BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

The Countercyclical Capital Buffer Rate

March 2023
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: 73.9% and its deviation from the long-term trend: -6.2 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 counter 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.

The traditional indicator supporting this proposal is the deviation of credit-to-GDP from its long-term trend. The analysis is further supplemented by additional indicators and expert judgement.[1] The Central Bank of Malta assesses variables related to the current account balance, 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

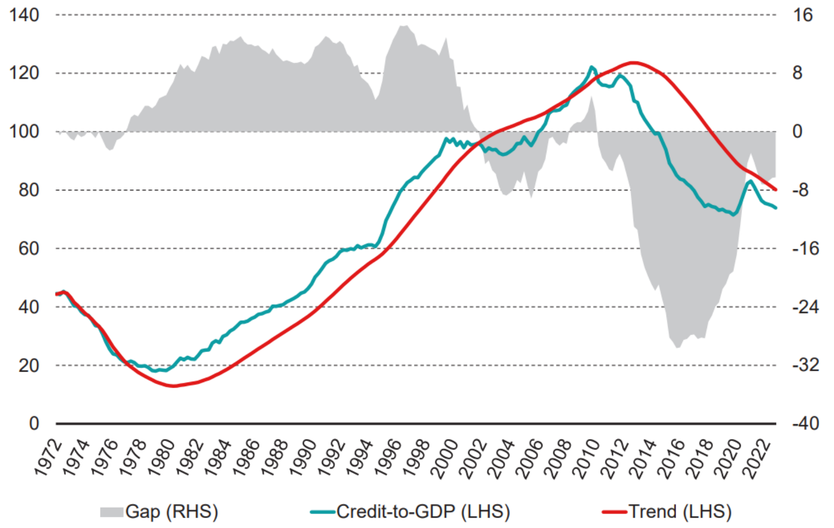
Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCyB, Chart 1 illustrates the results of the one-sided Hodrick-Prescott (HP) filter of the

[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 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 last quarter of 2022, the credit-to-GDP gap narrowed slightly to -6.2 percentage points while the credit-to-GDP ratio fell to 73.9% as economic activity continued to expand at a stronger pace than credit (see Chart 1). In line with this, real GDP grew by 6.9% in 2022 reflecting robust growth in exports and private consumption. Nonetheless, the Bank's latest economic forecast expects a slowdown in economic activity going forward with real GDP growing by to 3.7% in 2023 and eases further in 2024 and 2025 to 3.6% and 3.5%, respectively.[4] How this translates into the developments within the gap depends on other factors including the path of future credit growth. The gap remains below the activation threshold of +2 percentage points, and credit remains largely driven by mortgage lending. Although a recent pick-up in private NFC credit could be observed, this has to be seen in the context of previous subdued levels, which have also registered contractions after accounting for Malta Development Bank guaranteed loans. Furthermore, NFC leverage is still on a downward trend. This supplements the decision that at the current juncture, the decision is

[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.

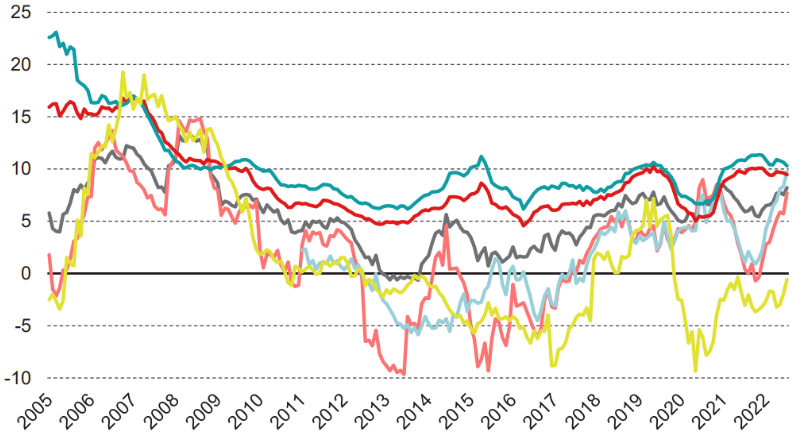
[4] Economic Projections - Central Bank of Malta (centralbankmalta.org)

not to activate the CCyB buffer rate above 0%, also given that this macroprudential tool is perceived to impact all segments of credit, which at this stage is deemed unwarranted. In this regard, cyclical risks which are being driven by mortgage lending are now being addressed with the introduction of a sectoral systemic risk buffer.[5]

