



Central Bank of Malta Annual Report 2018

24 April 2019



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CENTRAL BANK OF MALTA



Overview

- Financial results
- The ECB's monetary policy
- Economic situation and outlook
- The financial sector
- Macroprudential response



Financial results



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The low interest rate environment continued to weigh on the Central Bank's earning capacity

- The Bank's balance sheet expanded further. Total assets reached €8,853.9 million at the end of 2018, from €8,582.9 million in 2017.
- Operating profit before transfers to provisions decreased to €38.3 million, from €51.6 million a year earlier, mainly due to:
 - a reduction in net gains on the disposal of financial instruments,
 - a lower amount of income in respect of the remaining balance of Maltese lira fifth series currency notes, which were redeemable by the Bank until the end of January 2018, and
 - lower net interest income.
- The Bank transferred €10.3 million to provisions, leaving €28.0 million payable to the Government of Malta.



The ECB's monetary policy



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The ECB's monetary policy

- The ECB maintained an accommodative monetary stance. The interest rates on main refinancing operations (MROs), the marginal lending facility and the deposit facility were held at 0.00%, 0.25% and -0.40%, respectively.
- The Governing Council noted on several occasions that it expected interest rates to remain at present levels for an extended period of time, and well past the horizon of the net asset purchases. In June 2018, it clarified that interest rates would remain on hold at least through the summer of 2019.
- In March 2019 this commitment was extended until at least the end of 2019.



The ECB's monetary policy

- The asset purchase programme (APP) was extended, although as had been announced in 2017, the monthly pace of purchases was reduced to €30 billion from January 2018 and further to €15 billion from October. Net purchases under the APP ended in December 2018.
- In March 2019, the Council also announced that it would launch a new series of quarterly targeted longer-term refinancing operations (TLTROs), starting in September 2019.



Economic situation and outlook

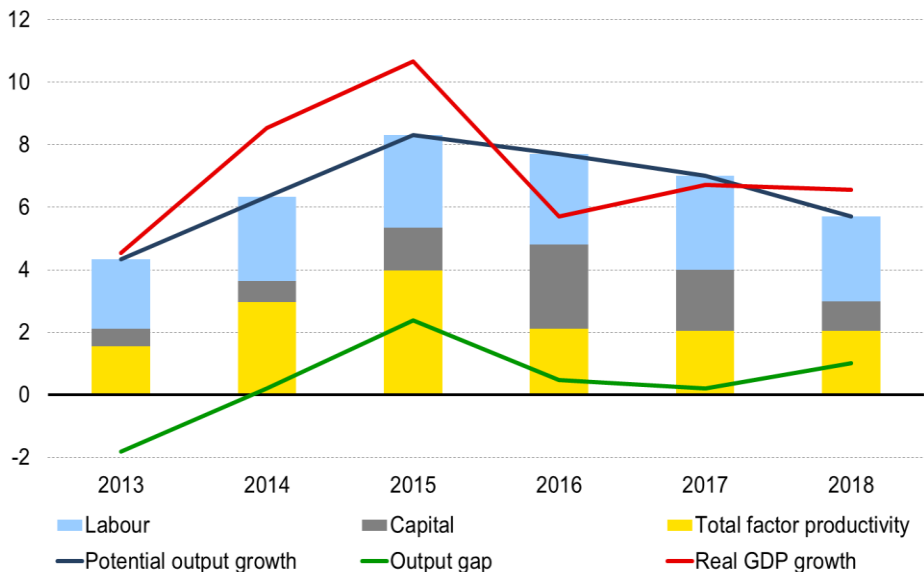


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Activity remained above potential, while the Bank's Business Conditions Index (BCI) continued to signal above-average conditions

CYCLICAL POSITION OF THE MALTESE ECONOMY

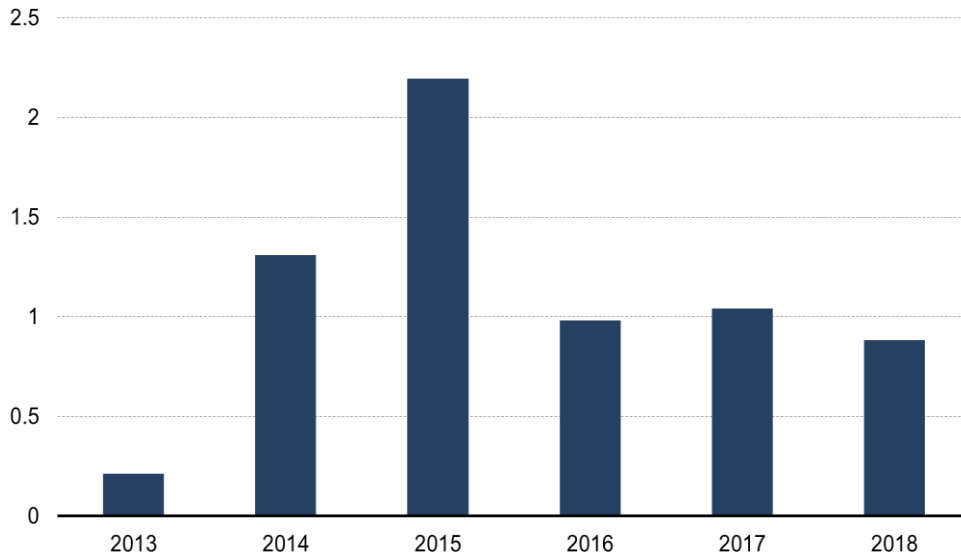
(annual percentage change; percentage of potential output; percentage points)



Sources: National Statistics Office; Central Bank of Malta estimates.

