BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

The Countercyclical Capital Buffer Rate

September 2024
Financial Stability Department

The Countercyclical Capital Buffer (CCyB)

In line with Article 136(7) of EU Directive 2019/878, transposed in the Central Bank of Malta's 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: 64.8% and its deviation from the long-term trend: -5.6 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 that are associated with the build-up of systemic risk. This enhances the resilience of the banking system and counters the pro-cyclicality of credit. 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.

In its assessment, the Central Bank of Malta looks at the deviation of credit-to-GDP from its long-term trend together with other additional variables and expert judgement related to the current account balance, private sector credit and other banking sector indicators. It also considers other possible macro-prudential policies implemented with the aim to tackle cyclical risk, 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%.[1,2]

Indicators used in the Assessment of the CCyB rate

Credit-to-GDP Gap

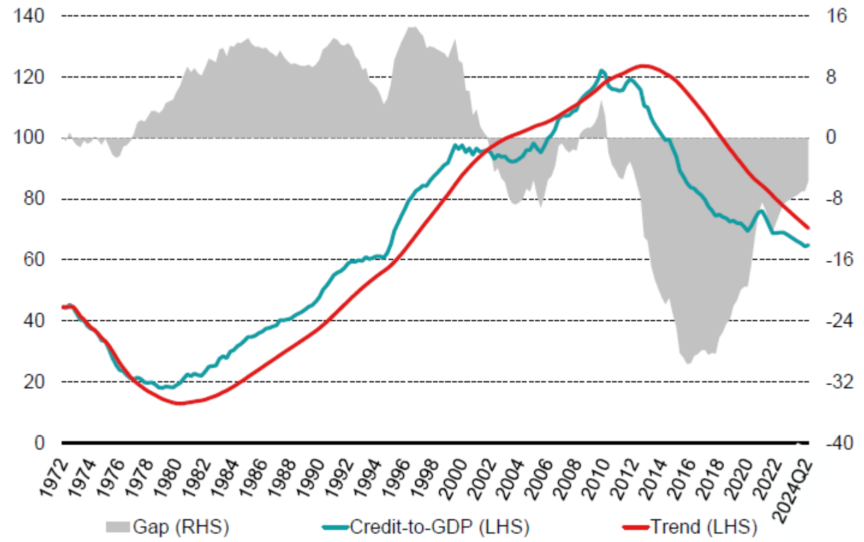
Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCyB, Chart 1 illustrates the results of the one-sided Hodrick-Prescott (HP) filter of the

[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 grey 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 second quarter of 2024, the credit-to-GDP gap narrowed to -5.6 percentage points, remaining well below the +2 percentage points activation threshold, while the credit-to-GDP ratio increased marginally by 0.4 percentage point to 64.8% as credit grew at a stronger pace than nominal GDP (see Chart 1). Real GDP grew annually by 6.9% in June 2024, reflecting robust growth in private consumption coupled with a surplus on the current account which was partly offset by lower gross capital formation.

Credit Growth

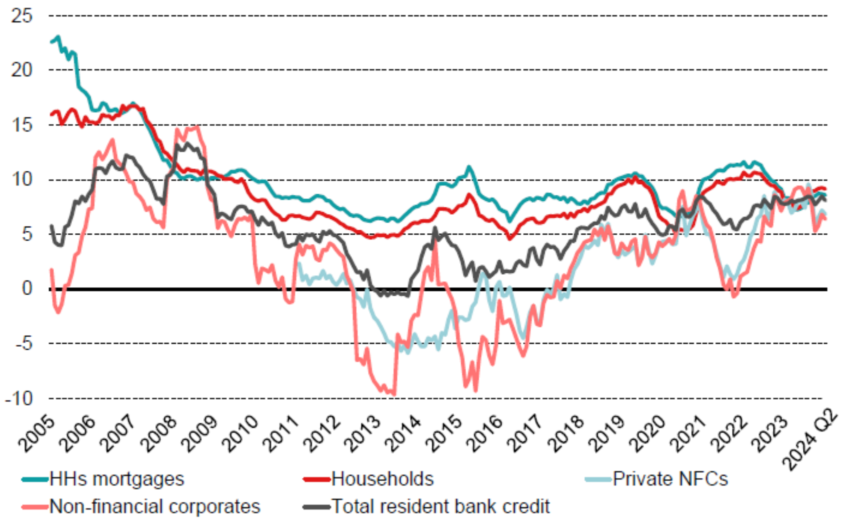
Resident credit grew at 8.1% in June 2024, somewhat faster than the 7.7% reported in the previous quarter and 7.8% in June 2023 (see Chart 2). This development continued to be largely driven by credit to households which increased strongly by 9.2%, in a large part driven by mortgages. The latter grew by 8.6%, remaining in line with the growth rate reported in the previous quarter, albeit still below the peaks reported post pandemic. During the first eight

[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.

months of 2024, the number and value of final deeds of sale transactions by households rose by 3.0% and 8.6%, respectively, as compared to the same period of previous year. Moreover, the number of promises of sale agreements involving households for residential real estate continued to increase, up by 3.4% during the first eight months of 2024. This could indicate that demand will also remain sustained in the short-term.