Credit Growth

In December 2022, resident credit growth accelerated to 8.2% compared to 7.7% in the previous quarter, and 5.9% in 2021 (see Chart 2). Such growth continued to be largely driven by credit to households, increasing by 9.5% owing exclusively to mortgages which grew by 10.3%. Although there are signs that the front loading of mortgages due to the tax relief scheme is dissipating with promises of sale also falling annually by a fifth, mortgages kept the growth momentum similar to pre-pandemic times. Consumer lending contracted further but at a less pronounced rate of just 0.6% in December 2022. Meanwhile, resident NFC lending picked up further momentum, to grow by almost 8% by end-2022, mainly due to pent-up demand largely in real estate following postponement of investment decisions during the pandemic.

Chart 2
ANNUAL CREDIT GROWTH RATE
(per cent)



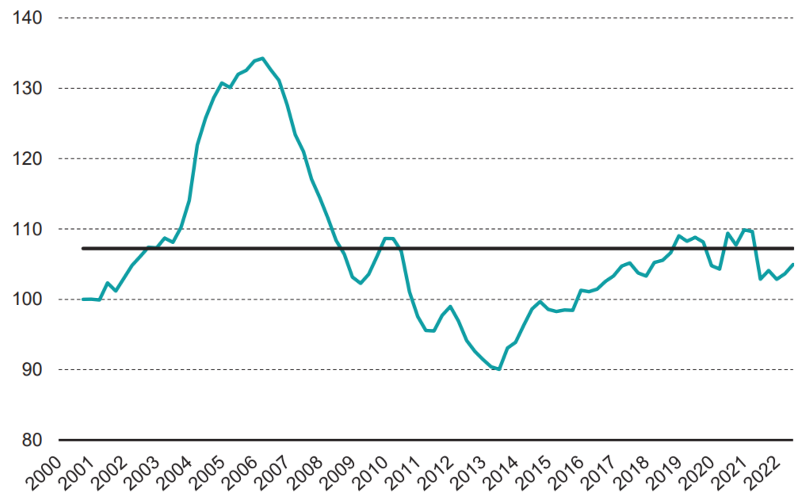
Source: Central Bank of Malta.
Note: A break in series was reported in May 2017 with regards to HH consumer credit due to a reclassification exercise.

[5] 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)]

Property market

Turning onto the property market, transacted property prices grew by an annual 6.3% in the third quarter of 2022, down by 1.3 percentage points compared to the previous quarter, being somewhat above the average since 2009 but still below the euro area average of 6.8%. Furthermore, after the general deterioration between 2013 and 2019, housing affordability improved slightly in recent quarters with the ratio of the median advertised property price-to-per capita income ratio hovering below the long-term average and 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 with 2000Q4 = 100.

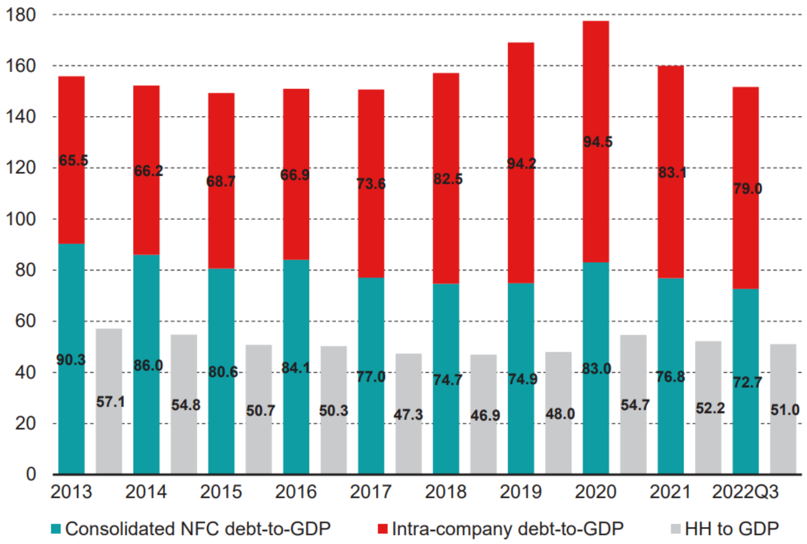
Meanwhile, the conservative haircuts and loan-to-value ratios applied by banks continue to mitigate any potential vulnerabilities that could stem from the real estate market, safeguarding banks and households' balance sheets. Conservative lending practices are also enforced through the borrower-based measures which were introduced in 2019 through the Banks' Directive No. 16. Delinquency rates on resident mortgages decreased further in 2022 whereas compensation of employees continued to improve.