BCI

(standardised)

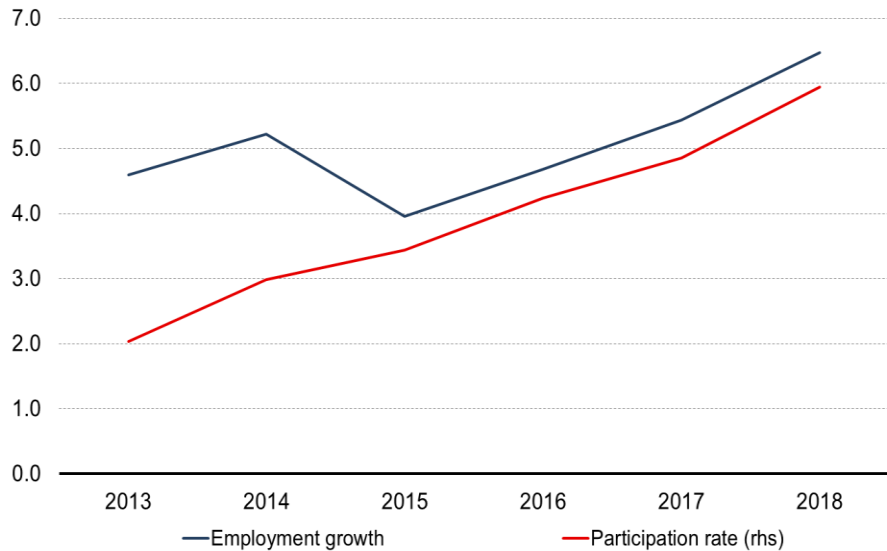


Source: Central Bank of Malta.

Labour market participation increased and the unemployment rate fell further

LABOUR MARKET PARTICIPATION*

(per cent)

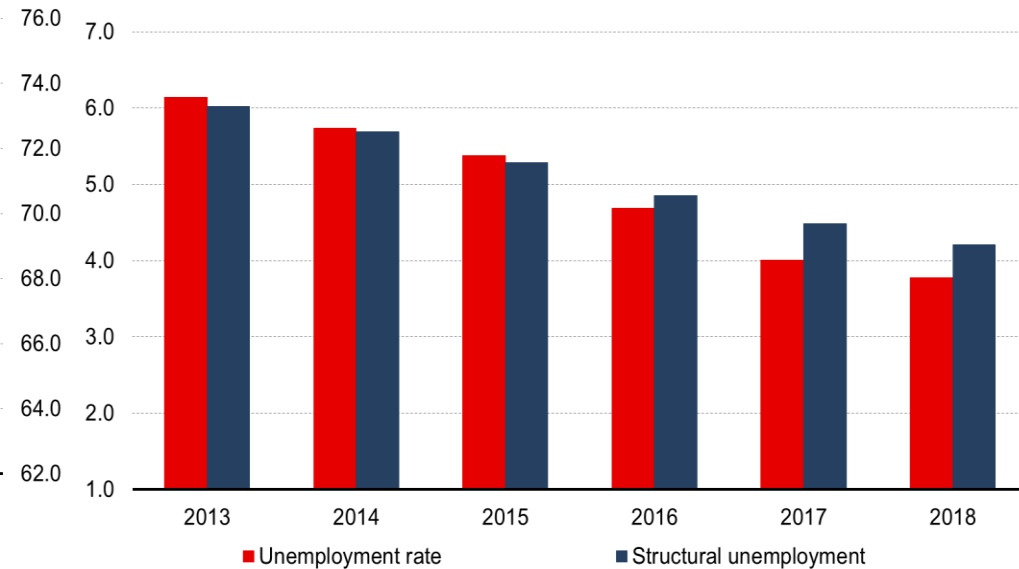


Source: Eurostat.

* Annual averages of Q1 - Q3 data.

UNEMPLOYMENT RATE

(seasonally adjusted; per cent)



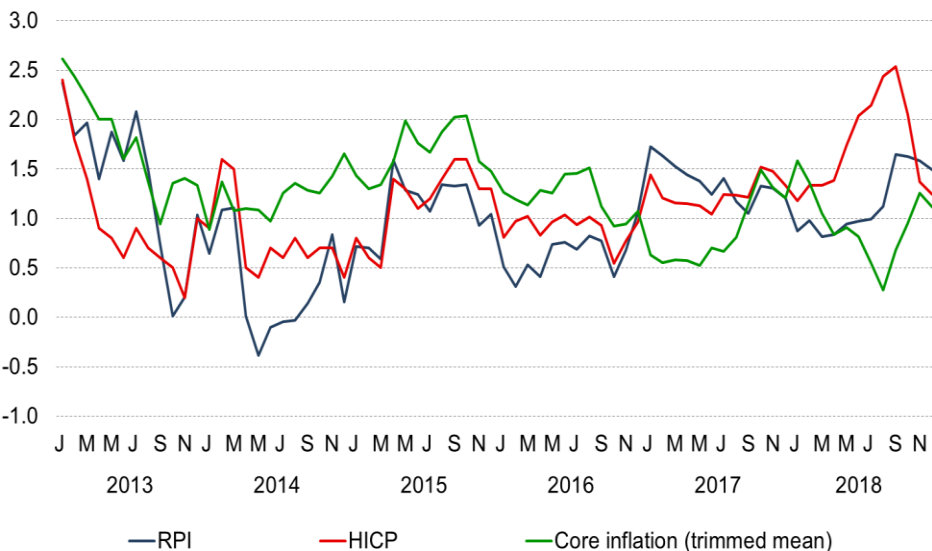
Sources: Central Bank of Malta estimates; Eurostat.