Moreover, resident NFC lending increased by 6.4% in June 2024, at a faster pace than the 5.3% recorded in the previous quarter, albeit 1.5 percentage points slower than the growth rate in June 2023. Such growth is still much higher than the historical average of 1.9%, covering the last 10 years. Sectoral level analysis show that cyclical dynamics are still predominantly driven by the real estate and construction sectors and hence are not widespread throughout all economics sectors.

Chart 2
ANNUAL CREDIT GROWTH RATE
(per cent)

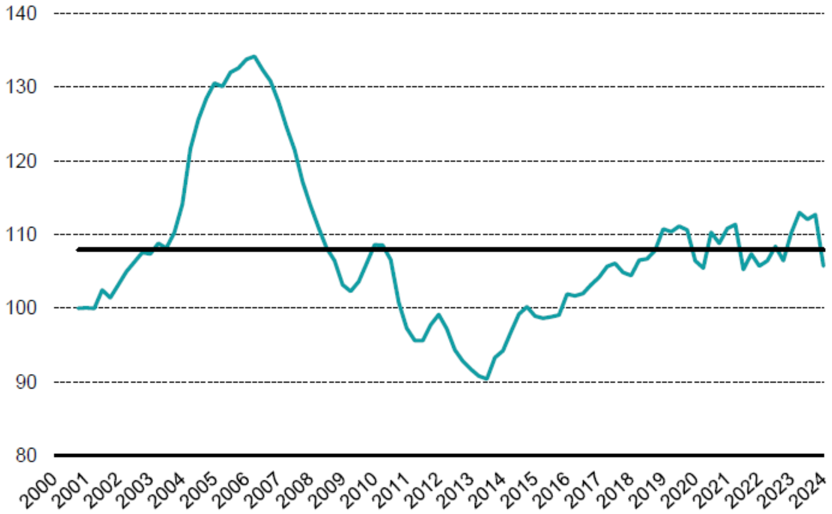


Source: Central Bank of Malta.
Note: A break in series was reported in May 2017 with regards to HH consumer credit due to a reclassification exercise.

Property market

Turning to the property market, transacted property prices increased by an annual 6.7% in the first quarter of 2024, in line with the previous quarter, but 0.6 percentage point slower than the first quarter of 2023. Such growth contrasts with the rest of the euro area, where on average prices declined by 0.6% in the first quarter of 2024. Housing affordability in Malta remained relatively stable over the recent years, with a slight slowdown reported in the first quarter of 2024 as the median advertised property price-to-per capita income, remained very much in line with the long-term average, and still noticeably below the peaks reported during the global financial crisis (see Chart 3).

Chart 3
MEDIAN PROPERTY PRICE-TO-PER CAPITA INCOME RATIO
(per cent)



Source: Central Bank of Malta.
Note: Based on the Central Bank of Malta advertised property prices. Refers to four-quarter moving average advertised property price and annual disposable income per capita. 2000Q4 = 100.

Meanwhile, the adherence by the banks to the Borrower-based Measures applying conservative haircuts and loan-to-value ratios as well as the application of the sectoral Systemic Risk Buffer (sSyRB), continued to mitigate any potential vulnerabilities that could stem from the real estate market, safeguarding banks, and households' balance sheets.[4] Delinquency rates on resident mortgages decreased further in the first half of 2024 whereas compensation of employees continued to improve.

Household and Corporate Debt

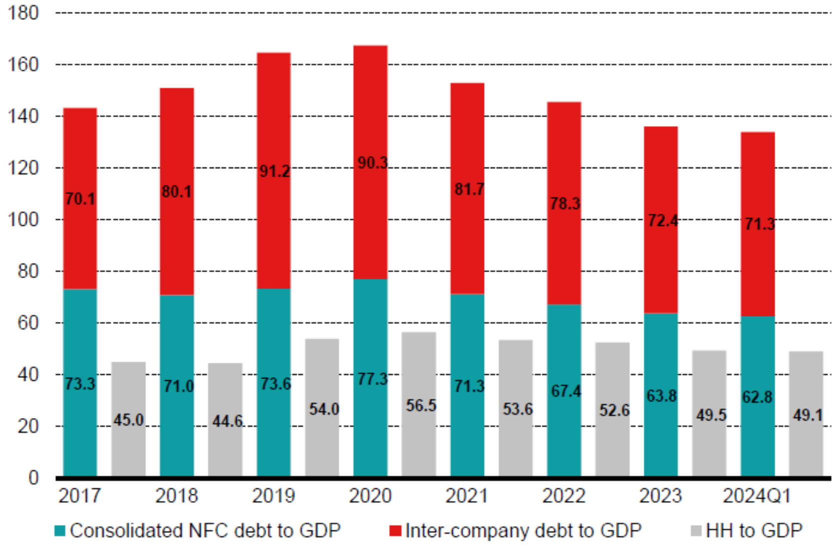
In 2024 Q1, private sector debt increased in absolute terms due to higher indebtedness for both corporates and households. Notwithstanding, expressed as a share of GDP, private sector debt declined to 183.2%, 2.5 percentage points lower than the level as at end-2023 reflecting the continued strong GDP growth (see Chart 4). The household debt-to-GDP ratio decreased marginally by 0.4 percentage point to 49.1% in March 2024, thus remaining below the euro area average of around 53%. Furthermore, household debt remained backed by