Household and Corporate Debt

During the third quarter of 2022, private sector debt increased further reflecting both higher corporate indebtedness and household debt. However, expressed as a share of GDP, private sector debt decreased to 202.7% in 2022, 9.5 percentage points lower than the level as at end-2021 on account of the strong recovery in GDP (see Chart 4). In the first three quarters of the year the household debt-to-GDP ratio fell by 1.2 percentage points to 51.0% when compared to December 2021, remaining below the euro area average. However, looking at household leverage, both their debt to financial assets and to disposable income rose to reach 24.1% and 85.1%, respectively in September 2022. Meanwhile, although households' net financial wealth remained relatively stable, as a share of GDP it narrowed to 152.4%. Such assets are mainly held in the form of deposits, indicating high levels of liquidity held by households.

Meanwhile, NFC debt-to-GDP fell by 8.3 percentage points to 151.7%. Given that intra-group debt is an important element of NFC debt, on a consolidated basis NFC indebtedness stood at a more contained rate of 72.7% of GDP, below the euro area average of 77.6%. Meanwhile, the NFCs' leverage ratio on a consolidated basis, remained stable at 27.3% and thus still below the euro area average. This highlights the diverging trends between households and corporates also in terms of debt leverage.

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

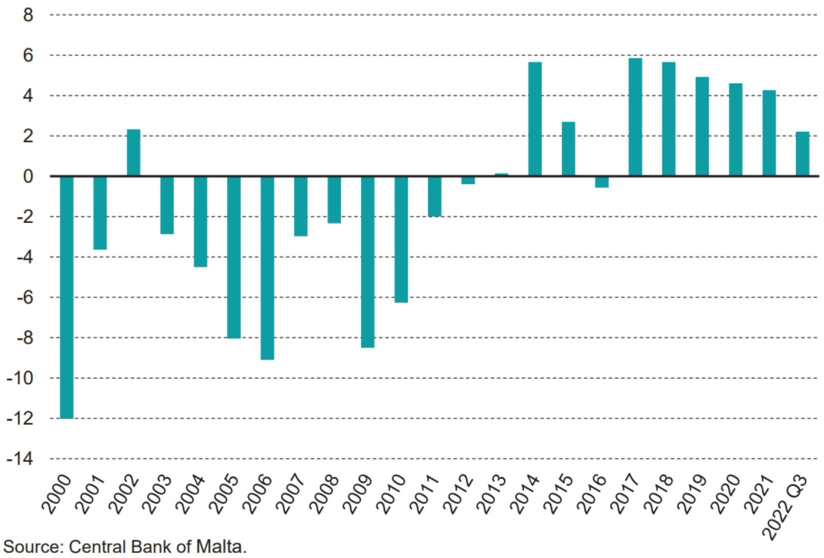


Sources: Central Bank of Malta; NSO.
Note: Based on four-quarter moving sum.

Current Account

On the external front, the current account remained in surplus at 2.2% of GDP as net services receipts continued to grow. The current account balance however declined compared to end-2021, mostly on account of lower net primary income and net receipts on goods (see Chart 5).

Chart 5
CURRENT ACCOUNT BALANCE
(per cent)



Source: Central Bank of Malta.
Note: Based on four-quarter moving sum.

The core domestic banks continued to report healthy aggregate capital levels, ample liquidity, as well as improved profitability. The core domestic banks' Total Capital Ratio and Common Equity Tier 1 (CET1) capital ratio stood at 22.6% and 19.1%, respectively in December 2022. The Liquidity Coverage Ratio (LCR) of the core domestic banks stood at 363.0%, indicating abundant liquidity and stable funding conditions as deposits continued to flow in, further building up banks' liquidity buffers.

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%. The standardised bank credit-to-GDP gap is currently negative at -6.2 percentage points, which is still below the reference threshold of positive 2 percentage points as indicated in the BCBS guidance.