



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

The Countercyclical Capital Buffer Rate

September 2020
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: 80.0% and its deviation from the long-term trend: -10.0 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 supporting 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

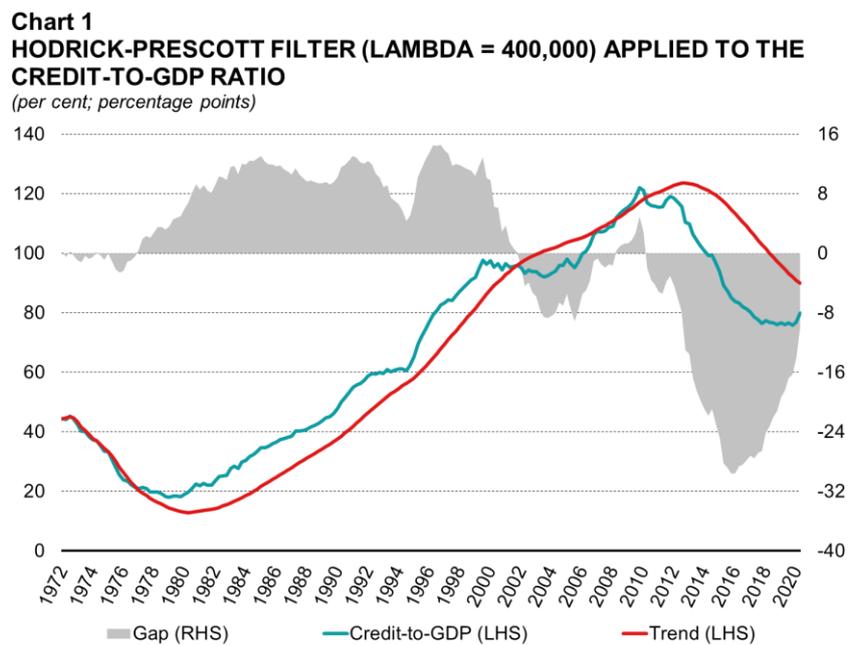
Indicators used in the assessment of the countercyclical capital buffer rate

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 smoothed credit-to-GDP plotted on the left-hand axis together with the actual series. The gap between the two is reflected in the light grey histogram which is plotted on the right-hand axis.



Source: Central Bank of Malta calculations.

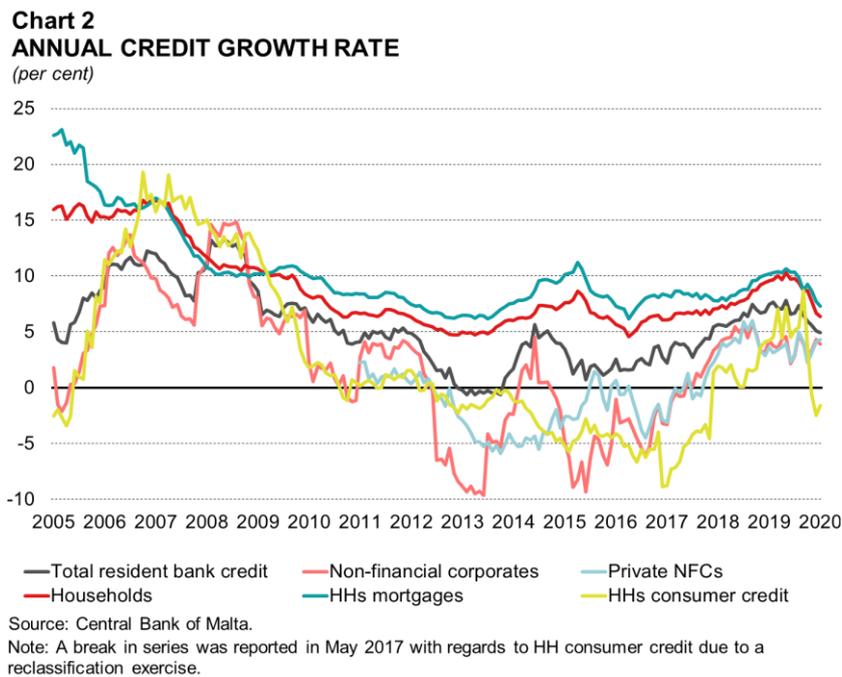
In the second quarter of 2020, the credit-to-GDP gap narrowed to -10.0 percentage points from a trough of around -30 percentage points in the first quarter of 2016. This reflects drop in GDP for the second quarter of 2020. The COVID-19 pandemic is also creating uncertainty surrounding credit developments largely on the back of the economic slowdown with anecdotal evidence indicating that firms' capital expenditure plans were postponed, coupled with slower mortgage growth, while lending for working capital increased. On balance, such developments have reinforced the decision that at the current juncture the CCyB rate of zero remains appropriate. Such decision is further corroborated by additional indicators to the headline indicator - the credit-to-GDP gap.

