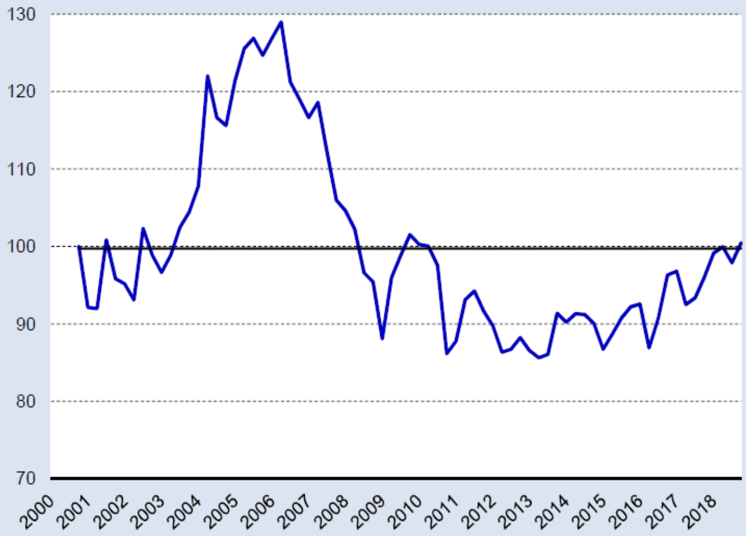
Chart 2
ANNUAL CREDIT GROWTH RATE
(per cent)



Source: Central Bank of Malta.
Note: A break in series was reported in May 2017 with regards to HH consumer credit due to a reclassification exercise.

Property prices rose by 6.2% in the fourth quarter of 2018, picking up some momentum although still at a slower rate compared to the growth rates reported in 2015, and at a more modest pace than nominal GDP. Such price developments reflect increased demand on the back of robust job-rich economic growth, increased disposable income, a higher female participation rate, inward migration, and budgetary measures aimed at first-time and second-time buyers. Supply is also responding to such demand pressures as dwelling permits have risen significantly in the past few years, aiding in attenuating property price pressures. Although the median advertised property price-to-income ratio increased since mid-2015, it remained well-below its peak in 2006 and in line with its long-term average since 2000 (see Chart 3).

Chart 3
MEDIAN PROPERTY PRICE TO INCOME RATIO



Source: Central Bank of Malta.
Note: Based on the Central Bank of Malta advertised property prices.

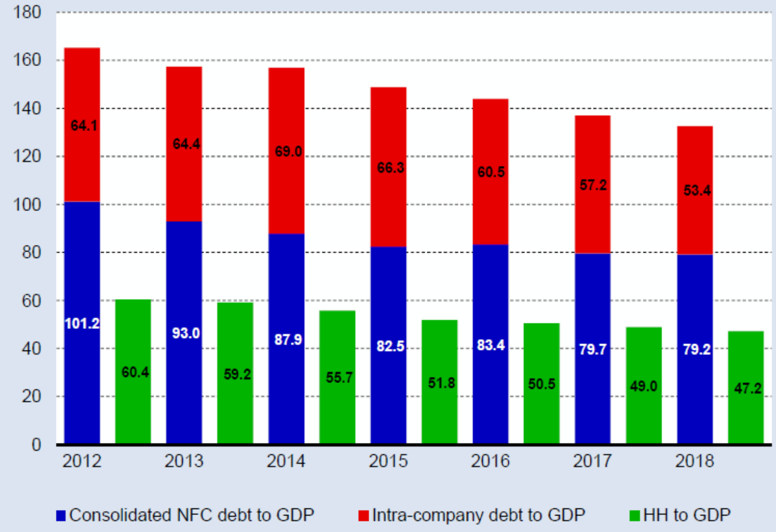
The conservative haircuts and loan-to-value ratios applied by banks help to mitigate any potential vulnerability that could stem from the real estate market, safeguarding both the banks' and households' balance sheet. Moreover, delinquency rates on mortgages have traditionally been low, whereas compensation of employees is growing at a healthy pace as economic activity remains strong. Overall, financial stability risks stemming from the housing market remain low and contained.

Household and Corporate Debt

Household debt increased by 5.2% in 2018, although when expressed in terms of GDP it decreased to 47.2% of GDP in December 2018, below the euro area average (see Chart 4). Notwithstanding, households' net financial wealth remained strong at 158% of GDP, mainly held in the form of cash and deposits.

Similarly, although corporate indebtedness increased by 5.6%, corporate debt-to-GDP dropped to 132.6% in December 2018 compared to the 136.9% in end-2017. Given that inter-group debt is an important component of NFC debt, on consolidated basis NFC indebtedness stood at a more contained rate of 79.2% of GDP, marginally below the euro area average. Furthermore, NFCs have a strong financial position with financial assets significantly exceeding their debt, with such ratio standing at about 179%.

Chart 4
HOUSEHOLD AND CORPORATE DEBT TO GDP
(per cent)

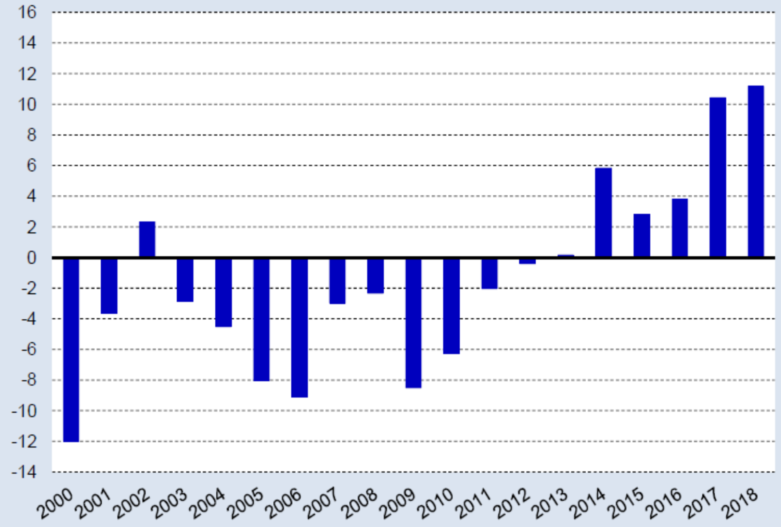


Sources: Central Bank of Malta; NSO.

Current Account

On the external front, the current account remained in significant surplus at 11.2% of GDP in December 2018, indicating that Malta is not currently resorting to external debt financing (see Chart 5).

Chart 5
CURRENT ACCOUNT TO GDP
(per cent)



Source: Central Bank of Malta.

The core domestic banks remained resilient and profitable, with capital ratios above their regulatory requirements together with ample liquidity and stable funding. All the relevant quantitative and qualitative information assessed were judged to convey strong indications that at the current juncture, the CCyB rate for Malta should continue to be set at zero. The standardised bank credit-to-GDP gap is currently negative at -19.1pp, which is well below the reference threshold of 2 percentage points as indicated in the BCBS guidance.