[4] On the 19th of January 2023, the Central Bank of Malta in collaboration with the Malta Financial Services Authority (MFSA) under the auspices of the Joint Financial Stability Board (JFSB) decided to set a Sectoral Systemic Risk Buffer (sSyRB) of 1.5% which is to be applied on the amount of risk-weighted assets held against domestic mortgages exposures to natural persons and secured by residential real estate (RRE).
[Sectoral Systemic Risk Buffer - Central Bank of Malta (centralbankmalta.org)](centralbankmalta.org)

significant net financial wealth which increased by 2.7% to 149.2% of GDP by the first quarter of 2024. Households' financial wealth is mainly held in the form of deposits, indicating high levels of liquidity. Household leverage proxied by the ratio of debt-to-assets remained quite stable at 24.0%. Meanwhile, disposable income also grew by 1.7% in 2024 Q1 as compared to December 2023, however the household debt-to-disposable income ratio still increased by 0.2 percentage points to 97.0% as at March 2024 due to a larger increase in household debt.

Meanwhile, NFC debt-to-GDP fell by 2.1 percentage points in 2024 Q1 to 134.1%. Given that intra-group debt is an essential element of NFC debt, on a consolidated basis, NFC indebtedness was limited to almost 63% of GDP, down by 1.0 percentage point as at end-2023 and being below the euro area average of 67.6%. NFC leverage remained quite stable at 26.5% in March 2024, slightly below the euro area average of 27.2%.[5]

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

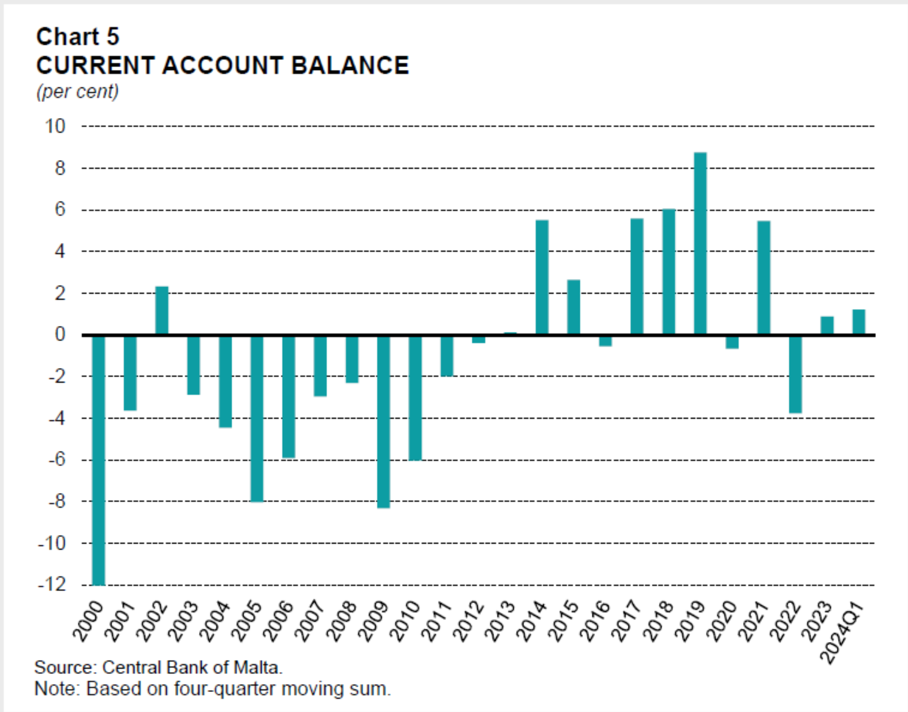


Sources: Central Bank of Malta; NSO.
Note: Based on four-quarter moving sum.

[5] ECB Data Portal

Current Account

On the external front, the current account balance remained in a surplus of 1.2% of GDP in March 2024 exclusively due to a robust surplus on services which more than fully offset net outflows particularly stemming from trading of goods and primary income (see Chart 5).[6]



The core domestic banks continued to report healthy aggregate capital levels, ample liquidity, as well as improved profitability. Their Total Capital Ratio and Common Equity Tier 1 (CET1) capital ratio stood at 24.2% and 20.6%, respectively in June 2024. Meanwhile, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) stood at 351.2% and 175.5%, respectively, indicating abundant liquidity and stable funding conditions. 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 0%, also given that this macroprudential tool is perceived to impact all segments of credit, which at this stage remains unwarranted. The standardised bank credit-to-GDP gap is currently negative at -5.6 percentage points, which is still below the reference threshold of positive 2 percentage points as indicated in the BCBS guidance. Furthermore, supplementary indicators also indicate that cyclical risks are being driven by mortgage lending, which are being addressed with the sSyRB and the Borrower-based Measures.

[6] The current account balance as at March 2024 reflects 4-quarter moving sum figures.