BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

The Countercyclical Capital Buffer Rate

December 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: 75.6% and its deviation from the long-term trend: -17.4 percentage points
- The buffer guide: 0%

Analysis

The aim of the countercyclical capital buffer (CCyB) is to strengthen banks' capital buffers during periods of excessive credit growth in a bid to enhance the resilience of the banking system and counter pro-cyclicality in the financial system. 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 credit 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

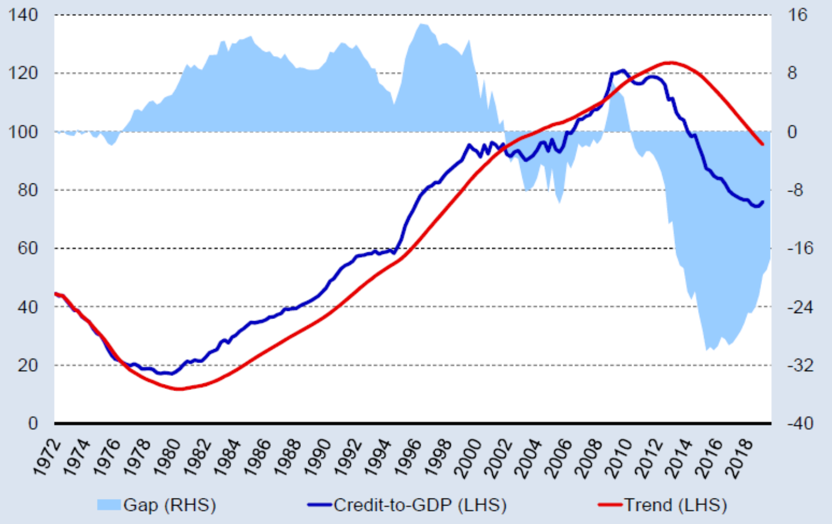
Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCyB, Chart 1 illustrates the results of the one-sided Hodrick-Prescott (HP) filter of the

[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 third quarter of 2019, the credit-to-GDP gap narrowed to -17.4 pp from a trough of -30 pp in the second quarter of 2015. Despite narrowing by almost half, the gap still remains in significant negative territory, with the CCyB rate of zero still remaining appropriate. Estimates based on historical developments also indicate that the dilution of the gap is expected to take several quarters before it returns in positive territory.

Such decision is further complemented by additional indicators to the headline indicator - the credit-to-GDP gap.

Credit Growth

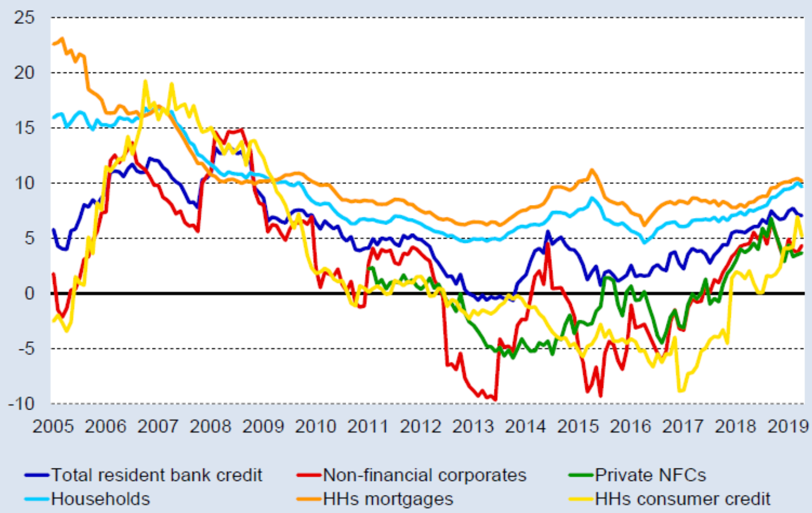
In September 2019, resident credit growth accelerated to 7.0% driven by both lending to households and NFCs. Overall lending to households rose by 9.7%. Mortgage lending increased by 10.2%, up by 0.1 pp compared to the previous quarter, but still lower than the double-digit growth rates reported prior up to 2007. Consumer credit also rose albeit by a

---

[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.

more contained rate of 5.2%, being 1.1 pp higher than the growth rate recorded in the first half of 2019 (see Chart 2). Meanwhile, growth in lending to NFC slowed to 4.3% in September 2019 from almost 5% in the previous quarter, largely due to slower growth in lending to private NFCs. Such growth rates continued to reflect the pick-up in gross capital formation amid robust economic developments, with the increase in lending largely concentrated in those sectors which are contributing the most to economic growth.

