



BANK ĊENTRALI TA' MALTA  
EUROSISTEMA  
CENTRAL BANK OF MALTA

## **The Countercyclical Capital Buffer Rate**

*December 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: 82.9% and its deviation from the long-term trend: -6.4 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 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.<sup>1</sup> 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%.<sup>2</sup>

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

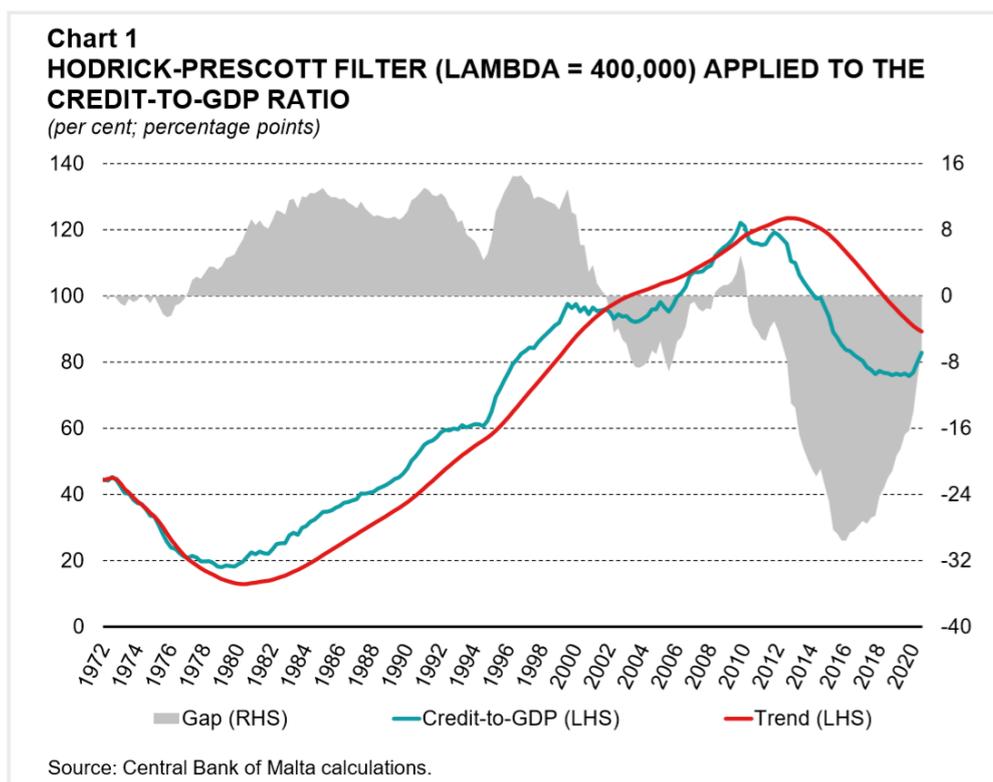
Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCyB, Chart 1 illustrates the results of the one-sided Hodrick-Prescott (HP) filter of the

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

<sup>2</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.

credit-to-GDP ratio for Malta.<sup>3</sup> 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.