HICP inflation rises, driven by a higher contribution from services. RPI inflation eases slightly.

PRICES IN MALTA: RPI, HICP AND CORE MEASURE

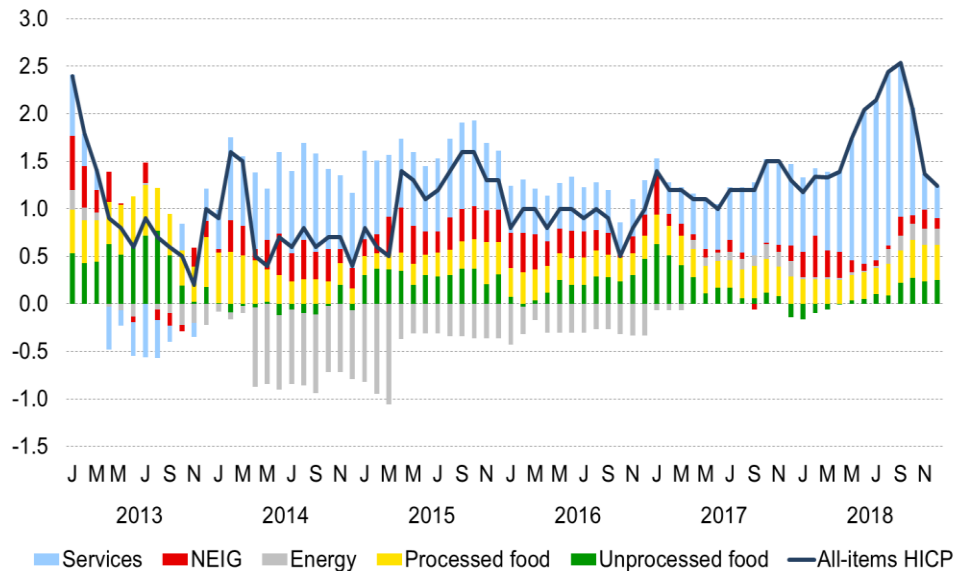
(annual percentage changes)



Sources: Eurostat; Central Bank of Malta estimates.

CONTRIBUTIONS TO ANNUAL HICP INFLATION

(percentage points; annual percentage change)

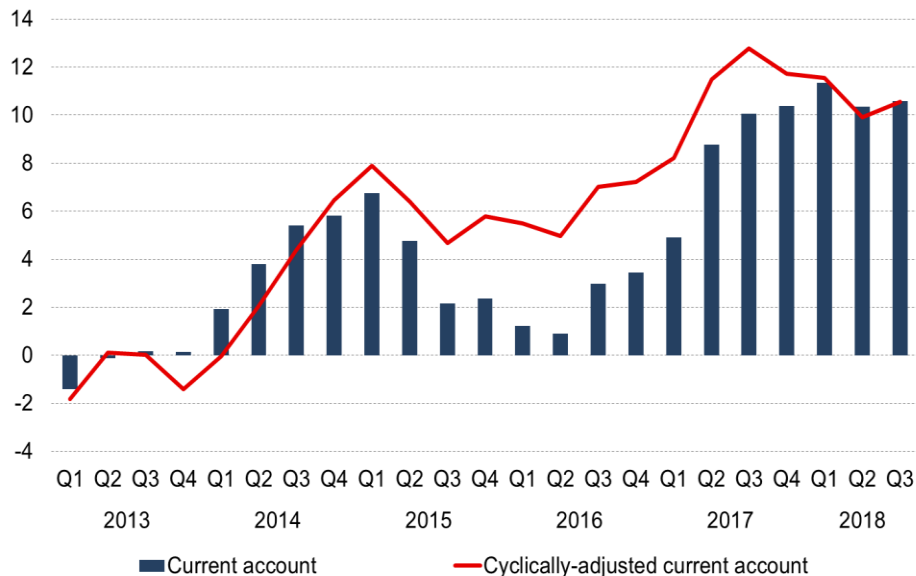


Source: Eurostat.

The current account surplus widens and the headline and cyclically-adjusted fiscal balance remain in surplus

