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DEEP-DIVE ANALYSIS INTO MORATORIA UPTAKE IN MALTA

BOX 6: DEEP-DIVE ANALYSIS INTO MORATORIA UPTAKE IN MALTA¹

Introduction

The COVID-19 pandemic has prompted public authorities – both locally and in other countries – to take various policy measures to contain the transmission of the virus. Measures such as business shutdowns, quarantines, and restrictions on mobility and social contact resulted in significant operational disruption and have brought some sectors of the economy to a standstill.

The various containment measures that were introduced in Malta resulted in, as elsewhere, reduced cash inflows for affected local businesses and households. In response, the Government and other authorities rolled out a package of support measures, among which were wage supplement schemes, tax deferrals, guaranteed bank lending and loan moratoria to alleviate such liquidity shocks, thereby avoiding undue insolvencies and employee layoffs.

As part of this support package, the Bank issued Directive No. 18 on ‘Moratoria on Credit Facilities in Exceptional Circumstances’ to lay down the eligibility criteria of borrowers for loan moratoria.² This box takes a deeper look at the loan moratoria uptake in Malta, including a sectoral analysis on the recourse by the private sector to this measure. It also aims to assess the financial stability impact on lenders, followed by an impact assessment on credit institutions’ NII and NPL ratios. A stress test also complements this analysis, testing banks’ resilience against potential cliff-edge effects, in other words, sudden increases in NPLs upon expiration of loan moratoria.

Impact on non-financial private sector

By combining granular loan data from the Bank’s Central Credit Register (CCR) and publicly available information, one could shed more light on the composition of granted loan moratoria in order to observe any interlinkages across sectors due to common sources of activity.

The economic shocks brought about by the COVID-19 pandemic have affected the financial position of firms operating in a variety of economic sectors in a heterogeneous manner. This is evidenced by the varying shares of loans under moratoria when compared to the outstanding loans granted in the respective sector as, shown in Chart 1. It also shows a varying degree of impact that can be inferred from the granting of loan moratoria, across sectors and also across time. The extent of the impact from the pandemic appears to be determined by the exposure of a particular sector to the type of (i) mobility restrictions on the local population, (ii) restrictions in international travel and (iii) the extent of such restrictions. The impact on these sectors also varies across time, reflecting the evolution of the restrictions mentioned above.

Chart 2 illustrates the movement in the composition of loan moratoria uptake by sector, in order to shed light on the drivers of sectoral recourse to moratoria. In doing so, this chart also compares the evolution of two indicators. The Stringency Index (SRI) provides daily observations of the degree

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² The Minister for Public Health and the then Minister for Finance and Financial Services on 13 April 2020 issued Legal Notice 142 of 2020 on ‘Moratorium on Credit Facilities in Exceptional Circumstances Regulations.’ Through L.N. 142 of 2020, the Bank was mandated to issue CBM Directive No. 18 on ‘Moratoria on Credit Facilities in Exceptional Circumstances.’ Directive No. 18 effectively reflects the provisions outlined in EBA Guidelines on legislative and non-legislative moratoria (EBA/GL/2020/15), which exempt EBA-compliant loan moratoria from being classified as non-performing. This in turn has a positive impact on banks’ capital position as it avoids the incidence of higher loss provisions following an undue classification of NPLs, thus allowing banks to continue to extend credit at a time of need.

of containment measures on a scale from 0 (no restrictions) to 100 (full containment).³ Meanwhile, the tourism activity index provides a comparison of monthly inbound tourists to corresponding monthly pre-COVID-19 figures, thereby providing an evolution of the impact on sectors exposed to tourism activity.

Combining evidence from both charts shows that the sectors whose financial position has been most affected were:

- i. Households;
- ii. Accommodation and food service activities (NACE code I);
- iii. Real estate activities (L);
- iv. Administrative and support service activities (N);
- v. Professional, scientific and technical activities (M – 70.1);
- vi. Financial and insurance activities (K – 64.2);⁴
- vii. Wholesale and retail trade (G);
- viii. Construction (F).