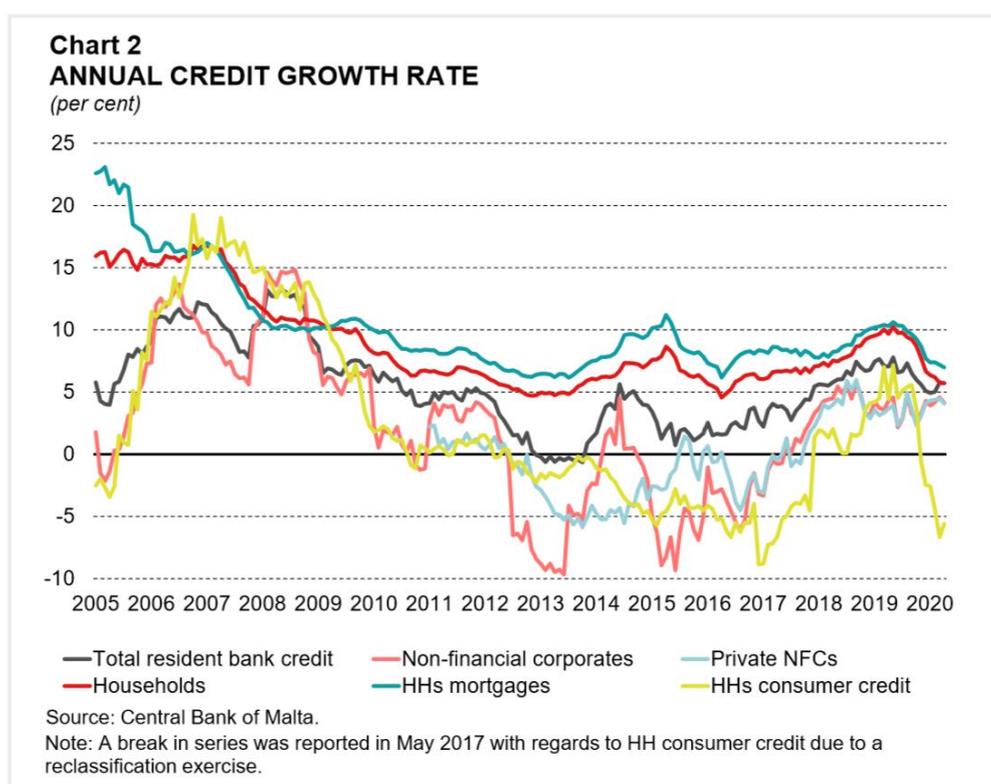


In the third quarter of 2020, the credit-to-GDP gap narrowed to -6.4 percentage points from a trough of around -30 percentage points in the first quarter of 2016. The narrowing of the gap in recent quarters mainly reflected a drop in GDP as the COVID-19 pandemic generated uncertainty resulting in a significant economic downturn. Although in the third quarter there were tentative signs of recovery in resident lending on the back of higher loans to NFCs as restrictions were lifted, growth rates are still lower than pre-pandemic levels. Anecdotal evidence indicates that firms are still being cautious about capital expenditure plans, while the growth in household lending continued to decelerate. 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.

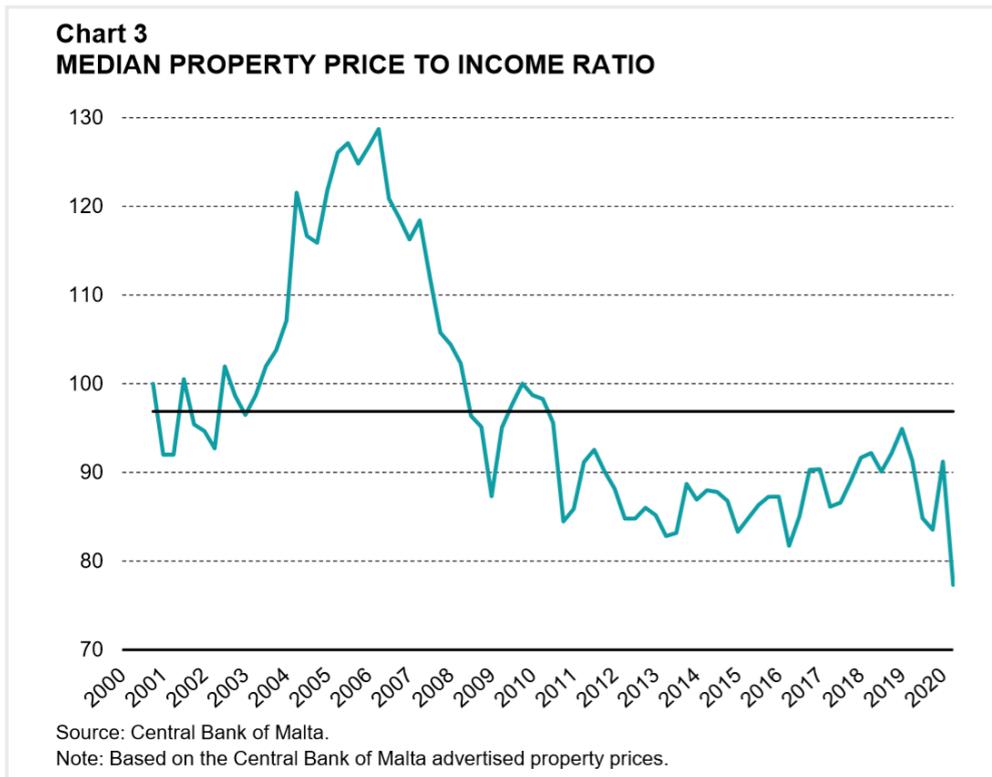
<sup>3</sup> Credit represents total bank credit. CRD IV Article 136 (2a) states that “an indicator of growth of levels of credit within that jurisdiction” shall be used by the Authority. Although Drehmann (2013) showed that credit gaps based on total credit outperform those based on bank credit as early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