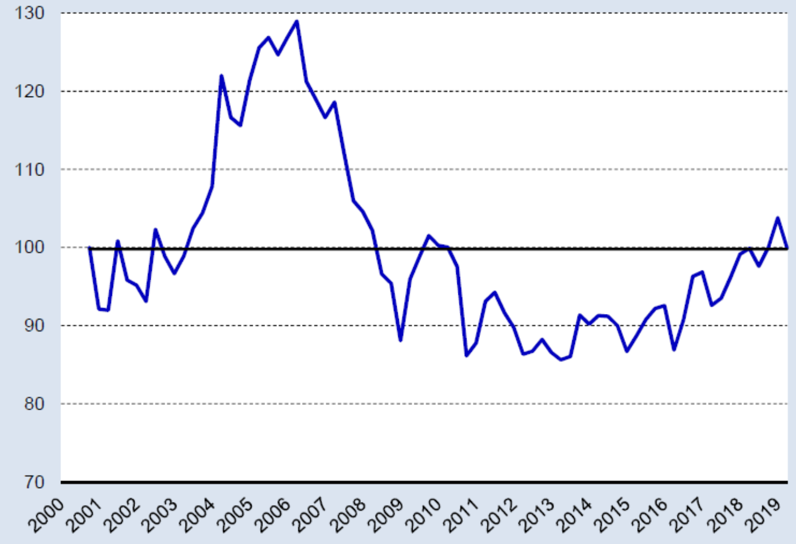
Chart 2
ANNUAL CREDIT GROWTH RATE
(per cent)



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.

During the second quarter of 2019, property prices rose by 6.3%, picking up some momentum compared to the previous year although still at a slower pace compared to the growth rates reported in 2015, but at a faster pace than nominal GDP. Such price developments reflected 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

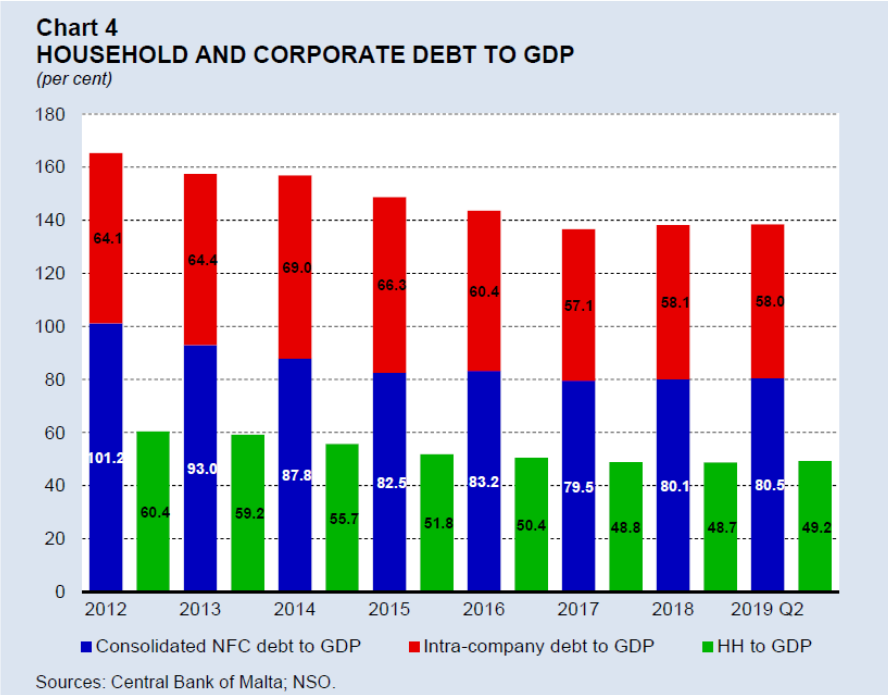


Source: Central Bank of Malta.
Note: Based on the Central Bank of Malta advertised property prices.