As shown in Chart 2, the SRI peaked in April 2020 (87), with containment measures being relaxed between June and July (31.5) of the same year and re-tightened at a stable level between August 2020 and February 2021 (52.78). The SRI shows a further tightening in March 2021 (75) followed by a loosening in April (68). Meanwhile, as expected, 2020-21 tourism levels were substantially below the corresponding pre-COVID-19 levels throughout the entire period analysed. A 56.6%

Chart 1
QUARTERLY AND MOST RECENT SECTORAL SHARE OF LOANS WITH MORATORIA TO TOTAL LOANS
(per cent)

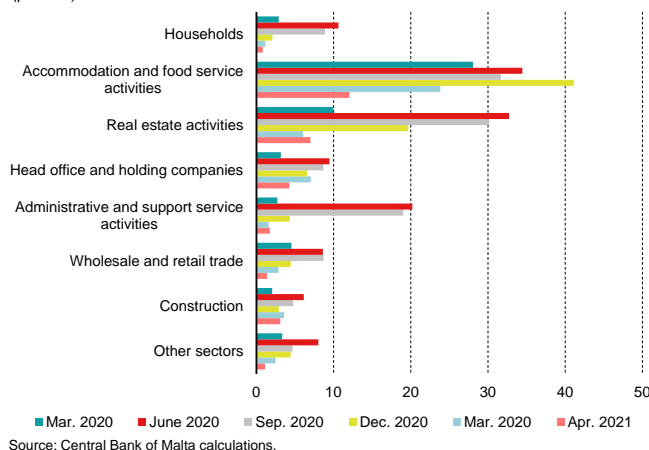
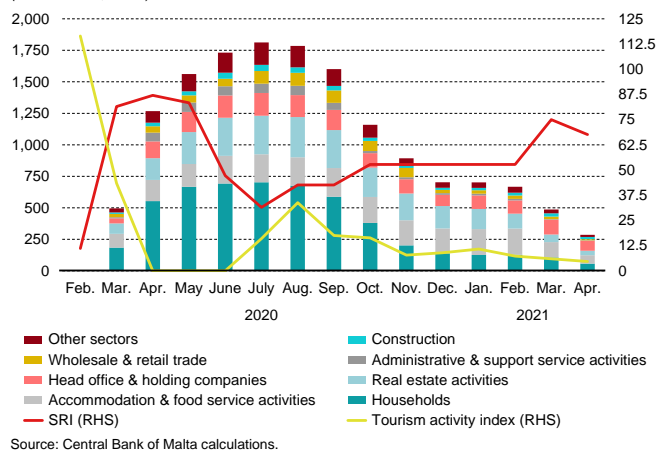


Chart 2
MONTHLY DISTRIBUTION OF LOANS WITH ACTIVE MORATORIA, STRINGENCY INDEX (SRI) AND TOURISM ACTIVITY INDEX
(EUR millions; index)



³ The SRI was chosen as it focuses exclusively on containment measures. This index was developed by Blavatnik School of Government and the University of Oxford (as part of the Oxford COVID-19 Government Response Tracker – OxCGR). In collaboration with the Bank, the OxCGR now also includes a timeseries for the Government’s COVID-19 response (see [Sant, 2021](#)).

⁴ Recourse to moratoria by the professional, scientific and technical activities, and the financial and insurance activities consisted of head offices (M - 70.1) and holding companies (K - 64.2), respectively. Since these are similar in nature, the dynamics of these two sectors are discussed simultaneously as ‘head office and holding companies’.

drop in inbound tourists was recorded in March 2020, with the airport remaining effectively closed between April and June of that year. The airport was subsequently re-opened in July, with tourist arrivals nevertheless remaining significantly below pre-COVID-19 levels during the peak season, with further drops recorded thereafter. In particular, a drop in tourist arrivals of almost 95% was recorded in April 2021, when compared to April 2019.

As the containment measures were relaxed and stabilised, an element of adjustment can be observed as reflected by the gradual reduction in outstanding moratoria in certain sectors, possibly also reflecting some adaptation to the containment measures in place. Meanwhile, sectors closely linked to tourism activity exhibited a consistent demand for loan moratoria throughout the period under review, mainly reflecting the impact of the global travel restrictions on these sectors.

On 14 January 2021, CBM Directive No. 18 was reactivated, allowing the submission of applications for new moratoria, or targeted extensions to existing moratoria, until March 2021. While 20.3% of outstanding moratoria reported for January related to newly-granted moratoria, this share dropped sharply during February (1.6%), March (3.4%) and April (0.4%). The higher moratoria application figures recorded in January are most likely a result of the reactivation of Directive No. 18 during this month – which reopened the application window following the original 30 September 2020 application deadline.