Credit Growth

Resident credit growth decelerated to 4.9% as at June 2020, largely on the back of a slowdown in credit to households, which rose by 6.4%, 2.3 percentage points lower than in the previous quarter. Mortgage lending grew by 7.3%, down by around 2 percentage points

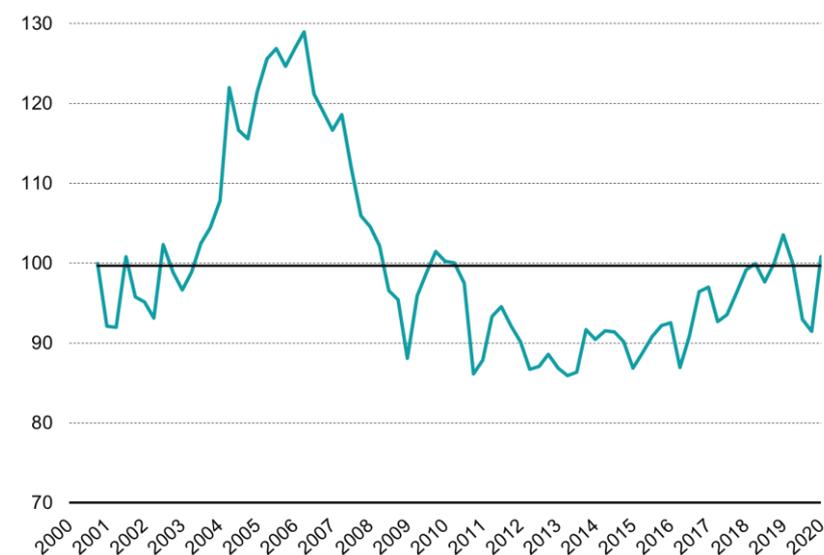
³ Credit represents total bank credit. CRD IV Article 136 (2a) states that "an indicator of growth of levels of credit within that jurisdiction" shall be used by the Authority. Although Drehmann (2013) showed that credit gaps based on total credit outperform those based on bank credit as early warning 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.

compared to the previous quarter while consumer credit contracted by 1.6% in 2020Q2, 5.2 percentage points lower when compared to March 2020 (see Chart 2). Meanwhile, NFC lending increased by 3.9% in June 2020, 2 percentage points higher than in the previous quarter.



During the first quarter of 2020, property prices rose by 5.6%, largely unchanged from the previous quarter but lower than in the same quarter the previous year. Property price growth started to decelerate prior to the pandemic but the uncertainty surrounding the COVID-19 pandemic, also caused a further slowdown in permits issued. 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.

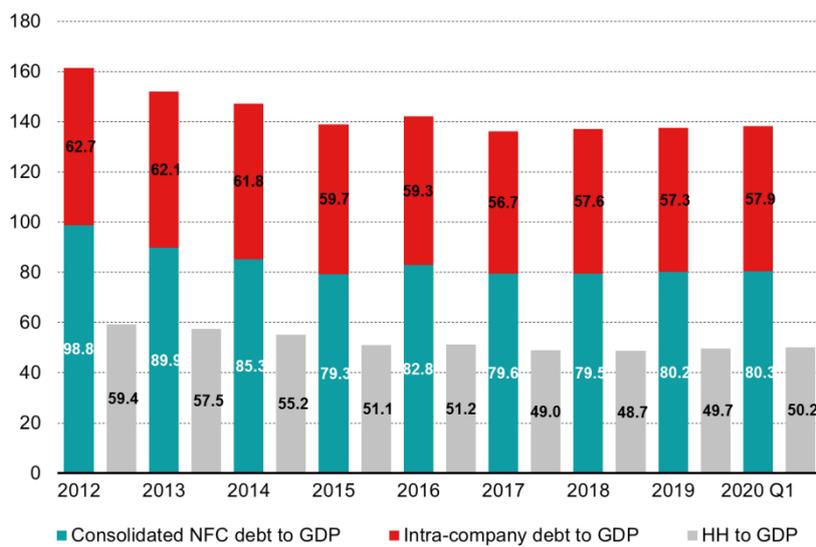
The conservative haircuts and loan-to-value ratios applied by banks help to mitigate any potential vulnerability that could stem from the real estate market, safeguarding both the banks' and households' balance sheet. Moreover, delinquency rates on resident mortgages have traditionally been low, whereas compensation of employees remained healthy despite dropping somewhat in Q2 2020 on the back of negative repercussions from the COVID-19 pandemic. Overall, on balance, financial stability risks stemming from the housing market remained contained also taking into consideration the fiscal and the latest policy measures including the implementation of moratoria and government guarantee schemes which are expected to ease some of the pressures on corporates and households alike.

