BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

The Countercyclical Capital Buffer Rate

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Financial Stability Department

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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: 69.6% and its deviation from the long-term trend: -6.8 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.

The headline indicator supporting this proposal is the deviation of credit-to-GDP from its long-term trend. The analysis is however further supplemented by additional indicators and expert judgement.[1] In its assessment, the Central Bank of Malta looks other additional 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

Credit-to-GDP Gap

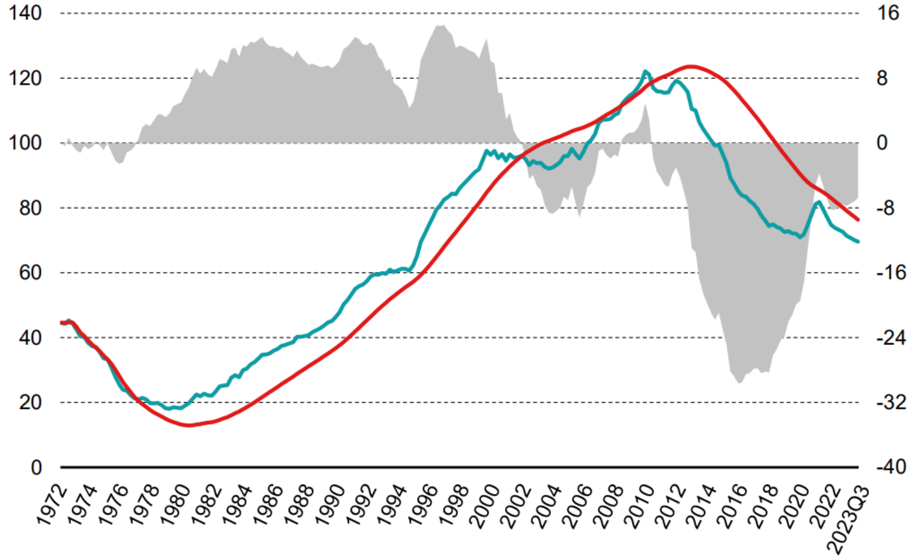
Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCyB, Chart 1 illustrates the results of the one-sided Hodrick-Prescott (HP) filter of the

[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 third quarter of 2023, the credit-to-GDP gap narrowed to -6.8 percentage points, though still below the +2 percentage points activation threshold, while the credit-to-GDP ratio fell marginally to 69.6% as nominal GDP continued to expand at a stronger pace than credit (see Chart 1). Real GDP grew by 6.7% in the four quarters to September 2023, reflecting robust growth in private consumption, partly offset by lower gross capital formation and a current account deficit.

Credit Growth

Resident credit growth continued to grow strongly in September 2023, up by 8.0% compared to 7.8% in the previous quarter, and 7.6% in September 2022 (see Chart 2). Such growth continued to be largely driven by credit to households which increased strongly by 8.0% mainly fuelled by mortgages which grew by a somewhat gradually lower rate of 7.7%, compared to

[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.

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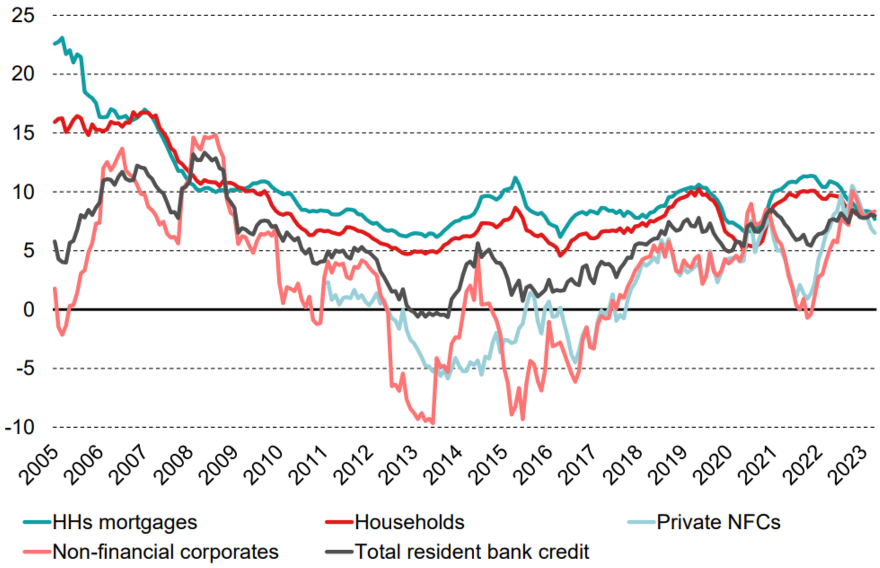
8.4% in the previous quarter and 10.9% in September 2022. Going forward, the mortgage growth rate could continue to moderate, reflecting in part the impact of the introduction of the sSyRB, and a possible pass-through of higher interest rates, which however has been limited to-date given the ample liquidity buffers of domestic banks, as well as strong competitive pressures. Notwithstanding, the number of promises of sale agreements signed in the first nine months of 2023 grew by 9.3% when compared to the same period of the previous year, which could indicate that demand will remain sustained in the short-term. Resident NFC lending also increased, up by 8.4% mainly towards property-related sectors and hence it is not widespread evenly across sectors. However, this reflects a deceleration when compared to the 10.1% in March 2023 as such elevated demand started to normalise during the past few months.