## Credit Growth

Resident credit growth increased marginally to 5.7% as at September 2020, exclusively on the back of higher credit to NFCs, with a growth rate of 4.2%, which is 0.2 percentage point higher than in the previous quarter. Otherwise, growth in household lending continued to decelerate, although by a much lower extent than in the previous quarter. Mortgage lending grew by 7.0%, down by around 0.4 percentage point compared to the previous quarter while consumer credit contracted by 5.6% in 2020Q3, 3.0 percentage points lower when compared to June 2020 (see Chart 2).



During the second quarter of 2020, property prices rose by 3.4%, a slower rate when compared to the previous quarter and 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, also reflected in a more muted mortgage growth. The median advertised property price-to-income ratio declined significantly in 2020Q3 and stands at the lowest point since 2000 (see Chart 3).

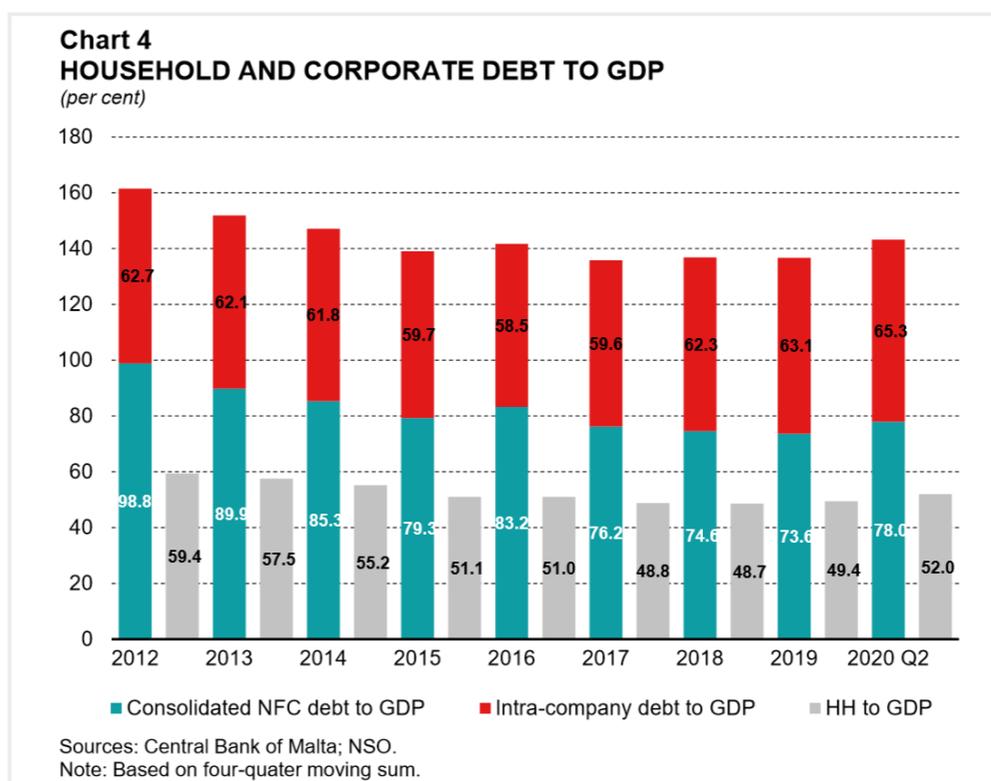


Meanwhile, the conservative haircuts and loan-to-value ratios applied by banks help to mitigate any potential vulnerabilities that could stem from the real estate market, safeguarding banks' and households' balance sheets. Although delinquency rates on resident mortgages increased marginally, these have remained low, whereas compensation of employees remained healthy, as there were signs of recovery in the third quarter of the year.