Since most moratoria were granted for a period of 12 months (including extensions), drops in outstanding amounts can be observed in March and April 2021, reflecting the expiration of these 12-month loan moratoria.

The evolution of moratoria take-up generally points to two main sources of shocks to domestic NFCs, namely:

- a. internal demand economic shocks resulting from social restrictions on the local population;
- b. external demand economic shocks resulting from reduced tourist arrivals.

The following sections elaborate on how the above shocks and a combination thereof affected sectoral take up of loan moratoria.

Activities mainly impacted by external demand economic shocks resulting from reduced tourist arrivals

The majority of the loan moratoria for accommodation and food service activities are linked to hotel operations, which closely followed developments in inbound tourism levels. Related to this sector, real estate activities – including leasing of property such as holiday and other short-stay accommodation – have also been similarly affected by lower tourist arrivals. ‘Head offices and holding companies’ consists of a combination of professional, scientific and technical activities (head offices) and other financial companies (holding companies) that also had a substantial share of moratoria granted to NFCs that manage group operations for companies involved in hotels. These moratoria are therefore linked to the nature of hotel group structures despite being captured under these two sectors. This also reflects the dependence and linkages of these sectors with tourism and hospitality activity.

Granular data analysis also shows that around one-third of loan moratoria granted to the construction sector is related to the tourism industry, hence also pointing at the far-reaching effects of the pandemic and the interlinkages among sectors. Reduced hotel demand for outsourced laundry services is another example of the extent of interlinkages, which is evidenced by loan moratoria applications by laundry services providers, falling under the other service activities sector.

The education sector was also impacted by reduced tourist arrivals with the loan moratoria granted under this sector being mainly towards language schools and, to a small amount, to diving schools.

Activities mainly impacted by internal demand economic shocks resulting from social restrictions on the local population

Social restrictions motivated the rest of loan moratoria to the accommodation and food service activities, which are linked to restaurants and catering activities, and a number of 'head offices and holding companies' involved with the management of diverse operations including retail outlets and transportation.

Restrictions on mass gatherings also impacted the demand for cinemas, casinos and performing arts, which was in turn reflected by moratoria applications under the arts, entertainment, and recreation activities. Loan moratoria linked to the production of food and beverages, which fall under the manufacturing sector, were likewise affected by lower sales from the restriction of social gatherings, such as weddings and mass events, though also by the decline in inbound tourism.

Another third of loan moratoria granted to the construction sector relates to varying construction activities which may have been impacted by local social restrictions, such as the closure of courts, which impeded the signing of deeds. Private tuition, within the education sector, was also impacted by the effective closure of schools, accounting for the remaining small share of loan moratoria granted under this sector.

Activities mainly affected by a combination of internal and external demand shocks resulting from reduced population mobility

Household loan moratoria were mainly granted to mortgage holders, but also included (to a much smaller degree) a combination of consumer credit and lending towards sole traders and non-profit institutions serving households (NPISH). Household moratoria accounted for the lion's share of total outstanding moratoria granted until October 2020. However, after peaking in July 2020, the financial position of households recovered thereafter, reflected in the low sectoral share of outstanding loans of 1.6% as at April 2021, as shown in Chart 1. While the aforementioned two economic shocks have both affected households, observations from developments in the NFC sector could shed light on the financial conditions of those in employment.

Reduced mobility, resulting from residents remaining indoors and lower tourist arrivals, affected the administrative and support services activities with requests for moratoria coming from NFCs related to the rental and leasing of water transport equipment, leasing of small aircraft and car rental activities. Related to this behaviour, loan moratoria applications can also be observed for transportation services, particularly public transportation, ferries, taxis and other land passenger services, all of which fall under the transportation and storage sector. Overall, the lower use of different means of transportation resulted in a lower demand for fuel services, which account for one third of loan moratoria applied under the wholesale and retail trade sector.

Another third of loan moratoria towards the construction sector was related to commercial real estate, possibly reflecting uncertainty about the prospects of the demand for rental office space due to work from home policies. The closure of non-essential business activities also resulted in demand for loan moratoria by service providers like hair and beauty salons, both falling under the other service activities sector.