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 resident mortgages have traditionally been low at 2.3% in September 2019, 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. Nonetheless, in July 2019 the Central Bank of Malta introduced Directive No. 16 on the Regulation on Borrower-Based Measures as a pre-emptive policy response, aiming to strengthen the resilience of both lenders and borrowers through the setting of minimum lending standards.

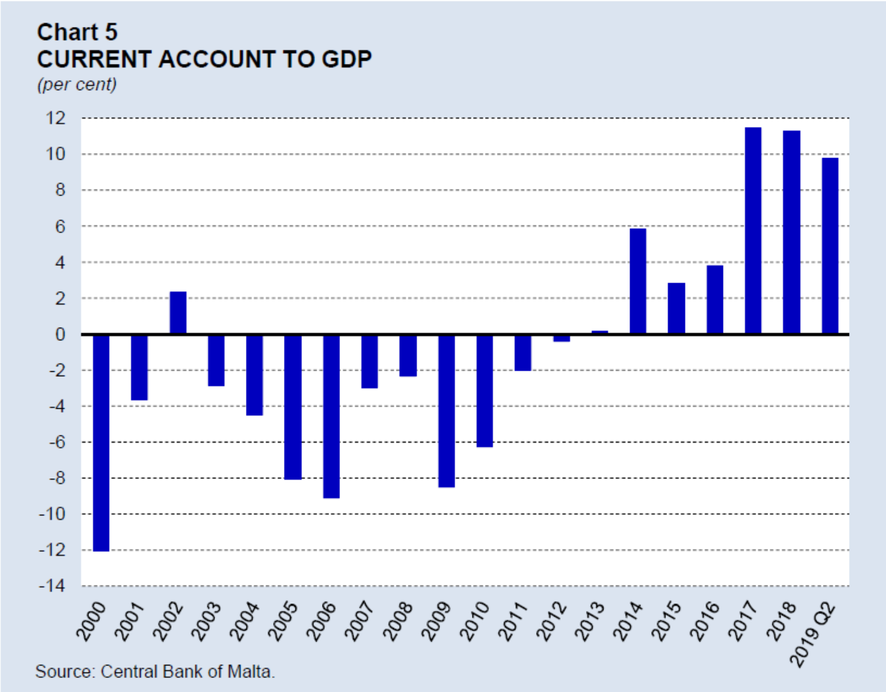
Household and Corporate Debt

Private sector debt increased in the second quarter of 2019 driven by higher corporate indebtedness and to a lower extent household debt. Expressed as a share of GDP, private sector debt rose by 0.9 percentage point to 187.7%. Household debt-to-GDP ratio increased by 0.6 percentage point during the first half of 2019 to 49.2% (see Chart 4). This however remained slightly below the euro area average. Meanwhile corporate debt-to-GDP edged slightly higher to 138.5%. Given that intra-group debt is an important element of NFC debt, on consolidated basis NFC indebtedness stood at a more contained rate of 80.5% of GDP, marginally below the euro area average. Furthermore, at about 178%, NFCs have a strong financial position with financial assets significantly exceeding their debt. Moreover, households' net financial wealth remained strong at about 163% of GDP, mainly held in the form of cash and deposits.



Current Account

On the external front, the current account remained in significant surplus at 9.7% of GDP in June 2019, although 1.5 pp lower than in 2018. However, the current account surplus still indicates that Malta is not currently resorting to external debt financing (see Chart 5).



The core domestic banks remained resilient and profitable, with Total capital ratio and Common Equity Tier 1 capital ratio standing at 19.8% and 17.2%, respectively in September 2019. Liquidity remained ample with core domestic banks' Liquidity Coverage Ratio standing at 278.4% above the regulatory requirements, indicating 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 -17.4 pp, which is well below the reference threshold of 2 percentage points as indicated in the BCBS guidance.