BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

The Countercyclical Capital Buffer Rate

March 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: 69.7% and its deviation from the long-term trend: -5.8 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.

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 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

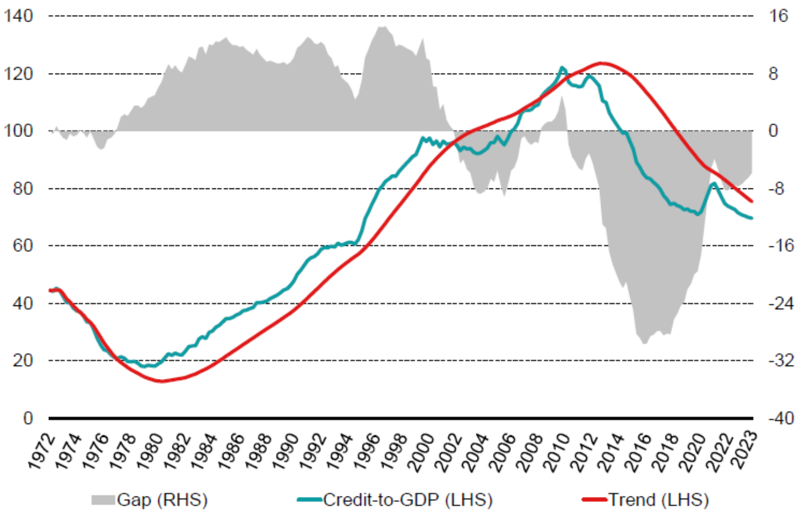
Based on the Basel Committee on Banking Supervision (BCBS) Guidance for the calculation of the CCyB, Chart 1 illustrates the results of the one-sided Hodrick-Prescott (HP) filter of the

[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 last quarter of 2023, the credit-to-GDP gap narrowed to -5.8 percentage points, remaining well below the +2 percentage points activation threshold, while the credit-to-GDP ratio fell marginally to 69.7% as nominal GDP continued to expand at a stronger pace than credit (see Chart 1). Real GDP grew by 5.6% in 2023, reflecting robust growth in private consumption coupled with a surplus on the current account which partly offset by lower gross capital formation.

Credit Growth

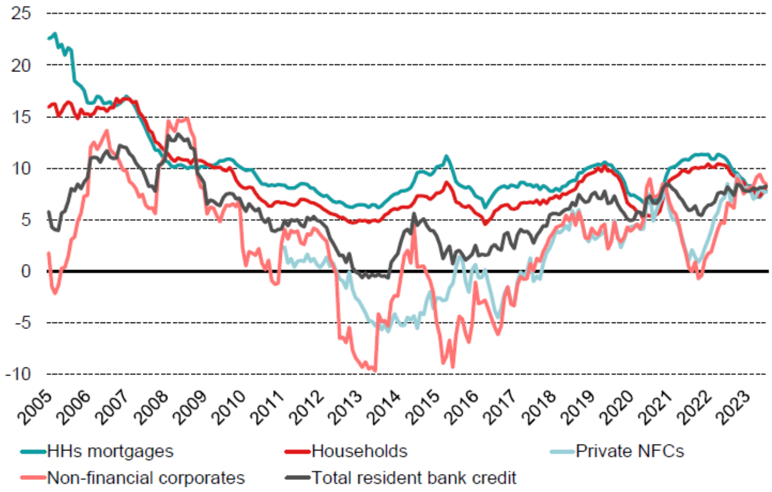
Resident credit continued to grow steadily, ending the year with a growth rate of 8.3% compared to the 8.0% in the previous quarter and 8.2% in December 2022 (see Chart 2). Such growth continued to be largely driven by credit to households which increased strongly by 8.2% mainly fuelled by mortgages which grew by 7.8%, compared to 7.2% in the previous quarter, albeit remaining below the growth rate of 10.7% reported in December 2022. This

[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.

slight uptick in growth in the fourth quarter of 2023 in part reflects a slight increase in final deeds of sale signed during the same quarter, compounded by the limited interest rate pass-through on mortgages. The latter was possible due to the ample liquidity buffers of domestic banks, as well as strong competitive pressures. The number of promises of sale agreements signed in 2023 grew by 8.6% when compared to the previous year, which could indicate that demand will also remain sustained in the short-term.

Resident NFC lending also increased, up by 8.6%. This was mainly towards the construction and real estate sectors, albeit other sectors also reported an increase but to a lower extent, largely the professional, scientific and technical activities sector. Notwithstanding, this reflects a deceleration when compared to a peak annual growth rate exceeding 9% which was reported in October 2023 as such elevated demand started to normalise during the past couple of months.

Chart 2
ANNUAL CREDIT GROWTH RATE
(per cent)

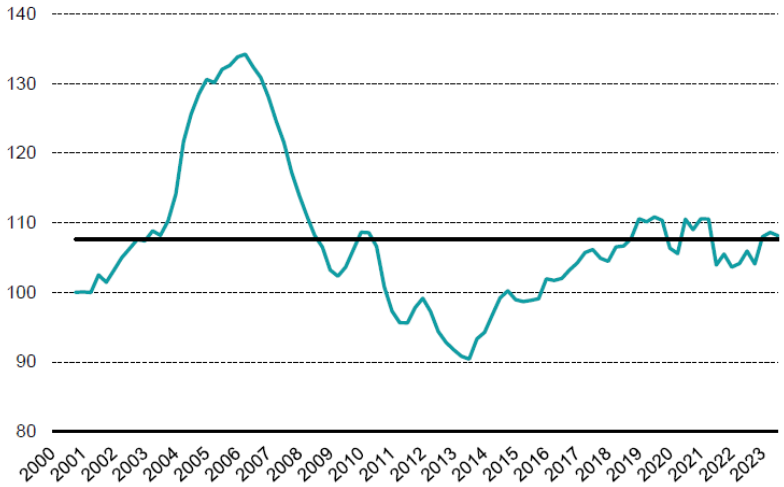


Source: Central Bank of Malta.
Note: A break in series was reported in May 2017 with regards to HH consumer credit due to a reclassification exercise.