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 eased some of the pressures on corporates and households alike. However, looking ahead, it is important from a financial stability perspective that banks continue to maintain adequate capital and liquidity buffers due to potentially higher NPLs as the moratoria granted on credit facilities expire.

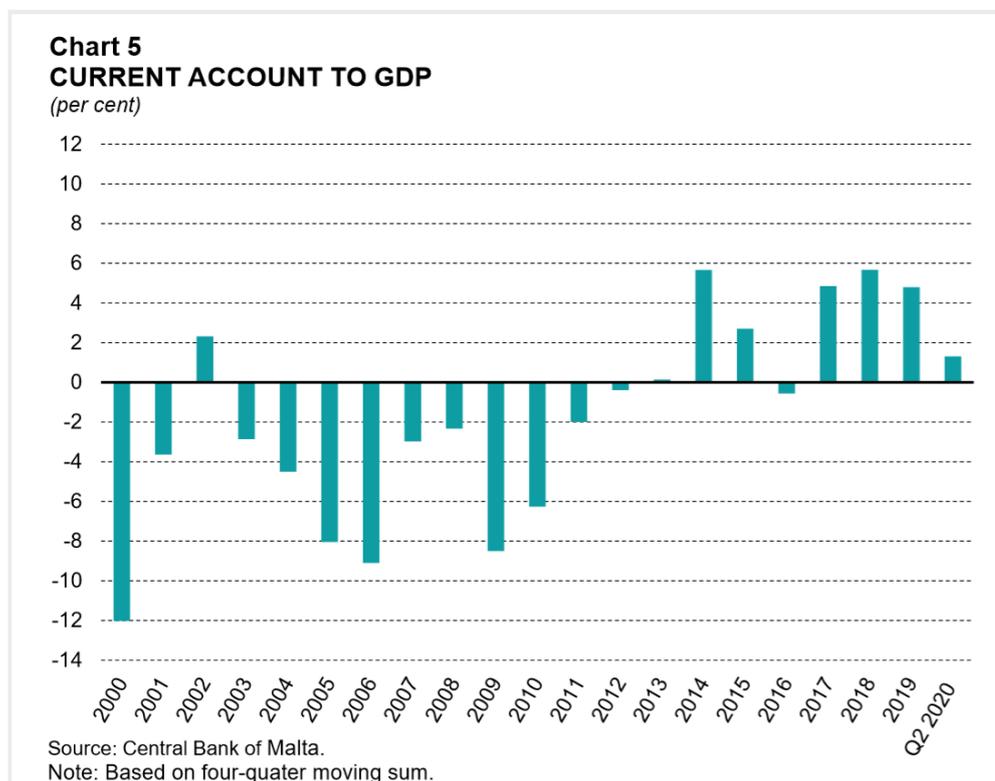
## Household and Corporate Debt

During the second 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 9.1 percentage points compared to end 2019 to 195.2% (see Chart 4). The household debt-to-GDP increased by 2.6 percentage points to 52.0%, remaining below the euro area average. Similarly, corporate debt-to-GDP also increased by a notable 6.5 percentage points to 143.2%, also remaining slightly below the euro area average. Given that intra-group debt is an important element of NFC debt, on consolidated basis NFC indebtedness stood at a more contained rate of 78.0% of GDP. Furthermore, at about 166%, NFCs have a strong financial position with financial assets significantly exceeding their debt. Also, the leverage ratio of NFCs declined by 0.5 percentage point in 2020Q2 to 32.9% sustaining the downward trend reported for a number of years, to now stand just below the euro area average of 35.2% in June 2020. Moreover, households' net financial wealth remained strong mainly held in the form of deposits.



## Current Account

On the external front, although the current account deteriorated in second quarter of 2020, this remained in surplus at 1.3% of GDP in June 2020, indicating that Malta is not currently resorting to external debt financing (see Chart 5).



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 20.0% and 17.4%, respectively in June 2020. Liquidity remained ample with core domestic banks' Liquidity Coverage Ratio standing at 329.7% in June 2020 and thus exceeding the regulatory requirement of 100%, indicating ample liquidity and stable funding as deposits continued to flow in, further building up banks' liquidity buffers. 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 brought about by the COVID-19 pandemic. The standardised bank credit-to-GDP gap is currently negative at -6.4 percentage points, which is still below the reference threshold of 2 percentage points as indicated in the BCBS guidance.