CURRENT ACCOUNT

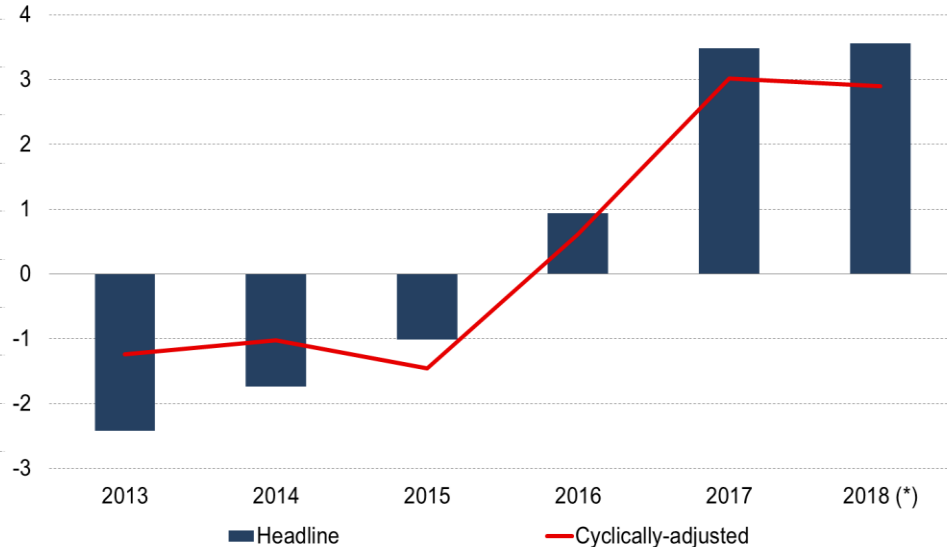
(four-quarter moving sums as a percentage of GDP)



Sources: National Statistics Office; Central Bank of Malta estimates.

GENERAL GOVERNMENT BALANCE

(% of GDP)



(*) Period ending September 2018 (based on four-quarter moving sums).

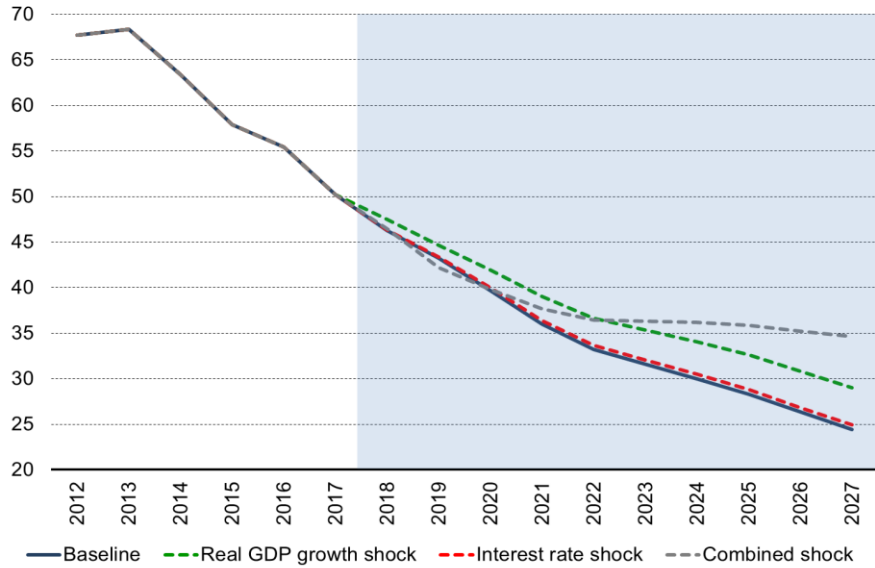
Sources: National Statistics Office; Central Bank of Malta estimates.



Debt Sustainability Analysis (DSA)

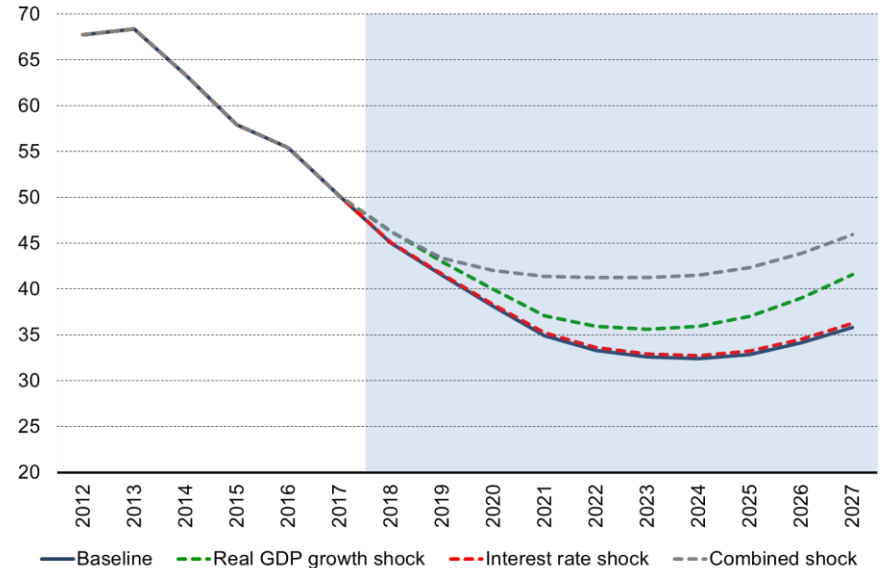
- Even under adverse conditions, the debt ratio will remain below 60%.

MALTESE GOVERNMENT DEBT-TO-GDP RATIO IN SCENARIO 1
(% of GDP)



Source: Author's calculations.

MALTESE GOVERNMENT DEBT-TO-GDP RATIO IN SCENARIO 2
(% of GDP)



Source: Author's calculations.