Chart 2
ANNUAL CREDIT GROWTH RATE
(per cent)

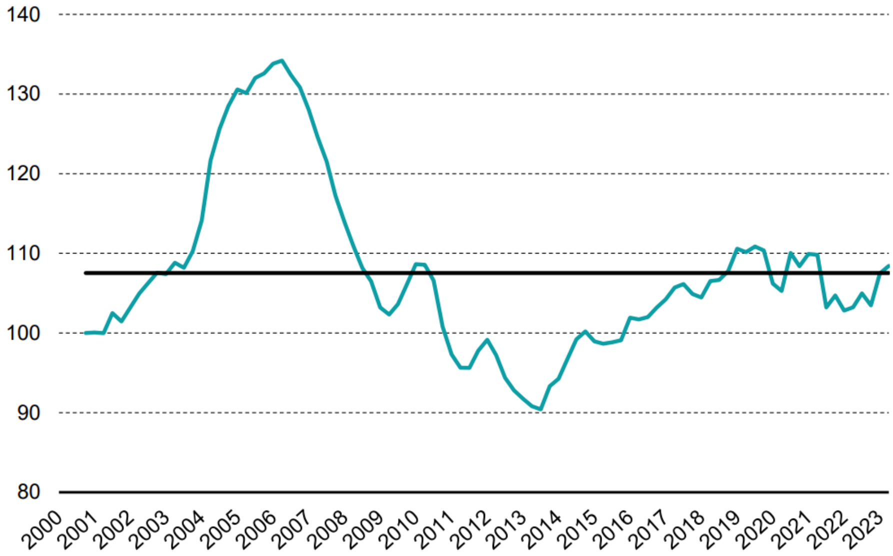


Source: Central Bank of Malta.
Note: A break in series was reported in May 2017 with regards to HH consumer credit due to a reclassification exercise.

Property market

Turning onto the property market, transacted property prices grew by an annual 4.5% in June 2023, down by 2.1 percentage points compared to the previous quarter, but still somewhat above the average since 2009. Property prices still grew at a much faster pace than in the euro area average, where they declined by 1.7% in June 2023, as most other euro area countries experienced deterioration in their property markets over the past few months. Housing affordability in Malta continued to show some marginal signs of deterioration in the second quarter of 2023, with the ratio of the median advertised property price-to-per capita income ratio now slightly above the long-term average, although 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.

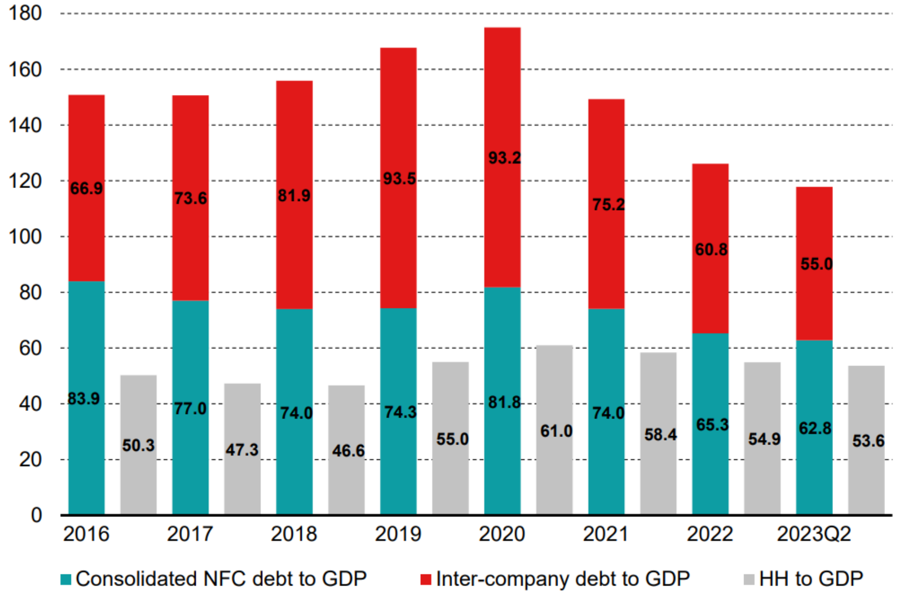
Meanwhile, the conservative haircuts and loan-to-value ratios applied by banks, continued to mitigate any potential vulnerabilities that could stem from the real estate market, safeguarding banks, and households' balance sheets. Delinquency rates on resident mortgages decreased further in the third quarter of 2023 whereas compensation of employees continued to improve.