Impact on credit institutions

Impact on NII

While the use of moratoria allowed borrowers to benefit from delaying monthly repayments to a future period with healthier cash flows, banks experienced a reduction in their cash inflow from interest income and capital repayments, in turn influencing their asset and liability management. The extent

of the impact from delayed monthly repayments on banks offering moratoria could be estimated by using the granular loan data from the Bank's CCR as at financial year ending December 2020 to calculate the forgone monthly repayments while moratoria were active as a share of monthly repayments potentially received from all loans. Chart 3 shows a box plot of the share of loans under moratoria in the portfolios of those banks that granted moratoria and the impact of the delayed repayments as

a share of these banks' potential interest income. As can be seen in the chart, the share of moratoria in these banks' loan portfolios ranges between just above 0% and 16.0%, while the estimated impact on NII ranges between 1.4% to 10.4% of potential income earned from loans. Although for some banks the share of loans under moratoria to total loans is higher than for others, the higher impacts on income earned from loans is linked to those banks that are more diversified overall but have higher concentrations to specific vulnerable sectors affected by the pandemic. Indeed, these banks have elevated sectoral shares of loans under moratoria for the accommodation and food service activities, and the real estate sector, which as described above have been affected by the low level of tourist arrivals.

Impact on asset quality

The data as at end April 2021 indicates that most moratoria have already expired. Chart 4 shows the sectoral composition of loans under moratoria as granted by the 11 banks with active moratoria during this period, distinguishing between the performing status of the expired loans. Out of the expired loan moratoria, only a very small proportion is currently classified as NPLs (red bar), which amounts to 0.5% of household loans, 1.5% of accommodation and food service activities, 1.5% of real estate activities, 2.2% of real estate activities, and 0.1% or lower for the remaining sectors. In the aggregate, NPLs stemming from expired loan moratoria amount to 0.7% of total NFC loans or 0.5% of total loans. When expressed as a share

Chart 3
BOX PLOT OF SHARE OF MORATORIA AND THEIR IMPACT ON BANKS' INCOME EARNED FROM LOANS
(per cent)

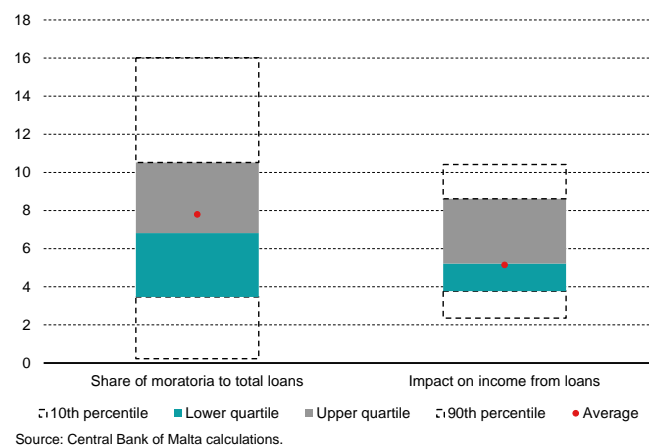
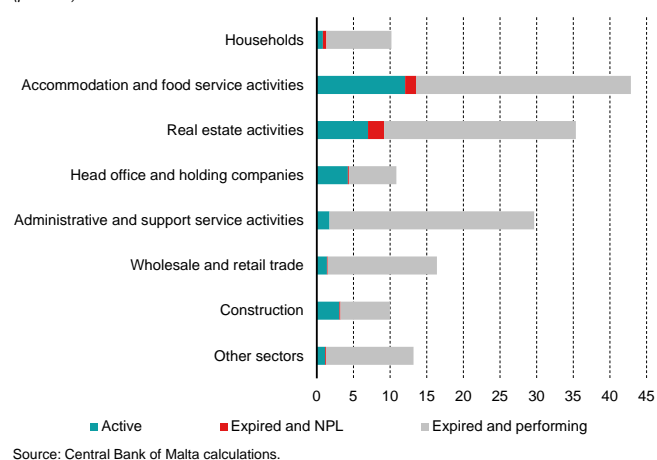


Chart 4
LOAN PORTFOLIO AS AT APRIL 2021 – 11 BANKS IN SCOPE
(per cent)