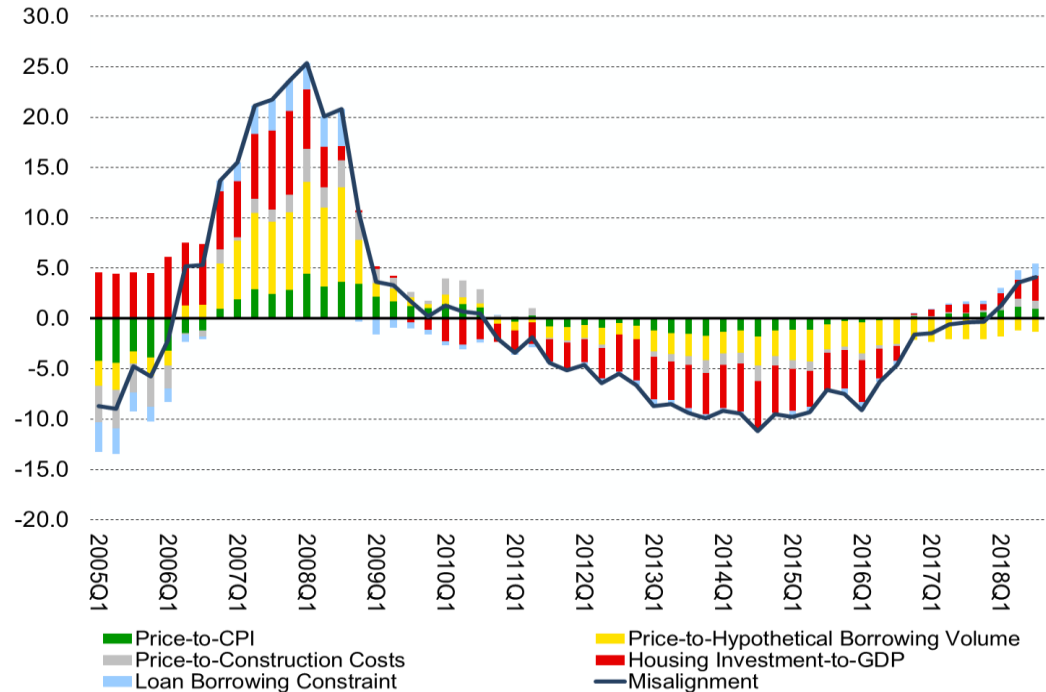


Misalignment index suggests house prices rose slightly above fundamentals in 2018

- House prices were slightly above the level consistent with fundamentals in 2018 Q3.
- The extent of misalignment in house prices remains modest especially when compared with the pre-crisis housing boom.

HOUSE PRICE MISALIGNMENT INDEX

(percentage points; based on transaction prices)



Source: Central Bank of Malta estimates.