Property market

Turning to the property market, transacted property prices increased by an annual 4.6% in September 2023, notably slower than the high of 7.6% reported in mid-2022. Property prices continued to grow in contrast to the rest of the euro area, where on average these declined by 2.1% in September 2023, as most euro area countries experienced deterioration in their property markets over the past few months. Housing affordability in Malta remained quite stable in the third quarter of 2023 as the ratio of the median advertised property price-to-per capita income remained largely unchanged in the third quarter of the year, 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 conservative haircuts and loan-to-value ratios applied by banks 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 last quarter of 2023 whereas compensation of employees continued to improve.

Household and Corporate Debt

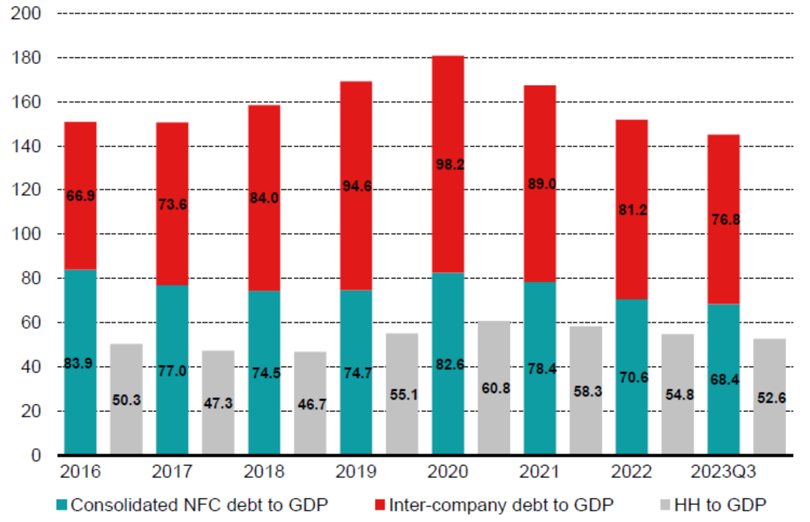
During the first nine months of 2023, private sector debt increased in absolute terms due to higher indebtedness for both corporates and households. Notwithstanding, expressed as a share of GDP, private sector debt declined to 197.8%, 8.8 percentage points lower than the level as at end-2022 reflecting the continued strong GDP growth (see Chart 4). The household debt-to-GDP ratio decreased by 2.1 percentage points to 52.6% in September 2023, thus remaining below the euro area average of around 55%. Furthermore, household debt remained backed by significant net financial wealth which increased by 4.5% to 165.3% of GDP by the third quarter of 2023. Households' financial wealth is mainly held in the form of

[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)

deposits, indicating high levels of liquidity. Household leverage proxied by the ratio of debt-to-assets remained stable at 23.3% when compared to end-2022. Meanwhile, disposable income also grew by 4.3% in the first nine months of the year leading to the household debt-to-disposable income ratio to remain quite stable at around 94% as at September 2023.

Meanwhile, NFC debt-to-GDP fell by 6.7 percentage points in the first nine months of 2023 to 145.1%. Given that intra-group debt is an essential element of NFC debt, on a consolidated basis, NFC indebtedness was limited to 68.4% of GDP, down from 70.6% as at end-2022 and very much in line with the euro area average of 68.1%. NFC leverage remained quite stable at around 27% in September 2023, slightly below the euro area average of 28.4%.[5]

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



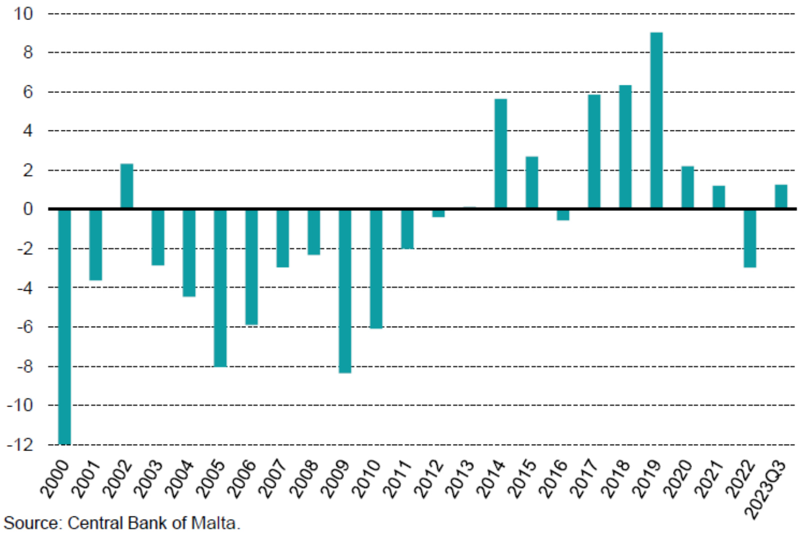
Sources: Central Bank of Malta; NSO.
Note: Based on four-quarter moving sum.

Current Account

On the external front, in September 2023 the current account balance turned into a surplus of 1.3% of GDP 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]

[5] ECB Data Portal
[6] The current account balance as at September 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 23.9% and 20.1%, respectively in December 2023. Meanwhile, the Liquidity Coverage Ratio (LCR) of the core domestic banks stood at 360.4%, 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 -5.8 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 being addressed with the sSyRB and the borrower-based measures.