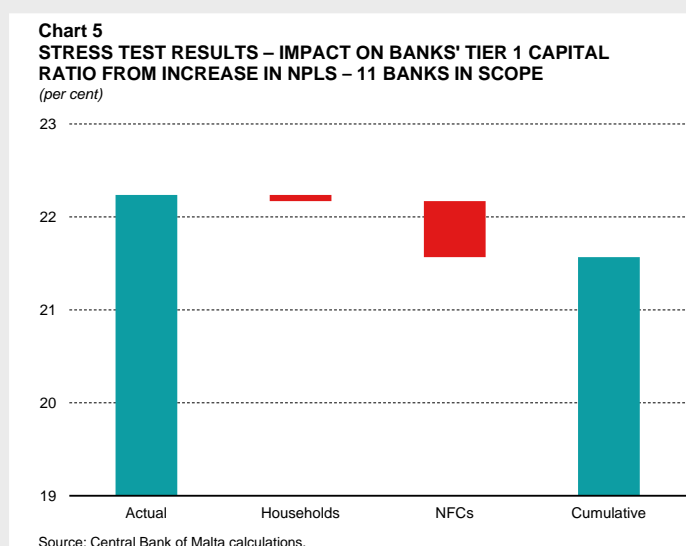


of total loans under moratoria, NPLs amount to less than 5% of the respective category, namely: 4.9% for households; 3.4% for aggregate NFCs (ranging between 0% and 6.2% at the sectoral level); or 3.7% of total loans.

While the most recent data shows that most loan moratoria have already expired, only a negligible increase in NPLs was observed. Nevertheless, this box includes a variant of the stress tests presented in Chapter 3 by assessing the impact on banks from a more significant increase in NPLs. The analysis applies direct information received from a survey conducted among a few banks on the effectiveness of measures implemented to mitigate the impact of COVID-19. Among others, banks were asked to quantify their expectation of loans being classified as NPLs once the moratorium period expires. This information was used to calibrate a more real-life scenario on the impact of NPLs from the loans benefiting from moratoria when compared to the worst-case scenario presented in Chapter 3.

Market intelligence indicates moderate expectations on immediate non-performing statuses of expiring loan moratoria, which can be aggregated as less than 10% for active household loan moratoria and less than 20% for active NFC loan moratoria. Based on these qualitative expectations and adding an overlay for conservatism, this test applies an assumption of 25% of both household and NFCs loans under moratoria becoming NPLs for all 11 banks with active moratoria. This assumption remains conservative even when taking into account the preliminary evidence from CCR of those loans being classified as ‘unlikely to pay’ after their moratorium expires. The magnitude of this assumption intentionally errs on the conservative side, particularly when compared to the observed increases of under 5% in NPLs from expired moratoria mentioned earlier.⁵ Therefore, this test is considered to be an adverse scenario for the assessment of potential cliff-edge effects and is intended to shock the system to assess its resilience. Furthermore, while 2021 interim profits could absorb part of the assumed losses, the test assesses the impact on the December 2020 Tier 1 capital ratio. NPL classification of expiring loan moratoria would impact the Tier 1 capital ratio in two ways – via the numerator through deductions from the Tier 1 capital from booking of impairments, and via the denominator through an increase in total risk-weighted assets.

The stress test estimates that, under this adverse scenario, loan loss provisions for the banks in scope would increase by €64 million while risk-weighted assets would increase by €86 million. As shown in Chart 5, these two impacts would lead to a drop in the Tier 1 capital ratio of 67 basis points from 22.24% in December 2020 to 21.57% post shock, with the largest impact arising from NFC loan moratoria, which tend to carry a higher monetary



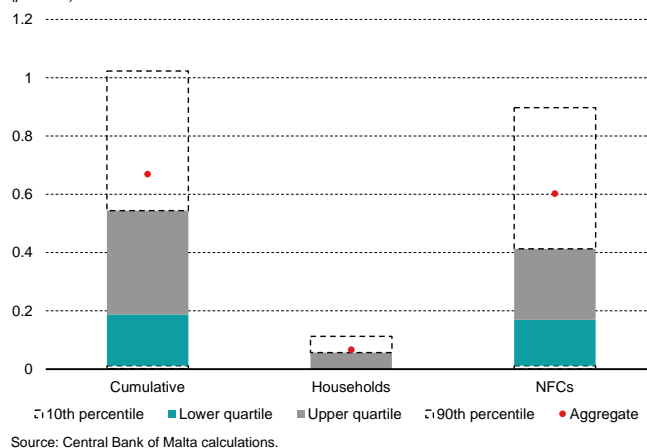
⁵ On 24 March 2021, the MDB widened the definition of working capital needs to also cover future loan repayment for the coming 18 months in case of SMEs, and for the next 12 months for corporates. Future loan repayments emanating from expiring moratoria can therefore be financed via the MDB CGS. The stress test does not take into consideration this development.

value when compared to household loans.