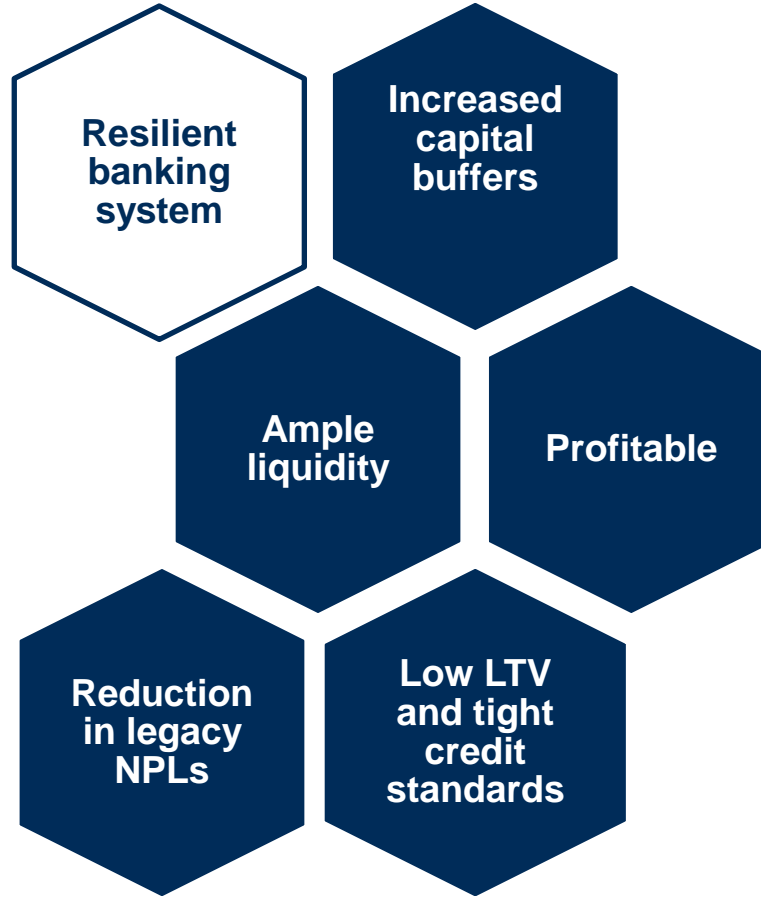


The financial sector



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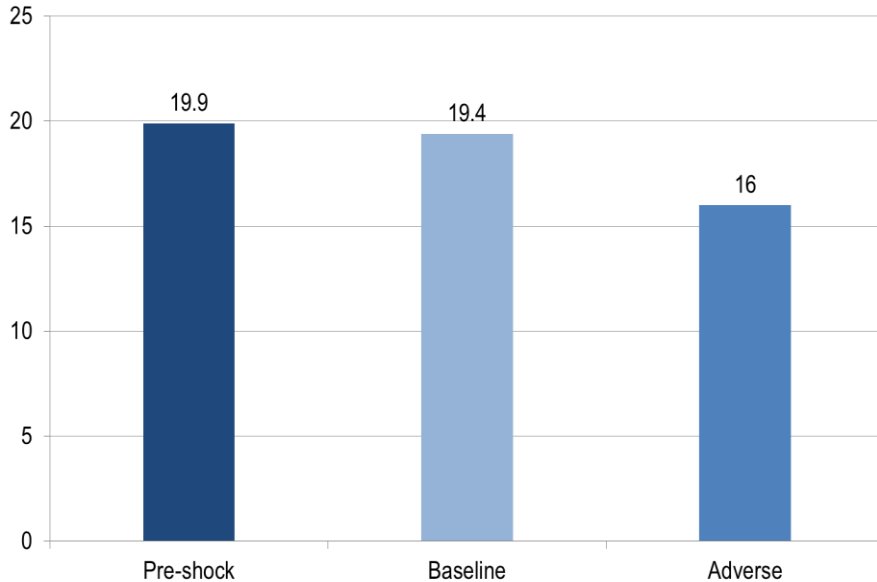
The banking sector remained resilient in 2018...



...even following rigorous stress tests by the IMF

IMF SOLVENCY STRESS TEST (11 BANKS)

(per cent)



Source: International Monetary Fund

The IMF also carried out three types of Liquidity Stress Tests (LCR, NSFR and cash-flow based) and an Interconnectedness Analysis.

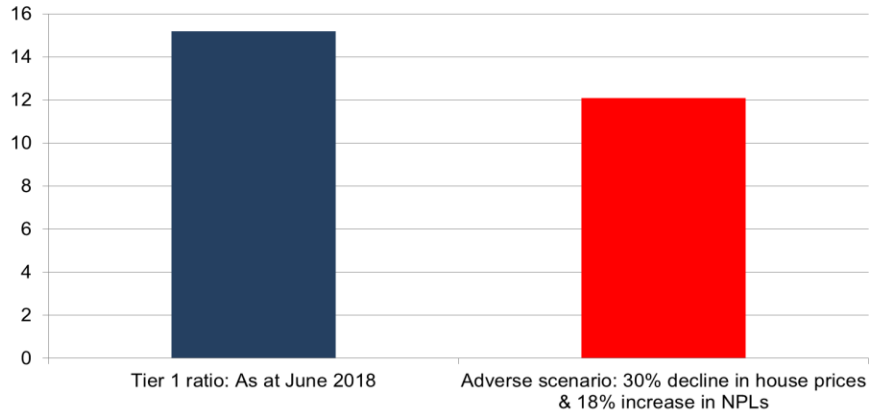
The IMF concludes that “*the banking system remains resilient under a severe scenario*”.

The CBM stress tests complement the findings of the IMF Stress Tests confirming banks’ resilience to adverse scenarios.

...confirming banks' and households' resilience

CBM STRESS TEST RESULTS - IMPACT OF A HOUSE PRICE DROP ON TIER 1 RATIO FOR CORE DOMESTIC BANKS

(per cent)



Source: Central Bank of Malta calculations.

CBM stress test results confirm core domestic banks' resilience to a 30% drop in house prices and a corresponding increase in NPLs of 18%.

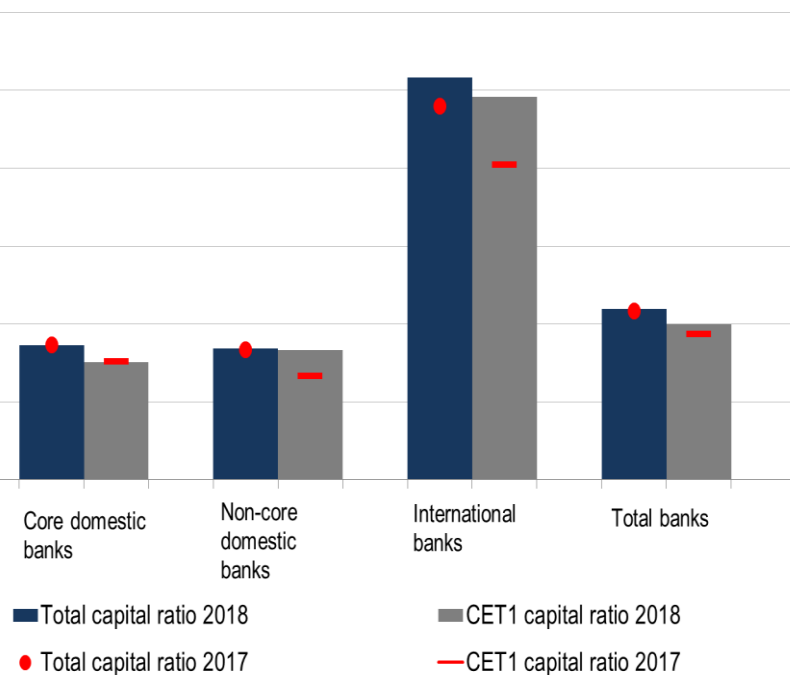
The IMF also carried out a stress test on households using the 2017 Eurosystem Household Finance and Consumption Survey.

Despite significant heterogeneity in share of indebted households across income deciles, the IMF finds broad resilience of households to drops in income and house prices as well as rises in financing costs.

Maintained adequate capital buffers but profitability has moderated...