Household and Corporate Debt

During the first half of 2023, private sector debt retreated further because of lower corporate indebtedness as otherwise household debt continued to increase. In line with this, expressed as a share of GDP, private sector debt declined to 171.4% in June 2023, 9.6 percentage points lower than the level as at end-2022 also reflecting the continued GDP growth (see Chart 4). The household debt-to-GDP ratio still decreased, although moderately by 1.3 percentage points to 53.6% in June 2023, remaining below the euro area average of around 55%. Furthermore, household debt remained backed by significant net financial wealth which increased by 2.1% to 163.6% of GDP in June 2023. Households' financial wealth is mainly held in the form of deposits, indicating high levels of liquidity. Looking at household leverage, although their debt grew at a slightly faster pace than their financial assets, household debt-to-assets remained quite stable at 23.8% when compared to end-2022. Meanwhile, the growth in disposable income remained limited with the household debt-to-disposable income ratio increasing slightly to 94.9% as at June 2023.

Meanwhile, NFC debt-to-GDP fell by 8.3 percentage points in the first half of 2023 to 117.8%. Given that intra-group debt is an essential element of NFC debt, on a consolidated basis, NFC indebtedness was limited to 62.8% of GDP, down from 65.3% as at end of 2022 and still below the euro area average of 68.8%. NFC leverage remained relatively stable at 27.9% in June 2023, slightly below the euro area average of 28.1%.[4]

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, in June 2023 the current account balance remained in a deficit of 1.3% of GDP mainly due to a trade deficit on goods and a net outflow on primary income.[5] When compared to end-2022, the current account deficit is less pronounced due to some offsetting effects from higher net services receipts (see Chart 5).

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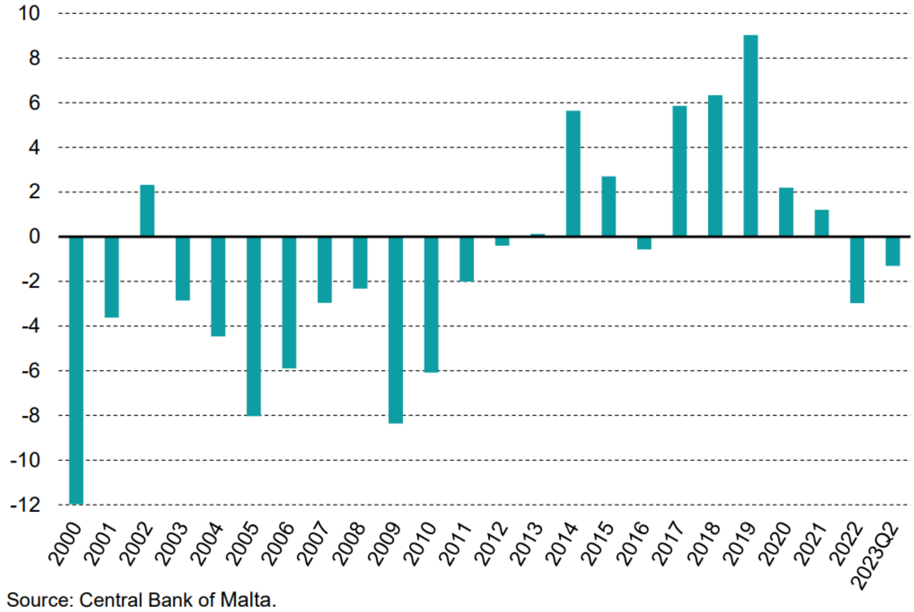
[4] ECB Data Portal
[5] The current account balance as at June 2023 reflects 4-quarter moving sum figures.

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 23.1% and 19.7%, respectively in September 2023. Meanwhile, the Liquidity Coverage Ratio (LCR) of the core domestic banks stood at 381.4%, indicating abundant liquidity and stable funding conditions, despite the slight annual decrease in customer deposits reported in September 2023. 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 -6.8 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 now being addressed with the introduction of a sectoral systemic risk buffer.[6]

[6] 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)