At the individual bank level, Chart 6 shows a higher dispersion of the impact on the banks' Tier 1 capital with the individual impact for most banks below the aggregate impact of 67 basis points (red dot). Indeed, similar to the estimated impact on NII shown in Chart 3, the higher impact can be attributed to banks which have a higher exposure to sectors hit by the economic shocks related to the pandemic. Nevertheless, the Tier 1 capital ratio

of each bank would be able to absorb the impact of the respective increase in provisions and risk-weighted assets while remaining well above the respective overall capital requirement.

Chart 6
BOX PLOT OF IMPACT OF INCREASE IN NPLS ON BANKS' TIER 1 CAPITAL RATIO – 11 BANKS IN SCOPE
(per cent)



Conclusions and Policy Response

While it is too early to fully assess the impact of COVID-19 on both the banking sector and the non-financial private sector, this box attempts to shed light on the effectiveness of loan moratoria as one of the key support measures enacted to mitigate the negative financial impact of the COVID-19 pandemic. The identified economic shocks indicate interlinkages among various sectors. Furthermore, the degree of impact of these shocks varies from sector to sector, as evidenced by the varying uptake of loan moratoria as a share of total loans of the respective sectors.

On the positive side, even though most loan moratoria have already expired, reported new NPLs have nevertheless remained low at under 5% of total loans under moratoria. This points towards borrowers being better placed to resume debt servicing. At the same time, the remaining active moratoria continue to support those borrowers who are still impacted by pandemic-related effects.

From the point of view of credit institutions, the relief provided to borrowers translated into an immediate impact on their inflows from monthly loan repayments. The impact on delayed cash inflows is estimated to reach up to 10% of annualised income on loans for those banks more exposed to vulnerable sectors. The extent of the impact on these banks reflects the importance of diversification in loan portfolios so as to minimise concentration risk.

Despite the granting of EBA-compliant moratoria, banks were required to proactively engage with clients and – through ‘unlikeliness-to-pay’ assessments – identify at an early stage deteriorations in asset quality so as to avoid sudden increases in NPLs and adverse repercussions therefrom (cliff-edge effects). Recent data from the Bank's CCR confirms that the asset quality of loans with expired moratoria remained high, with only 0.5% of household loans and 0.7% of NFC loans being classified as NPLs once the moratorium period expired. Moreover, the stress test conducted on active moratoria indicates that, should there be a deterioration in asset quality, banks' Tier 1 capital would be able to absorb the losses while remaining above the respective overall capital requirement.

By avoiding an undue and potentially premature classification of certain distressed borrowers as non-performing, loan moratoria have alleviated pressures on banks' capital. This, together with other measures, has in turn supported banks' ability to keep supporting the flow of credit to the economy.

Overall, initial evidence points towards loan moratoria not leading to an excessive increase in NPL ratios. This augurs well against the risks of potential cliff-edge effects on the financing needs of the economy, since as noted earlier the impact on capital is expected to be contained. The Bank will nonetheless keep these developments under review as more data become available.

Moreover, the Authorities have a number of tools to prevent higher NPLs from having a lasting impact on banks' asset quality, such as the MFSA's [Banking Rule No. 9 - Measures Addressing Credit Risk Arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions Authorised Under the Banking Act 1994](#) and the EBA Guidelines on management of non-performing and forborne exposures ([EBA/GL/2018/06](#)). These measures are also complemented with supervisory expectations which guide banks to book higher levels of accounting provisions through IFRS 9 in order to account for higher credit risks.⁶ Supervisors are also adapting their supervisory review and evaluation processes to reflect COVID-19-specific credit risk. Apart from the timely recognition of NPLs, prudent provisioning expectations apply through the ECB's Addendum to the ECB Guidance to banks on nonperforming loans, MFSA Banking Rule No. 9 and the CRR (Pillar 1) prudential NPE treatment. This is crucial if banks are to keep up the momentum in the timely accumulation of provisions, so as to avoid any unexpected cliff-edge effects, preserve the value of their capital, and enable them to continue supporting the economic recovery.

⁶ [ECB's Identification and measurement of credit risk in the context of the coronavirus \(COVID-19\) pandemic.](#)