CAPITAL RATIOS

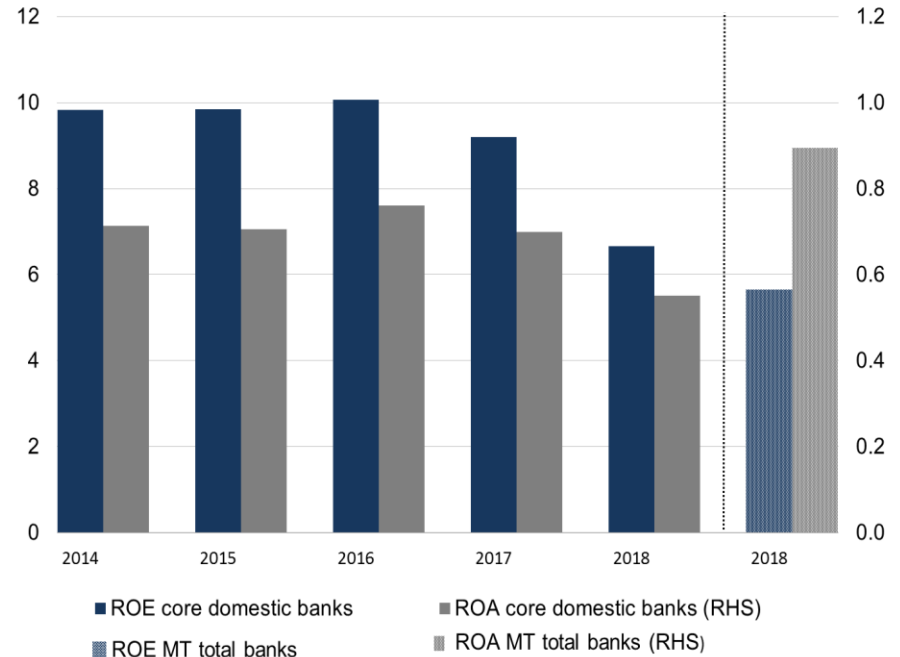
(per cent)



Source: Central Bank of Malta.

RETURN ON ASSETS AND ON EQUITY

(per cent)

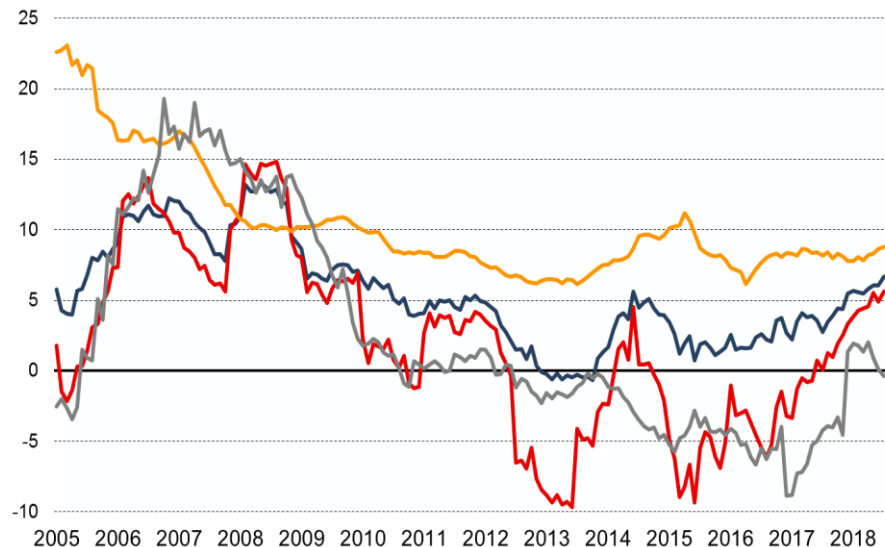


Source: Central Bank of Malta

...yet credit growth strengthened and asset quality improved further

ANNUAL CREDIT GROWTH RATE

(per cent)



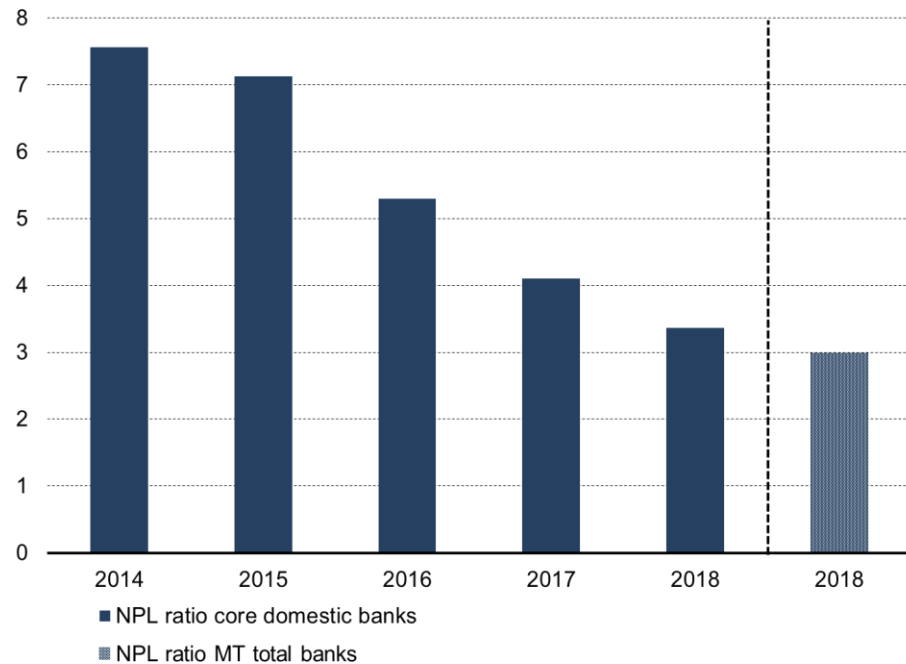
— Total resident bank credit — Non-financial corporates
— HHS mortgages — HHS consumer credit

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

Source: Central Bank of Malta.