Household and Corporate Debt

During the first quarter of 2020, private sector debt increased owing to higher corporate indebtedness and to a lower extent household debt. Expressed as a share of GDP, private sector debt rose by 1.2 percentage points compared to end 2019 to 188.4% (see Chart 4). The household debt-to-GDP increased by 0.5 percentage point to 50.2%, remaining below the euro area average. Meanwhile corporate debt-to-GDP edged slightly higher to 138.2%. Given that intra-group debt is an important element of NFC debt, on consolidated basis NFC indebtedness stood at a more contained rate of 80.3% of GDP, slightly below the euro area average. Furthermore, at about 183%, NFCs have a strong financial position with financial assets significantly exceeding their debt. Also, the leverage ratio of NFCs declined by 0.6

percentage point in 2020Q1 to 31.8% sustaining the downward trend reported for a number of years, to now stand just below the euro area average of 34.8% in March 2020. Moreover, households' net financial wealth remained strong mainly held in the form of cash and deposits.

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

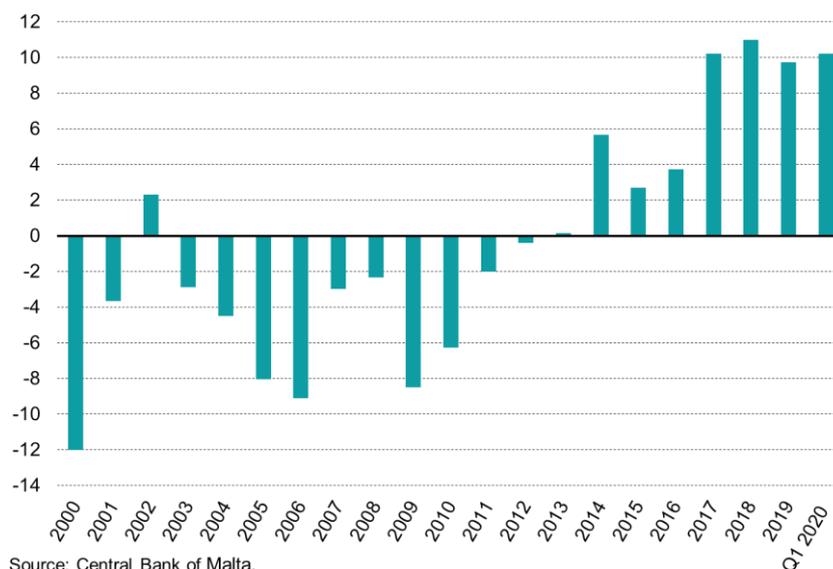


Sources: Central Bank of Malta; NSO.
Note: Based on four-quarter moving sum.

Current Account

On the external front, the current account remained in surplus at 10.2% of GDP in March 2020, 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.
 Note: Based on four-quarter moving sum.

The core domestic banks entered the COVID-19 outbreak with healthy capital levels, liquidity and profits. The Total Capital Ratio and Common Equity Tier 1 capital ratio standing at 19.7% and 17.2%, respectively in March 2020. Liquidity remained ample with core domestic banks' Liquidity Coverage Ratio standing at 357.4% in March 2020 and thus exceeding the regulatory requirement of 100%, indicating ample liquidity and stable funding as deposits continued to flow in, further building up the banks' liquidity buffer. This is buttressing further banks' resilience to the crisis and in their role in providing credit to the economy.

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. This is also in view of the current developments and the economic slowdown envisaged due to COVID-19. The standardised bank credit-to-GDP gap is currently negative at -10.0 percentage points, which is well below the reference threshold of 2 percentage points as indicated in the BCBS guidance.