NPL RATIOS

(per cent)



Source: Central Bank of Malta.



Macroprudential response



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Activated macroprudential structural measures

Other Systemically Important Institutions (O-SIIs) Buffer

- The three O-SIIs identified in 2018 were reconfirmed for 2019 as per CBM and MFSA methodology for the identification of O-SIIs.

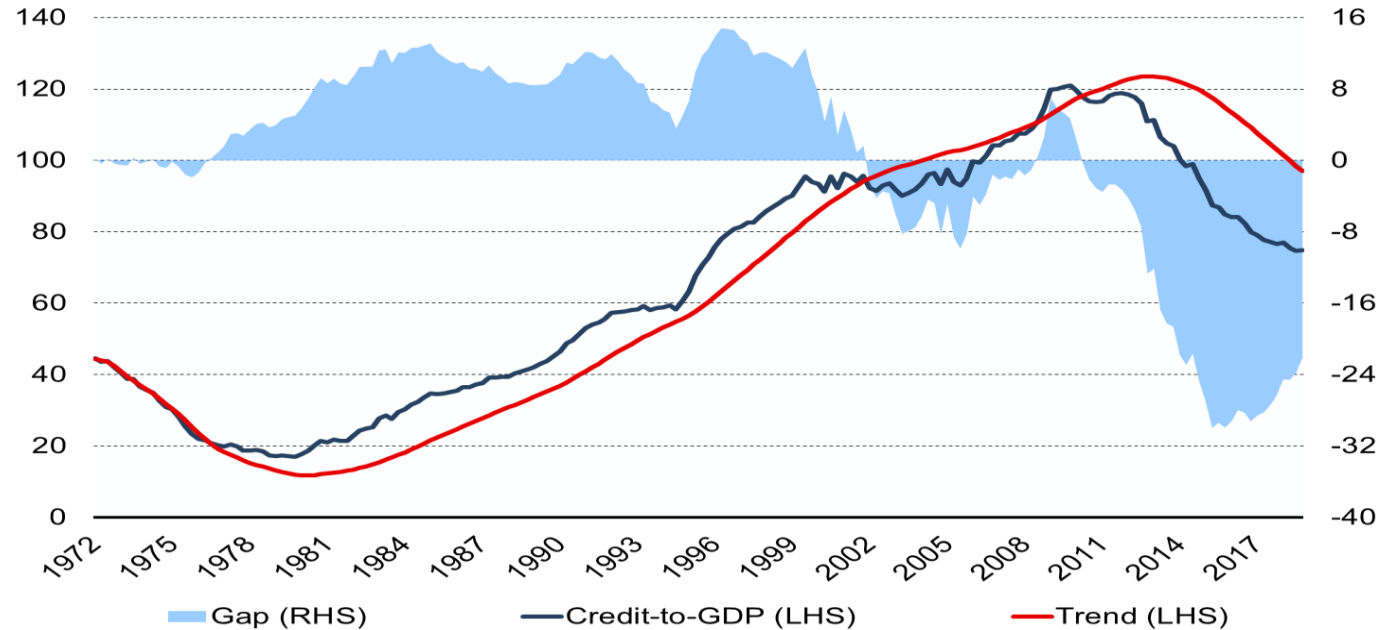
Excessive NPLs MFSA's Banking Rule 09 (BR/09)

- Banks with an NPL ratio higher than 6% are required to adhere to a 5-year reduction plan.
- Banks are annually required to submit self-assessments.

Cyclical risks remain low... CCyB set at 0%

HODRICK-PRESCOTT FILTER (LAMBDA = 400,000) APPLIED TO THE CREDIT-TO-GDP RATIO

(per cent; percentage points)



Source: Central Bank of Malta calculations.



Borrower-Based Measures

- Pre-emptive measure to safeguard resilience of borrowers and lenders exposed to the domestic residential real estate loans.
- Following a public consultation, the Directive on Borrower-Based Measures was published on 29 March 2019 and will come into effect on 1 July 2019.
- The measures divides borrowers in two categories:
 - First time buyers and non-first time buyers purchasing their primary residence
 - Buyers purchasing any other residential real estate apart from their primary residential property.
- Conditions are tighter for those categories of borrowers taking loans for property used for non-personal residential purposes.



Summing up...

- The banking sector in Malta remained resilient to external shocks and remained a driver to economic growth.
- Capital levels remained above minimum regulatory requirements even under severe stressed scenarios.
- Ample liquidity buffers in the banking system.
- Core domestic banks reported a further decline in non-performing loans.
- A number of macroprudential measures already taken.



...but challenges remain

- A prolonged low interest rate environment will continue to weigh down on profitability levels.
- Increasing regulatory costs such as MREL and the NPL guidance will also impact adversely profitability.
- Structural risks such as the concentration in the loan portfolio including the increasing property-related exposures.
- Traditional models of banking are challenged by Fintech companies and other non-bank financial institutions.
- Operational threats such as the more sophisticated cyber attacks.



Thank you



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